



Bergquist & Rossi

Trusted Corporate Tax and Transfer Pricing Advisors

Research & Development Tax Credit

U.S. R&D Credit Rules Summary

What is the R&D Credit Benefit?

Federal Tax Credit

- A Tax Credit is a dollar for dollar reduction in taxes paid
- Applicable to C-Corps, S-Corps, LLC's Partnerships, Sole Proprietorships

Retroactive Benefit

- The R&D Tax Credit regulations allow eligible taxpayers to "look back" to all open tax years for potential research credits that were never claimed.

Immediately Available

- Congress has made R&D credit Permanent
- A tax incentive provided by the U.S. government to encourage businesses to invest in activities within the U.S.

Tax Credit Rate

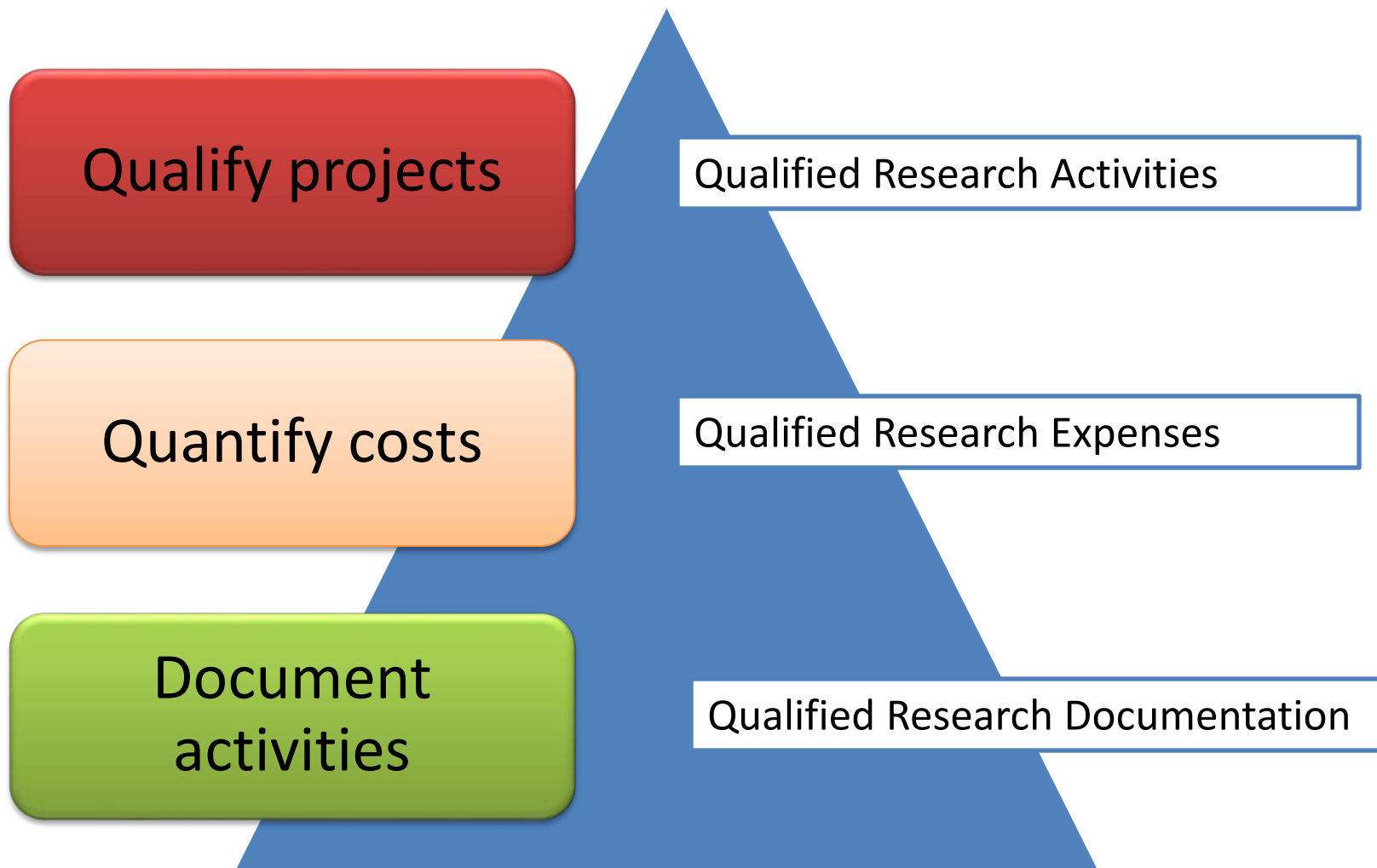
- R&D Credit = 14%
- Benefit is reduced for deductions lost, thus a 35% tax rate = 9.10% net benefit
- Idaho R&D Tax Credit = 5%

What is Research and Development?

Qualified R&D spending takes place in many areas within a business,

- Seeks to solve a technical problem
- Eliminates uncertainty
- Innovation
- Process improvement and development
- Research and Development is not limited to successful activities

Steps to determine R&D Credit



What is a “Qualifying” Research Activity (QRAs)?

- Qualifying Activities

- Engineering Efforts
- New Product Design
- Substantial Improvements
- Computer Modeling
- Experimentation Efforts
- Laboratory Testing
- Developing Prototypes
- Technical Discussions
- Unsuccessful but Otherwise Qualifying Initiatives

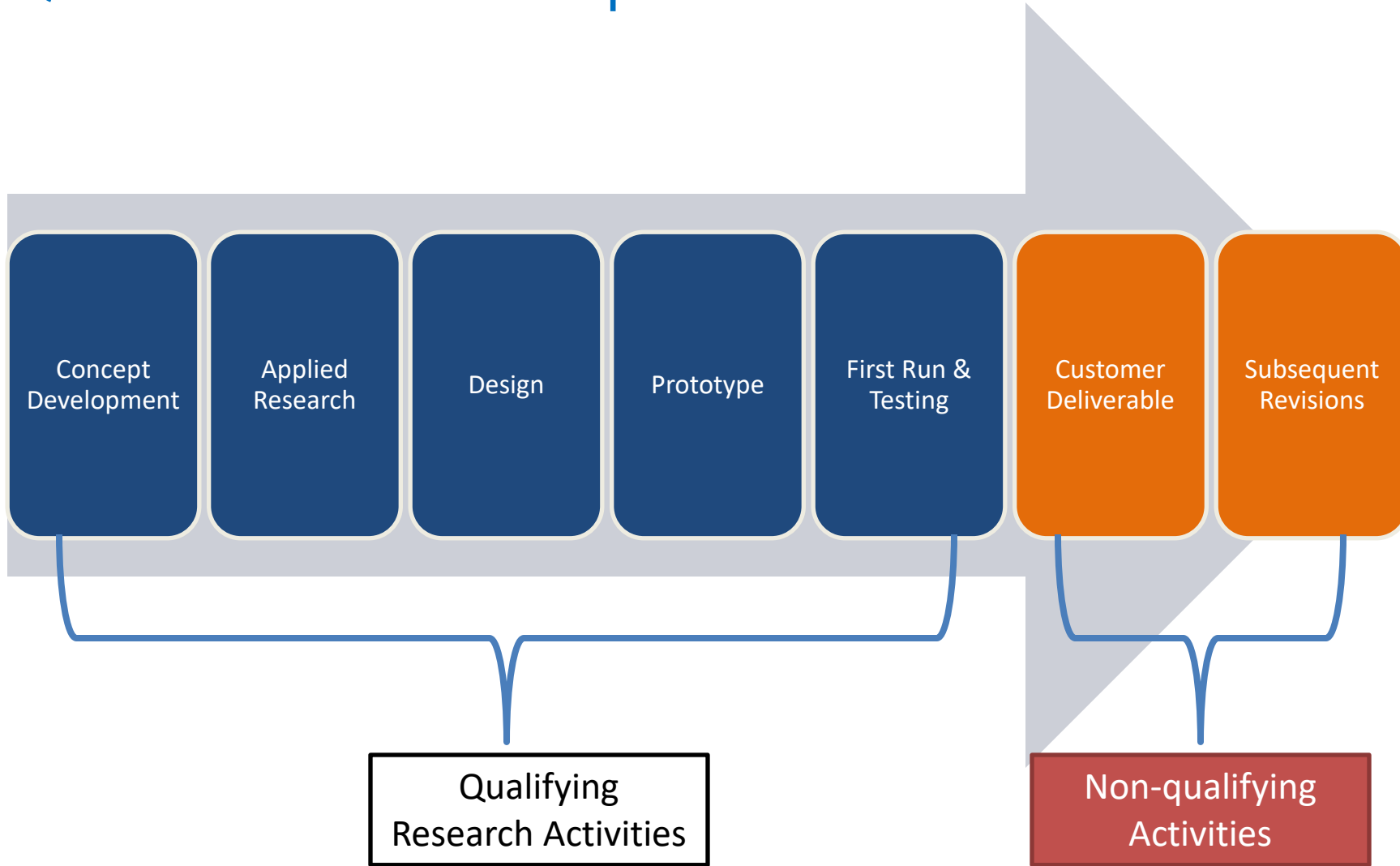
- Non-Qualifying

- Research after Commercial Production
- Reverse Engineering
- Market Research
- Research Related to Style or Consumer Taste
- Research Related to Management Techniques
- Research Conducted Outside the U.S.
- Funded Research

Specific Examples of QRAs

- Develop new, improved or more reliable products, processes or formulas
- Develop prototypes and models including computer generated models
- Design tools, jigs, molds and dies
- Develop or apply for patents
- Perform certification testing
- Conduct testing of new concepts and technology
- Develop new technology
- Attempt using new materials
- Perform environmental testing
- Add new equipment
- Automate/streamline production process or manufacturing process
- Develop software or hardware
- Improve or build new manufacturing facilities

QRA Timeline - Concept to Production Activities



Qualified Research Expenditures (QREs) includes:

Wages

- Wages subject to withholding or SE tax
- Direct research
- Direct supervision of research
- Direct support of research

Supplies

- Consumed in R&D process
- Prototypes costs, lab supplies, etc...

Contract Research

- Fees paid to outside contractors
- 65% of qualifying costs are eligible

Qualified Research Activities - Test

Four Part Test – Must Meet All Four to Qualify as QRAs

Permitted Purpose

The activity must relate to a *new or substantially improved* product or process intended to improve:

- Function
- Performance
- Reliability
- Quality

Technological in Nature

The activity must *fundamentally* rely upon principles of:

- Engineering
- Physical Science
- Computer Science
- Biological Science

Technological Uncertainty

The activity must be intended to discover information to *eliminate technological uncertainty* related to:

- Appropriateness of a product design
- Method of a product or process
- Capability of a product or process

Process of Experimentation

Substantially all (80%+) of the activities must relate to a *systematic* process of experimentation involving:

- Evaluation of one or more alternatives
- Confirming hypothesis through trial/error, testing and/or modeling/simulation

Example of Statutory Four Part - Test

| # | Four Part Test | Explanation |
|---|---------------------------------|--|
| 1 | Technological Uncertainty Test | Company wanted to improve an existing bed coil mechanism and was uncertain as to how to design it. |
| 2 | Technological in Nature Test | The mechanism would be used in hospital beds and the work would rely on mechanical engineering sciences. |
| 3 | Process of Experimentation Test | Different design alternatives were considered and a prototype was created, tested and analyzed in an attempt to eliminate the uncertainty. |
| 4 | Permitted Purpose Test | The goal of the research was to substantially improve the performance and reliability of the mechanism . |

Summary: R&E Credit Study Process

- Identify Qualifying Business Activities or Components
- Identify Personnel Who Were Involved
- Identify Hours By Employee By Activity For Each Qualifying Business Component
- Identify Supplies Consumed While Performing Qualifying Activities
- Identify Contractor Costs Related to the Performance of Qualifying Activities on Qualified Projects (Business Components)
- Calculate the Tax Credit Amount

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For more information:

If you would like to learn more about how Bergquist & Rossi can assist your company, please feel free to contact us:

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