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## Audit Exemptions and Reduced Tax Rates Are Making R&D Tax Credits Even More Appealing

For many large businesses, claiming the R&D tax credit provides significant funding that can be reinjected into the continuous improvement of products and processes or have a significant impact on a company's results.

However, the possibility of being audited, which can be demanding both in terms of time and resources can create a hindrance for those looking to file a claim. Not only is the outcome of an audit uncertain (as jurisprudence constantly evolves) but audits can occur up to 3 years after filing or amending a claim. For companies lacking experience with the audit process, it can therefore be difficult to defend a claim without the proper support.

So, what if audits no longer had to be part of the R&D tax credit process? No, you aren't dreaming. To provide companies with assets greater

than \$10 million with a simplified process for determining the amount of QREs (qualified research expenses) they can claim, the IRS Large Business and International Division (LB&I) has released a directive that streamlines the claims process for both the taxpayer and the IRS.

The directive states that examiners can accept as sufficient evidence of QREs the Adjusted ASC 730 Financial Statement R&D line item amounts for the credit year. Adjusted ASC 730 Financial Statement R&D line item is made up of the research and development costs currently expensed on a company's Certified Audited Financial Statements pursuant to ASC 730 for U.S.

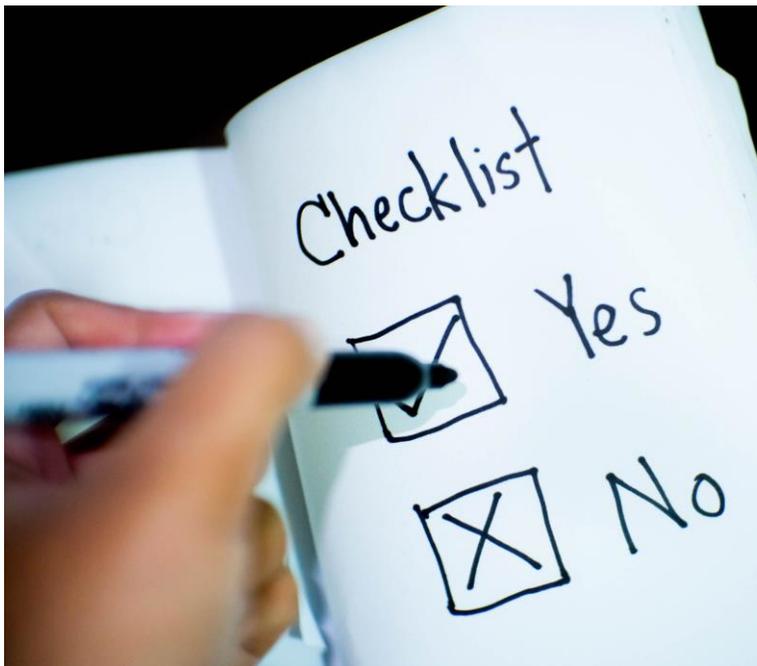


GAAP purposes and includes certain specified adjustments made to ASC 730 Financial Statement R&D.<sup>1</sup>

This approach acts as a haven or safe harbour for those reporting GAAP ASC 730 R&D costs on their audited financial statements, meaning if a company's claim falls under the specified rules and regulations and it can be supported, the expenditures claimed will not be contested by the IRS.

For companies choosing to follow the directive, the IRS will then request that they provide a series of completed disclosure statements. Despite the risk of audit being removed from the equation, companies must still ensure that the claim is properly documented and supported, or risk losing the privilege of claiming the ASC 730.

## What Is the Impact of Using the ASC 730 on an R&D Tax Credit Claim?



The ASC 730 is useful for companies with assets greater than \$10 million who are willing to take a reduction in the amount of tax credits they can claim in exchange for exemption from audit. Expenses that qualify for audit exemption include:

**Wages:** 95% of taxable wages can be claimed for qualified individual contributors, including middle managers, technicians, engineers and researchers, while only 10% of this amount can be attributed to upper level management.

**Supplies:** All supplies used in the R&D process other than prototype overhead expenses can be claimed under ASC730.

**Computer rentals and leases:** This refers to amounts paid by a company for the use of computers to conduct qualified research. This can also include cloud-computing costs associated with R&D.

Since eligible R&D tax credit criteria are so broad, there may be many other expenses incurred through the improvement of products and processes that qualify for the tax credit but do not qualify for audit exemption under ASC730.

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<sup>1</sup> IRS: Guidance for Allowance of the Credit for Increasing Research Activities under I.R.C §41 for Taxpayers that Expense Research and Development Costs on their Financial Statements pursuant to ASC 730

This does not mean that companies that take advantage of the ASC730 cannot also claim these additional expenses. It simply means those expenses may be subject to an audit, and companies should be prepared to support and defend them. Proper documentation detailing all R&D expenses claimed must be provided to the IRS, so a reconciliation can be performed between expenses claimed under ASC730 and total R&D tax credit expenses claimed.

It is important to note that applying for the ASC730 safe harbour is not a one-time process, and companies must complete the certification and related documentation for each year they wish to receive audit exemption.

## **Tax Cuts Mean More Money for Continuous Improvement**

While there are many benefits to claiming the R&D tax credit, the fact that it was taxable at 35% meant a significant portion of the claim was fed back into government. The good news for companies planning to claim the tax credit for fiscal years starting January 1st, 2018 is that the introduction of the Tax Cut and Job Act (TCJA) has reduced the tax rate from 35% to 21%.

This reduction in the tax rate results in most companies receiving a net tax credit increased by approximately 22%. Therefore, large companies that are considering incorporating the ASC 730 into their R&D tax credit process but are concerned about the reduction in their total claim can take some comfort in the cushion provided by the reduction in the tax rate.

## **To ASC 730 Or Not to ASC 730? That Is the Question**

While a safe harbour from audits can seem like an easy choice, it isn't one that should be made lightly. The decision to adopt the ASC 730 directive is one that should be taken following a complete assessment of an R&D tax credit claim's potential, a company's ability to dedicate time and resources to an audit, and an understanding that audit exemption does not equal documentation exemption. It is critical to understand the benefits, risks and procedures associated with claiming the R&D tax credit, regardless of whether ASC 730 adoption becomes the chosen path. Companies must take the time to grasp the process in its entirety, from eligible activities to documentation to application to claim support. Those that do stand to profit from funding that can help them offset some of the costs associated with performing the activities required for them to stay ahead of the competition.

### **About Ayming**

Ayming is a leading international business performance consulting group serving 20,000 clients and backed by 30 years of proven results. Dedicated to helping companies increase funding and decrease costs, Ayming completes 15,000 R&D and innovation projects and secures \$1.5B in funding for its clients annually using a comprehensive and non-intrusive approach and can help with the compliance and documentation process for ASC 730.

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