

R&D Tax 101

Everything you need to know about the US R&D tax credit.



ayming



What are R&D Tax Credits?

...and do you qualify? Probably!

Our team speaks to companies every day who don't believe the U.S. R&D tax credit incentive applies to them. In reality, the definition of R&D for tax purposes covers a much broader range of activities than you might think, and some of your everyday activity will likely qualify too.

U.S. R&D incentives aren't just for scientists in white lab coats; they're designed to apply to all industries and sectors utilizing hard sciences. Some of our most innovative clients are software developers, manufacturers, and engineering firms.



We understand your business and what R&D means to you

We are aware how time-consuming and complicated claiming R&D incentives can be, which is why your R&D incentives team is so important. Ayming USA's team does not just consist of tax experts, our roster contains extensive technical expertise. The team comprises scientists, engineers, software developers and other technical specialists. As such, we can work with you to ensure no stone is left unturned.

With an expanded understanding of the technicalities unique to your projects and industry knowledge, alongside the complexities of R&D tax legislation, you can be confident all eligible R&D activity is correctly identified. In addition to technical experts, we have experienced tax and accounting specialists. This assurance will provide you with a greater comfort that each R&D claim is submitted in accordance with all relevant tax code, regulations, and case law.

Given the questions our team encounter on a regular basis, we have compiled some of the most frequently asked questions. If we haven't answered your question below in the list, please feel free to reach out and we will make sure your question is answered.



Thomas Folsom
Managing Director, Ayming USA
(832) 492-5349
tfolsom@aymingusa.com

I'm claiming for the first time



1 What is the US R&D Tax Credit all about?

The federal R&D tax credit, also known as the Research and Experimentation (R&E) tax credit, was first introduced in 1981 as a two-year incentive and has remained part of the tax code ever since. Its purpose is to reward U.S. companies for increasing their investment in R&D in the current tax year. It is available to any business that attempts to develop new, improved, or technologically advanced products or trade processes. In addition to activities such as creating new products or trade processes, the credit may also be available to taxpayers that have improved upon the performance, functionality, reliability, or quality of existing products or trade processes.

In 2015, President Obama signed into law the Protecting Americans from Tax Hikes (“PATH”) Act. This legislation retroactively renewed various expired tax provision and made the R&D tax credit permanent.

2 What is R&D for Tax Purposes?

Qualified research expenses are expenditures incurred in connection with a trade or business representing R&D costs in the experimental or laboratory sense (Regs. Sec. 1.174-2(a)(1)). Costs qualify as experimental if they are for activities intended to discover information that would eliminate uncertainty pertaining to the development or improvement of a business component, which refers to any product, process, computer software, technique, formula, or invention that is held for sale, lease, or license or is used in the taxpayer’s trade or business (Regs. Secs. 1.174-2(a)(1) and (3)).

Please note that development does not need to be entirely new, and appreciable improvements to existing technology or the adaptation of technology to a new application can also be considered an advancement, as long as it does not exist within the public domain.

To ensure each qualified research expense is incurred in connection to experimental activities, each developmental project is subject to a four-part test that is outlined below:

1. New and Improved Business Component: A business component is any product, process, computer software, technique, formula, or invention, which is to be held for sale, lease, license, or used in a trade or business of the taxpayer. Often times, there is significant overlap between business components. At Ayming USA, we will navigate this overlap along side you and your team.

2. Elimination of Uncertainty: When conducting development efforts, there must uncertainty related to one or more of the following criteria: the appropriate design, the methodology, or the capability of development efforts to achieve the intended result. To overcome such uncertainty, you and your development team rely on a process of experimentation further detailed below.

3. Process of Experimentation: This requirement is designed to evaluate one or more alternatives to achieve a result where the capability or the method of achieving that result, or the appropriate design of that result, uncertainty exists at the project outset. One metric to evaluate this is whether or development underwent a trial-and-error process to reach the final design.

4. Technological in Nature: In the simplest of terms, research and development activities must rely upon a hard science. Examples include but are not limited to physics, computer science, engineering, mathematics, and more.

Please note that a success is not a requirement to make a claim for qualified research expenses. In fact, it is often the case that cancelled projects contain significant qualified expenditures. At Ayming USA, we will ensure each qualified expense is properly analyzed in accordance with current tax code, regulatory authority, and tax court rulings.

3 What doesn't qualify?

Numerous R&D exclusions exist under the tax code. Often, it feels like navigating these waters can be overwhelming. We have outlined some of the most common exclusions our team regularly encounter below:

Foreign research: The only expenses that can be captured toward the R&D tax credit must be incurred in the United States or a United States territory. However, if you utilize foreign resources—this is fine! We can still capture the expenses incurred in the U.S.

Surveys: Synthesizing through extensive data is understandably a feat, but the R&D tax credit specifically excludes such work.

Advertising or Promotions: Advertising campaigns can certainly contain significant design effort—however, such activity is specifically excluded for purposes of the research and development tax credit.

Funded Research: This particular exclusion is one of the most litigated exclusions. Fortunately, at Ayming USA, we have in-house attorneys who analyze and ensure expenses incurred under contract are permitted.

Rest assured, at Ayming USA, we are fundamentally aware of these exclusions and will validate your qualified research expenses in accordance with current guidance.

4 Do I qualify and what is the benefit?

There are several methods for calculation the R&D tax credit. These methods are often dictated by the year you began conducting development activities. Additionally, numerous calculation methods account for factors such as start-up companies and corporate structures consisting of multiple entities and ownership.

Each company's development efforts and tax position vary. In our experience, no two companies are alike. At Ayming USA, we will provide you with an initial assessment at no cost.

5 How do I claim the US R&D Tax Credit?

An R&D claim is submitted Form 6765. At Ayming, we work with you to prepare these forms and work with your CPA (or yourself!) to ensure these forms are properly placed into the relevant tax filings.



I've claimed
before



The main pitfalls of R&D claims generally fall into three categories:

① Not claiming all relevant costs

Often, companies feel that much of their work is “day-to-day” if it is not dedicated to a specific R&D project. However, if a project meets the qualifying criteria, it is still possible to claim for these activities and boost the total claim value. Some activities that indirectly contribute to R&D such as project management often go unclaimed, even though they are eligible under the scheme.

② Overclaiming

Conversely, some companies do not fully understand the criteria and as a result, will claim for activities or cost categories that do not qualify. For example, an early-stage company may have to undertake substantial market research before identifying the desired features for a product. Whilst this is crucial to the development of the product, it is often removed from resolving technological uncertainties. Therefore, such expenses cannot be claimed and should be properly excluded.

③ Providing insufficient substantiation

While it is essential to avoid overclaiming, or under claiming, it is perhaps more crucial to provide sufficient documentation to ensure your tax credit is properly substantiated. This includes a detailed explanation of how you have calculated your figures and a description of the qualifying activities. In some cases, companies may be claiming the right amount, but will provide inadequate substantiation. This can lead to lengthy conversations to retrospectively justify the claim in the future.

At Ayming USA, each analysis is substantiated with a detailed narrative for your records. Further, in the event of a review, our services include audit defense as no cost to you. We stand behind our work.



I want my claim to be faster and more efficient



Most companies using the R&D tax credit want to focus on their business, rather than admin, but R&D tax claims can often be slow and distract from what's important. Below are some of the ways that claimants increase the duration of an R&D tax claim and how to reduce it:

1 Looking at every R&D project in too much detail


It is important to note that this tax incentive and that the government wants companies to use it without undue extra work. As a result, it is unnecessary to produce a description for each qualifying project and instead, use a robust strategy to highlight the most important activities when substantiating a claim.

At Ayming USA, we are acutely aware of how much is effort is necessitated for each expenditure, project, and related analysis.

2 Spending too much time identifying expenses and projects

Again, the process of identifying qualifying expenditure is often a thoroughly detailed exercise but, in many cases, isn't necessary. Using a reasonable and robust methodology can help to eliminate hours of combing through data. However, it's crucial to ensure that this methodology is still justifiable in light of the claim's size.

(832) 492-5349
tfolsom@aymingusa.com
www.aymingusa.com

 [linkedin.com/company/ayming](https://www.linkedin.com/company/ayming)
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