Looking Back to Look Forward

The Evolving World of Tax Credits

ayming

FURTHER **TOGETHER**

Looking to the past often provides great insight into the future

It is difficult to imagine that it has been nearly two years since the COVID-19 pandemic became an undeniable presence in day-to-day life. In March of 2020, individuals and businesses alike encountered increasingly unchartered waters requiring continuous adaptation. The following year, navigating such unchartered waters became increasingly the norm. Historically, such adaptations have generally led to indisputable innovations and legislative change. With the 2022 year upon us, one should expect more changes requiring continued adaptation. Fortunately, looking to the past often provides great insights into the future.

In 2021, Ayming USA published: "An Outlook: Employee Retention Credit – What's Next?" Found within this publication, the newly minted and valuable Employee Retention Credit ("ERC") tax benefit was outlined. At the time of publication, the future of ERC remained uncertain. Today, legislative changes have confirmed that the availability of ERC is limited to the period of March 13, 2020 through the third quarter of tax year 2021.

As we worked with various companies to identify, calculate, and ultimately produce a valuable (and often lucrative) ERC tax benefit, the occurrence of a particular inquiry was common: "How does ERC interact with the Research & Development ("R&D") Tax Credit? At the time, the answer to that question was not readily apparent. Fortunately, today, the answer to this question can be answered with far more certainty.

In tax year 2021, the IRS released updated guidance (Notice 2021-23) that clarified the interplay between ERC and R&D tax credits. Fortunately, the interplay between both is relatively straight forward. Found within guidance 2021-23, wages must be properly reduced by the ERC amount for purposes of the R&D tax credit. As a result, employers claiming both credits must ensure there are no instances of overlap between both incentives. Such interplay between ERC and R&D tax credits further highlights the importance of utilizing a singular service provider to ensure consistency for credit claims.

At first blush, IRS Notice 2021-23 suggests many employers may find themselves with a reduced R&D credit. However, as noted earlier in this article, the unprecedented nature of the past the past two years has resulted in companies engaging in inherently innovative efforts. Simply put, the business goal of 2020 was arguably focused on remaining sufficiently operational. Whereas, in 2021, countless companies underwent significant and often transformative operational changes to accommodate newly shaped marketplaces. Such changes likely qualify for purposes of the R&D tax credit. With this in mind, a deeper dive into a business's potentially qualifying activities throughout the 2021 year is highly advised.

Moving Forward

While guidance issued throughout the 2021 year regularly emphasized ERC, the 2022 tax year has made way for additional guidance pertaining to the longstanding R&D tax credit. In October of 2021, the IRS published Notice 2021-203 that modified what constitutes a valid R&D tax credit claim. In summary, the Notice requires that all amended returns requesting a refund related to the R&D Tax Credit must include the following.

- Identify all the business components to which the Section 41 research credit claim relates for that year

- For each business component, identify all research activities performed and name the individuals who performed each research activity, as well as the information each individual sought to discover

- Provide the total qualified employee wage expenses, total qualified supply expenses, and total qualified contract research expenses for the claim year. This may be done using Form 6765, Credit for Increasing Research Activities

Historically, a submittal of Form 6765 standing alone provided a sufficient claim for purposes of a valid R&D tax credit claim. However, in the event a credit claimant was subject to IRS review, much of the informational requests pertained to what now must be provided at the time of the claim itself. In other words, a valid R&D credit claim must now contain detailed informational requirements to be deemed sufficiently valid at the time of filing.

At the time of this publication, the grace period for complying with informational requirements has now passed. As such, companies should expect to see an increase in the level of documentation now required for their R&D tax credit claims.

With IRS Notice 2021-23 implementing ERC and R&D interplay requirements alongside newly issued guidance for valid R&D claims, the 2022 tax year will be all too familiar territory for companies continuing to adapt and innovate.

With millions of dollars delivered in ERC and R&D tax credits in the past two years alone, Ayming USA is uniquely positioned to provide defensible credit claims for businesses claiming multiple tax incentives. Contact us today.

insights@aymingusa.com
www.aymingusa.com
linkedin.com/company/ayming