



START-UP COMPANIES CAN NOW BENEFIT FROM THE R&D TAX CREDIT

If you're a start-up company with annual gross receipts of less than \$5 million, you can reduce your 2017 labor costs by up to 6.2%.

The federal R&D tax credit is a dollar-for-dollar reduction of federal income tax liability for qualified expenditures incident to the development or improvement of a product, process, software, formula or invention. It was recently made permanent by The Protecting Americans from Tax Hikes Act of 2015 ("PATH" Act).

Previously, a company had to actually generate a profit and taxable income to utilize the R&D tax credit. Now the PATH Act allows start-up companies who do not yet generate federal income tax liabilities to utilize the credit against their payroll taxes, provided the companies perform "qualified research".

What is it

The Federal Credit for Increasing Research Activities, aka "The R&D tax credit."

What's the value

Potential reductions in US labor costs for start-up companies ("qualified small businesses") of up to 6.2%.

Who qualifies

The tax code defines "qualified small businesses" as having less than \$5 million in revenue and being less than five years removed from their first year of attaining revenues.

How are the savings realized

Effective for the 2016 tax year, qualified small businesses can claim a R&D tax credit on 2016 tax returns and, thanks to a new tax code provision, apply those credits against 6.2% of payroll costs.

Timing

To maximize benefit, eligible companies should file 2016 federal income tax returns on or before March 15, 2017. Credits cannot be applied against payroll taxes until the quarter after the tax return is filed.

A timely-filed return enables the taxpayer to maximize their payroll tax offset for 2017 as it can be used in the second quarter (the credits cannot be applied against payroll tax until one quarter after the income tax return is filed).





How

- 1 File 2016 federal tax return ASAP**
- 2 Include Form 6765 claiming the R&D tax credit**
Designate the portion of your 2016 R&D tax credit to be applied against payroll tax (max \$250,000 per year.)
- 3 Second quarter 2017, the Company files its quarterly payroll tax return (Form 941)**
(Attach Form 8974 to Form 941)
- 4 Repeat this process for quarters three and four**

An Example

An early-stage information technology company has approximately \$1,500,000 in annual payroll expenses per year of which \$1,000,000 consists of wages paid for software development. If the company meets the definition of a qualified small business, it should qualify for approximately \$45,000-\$100,000 in federal R&D tax credits. Assuming the company has no tax liabilities to offset, it can apply the R&D credits against the OASDI portion of its payroll tax (\$93,000, or 6.2% of wages), generating immediate cash recoveries.

The below table displays the potential benefit and cash flows with and without the credits:

	with R&D Tax Credit	without R&D Tax Credit
2017 Total Payroll	\$1,500,000	
2017 OASDI Tax	\$93,000	
2016 R&D Qualified Wages	\$1,000,000	
2016 R&D Credits	\$50,000	
Q2 Payroll Tax Liability (including OASDI)	\$4,875	\$28,125
Q3 Payroll Tax Liability	\$4,875	\$28,125
Q4 Payroll Tax Liability	\$24,625	\$28,125
Total cash savings realized	\$50,000	\$0

Next Steps

In order to get as much value as soon as possible, companies that are potentially eligible should begin preparing in the 4th Quarter of 2016 in order to take advantage of the benefit in 2017. These opportunities to realize savings via federal tax credits do not come along often.

TRCG can help start-ups take advantage of every cost recovery opportunity available. Contact us for a free consultation to determine if an R&D tax credit study could be beneficial to your organization.