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# Everything You Need to Know About R&D Tax Credits

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# Agenda

- Overview of the R&D Tax Program
- Benefits
- Qualification Criteria
- Case Study
- IRS Requirements
- Do's and Don'ts
- Q&A





# What Is R&D Tax Credit?

- General business tax credit for businesses that incur R&D costs in the US
- Established in 1981, made permanent in 2015
- Credit can be claimed on all open tax years (typically 3)



# How Can I Use It?

- Carry back to the previous year
- Current tax year or carry forward 20 years
- Payroll taxes up to \$250k / year
- Alternative Minimum Tax



# But I'm Not Profitable

Offset payroll taxes up to \$250k / year if you:

- Have revenues for 5 years or less
- Have \$5m or less in revenue for the tax year
- Are not a tax exempt organization under 501

Additional credits can be carried forward.



# But I'm Not Profitable...

Offset AMT if you have less than \$50 million in average revenue for 3 preceding years.

Find out what your AMT is.

AMT exempt if:

- 1<sup>st</sup> tax year
- Gross receipts for 3 preceding years does not exceed \$7.5M (\$5M if 1<sup>st</sup> 3 years of business)



# Applicable Industries



**Software  
Development & ICT**



**Manufacturing**



**Bio Technology**



**Oil & Gas and  
Energy**



**Agriculture**



**and more**



# How Do I Qualify?

- New or improved business component
- Technological uncertainty
- Systematic process
- Technological in nature







# 1. Permitted Purpose

The purpose of the work must be to either:

- Create new product or process
- Improve existing product or process

The product or process must be developed for commercial purposes (sale, lease, license, etc.)



## 2. Technological Uncertainty

Achieving a given result or objective is unknown based on available technological knowledge or experience

May arise from shortcomings of current state of technology

It is determined in the context of the company



# 3. Process of Experimentation

Work must be done using a systematic approach to evaluate one or more alternatives:

- Formulate hypothesis or potential solution
- Execute testing
- Develop logical conclusions

Keep records/documents of experimentations (iterations/trial and errors)



# 4. Technological in Nature

Process of experimentation must rely on standard principles of:

- Engineering
- Computer Science
- Physical or Biological science

Exclusions for Social Science, etc.



# Exclusions

- Research conducted after commercialization of the business component;
- Adaptation/duplication of existing business components;
- Reverse engineering;
- Surveys, studies, activities related to management function, market research, routine data collection/testing;
- Software developed for internal use;
- Foreign research conducted outside of the US;
- Research related to social sciences, arts or humanities;
- Research funded by any grant, contract or otherwise by another person or government entity.



# What Can I Claim?

- US employee salaries
- US subcontractors costs
- Materials consumed in R&D, off-premise lease computer costs, patent costs





# How Much Can I Recover?

## Federal

- ~10% for new claimants or claimants with increasing R&D spend

## State

- California is ~7.5% of eligible expenditures, calculated as 15% of half of the average R&D expenditures over the past three years



# Case Study

- Software startup with operations in California
- 5 developers (1 front-end, 4 back-end)
- Avg. salaries are \$150K per year and ~80% of time is eligible







# Case Study

Qualified research expenditures (QRE)	\$ 783,161
Base amount	\$ 391,580
R&D costs eligible for this method	\$ 391,580
<b>Federal</b>	
Expenditures	\$ 391,580
Rate	20%
Federal Credit	\$ 78,316 towards social security offset
<b>State (California)</b>	
Expenditures	\$ 783,161
Base amount	\$ 391,580
R&D costs eligible for this method	\$ 391,580
Rate	15%
State credit	\$ 58,737 towards income taxes
<b>Total credits</b>	<b>\$ 137,053.19</b>

\* Front end development typically not eligible

\* Base amount is typically 50% of QRE



# When To Claim?

- Must be specified and elected on the timely filed 2016 tax return (including extensions) before you can begin to offset payroll taxes in 2017
- March 15: S-Corps with Dec YE. Others need to claim by the 15th day of the 3rd month following the end of the tax year
- April 15: C-Corps with Dec YE. Others need to claim within 4.5 months following the end of the tax year
- You can request a 6 month extension



# Technical Documentation

- Documented at the time the work was completed
- Highlight technical challenges
- Dated





# Technical Documentation

Document technical challenges/obstacles as the work progresses:

- Capture the problem and the iterations undertaken to attempt to resolve the problem
- What are the different hypotheses and how was each hypothesis tested?
- For a typical software project, only the major technical challenges/obstacles encountered by the team in a month need to be documented – not every little problem.



# Time Tracking

- Track time by project and activity
- Track all activities, including non-R&D
- Any type of system can be used (or excel if you don't have one)
- Time sheets can be entered daily or weekly and at half or quarter day intervals

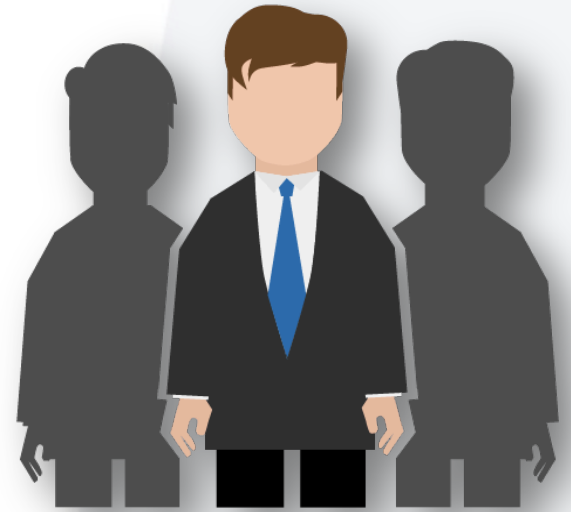


# **IRS Review**

R&D Tax Review  $\neq$  Tax Audit

Multiple types of Reviews:

- Technical
- Financial
- Technical & Financial





# Do's

- Document activities and track times
- Verify payroll/ PEO arrangement





# Don'ts

- Underestimate the importance of documentation
- Focus on the business opportunity
- Leave R&D claims until the last minute





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# Q&A

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