



ROMO INCENTIVES GROUP

The R&D Tax Credit

CALED Annual Conference

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Agenda

- Overview
- Benefits
- Qualifying industries
- Qualified Research Activities (QRA's)
- Qualified Research Expenditures (QRE's)
- The Four-Part Test
- Excluded activities
- Credit calculation
- Additional considerations
- R&D Tax Credit methodology

R&D Tax Credit Overview

- Introduced in 1981
- CA conformity
- 2004 Regulations
 - Elimination of “Discovery Test”
 - Relaxed documentation requirements
- Federal and CA non-refundable tax credit
- Federal credit renewed through 12/31/11
- CA credit is permanent

Benefits

- Federal carryforward 20 years
- CA credits do not expire
- Statute of limitations (3 – Fed and 4 – CA)
- Federal credit = 20% (gross)
- CA credit = 15% (gross)
- Fed + CA ~ 13% (net)

Qualifying Industries

- **Manufacturing**
- Tool & Die
- Job Shops
- Chemical Companies
- Software Development
- Apparel
- Wineries / Dairies
- Food Processing
- Waste Management
- Architectural Firms
- Engineering Firms
- Agribusiness

Qualified Research Activities (QRAs)

- New or innovative products
- Process improvements
- Design and engineering staff
- Prototype development
- Enhancement of existing products
- Patent development
- Qualification testing
- PhD research

Qualified Research Expenditures (QREs)

- Wages
 - Wages subject to withholding or SE tax
 - “One above, one below” rule
 - 80% rule
- Supplies
 - Consumed in R&D process
 - Prototypes
- Contract Research
 - Fees paid to outside contractors
 - 65% rule

4-Part Test

- New or improved business component
- Technological in nature
- Elimination of uncertainty
- Process of experimentation

New or Improved Business Component

Business Component R&D Matrix					
The Project's Business Components	The Purpose of the R&D Activities Related to Development of New or Improved:				
	Function	Performance	Reliability	Quality	Durability
Product	✓	✓	✓	✓	✓
Process	✓	✓	✓	✓	✓
Computer Software	✓	✓	✓	✓	✓
Technique	✓	✓	✓	✓	✓
Formula	✓	✓	✓	✓	✓
Invention	✓	✓	✓	✓	✓

Technological in Nature

- Apply principles of hard sciences (biology, chemistry, physics, computer science, engineering, etc.)
- Soft sciences (accounting, marketing, legal, etc.) do not qualify

Elimination of Uncertainty

- R&D activities must be intended to discover information new to the company
- Uncertainty can be capability (“Can we do it?”) **or** design (“How can we do it?”)

Process of Experimentation

- Must evaluate one or more hypothesis
- Must be designed to achieve a result that was uncertain at the outset
- Testing of alternatives through modeling, simulations, trials and test runs
- Taxpayer does **not** need to succeed

Excluded Activities

- Research after commercial production
- Adaptation of existing business components
- Surveys and studies
- Foreign research
- Funded research
- Internal-use software (IUS) and the “High Threshold of Innovation Test” (HIT)
 - The innovation test
 - The economic risk test
 - The commercial availability test

Credit Calculation

- **Regular Research Credit (RRC)**
- Alternative Incremental Research Credit (AIRC)
 - Fed: Repealed for years ending 1/1/09 and later
 - CA: Calculated as a % of QRE's in excess of fixed base
- Alternative Simplified Credit (ASC)
 - Available beginning 1/1/07 – CA does **not** conform
 - May be attractive option for companies “base limited”
 - Claiming ASC is an election on a timely filed federal return
 - 12% in 2007-2008 and 14% in 2009

Additional Considerations

- Tier 1 status
- *Cohan* rule and documentation
- AMT
- § 280C(c)(3)(A) election
- Controlled groups
- Small Business Jobs Act of 2010 (H.R. 5297)

R&D Tax Credit Methodology

- Phase I – Feasibility Analysis
- Phase II – Implementation
 - Qualify projects
 - Quantify costs
 - Document activities
 - Perform calculation
- Phase III – Delivery
 - Report
 - Amend tax returns
- Phase IV – Audit Support

Q&A

Questions?

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