R&D Tax Credits: New Opportunities for Small Businesses

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For companies developing new products and /or manufacturing processes in the United States, the Research and Development (R&D) tax credit continues to serve as a great catalyst to drive innovation. Recently, the IRS issued interim guidance on how eligible small businesses can benefit from a new provision that enables them to apply their Section 41, Research and Development tax credit against their payroll tax liability instead of their income tax liability, allowing qualified companies to start using the credits before becoming profitable. Prior to 2016, taxpayers could only utilize the research credit against their income tax liability.

Under the PATH Act of 2015, a qualified small business can choose to apply a portion of its R&D credit against the employer portion of Federal Insurance Contribution Act (FICA) payroll taxes, effective for years beginning after December 31, 2015. A qualified small business is defined as, a business that has gross receipts of $5 million dollars or less for the tax year. In addition, the business cannot have had gross receipts for any tax year before the five year tax period ending with the current tax year under consideration.

Eligible small businesses with qualifying research expenditures (wages, supplies and contract research) can choose to apply up to $250,000 of their R&D credit against its payroll tax liability by filing Form 6765, Credit for Increasing Research Activities, with its timely filed business income tax return.

Under a special rule for tax year 2016, a small business that has already filed its 2016 tax return and did not elect this option can still make this election by filing an amended tax return by December 31, 2017.

A small business can then claim the payroll tax credit by filing Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities. This form gets attached to the business's payroll tax return – Form 941.

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