Is Your Technology Company Missing Out On a Significant Tax Incentive?

October 6, 2021

The Research and Development ("R&D") Tax Credit (or "R&D Credit") is an often an overlooked tax incentive due to many misconceptions regarding its applicability to those creating or introducing a new product or technology to the marketplace.

What is the R&D Tax Credit?

The R&D Tax Credit was first introduced by Congress in 1981 as a temporary measure. However, the credit, which can be used to offset both federal and certain payroll tax liabilities, was eventually made permanent in 2015.

Specifically, the credit is available to any business that attempts to develop new, improved or innovative products, software or trade processes. Examples of various credit qualifying efforts commonly performed by technology companies may include developing or improving the following:

- Algorithms for enhancing fundamental, basic or underlying computer processes (e.g., improving methods of sorting or searching for data);
- Architectures, software;
- Order management system functionality;

- E-commerce applications development;
- Image or signal processing, artificial intelligence advancements, or speech recognition; or
- Cloud-based solutions, market simulation platforms and custom enterprise platforms.

Does my technology company qualify for the R&D Tax Credit?

In order to qualify for the R&D Tax Credit, your research and development efforts must meet a four-part test under the IRS regulations. The qualification criteria related to your R&D activities are:

1. The activities must relate to the development of a new or improved business component, defined as a product, process, software, formula or invention to be sold or used in a taxpayer's business.
2. The activities must be intended to resolve a technological uncertainty which may be related to the capability of achieving project goals, appropriate design, or methods and techniques required for developing the business component.
3. The activities must rely on a hard science, such as engineering, computer science, biology, chemistry or physics.
4. The activities must constitute a process of experimentation involving testing and evaluation of alternatives to eliminate technological uncertainty.

What types of expenses are eligible for the R&D Tax Credit?

The R&D Credit is primarily comprised of the following types of qualified expenses:

1. Wages paid to employees directly performing "Qualified Research Activities," as well as wages related to supporting or supervising those individuals.
2. Supplies used and consumed in the process of experimentation or used to build and/or testing of prototypes.
3. Certain rental or lease payments to cloud service providers for the costs of hosting a development-related server.
4. Contractor expenses paid to a third party for performing certain research

activities on behalf of a taxpayer, regardless of the success of the research, subject to 65% of the actual cost incurred.

5. Basic research payments made to qualified educational institutions and various scientific research organizations, subject to 75% of the actual cost incurred.

Conclusion

The R&D Tax Credit is a valuable tax incentive available to technology companies seeking to minimize tax liability, lower overall effective tax rates, generate cash flow, and refuel R&D cycles. Depending on the stage and size of the company, the R&D Tax Credit can be used against payroll taxes or income tax liability. While properly calculating and claiming the credit requires considerable expertise, it provides significant monetary and operational benefits to eligible companies. If you are engaging in any type of R&D-related activities, you should be considering and planning for this opportunity. Doing so will increase your company's competitiveness and allow you to drive growth and innovation for years to come.

For more information on the R&D Tax Credit, please contact either Chris Noble, Leader of Anchin's Technology Group, at chris.noble@anchin.com, or Yair Holtzman, Leader of Anchin's R&D Tax Credits Group, at yair.holtzman@anchin.com, or your Anchin Relationship Partner.