



## Office of Senator Chris Coons

### **WHAT IS THE R&D CREDIT?**

The federal research and development (R&D) tax credit was created by Congress in 1981 and was designed to incentivize innovation by making research activities cheaper for businesses. In short, the credit allows businesses to offset a portion of their tax liability if they can prove that they have made investments in qualified research and development activities.

### **WHAT TYPES OF ACTIVITIES QUALIFY?**

In general, a company may qualify for R&D tax credits if they have invested time, money, and resources in activities that contribute to creating or improving a product, process, technique, formula, invention or software application system. The following examples provide a few areas to consider:

- Conducting research or directly supporting research activities
- Developing or testing new products, processes or systems
- Developing new manufacturing processes
- Maintaining laboratory equipment
- Using outside contractors to conduct research and development activities

### **WHAT EXPENSES QUALIFY?**

Expenses that qualify typically fall into a few categories:

- **Wages.** The research expenditure is only eligible if the wage is paid to the employee for performing a qualified research and development oriented service.
- **Supplies.** Supplies are any tangible property other than land or land improvements. Supply expenses must be directly linked to qualified research activities. Qualified supplies include prototypes and testing materials. The taxpayer may not include travel, shipping or royalty expenses as supply expenses.
- **Contract Research.** Contract research may be claimed for payments to third-party contractors that meet the qualification requirements for wages. This expenditure requires the taxpayer to have rights into the research results and to take on development risk.

### **HOW DO YOU PROVE YOUR EXPENSES?**

Without properly documenting your research and development expenses, you might miss out on the tax savings this credit can provide. In general, companies must provide documentation to certify:

- **Employee time.** Taxpayers must provide evidence that links an employee's time directly to an R&D project or activity. This documentation can include time-tracking documentation tying an employee's hours to a specific project, such as through payroll records. This could also include contracts with third-party developers who conduct contract research.
- **Expenses.** Taxpayers must also provide documentation of equipment or materials purchased for specific R&D projects. This can be accomplished through project reports and expense receipts.

### **R&D CREDIT – 2016 AND BEYOND**

At the end of 2015, Congress passed tax legislation that not only made the R&D credit permanent but also expanded the credit to allow startups and small businesses to access it. The idea to expand the credit to startups was drawn from a bill that I introduced with Senators Pat Roberts (R-KS) and Chuck Schumer (D-NY). Rather than shutting our startups out of the R&D tax credit, we will finally open the doors to these innovators and see what they can do.

## Office of Senator Chris Coons

### **INNOVATORS JOB CREATION ACT (S. 455)**

While the R&D credit is essential for our innovators, historically it has not been accessible to many small businesses and startups. The main reason small businesses could not access the credit is simple: the R&D credit could only be applied against a company's income tax. Since most startups are not profitable in their early years, they don't have an income tax liability against which to take a credit. That's why I partnered with Senators Pat Roberts and Chuck Schumer to introduce the Innovators Job Creation Act.

The Innovators Job Creation Act was designed to implement simple changes to open up the R&D credit to small businesses and startups. Now that these ideas are law, thousands of innovative small firms will be able to claim the R&D credit, boosting their capacity to invest in innovation and job creation. The Innovators Job Creation Act:

- **Allows the R&D Credit to be claimed against the Alternative Minimum Tax.** Even if a company is entitled to the R&D credit, many companies could not claim it because the R&D credit could not be used against the Alternative Minimum Tax (AMT). The AMT is a supplemental tax imposed on companies that benefit from other tax exemptions. By allowing companies to use the R&D credit against their AMT, companies have another avenue to take advantage of the credit. This provision is available for companies that have less than \$50 million in gross receipts per year over the last three years.
- **Enables startup firms to claim the R&D credit by claiming against their employment taxes.** If a startup company cannot access the R&D credit because it does not have an income tax liability, it can claim the R&D credit against taxes it pays on employee wages. The benefit is capped at \$250,000 per year. This provision is available for companies that are less than five years old and have gross receipts of less than \$5 million a year.

### **WHAT THIS MEANS FOR SMALL BUSINESSES**

My proposals from the Innovators Job Creation Act are now law. This means that if you own a small business that invests in qualified research and development activities and meet the criteria stated above, you may be able to claim the credit for expenses incurred in 2016 and beyond. Now more than ever, innovative and research-intensive startups should take the time to contact an accountant, tax consultants, the IRS, or local small business resources to see if they will qualify for the R&D credit when they file their taxes next year. Helpful links are included below.

### **R&D RESOURCES**

IRS Website - R&D Credit:

<https://www.irs.gov/businesses/small-businesses-self-employed/research-and-development-manufacturing-tax-tips>

IRS Form 6765 - R&D Credit: <https://www.irs.gov/pub/irs-pdf/i6765.pdf>

Delaware Small Business Development Center - Tax: <http://delawaresbdc.org/resources/legal-tax-regulatory/>

### **DELAWARE R&D**

The state of Delaware offers its own incentives for R&D:

Delaware Department of Taxation - State R&D Credit: [http://revenue.delaware.gov/services/current\\_bt/2070AC.pdf](http://revenue.delaware.gov/services/current_bt/2070AC.pdf)

Delaware Economic Development Office: <http://dedo.delaware.gov/Incentives/Tax-Credits#job-creation-tax-credit>