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### Smart Answers

## The R&D Tax Credit Explained for Small Business

By Karen E. Klein August 16, 2011



Research and development tax credits are often overlooked by entrepreneurs, who assume they must have on-site laboratories or breakthrough research to claim the credits. Others fear they'll face complex tax calculations or trigger an IRS audit. But small and midsize businesses that employ engineers or outsource product testing can claim R&D credits, says Sean Haggard, a CPA with Florida accounting firm Kaufman Rossin. The credits have become more attractive for small companies in recent years because they've been simplified, can be transferred in an acquisition, and can be taken retroactively, he says. And they are particularly good for startups, since R&D costs incurred in years when a company has no income can be carried forward to offset taxes on future profits.

### **Q: What is the research and development tax credit?**

**A:** The rules were promulgated in 1981 to incentivize technological advances and the hiring of workers to perform R&D. The companies that receive the greatest dollar benefit of the R&D credit—80 percent—have \$250 million or more in gross receipts, according to IRS statistics. The cost of this credit in 2008 was substantial: \$8 billion. That has grown from \$5 billion in 2004, and those numbers just count C corporations. In 2006, the IRS broke out numbers to show that \$388 million in R&D credit was claimed on individual tax returns, including pass-through income from smaller companies organized as S corps or partnerships.

### **Do you feel that the R&D credit is underutilized by small and midsize companies?**

Small and midsize companies don't know how to capture qualified research expenses and quantify them. Also, in most small companies, the R&D is heaviest up front, when they are

developing products and services. Because their research costs decrease over time, it's tougher for them to utilize the credit.

About 5,600 C corporations with less than \$5 million in gross receipts claimed the R&D credit in 2008. These small companies received less than 7 percent of the \$8 billion credit. Startups benefited on average of \$151,000 per claim.