

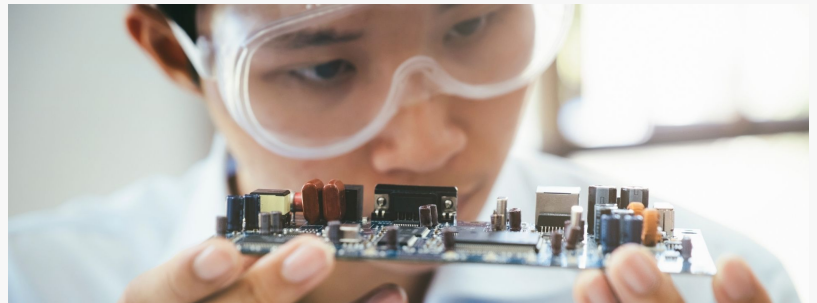
How to Calculate and Qualify for the R&D Tax Credit

Despite reforms introduced in the Tax Cuts and Jobs Act (TCJA), the Research & Development (R&D) tax credit provides an opportunity for businesses.

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Despite the reforms introduced in the Tax Cuts and Jobs Act (TCJA), the Research & Development (R&D) tax

credit provides opportunities to bring down income tax liabilities, allowing companies to save on their returns.



R&D Tax Credit

However, the concept of R&D tax is shrouded with uncertainty. Due to common misconceptions about R&D tax application to business operations, many businesses fail to benefit from the [R&D tax credit](#). Confusion surrounds issues like how to calculate the R&D tax credit, identifying qualifying activities and expenditures, credit utilization, and more.

By understanding, identifying, and claiming the R&D tax credit, businesses can benefit by lowering their tax burden.

What Is the R&D Tax Credit?

R&D [tax credits](#) can be defined as a government incentive to encourage investment in innovation. It is available to businesses developing new and improved business components that enhance functionality, reliability, performance, or quality.

Companies can attain R&D tax credits on several business components, including products, computer software, processes, techniques, and inventions to enhance functionality, reliability, performance, or quality. It is available on both the federal and state level. Over 30 states offer R&D tax credits to companies investing in innovation.

Who Is Eligible for the R&D Tax Credit?

Wondering how to calculate the R&D tax credit? First, determine if the business entity is eligible. One of the leading reasons businesses fail to benefit from R&D tax credit is a lack of clarity regarding R&D tax credit eligibility.

The eligibility criteria for R&D credit are much broader than many companies realize, encompassing product development and several activities and operations.

Companies investing in new manufacturing processes and quality enhancements may be eligible for R&D tax credits. They may be eligible to apply for R&D tax credits if the business devotes resources and time for any of the following purposes:

- Creating new and innovative products
- Enhancing existing products
- Hiring scientists, engineers, or designers that devote their time to the R&D process
- Developing patents, new processes, or software

Start-ups are also strong contenders for R&D tax credits, which can be utilized to offset their payroll tax for up to the first five years of operation. Also, keep in mind that R&D tax credits are retroactive. Meaning, businesses may be able to claim R&D credits for up to the past three open tax years for federal and in most states, depending on when the tax returns were filed.

How to Claim the R&D Tax Credit?

Businesses must understand how to calculate the R&D tax credit and how to claim it. The total amount of R&D tax credits that a company can claim depends on multiple factors and can be challenging to calculate. However, the effort is worthwhile as the R&D tax credit can bring down the overall tax burden on a company.

Plus, companies that have never received R&D tax credit can take a look at open tax years to claim any opportunities they might have missed in the past. Typically, companies can consider three to four years, depending on when the tax returns were filed.

In cases where the business does not have a taxable income or the tax credit use is limited, the federal R&D tax credit can be carried forward for up to twenty years. Another option is to use it to offset the company's payroll tax. State tax credits can also be carried forward; however, the duration varies from state to state.

Necessary Documentation to Claim the Credit

Documentation of R&D activities may play a pivotal role for companies that have claimed R&D tax credits or plan to do so in the future. Here it is important to reiterate that R&D tax credits can be reclaimed for both current and previous tax years.

Therefore, documenting all R&D activities can help position the company to increase the number of credits.

To claim tax credits, R&D documentation must establish the amount of expenses on qualified research activities. The documentation must be contemporaneous.

Examples of contemporaneous documentation can include payroll records, project lists, project notes, general ledger and expense details, laboratory results, emails, and any other documents that the company produces on a regular basis during the course of business.

Combined with reliable employee testimony, such contemporaneous records can lead to a successful R&D credit claim.

How Tax Reform Impacted the R&D Tax Credit

Increased Credit, Decreased Tax Rates

Under IRC Section 174, taxpayers were not allowed to take a deduction equal to the amount of R&D credit. As a result, companies could not enjoy double tax benefits. They were also required to bring down their R&D expenses by the amount of the tax credit. The expense reduction created an income increase. Consequently, the corresponding taxes also hiked.

In line with IRC Section 280 C(c) (3), taxpayers could prevent a reduction in research expenses by opting for reduced credit. However, as the maximum corporate tax rate was reduced, the AMT rate was eliminated, boosting credits.

Retention of ESBs Credits

Prior to the tax reform, owners of pass-through companies and businesses with average revenue of less than \$50 million over three years were deemed eligible to use the R&D credit to offset AMT. However, TCJA eliminated AMT, benefiting individual taxpayers and allowing them to benefit from businesses in which they have ownership.

Retention of Qualified Small Businesses and Start-Up Payroll Credits

Start-ups with less than \$5 million in revenue can make select options that allow them to offset payroll taxes for up to the first five years they have gross receipts. They can offset up to \$250,000 in payroll taxes.

Usability for Individual Taxpayers

Prior to tax reforms, AMT at the individual level kept business owners from using R&D credits. Fortunately, things have changed. AMT exemptions for individuals are on the rise. In other

words, individual taxpayers can employ credits from their businesses.

[Windes](#) Can Help. For more information, connect with Windes at 844.494.6337 or info@windes.com.

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