What you need to know about R&D tax credits for The Modern Firm®

Rootworks

R&D tax credits advisory services: A win for your clients; a win for your firm

Your small business clients' needs are ever-changing. Running a business is complex and time-consuming, which is why clients lean heavily on their trusted advisor for support that expands beyond standard tax and accounting compliance work. This can include such services as accounting system setup, cash flow forecasting, KPI analysis, and, yes, advisory on federal and state research and development (R&D) tax credits.

R&D credits have been spotlighted in recent years, primarily because most business owners have no idea these credits exist. In response, many firm leaders are starting to add R&D credits to their advisory product roster.

The goal? To help clients navigate eligibility requirements and claim their due credits.

This eBook is designed to answer your questions around R&D tax credits. This includes background on why the credit was introduced, what it means for your clients and your firm, how to determine eligibility, and more.

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What is the R&D credit?

The R&D credit applies to businesses across thousands of industries that incur research and development costs. It was introduced in 1981 to boost jobs geared toward developing, designing or improving products, processes, formulas or software. These jobs can include software development, manufacturing medical equipment and engineering of new products, to name just a few.

Beyond its general scope, the R&D credit translates to money on the table.

If a business attempts to develop a new or improved product, process, software, technique, invention or formula, there's a good chance they qualify for the R&D credit, even if the attempt fails.

The credit was created as an incentive for businesses to keep jobs in the United States and boost the economy. It really became more enticing for small businesses as a result of the PATH Act of 2015, which made the credit permanent and expanded eligibility requirements.

Beyond its general scope, the R&D credit translates to money on the table. In fact, businesses can typically generate a federal tax credit averaging between 6 to 8 percent of certain U.S.-based costs tied to development activities.

As the client's trusted advisor, you can expand your role by being the source for the R&D tax credit and helping them claim it.

Why you should care about R&D credits

R&D credits equate to money on the table. In fact, here's an eye-opening example of just how much money your clients could be missing out on:

Real-world client example

A business in the specialty engineering industry developed and improved upon a training technology. When determining their eligibility for possible R&D credits, ***the firm discovered that the client's innovations in training technology had earned them $736,120 in credits****. That's $736,120 per year that was left on the table and could be claimed retroactively for up to three years.*

From the example above, this is money that can be applied to future payroll taxes if there are no income tax liabilities. Money that can be funneled back into the business to continue to encourage additional growth and innovation. Money that the client had no idea about. Money almost lost.

So, what is 'innovation'?

If you're now asking, "What constitutes innovation?"… you're not alone. It's the million-dollar question, and it's one we have an answer for.

"Innovation" can encompass many things, including new ideas, methods or devices. In simplest terms, it's the introduction of something new.

For example, innovation can include creating a new website platform for your clients. It can also include creating a new process to manufacture dental devices such as crowns or dentures. But wait, there's more. It can also include a new formula for a vaccine, a new way to brew beer or a new layout in a manufacturing plant.

Unfortunately, money is often left unclaimed when it comes to R&D credits because clients (and even many firms) don't realize that their activities or industries qualify for the credit. But with a little guidance, you can become an expert on R&D credits and proactively offer this much-needed advisory service to your clients.

Identify qualifying clients

You likely already have a good deal of client data on hand. So, the next step is to identify which clients qualify for the credit. Of course, knowing where to start can be difficult, so be sure to follow our recommendations.

Capture more data

If you need to capture more data to qualify clients, apply a process that is streamlined and automated. For example, launch an online survey. Use tools such as SurveyMonkey, HubSpot or SurveySparrow to automate the process. While many online survey options exist, these are free to use and easy to set up...and they ensure that data is captured in one place.

You can also supplement the data collection process manually. This entails "interviewing" clients while face-to-face (via video meeting or onsite). Be prepared by having a structured list of questions ready.

Organize the data

Once you've started gathering data via surveys and/or meetings, be sure the information is tracked within your CRM-style solution. Create dropdowns or checkboxes with qualifying data, and continue to record details as questions come up during meetings or one-off conversations. Using the Rootworks client intelligence platform, ClientView™, is ideal.

Use data to create and review reports in your system of choice so that you have the qualifying information at your fingertips and can devise a plan for next steps.

Whether you already have all needed client data on hand, send a digital survey to gather data, or qualify clients face to face, we recommend starting with the following list of standard qualifying questions:

Standard qualifying questions

1. **Is my client within a qualifying industry?**
   ☐ Yes ☐ No
2. **Are my client's business activities being performed within the United States?**
   ☐ Yes ☐ No
3. **Is my client growing or developing new products, solutions or processes?**
   ☐ Yes ☐ No
4. **Has my client ever taken any tax credits?**
   ☐ Yes ☐ No
5. **Was my client's business established in the last five years?**
   ☐ Yes ☐ No
6. **Does my client hire programmers, coders or engineers?**
   ☐ Yes ☐ No
7. **Does my client have at least 10 or more employees?**
   ☐ Yes ☐ No
8. **Does my client use 1099 contractors to augment staff?**
   ☐ Yes ☐ No
9. **Is my client profitable and taxable?**
   ☐ Yes ☐ No
10. **Does my client's gross payroll exceed $500k?**
    ☐ Yes ☐ No

Notes:

How to determine eligibility

Advance your trusted advisor role by being your clients' go-to source for R&D credits. Based on in-house data and information gathered from the 10 qualifying questions, you can begin to determine if clients are eligible for credits and help ensure that they're not leaving money on the table.

To further aid you in determining eligibility, consider the most common qualifying activities and industries:

Common qualifying activities

Product
This includes developing a new or improved upon product. For example: a medical device, pharmaceuticals or cosmetics.

Manufacturing process
A process could include changing the layout of a manufacturing facility to improve an existing process. Or a dentist who creates dentures or crowns in-house.

Software
This includes creating a new website or platform for public or internal use. It can also include hiring developers in the United States to do the work on new platforms or apps.

Invention
An invention can include new software technologies that utilize new algorithms or automations; something that is patentable.

Technique
A technique can include, for example, a new way to brew beer or distill whiskey.

Formula
Formulas can include new vaccines, medicines or therapeutics.

If your clients perform any of these activities, chances are they likely qualify for the R&D tax credit.

Note: It's also important to understand that even if attempts to create new products or software are unsuccessful, a client may still qualify. Failure to produce a successful innovation is not an automatic disqualifier for the R&D credit.

Common qualifying industries

Consider a short list of common qualifying industries:

- Software
- Manufacturing
- Biotechnology
- Pharmaceutical
- Natural resources
- Services
- Real estate
- Agriculture

Note: While the above represents common qualifying industries, this list is not all-inclusive.

To ensure that qualified clients are not overlooked based on industry alone, be sure to also apply the following three criteria points as you work through the qualifying process:

1. The business has gross receipts/revenues of less than $5 million for the current tax year.
2. The business has gross receipts/revenues for five years or less. The business must not have gross receipts for any tax year before the five-tax-year period ending with the tax year for which they are applying.
3. The business is not a tax-exempt organization under section 501.

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Dispelling the myths of R&D credits

While some clients might understand the value of R&D credits, they can often be resistant to take action based on a few common myths. Let us help you dispel the most common reasons that prevent companies from taking advantage of the credit.

Myth #1

Our activities aren't innovative or groundbreaking

There are many qualifying activities that your clients might not realize. For example, creation of an app or a tool to better manage a component of their business. This is true even if the app is only being used internally.

Myth #2

We don't track our time

Keeping time sheets is not a requirement. The IRS accepts and acknowledges estimated time.

Myth #3

We don't document our work

While a company may not formally document work on projects, the team most likely exchanges emails and texts about the work—creating an audit trail of documentation.

Myth #4

This will be too time-consuming

We're going to level with you here. Without a plan in place, the process can be time-consuming. Of course, this is where your firm's advisory services can help relieve clients of some (if not nearly all) of the process burden.

Myth #5

Our customers pay for our projects

While customers may pay for projects, your client is still doing the work. They are conducting the research, development and testing—along with supervising the work. This qualifies, as long as the outsourcing remains in the United States.

Myth #6

We are an S-Corp or a Partnership

Being an S-Corp or a Partnership doesn't disqualify a client from eligibility. The client does not have to be a C-Corp to qualify.

Myth #7

We aren't profitable

Especially for startups, being a profitable company is not a requirement for eligibility. As long as the team is putting in the effort for R&D, they can qualify.

Myth #8

This will trigger an audit

Honestly, anything can trigger an audit when filing a return. However, the chances that filing a return for R&D credits results in an audit are extremely low—coming in at about a 1 to 2 percent chance.

Be prepared to talk clients through any preconceived beliefs while also educating them on the potential cash they could be missing out on. This is money that could be used to improve cash flow, reduce federal and state income tax liability, or reduce effective tax rates.

And because money talks, also consider showing clients a few real-life examples of "found" money.

Note: Some estimates can go back up to three years.

Industry: Specialty engineering

Employee count: 40

Credit estimate (retro/current): $736,120

Qualifying activity: Developed training technology

Industry: Biotechnology

Employee count: 65

Credit estimate (current): $395,000

Qualifying activity: Drug therapy creation

Industry: Manufacturing

Employee count: 47

Credit estimate (retro/current): $371,700

Qualifying activity: Developing new equipment

Master R&D tax credits and grow your firm

Armed with knowledge on R&D credits and understanding the value to clients, consider creating a new and highly lucrative service offering. Adding R&D tax credit advisory to your product roster not only enables you to deliver added tax savings to clients and expand your advisor role, but also opens the door to a lucrative new revenue stream.

R&D Amendments product example

For example, create a product called "R&D Amendments" and charge a fixed fee. You could potentially charge $600 per amended return. For two shareholders and three years of amended returns, this could mean a $3,600 engagement!

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Final words...

Today's business clients have a real need for R&D tax credit services, they likely just don't realize it. This is where your firm comes in!

There's nothing more reassuring to a client than knowing that someone they trust is there to help, whenever they need them. R&D tax credits can be one more high-value advisory service that sets you apart from other firms and keeps bringing your clients back to you as the go-to source for business success.

Want to learn more about providing R&D tax credit services?

At Rootworks, our team is committed to helping our members build a lucrative product lineup that offers exceptional value to clients. We're continually developing tools and resources to support our members in achieving this important goal.

If you want to learn more, please contact us at membership@rootworks.com

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