RESEARCH AND DEVELOPMENT CREDITS A WINDFALL FOR SMALL AND MID-SIZED MANUFACTURERS

The growth in our manufacturing sector is fueled by continual innovation and development in manufacturing processes as well as the products manufactured. This requires continual investments in hiring and keeping skilled technical employees and taking risks in continual research and development. Fortunately, since 1981, the Federal Government has implemented an incentive program called the Research & Development Tax Credit, which rewards US manufacturers for making these investments and taking more risks. This incentive is in the form of tax credits which reduces the manufacturers' tax liability each year – if the credit is claimed. Unfortunately the provisions of these incentives contained stringent requirements, making it too difficult for the vast majority of US firms to benefit. Realizing that small to mid-sized firms accounted for the majority of US innovation, congress liberalized these statutory requirements in 2001. It is now no longer necessary for companies to maintain precise time sheets documenting the time an employee spent on qualified R&D activities. Moreover, this research no longer has to result in innovations to an industry; it simply has to be new to the firm that developed it.

Some estimates are that over 100,000 U.S. companies do not claim these credits, or the proper amount of these credits, and in total would receive as much as $30 billion if they did so. This is far in excess of the roughly $7 billion per year currently taken. These credits can mean cash refunds to the manufacturer (with interest) or dollar for dollar reductions is future tax liabilities. Due to procurement complexity, over 90% of small to mid-size manufacturers eligible for these incentives rarely claim more than the minimum amount they are due year after year – leaving billions remaining in government coiffeurs.

Companies often fail to realize they are qualified for R&D credits if they engage in any product design or process improvement activities. The definition of R&D, in the tax sense, is much broader than scientists and chemists in white coats. Most companies are surprised to find out that many of their daily activities qualify for the R&D Tax Credit. In general, if a company has expenses generated internally or through third parties that are towards improving existing products or processes, developing new products or processes, obtaining patents or developing new software for internal use or for sale outside of the company, then R&D Tax Credits are potentially available to them. The Internal Revenue Code (IRC) § 41 qualifies activities that include the design or development of new or improved function, performance, quality or reliability of "business components". These components are further defined as: products, processes, techniques, formulas, software, or inventions.

Qualified research expenses include the costs of supplies used in the research, wages paid to employees in the conduct of the research effort or in the direct supervision of such effort, payments made to third parties for computer time used in the research, and 65% of the contract fee paid to a third party for research or patent work conducted on a taxpayers behalf.

This brief appears courtesy of Tony Hnyp, managing director at ZTL. ZTL assists smaller and middle - market companies in the manufacturing, service, information and export industries by obtaining for them the same level of government incentives as the Fortune 500 receive. We operate strictly on a contingency basis, assuming all risk for our efforts and causing no disruption to a company's cash flow. Tony may be reached at 541-350-0202 or at tonyh@ztllc.com.

The manufacturing sector is the largest beneficiary of research and development credits, yet less than 5000 manufacturers filed for these credits according to the latest (2003) government statistics, divided by industry in the table below:

Manufacturing Sector	Claims Filed	Credits
Computer and Electronic Product	1,650	1,168,467,000
Chemical	632	1,001,644,000
Transportation Equipment	209	896,992,000
Miscellaneous	626	198,891,000
Machinery	407	134,808,000
Electrical Equipment, appliance, and component	543	117,260,000
Paper	35	66,653,000
Fabricated Metal Product	292	59,387,000
Food	129	49,120,000
Petroleum and Coal Products	30	39,400,000
Plastics and Rubber	126	21,245,000
Textile Mills and Textile Product Mills	22	10,160,000
Nonmetallic Mineral Product	45	9,670,000
Primary Metal	45	8,077,000
Furniture and Related Product	24	6,610,000
Beverage and Tobacco Product	10	3,114,000
Printing and Related Support Activities	54	2,274,000
Wood Product	8	1,583,000
Apparel	10	348,000
TOTAL	4,915	3,797,438,000