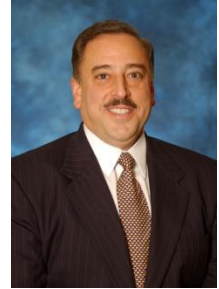




NJ BUSINESSES CAN BENEFIT FROM RESEARCH TAX CREDITS



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An often overlooked federal income tax credit is available to businesses that experience increases in certain research and product development (R&D) activities. The Tax Relief Act of 2010 extended the credit through December 2011 and it will probably be reviewed by Congress, along with much of the U.S. budget, before then. This credit, which has been regularly improved and extended since it was first introduced in 1981, is intended to incentivize manufacturing and other companies to conduct R&D activities. Indeed, because it directly reduces income taxes owed, it is more beneficial than straight deduction of R&D expenses. Moreover, the credit may be claimed up to three years after the tax return was filed or two years from any tax payment made for the year the R&D occurred, whichever is later.

A company is performing R&D activities if it is:

- investigating or implementing a new process or significant improvements to existing processes for design, manufacturing, testing or quality control;
- developing new products or making substantial improvements to existing ones;
- endeavoring to solve technical problems related to new customer orders or changes in product application.

Such activities may occur in a broad array of industries, including electronics, packaging, food and consumer goods, pharmaceutical, tooling, furniture, engineering, software, and even in breweries, distilleries and dairy farming. To qualify for the tax credit, however, these activities also must be:

- considered currently deductible R&D expenses;
- experimental/lab activities to eliminate uncertainty from or improve process or product;
- reliant on sciences--physical, biological, computer--or engineering;
- for the discovery of technical information to apply to product development.

The research tax credit is incremental, requiring an *increase in R&D spending*. The federal credit equals 20% of qualified research expenditures (QREs) for the current year over a base amount. In addition, New Jersey provides a tax credit equaling 10% of excess QREs over a base amount for research conducted in-state.

A company's base amount is calculated as a ratio of QREs to revenue over select years. QREs are those incurred in direct support of the activities listed above and are generally classified as:

- in-house research expenses – wages for employees and direct supervisors, costs of supplies;
- contract research expenses – amounts paid to non-employees, e.g., outside laboratories;
- payments for computer usage for qualified activities.

Merely presenting a list of additional R&D activities and expenditures will not prove eligibility to claim the credit or to amend (increase) an earlier claim. Instead, the activities and costs associated with *each individual R&D project* must be presented—and accurately quantified, connected and documented. For example, an employee's time on a project and the related wages must be identified and verified. This process can require significant time and input from the company's senior operating personnel, such as engineers and production managers, as well as its financial executives. Some companies hire outside consultants to review and document these activities.

Although a project-based accounting system is recommended, no specific accounting or bookkeeping system is required to track R&D expenses. However, demonstrating consistent historical treatment of them *is* necessary when claiming a research credit. Any change in accounting method or significant business event, such as a merger or acquisition, should compel a recalculation of R&D deductions and the resultant base amount, income, tax liabilities and tax credits claimed. The accuracy of these computations for the relevant years is vital. A comprehensive and effective tax analysis will ensure that all possible R&D costs are captured to provide the maximum tax benefit to the company.

Thorough accounting and technical records that offer contemporaneous documentation and clearly link specific R&D projects to the related supporting activities and expenses must accompany and substantiate a company's claim for a research tax credit. While the process of identifying and documenting these activities and expenditures may seem involved, a company could reap a substantial, multi-year tax benefit if it qualifies for the research credit.

About Cowan, Guteski & Co., P.A.

As a diversified certified public accounting firm, Cowan, Guteski & Co., P.A. is committed to being an active partner in its clients' growth by delivering value beyond accounting, innovative solutions and consistent exceptional service. To discuss your particular situation or R&D tax credits, contact Stephen Reed, CPA, Shareholder-in-Charge, Manufacturing & Distribution Services Group, at 732-676-4100 or sreed@cowanguteski.com. You can also visit www.CowanGuteski.com for more information on the services available to meet the unique needs of manufacturers and distributors.



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