



# ADP SmartCompliance<sup>®</sup>

## Tax Credits Module – Research & Development (R&D) Tax Credit

More businesses than ever before may benefit from the R&D Tax Credit. All businesses with qualified R&D activities and expenditures, regardless of their industry, size or profitability, may be eligible to take advantage of this opportunity.

### Overview

On December 18, 2015, the Protecting Americans from Tax Hikes (PATH) Act of 2015 was signed into law. The PATH Act permanently extended the research and development tax credit available under Section 41 of the Internal Revenue Code (the “R&D Credit”), and effective as of January 1, 2016, it also broadened the ability of many businesses, especially Small-to-Midsize Businesses (SMB), to take advantage of the R&D Credit.

Recognizing that thousands of our clients may now be examining the impact of the new laws applicable to the R&D Credit, ADP has formed an alliance with KPMG LLP (“KPMG”), the US audit, tax and advisory firm, to make available a new high quality service offering to help eligible companies reap the benefits of the R&D Credit in an efficient and cost effective manner.

### What is a R&D Credit?

- The R&D Credit is a tax incentive to encourage investment in product or process improvements in the United States. The federal incentive allows eligible companies to receive a tax benefit and a dollar-for-dollar tax savings up to 20% of their qualified R&D spending above a base amount calculated from prior years.<sup>1</sup> In addition, many states also offer R&D credits for qualifying research activities performed within their borders.
- The activities that are eligible for the R&D Credit may be broader than many businesses or their current tax advisors understand. If a business invests in the development or improvement of products, manufacturing processes, software, techniques, formulas, or inventions, then they may qualify for the R&D Credit. By reviewing your investments in these areas, ADP and KPMG can help determine if your business is engaged in a qualified activity.

### Why pursue the R&D Credit?

The R&D Credit may be one of the more underutilized opportunities afforded to U.S. businesses. Many eligible businesses, including SMBs, do not take full advantage of the credit due to misinterpretation or lack of information about the

law. As a result, they may forego significant tax credits and, in some cases, refunds for their qualified R&D expenditures.

With the expansion of the R&D Credit program, more businesses can potentially benefit and secure a tax credit. The potential benefits of the R&D Credit could include:

- Improving your business’s cash flow through federal and state R&D tax credits;
- Receiving a tax benefit and dollar-for-dollar tax savings up to 20% of your business’s qualified R&D spending above a base amount calculated from prior years;
- The ability to claim up to a \$250,000 tax credit against your federal payroll tax liability for tax years beginning after December 31, 2015, if you are a qualified small business; and
- The ability to carry forward your tax credits for up to 20 years

### What are the new R&D Credit benefits created by the PATH Act?

Historically, the R&D Credit could only be used by eligible businesses to offset regular income tax, which meant that many SMBs who were subject to the alternative minimum tax (AMT) could not reap the full benefits of the R&D Credit. Starting in 2016, however, the PATH Act significantly enhanced the potential benefits of the R&D Credit, especially for SMBs, to now allow for the following:

- “Eligible small businesses,” generally defined as those businesses having less than \$50M in average gross receipts over the past 3 taxable years, may now be eligible to use the R&D Credit to help offset their AMT liability. This means that a SMB may be able to reduce its Federal tax liability with the R&D Credit, regardless of whether it is paying regular tax or AMT.<sup>1</sup>
- “Qualified small businesses,” generally defined as those businesses having less than \$5M in gross receipts for the taxable year and having gross receipts for no more than 5 taxable years, may now be eligible to use the R&D Credit to help offset their payroll taxes (FICA), up to a maximum of \$250,000 per taxable year.<sup>1</sup>

## How do you claim the R&D Credit?

While the R&D Credit can be beneficial for a wide range of companies, the eligibility and documentation requirements are stringent and complex. Companies seeking to claim the R&D Credit must be prepared to perform an R&D study, which involves identifying, documenting, and supporting the associated costs of their qualifying R&D activities and expenses.

The costs eligible for the R&D Credit are called QREs (Qualified Research Expenses) and are defined as the sum of in-house research expenses and contract research expenses. These research expenses generally include:<sup>1</sup>

- **Supplies:** Most tangible personal property used or consumed during the qualified R&D activity
- **Contract Research:** A percentage of the amount paid to any contractor brought in to assist with the qualified R&D activity
- **Wages:** For those directly working on, supervising, or supporting the qualified R&D activity;

The largest component of most R&D studies is typically employee wages. In fact, a business needs the wage and the associated payroll information in order to complete a valid R&D Credit study.

## Why is ADP so focused on the impact of new changes to the R&D Credit on our clients?

- The eligibility and documentation requirements involved in producing a quality R&D study can be a significant undertaking for a business. Due to the need for the wage information to complete the study, ADP is often in a unique position to assist our clients in their data gathering efforts.
- There could be risk associated with claiming the R&D Credit if the qualified research activities and associated qualified expenses are not properly identified and documented.

Working with a trusted service provider such as ADP can help companies streamline the R&D study process while also helping to reduce and mitigate their risks associated with the R&D Credit.

## How can ADP help you maximize your R&D Credit opportunity?

ADP can help companies efficiently and effectively identify and maximize the capture of R&D Credits for which they are eligible by conducting a study of the business's R&D activities and expenses. Together with KPMG, ADP offers clients an R&D Credit service offering that encompasses the following:

- A documented calculation template to support the credits claimed, which is delivered by a team of experienced R&D Credit professionals.
- A streamlined, efficient client experience, particularly when ADP has access to much of the wage data needed to complete the study on a client's behalf;
- A comprehensive study reviewing all QREs associated with the project, including wages, supplies and contract research expenditures; and
- A transparent approach to delivering the R&D study and related documentation to support the R&D Credit amounts for which a client is eligible, including descriptions of methodology & procedures utilized

With ADP's ability to access your business's payroll information and KPMG's national team of tax and accounting professionals focused on the R&D Credit, we have created an alliance that can help ADP payroll clients identify and capture the available tax credits associated with its R&D investments.

To learn more about ADP's new R&D Credit offering please go to <http://info.adp.com/RDTaxCredit>.

<sup>1</sup> See IRC section 41 (2016); Protecting Americans from Tax Hikes Act of 2015, Consolidated Appropriations Act 2016, Division Q, H.R. 2029, 114th Congress (2015-2016).

The KPMG services described herein may not be permissible for KPMG audit clients or their affiliates.

## About ADP SmartCompliance

The ADP SmartCompliance platform adds a layer of services and best-practice processes to your current HCM solution to help you close the gap between core HCM technology and the myriad of HCM related compliance pressures you may face. This solution marries people, process and service with your technology to help off-load many of the risk-laden, manual and administrative tasks required of you. And it's a scalable solution that can provide continuity as your organization and the legislative landscape continue to evolve.



**For more information about the ADP SmartCompliance tax credits module, contact your local ADP Representative or visit [www.adp.com/taxcredits](http://www.adp.com/taxcredits)**

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