

GAMES Brief

Eight Myths that Keep Software Developers from Claiming *The R&D Tax Credit*

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By any measure, software development is one of the fastest growing and most innovative sectors of our economy – but while many may associate this success with bigger names such as Apple or Microsoft, it's the smaller firms that are pulling the economy forward. According to an article from [entrepreneur.com](#), custom software development was the second fastest growing industry among U.S. small businesses in 2012, with a total growth of 14.29 percent. Unlike these larger firms however, smaller software developers are not taking advantage of every opportunity to improve their bottom line.

At nearly \$10 billion a year, the Research and Development (R&D) tax credit is one of the biggest incentives available and can save software developers hundreds of thousands of dollars – yet only one out of twenty small and medium sized companies eligible for this credit takes advantage of it. And why? There are a number of self-censoring myths preventing developers from securing the credit – which is a shame to think when we have helped firms, such as an \$11 million dollar Network Engineering Company receive over \$1.6 million in benefits. Taking advantage of these incentives for many companies can be the easiest way to get funding quickly. Avoid allowing your business to fall victim to the following myths:

One: The Research and Development (R&D) tax credit is only for companies that are inventing something brand new.

Nonsense. The R&D tax credit is not just for inventing something or getting a patent. It is also available (and most typically used by) companies that are improving or modifying an existing product—that is, making a product cleaner, quicker, greener, cheaper, etc. As such, computer software is a good candidate for the R&D tax credit.

Two: The R&D tax credit is only for companies with laboratories and test tubes.

Wrong. While companies involved in basic research are obviously prime candidates for the R&D tax credit, the credit is very much about encouraging applied science – solving a customer’s problem or a production issue using known scientific principles. For instance, a company bringing in \$31 million in annual revenue developed a software program providing direct, secure connection to mortgage lenders, banks, and appraisal management companies. The software also allows users to search the National Collateral Database and provides a secure online messaging system that stores communication pertaining to an assignment. For developing this software, the company received \$2 million in federal credits – money essentially earned by creating a useful, everyday application.

Three: The R&D tax credit isn’t for companies in my industry.

Think again. Thousands of software companies secure the R&D credit for any number of eligible activities, including developing management software for call centers, improving commercial billing solutions, and enhancing weather forecast prediction software. Self-censoring is the biggest road block to companies taking the R&D tax credit and assuming your company is not eligible is a mistake that can literally cost hundreds of thousands of dollars.

Four: The R&D tax credit is only for the big companies.

That is exactly what too many small and medium businesses think. While the big guys, with their armies of tax lawyers, are all over the R&D tax credit, too often small and medium companies act as if there were a velvet rope barring them from taking the R&D tax credit. According to the Small Business Administration Office of Advocacy, 60 to 80 percent of all new American jobs come from small to midsized businesses. Given their role in expanding the American economy, isn’t it high time that small and middle market companies take advantage of the same perks offered to large corporations?

The R&D tax credit is available for small and medium businesses, but you do need to show up and apply to get it – the IRS isn’t simply handing out credits.

Five: The R&D tax credit won’t help me with my state taxes.

Au contraire. Thirty-eight states have a state R&D tax credit – and several states are looking this year to expanding their R&D tax credit or creating one. We have worked with companies that have been able to use their state R&D tax credit to eliminate or significantly reduce their state income taxes. For instance, a company that improved their tracking and recording software was awarded not only \$301,000 in federal credits, but also received an additional \$362,000 in state credits for their work.

In most situations, if your company is eligible for the federal R&D tax credit, it will also be able to benefit from the state R&D tax credit.

Six: The R&D tax credit won't help my bottom line.

Incorrect. In fact, software developers are typically the greatest beneficiaries of the R&D tax credit. The R&D credit is specifically designed to find federal and state tax savings from the tens of thousands of dollars to well over a million dollars for these firms. For example, a mobile application developer that brought in \$4.3 million in annual revenue received \$617,000 in federal credits for software testing and other improvements made to their application. Much black ink (and green dollars) has been realized for companies thanks to the R&D tax credit.

Seven: It's all too good to be true - it must be snake oil.

The R&D tax credit benefits thousands of companies a year and has been part of the Internal Revenue Code since 1981. While the IRS isn't giving away this tax credit –you need to have proper documentation of your activities and correctly apply the law– it is certainly a credit that is widely recognized and utilized by a wide range and number of businesses every year.

Eight: We are going to have tax reform and the R&D tax credit is going to go away.

The R&D tax credit is a close third to motherhood and apple pie when it comes to support in Washington, D.C., and the credit is supported on a bipartisan basis in both houses and by the Obama Administration (and by every previous administration since it was first put in place in 1981). All indications are it will stay in place even with tax reform; in fact, it could well be expanded. A recent study conducted by Goldman Sachs on technology, internet and biotech companies in the NASDAQ 100 revealed a strong correlation between R&D and sales growth, a fact that Congress will be very aware of once the bill is up for renewal. Moreover, in many cases your business may be eligible to file an amended return and claim the credit for the previous three years - more money in your pocket to grow your business and create new jobs.

The R&D tax credit is a tried and proven means for software developers to save hundreds of thousands on their bottom line for the work they perform on a daily basis. Given the innovations software developers have created over the years and the far-reaching impact they have had on our economy and daily lives, isn't it time for developers to take advantage of every incentive coming their way? Take a second look and see what the R&D credit can do for your business.

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