



# Financial Adviser

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## R&E Tax Credit Offers Significant Savings Opportunity

A number of businesses are revisiting the Research and Experimentation Credit and receiving significant tax benefits for doing so. This renewed interest is due to changes the Internal Revenue Service has made to R&E Credit regulations, for periods 1998 to 2003, which have allowed many more businesses to take advantage of this tax savings opportunity. Identifying some of these changes can assist in understanding why the credit has broader application and can benefit more entities today than in the past.

### Discovery test eliminated

Under prior rules, the credit required that new science needed to be discovered in order to qualify. Currently, if the knowledge is new to the discovering entity, this qualifies even though other organizations have knowledge of and are using this information already. The only requirement is that the information is new to the discovering entity.

### Uncertainty of capability, method and design

The credit requires that uncertainty associated with the development or improvement of a business component must exist. Prior rules mandated that uncertainty must exist in all three aspects of business component development (e.g. uncertainty of capability, method and design). Many operations are aware that the capability and/or method of producing a new product or process are known, but at the outset the final design is uncertain. The new rules require only one of these aspects be uncertain.

### Costs qualifying for the credit

There are different costs that qualify for the credit calculation. Wages, supply costs, outside consulting costs and computer programming costs in the development of a new process or product can qualify. These are all the costs incurred up until the time the product or process is ready for commercial production. The wages considered are not just that of engineers, but of

all individuals that are involved in conceptualization of the development of a new product or process. This can be some or all of the wages of top executives on down to the assembly line worker who provides input.

### Contemporaneous recordkeeping rule eliminated

The new rules indicate that any reasonable approach to determine the cost of employee or owner time involved in the development process qualifies. This differs from the old rules that permitted only the cost of time documented in company records during the period incurred.

### Ultimate success of development not required

Costs incurred for the development qualify even if the new or improved products or processes are not ultimately successful. Processes can be as sophisticated as ISO process improvement development or as simple as developing a process to produce a new or improved customer specified product. The time required to develop the design of the process qualifies even though the customer chooses not to proceed with the commercial production of the product for any reason.

### New rules apply to all open tax years

The new rules provide that the R&E Credit can be considered for the recent year and also apply to prior years that remain open to the filing of amended returns. This means that three or possibly four years can be currently filed to obtain this benefit.

Many manufacturers and producers have found that with proper understanding and application of these new tax rules to their specific production that this credit can result in a significant worthwhile tax benefit. ★

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