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The Research & Development Tax Credit – More Options, More Opportunity, More Attractive

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At present, no R&D credit is available for taxpayers since IRC §41, which provided the basis for taking the credit has expired on December 31, 2005. The good news is that congress not only wants it back – but also wants it better than it was before.

Both the Senate and the House have already passed separate tax reconciliation bills that would restore the credit and make it more accessible for taxpayers. These two separate bills ("H.R. 4297, Tax Relief Extension Reconciliation Act of 2005" and "S. 2020, Tax Relief Act of 2005") would extend the credit at least through December 31, 2006, but President Bush is calling for a permanent research credit that will never expire again. The two bills must concur before one can be passed, but either proposed modified R&D credit would provide more options and opportunity for the taxpayer.

What Makes the Modified R&D Credit Better?

The research tax credit was Congress' way of encouraging businesses to develop new or improved products or manufacturing processes. It has been extended and amended several times.

In its latest form, and in an ideal world, the credit would yield the taxpayer about 13 cents for every \$1 spent on incremental qualified wages and supplies, and about 9 cents for every \$1 of incremental qualified contract research payments. Currently the criteria and computation of the credit is complex and cumbersome. Consequently, modifications to the credit's computation and criteria for claiming it could present major tax planning opportunities for printing companies.

There are three modifications, which are agreed upon by both the Senate and the House Ways and Means:

1. The creation of an alternative simplified credit (ASC) for qualified research expenses (QRE). This would simplify the computation of the credit by allowing a flat 12 percent of the QRE for taxable years, which exceed 50 percent of the average QRE for the three taxable years preceding the credit determination year. If a taxpayer has no QRE in one of the three preceding tax years,

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then the taxpayer could take six percent of the QRE for the credit determination year as a credit. The taxpayer would have to make an election for the ASC that could not be revoked without the consent of the IRS.

2. The modification of the existing alternative incremental credit (AIC), which increases the rates for all three steps. The first step increased from three percent to 2.65 percent. The second increased from 3.2 percent to four percent, and the third step increased from 3.75 percent to five percent.
3. The taxpayer can choose between either the ASC or AIC, but could not claim both of them.

The opportunity exists with the creation of the ASC and is supported by both bills. Granted the ASC provides a far more simplified method for computing and claiming the credit, it would behoove printing companies to compute the credit using all three methods (ASC, AIC and the Standard method) initially. This would provide the taxpayer with the ability to consider which method would best serve the company in the long run before making any election.

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