



MANUFACTURING YOUR WAY TO LOWER TAXES

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With the 2012 year under way, you will soon be doing a review and assessing your 2011 business results. Just like an engineer or programmer applies a keen eye to their design work, a similar discipline can be applied to the bottom line of your company.

One tax benefit available to businesses and their shareholders that is often overlooked, especially in the “Job Shop/Contract Manufacturing” environment, is the Research and Development (R&D) Tax Credit. This specialized and underutilized part of the tax code, is a dollar for dollar reduction of a company’s or its shareholder’s tax liability. The credit is a benefit to incentivize and encourage innovation and investment so that U.S. companies can compete more effectively on a global basis.

Because they typically don’t have their own product line and are making parts for other companies, it’s widely believed that “Job Shops” do not perform Research and Development (R&D). “We get a drawing from our customer and we just make the part” is a common response from people that don’t understand how broad the definition of R&D is for tax credit purposes. However, what these companies don’t realize is that much of what takes place on a day-to-day basis may qualify for the R&D Tax Credit. This mistaken belief is causing many precision machining companies to leave money on the table. For companies that have not taken advantage of the R&D Tax Credit in the past, this can potentially mean the cre-

ation of immediate and substantial amounts of cash, minimally into the many tens of thousands of dollars annually, and occasionally \$100,000 or more. In addition, companies can reduce future tax liabilities and improve cash flow.

R&D doesn’t just take place in a lab with scientists in white coats. At a high level, activities associated with developing and/or improving a product or process can qualify for the R&D Tax Credit. In the machining environment, much of the R&D taking place will be “process” R&D. In some cases, you may be given a drawing by your customer. You will still have to figure out if you can make the part, how to make the part, and if you can make a profit. In many of these instances, just because you are provided with a drawing doesn’t mean you are ready to go right to production. Often there are adjustments or changes to the initial design. This requires back and forth communication between you and your customer about how to improve and manufacture the part according to specifications. In other cases, customers may come to you with only a concept. They look to your company to do the entire design/engineering of that part. Unfortunately, sometimes you are not able to meet your customer’s request. The key thing to understand about the R&D Tax Credit in the “Job Shop” environment is that it’s okay to be confident that you can meet a customer’s request and/or make a part. What determines if you are doing R&D is if

it’s “not readily known” at the outset HOW you will make that part. If you are doing repeat work on a part that you have already produced in the past, then you are not doing R&D. However, if you are working on a new part or making modifications to an existing part, and in doing the designing/modeling/prototyping of the part, you have multiple options you have to filter through, or you just don’t know how you are going to make the part, you are doing R&D! There’s a difference between being confident you will ultimately figure something out, and having to go through a process of experimentation to get there.

Additionally, research and development can also be taking place when you are improving your manufacturing processes through automation and technology. When deciding to purchase and implement new equipment, presumably it is being done because of increased performance/efficiencies and output that will be realized. Other times it will be because of new capabilities you want to offer. While the cost of the equipment is not a qualified expense because it is being depreciated, the time spent by employees evaluating and implementing the new equipment/manufacturing process is another example of R&D.

Effective use of the R&D Tax Credit in “Job Shops” includes understanding what activities qualify, identifying everyone in a company that is touching R&D (it’s not just the engineers), and how much time they are spending on these activities. Being able to document the projects and time allocations of people is also an important aspect for successfully claiming R&D Tax Credits. Finally, understanding when you are no longer doing R&D is equally important. Once you have figured something out and are ready to go to production, that’s when the R&D stops.

With tax season upon us, now is a great time to evaluate whether your company would benefit from the R&D Tax Credit in a meaningful way.” For more information about if/how your company can benefit from the R&D Tax Credit, contact Scott Schmidt at NTMA National Associate Member Black Line Group, a company that focuses solely on assisting companies utilize the R&D Tax Credit, at 763-550-0111, via email at scott@blacklinegrp.com, or online at www.blacklinegrp.com.

