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Small Business Owners R&D Tax Incentive

If you are a small business owner, you should take advantage of the R&D tax incentive open to you. Many small business owners mistakenly assume that they are not eligible for this tax benefit because they do not have a large laboratory filled with research personnel doing R&D. But even if you outsource your product testing or employ engineers to do your technical work, you may qualify for this tax credit.

Generally, if your business is in industries like biotechnology, software development, technology services, software-based services etc, you should qualify for the R&D tax credit. Doing any form of research and developing a product you intend to patent would generally qualify you also.

Here's the good news – the rules have recently been simplified. In fact, if you acquire a small business, the tax credits can be transferable and be applied retroactively. This is good news especially to new businesses because it means the credit incurred for R&D expenses in the initial years when there is little or no income can be carried forward to offset taxes on future profits. Here's the kicker – the time you have to carry forward your R&D tax credit is a whopping 20 years!

The simplification of this tax credit came in the form of the Alternative Simplified Credit (ASC) process when it was introduced in 2007. The ASC allows small to medium sized business owners to calculate the R&D tax credit based on their prior 3 years research expenditure. However, if you are a new business owner and have not been in business for 3 years, you can utilize 6% of your qualified research expenses to offset any tax liability you may have. If you are not taxable yet because your business has not started making profit as a startup, you can claim the credit prospectively and carry it forward

into a year when you do owe taxes (up to 20 years into the future).

If you are not new in business, you need to calculate 50% of your R&D expenses for the preceding 3 tax years. The amount of tax credit you're entitled to is based on what you spend exceeding this amount. Say if you spent an average of \$20,000 per year the last 3 years, 50% of that would be \$10,000.

So if you spent \$22,000 in R&D this year, then your tax credit would be 14% of \$12,000 (i.e the amount \$22,000 exceeds \$10,000) which works out to be \$1,680. The 14% rate applies to the tax years 2011 and 2012.