



## R&D Tax Credits and Their Application in the Mortgage Industry

### What is the R&D Tax Credit?

The Federal Credit for Increasing Research Activities, commonly referred to as the R&D Tax Credit, was enacted to incentivize businesses to invest in the development of new or improved business components that result in the creation of new jobs in the U.S and strengthen the nation's economic competitiveness through innovation.

### How much is the credit worth?

The federal R&D credit rate is 20% of eligible expenses (14% for Alternative Simplified Credit calculations). In addition, most states have some form of credit or incentive for research and development activities, increasing the benefit to companies with qualifying expenditures.

### What costs qualify?

In general, companies may qualify for R&D tax credits if they have invested time, money and resources in activities that contribute to creating or improving a product, process, technique, formula, invention or software application system. The following are examples of qualifying activities:

- Conducting research
- Developing new or improved concepts or hypotheses
- Developing or designing new products, processes or systems
- Modifying or redesigning existing processes or systems
- Testing new materials and concepts
- Developing internal software solutions
- Designing or evaluating product alternatives
- Reviewing experimental results
- Developing new manufacturing processes
- Participating in technical meetings
- Compiling research documentation and data
- Directly supporting or supervising research activities
- Using outside contractors to conduct research and development activities

Expenses that qualify under the federal R&D tax credit regulations include:

- Employee wages related to time spent:
  - Engaging in qualified research and development activities
  - Directly supervising qualified research and development activities
  - Directly supporting qualified research and development activities
- Contract research expenses
- Supply expenses

### Why now?

While the R&D tax credit has been around since 1981, it was recently made permanent after being extended several times since it was created. Additionally, recent changes passed by Congress expanded the credit to include more qualifying expenses and made it easier for taxpayers to claim the credit. Qualified small businesses may now apply the credit against Alternative Minimum Tax (AMT), and qualified startup companies may elect to use up to \$250,000 of R&D credits against their payroll taxes.

## The truth about recent R&D publicity

Despite what some may promote, there are no specific industries that have been targeted by Congress for application of the R&D credit. Certain industries and market environments make it easier to apply the R&D provisions, but any business can engage in R&D activities, regardless of industry or specialty. In fact, when the proposed regulations from 2001 were slightly modified in late 2015, these changes made more internal-use computer software development activities potentially eligible for the R&D tax credit – allowing more industries to qualify than before (as long as the development satisfies very specific requirements).

That said, although mortgage companies engage in software development or enhancement activities, they often don't rise to the level of qualifying expenses because there isn't sufficient customization to software or development of truly proprietary software systems. This has historically limited the applicability of the R&D credit within the mortgage industry.

## IRS audit challenges

Businesses and CPA firms are often hesitant to claim R&D tax credits because the risk of information leaks, or the risk associated with an IRS audit, are often considered too high to be worth the reduction in tax liability.

While the risk of an audit from the IRS is relatively low, some believe that claiming an R&D credit increases the chances of being selected for examination. There is no public information to support this, but it is still a commonly-held opinion.

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When our tax team identifies expenses that potentially qualify for the R&D tax credit, we recommend that our clients use a quality 3rd party R&D expert. Richey May works closely with many qualified R&D experts, all of whom offer a free preliminary analysis. If you believe your business might be eligible for the R&D tax credit, contact us today at [info@richeymay.com](mailto:info@richeymay.com) to discuss further.

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