



Something's Brewing on the R&D Tax Credit Front

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Breweries and distilleries often overlook the potential tax savings opportunities available with the R&D tax credit. As most breweries invest resources and time towards improving processes and developing new products, the R&D tax credit could provide your tasty venture dramatic tax savings. Recent legislation has made the credit permanent and also enhanced its application by not limiting it to AMT (Alternative Minimum Tax) as well as providing a new potential payroll tax credit offset opportunity.

The R&D credit is a dollar-for-dollar benefit-against-tax designed to stimulate efforts aimed at the advancement of U.S. companies. While it is primarily federal, certain states offer their own version as well. Computation of R&D is fairly complex and entails several different elections. The credit is primarily derived from an allocation of employee time, consultant expense, and related R&D supplies.

As of January 2016, eligible small businesses (\$50 million or less in gross receipts) may claim the credit against the Alternative Minimum Tax (AMT). This will benefit a significant number of closely-held businesses and their shareholders who previously had to defer some or all use of their credit due to the AMT limitations. Additionally, certain small businesses (\$5 million or less in gross receipts) will have the ability to offset the credit-against-payroll tax liability (capped at \$250,000 for up to five years). There are many complexities to this law and how to apply it to your business.

The activities performed by brewers and distillers must meet the following criteria in order to qualify for the R&D credit:

- **Technical in Nature:** Though the R&D credit is not just for scientists, its application is science-based. To qualify, research and development activity must rely on the principals of engineering, physics, biology, or computer science.
- **Permitted purpose:** Contrary to popular belief, R&D does not exclusively pertain to new products. Taxpayers can reap the benefits of R&D as long as they are working on projects undertaken for the development of a new or improved aspect of their business. Processes, functions, products, quality increases, and substantial cost reductions all fall under the umbrella of permitted purposes.
- **Process of Experimentation:** Qualified research involves an element of trial and error. The venture's process of experimentation must be designed to evaluate alternatives to achieve a result where the potential to achieve that result is initially uncertain. Measures that are taken to produce a hypothesis and test it are noted by the IRS when deciphering which research and development activities are entitled to the R&D credit.

Some Examples of R&D Activities Within the Brewing and Distillery Industry Include:

- ⇒ Adding new equipment pertaining to process improvement or new bottling/brewing equipment
- ⇒ Developing new or improved hopping techniques or varieties of hops
- ⇒ Developing new or improved yeast strains or fermentation processes
- ⇒ Developing new or improved bottling and canning processes.
- ⇒ Developing new or improved bottle designs (including cans/crowns, etc.)
- ⇒ Developing new or improved keg filling techniques, water recycling, or waste management
- ⇒ Developing new or improved product formulations or improved ingredient mixing methods
- ⇒ Developing new or improved prototype batches or improved preservatives
- ⇒ Testing of new or improved designs to ensure shelf life or longevity
- ⇒ Testing of product ingredient combinations relative to new flavors or enhancements

To support qualified research, brewers and distillers must maintain documentation on paper or electronically. In addition to issuing logs and meeting minutes, taxpayers may utilize email communications, technical reports, and patent applications to warrant the R&D credit. Where there is indication of efforts to improve an existing process, research and development documentation is broad and takes many forms. Between information provided by taxpayers (or lack thereof) and the standards set by the IRS, distribution of the R&D credit can be challenging. This difficulty has shown up time and again in numerous court cases over the years. Keeping detailed records of research and development activities and consulting with a CPA firm that understands the credit can prevent future headaches and maximize your credit opportunity.

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