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Research and Experimentation Tax Credit Extension

Issue

Changes made under the *Tax Extenders and Alternative Minimum Tax Relief Act of 2008* (TEAMTRA), passed by Congress and signed into law on Oct. 3 as part of the \$700 billion rescue package for the financial markets, could have an impact on the federal research and experimentation research tax credit for qualifying expenses incurred during 2008 and beyond.

Taxpayers Potentially Affected

Any business that has product or process development activities.

Background

Companies that complete activities to develop new or improved products or processes might be eligible for a tax credit for research expenses. Taxpayers have been able to claim the research credit using one of three calculation methodologies: the regular calculation, the alternative incremental calculation, or the alternative simplified calculation. TEAMTRA puts into effect some significant changes to the methods available for claiming the research credit. All companies must carefully analyze all the available options for calculation.

The first change enacted by TEAMTRA is a retroactive extension of the research credit through Dec. 31, 2009. This retroactive extension ensures that taxpayers are able to claim the credit in both 2008 and 2009 with no lapse after the last expiration date of Dec. 31, 2007.

The second change is the elimination of the alternative incremental credit (AIC) for tax years ending after Dec. 31, 2008. The AIC, an alternative credit calculation, benefited some taxpayers that were limited in claiming the regular research credit.

In late 2007, Congress added a third research credit calculation option known as the alternative simplified credit (ASC). The ASC calculation method must be elected by the taxpayer each year on a tax return filed on time and, once elected, cannot be changed for that year. The ASC allowed for a credit equal to 12 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding tax years. The rate is reduced to 6 percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years.

TEAMTRA's third change is an increase in the rate of the ASC to 14 percent for taxable years ending after Dec. 31, 2008.

The regular calculation method for the research credit remains unchanged.

All the modifications to the research credit in this legislation have to do with the calculation of the credit. The rules related to qualifying activities and costs remain the same and require an in-depth knowledge of Internal Revenue Code Sections 41 and

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174 to navigate, properly claim, and sustain the federal research credit. Appropriate documentation of qualifying research activities and costs remain paramount to successfully claiming and sustaining a federal research credit.

Many states allow research credits and often follow the federal calculations. Companies should be aware of how the change in the law will affect the research credit computation at the state level.

Contact

If you have any questions or comments about the federal research and experimentation credit, contact Marie Powell, Federal Tax Specialty Services, Crowe Horwath LLP, at 317.706.2745 or marie.powell@crowehorwath.com.

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