Three Tax Incentives Your Business Should Be Using

Too many CFOs and other financial executives are either unaware of the tax incentives they can tap to save substantial amounts of money or are slowed by misconceptions of how the system works.

One would think that most chief financial officers, tax executives and business owners take full advantage of all the bells and whistles provided in the United States tax code — all 7,000 federal, state and local tax credits and incentives. But it's apparent that's not the case, and businesses are consistently failing to take full advantage of significant benefits.

The Government Accountability Office (GAO) found in a recent study that in the case of one incentive, the Research and Development Tax Credit, the overwhelming benefit is going to the biggest of companies. It wasn't because medium-sized companies didn't qualify for the R&D credit; it was because they weren't applying for it. The following outlines qualifications and how to qualify for these tax incentives.

1. The Research and Development Tax Credit

Self-censorship by business executives is the biggest obstacle right now to companies taking full advantage of the Research and Development Tax Credit. All too often, business executives think the R&D credit is for the Silicon Valley tech companies, big pharmaceuticals or maybe designers of the Space Shuttle. Nothing could be further from the truth.

The range of industries that qualify for the R&D credit is as wide as the membership of the Chamber of Commerce — apparel, software, tool and die, architecture and engineering and many others. Bottom line, if a company "makes something," there's a good chance it is engaged in activities that qualify for the R&D Credit.

Industry executives also need to be mindful of the types of activities that qualify. A "eureka!" moment — in which you have changed the world to get the credit — is not a prerequisite. The old "discovery test" was tossed out in 2001. The question is whether the goal is developing something that is "new to you." Modifications and improvements count too, so it's not just the original BlackBerry, but all the new versions as well.

For example, consider company efforts to be greener, more cost efficient or less wasteful. All of these are candidates for the credit. Think of the credit the way Congress thinks of it: As a wage-based inducement to help keep manufacturing jobs in the U.S. An unfortunate reality is that mistaken and outdated notions about what activities qualify for the credit — especially in light of recent case law — often cause companies that already take the credit to underutilize it.

For example, most small and middle-sized job shops — businesses that make products to order — aren't taking advantage of this particular R&D credit. They, like many others, are under the impression that it exists only for high-tech companies doing basic research. When speaking to job shops about the R&D tax credit, often the first objection one hears is "we don't design the products … our customers usually design the products."
Job shops and contract manufacturers typically do very little product development. Their activities tend to focus on process development, which also qualifies for the R&D credit. They spend their time developing ways to make the customer-designed part in commercial quantities.

Toward that end, they usually make engineering changes to parts to make them moldable through the latest CAD/CAM software applications. They then have to design and develop the tools, molds, dies, jigs and fixtures that will be used to ultimately produce the part. Prototype parts have to be produced and tested to ensure that they meet product specifications before the final parts are sold. Most job shops are surprised to learn that all of these activities are eligible for the R&D credit.

Understand, however, the R&D tax credit isn't a given; the Internal Revenue Service isn't giving it away. Understanding the law and regulations and providing the IRS with the necessary documentation are a challenge. However, the bottom line benefits for a business can be exceptional, especially considering recent taxpayer-favorable court victories. Those businesses that do take advantage of the credit every year can reduce their taxes by billions, in aggregate.

2. Hiring and Training Incentives

Federal Incentives. The Federal Empowerment Zone and Renewal Community hiring credit are programs that provide up to $1,500 to $3,000 in tax credit per qualified employee. In many geographic areas and industries, a very high percentage of employees will qualify. Although these incentives expired on Dec. 31, the statue of limitations is three years, so there is still time to amend returns to obtain cash refunds on taxes previously paid and reduce tax liability on a filed 2009 return.

Another federal incentive that provides $2,400 to $9,600 in tax credit per qualified new hire is the Work Opportunity Tax Credit. This program is still active and is prospective, so there is no retroactive benefit. And in March, federal legislation passed that provides payroll tax relief for new hires of individuals who have been unemployed for more than 60 days and a $1,000 credit if the employee stays on payroll for 52 weeks.

3. The Domestic Production Activities Deduction (DPD)

Many business owners and executives are aware they qualify for the DPD because their companies manufacture products in the U.S. However, some are unaware that this powerful incentive can be taken by U.S. software developers, architects, engineers, construction companies and television and music producers. What's more, business owners that do know they qualify are generally unaware of the guidelines the IRS has placed to claim the DPD.

For example, one business that was not taking advantage of the DPD was a chemicals company that utilized tolling facilities to produce the chemicals it developed. Upon review of the contracts between the tolling entities and the taxpayer, it was determined that the company bore the benefits and burdens of the chemicals during production and subsequently found $500,000 in refunds over three years.

The legislatures that established these tax opportunities want businesses to take advantage of them. That doesn't mean, however, that they have made them simple. Far from it.

Taking full advantage of these credits and incentives generally requires expert guidance from specialists. You'll need to determine whether the extra effort is worth the tax savings. Generally, the numbers in black ink shown to shareholders indicate the effort the CFO makes is well worth it.