

How People Advisors Can Create Value

WITH

R&D Tax Credits



+

gusto



Welcome

We're glad you're here.



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Agenda

Opportunity

Fact v Myth

**A Closer Look at
R&D Tax Credits**

Q&A

The opportunity.



Humphry Slocombe...
the stuff of local legend.





What flavors could
Humphry Slocombe
invent with an extra
\$250,000?

\$32.5m

Amount Gusto helped over
1,000 clients claim in R&D tax
credits in 2018



Poll 1

Have you helped clients
secure federal R&D tax
credits?

People Advisors combine
financial expertise with
people-focused guidance

The concept of
People Advisory is
that people are the
heart of every
business.



Gusto Pro Action Items alert you to the opportunity

Action items ⓘ

Clients

Firm

^ These clients might be eligible for up to \$250 thousand in tax credits

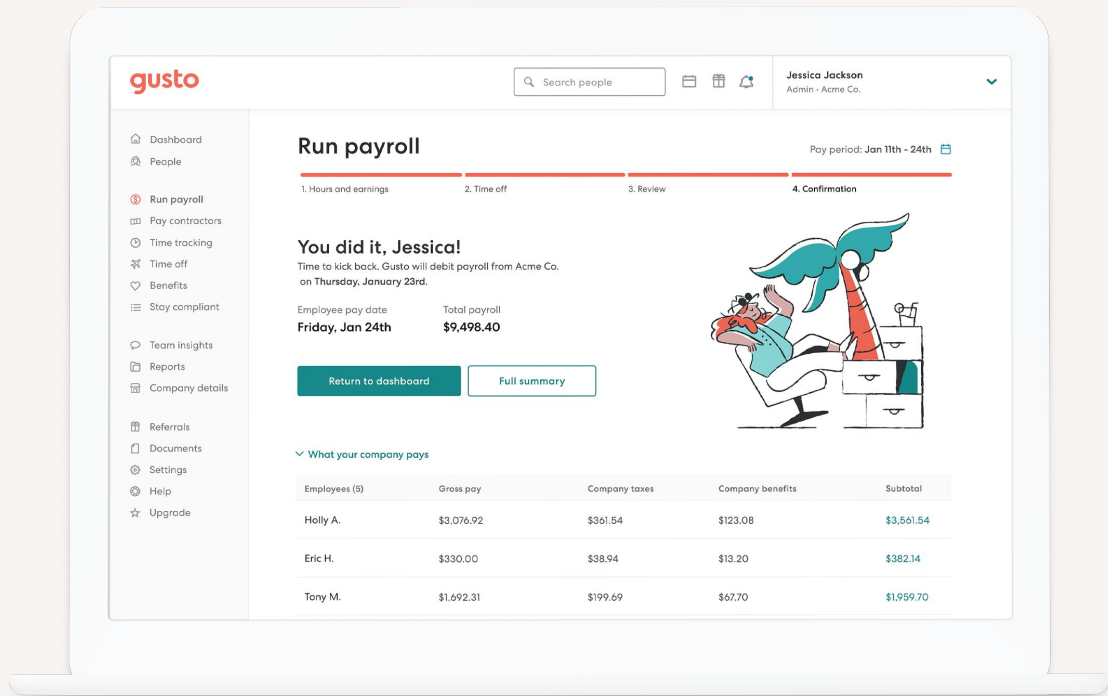
It looks like 3 clients could qualify for R&D tax credits. We make it easy to perform R&D studies and file the right forms, so your clients can earn money.

[Learn more](#)

Clarus R+D
experts handle
the tax study and
you receive a
revenue share



Clients claim the credit with Gusto's real time processing



A closer look at R&D tax credits

WHAT IS IT?

The Federal Research and Development Tax Credit

1981 Originally established in 1981, the credit was created to encourage innovation by US companies using US workers.



Innovation is expensive. Government tax break intended to offset some of the cost.

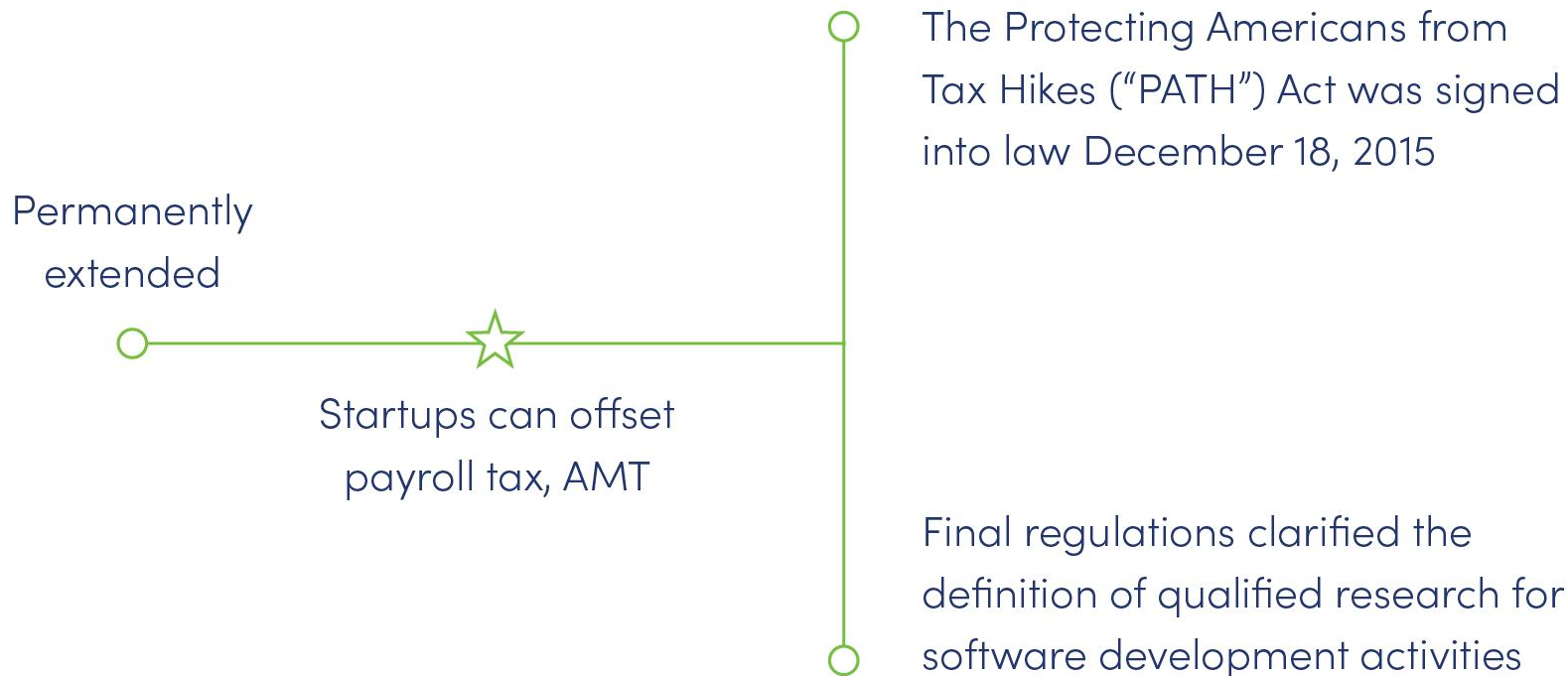


New innovation leads to growth of domestic businesses and new domestic jobs.



Due to the way the credit was structured it excluded many companies that create innovation, namely startups.

What Changed?



The Impact

- ✓ No more worry about the credit disappearing
- ✓ Huge opportunities for SMBs and startups to monetize the credit
 - >> 7-10% of qualifying spend
 - >> Payroll tax election for Qualified Small Business
 - >> Credit against AMT for Eligible Small Business
- ✓ Confidently claim investments in software




**Estimated
\$11 billion
impact over
10 years.**

R&D tax credits are worth it



- ✓ Largest incentive in the tax code
- ✓ Prior to 2015 and the PATH Act, participation was limited:
 - >> Needed to be income tax paying
 - >> AMT frequently limited taxpayers ability to monetize the credit
 - >> Needed to have money and resources to justify claiming the credit
- ✓ Since 2015, the number of companies claiming the credit has drastically increased
- ✓ As a result, local and regional CPA firms need to have a solution
- ✓ It's no longer safe to assume that you don't have clients that qualify



Who qualifies for the payroll tax offset?

'Qualified Small Business'

- ✓ <\$5 million in receipts in the tax year in which it makes the payroll election, AND
- ✓ \$0 receipts in any tax year preceding the five-tax-year period that ends with the tax year of the election (e.g., For a 2019 payroll election, cannot have had any revenue prior to 1/1/15)

Qualified businesses can:

- ✓ Claim up to \$250,000 R&D tax credit against their payroll taxes each year
- ✓ Make a payroll offset election for up to 5 years that they are a qualified small business



Who qualifies for the credit against AMT?

‘Eligible Small Business’

- ✓ Average annual gross receipts of \$50 million or less in the three preceding tax years

Eligible businesses can:

- ✓ Apply credit to reduce Alternative Minimum Tax liability as well as regular tax for tax years beginning after December 31, 2015



Polling Question

Which industries do most of your clients fall under?

- a** Service
- b** Technology
- c** Non-profit
- d** Manufacturing
- e** A little of everything



Lab coat *not* required

Traditional scientific work qualifies for the credit, but so do activities in a wide range of industries that develop new products, processes, computer software or make improvements to these types of technologies.

R&D industries include:

- >> Manufacturing
- >> Consumer products
- >> Medical devices
- >> Software development
- >> Chemical
- >> Apparel
- >> Telecommunications
- >> Pharmaceuticals
- >> Food & beverage
- >> Engineering
- >> Aerospace
- >> Cosmetics

What Qualifies as R&D?



1

Building new software/tech-based platforms, programs, and applications

2

Developing and iterating existing technology

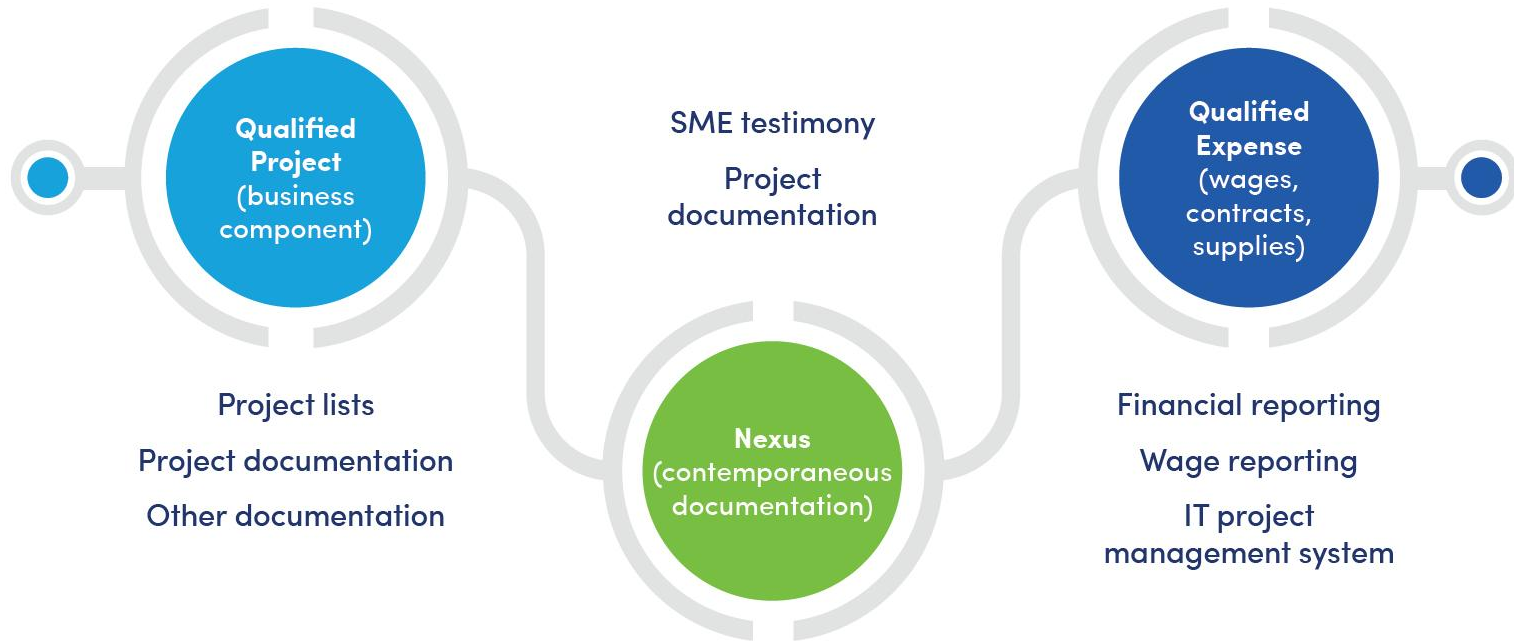
3

Scientific research and development

4

Creating or improving products and services

Basics of an R&D Study





QUALIFYING PROJECTS

The 4 Part Test

1 Permitted Purpose

Product, process, software, formula, technique with increased:

- | | |
|----------------|----------------|
| >> Function | >> Reliability |
| >> Performance | >> Quality |

2 Elimination of Uncertainty

Capability or method of development or improvement

Appropriateness of business component design

3 Process of Experimentation

Evaluate one or more alternatives in attempt to resolve uncertainty

- ✓ Implementation of scientific method, trial and error process
- ✓ Evaluate alternatives, develop/test hypothesis, evaluate results, refine, success/failure

4 Technological in Nature

Activities must rely on:

- | | |
|------------------------|---------------------|
| >> Physical sciences | >> Engineering |
| >> Biological sciences | >> Computer science |

Qualifying Expenses

Qualified Research Expenditures (QRE's)

WAGES

Often the largest component(1) W-2, Box 1, for research, direct supervision, direct support – must be US based

CONTRACTING

65% of contract research expenses may be eligible – must be US based

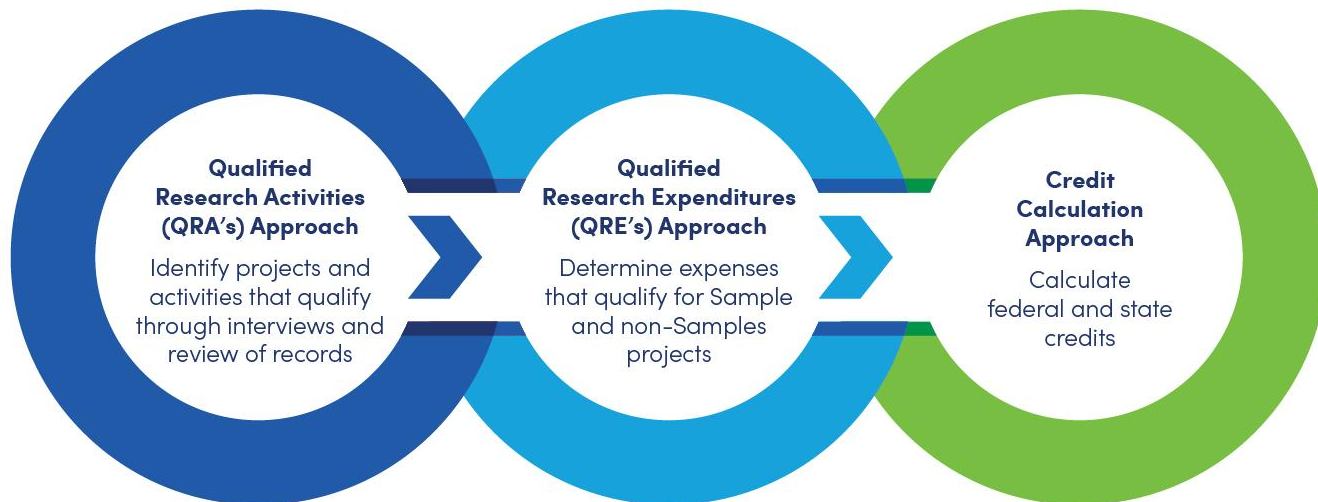
SUPPLIES

Non-depreciable, tangible personal property used in development activities, generally consumed or destroyed during process

Credit = 7-10% of your QRE's

Establishing Nexus

After establishing qualifying projects, we must show nexus, or connection, between the project and the qualifying expenses.





How is the credit amount determined?

Calculation methods include:

- 1 Regular method
- 2 Alternative simplified method

Either method can be more beneficial to the taxpayer.
Both should be considered.

Regular Method

**Credit =
20% of current
year QREs in
excess of
base amount**

Base amount = fixed base percentage *
average annual gross receipts for the 4 taxable years
preceding the credit year

>> Minimum base amount 50% of credit year QREs

Fixed base percentage = aggregate 1984-1988
QRE / aggregate 1984-1988 gross receipts

>> Maximum fixed base percentage 16%

This method of calculating the credit determines the fixed base percentage using qualifying R&D spend from the mid-1980s.

* There are Start-up rules for businesses that do not have at least three years of Gross Receipts and QREs during that period.

Alternative Simplified Method

Alternative simplified method allows taxpayers to determine a base amount considering only more current data on qualifying activities.

**Credit = 14% of current year
QRE in excess of 50% of
prior three year average QRE**

Documentation Requirements

The taxpayer must keep documentation of:

1

How they met the requirements to qualify for the credit, and

2

How the credit was calculated.

Reg 1.41-4(d) Recordkeeping for the research credit. A taxpayer claiming a credit under section 41 must retain records in sufficiently usable form and detail to substantiate that the expenditures claimed are eligible for the credit.



Polling Question

How do you currently handle R&D studies for your clients?

- a** None of my clients need R&D studies.
- b** I manage R&D studies for my clients.
- c** I outsource it.
- d** I haven't offered R&D studies to my clients, yet.

Show Me The Money: Payroll Credit

Use of the R&D credit against payroll tax requires capturing the credit on quarterly form 941 and filing form 8974 each quarter. Gusto's got you covered.

PROCESSING OPTIONS

- >> IRS refund – refund of tax offset by credit provided to taxpayer directly by IRS
- >> Credit not supported – some payroll providers do not support the credit; using the credit requires amending quarterly payroll tax returns
- >> Real time application of credit through Gusto (RTP) – reduction of payroll tax impounding during the applicable quarter

SUBMISSION AND TRACKING OF CREDITS

- >> Payroll providers have varying processes for receiving client credit information and tracking use
- >> Single submission vs quarterly submission
- >> Electronic submission of credit details vs email submission of completed tax forms
- >> Access to reporting of credit use vs quarterly requests made of provider



Show Me The Money: Income Credit

R&D credits used against income tax are non-refundable general business credits with a 20 year carryover period.

IRC Section 280C(1) requires that deductions are reduced in the credit year by the amount of credit determined for the year.

- >> Result is increase in income tax for reduced deduction before use of tax credit
- >> Net benefit of the credit is credit amount * (1 – tax rate)

Taxpayer can elect on form 6765 of the originally filed tax return to receive a reduced credit under IRC 280C(c)(3).

- >> Credit is reduced by the tax rate in this case but deductions are not adjusted



Amending returns for R&D credits

How far back can I go?

Income Tax Credit

Returns can typically be amended to claim the R&D credit as long as the statute of limitations for the tax year has not yet run. There is potential to adjust closed years for open items in some circumstances.

Payroll Tax Credit

Making the payroll election on an amended return, if missed on the originally filed return, was permitted through 12/31/17.



Gotchas

IP rights

Controlled groups

Estimating techniques

Excluded activities

Funded research

Internal use software

Statistical sampling

The R&D tax credit is a significant benefit.

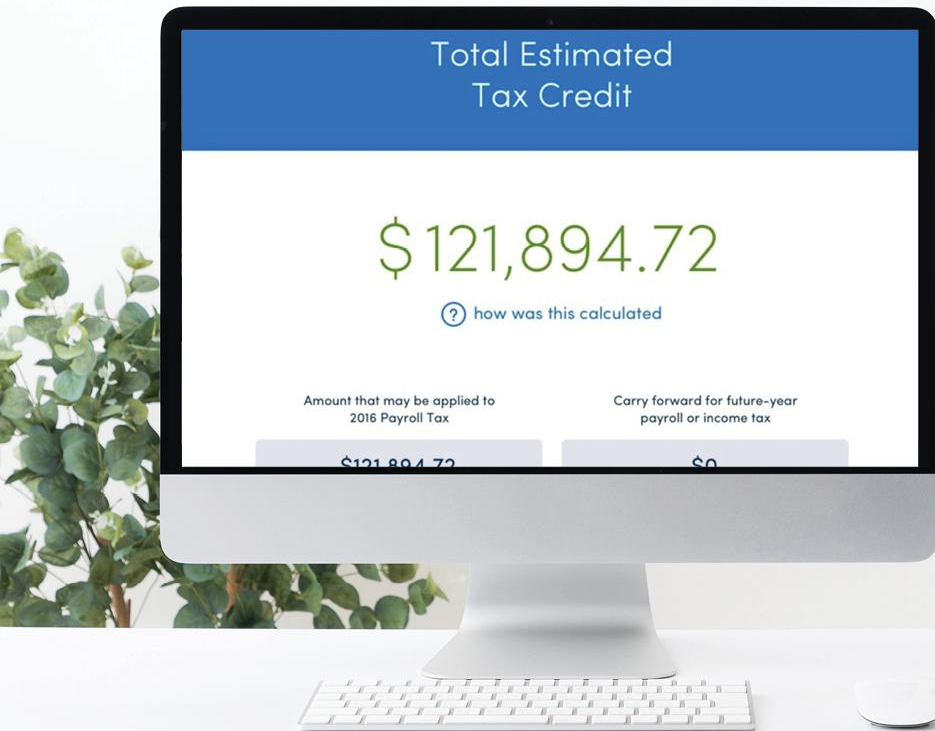
It's important to get it right.

Why do so many SMBs miss the R&D credit?

- >> Lack of understanding
- >> Can't monetize the credit
- >> Complexity of the calculation
- >> Cost
- >> Fear of audit

At Clarus R+D, we believe in simplifying the process. We make it easy for growing businesses to claim the R&D tax credits they've earned.

Technology For The Win



R&D studies made easy

- >> Auto import of payroll
- >> Multi-year, multi-project
- >> Save/resume progress
- >> Real time credit calculation
- >> Self guiding 'wizard' based interface with lots of help and examples
- >> Compliant report generation
- >> Real time processing of credit

Steps to partnering with us



Steps to partnering with us



1 REFERRAL

A good way to start. Refer your clients to a trusted and proven partner while you manage the client relationship.

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Offer R&D tax credit services under your brand while freeing up more time for high-impact advisory conversations.

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3 EARN A BONUS

Boost your firm's bottom line when the work is done.



Polling Question

Are you ready to get started?

- a** Yes, let's talk.
- b** I need more information.
- c** Maybe later.



Q&A

Thank you for joining us.

**To learn more, go to:
clarusrd.com/gusto-partner**