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SPECIALTY TAX PROFESSIONALS

R&D TAX CREDIT

Guide for Software Companies

Might you qualify?

The R&D credit is a powerful federal tax incentive that helps businesses improve their offerings and compete while significantly reducing their tax burden. It incentivizes the development of new and improved products and processes. The purpose of the credit is to keep good jobs in the U.S. and increase global competitiveness through technological advancement.

It's no surprise that **companies in the software industry are some of the main benefactors of the R&D tax credit.** Just the terms "good jobs" and "technological advancement" automatically call to mind software development.

However, misconceptions about what qualifies for the credit keep many software companies from pursuing it. They may think their companies are too small, or that they don't qualify because they don't engage in the right kind of development.

The truth is that companies don't have to develop revolutionary new software products in order to qualify! There only needs to be technical uncertainty regarding the appropriate software solution and a process of evaluating the alternative, competing software design or system architecture options. **The R&D tax credit can also apply to the design and development of software-related services, like SaaS solutions, cloud storage and computing, and even website hosting.**

IN THIS GUIDE, WE'LL COVER:

- The types of projects that may qualify for the credit
- The IRS test for qualifying business activity
- A list of common qualifying activities for software companies
- The types of expenses that qualify for the credit
- Next steps if you believe your company may qualify

The R&D tax credit isn't just for multinational tech giants. It's also for companies of all sizes, working on a range of software-based projects.

Qualification for the R&D tax credit isn't based on the industry or type of business but rather on the activities that a company performs. Potentially any company that performs qualifying business activities on U.S. soil can take advantage of the credit.

In fact, software companies are an ideal fit for the R&D tax credit, as they are always looking for ways to improve products and processes.

Examples of tech companies/sub-industries that may qualify include (but aren't limited to):

You don't have to be a large company to qualify for the R&D tax credit. Even qualifying startups and small businesses with little or no federal income tax burden may use the tax credit to offset their payroll tax or AMT.

The IRS uses a four-part test to determine if a business activity qualifies as research. We've provided the test here, along with a list of common qualifying activities for software companies.

- Software product developers
- Mobile app developers
- Software publishers
- Computer systems design and related services
- Data processing
- Hosting and related services
- Internet publishing and broadcasting
- Web services

IRS Four-Part Test for Qualifying Business Activity

Qualified Business Component

The activity must relate to a new or improved product, process, formula, computer software, program, technique or invention.

1

Technological in Nature

The activity being performed must fundamentally rely on the principles of physical science, biological science, chemistry, computer science or engineering.

2

Eliminate the Uncertainty

The activity must be intended to discover information to eliminate uncertainty concerning the capability or method for developing or improving a product or process or the appropriateness of the product or process design.

3

Process of Experimentation

The experimentation process can include the evaluation of alternatives. Examples include systematic trial and error, prototype creation and testing, computer aided modeling, and simulation in an effort to resolve the technical uncertainty.

4

Common Qualifying Activities for Software Companies

The IRS considers many activities related to the software development process as qualifying for the R&D tax credit. These activities begin the moment the qualifying company decides what software they want to develop and carries through to the mapping out of a plan, meeting the design requirements and releasing the software for commercial use.

Qualifying activities may include:

- Design and development of new, improved or specialized technologies
- Design and development of new system architectures, operating systems, or firmware
- Mobile app design and development
- Development of new algorithms
- Design of new database management systems and techniques
- Concept development/brainstorming alternatives for programming
- Evaluation and establishment of functional specifications
- Proof of Concept/writing test code (similar to prototype development)
- Programming/coding
- Compiling and testing source code
- Integration, functional, performance, stress, and regression testing
- Alpha/beta testing

Qualifying R&D Expenses

Expenses that qualify for the R&D tax credit are known as qualified research expenses or qualifying research expenditures (QREs).

Common QREs for software companies can include:

- Wages paid to software developers, engineers, programmers and other professionals for time spent engaging in qualifying activities
- Wages paid to employees for time spent directly supervising or directly supporting personnel that engage in qualifying activities
- Amounts paid to subcontractors and freelancers to perform qualified research or services
- Certain supplies used in the conduct of qualified research
- Payments to another person for the right to use computers in the conduct of qualified research, such as for access to cloud-computing servers through cloud service providers

Employee compensation is typically the biggest qualifying expenditure from a properly conducted R&D tax credit study.

Since software companies invest in high-wage programmers, developers and other skilled tech professionals, this can result in a large credit.

It looks like my firm may qualify. What's next?

Determining if your company qualifies requires an evaluation of the facts and circumstances of your activities. It's a complex process, but it's not something you have to handle on your own as an owner or accountant. You can work with a specialty tax partner like Tri-Merit.

Here are the steps.

1. Get a Feasibility Analysis

Tri-Merit will do much of the work upfront, and at no cost, to determine if you qualify. This is our standard phase one feasibility analysis. We examine your ability to capitalize on the credit. A feasibility analysis saves valuable time by identifying potential problem areas before committing to a full tax study.

There's no risk in exploring the possibilities. Call (847) 637-5677 for more information or to set up a consultation.

2. Get an R&D Tax Credit Study

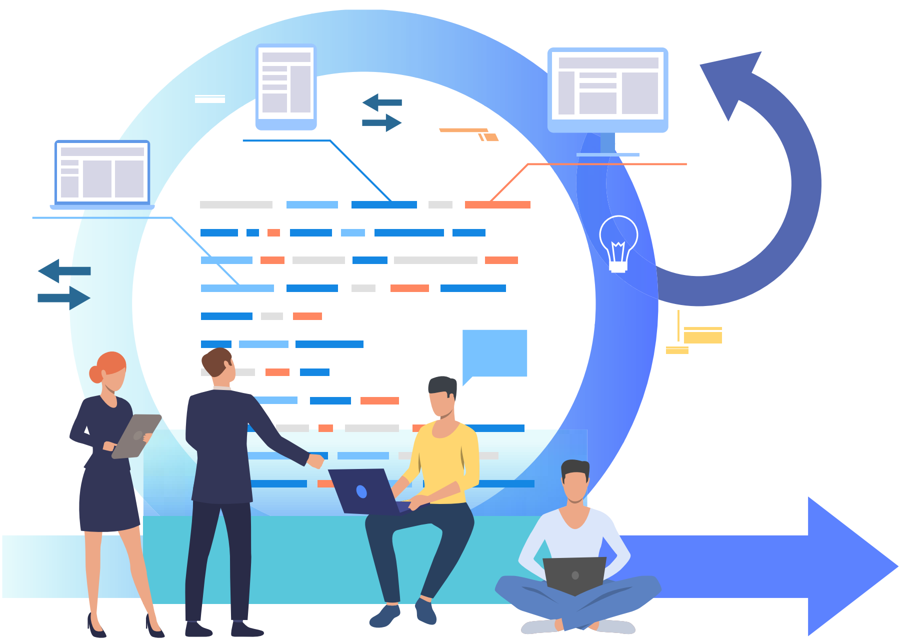
Tri-Merit simplifies the process of determining:

- the size of your potential credit
- the usability of those credits
- the appropriate method for supporting the credit claims so they hold up under the most stringent IRS scrutiny

Every Tri-Merit study includes audit defense, so we'll be with you every step of the way.

The goal is to optimize the return from the R&D credit through genuine consultation, expert evaluation and proper documentation processes.

By taking advantage of the R&D tax credit, a Midwestern software development firm we worked with saved more than $700,000 in federal and state income taxes over two years.



Tri-Merit Makes the Process Surprisingly Simple

Tri-Merit's team of engineers, attorneys and CPAs make the process easier by taking a customizable, flexible and thoughtful approach to produce the best possible outcome. We engage clients in the most efficient and effective way possible, resulting in a refreshingly straightforward process.

You'll feel confident that our team is working on your behalf to ensure:

- proper processes are followed
- IRS guidelines are met
- all reports and documentation are clear, concise and meticulously detailed to substantiate every claim

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Call us to set up a free, no obligation consultation.

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www.tri-merit.com