



# TAX

## RESEARCH CREDITS & INCENTIVE SERVICES

# STARTUP COMPANIES CAN NOW INCREASE CASH FLOW USING THE R&D TAX CREDIT

**If you're a startup company with annual gross receipts of less than \$5 million, you can reduce your labor costs by up to \$500,000.**

As a result of the PATH Act (Protecting Americans Against Tax Hikes Act) of 2015, along with further enhancements from the IRA (Inflation Reduction Act) of 2022, qualified small businesses may apply their R&D tax credits against certain payroll tax expenses resulting in significant increases in cash flow.

### WHAT IS IT?

The Research & Development (R&D) Tax Credit is a permanent credit made available to help companies reinvest in their future. R&D incentives provide significant tax benefits at the federal and state levels by reducing current and future years' tax liabilities. They can equal up to 10 percent of annual R&D qualifying expenses at the federal level and even more when state benefits are considered. R&D credits are dollar for dollar reductions in tax liability.

### WHO QUALIFIES?

The tax code defines "qualified small businesses" as a business realizing less than **\$5 million in revenue and being less than five years removed from their first year of attaining revenues.**

### WHAT'S THE VALUE?

Potential reductions in U.S. labor costs for start-up companies ("qualified small businesses") of up to 100% of employer paid Social Security and Medicare (capped at \$500,000 annually).

### HOW ARE THE SAVINGS REALIZED?

Qualified small businesses can claim a R&D tax credit on an original federal return and apply those credits against the employers portion of Social Security (capped at \$250,000) and Medicare (capped at \$250,000).

## HOW?

**1. Work with trusted advisor to complete a R&D tax credit study.**

**2. File federal tax return, as early as possible, including Form 6765.**

Include a properly completed and substantiated Form 6765 in your Federal return to claim the R&D tax credit. Designate the portion of your R&D tax credit to be applied against payroll tax (max \$500,000 per year).

Note: the election applying the credit against payroll tax can only be taken on a timely filed return, including extensions.

**3. Starting the following quarter, the Company files its quarterly payroll tax return forms.**

File Forms 8974 and 941 together to claim your credit against payroll tax and receive your refund.

**4. Repeat this process until credits are fully utilized.**

## AN EXAMPLE

An early-stage information technology company has approximately \$2,250,000 in annual payroll expenses of which \$1,000,000 consists of wages paid for software development. If the company meets the definition of a qualified small business, it should qualify for approximately \$100,000 in federal R&D tax credits. Assuming the company has no income tax liabilities to offset, it can apply the R&D credits against the employer paid portion of its payroll tax (\$139,500, or 6.2 percent of wages), generating immediate cash recoveries.

The below table displays the potential benefit and cash flows with and without the credit:

	With R&D Tax Credit	Without R&D Tax Credit
Total Payroll	\$2,250,000	\$2,250,000
R&D Qualified Wages	\$1,000,000	\$1,000,000
Annual Payroll Tax	\$139,500	\$139,500
R&D Credits	\$100,000	—
Payroll Tax Paid	\$39,500	\$139,500
Cash Savings Realized	\$100,000	—

## DOCUMENTATION REQUIREMENTS

Substantial documentation is a mandatory component of claiming an R&D Tax Credit. Samples of the types of documentation required are payroll records, project lists, project memos, labor detail summaries, client contracts, whitepapers, general ledgers, etc.

Documentation should substantiate the amount of credit, provide nexus between the expense amounts and the activities as well as identify and demonstrate the qualified nature of activities.

## NEXT STEPS

In order to get as much value as soon as possible, companies that are potentially eligible should begin preparing immediately to take advantage of the benefit.

## FOR MORE INFORMATION



**BRETT NOWAK**  
MANAGING DIRECTOR  
+1 571 278 9495  
bnowak@alvarezandmarsal.com



**STEPHANIE DOUGHTY**  
MANAGING DIRECTOR  
+1 985 474 9117  
sdoughty@alvarezandmarsal.com



**KATHLEEN KING**  
NATIONAL R&D PRACTICE LEADER  
+1 202 688 4213  
kking@alvarezandmarsal.com



**JENNY GOLDINSTEIN**  
SENIOR DIRECTOR  
+1 212 328 1038  
jgoldin@alvarezandmarsal.com

## ABOUT ALVAREZ & MARSAL TAX

Alvarez & Marsal Tax, part of Alvarez & Marsal (A&M), a leading global professional services firm, is an independent tax group made up of experienced tax professionals dedicated to providing customized tax advice to clients and investors across a broad range of industries. Its professionals extend A&M's commitment to offering clients a choice in advisors who are free from audit-based conflicts of interest, and bring an unyielding commitment to delivering responsive client service. A&M Tax has global presence in major metropolitan markets throughout the Americas, EMEA, and APAC.

Alvarez & Marsal Tax is a founder of Taxand, the world's largest independent tax organization, which provides high quality, integrated tax advice worldwide, and represents the Global Network in the US and UK. Taxand professionals, including 770+ partners and more than 3,000+ advisors in 48 countries, grasp both the fine points of tax and the broader strategic implications, helping you mitigate risk, manage your tax burden and drive the performance of your business.

Follow A&M on:



© 2024 Alvarez & Marsal Holdings, LLC.  
All Rights Reserved. 440221

To learn more, visit [AlvarezandMarsal.com](https://www.alvarezandmarsal.com).

**ALVAREZ & MARSAL TAX**