Anchin Alert

Anchin, Block & Anchin LLP
Accountants and Advisors

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Permanent R&D Tax Credit - A Perfect Fit for U.S. Businesses in the Apparel Industry

On December 18, 2015, President Obama signed into law *The Protecting Americans from Tax Hikes Act (PATH) of 2015*. This legislation retroactively renews and makes permanent a collection of expired tax provisions for both businesses and individuals, commonly referred to as "tax extenders." The tax credits and deductions made permanent by the legislation include the Research and Experimentation (R&E) tax credit, also known as the Research and Development (R&D) tax credit, the Child Tax Credit, the American Opportunity Tax Credit, the Earned Income Tax Credit, the above-the-line deduction for teachers who buy school supplies, and the Section 179 deduction.

The R&D tax credit is the largest single item in the package, with an estimated cost of $113 billion over 10 years. ***In addition to making the R&D tax credit permanent, the legislation in the PATH makes two changes which greatly expand the credit and make it available to taxpayers who previously were unable to utilize the credit because of their tax situation.*** Many of these taxpayers can be found in the apparel industry, which is relatively more fragmented than other industries - with many entrepreneurial startups and numerous product design, development and manufacturing costs. The two changes, both effective for tax years beginning after December 31, 2015, are as follows:

1. PATH allows small businesses to take the R&D tax credit against their alternative minimum tax (AMT). The AMT restriction has long prevented qualified companies from utilizing the research credit, so this new legislation will remove that hurdle for any qualified company with less than $50 million in gross receipts.

2. PATH allows startup businesses with gross receipts of less than $5,000,000 to take the R&D tax credit against their payroll taxes (essentially making it a refundable credit capped at $250,000 for up to 5 years).

The R&D tax credit benefits U.S. apparel companies who develop new or improved products or processes through technical activities that lead to an elimination of design or development uncertainty. It particularly applies to design of new fabrics or garments that are better performing, more functional, have more safety features, are more comfortable or are of a higher quality. The research credit is applicable not only to revolutionary innovations, but also to evolutionary advances or improvements for an individual company's products and processes. Examples of these advances might include improving manufacturing or production processes to increase yield, reduce waste and byproducts, to improve safety profile or to comply with U.S. regulatory requirements. More specific examples include developing products that have reflective properties for high visibility, fabrics that are sweat resistant for better athletic performance, or designing swimwear with built in rash guards and UPF ultraviolet ray protection. Developing new packaging or labeling systems might also qualify.

In addition to employee working time spent performing, supporting or supervising these types of qualifying initiatives, allowable expenses may also include supplies associated with making prototypes or trial production runs for new product candidates. Increasingly, business management teams are recognizing the importance of taking advantage of this generous incentive as a powerful weapon for remaining competitive, refueling their critical innovation engines and for creating free cash flow.

Correctly identifying qualifying projects, along with properly calculating and documenting expenses is critical to both maximizing the financial benefit and ensuring the sustainability of every R&D tax credit claim. Anchin's R&D team is particularly skilled and experienced at identifying such qualifying projects and initiatives in each area of a company's business and at examining and capturing all allowable expenses.

For more information, please contact Marc Federbush, Partner and Practice Leader of Anchin's Fashion Group at marc.federbush@anchin.com, or Yair Holtzman, Partner and Practice Leader of Anchin's Research and Development Tax Credits Group at yair.holtzman@anchin.com.

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Anchin, Block & Anchin LLP
Accountants and Advisors
1375 Broadway, New York, NY 10018
212.840.3456 • www.anchin.com