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Making the R&D Tax Credit Work for Small and Medium Businesses

alliantgroup welcomes the opportunity to submit comments for the record for the Senate Finance Committee's review of current federal income tax law within the Committee's Tax Reform Working Groups.

alliantgroup is the national leader in working with small and medium businesses and their accountants -- assisting them in qualifying for the Research and Development (R&D) tax credit.

We are proud to have worked with thousands of companies across the country in the last 10 years to ensure that they benefit from this important incentive provided by Congress --resulting in the creation of thousands of jobs. Our comments are based on our unmatched experience working with small and medium businesses seeking to benefit from the R&D tax credit.

We commend the Committee for forming these Tax Reform Working Groups and undertaking this review of current law. The purpose of this statement is to highlight those changes that we encourage the Committee to consider that will greatly enhance the benefit of the R&D credit for small and medium businesses.

As the Committee likely knows, a number of countries provide additional incentives for small and medium-size enterprises. By contrast, the US R&D tax credit provides no additional incentives for small and medium businesses. In fact, US tax policy actually erects barriers that limit these businesses from enjoying the incentives of the R&D tax credit.

The negative impact of these barriers is made clear by the findings of the GAO 2009 report to the Senate Finance Committee on the R&D tax credit which highlighted the small amount of overall dollars of the R&D tax credit that go to small and medium businesses.

These roadblocks in the tax code and regulations work against small and medium businesses taking the R&D tax credit and act directly against our nation's goals of fostering economic

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productivity and encouraging job growth. This is especially troubling in light of the testimony the Senate Finance Committee heard back on September 20, 2011 from OECD that small firms are more responsive to R&D tax incentives. Thus, current tax law and regulations operates against small and medium businesses taking the R&D tax credit and is especially prejudicial against the very firms that would be most responsive to such a credit

The good news is that with a few minor changes in the law and regulations, the R&D tax credit will provide significant benefits to small and medium businesses. These changes should be considered by the Ways and Means Committee to make the R&D credit permanent as well as any extensions of the R&D credit and any jobs bill.

ALLOW THE R&D TAX CREDIT AGAINST THE AMT

The top barrier for small and medium businesses taking the R&D credit is that the credit cannot be used to reduce the business owners' alternative minimum tax (AMT). This means, that a business owner of a pass-thru entity that is subject to the AMT cannot use the R&D credit to reduce her taxes. Alliantgroup has found in reviewing tens of thousands of tax returns that 8 out of 10 businesses that would otherwise benefit from taking the R&D credit will receive little to no benefit from the R&D credit because the credit cannot be used to reduce AMT. Given that the vast majority of small and medium businesses are organized as pass-thru entities, the potential benefit of the R&D tax credit to encourage innovation and create jobs is greatly diminished.

The Senate Finance Committee made the right policy call in allowing the R&D tax credit to be taken against AMT in enacting the Small Business Jobs Act of 2010. We have seen first-hand that this simple change in the law has translated into providing significant benefit to thousands of small and medium businesses and helped create a small city worth of jobs. The only drawback is that this legislation was good for only one year – 2010. Alliantgroup encourages the Committee to make this common sense change permanent in its proposed legislation. We are pleased to note that the Senate Finance Committee also heard support from its witnesses at the hearing on September 20, 2011 for allowing the R&D tax credit against the AMT. The Committee passed this provision last year in a markup.

ALLOW NEW AND SMALL BUSINESSES TO TAKE THE R&D CREDIT AGAINST THE EMPLOYER PAYROLL TAX

While the AMT exclusion for the R&D tax credit would greatly benefit a large number of small and medium businesses, many startups would still be ineligible for the credit because they are not making a profit. Several states, and particularly Louisiana, Minnesota, New York and Arizona have had great success with an R&D tax credit that is provided even if a company doesn't owe tax.

Alliantgroup, working with companies in these states, has witnessed that an expanded, refundable R&D credit has meant companies starting up, keeping their doors open or expanding and creating

new jobs. And the credit in the bill introduced by Senators Roberts, Schumer and Coons allows this ‘jobs credit’ to be taken against payroll taxes. It is not refundable.

The Senate Finance Committee needs to bear in mind that while the engines for job growth are small and medium businesses, it is particularly new businesses that are key to an increase in jobs. The importance of encouraging entrepreneurship and startups for job growth was underscored by an August 2010 NBER Working Paper, *Who Creates Jobs? Small v. Large v. Young*. In addition, studies have shown that a great deal of innovation is concentrated in new businesses. Therefore, an R&D credit that is also available to new businesses will bolster both innovation and jobs.

As the Senate Finance Committee read in the written testimony from the OECD of September 20, 2011, it is not only the states that have looked at a refundable R&D tax credit. The OECD testimony notes that a recent trend is for countries to target R&D tax incentives to offset employer Social Security contributions and other taxes on labor income. The OECD testimony highlights that “Increasing cash flow is important for small, research intensive firms with little revenue but high investment in intellectual and human capital.” Further, we note that Senate Finance Committee hearing witnesses Prof. Nellen and Mr. Rashkin in their testimony also called for a refundable/transferable credit for small and startup businesses.

An R&D tax credit – taken against payroll taxes paid by companies – and capped at \$250,000 could provide much-needed cash for credit-starved innovative startups. Such a proposal would ensure that some of our most cutting edge new companies would actually receive the benefit of the R&D tax credit – as opposed to being on the outside looking in. The Committee passed this provision last year in a markup.

