CLIENT SUCCESS STROY: RESEARCH & DEVELOPMENT TAX CREDITS

An Accounting "Reconstruction" Yields 1,000 Percent ROI

Background: AAFCPAs performed audit and tax work for an entrepreneurial company with $10 million per year in revenue. Our client was a developer and direct seller of specialized software applications used by educational institutions and organizations. We determined that the client was investing time and expense in developing the software, but was not taking any tax credits to which they were entitled for qualifying research and development expenses ("R&D") pursuant to Section 38 of the Internal Revenue Code. Specifically, the client expended significant money and effort on two product upgrades and the development of one brand new product in their field. This was determined partly as a result of our innovative approach to client service, which allows for three on-site visits to client facilities per year at no charge. This is how we best learn the client's business, while helping to uncover issues and opportunities related to accounting and tax functions.

Client Goals: The client wanted to improve after-tax income, not only to improve its cash position, but to enhance its attractiveness for sale.

Obstacles and Challenges: Although the client had made qualifying R&D expenditures, the amounts were not readily ascertainable or identifiable because the company accounting system was not designed to track these expenses. There had been no expense accounting for R&D and the client's general ledger was not designed to show the costs associated with R&D activities.

AAFCPAs Solution: We interviewed the key people involved in the client's R&D efforts, worked with management to review payroll records for individuals engaged in R&D efforts, and analyzed invoices paid by the client to find expenses related to qualified consulting services, supplies and computing related expenses. We figured out how to retrieve this information for the base period, and for all open tax years, relying in part on payroll and expense statements that were helpful in reconstructing R&D investments. We also determined that the president spent much of his time on R&D, knowing that this often happens in entrepreneurial technology startups. We used records of his time to calculate the portion of his wages that were associated with R&D efforts. We also devised a way to identify eligible R&D activities, determining which of them were related to a process of experimentation for new or improved function, performance, reliability or quality, and were limited to research undertaken to discover information that is technological in nature and intended to be useful in the development of a new or improved business component. In doing so, we also identified qualifying in-house expenditures, such as wages and other income related to time spent directly supervising or supporting research activities.

Results: We prepared and the company filed amended tax returns for a period of three years, resulting in a tax refund of more than $120,000. This was more than ten times the amount of our fees, providing our client with an outstanding return on investment for our professional services.

We also helped the client to change its information capture and reporting systems going forward so that qualifying R&D expenses could be easily incorporated into future tax returns. The client company was ultimately sold for an acceptable price with the tax credits helping to improve the after-tax picture in the financial statements.

About AAFCPAs: AAFCPAs is an attractive alternative to the Big 4 and National CPA firms. We provide best-value assurance, tax, accounting, and business & IT advisory solutions to nonprofit organizations, commercial companies, and wealthy individuals/estates. Since 1973, AAF's sincere approach to business and service excellence has attracted discerning clients along with the best and brightest CPA and consulting professionals. AAF donates 10% of its net profits annually to nonprofit organizations.

Contact

John Finning
jfinning@aafcpa.com
774.512.4105