

## KBKG Tax Insight: Is a More Valuable R&D Credit Coming Soon?

The R&D tax credit, which was made permanent in 2015 and now, it could get even better with bi-partisan support, Senators Chris Coons (D-DE) and Pat Roberts (R-KS) have introduced a bill increasing the R&D credit up to 25% for companies that not only conduct qualified research, but also manufacture their products in the US.

Since 2005, there have been an increasing number of companies claiming the credit for increasing Research and Development activities. Established in 1981 and expanded several times since, the purpose of the credit was to encourage job growth in the United States. However, as labor costs continued to rise over the past 12 years, there has been an increase in the number of companies outsourcing to foreign countries much of their R&D and nearly all of their manufacturing operations.

**KBKG Insight:** Manufacturing is already the largest industry with respect to the research credit which accounts for more than half of the \$12 billion claimed annually. Allowing companies that manufacture in the US to claim an additional 25% credit will enhance the sector's standing and it will encourage companies to keep their manufacturing in the US.

Although the United States still leads the world in scientific research and innovation in total dollars, countries such as Germany, Japan and South Korea spend more than the United States as a percentage of their respective GDPs. Rising manufacturing costs, combined with favorable tax treatment in foreign countries, have led many companies to set up operations in Mexico, Europe, India and China. Others have contracted the manufacturing of their products altogether to companies in foreign countries.

Industry experts have commented that the amount of R&D activity increases by 50% when located near a manufacturing facility. When new products are introduced, these prototypes have to be assembled, tested, redesigned and trial runs conducted to ensure manufacturability. Improvements are made to the manufacturing line to allow for the introduction of new parts. New tooling is often developed in the machine shop on-site for these new prototype components. Process improvements are made to the manufacturing facility to increase efficiency, improve performance, increase speed, improve accuracy, reduce scrap, reclaim recyclable materials and reduce energy consumption. These "manufacturing" activities are really *qualified research activities*, the cost of which can be captured toward the research credit.

This should come as a welcome relief to companies who already design, develop and manufacture products in America, and could make companies reconsider moving their manufacturing operations off-shore.

**Author:** Michael Maroney