

Additional Research and Development Tax Credit Opportunities for Companies Using Molds or Dies

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While the research and development (R&D) tax credit has been available since 1981, a court case issued on November 11, 2009, can have a significant positive impact for companies who either develop tooling or have tooling developed for them that requires them to modify the tooling for final use in production.

Contrary to popular belief, the R&D tax credit isn't limited to high-tech, biotech, and pharmaceutical companies. In fact, a number of Wipfli's clients, who utilize tooling in their manufacturing process or are tool and die makers themselves, have received significant benefits from this credit. Recent clarification to the tax code has established a more lenient interpretation of the activities that qualify, making the definition of R&D for tax purposes much broader than most organizations realize. Today's R&D tax credit can apply to a variety of areas, including manufacturing, engineering, quality assurance, maintenance, sales, and information technology. And it isn't just a research credit; it's also a process improvement credit. In fact, for many manufacturers, the daily operations of making new, lighter, stronger, less expensive, or more reliable products or of developing more efficient and economical processes are considered qualifying activities. There are two calculation methods commonly used. The first is a traditional credit. The credit is equal to 20% of the qualified expenditures in excess of a calculated amount tied to sales. The second method is the alternative simplified credit. This credit is equal to 14% of the qualified expenditures in excess of a calculated amount tied to prior qualified research expenditures.

In *TG Missouri Corporation v. Commissioner (133 T.C. No. 13)*, the taxpayer was a contract manufacturer of automotive parts. The taxpayer designed and built molds in-house, as well as contracted with third-party toolmakers to build the production molds they do not construct. When the taxpayer contracted with the third-party toolmaker, the toolmaker would construct the mold to the taxpayer's design specifications. The outside toolmaker does not guarantee that the mold will perform to the taxpayer's customer's specifications or produce the desired part in accordance with the design specifications of the taxpayer's customers. After the third-party toolmaker finishes constructing the mold, the taxpayer then tests the mold and incurs additional design and engineering costs to modify the production mold so the mold produces the desired component part. Once the mold is finished and is capable of producing production parts to meet customer specifications, the taxpayer either sells the mold to the customer or retains ownership. In either case, the taxpayer will use the mold to produce the parts for the customer.

In the taxpayer's calculation for the R&D credit, the taxpayer included the costs paid to the third-party toolmakers as supplies eligible for the research and development tax credit. The IRS disallowed these amounts on audit, stating that a cost associated with an item that becomes a depreciable asset is not eligible for the R&D tax credit. The taxpayer contested that the molds sold to customers were not depreciable assets in their hands, and therefore, the costs associated with developing them, including the amounts paid to third-party toolmakers, were eligible for the credit. The Tax Court agreed with the taxpayer and allowed the amounts paid to third-party toolmakers as supplies eligible for the R&D tax credit.

This court case has a significant positive impact for all taxpayers, and the findings can be applied to many situations. Companies who either develop tooling or contract with others to develop tooling to their specifications can apply the findings of this court case to claim the amounts paid for the tooling materials, including those amounts paid to third parties as qualified expenses for the research credit. Depending upon your company's circumstances, this can substantially increase the amount of costs eligible for the credit and, therefore, significantly increase the company's benefit of the credit.

To learn more about how Wipfli has assisted other companies to benefit from the R&D tax credit, please visit www.wipfli.com and download the article, *Real Stories, Real Money: How Five Manufacturers Got Their Fair Share of R&D Tax Credits*.

About the Author

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