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TAX ALERT

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Tax Reform Retools, Upgrades R&D Incentives

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The Tax Cuts and Jobs Act (P.L. 115-97 or the Act) was signed into law on December 22, 2017, bringing a flurry of concerns and questions to the forefront of every taxpayer. The biggest tax legislation since 1986, the Act has made numerous sweeping changes to the tax code. The Credit for Increasing Research Activities (R&D Tax Credit) survived seemingly untouched. However, there are significant changes to how the R&D tax credit will be utilized by many taxpayers.

- **Net Operating Loss (NOL) Limitation**

  Under the Act, NOLs originating in 2018 and subsequent years reduce up to 80 percent of taxable income. Whereas under prior law, NOLs reduced up to 100 percent of taxable income. This opens the door for many companies generating NOLs to now utilize the R&D tax credit to apply towards the tax on the 20 percent of income not reduced by NOLs. However, this limitation does not apply to existing NOLs created in 2017 or prior years. Existing NOLs from 2017 and prior years continue to reduce taxable income without applying the 80 percent limitation.

- **Corporate Income Tax Rate Cut Makes the R&D Credit More Valuable**

  With the corporate tax rate reduced from 35 percent to 21 percent, the benefit of the R&D Tax Credit has been enhanced. The increased benefit is a result of the credits interaction with the R&D expense deduction. For a Company with a $100,000 R&D Tax Credit, the taxpayer will receive an additional $14,000 in cash tax savings as a result of the change.

- **Elimination of Corporate Alternative Minimum Tax (AMT)**

  Historically the R&D Tax Credit was not eligible for most taxpayers subject to AMT. The elimination of the corporate AMT tax enables more corporate taxpayers to utilize the R&D Tax Credit.

Unfortunately, the Act made changes to the way taxpayers account for research and experimentation expenditures. Until 2022, taxpayers can continue to deduct research expenses in the year incurred. However, under the new law, taxpayers are required to capitalize and amortize specified research expenses over five years beginning with expenditures incurred after December 31, 2021.

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