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Craig Smalley • Sep. 08, 2017


For whatever reason, I thrive when a client brings me a complicated and complex tax problem to solve. I use Thomson Reuters Checkpoint as my research software. Each weekday morning around 4:30 a.m., I get an email from Checkpoint with excerpts about recent Tax Court cases and tax law changes. I typically spend about one hour, sometimes two, going through those emails. I may not have a client at that moment who is affected by these new tax rulings or regulations, but you never know what tomorrow will bring.

About a year ago, I was getting updates about the research and development (R&D)



produce the games could be expensed.

The cut-throat business of video game design works like this: The company will start designing a game, but sometimes the game won't work right or the technology hasn't caught up with the vision of the game designer, so they may abandon the project and move on to another game. If all of the costs to design one game are capitalized until the game is released, what happens to the expenses for a game that is abandoned?

There is something special that I remembered reading about the R&D credit and the video game industry. In that industry, the designing of the game is all R&D. The wages paid to the programmers, and most expenses that go into the design of the game, qualify for the R&D credit. So, I explained this to the company's owners, and I found myself amending their 2015 return and redoing 2016's return. The three partners ended up with a $325,000 tax credit, which flowed over to their personal tax returns and saved them a ton of money. The owners said to me "you have a client for life."

The second client I poached came to me for a second opinion. Their company manufactures motors for toy helicopters, drones, and other things. What they do is spend time and money researching the motors and then developing prototypes. If the prototype works, they ship it to China where the product is manufactured and they sell it. Sometimes these motors work, and other times they don't.

The point is, the whole R&D process for these motors qualifies for the tax credit, which I explained to the client. On their original returns, they owed several thousands of dollars in taxes; however, after I amended the returns, the credit wiped out 90% of the taxes they owed in the previous years. The client was ecstatic and turned their entire business over to me, and now we do everything for them.

I just finished a proposal for the third client. He develops learning programs and sells



business, you are going to pay tax on the profit. However, I explained to him that most of his tax liability will be eaten up by the R&D credit. Reinvesting back into his business will not hurt him in taxes.

We'll see if we get our third client because of the R&D credit. As a refresher, the R&D credit works like this:

The R&D tax credit is for taxpayers of any size that design, develop or improve products, processes, techniques, formulas or software. It is calculated on the basis of increases in research activities and expenditures; thus it is intended to reward, in general, not static programs but those that pursue innovation with continually increasing investment. However, an alternative simplified method allows taxpayers to claim research credits if research costs remain the same or even decline when compared with prior years.

There are two different ways to calculate the credit: the regular research credit (RRC) or the alternative simplified credit (ASC). The basic difference between the two is that the RRC uses a base period, which can lower the amount of the credit. Election to use the ASC greatly reduces the administrative headache of the RRC. The ASC does this by shifting the measurement of the research over the prior three years. The shifting of this measurement can mean a higher credit that can be taken.

Note that Congress likes to play around with the R&D credit, so before you recommend it, make sure that you fully understand it.

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Craig W. Smalley, MST, EA, is the Founder and CEO of CWSEAPA, PLLC. He has been admitted to practice before the Internal Revenue Service as an Enrolled Agent and has a Master's Certificate in Taxation from UCLA. In practice since 1994, Craig is well-versed in U.S Tax Law and U.S. Tax Court cases, and specializes in individual,



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