



# Special Report Special Report Special Report Special Report

---

## **The Goose That Lays Suppliers' Golden Egg: Vital Capital Can Be Reclaimed Through Research and Experimentation Tax Credits**

---

Automotive Aftermarket Suppliers Association  
September 2011

# **The Goose That Lays Suppliers' Golden Egg: Vital Capital Can Be Reclaimed Through Research and Experimentation Tax Credits**

***Presented by***

***The Automotive Aftermarket Suppliers Association & McGladrey***

Forget about those e-mails from expatriates of Third World countries promising wealth or infomercials promising riches through real estate. The real deal for suppliers is from their Uncle Sam: Research and Experimental (R&E) tax credits.

Of course, R&E tax credits are not the goose that lays the suppliers' golden egg. It is a tax credit for the company's capital invested in new products, product improvements or improved lines and improving and streamlining manufacturing processes. What makes the R&E tax credit seem like a windfall is the tax law allowing companies to reclaim their R&E investments for up to three previous tax years.

The automotive aftermarket supplier industry is one of the manufacturing segments ripe for R&E activities, according to Byron Schneidman of McGladrey. "In the automotive industry, a lot of businesses are involved in R&E activities but aren't aware of it, such as researching new products, improving parts and products, and so forth. There is an impression that only original equipment manufacturers qualify for the credit whereas aftermarket suppliers do not. Nothing could be further from the truth. We have performed R&E tax credit studies for many members of the AASA. In these studies, we have found many suppliers involved with process improvements on the shop floor and product improvements that qualify for the credit. Most aftermarket suppliers are involved in designing universal parts or in improving the performance, reliability, or durability of their products and these activities are likely to qualify too," Schneidman said.

## **Raising Awareness**

According to Schneidman, "R&E tax credits have been around a long time, but it has been a confusing area of tax law. The problem for companies seeking to recover R&E tax credits has been twofold: the Internal Revenue Service (IRS) and their own tax advisors."

The IRS is responsible for enforcement and collection, not creation of tax laws. They have become more aggressive in those roles than was intended. The R&E tax credit is a tier one issue with the IRS meaning that it is subject to a higher level of scrutiny than other issues in the event of an IRS examination.

R&E tax credits are an area of tax law often politicized by presidential administrations to achieve its economic agendas. "All administrations have understood that the R&E tax credit translates into job growth," he said. "Each administration has used this to enhance its budget. This is a very lucrative area of tax law. It can provide manufacturers capital to reinvest. The R&E tax credit has expired and been reinstated in the tax law more than 14 times since the 1980s."



## **Manufacturing Experts Needed**

More companies and industries are seeking the R&E tax credits according to Schneidman. Tax preparation and calculation of the credit is where businesses hit the second most common obstacle.

“What we find is that to get businesses the full R&E credit, it takes knowledge of more than just the tax law,” Schneidman said. “You need to understand manufacturing and engineering processes, and often the traditional tax preparer does not have the in-depth understanding of these processes to appropriately develop a methodology for uncovering R&E activities eligible for the credit.

“The average tax preparer has never performed an R&E tax credit study accurately identifying R&E activities and employees,” Schneidman noted. “That’s why most companies are overlooking R&E tax credits. This is a job for an R&E tax credit expert who is committed to this area of tax law and who has performed many studies. For his team, Schneidman trains his people in not just the tax law, but also in understanding manufacturing and engineering processes.

## **No Invasion**

For many businesses, tax preparation can mean paying for hours of research and investigation – and hours of staff time. It can be an invasive approach.

Schneidman noted that his teams take a value-added approach to recapturing R&E tax credits. “We do not impose an ongoing licensing fee for using our methodology going forward,” he said. “Our fees are usually a fraction of the tax benefit.”

Most of the work is performed in the field. “Our client’s time tends to be completed in three to four weeks,” he said. The process begins with a preliminary assessment that generally takes one to two days and usually there is no charge for this phase of the project, he noted. “We educate the client on our process and the R&E tax credit and determine if any barriers exist to getting the credit before performing a full-blown study. We also estimate the benefit of the R&E credit and the associated fees so that business can make an informed decision prior to conducting the full study.”

According to Schneidman, the preliminary assessment usually is the determining factor for the business decision to continue with the full study. “Clients don’t consider it invasive, especially considering the potential to get hundreds of thousands of dollars in taxes back,” he said.

“Businesses commonly miss a lot of R&E tax credits in revamping their manufacturing processes,” Schneidman said. “Generally activities performed to reach a better flow rate, improve efficiency, reduce head count, improve quality and reduce scrap, etc. are likely to constitute qualifying activities.”

And the refunds can be significant. “It can be big money,” Schneidman said.

“Even if an automotive manufacturer is not a large taxpayer, the company can use the tax credit to offset current tax,” Schneidman said. “If the company can’t use all the credit, it can carry back unused credits one year and carry credits forward 20 years, dollar for dollar. It’s real money. The credit does not replace deductions; it’s a true credit on top of deductions.”



## The Time Factor

The only caveat is the time factor: once a company passes the three-year statute of limitations, the R&E tax credit expires and is gone forever.

“We’ve seen situations where immediate action was needed or the credit could be lost,” Schneidman said.

But businesses interested in R&E tax credits should act fast — and seek out the right professional assistance. “If you’re interested in claiming the credit and your current tax advisors have not performed these types of studies — seek a second opinion,” Schneidman said. “Hire the best expert you can find, because there is a direct correlation between the amount of credit identified and the experience of the person performing your study and the ability to defend the credit in the event of an IRS audit.”

“The experience level of people doing the credit study is vital,” Schneidman said. “The refund can be huge, but if the experience of the advisors isn’t there, it can be missed.”

### **For more information, contact:**

Byron Schneidman  
Managing Director  
McGladrey  
312-634-4420 or [byron.schneidman@mcgladrey.com](mailto:byron.schneidman@mcgladrey.com)

*McGladrey is an affiliate member of AASA and an AASA Solution Partner through its “ValueInsight” program. For more details about affiliate membership and AASA Solution Partners, visit [www.aftermarketsuppliers.org](http://www.aftermarketsuppliers.org) or contact Jennifer Gilbertson, [jgilbertson@mema.org](mailto:jgilbertson@mema.org).*

