

The PATH Act of 2015

What is the Payroll Tax Offset?

With the passing of the PATH ACT of 2015, the Research & Development Tax Credit has finally become a permanent fixture of the U.S. tax code, but more notably, the legislation makes a key enhancement that will significantly benefit many start-ups and small to mid-sized businesses. The legislation allows qualified small businesses to apply credits in excess of income taxes to FICA taxes. This is especially beneficial to companies that were unprofitable and have no income taxes. The PATH Act will generate a cash flow for unprofitable businesses where one did not previously exist.

The Payroll Tax Offset:

- Allows a payroll tax offset for start-up businesses (under \$5 million in gross receipts)
- These companies can take a credit against FICA taxes only
- Maximum credit is capped at \$250,000 per year for five years
- Effective for January 1, 2016, but not available for 2015 or earlier periods

Tell me more...

Qualified companies can now take a credit against the employer's portion of Federal Insurance Contributions Act 'FICA' taxes. The FICA tax is a Federal tax on gross salaries to fund the Social Security and Medicare programs. While it is levied on both employers and employees, only the employer portion will be subject to offset R&D credits in excess of income taxes. The IRS has not yet indicated whether they will allow offset against both pieces of the FICA tax (Social Security and Medicare) or just one. Companies should keep their Form 941's available so that the appropriate taxes can be extracted.

What is a "Qualified Small Business?"

A "Qualified Small Business" is described as a business with under \$5 million in annual gross receipts and has generated gross receipts for no more than five years. Hence, the PATH Act is particularly valuable for start-up companies with R&D expenses but no taxable income. Since no-profit companies have no income taxes to offset, the R&D credit can be applied directly to its FICA taxes, thereby benefitting the company regardless of its no-profit situation.

Is there a limit on how much I can claim?

Yes, there is a maximum credit capped at \$250,000 per each eligible year for five years. The IRS has not yet indicated whether the payroll tax deduction line (taxes and licenses) will be reduced while another line increases by the same amount for the credit. That will likely be the case, though, and a credit is always more beneficial than a deduction. Furthermore, any unused credit may be carried forward to offset against future payroll tax liabilities.

Can I apply this new rule to previous tax years?

Unfortunately, the payroll tax offset cannot be applied to any years previous to tax year 2016.

EXAMPLES of how the Payroll Tax Offset works

➔ Example 1

DEVO, a small tech company founded in 2014, had acquired substantial R&D and payroll expenses in tax year 2015, however no revenue was produced. Since it worked at a loss, DEVO did not claim any R&D Tax Credit in 2015. Moreover, the small company expects 2016's activities to be comparable with those of 2015.

DEVO's 2016 Activity

<i>Business Form of the Taxpayer</i>	<i>C-Corporation</i>
<i>R&D Tax Credit Eligibility</i>	<i>\$150,000</i>
<i>Payroll Tax Liability</i>	<i>\$100,000</i>

Because of the PATH Act, DEVO should secure the \$150,000 of R&D Tax Credit in 2016 and elect to offset it against the \$100,000 of payroll tax liability and carry forward the remaining \$50,000 to offset against future payroll tax liability.

➔ Example 2

DEVO's 2017 Activity

<i>Business Form of the Taxpayer</i>	<i>C-Corporation</i>
<i>R&D Tax Credit Eligibility</i>	<i>\$200,000</i>
<i>Income Taxes</i>	<i>\$100,000</i>
<i>Payroll Tax Liability</i>	<i>\$150,000</i>

In 2017, DEVO started to make a profit. DEVO will apply their \$200,000 R&D Tax Credit against their income taxes, leaving \$100,000 of the credit remaining. Under the PATH ACT, this remaining credit will be used to offset \$100,000 of their \$150,000 payroll tax liability.

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