

MANUFACTURING

POSSIBILITIES



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Can You Benefit from the R&D Tax Credit?

OVERVIEW

The research and development (R&D) credit can help support manufacturers' innovative efforts, but some companies are still approaching research gingerly. Given the credit's history, that's understandable, but the tax advantages mean manufacturers should take a second look. This article explains the R&D credit and its benefits.

The research and development (R&D) tax credit can help support manufacturers' innovative efforts, but some companies are still approaching research gingerly. Is your company developing a new product or prototype? Have you made improvements to your existing processes? Have new technologies been developed in the past few years? If you answered yes to any of these questions, you may be eligible for additional tax credits.

What is it?

Despite strong bipartisan support for making the credit permanent, the Emergency Economic Stabilization Act of 2008 (EESA) only extended the credit for 2008 (retroactive to Jan. 1) and 2009. Please check with your tax advisor for the latest information.

Under EESA, some manufacturers may be eligible for a credit for up to 20% of qualified R&D spending in excess of a certain amount based on the company's historical activity. For those who don't qualify for the full credit, the legislation increases the Alternative Simplified Credit (ASC) rate to 14% for 2009, while eliminating the Alternative Incremental Credit. Regardless of which benefit you claim, your company must prepare in advance.

Although the R&D credit is used by many manufacturers, there are still many misconceptions as to what qualifies for the credit and how to take advantage of it. The rules can be complex, so it

is important to analyze your situation first before deciding what is best for your company.

What's required?

The R&D credit is based on a manufacturer's increase in R&D activities measured as a percentage of revenue over a historical baseline. If R&D expenditure growth outpaces revenue growth, you probably qualify. If, however, your R&D-to-sales ratio is lower now than during the base period (1984-1988), you can qualify for the ASC of 14% of the excess of your current year research expenses over 50% of your average R&D expenditures for the last three years.

Your tax advisor can help you decide which credit is appropriate, as well as how to document and claim the credit. This may require that you set up project accounting processes that will support your claims, as the IRS has designated the R&D credit a "Tier One" issue. That means they use a standardized process to audit credit claims, and examiners focus on documents created at the time the research was performed.

What do you need to do?

To protect your tax advantage, thoroughly document your R&D projects. Establish project files and accounting processes immediately, and track progress and results during the project's life. Then use these guidelines to prepare yourself to withstand an IRS audit:

- Note significant dates from concept to commercialization.
- Work with your tax advisor to create narratives that discuss each project's R&D credit qualifications.
- Link employee hours and activities to specific projects.

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- Use calendars and other supporting documents to bolster timesheet entries.
- Identify supplies used in R&D for each project and segregate them in a separate general ledger account.
- Obtain work orders, itemized invoices or other documentation from contractors demonstrating the work performed on R&D activities.
- Specify who is assuming the financial risk and who will retain intellectual property rights for each project.

Risk and intellectual property assignments are required to claim the R&D credit, and the IRS has been critical of less-detailed methods of quantifying costs. Establish tracking systems that justify your claims.

The IRS doesn't require manufacturers with several R&D projects to document each of them individually. Instead, you may use a statistical sample; a judgmental sample isn't acceptable. Consult your tax advisor on how to assemble a sample that holds up to IRS scrutiny.

Why do it?

It may seem daunting to create the records you'll need to claim the R&D credit, but it will be time well-spent. Not only will you see a tax reduction for the current year, but you may qualify for refunds if you can capture and recover credits for previous years.

Additionally, the R&D credit is a substantial tool to maximize your company's value. Manufacturers rely on research to bring new products to market, and new products can increase market value, cash flow and your return on investment. They also help keep U.S. manufacturers competitive in the world market.

Take Advantage

According to the National Association of Manufacturers, 18,000 companies use the R&D credit each year, with 70% of the credit dollars going to pay employees involved in R&D activities. That's an advantage you really don't want to miss.

Leasehold Depreciation Break Extended

Manufacturers who used rented facilities as part of their operations may also benefit from another provision of the Emergency Economic Stabilization Act of 2008: the extension of the 15-year straight-line depreciation for leasehold improvements to include property placed in service before January 1, 2010.

Qualified improvements include interior upgrades made more than three years after the building was placed in service, excluding elevators, building enlargements or improvements to the building framework.

Manufacturers may depreciate such improvements over 15 years, rather than the 39-year depreciation schedule required for other improvements. Because as of this writing the extension is temporary, manufacturers who are considering leasehold improvements may want to complete them this year. But check with your tax advisor before taking action, because this tax break could be extended or expanded.

Action Plan

Many activities qualify for the R&D Tax Credit; a few significant ones are listed below.

- Develop new, improved or more reliable products/processes/formulas/techniques.
- Develop or improve production/manufacturing processes.
- Automate and/or streamline internal processes.

If your company is involved with any of these activities, you may be eligible to claim the Credit on your current year return and possibly on an amended return. ■

When it Comes to Collections, Shoot Straight

OVERVIEW

A good collection process is like a good employee—it starts working immediately. If a manufacturer lets overdue bills slide, its customers may start to assume they can ignore the due dates—with disastrous implications for the company's cash flow and profitability. This article details an effective collection process.

When it comes to collections, shoot straight. Demanding payment for your products may not be fun, but it's important. And in a weak economy, it may mean the difference between financial solvency and serious trouble. The challenge is to improve your collections without alienating either your employees or your customers. Fortunately, it can be done.

Time is Not on Your Side

A good collection process is like a good employee—it starts working immediately. If you let overdue bills slide, your customers may start to assume they can ignore your due dates—with disastrous implications for your cash flow and profitability.

To prevent that from happening, start early. Ask your customers for their billing requirements, and how you can make it easier for them to pay on time. Work to meet those requirements, but if your systems can't accommodate them, be honest in saying so.

Then be proactive in following up on your bills before they're due. If you send bills payable in 30 days, call each customer after 21 days. Make sure everything is all right with orders, and work to resolve any issues immediately, before payment is due.

Be Accurate, be Prepared, be Polite

One of the most common—and most preventable—reasons for payment delays is confusion over invoices. Be sure that the invoices you're sending accurately reflect the work done for each customer. In other words, don't let your invoices offer any excuses to delay payment.

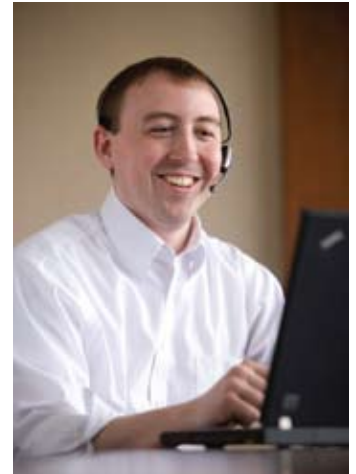
Accurate bills and follow-up reminder calls will help speed payments, but they won't eliminate overdue invoices. Sometimes you're going to have to call customers who haven't paid. When you do, be prepared and be polite. Before you make the call, review all the relevant paperwork and have it in front of you for reference. Then be professional in requesting payment.

One of the things you'll need to establish, particularly when the economy is in a slump, is whether the customer can't pay or merely isn't paying. If it's the former, be flexible. Collecting a little at a time is better than not collecting at all. If a customer is lax, however, don't let yourself be sidetracked. Keep the conversation on the payment, and don't end the dialogue without a commitment that you'll be paid a specific amount by a specific date. If you don't receive the payment as promised, call back at least once a week until you do.

Also, prioritize your collection efforts. If a large customer owes you \$50,000 and 10 smaller customers owe you \$2,000 each, focus on the large vendor first. It's fine to treat them all equally if you have the resources, but getting the big accounts current first will do more to protect your cash flow, delinquencies, days sales outstanding—and your bottom line.

Collect What you Deserve

There's no one right answer on how to manage your collection process, but failing to manage it at all can be disastrous for your manufacturing company. Making collection calls may not be pleasant, but you've earned what you're owed. You deserve to collect it. ■



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FORWARDING SERVICE REQUESTED

Expanded ADA Boosts Employer Responsibility

Recent changes to the Americans with Disabilities Act (ADA) extend coverage to more people in the workplace because of the ADA Amendments Act (ADAAA) which took effect Jan. 1. A “disability” is now defined as a physical or mental impairment that substantially limits one or more life activities, as well as a record of such an impairment or being regarded as having such an impairment. Transitory, minor impairments—those lasting six months or less—are not included, and you are not required to provide reasonable accommodations for those who have “regarded as” claims.

Another noteworthy change is that the ADAAA defines “major life activities” as caring for oneself, sleeping, eating, walking, hearing and other mental and physical capacities, but also includes major bodily functions such as immune system functions, cell growth, and endocrine and reproductive functions.

If someone has a condition in remission, that condition is now considered a disability if it would substantially limit a major life activity when active. And, with the exception of corrective eye lenses, you can’t consider the effect of mitigating measures in determining whether someone has a disability.

In short, Congress made it clear that ADA coverage should extend to more people and that courts should focus on whether individuals have been discriminated against on the basis of a disability rather than determining whether they are covered by the ADA. As a result, employers should use an equally rigorous standard in applying ADA provisions to their workforces.

To ensure you’re in compliance, make your managers and supervisors aware of the new law and consult your attorney about whether you need to make any changes to your policies and procedures. ■