

**Escaping the Lab, the
Secrets of Nexus, and More:**
Timely Tax Topics for Your Business



GAIN OPPORTUNITY:
RESEARCH & DEVELOPMENT
CREDIT

NEW ASPECTS TO RECEIVING R&D CREDITS



Missed prior years?



Develop software?



Beyond the lab

IN GENERAL...

Standard Method

IRC Section 41 provides for an income tax credit equal to the sum of 20% of the excess of qualified research expenses (QREs) over a base amount.

Alternative Simplified Credit (ASC)

Under the ASC method, the tax credit equals 14% of the portion of the QREs for the tax year that exceeds 50% of the average QREs for the three tax years preceding the tax year for which the credit is being computed.

THE ALTERNATIVE SIMPLIFIED CREDIT & AMENDED TAX RETURNS

Previous Rule

- Required an election on a timely filed original tax return.
- The election could not be made on an amended tax return.

New Final Regulations

The regulations remove the rule that prohibits a taxpayer from making the election to use the ASC on an amended return.

WHAT IS QUALIFIED RESEARCH?

- Undertaken for the purpose of discovering information
- Technological in nature
- Application intended to be useful in developing a new or improved business component
- Substantially all of the activities of which constitute elements of experimentation for a new or improved function, performance, reliability or quality

INTERNAL USE SOFTWARE

Previous Rule

In order to be qualified research, costs incurred to develop software used internally by a taxpayer had to meet a “high threshold of innovation” test.

- The software must be innovative
- The software development must involve significant risk
- The software must not be commercially available for the taxpayer to use (that is, it is not available without considerable modification)

INTERNAL USE SOFTWARE

New Proposed Regulations

- Provides that *internal use software* is software developed by the taxpayer for use in general and administrative functions that facilitate or support the conduct of the taxpayer's trade or business.
- The proposed regulations provide that software is *not developed primarily for internal use* if it is developed to:
 - be commercially sold, leased, licensed, or otherwise marketed to third parties, or
 - enable a taxpayer to interact with third parties or to allow third parties to initiate functions or review data on the taxpayer's system

QUALIFYING EXPENSES

- Wages and salaries
- Supplies
- Contract research expenses



R&D CREDIT

Maine

- Activities qualifying for federal R&D credit may qualify for Maine Research Expense credit
- Maine Super Credit for Substantially Increased Research and Development was discontinued



R&D CREDIT

New Hampshire

- Credit available for expenditures made during the year for qualified manufacturing R&D
- Application filed by June 30th
- Limitations apply (aggregate amount of credit \$2,000,000)





GAIN INSIGHT:
STATE TAX TOPICS

STATE TAX TOPICS

- What is Nexus?
- Apportionment Issues & Trends

PUBLIC LAW 86-272

- Restricts a state from collecting income tax where solicitation of sales is the only activity within the state
- Applies only to soliciting sales of tangible personal property
- Protected Activities:

Solicitation of sales by employees or independent contractors if:

- Orders approved outside the state
- Orders filled or shipped from outside the state

NEXUS

WHEN DOES NEXUS EXIST?



PHYSICAL PRESENCE STANDARD

- Generally, temporary or permanent presence of people (employees, service personnel or sales agents) or property (inventory, offices & warehouses)
- Varies by state

ECONOMIC NEXUS EXISTS

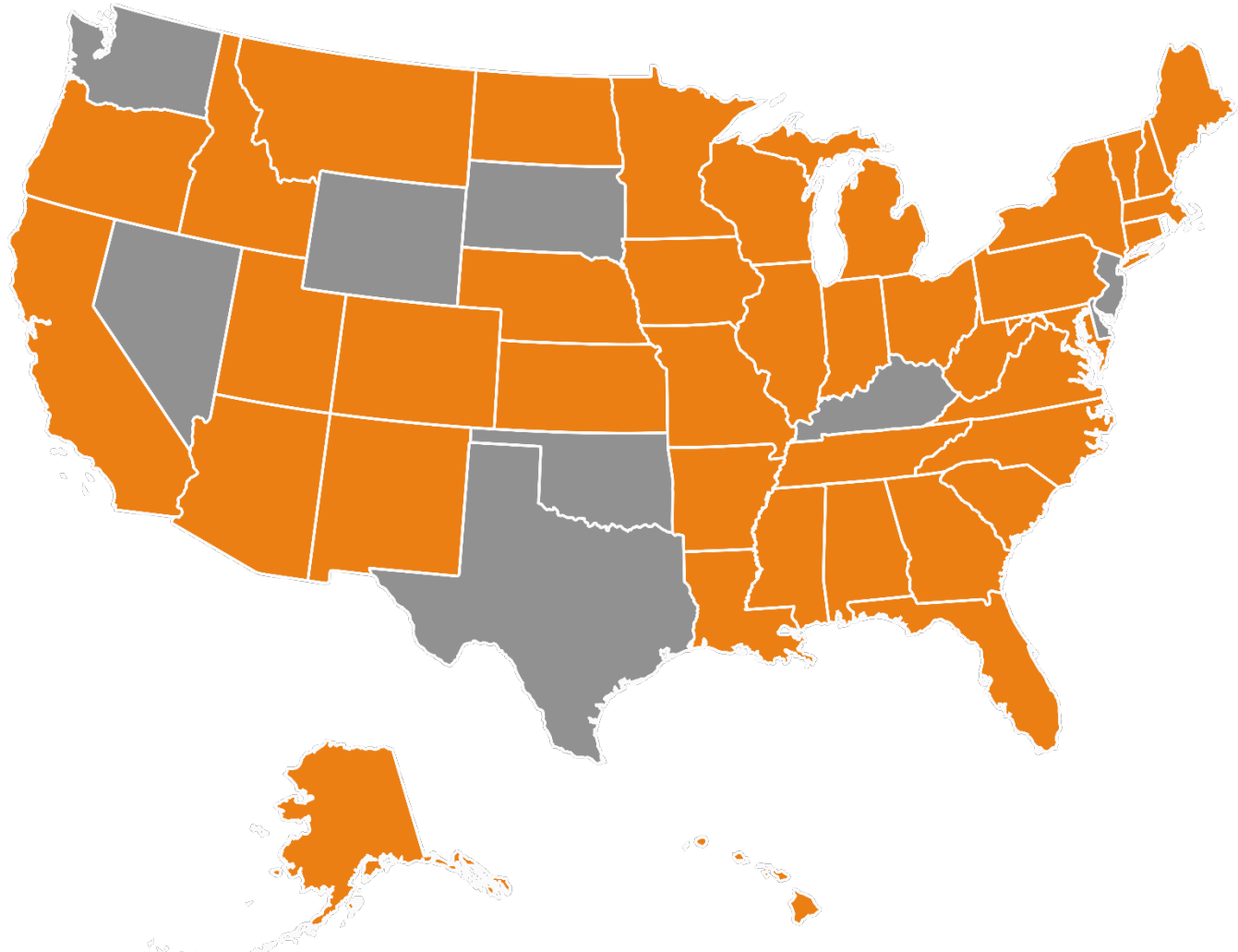
When an out-of-state business:

- Directs economic activity in the state
- Derives income from a state's local market by making sales to customers in the state
- Receives income from intangible property

Where there is:

- Affiliation and intercompany transactions
- No affiliation, but direct connections
- No affiliation, but in-state customers

MOST STATES HAVE ADOPTED ECONOMIC NEXUS STANDARDS



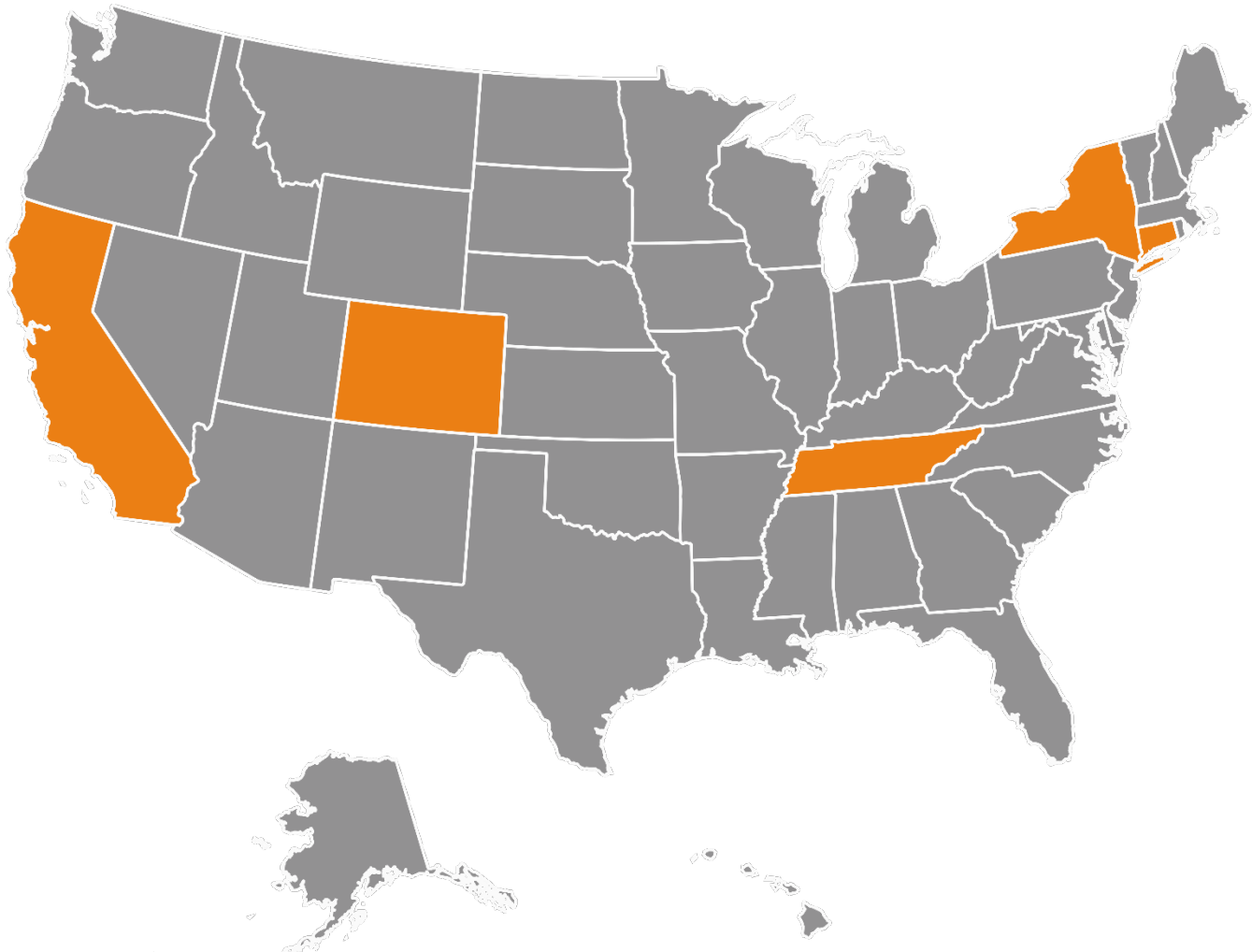
FACTOR PRESENCE

Multistate Tax Commission standard:

- \$50,000 of property
- \$50,000 of payroll
- \$500,000 of sales
- 25% of total property, total payroll, or total sales

STATES UTILIZING FACTOR PRESENCE

Income taxes – assuming P.L. 86-272 does not apply



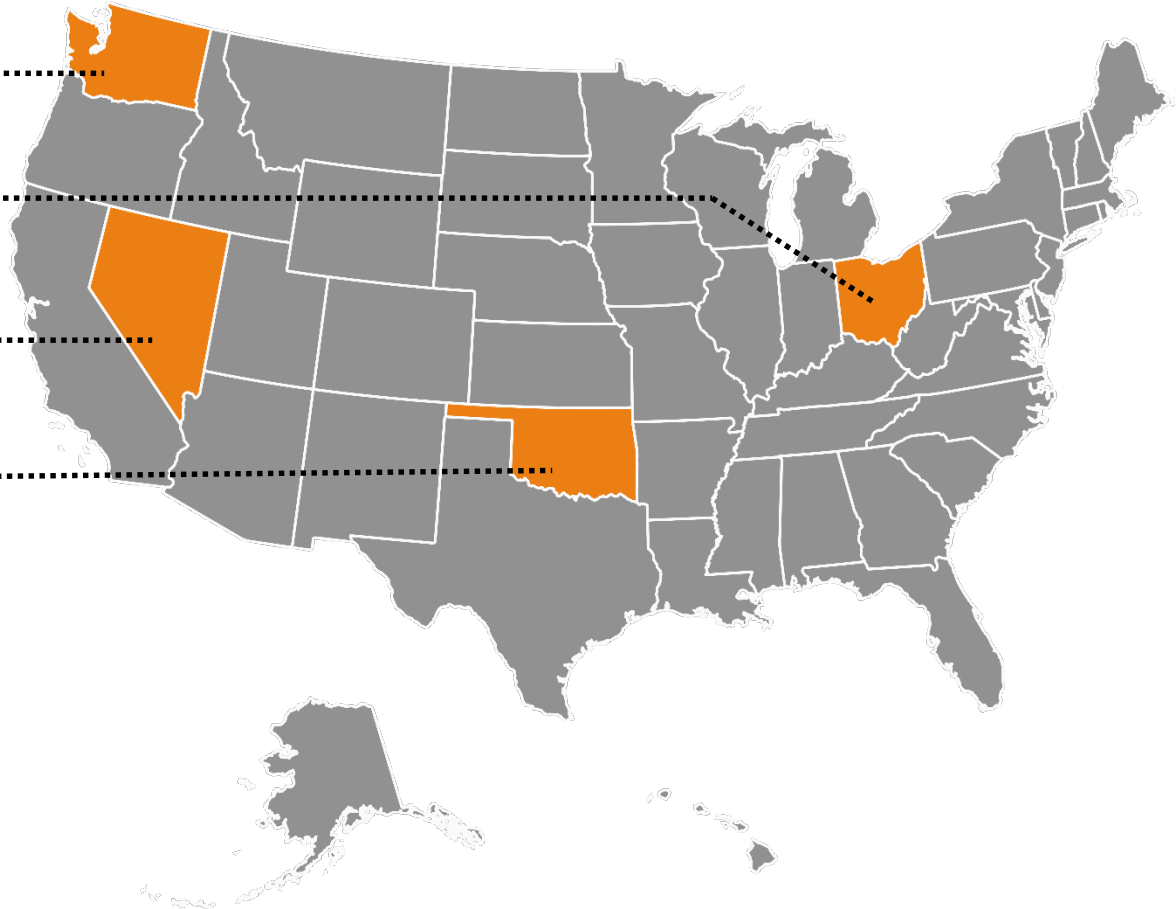
GROSS RECEIPTS TAXES

Business & Occupancy Tax

Commercial Activity Tax

Commerce Tax

Business Activity Tax



A photograph of a server room aisle with blue server racks on both sides and a metal grating floor. A large, fluffy white cloud is superimposed over the center of the image, partially obscuring the server racks and the floor.

OTHER NEXUS ISSUES

- Web Server Nexus
- Software as a Service (SaaS) or Cloud Computing
- Telecommuting

CASE STUDY

Employee of Maine company, working out of home in Missouri, supporting sales function in an engineering capacity

- Sales tax nexus?
- Income tax nexus?

CASE STUDY

A Maine manufacturer selling products out-of-state, and contracting with a third-party for installations.

- Sales tax nexus?
- Income tax nexus?

APPORTIONMENT BASICS

Computing the apportionment formula

Property factor



Payroll factor



Sales factor

STATE SPECIFIC APPORTIONMENT METHODS

- Three factor, equally weighted
- Three factor, double weighted sales factor
- Single sales factor

SOURCING SALES OF TANGIBLE PROPERTY

Tangible Property:

Sales of tangible property are generally assigned to the state in which the goods are delivered or shipped.

Services:

- Cost of Performance
- Market-Based

STATE SPECIFIC SOURCING METHODS

MAINE
Market-based

NEW HAMPSHIRE
Cost of performance

VERMONT
Cost of performance

MASSACHUSETTS
Market-based



GAIN INTEREST & DIVIDENDS NH SPECIFIC TAX OPTIONS

NH INTEREST & DIVIDENDS TAX – WHO SAYS NH DOESN'T HAVE AN INCOME TAX?

5% tax on interest and dividends

- NH Resident individuals with interest and dividend income
 - \$2,400 exclusion for single taxpayers
 - \$4,800 exclusion for married filing joint taxpayers
- NH Entities with non-transferable shares [\$2,400 exclusion]

WHAT INCOME IS SUBJECT TO THE I & D TAX?

- Interest and Dividend income
- Dividends from corporations, including distributions from S-corps
- Distributions (dividends for I&D purposes) from accumulated profits of:
 - Partnerships
 - Limited Liability Companies
 - Associations

Provided ownership interest of the unincorporated entity is represented by transferable interests.

TRANSFERABLE VS. NON-TRANSFERABLE INTERESTS

Transferable = “Able to transfer all rights in an ownership interest without the approval of another member or partner without causing dissolution of the entity.”

Non-Transferable Interest

1. LLCs with operating or partnership agreement language that is “non-Transferable” makes distributions not taxable for I&D purposes.
 2. NH resident Members of LLCs will not be subject to I&D Tax if operating agreement provides either:
 - That if any member transfers any of the member’s membership rights, the LLC will be dissolved;
- OR**
- That no member may transfer all or any of the member’s membership rights without the consent of a majority in interest of the other members.

ONLY NH RESIDENTS ARE SUBJECT TO THE INTEREST & DIVIDEND TAX

NH S-Corp located in NH with a MA shareholder

- MA shareholder subject to the I&D tax?

ONLY NH RESIDENTS ARE SUBJECT TO THE INTEREST & DIVIDEND TAX

MA S-Corp located in MA with a NH shareholder.

- NH shareholder subject to the I&D tax?

CASE STUDY

LLC with transferable interests, has the following activity for the current year:

- \$100,000 Distribution to a NH resident member owning 50% of the LLC
- Entity level interest income of \$2,000
- Entity level dividend income of \$3,000

I & D Tax Issues:

- NH resident member pays I&D taxes of \$4,880 on distributions.
- Of the \$5,000 of interest & dividend income, the entity allocates 50% to each member. As a result, the NH resident member will pay I&D taxes of \$5 (\$2,500-\$2,400 = \$100 x 5%)

CASE STUDY

LLC with non-transferable interests, has the following activity for the current year:

- \$100,000 Distribution to a NH resident member owning 50% of the LLC
- Entity level interest income of \$2,000
- Entity level dividend income of \$3,000

I & D Tax Issues:

- Entity pays I&D taxes of \$130 ($\$5,000 - \$2,400 = \$2,600 \times 5\%$)
- NH resident member pays no I & D tax on the \$100,000 distribution

CHOOSING AN ENTITY

- LLCs
- S-Corporations

Conversion of “S” Corporation to Limited Liability Company

- Retains the Federal “S” Corporation status
- Must comply with all requirements for a “F” type corporate reorganization

Benefits of Conversion

- No Change in Federal Tax Filings
- No Change in NH Business Tax Filings
- No I& D Tax on distributions to NH resident owners of the Business

INTERESTED IN MORE? CONTACT US.



Matthew Litz, CPA
mlitz@berrydunn.com



Sheena Curtis, CPA, MST
scurtis@berrydunn.com



Jim Piraino, CPA, MST
piraino@berrydunn.com