

AN ALERT FROM THE BDO RETAIL & CONSUMER PRODUCTS PRACTICE

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► SUBJECT

R&D TAX INCENTIVES – CASH FOR THE FASHION & APPAREL INDUSTRY

► DETAILS

When the topic of research and development (R&D) tax credits is discussed, companies in the Fashion and Apparel industry may not be the first to come to mind. These industries, though, often make investments eligible for significant R&D tax credits. In fact, the average federal R&D credit reported by apparel manufacturers in 2009 is approximately \$235,000, according to the most recent IRS statistics. And many companies increase that number considerably, tacking on the “double dip” opportunities afforded by more than 40 states in the U.S. By maximizing these opportunities, Fashion and Apparel companies can generate sizeable tax savings, including generating cash today for their past and future investments.

Overview of the R&D Credit

To qualify for the credit, regulations require a company to attempt to develop or improve the functionality, performance, quality, or reliability of one of its products, processes or software (component). This is in contrast to what many people imagine when thinking of R&D – a requirement that it must both succeed and do something that has never been done before. Understanding that this requirement does not exist, many apparel companies are taking credits for many of their design-related expenses.

As defined in the tax code, an activity can qualify if:

- 1) It attempts to develop or improve a component in one of the ways described above
- 2) The company’s capability or methodology for doing so, or the appropriate design of the component, is uncertain
- 3) The company must undertake a process of evaluating different alternatives to try to eliminate the uncertainty
- 4) That process’s success or failure depends on engineering or the physical, biological or computer sciences

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For the federal credit, eligible expenses include wages paid to company personnel and payments to consultants who perform or directly supervise or support activities in the U.S. involving the four elements above, as well as expenses for supplies used in those activities. Many of the states include these same expenses but require the work to be performed within the applicable state.

Eligible Activities in the Fashion and Apparel Industry

In the Fashion and Apparel industry qualified activities typically relate to the scientific or engineering design of a business component. Development activities related to the aesthetic design of a business component (e.g., color, patterns and/or style preferences) typically do not qualify. Examples of scientific or engineering design include, but are not limited to, activities related to attempts to develop or improve:

- Leather and other fabrics
- Dye formulation treatments
- Construction and structural integrity of fabric or materials
- Colorfastness issues and tensile strength of garments
- Weaving techniques
- Material usage
- Manufacturing processes generally
- Weather resistance
- Fabric that can wick perspiration away from the wearer's body
- Comfort and joint cushioning for footwear

The wages and expenses paid to people performing, directly supervising or directly supporting these activities, as well as the supplies used to conduct them, may qualify.

Software development expenses can also qualify. As is true with manufacturing, distribution and retail companies, fashion and apparel companies are increasingly developing software to increase efficiency and improve customer-facing and internal processes. Expenditures for such developments are usually a large expense for a company and can often qualify. Such expenditures include those to develop or improve systems related to:

- Warehouse management
- Point of sale
- Price optimization
- Labor scheduling
- Merchandising;
- Customer, supplier or internal billing

Opportunities for Multinational Companies

In addition to the U.S., many other countries offer tax incentives for conducting R&D activities, with some of them being significantly more generous than those in the U.S. Companies doing business in more than one country can take advantage of varying national tax incentives, including tax credits, deductions, super-deductions and exemptions.

Like 10 or so U.S. states, many countries allow some or all of their R&D tax credit to be "refunded," which means that businesses do not need to have any income tax liability or revenue to receive a cash benefit; the credit is effectively a cash subsidy. In addition to a refund, many countries allow unused credits/deductions to offset tax liability in other periods, including, among others:

- Australia
- Canada
- France
- United Kingdom

In addition, although the U.S. credit requires activities to be performed in the U.S., several countries allow activities to be conducted in other countries. For multinational companies, this enables them to receive tax incentives for the same activities in more than one country. The United Kingdom, Japan and Australia are examples of countries that allow at least a portion of qualified work to take place outside their jurisdictions.

Although these incentives may be enticing for multinational companies, there are many other factors to consider when comparing subsidies among countries, including varying eligibility requirements, limitations and definitions of qualified research. However, taking advantage of available programs may allow multinational companies to further their growth objectives and achieve their financial goals.

Conclusion

In the current competitive economy, it is increasingly important to capitalize on all available tax credits and incentives. As R&D incentives exist on the federal, state and international levels, corporations in the fashion and apparel industry may find these incentives to be the perfect fit. Additionally, if you feel an R&D tax credit was overlooked in prior years, your organization may have the opportunity to recover past investments in the current year.

A version of this article will appear in [Chain Store Age](#) in March.

For more information on these R&D credits or how your organization can take advantage of these credits, please contact:

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