



Indiana Research Expense Credit

The State of Indiana offers two tax incentives targeted at encouraging investments in research and development. Taxpayers may receive a credit against their Indiana state income tax liability calculated as a percentage of qualified research expenses incurred in Indiana. A Qualified Research Expense (QRE), the Indiana credit established under IC 6-3.1-4, is defined by Section 41(b) of the Internal Revenue Code (IRC) effective Jan. 1, 2001. HEA 1472-2015, effective Jan. 1, 2016, amended the research expense tax credit definitions to align with the IRC. The other incentive is a 100% sales tax exemption for qualified research and development equipment and property purchased for use in Indiana as noted in IC 6-2.5-5-40.

RESEARCH EXPENSE CREDITS: A taxpayer may be eligible for a credit on qualified research expenses. The potential value of the credit is equal to the taxpayer's qualified research expense for the taxable year, minus the base period amount up to \$1 million, multiplied by 15%. A credit percentage of up to 10% is applied to any excess of qualified research expense over the base period amount greater than \$1 million. Additionally, for Indiana qualified research expenses, an alternative method of calculating the credit is available. At the taxpayer's election, the amount of the taxpayer's research expense tax credit is equal to 10% of the part of the taxpayer's Indiana qualified research expense for the taxable year that exceeds 50% of the taxpayer's average Indiana qualified research expense for the three taxable years preceding the taxable year for which the credit is being determined. However, if the taxpayer did not have Indiana qualified research expenses in any one of the three taxable years preceding the taxable year for which the credit is being determined, the amount of the research expense tax credit under the alternative method is equal to 5% of the taxpayer's Indiana qualified research expense for the taxable year. Credits awarded in accordance with the relevant statutory provisions may be carried forward for up to 10 taxable years.

POTENTIAL VALUE OF INCENTIVE: The amount varies based upon the amount of the qualifying transaction. A taxpayer who qualifies for the exemption must claim the exemption in a manner prescribed by the Indiana Department of Revenue (DOR). Form (IT-20REC), used to claim the exemptions, is available at www.in.gov/dor/tax-forms/.

CARRY FORWARD: In years when a company has no or insufficient income, the credit can be carried forward to offset tax on future income. In most cases, credits that cannot be used immediately (due to losses) will carry forward for up to 10 years.

RETROACTIVE CLAIMS: Indiana does not allow a carryback, although for federal purposes, a taxpayer can claim the credit retroactively by filing amended returns for the

past three tax years (or more if the company had losses during that time).

DOCUMENTATION: If you envision a time when you might claim the credit, either now or in the future, start by documenting potential projects (products or processes). Evaluate all of your company's activities for eligibility, then track all qualifying expenses and documentation supporting these costs. Documenting projects and expenses can attract investors and increase your company's value.

To start, begin by collecting documents that substantiate amounts including financial, tax and payroll records. Collect documents that provide nexus between the amount and the activities performed (project accounting or time tracking records). In addition, collect documentation that identifies and demonstrates the qualified nature of the activities.

Documentation examples include: employee time tracked to projects, project development notes, test reports, project designs, email communications, mock-ups or models. For software development projects, information extracted from project management tools or repositories that help demonstrate a process of experimentation may be included as documentation.

Remember to retain notes, design revisions, and other supporting documents related to potentially qualifying projects in one central location. Isolate and track expenses related to potential activities in a manner that works for your business and accounting system.

RESEARCH AND DEVELOPMENT SALES TAX EXEMPTION: There is a 100% sales tax exemption for qualified research and development equipment and property purchased. Taxpayers may file a refund claim for sales tax paid on such a retail transaction if this option was deferred during the initial transaction.

Step 1: Does the activity or business component ¹ qualify?

- There's technical uncertainty
- There's a process of experimentation
- It's technological in nature
- It's conducted for a qualified purpose
- **It is not:**
 - Research performed after commercial production
 - Duplication or reverse engineering
 - Adaptation or custom-built component for a particular customer's requirements or needs
 - Survey studies, market research or routine data collection
 - Foreign research performed outside of Indiana
 - Funded research
 - Research in the social sciences, arts, or humanities

IF YES, MOVE TO STEP TWO

Step 2: Does the expense qualify?

It's for qualified wages, supplies, contract research, or corporate leasing.

If wages:

- They're W-2 taxable income
- They're paid to an employee who performs or directly supports or supervises qualified activities
- They meet the "substantially all" test

If supplies:

- They're either tangible personal property, extraordinary utilities, or computer server leasing expenses
- They aren't capital items or general administrative supplies

If contract research:

- IT would qualify if performed by a direct employee
- It's performed under an agreement that puts the credit claimant at financial risk while granting it substantial rights over the final product
- Generally, it isn't more than 65% of what's paid to the contractors

If computer leasing:

- It's paid to a cloud service provider for hosting software under development

IF YES, IT COULD QUALIFY!

¹ If the business component is software, the tests will be different.

