

Research tax credits for trading platforms

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Find out if your company can benefit from the new alternative simplified method.

Overview of the opportunity

Many Quantitative Funds, Mutual Funds and Broker Dealers have increased their software development expenditures to develop new investment modeling and trading technologies. These expenditures on new technology may qualify for the research & experimentation tax credit. Recent tax code changes, first available for 2007, may make it easier to calculate the credit.

The new Alternative Simplified Credit allows financial service companies to calculate their credit based on research activities in the most recent three years, rather than requiring a base period calculation from up to 24 years ago. This new method of calculation can make it practical for financial companies to claim the research credit while building a sustainable audit trail for the IRS.

What is the alternative simplified method?

The alternative simplified credit is equal to 12 percent of the qualified research expenses for the taxable year that exceeds 50 percent of the average qualified research expenses for the three preceding taxable years.

In the event the taxpayer does not have qualified research expenses in any one of the three preceding taxable years then the credit will equal 6 percent of the qualified research expenses for the taxable year.

The new alternative simplified research credit is first available for tax years beginning in 2007.

Hasn't the credit expired?

The research credit expired after 2007. However, the research credit has frequently expired and been retroactively restored in the past. A number of legislative proposals to retroactively extend the credit at least through 2008 are pending.

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What is the benefit?

The following chart shows the benefit for 2007:

Tax year 2007	
2004 QREs	10,000,000
2005 QREs	10,000,000
2006 QREs	<u>10,000,000</u>
Total QREs (3Ys)	30,000,000
Ave. annual QREs	10,000,000
50% of ave. annual QREs	<u>50%</u>
Base amount	<u>5,000,000</u>
2007 QREs	<u>10,000,000</u>
CY QREs > Base amount	<u>5,000,000</u>
Research credit percentage	<u>12%</u>
Total gross research credits available	600,000

What activities qualify for the credit?

There are three types of costs that qualify for the research credit: internal wages of software developers and direct support personnel, supplies and contract labor. Typically for the quantitative funds, mutual funds and broker dealers, the software projects that will possibly qualify for the research credit are those that are front office systems, i.e., the software that provides the trader with market intelligence and those systems that allow automated trading, clearing and surveillance.

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