Manhattan's Silicon Alley Federal & State R&D Tax Credit Opportunity

By Spencer Marr, Charles G. Goulding and Charles R. Goulding

Spencer Marr, Charles G. Goulding and Charles R. Goulding explain the technological advances being made in New York's Silicon Alley, a connected network of companies and universities, and suggest that tax planners become familiar with the R&D tax credits that may be available to companies.

On top of creating thousands of jobs, the boom in high-tech start-up industry in New York City (NYC) is sure to present substantial Research and Development (R&D) Tax Credit opportunities. Manhattan's "Silicon Alley," located in the Chelsea and SoHo neighborhoods, is attracting large and small tech companies. From a tax standpoint, the more time spent developing new products and technical services, the greater the likelihood that companies will qualify for the R&D tax credit.

R&D Tax Credit Defined

The Research and Development Tax Credit, federally enacted in 1981, allows a credit of up to 13 percent of eligible spending for new and improved products and processes. Qualified research must meet the following four criteria:

1. new or improved product, processes or software;
2. technological in nature;
3. elimination of uncertainty; and
4. process of experimentation.

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Eligible costs include employee wages, cost of supplies, cost of testing, contract research expenses and costs associated with obtaining a patent.

The New York City Tech Market

A recent Wall Street Journal report puts the current number of high-tech jobs in Manhattan at 90,723, up from around 70,000 in 2005.[1] While much of this growth is due to the establishment of large national headquarters for tech giants such as Google, Twitter and Yelp, the increased number of high-tech jobs also reflects the entry of many small companies into the city market. These companies are lured to Manhattan because of the access to talent, investors and customers Silicon Alley provides.

The high concentration of resources in one geographic area provides efficiencies similar to those enjoyed by companies clustered in Silicon Valley, California. R&D activity in both areas reflects a movement toward interconnectedness and open knowledge sharing. Rather than pour large sums of money into in-house R&D programs, high-tech firms are finding ways to leverage the knowledge and creativity of outside sources. Geographic clustering facilitates this trend.[2]

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Manhattan's local officials are making their best efforts to promote further development of Silicon Alley. For instance, the city plans to assist many potential applicants in obtaining jobs at newer start-ups. Further, the deputy mayor for economic development, Robert K. Steel, has gone on record saying that the attraction and retention of technology companies is central to the city's long-term economic growth plans.[3]

Creating a High-Tech Campus

Another way in which NYC aims to promote Silicon Alley is through the creation of a new, vast, tech-centered campus. When Applied Sciences NYC, a division of the New York City Economic Development Corporation, solicited proposals for the campus, they underestimated the volume of submissions they received. Several of the nation's leading research institutions, ranging from New York University (NYU) and Stanford University to the New York Genome Center and the Mount Sinai School of Medicine, have garnered attention for their ambitious plans to develop anywhere from 400,000 to 2,000,000 square feet of research and applied science laboratories. Each submission has been so impressive that Mayor Bloomberg recently hinted that the city might be willing to help fund two research campuses.[4]

Even before being announced winner of the Applied Sciences NYC proposal in April,[5] NYU already had created a momentum shift in the city towards increased research facilities by merging with Brooklyn Polytechnic Institute. The merger, which occurred in 2008, greatly augments NYU's technical course offerings.

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The Added New York Benefit

In addition to the R&D tax credit, New York State offers an additional 18-percent credit for Qualified Emerging Technology Companies (QETC). To qualify, a company must meet requirements similar to those for the R&D tax credit. In addition, a qualifying firm must have:

- 100 or fewer full-time employees;
- at least 75 percent of full-time employees employed in New York State;
- annual sales less than $10M and gross revenue less than $20M; and
- New York-based R&D expenses must be over six percent of net sales.

Additionally, New York State qualifying companies must be in one of the following industries:

- information and computer technologies;
- advanced materials and processing technologies;
- engineering, production, and defense technologies;
- electronic and photonic devices;
- biotechnologies; or
- remanufacturing technologies.

The start-ups now moving into Silicon Alley are primed for the QETC credit, as the majority of them are in a qualifying industry and meet the criteria necessary to receive an 18-percent R&D tax credit. The QETC credit has the added benefit of being fully refundable, unlike the federal R&D credit. This means that a qualifying company without the tax capacity to utilize the credit can essentially use the New York State credit as cash venture capital funding.

Facebook "Friends" New York

According to Chief Operating Officer, Sheryl Sandberg, Facebook will add thousands of jobs in 2012,[6] likely due to its proposed IPO. Eager to court the tech giant, New York City has unveiled plans to assist Facebook in opening its first engineering space outside of Silicon Alley in early 2012. In so doing, the city is poised to capitalize on many new jobs Facebook plans to create, providing Silicon Alley with one of the industry's prize tenants.

Conclusion

Like Facebook itself, Silicon Alley is a connected network of companies. The innovations which result from this nexus of activity will frequently be collaborative in nature, reflecting the efforts of an entire ecosystem including universities and tech firms, large and small. Federal and New York State R&D incentives reward these efforts. As Silicon Alley develops, tax planners should familiarize themselves with how New York is preparing for the future.

Endnotes

1 Wall Street Journal, 2005, available online at *http://online.wsj.com/article/SB10001424052970204531404577050661264784408.html?mod=googlenews_wsj*.

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