-- Speaker 0 00:00:04 Make It Right. The manufacturing podcast.
Speaker 1 00:00:10 How often does your manufacturing company bid on a project or improve a product or a process, or even manufacture a new size of a product? These activities cost money and in America, they also qualify for R and D tax credits though. Many may think that these research and development tax credits are for technology or drug companies. In fact, 70% of all tax credits are claimed by manufacturers. Welcome to the maker ride podcast. I'm Janet Eastman. And this week on the show, we're going to look at ways American manufacturers can save a significant amount of money by using R and D tax credits. There are nine common activities that manufacturers perform things like determining requirements and quoting on sales projects to trial production runs and quality approvals. They can all qualify for R and D tax credits. My guest today is John Madsen. He's vice president and manufacturing practice leader at Black Line Group. Black Line Group, are R and D tax credit experts. And John was last on, Make It Right back in August of 2018, our very first year on episode 16. So it's great to speak with you again, John. Thanks so much for being back on the show.
Speaker 2 00:01:20 Hi Janet. Thank you so much for the opportunity to share.
Speaker 1 00:01:24 Oh, my pleasure. When I actually was looking at a Black Line Group's website recently, I saw this fantastic thing about the nine manufacturing activities that qualify for R and D tax credits. So I got really excited and had to give you a call. So you talked to a lot of manufacturers and right now I'm curious to know how they're doing in this time of COVID-19.
Speaker 2 00:01:45 Sure, sure. Uh, in general, you know, business was great in the beginning of the year and kind of that, uh, end of February, beginning of March, the effects of COVID, uh, began kind of a downturn on the manufacturing industry. And, um, unless you were in some product related to the COVID with face shields or mass or something like that, uh, we, we saw a dramatic slide in business kind of like late February, early March, uh, hitting bottom, right around the mid may timeframe, uh, hearing from businesses, they were off anywhere from 25 to 45% during this time. And, uh, sometime kind of that late June, early July, uh, we started to see a little bit of a turnaround and for many of them, uh, we saw kind of a dramatic spike in business and, uh, polling, many of them just last week, uh, were they're expecting business to finish somewhere around like minus 10% to plus 5%. So to go from, you know, minus 45 to, you know, minus 10 or plus five is a dramatic turnaround in a very, very short period of time.
Speaker 1 00:03:08 <inaudible> so this is a good time for people to be taking care of, uh, taking advantage of these tax credits are manufacturers actually doing that?
Speaker 2 00:03:19 We are, you know, my concern was that a business for BlackLine group would not be a very good this year. If I'm many of the businesses we work with, we're going to have a bad year. And, um, you know, it seems like a lot of them, at least our current clients are returning. Um, so there are a number of clients out there that, uh, certainly could take advantage of this and use it to, you know, not only help the business, but maybe reinvest in some technology or, or things of that nature to help their business to be even a little bit better. Um, some of the, some of the companies out there were forced to lay people off, uh, when the PPP money ran out. So this might be a good revenue resource to, uh, reinvest in maybe automation for some of those employees that maybe didn't return to the business.
Speaker 1 00:04:22 So you have, um, a test that you can have people go through to figure out if they're going to qualify for these R and D tax credits. So explain how this four part test works.
Speaker 2 00:04:34 Absolutely. Uh, I think there's about 805 pages of tax code related to R and D tax credits, but a BlackLine group, we just really like to simplify it. And the four part test is, first of all, the permitted purpose, are you intending to develop or improve a product or process for yourself or for your customers? So here's where a lot of manufacturers get hung up. Even if their customer gave you a blueprint or a CAD file told you the material to make it out of, uh, gave you the specifications, that is t --

-- he qualification to manufacture the part, but the secret sauce comes in how you make that part. So is there, you know, something related to function, performance, quality, reliability, or even cost reductions under that permitted purpose, uh, that these are kind of the highlighted activities that I could qualify. Uh, number two is technical uncertainty.
Speaker 2 00:05:39 You know, of course you have the capability or the methodology to make these products. Otherwise you wouldn't be in this business, but it's how you make the product. So in that, how, where is the uncertainty, you know, unfortunately when ran a midsize manufacturing company, we through probably 85 to 90% of the quotes, we did write in the trash at the end of every year. So we had a saying, we'll worry about it when we get the job, you know, is that the right plan? Well, when you're throwing most of your quotes in the garbage, you're going to have some uncertainty when you are awarded that job. So what is the uncertainty, which is number two, that goes hand in hand with number three, the process of experimentation, which is evaluating those alternative, what is the best choice? What is the right machine to run it on, to hold the tolerance? What is the, you know, are you going to prototype something before you go into full production or build a tool? So two, the uncertainty side and three, the process of experimentation is answering that uncertainty question. And then lastly is technological in nature. So the activities must rely on the following sciences, which include engineering, physical computer, or biological science. So at the end of the day, could you claim an R and D tax credit for improving a website? The answer is no, it must rely on the four part test.
Speaker 1 00:07:23 Hmm. And you were talking about all the quotes that you threw in the garbage, um, even if you don't land a job, but you've done the research in order to apply or put that quote forward, is it correct? In my understanding that you can actually apply for a tax credit for that?
Speaker 2 00:07:43 Absolutely. The time that it is put forth to design the process, you know, basically whoever is putting that quotation together has to consider, you know, what type of material how's it going to flow, or how's it going to bend or, you know, based on the industry and then all of the parameters related to that, what comes next? What does the process are you going to have to drill or tap or trim? And at the final stage, how are you going to package it? You know, is it something that is so delicate that you may need some special packaging to get it from your manufacturing facility to either the customer or the product user? So the answer is yes. Um, these are qualifying activities and the time put forth to put these quotes together. Now I'll qualify. It's new quotes. If you're doing a requote where you're just, you know, reevaluating, updating material price, or an outside vendor that is contributing to the manufacturer, this product that would not qualify, but the time put into new quotes or even revisions, uh, certainly can qualify,
Speaker 1 00:09:05 I guess it all comes down to that word research, right? If you have to do a bunch of work to figure out, um, how you would actually, um, do the job that is associated with that quote that's research and it's a tax credit,
Speaker 2 00:09:20 It is, it is. Yes.
Speaker 1 00:09:22 Okay. So there are nine manufacturing activities that can qualify for these R and D tax credits. And some of them are quite surprised at code. Can you give me just a really quick overview of the activities that qualify? And I know you've mentioned a couple of them, but just give me a quick overview.
Speaker 2 00:09:37 Sure. Absolutely. Um, many times when people are looking at these activities, they forget about where the process starts to begin with. And that is with some of your salespeople. Now, each organization is a little bit different. Some may have, you know, outside sales reps, internal sales reps, or sales people that actually do the quoting. But you know, if a sales person is taking somebody golfing or out to lunch, obviously that is not an R D related activity. But what I like to say is if they're involved in a portion of the fit form function side of the equation, they are now starting to gather information that they may use to quote that project themselves, or hand that information off to an engin --

-- eer that may help design a tool or whatever related to that. So this is where we start, you know, in the sales, then it may go to design meetings where the sales person is handing off the information.
Speaker 2 00:10:44 Again, depending on the size of this project, uh, you may get a number of people involved. What I did was, you know, if it was a unique welding job, I would bring people from the shop into this meeting to help participate. So we could engineer actually the very best process, which should give us the very best, a quote, or make suggestions back to the client that makes it easier for us to manufacturer. And again, hopefully lower their quote could be related to, you know, once you're awarded that project, you know, who's beginning the process, who's designing the layout who might be doing, you know, if it's sheet metal of flat blank layout or designing the process, sometimes estimating we'll put together their best guess. But now that the project has been awarded, sometimes some companies will have somebody do a overview to make sure that process still makes sense.
Speaker 2 00:11:51 Next step could be toolmaking, you know, who's doing the drawing, who's doing the product trial tool layout. Who's building that tool. These are all qualifying activities, um, could be engineering that process. Now, did somebody come up with a better idea? You know, let's incorporate that, uh, once it hits the shop floor, you know, how do you prove out that process? You know, as setting it up, we look at not only the person doing the activities, but we can look at one up supervision or in other words, who do they ask if they have a question or a concern? So it could be related to setting up the job who is setting it up for the first time, uh, who's doing the programming. You know, these are related activities that certainly could qualify including quality. They are part of the process. So if they're writing an ICER P pap, um, some of these things that is, uh, determining that the product that was manufactured is not only good, but it's stable.
Speaker 2 00:13:01 You know, that product product one, they manufactured is the same as product 100. So it could even be a warrant, parts, submissions, uh, control plans. Uh, FMLA is these were all related activities that could qualify under the quality. And then back to packaging, you know, if you're dumping them all into a box, a standard cardboard box, of course, that would not qualify, but you know, today returnable containers are important. If it's a large uniquely shaped item, uh, there may be some design work that goes into that returnable container, or even if it's a small machine delicate part, uh, there might be some uniquely designed egg crates again, to protect that product until it reaches its final destination. Hmm.
Speaker 1 00:14:01 So those are the nine that actually qualify. What are some of these qualifying activities that are really hard for manufacturers to spot or recognize,
Speaker 2 00:14:10 You know, to the untrained eye. Many manufacturers really don't realize what could qualify because they are just doing their day to day, day to day activities. And really don't have that manufacturing eye to look at it as a third party. But, um, you know, these are some of the activities that I qualify even, you know, maybe maintenance, you know, that is kind of a, a hidden gem as well. And by maintenance, you know, it is not oiling presses or, or things of that nature, but many times the maintenance person or team has some unique skill sets that, you know, I need a tray this high to catch the parts. So we don't damage them. And after a little bit of grumbling from the maintenance group, uh, sure enough, that afternoon, they come back with something they designed and built. So things of that nature may also be included into the manufacturers R and D tax credit.
Speaker 1 00:15:19 Wow. So in this time of COVID like some manufacturers have completely changed their products and their processes to meet the challenge of COVID-19. So this would be an example of where a manufacturer could really take advantage of the R and D tax credits in this particular year. Right?
Speaker 2 00:15:36 Absolutely. Um, many manufacturers, um, you know, are ingenious, just leave the manufacturing community alone and they will figure out how to abide by the rules, uh, whether it's a pandemic or tax change or whatever it is. Uh, they're they're --

-- geniuses. So even related to this, did they develop a new product? You know, again, are they making face shields? Are they making something related to COVID? Uh, so if they've developed a new product or a new process for themselves or for their customers could be dividers between employees, uh, could be in dividers for lunch rooms again, to help keep their, their employees or, you know, even make that product for sale. These are things related to COVID that certainly are worth talking about and could qualify.
Speaker 1 00:16:34 So what is the actual key to being successful when applying for tax credits, you might be doing all of this stuff, but how do you prove that you did it?
Speaker 2 00:16:43 Sure. And that's where we partner with those manufacturers and help them, you know, qualify those activities. Uh, we won't claim a dime on your behalf without justifying and knowing. So, uh, working with a tax partner is certainly a activity that would, would help. So knowing the tax law, knowing the four part test and knowing, you know, the activities, what we do is we walked through those activities and I give the clients a, uh, estimate of what their state and federal credit would be in, along with our fee. So at that point they would know what the credit is, their ROI and related to that, they would be able to determine if this is an activity that makes sense for them.
Speaker 1 00:17:39 Is there a documentation that they have to provide and time tracking for their employees and whatnot too, to show how much time and activity was invested to apply for these tax credit, not to apply for the tax credits to actually qualify for the tax credits?
Speaker 2 00:17:55 Yeah. Uh, certainly if, uh, the business has time-tracking, uh, that is a great place to start because many of the employees in the factory do track their time punch in and out of individual jobs that is extremely helpful, but not necessary. Um, so you've got your engineers, maybe you're quoting people on salary and kind of the office. What we do is we interview them and these activities now are documented based on, again, that four part test, you know, where was the permitted purpose? What was the uncertainty? And again, what did you do to solve that uncertainty? So those are the things that we help them qualify and document.
Speaker 1 00:18:43 Are there some tax credits that almost all manufacturers should be able to claim?
Speaker 2 00:18:49 Sure. Uh, of course, many manufacturers went out there and they're aware of the carers act and with the cares act, uh, I think that started about March 27th of 2020. You know, there are some things within the cares act. Of course, everybody heard of the PPP, let some things out there that are not maybe as known are the net operating loss that can be carried back up to five years. So if you had, um, maybe losses in 2019, or even 2020, uh, even a loss incurred in 2018, they can now be carried back, um, a previous of five years. So that's something they can work with their CPA on. So if they were profitable, you know, five years ago, those losses could be feathered out making this year, you know, a little less painful for the manufacturer.
Speaker 1 00:19:54 Okay. So explain how the total qualified research explain expanse or that Q R E is calculated. And also just how the value of the tax credit is determined. So people can get an idea of, you know, what potentially, you know, if they're guesstimating, what their tax credit might be
Speaker 2 00:20:13 Sure what we do under the qualified cost are the QRS. There are three main areas to look at. One is wages. So again, we go back to that four part test who in your organization is doing something related to the four part test. And we would look at their W2 box, one wage and through conversation and documentation, we would determine, you know, at that point who qualifies, who does not, or a percentage of the day we on theory that they do qualify. So for example, a salesperson may only qualify at a lower percentage. An engineer may qualify at a much, much higher percentage set up people. All of these people will qualify at a different rate. So we would look at their W2 box one wage, let's say it's $100,000 simply because I like easy math and, you know, a salesperson qualified at 20% of their day.
Speaker 2 00:21:26 So 20% of a hundred thousand is $20,000 that would go into the qualifying costs bucket. We would t --

-- hen go through all of the employees that are related to again, the four part test and get a total of wages. The next thing we would do is look at supplies. So under supplies, what was used in the process of experimentation, what was tried, you know, if you're a machine shop and there was this very unique cutter out there that was guaranteed to give you five times the tool life, but it was a thousand dollars and you kind of say, Oh, you know, that's pricey. But if you know, we're going to get five times the tool life, it might be worth it. Of course, I'm making this all up as we go. So the R and D tax credit is there to offset some of that risk of trying quote unquote, R and D related activities.
Speaker 2 00:22:30 So if that a thousand dollar cutter did not work, that's something that you could drop into the supplies bucket, or if you're building a tool, things related to that, there are items within building a tool for the first time that can drop into supplies. And then lastly is contractor research. So under contractor research, uh, to simplify it, what I like to say is some expertise that is needed that may not be within the four walls of your building. So it could be a, an influx of business. And you had to reach out to a, another engineering firm to help you, or you hired some 10 99 employees, uh, engineers to help you solve a problem or lay out a building or something. You know, we're gonna look at all of these activities and help you determine if that qualifies or not, um, could even be as simple as reaching out to a metallurgist to verify the product to your building or the raw materials you're using is exactly what it says.
Speaker 2 00:23:43 So things of this nature, you know, outside of your expertise that is needed to help you with this product. So those would be the three main areas under qualifying costs. So then what we would do then is total that all up, based on your wages supplies, we can take those at 100% of your invoice contractor research. We take that at 65% of that invoice do our calculations. And somewhere between eight and 12%, again, this is a very generalized discussion, but eight and 12% of the grand total would eventually be your R and D tax credit. So again, some States allow state credit, but of course federal credit would apply to all manufacturers.
Speaker 1 00:24:39 Wow. Okay. So I'd like you to share a story with me where you've seen R and D tax credits benefit of man you CA manufacturing company.
Speaker 2 00:24:48 Oh, well, let's see. Um, I've had 40 years in contract manufacturing. So when I am able to walk into a factory and look around, um, there are opportunities everywhere, and this was a manufacturer in Minnesota and, uh, about 12 to 13 million in revenue is the size of the business. Um, he said, you know, I've had two or three other firms come in here, John, I do not do R and D. I just make custom products for my customers. So custom products is one of those trigger points that goes off and said, you know, can, can we talk a little bit more long story short, uh, like many manufacturers, they have displays in their lobby and having an engineering and tool and dye design background. I can't just look at them. I got to pick them up. I got to hold them and look at them.
Speaker 2 00:25:52 And, uh, when the owner walked into the room, my first comment was, you know, if you form this bird down, uh, on this form, you wouldn't have spent so much time grinding those particular part. And he looked at me and said, you're not ordinary CPA. Are you? I said, I never claimed to be a CPA. So fast forward, uh, we took a tour, uh, we went through the four part test. We gave them an estimate of what we believed his credit would be. We actually exceeded that estimate and that 13 million in revenue customer, we found them $1.3 million in tax credits.
Speaker 1 00:26:36 Oh, wow. I bet you, he was happy.
Speaker 2 00:26:41 Yeah. I think I made his card list. So what in turn, what he did was he reinvested that right back into his business. So he bought a new break. He bought a used turret and a laser, and he said, you know, because of the R and D tax credit and the expertise that came with it, he said, I can see myself being profitable by re manufacturing parts and an updated new way, uh, to be profitable well into the upcoming years. So I'm just one of many stories. We have a black line.
Speaker 1 00:27:21 Wow. That's amazing. So h --

-- e did, he did say that that key word, which was custom, which means research. So these are things that you really have to, if these are falling out of your mouth, when you're talking about your business, you probably do qualify for an R and D tax credit. Um, John, I'm curious for some tips that you can give to manufacturers when they're looking at their business, you know, just that really top line overview. Like if I take a quick look at what I do in my business, can I see some R and D tax credits? What would you give them as tips to look for?

Speaker 2 00:27:53 Yeah. The first tip is if you are a contract manufacturer, I mean, that is a sweet spot because you are manufacturing custom products for your customer. Um, if you have maybe tried some automation, if you are looking at, uh, upgrading equipment, uh, some things related to this, um, and even related to software, there are opportunities on software, not, you know, buying a, the latest edition of solid works, but if you are actually writing code to customize something within your manufacturing facility, there might be opportunities related to that.

Speaker 1 00:28:42 Wow. Okay. We're almost out of time, John, but BlackLine group has this one minute assessment that can help a business learn if they qualify for tax credits and it is on your website. So it's pretty quick to, to fill out and it's right on the, how we help section of your website. Is that correct?

Speaker 2 00:29:00 That is correct. Www dot BlackLine, G R p.com backslash how dash weed dash help. And, uh, I would be more than happy to talk to anyone and just walk them through the process to see if this qualifies and would help their business, you know, be a little more competitive, grow faster and increase their profitability.

Speaker 1 00:29:25 Well, there is gold in them there tax credits, uh, John. So thank you so much for taking the time to talk to me.

Speaker 2 00:29:31 Thank you so much for allowing us to share with the manufacturers. And, uh, hopefully they use this money to reinvest it back in their business. John, with BlackLine

Speaker 3 00:29:42 Group, it's John Madsen, and he is the vice president and manufacturing leader at Black Line Group, the're R and D tax credit experts. That is our show. This week, you can check out Twitter and LinkedIn feeds to share more manufacturing information with you, and you can find our podcast on iTunes, Google play, Stitcher, Spotify, and YouTube. Make It Right is brought to you by KevinSnook leadership advisor and author of the bestselling book, Make It Right. Five steps to align your manufacturing business from the front line to the bottom line. I'm Janet at Eastman. Thanks very much for listening to Make It Right.

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