

Unique challenges

How life science companies can reduce tax-planning complexities **Interviewed by Arthur G. Sharp**

Life science companies face unique challenges in their operations that are often too complex for them to resolve alone. Among them are accounting for equity and debt financing transactions and licensing arrangements.

According to Scott Taylor of Burr Pilger Mayer LLP, “The main obstacles life science companies face are concerns about the amount of cash they ‘burn’ in doing their research and development work. They must raise capital financing constantly, unless they can raise significant amounts of funding all at once, which is difficult to do in these uncertain times.”

Ideally, then, companies can benefit from accounting professionals’ counsel as soon as they acquire their first sizable amount of equity financing or when they may be looking at a product launch in the near future that will generate taxable income.

Smart Business spoke with Taylor to get an idea of the benefits life science companies can derive from working with accounting professionals.

Why is it so difficult for life science companies to raise funds today?

Capital markets have become less fluid recently. That makes it difficult for life science companies to raise debt or equity financing. Therefore, they have to look at cutting costs to extend the time period in which their cash will last. In the biotech area, they have a lot of creative equity or debt instruments that have been developed for financing because of their need to raise capital for R&D.

What challenges exist for life science companies from a tax-planning perspective?

On the tax side, life science companies must grapple with the concept of stock-based compensation for employees. Companies will incur problems in the area of stock options if they don’t evaluate the fair value of their common stock frequently — preferably annually. Other areas that affect life science companies from a tax-planning view involve acquisitions, net operating losses (NOLs) and initial public offerings (IPOs). For instance, if a life science company is about to be sold, e.g., through an M&A transaction, or by going public, it might want to look at its NOLs closely for ‘changes in control’ (Section 382 limitations).



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How do losses affect tax planning for life science companies?

Life science companies frequently incur losses when they are doing R&D work. In such cases, it helps them to let accounting professionals look at their NOLs to advise them on how to work with their losses most effectively so they can be used to offset future taxable income. Additionally, there can be a limit to how much of those NOLs they can use if they have a change in control.

An additional concern on the income tax side is that issues arise when a company is starting to see product sales. There will be income tax considerations at that point. When companies become profitable they may not have to pay income taxes if they can offset taxable income with NOLs.

Can life science companies doing qualified R&D work get a tax credit for it?

Yes. They have to determine in this case if they are properly capturing whether the qualified expense they are claiming is truly an R&D credit. That becomes an important consideration when a life science company turns profitable. Companies should not wait for that to happen,

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because contemporaneous documentation is normally required to sustain R&D expenses and tax credits.

How do accounting professionals help life science companies?

They can help companies from the start-up phase to IPO. Accountants can close the books on a monthly basis, provide reports to the board of directors and investors about the company’s financial performance, and do audits when required, for example, when there is venture capital equity financing involved. Remember, parts of the equity transaction documents for the stock financing often require an annual audit.

Once a life science company turns public, accountants can do its public company audits and assist with other SEC filings. These services help life science companies avoid the pitfalls that can trap them if they try to do their accounting, tax planning and compliance themselves.

What pitfalls exist?

The accounting requirements for stock-based compensation, stock options, restricted stock, preferred stock financing or licensing agreements have a lot of complexity under GAAP. Consequently, there is some likelihood that life science companies would misapply the proper accounting.

On the tax side, they might forget to take certain important elections that are often done in a company’s early years. They might not capture R&D tax credits properly or consider capitalizing and amortizing R&D costs properly in order to extend the deductibility of those expenses. There is no need for life science companies to run those risks — or incur the costly penalties that can result if a company submits incorrect income tax returns to the IRS that might get audited. In such cases, they might have a tax liability or a tax penalty. <<

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