



NEW JERSEY'S E-COMMERCE INDUSTRY PREVAILS WITH HELP FROM R&D TAX CREDITS

Federal and State R&D Tax Credits provide excellent opportunities for many businesses in New Jersey involved in the E-commerce industry to distinguish themselves from the competition.



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The rapid growth in New Jersey's E-Commerce sector has greatly accelerated as a result of the pandemic. New Jersey is perfectly located to meet the needs of product sellers and logistics companies serving the NYC metropolitan area, the mid Atlantic, Philadelphia and Washington D.C. New Jersey has 11,000 manufacturers and 110,000 retailers, most of which are now doing some sort of e-commerce.

E-COMMERCE

A sheltering, at home public is shying away from retail and restaurants. Working with NJMEP, our New Jersey clients are taking advantage of E-commerce and R&D tax credits. The industries these clients are in vary, but generally they include:

1. Food processors,
2. Apparel manufacturers and distributors,
3. Candy, energy bar and snack companies,
4. Personal care product including cosmetics and hair products
5. Giftware
6. Home goods and décor items
7. Kitchen and cooking products/appliances
8. Electronics
9. Jewelry
10. Pharmaceuticals
11. Parts Companies

RETAIL E-COMMERCE CONVERSION

The November 2020 announcement by TJ Maxx that it was starting an E-commerce initiative was significant. TJ Maxx, owner of the largely successful 4,000 TJ Maxx, Marshalls and HomeGoods store brands, has been a steadfast retail holdout that long resisted E-Commerce. In November 2020 things changed. Its CEO, Ernie Herrman, said, "Customers have been reluctant to return to bricks-and-mortar stores." Also, in November, Amazon announced a major e-commerce prescription drug program that caused major drug retailers to suddenly reduce their prices.

In fact, in-store spending fell by 52%ⁱ in the Northeast this past Black Friday; it fell by 42% in the Southern United States. This past 2020 Black Friday was all about online retail and e-commerce appeared to be the panacea for Covid – wary shoppers this year.

JEWELRY

When people hear Tiffany[®] they think of the quintessential 5th Avenue New York retail jewelry store. However that small location pales in comparison to Tiffany's huge distribution centers in Whippany, New Jersey and Parsippany, New Jersey. The days of visiting jewelry stores and trying on a piece before purchasing has now been limited to fine occasions (i.e. engagements, anniversaries, etc.). Between 2017 and 2018, online jewelry sales increased by more than 14%.^{iv} The 42 jewelry retailers tracked by "Internet Retailer" generated more than \$5 billion in e-commerce sales in 2018. It appears that consumers are losing their hesitations about buying expensive jewelry online.



Tiffany & Co. Customer Fulfillment Center, Parsippany, NJ [Source: BusinessYab]

FOOD

With reduced restaurant hours, travel constraints and seating limits, Americans are eating home-cooked meals, and prepared meals. We work with multiple New Jersey prepared food companies that are using technology to showcase products on the web, process orders and coordinate preparation and delivery. Sales of packaged and prepared foods that were declining pre-pandemic have since rebounded. Some of our food industry clients have had to become resourceful during this time and modify their product offerings as well as streamline their production processes (i.e. maintaining Covid guidelines for distancing, etc.).



Meal Kit Delivery Services

SHOPIFY SOFTWARE ENABLES E-COMMERCE VENDORS TO HAVE MORE OPTIONS

Shopify has revolutionized the e-commerce industry in that it provides online vendors an easy-to-use alternative to Amazon. Shopify has provided smaller vendors with an online selling platform on which they can manage, market and sell their products. Customers have a consistent experience while on the site and vendors can manage their payments, shipping and inventory on this platform, as well. Shopify is also less expensive than Amazon's Professional plan option and more scalable and transparent. In the third quarter of 2020, Shopify's gross merchandise value was \$30.9 billion, more than double that of a year ago. Shopify has been expanding its offerings on the e-commerce "back-end," including logistics, shipping and fulfillment. Shopify has a market cap that exceeds \$100 billion. Last year it surpassed Ebay to become the second largest e-commerce preference in the United States, following only Amazon.^v In September 2019, Shopify announced the acquisition of 6 River Systems, a Massachusetts-based fulfillment solutions company.^{vi} This purchase was intended to help fulfill the growing demand for its e-commerce platform.

THE FEDEX TAX CASE

The Federal tax authority for E-Commerce and Distribution centers obtaining R & D tax credits became clear when FedEx won a major tax case for a large R&D tax claim. In the late 1990s, Federal Express incurred large expenses developing internal use software related to package tracking. It has always been understood that internal software R&D tax claims had to be a bit more innovative, involve some more economic risk, and not be available off the shelf. The IRS challenged the FedEx claim asserting that internal software claims "had to be unique or novel, had to be as significant and inventive as prior software based on new regulations." The court, however, disagreed with the IRS' approach and allowed Federal Express to take the R&D tax credit. In recent years, software has become much more integral to the U.S. economy, and the FedEx case highlights how the entire transportation, logistics, and distribution industry is no different. It became clear that the transportation, logistics, and distribution industry can be entitled to R&D tax credits thanks to Federal Express winning this important tax case.



E-COMMERCE TECHNOLOGY EXAMPLES

Globally, the e-commerce industry is worth about \$221 trillion according to the United Nations Conference on Trade and Development (UNCTAD). In 2019 alone, it is expected that internet retailers will have amassed approximately \$1.92 billion in global sales. Large online retailers are revolutionizing the way in which consumers shop in today's market. In meeting consumer demands, online retailers and e-commerce companies must invest heavily in research and development, enabling them to continually innovate and improve on existing products and processes. E-commerce companies engage in extensive research and development whether it is improvement in warehouse and distribution processes, software integration, or custom developments, internet retailers are vigilant about consistently improving processes.

The volume of goods being processed in today's E-Commerce facilities is so immense that these businesses must automate to increase throughput. The projects we work on include, and are not limited, to warehouse management systems (WMS), conveyor systems, automation, sensors, voice-activated robots, robots for picking, packing, and truck loading, and collaborative robots, or "co-bots," for logistics support.

E-commerce is an industry that is at the intersection of warehouse improvements and software development. A warehouse is not merely a large building that stores items. On the contrary, there is a lot of logistics coordination, inventory accuracy and throughput analysis that is often underway at these warehouse/fulfillment centers. One of our e-commerce clients had several improvement projects that included: development of data warehouse solutions; new inventory solutions for warehouse operations and a whole host of software development projects to improve and streamline the online experience for their customers. E-commerce vendors are also implementing new social distancing software applications.

Just as this article was being submitted for publication, Facebook announced it was acquiring Kustomer, a start-up focused on providing agents with better data and a more unified picture of users by bringing together social media channels and companies. The deal is reportedly worth \$1 billion^{vii} and will help take Facebook from a messaging app to a purchasing one. This will require more sophisticated e-commerce platform and software development.

THE RESEARCH & DEVELOPMENT TAX CREDIT

Enacted in 1981, the federal Research and Development (R&D) Tax Credit allows a credit of up to 13% of eligible spending for new and improved products and processes. Qualified research must meet the following four criteria:

- New or improved products, processes, or software
- Technological in nature
- Elimination of uncertainty
- Process of experimentation

Eligible costs include employee wages, cost of supplies, cost of testing, contract research expenses, and costs associated with developing a patent. On December 18, 2015, President Obama signed the bill making the R&D Tax Credit permanent. Since 2016, the R&D credit has been used to offset Alternative Minimum Tax (AMT) and startup businesses can utilize the credit against \$250,000 per year in payroll tax liabilities.

THE NEW JERSEY STATE R&D TAX CREDIT

The New Jersey R&D tax credit utilizes the same definition as the Federal credit and provides a credit of 10% of the excess qualified research expenses over a base amount plus 10% of the basic research payments.ⁱⁱⁱ

There is a significant emphasis on the design process to determine what will meet the functional needs of the product as well as be flexible, adaptable and reusable for other product-types. The equipment integrated into the process must not only perform a singular function, but should also be able to be adaptable to various packaging processes and products.

CONCLUSION

New Jersey is an ideal E-commerce location. Particularly in this new Covid environment, retailers are looking online to expand. In fact, Macy's has focused heavily on its digital presence over the past few years and it paid off during this Coronavirus Pandemic since the lack of physical store sales was compensated for with a healthy 53% gain in online sales. While this was not enough to completely offset the steep decline in physical store sales this year, it did support Macy's enough during this time. So much so that Macy's has decided to "go dark" and turn some of its brick and mortar retail shops into regional fulfillment centers for online orders. Obviously, Macy's is not alone in this online trend. New Jersey also has deep in-state resources for automation and software that will help aid in this new trend. New Jersey E-Commerce sellers should contact NJMEP to obtain incentives for their innovation activities.

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