



# RESEARCH AND DEVELOPMENT (R&D) TAX CREDIT WEBINAR

---

**Presented by:** Patrick Rogers, EA, MST, Principal and R&D Director

# DISCLAIMER

*Information and training provided by Brown Plus as part of this webinar is intended for reference and information only. As the information is designed solely to provide guidance and is not intended to be a substitute for someone seeking personalized professional advice based on specific factual situations, responding to such inquiries does NOT create a professional relationship between Brown Plus and participant and should not be interpreted as such.*

*Although Brown Plus has made every reasonable effort to ensure that the information provided is accurate, Brown Plus makes no warranties, expressed or implied, on the information provided. The participant accepts the information as is and assumes all responsibility for the use of such information.*



# PRESENTED BY:



**Patrick Rogers, EA, MST**

*Principal and R&D Director*

[PatrickRogers@brownplus.com](mailto:PatrickRogers@brownplus.com)

# AGENDA

- R&D Tax Credit: *Function, History and Recent Developments*
- Qualifying for the R&D Tax Credit
- Identifying Qualified Research Activities (QRAs)
- R&D Credit Misconceptions
- R&D Case Studies Across Industries
- Brown Plus R&D Study Process
- Internal Revenue Code Section 174
- Tax Form Changes: *Reporting Requirements and Recordkeeping Requirements*
- **Q&A (Please use chat box throughout)**

# INTRODUCTION TO THE R&D TAX CREDIT

- What is the R&D Tax Credit?
- Who is eligible?
- Key benefits for businesses



# WHAT IS THE R&D TAX CREDIT?

- An incentive designed to encourage companies to develop new or enhance existing products, processes, techniques, formulas or software within the United States.
- The credit applies directly to offset a company's tax liability based on qualified research expenses (QREs) spent on qualified research activities (QRAs), including wages, supplies and contract research expenses.
- Available at both the federal and state level.
- Federal effective benefit is typically 5% to 10% of a company's qualified research expenses during a given year, with no limitation on the amount of credit and expenses that can be claimed each year.
- Is non-refundable, any unused credit can be carried back one year and carried forward up to 20 years.
- Can offset up to \$500,000 in payroll tax for qualified startups:
  - Small Businesses with <5 years of revenue and <\$5 Million in gross receipts

# HISTORY AND LEGISLATIVE EVOLUTION

- Origins of the R&D Credit
- Major Milestones
- Legislation and Key Changes

# R&D CREDIT TIMELINE

Year	Milestone	Details
1981	R&D Credit Introduced	Under the Economic Recovery Tax Act, the R&D credit was enacted as a temporary provision.
1986	Definition Narrowed	The Tax Reform Act tightened requirements, defining “qualified research” more strictly to reduce abuse.
1990s	Periodic Extensions	Congress repeatedly extended the credit, often retroactively, which created uncertainty for businesses.
2003	IRS "Four-Part Test" Guidance	Codified how companies could determine if an activity qualified for the credit.
2015	Credit Made Permanent	The PATH Act (Protecting Americans from Tax Hikes Act) made the R&D credit a permanent part of the tax code. It also expanded eligibility to startups and small businesses.
2017	TCJA Maintains Credit	The Tax Cuts and Jobs Act (TCJA) preserved the R&D credit and introduced Section 174 amortization rules (to take effect in 2022).
2022	Mandatory Amortization Begins	Businesses can no longer immediately deduct R&D expenses. Instead, they must amortize them over 5 years (U.S.) or 15 years (foreign) under Section 174.



# RECENT DEVELOPMENTS

## Proposed Legislation:

**March / April 2025:** Attempts are in motion to extend the soon-expiring Tax Cuts and Jobs Act of 2017 (TCJA) and expand tax cuts. The budget reconciliation process has begun, and new legislation will be developed over the coming months.

**House Passes Budget that Paves Way for Permanent R&D Tax Relief:** The budget deal unlocks the path to permanently extend key provisions from the 2017 tax law – includes long-awaited fixes to Section 174 and R&D expensing.

**R&D Expensing Provision Still in Legislative Negotiations:** Momentum is building for tax reform as the House targets a floor vote the week before Memorial Day.

# QUALIFYING FOR THE CREDIT

To qualify for the R&D Tax Credit, a company's innovative product, process, technique, formula or software does not need to be new to the world or new to the industry; it simply needs to be new to the business. Additionally, the company must also be able to demonstrate that activities satisfy a **four-part test** from the IRS:

1. **Permitted Purpose:** The research creates a new or improved product or process that results in increased performance, function, reliability or quality.
2. **Technological in Nature:** The process of experimentation relies on one or more hard sciences, such as engineering, physics, chemistry, biology or computer science.
3. **Elimination of uncertainty:** The research activity has attempted to eliminate uncertainty about the development or improvement of a product or process.
4. **Process of experimentation:** The company has evaluated alternatives for achieving the desired result and can demonstrate having done so through modeling, simulation, systematic trial and error or other methods.

# R&D QUALIFICATION CRITERIA: FOUR PART TEST

1 §41(d)(1)(B)(ii)

## PERMITTED PURPOSE

- New or improved product, process, technique, formula, invention, or computer software
- The purpose of the research must relate to a new or improved function, performance, reliability, or quality

2 §41(d)(1)(B)(i)

## TECHNOLOGICAL IN NATURE

The activity is undertaken to discover information that is technological in nature

3 §41(d)(1)(A)

## THE UNCERTAINTY TEST

The activity must involve technical uncertainty or risk related to:

- Capability (if it can be done), or
- Method (how it can be done), or
- The Appropriate Design

4 §41(d)(1)(C)





## PROCESS OF EXPERIMENTATION

The qualified activity must involve the evaluation of one or more alternatives where the capability and method of achieving the result is uncertain as the outset



# WHAT COSTS QUALIFY FOR THE CREDIT?

- Wages of employees working directly on the innovation, along with supervisors
- Contract research expenses, computer leasing
- Supplies, if expended in the process of R&D activities

WAGES 	SUPPLIES 	COMPUTER LEASING 	CONTRACT RESEARCH 
<ul style="list-style-type: none"><li>▪ Performing qualified research</li><li>▪ Technical supervision of qualified research</li><li>▪ Technical support of qualified research</li></ul>	<ul style="list-style-type: none"><li>▪ Tangible personal property utilized during the process of qualified research</li><li>▪ Cannot be subject to depreciation</li></ul>	<ul style="list-style-type: none"><li>▪ Owned and operated by someone other than the taxpayer</li><li>▪ Cloud computing costs most common</li></ul>	<ul style="list-style-type: none"><li>▪ Any amount paid or incurred by the taxpayer to any person/company other than employees for qualified research</li><li>▪ Includable up to 65% (75% for research consortia)</li></ul>

# WHAT ACTIVITIES QUALIFY FOR THE CREDIT?

## If you are developing:

- New or improved software concepts, algorithms or code
- Prototypes using computer-aided design (CAD) to meet specifications of customers
- New or improved concepts or hypotheses
- New or improved processes or techniques to increase overall performance
- Processes or products that meet state or federal regulatory requirements
- Robotics and automated technology

## If you are designing:

- Building and testing first article prototypes
- Custom tooling and fixtures
- A manual process into an automated one through software development
- ERP Systems

## If you are improving:

- Durability, strength and service life
- Speeds and feeds while ensuring quality and integrity of the platform / parts
- Processes including filling and sealing of products, packaging, die design techniques and minimizing environmental impact

# WHAT ACTIVITIES AND COSTS DO NOT QUALIFY?

- Efforts that would be 'routine' or keeping lights on activities
- Reverse Engineering
- Research conducted outside the U.S.
- Funded research does not qualify; not considered funded if both the economic risk and substantial rights tests are met
- Not all R&D costs qualify for the credit under Section 41; costs for land, depreciable properties, research after commercial production, marketing research and quality control are generally excluded



# R&D CREDIT MISCONCEPTIONS

- **#1: The innovation or qualifying activity must be “new to the world” or one of a kind.**
  - Regulations were proposed in 2001 and then finalized in 2003 to eliminate this “Discovery Rule,” which now means that the activity only must be “new to the taxpayer” to qualify.
- **#2: Only companies with scientists conducting research will qualify for the R&D tax credit.**
  - The definition of R&D within Section 41 of the Internal Revenue Code has expanded since it was first enacted in 1981 to include all the hard sciences, such as engineering, physics, chemistry, biology and computer science.
- **#3: Our pass-through business and shareholders are subject to Alternative Minimum Tax (AMT), so we are unable to benefit from the R&D Tax Credit.**
  - Starting in 2016, the R&D Tax Credit can now be used to offset both regular and AMT taxes if the pass-through business is an Eligible Small Business with average gross receipts of \$50 million or less over the previous three years.

# CASE STUDIES: INDUSTRY APPLICATIONS

- R&D Engagement Examples and Savings Achieved
- Manufacturing “Company A”
- Software/Technology “Company B”

# R&D MANUFACTURING CASE STUDY



Company A engaged Brown Plus to conduct an R&D Tax Credit Study for the 202X Tax Year. QRAs and QREs for this study were identified and Brown Plus documented the activities of each department where QRAs were undertaken during the 202X Tax Year.



Company A’s QRAs included improving their manufacturing process by hiring a contractor to design, build and install guards on their recutters and conveyors used in their production lines. These guards reduced and prevented injuries by blocking hazardous areas and reduced downtime. To increase productivity, Company A also initiated a project to replace its manual packaging with a flexible, automated packaging line. This included process flow analysis, efficiency studies and equipment selection and testing.



The activities were analyzed to determine their eligibility under IRC Section 41 and a sampling of projects was reviewed to support the departmental QRAs. The final step was to organize the completed documentation and other supporting materials into a study. This study serves as a main source of information for the examiner to determine whether these activities and projects satisfied the IRC Section 41 criteria.

For Tax Year 202X		
Federal	Gross Credit	\$89,550
Pennsylvania	Gross Credit	\$24,358
Total Credit		\$113,908

The breakout of the qualified research expenditures (QREs) is summarized below:

For Tax Year 202X		
	Federal	Pennsylvania
Qualified Wages	\$748,663	\$748,663
Qualified Supplies	\$-	\$-
Qualified Contract Expenses	\$278,948	\$182,503
Total	\$1,027,611	\$931,165

TOTAL 202X GROSS R&D TAX CREDIT: \$113,908



# R&D FINANCIAL SOFTWARE CASE STUDY



Company B is a start-up financial tech firm that develops tools for clients to manage, track, and analyze financial data. They engaged Brown Plus to conduct an R&D Tax Credit Study for the 202X Tax Year. QRAs and QREs for this study were identified and Brown Plus documented the activities of each cost center where QRAs were undertaken during the 202X Tax Year.



Company B’s strong focus on user experience and innovation, they continually invest in improving its product interface and underlying architecture. To maintain a competitive edge, Company B’s QRAs included developing new financial analysis modules and improving their existing products and interface process to support changing regulatory and client needs.



The activities were analyzed to determine their eligibility under IRC Section 41 and projects were reviewed to support the company’s QRAs. The study was completed and by documenting their activities and applying the IRS’s four-part test, Company B was able to claim a significant R&D tax credit. The benefit offset a portion of payroll and income taxes, freeing up capital to reinvest in further product development and expansion.

For Tax Year 202X		
Federal	Gross Credit	\$189,396
Pennsylvania	Gross Credit	\$166,264
Total Credit		\$355,660

The breakout of the qualified research expenditures (QREs) is summarized below:

For Tax Year 202X		
	Federal	Pennsylvania
Qualified Wages	\$2,145,568	\$2,145,568
Qualified Supplies	\$-	\$-
Qualified Contract Expenses	\$260,026	\$260,026
Total	\$2,405,594	\$2,405,594

TOTAL 202X GROSS R&D TAX CREDIT: \$355,660

# BROWN PLUS R&D STUDY PROCESS

- Step-By-Step Methodology
- Value Proposition
- Client Engagement
- Deliverables and Support
- Industry Expertise

# OUR R&D STUDY PROCESS

**Step 1:** Meet to tour and discuss the client's activities and determine R&D Tax Credit feasibility.

**Step 2:** Gather technical and financial data relevant to the credit, such as wages, technical contractor costs, etc., to substantiate QRAs and QREs for the tax years included in the report.

**Step 3:** Prepare an estimated range of R&D Tax Credit value and provide to the client.

*Depending on the potential value, we will either recommend a full study (which includes a study report deliverable) or a calculation of the credit only.*

**Step 4:** Schedule interviews with the employees involved in the R&D process to validate and document their involvement in QRAs.

**Step 5:** Gather all relevant information and prepare the calculations of the R&D Tax Credits for federal and state, if applicable, and provide to the client for inclusion in their tax returns.

**Step 6:** Prepare the study report deliverable for client files.



# HOW WE HELP OUR CLIENTS WITH THE R&D TAX CREDIT

Our professionals simplify a complex section of the Internal Revenue Code that can be intimidating to clients and transform it into tax credits that provide cash flow savings. We do this by evaluating potential areas of opportunity and then preparing the R&D Tax Credit study accordingly.

**In the past five years, we've helped our clients obtain approximately**



**\$5.5 MILLION**

**of federal and state R&D Tax Credits.**

# IRC SECTION 174

## Tax Cuts & Jobs Act (TCJA)

- Amended IRC Section 174 to mandate capitalization of R&D expenditure and amortize over 5 years for domestic activities (15 years for foreign)
- Previously these expenditures were able to be deducted when incurred
- Delayed provision of TCJA that went into effect in the 2022 tax year
- Once the mandated capitalization came into place in 2022 it gained a lot of attention and pushback from numerous industries and associations due to its severe negative impact on small and mid-size U.S. businesses

# IRC SECTION 174

## Similarities and Differences in IRC Section 174 R&D Expense and IRC Section 41 R&D Credit

- **PLEASE NOTE:**
  - **All IRC Section 41 R&D credit expenses must be IRC Section 174 expenses**
  - **Not All IRC Section 174 expenses are IRC Section 41 R&D expenses**
- Section 174 has a more expansive definition:
  - Office and Overhead costs
  - Employee Burden (taxes/benefits/insurance)
  - Patent and Patent Pursuit
  - Utilities
  - Contractor Research: 100% vs 65%



# R&D TAX FORM CHANGES / COMPLIANCE

- **Form 6765**, *Credit for Increasing Research Activities*, is used to:
  - Calculate and claim the credit for increasing research activities
  - Elect the reduced credit under Section 280C, if desired
  - Elect and calculate payroll tax credit, if applicable
- In June of 2024, the IRS revised Form 6765 for tax years starting after December 31, 2024. The revised form mandates that certain taxpayers must provide additional specifics about their R&D initiatives and information about the projects must be submitted with the tax return.
- **New Value Inputs**, Number of business components for the tax year (identifying each new or improved product, process, computer software, technique, formula, or invention).
- **Provide** the amount of officers' wages included as QREs.

# FEDERAL FILING REQUIREMENTS

- **More Documentation, More Complexity** – The IRS now requires additional reporting on qualified expenses, research activities, and business components right from the start.
- **Stricter Wage Classification** – Businesses must separate direct R&D labor, supervisory roles and support staff—meaning better tracking systems are a must!
- **Increased IRS Scrutiny** – The IRS is tightening compliance with these changes. Mistakes could lead to claim delays or lost credits.
- **New Sections (Including Section G)** – Optional for 2024, but mandatory in 2025—businesses need to act now to stay compliant.

# DOCUMENTATION STANDARDS RECORDKEEPING REQUIREMENTS

- **Tax Years 2024 & 2025 Require More Documentation** – Mostly all taxpayers will be required to adopt additional level of details when filing the R&D Tax Credit.
  - Having the following essential primary documents on hand, will be helpful when businesses will be asked to provide required documentation to the IRS.
- **Organize Business Components** – List of all business components that the business engaged in during the current tax year they are filing by breaking out the actual name and unique identifier of those projects.
- **Link Expenses to Research Activities** – Establish a clear connection between the costs and specific tasks they support. For example, invoices for materials should indicate which research project they were used for, and employee timesheets should show the time spent on specific R&D tasks. Making the connection between the cost and the QRA is critical for meeting IRS requirements.



# DOCUMENTATION STANDARDS RECORDKEEPING REQUIREMENTS (continued)

- **Backup Documentation** – In addition to primary records stated previously, it is advisable to also maintain backup documentation that can help support the business' claim in more detail. This can include emails to provide context on how QRAs progressed over time and meeting notes to show how decisions were made during the research process.
- **Work with a R&D Tax Credit Professional** – Working with a tax professional who understands the specific requirements and regulations of different jurisdictions can help businesses navigate the complexities of R&D Tax Credit documentation.
- **The Brown Plus R&D Tax Practice** can help organizations identify their QRAs, document their expenses and ensure their compliance with all IRS and State regulations.



***“The best way to predict the future is to invent it.”***

- Alan Kay, American Computer Scientist

# Q&A

Questions? We're here to help.