



Tax Credits & Incentives: Federal R&D Credits

EXPAND YOUR RUNWAY THROUGH CREDITS &
INCENTIVES
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CERTIFIED PUBLIC ACCOUNTANTS

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TODAY'S SPEAKER



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OVERVIEW

- Federal R&D Tax Credits (IRC § 41)
- Identifying Eligible Activities
- Audit Considerations
- Documentation Best Practices
- State R&D Incentives
- R&D Study Process
- Recent Changes & Updates
- Key Takeaways & Other Considerations

R&D TAX CREDIT BASICS



- General Business Credit for qualified research expenses incurred in a given tax year
- Dollar for dollar reduction in tax liability
- Can be used by eligible small businesses to offset payroll taxes or AMT if they are not generating taxable income

BENEFIT

- Generally, credit equates to approximately 6-8.5% of qualified research expenditures
 - Unused credits carryback 1 year, carryforward 20 years
- Eligible taxpayers may be able to offset the employer portion of FICA taxes
- Flow-through entities – offsets owners' personal income tax attributable to business

R&D ACTIVITY MISCONCEPTIONS

- White lab coats and test tubes are required
- Only businesses engaged in scientific or technological research are eligible
- Only businesses with significant income tax liabilities would benefit
- If the project does not move forward, it does not qualify
- A business must develop a brand-new product or process in order to qualify

FEDERAL R&D ELIGIBILITY

THE FOUR-PART TEST

The four-part test can help you determine if your company's activities qualify for the Research and Development (R&D) tax credit.

1

TECHNOLOGICAL
IN NATURE

The activity performed must fundamentally rely on principles of the sciences:

- a. Physics
- b. Biology
- c. Engineering
- d. Computer Science
- e. Chemistry

PERMITTED
PURPOSE

The activity must relate to a new/improved business component(s):

- a. Function
- b. Performance
- c. Reliability
- d. Quality

2

3

TECHNICAL

FEDERAL R&D ELIGIBILITY

- a. Function
- b. Performance
- c. Reliability
- d. Quality

PROCESS OF EXPERIMENTATION

There must be a process of experimentation that considers more than one alternative to achieve a result (ex - modeling, simulation, or trial and error).



TECHNICAL UNCERTAINTY

The activity must be intended to discover information to eliminate uncertainty concerning the capability, method, or design for developing or improving a product or process.

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FEDERAL R&D ELIGIBILITY



- Work must be performed in the U.S.
- Funded research does not qualify
- The level of technological advancement does not matter
- Success is not mandatory – failure can qualify
- Duplicating what others have done can qualify

NON-QUALIFIED ACTIVITIES

- Research conducted after initiating commercial production of a product
 - Data collection, quality control, trials
- Research to adapt an existing product to a particular customer's specifications
- Surveys and studies
- Research involving social sciences, arts, or humanities

CPE POLLING QUESTION #1

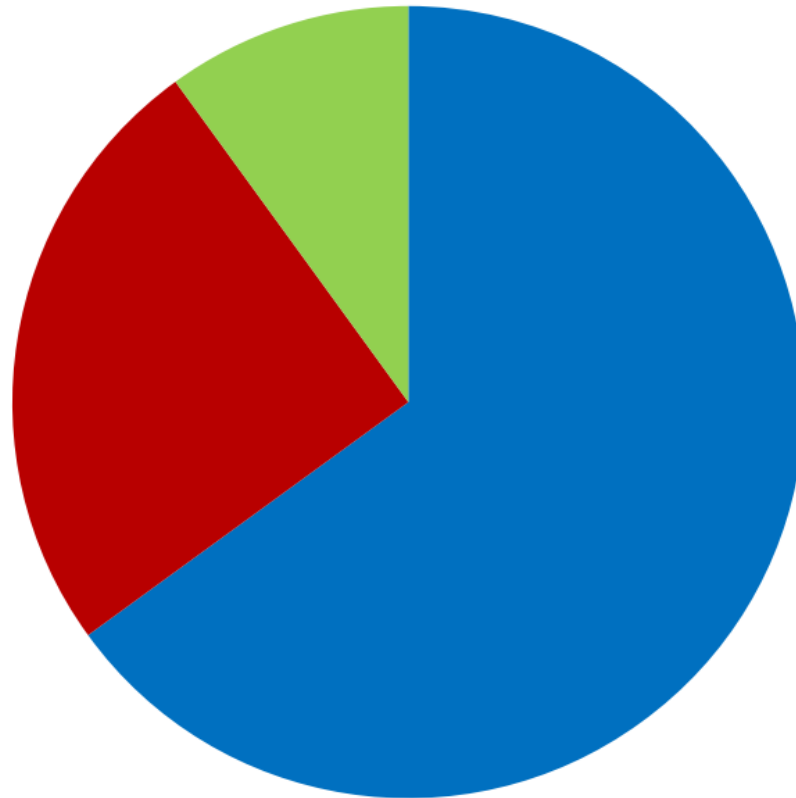
Why are you attending this webinar?

- Learn about tax credits
- Earn 1.0 hours of CPE credit
- Both

SOFTWARE DEVELOPMENT

- Internal use Software (IUS) vs. Non-IUS
- IUS must pass the High Threshold of Innovation Test
 - Software is innovative
 - Development involves significant economic risk
 - The software is not commercially available
- Design related to aesthetics does not qualify

QUALIFYING RESEARCH EXPENDITURES



■ Wages

■ Contract
Research

■ Supplies

Source: KBKG R&D Tax Credits for the Food & Beverage Industry

QUALIFIED WAGES



- Taxable wages
 - Employees actively performing qualified research
- Engineers, scientists, computer programmers, etc.
 - Direct supervision of employees performing R&D
 - Direct support of employees performing R&D

QUALIFIED RESEARCH EXPENSES (QRES)

- Supplies used in R&D
- Contract research (100%, 75%, or 65% of cost)
- Rental/lease of computers used in qualified research (cloud- computing)

R&D Expenses Under TCJA



Starting in 2022, businesses will no longer be able to expense R&D costs as incurred.



R&D expenses must be amortized over 5 years

15 years if research is outside of the US



Could have major impact on companies with significant qualified research expenses

CPE POLLING QUESTION #2

Does your manufacturer currently take advantage of R&D tax credits?

- Yes
- No

AUDIT CONSIDERATIONS



- Claiming significant R&D credits still increases the likelihood of an IRS audit
- Common issues in court cases:
 - Business component
 - Wages and supplies
 - Base period
 - Four Part Test
 - Substantiation
 - Reasonable expenses

AUDIT CONSIDERATIONS



- IRS targets the use of estimates when determining QREs (e.g. time spent on specific activities or projects)
 - Recommend formal time tracking system with documented activities
 - QREs should not include overhead, depreciation, or other general and administrative expenses
- Contemporaneous documentation is key in audit

DOCUMENTATION BEST PRACTICES



ACTIVITIES

1. Keep a list of qualified projects you are claiming for the credit and a record of how the projects meet the four-part test.

2. Retain contemporaneous documentation for R&D projects.

Examples of documentation:

- ▶ Test reports
- ▶ Project proposals
- ▶ Time sheets
 - ▶ Emails
- ▶ Status reports
- ▶ Job descriptions
 - ▶ Patents

WAGES

1. Include everyone's job title.

2. List out all employees and their involvement in R&D.

DOCUMENTATION BEST PRACTICES



SUPPLIES & COMPUTER LEASING

1. Document how the supply was used in the R&D process (specific R&D job cost sheet).
2. If you are qualifying some supplies, but not others, keep a write-up or documentation to support why certain supplies are being claimed.
3. Consider creating separate general ledger expense codes that are dedicated to R&D supplies.

CONTRACT RESEARCH

1. Keep a copy of the contract.
2. Document how the contract research is related to your R&D activities.

STATE CREDITS

- Many states also offer R&D tax credits or related benefits.
 - Generally, based on where the work is performed.
- NYS does not have a state-level R&D credit, unless you are in the Excelsior Jobs Program.
- NYS does have an Investment Tax Credit on certain eligible fixed assets used in the R&D/MFG process.

THE R&D STUDY PROCESS



- Phase 1 – Initial conference call with L&M and third parties, if necessary – no cost
- Phase 2 – On-site visits, interviews with key personnel, obtain documentation, calculate QREs and R&D credit
- Phase 3 – Documentation and report

CPE POLLING QUESTION

#3



- Does your company have qualified research expenses?
 - Yes
 - No



CHANGES TO FORM 6765



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FORM 6765

- Historical filing requirements for Form 6765 were much less burdensome on taxpayers.
- Changes aim to collect certain information that would be required upon a review of the credit.
- Prevent false or inflated claims.
- Emphasis on business components and detailed expense analysis

REFUND CLAIMS ON AMENDED RETURNS

- Similar to Canadian credit, requires extensive information.
- Must identify all business components and research activities.
- No successful amended claims submitted yet.
- Recommend claiming credit on original return due to additional information required.

CHANGES TO FORM 6765



- Addition of 3 entirely new sections
 - In line with refund claims that went into effect in January 2022
- The form went from 2 pages to 5 pages.
- Extensive business component information is now required.
- Still some uncertainty surrounding certain definitions.

SECTION G



- Section G is optional for 2024 but will become mandatory for tax years beginning after 2024.
 - Must report at least 80% of total QREs in descending order, but no more than 50 business components should be reported.
 - Reporting exemption for companies with
 - QREs less than \$1.5 million AND less than \$50 million in gross receipts OR
 - Qualified Small Businesses that are electing the reduced payroll credit.
-

PROPOSED DRAFT FORM 6765

Form 6765
(Rev. December 2024)
Department of the Treasury
Internal Revenue Service
Name(s) shown on return

Credit for Increasing Research Activities

OMB No. 1545-0619

Attach to your tax return.
Go to www.irs.gov/Form6765 for instructions and the latest information.

Attachment
Sequence No. **676**

Identifying number

- A** Are you electing the reduced credit under section 280C? See instructions. Yes No
B Are you a member of a controlled group or business under common control? Yes No
 If "Yes," complete and attach the required statement. See instructions for required attachment.

Section A—Regular Credit. Skip this section and go to Section B if you are electing or previously elected (and are not revoking) the alternative simplified credit.

1	Certain amounts paid or incurred to energy consortia (see instructions)		1
2	Basic research payments to qualified organizations (see instructions)	2	
3	Qualified organization base period amount	3	
4	Subtract line 3 from line 2. If zero or less, enter -0-		4
Note: Complete Section F before going to line 5.			
5	Total qualified research expenses (QREs). Enter amount from line 48	5	
6	Enter fixed-base percentage, but not more than 16% (0.16). See instructions	6	%
7	Enter average annual gross receipts. See instructions	7	
8	Multiply line 7 by the percentage on line 6	8	
9	Subtract line 8 from line 5. If zero or less, enter -0-	9	
10	Multiply line 9 by 50% (0.50)	10	
11	Enter the smaller of line 9 or line 10	11	
12	Add lines 1, 4, and 11	12	
13	If you elect to reduce the credit under section 280C, then multiply line 12 by 15.8% (0.158). If not, multiply line 12 by 20% (0.20) and see instructions for the statement that must be attached	13	

Section B—Alternative Simplified Credit. Skip this section if you are completing Section A.

14	Certain amounts paid or incurred to energy consortia (see the line 1 instructions)	14	
15	Basic research payments to qualified organizations (see the line 2 instructions)	15	
16	Qualified organization base period amount (see the line 3 instructions)	16	
17	Subtract line 16 from line 15. If zero or less, enter -0-	17	
18	Add lines 14 and 17	18	
19	Multiply line 18 by 20% (0.20)	19	
Note: Complete Section F before going to line 20.			
20	Total qualified research expenses (QREs). Enter amount from line 48	20	
21	Enter your total QREs for the prior 3 tax years. If you had no QREs in any 1 of those years, skip lines 22 and 23	21	
22	Divide line 21 by 6.0	22	
23	Subtract line 22 from line 20. If zero or less, enter -0-	23	
24	Multiply line 23 by 14% (0.14). If you skipped lines 22 and 23, multiply line 20 by 6% (0.06)	24	
25	Add lines 19 and 24	25	
26	If you elect to reduce the credit under section 280C, then multiply line 25 by 79% (0.79). If not, enter the amount from line 25 and see the line 13 instructions for the statement that must be attached	26	

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 13700H

Form **6765** (Rev. 12-2024)

Form 6765 (Rev. 12-2024)

Page **2**

Section C—Current Year Credit

27	Enter the portion of the credit from Form 8932, line 2, that is attributable to wages that were also used to figure the credit on line 13 or line 26 (whichever applies)	27	
28	Subtract line 27 from line 13 or line 26 (whichever applies). If zero or less, enter -0-	28	
29	Credit for increasing research activities from partnerships, S corporations, estates, and trusts	29	
30	Add lines 28 and 29	30	
<ul style="list-style-type: none"> Estates and trusts, go to line 31. Partnerships and S corporations not electing the payroll tax credit, stop here and report this amount on Schedule K. Partnerships and S corporations electing the payroll tax credit, complete Section D and report on Schedule K the amount on this line reduced by the amount on line 36. Eligible small businesses, stop here and report the credit on Form 3800, Part III, line 4i. See instructions for the definition of eligible small business. Filers other than eligible small businesses, stop here and report the credit on Form 3800, Part III, line 1c. Note: Qualified small business filers, other than partnerships and S corporations, electing the payroll tax credit must complete Form 3800 before completing Section D.			
31	Amount allocated to beneficiaries of the estate or trust (see instructions)	31	
32	Estates and trusts, subtract line 31 from line 30. For eligible small businesses, report the credit on Form 3800, Part III, line 4i. See instructions. For filers other than eligible small businesses, report the credit on Form 3800, Part III, line 1c	32	

Section D—Qualified Small Business Payroll Tax Election and Payroll Tax Credit. Skip this section if the payroll tax election does not apply. See instructions.

33a	Check this box if you are a qualified small business electing the payroll tax credit. See instructions	<input type="checkbox"/>	
33b	Check the box if payroll tax is reported on a different EIN	<input type="checkbox"/>	
34	Enter the portion of line 28 elected as a payroll tax credit (do not enter more than \$500,000). See instructions	34	
35	General business credit carryforward from the current year. See instructions. Partnerships and S corporations, skip this line and go to line 36	35	
36	Partnerships and S corporations, enter the smaller of line 28 or line 34. All others, enter the smallest of line 28, line 34, or line 35. Enter here and on the applicable line of Form 8974, Part 1, column (e). Members of controlled groups or businesses under common control, see instructions for the statement that must be attached	36	

Section E—Other Information.

See instructions.

37	Enter the number of business components generating the QREs on line 5 or line 20	37	
38	Enter the amount of officers' wages included on line 42	38	
39	Did you acquire or dispose of any major portion of a trade or business in the tax year? <input type="checkbox"/> Yes <input type="checkbox"/> No		
40	Did you include any new categories of expenses as current year QREs? <input type="checkbox"/> Yes <input type="checkbox"/> No		
41	Did you determine any of the QREs on line 5 or line 20 following the ASC 730 Directive? <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," enter the amount from Appendix C Line 19 (you may attach your Appendices A, B, C, and D here) This ASC 730 Directive only applies to taxpayers with assets equal to or greater than \$10,000,000 who follow U.S. GAAP to prepare their Certified Audited Financial Statements showing the amount of currently expensed Financial Statement R&D. See instructions.	41	

Section F—Qualified Research Expenses Summary.

See instructions.

A Are you required to complete Section G? See instructions to determine if you are required to complete Section G, and how to complete Section F if you are not required to complete Section G <input type="checkbox"/> Yes <input type="checkbox"/> No			
42	Total wages for qualified services for all business components (do not include any wages used in figuring the work opportunity credit)	42	
43	Total costs of supplies for all business components	43	
44	Total rental or lease cost of computers for all business components	44	
45	Total applicable amount of contract research for all business components (do not include basic research payments)	45	
46	Enter the applicable amount of all basic research payments. See instructions	46	
47	Add line 45 and line 46	47	
48	Add lines 42, 43, 44, and 47, then enter line 48 on either line 5 or line 20, whichever is appropriate	48	

Form **6765** (Rev. 12-2024)

Section G—Business Component Information. Complete lines 49(a) through 49(f) for each business component you are required to report. See instructions. Attach additional sheets if necessary to capture all business components.

BC	49(a) EIN of the controlled group member conducting the research activities on this business component	49(b) Controlled group member's principal business activity code	49(c) Business component's name or unique alphanumeric identifier (see instructions)	49(d) Business component type (select one from available options)
1				
2				
3				
4				
5				
6				
7				
8				
9				
10				
11				
12				
13				
14				
15				

BC	49(e) Software (if applicable, select from the available options)	49(f) Describe the information sought to be discovered. Use the space provided.
1		
2		
3		
4		
5		
6		
7		
8		
9		
10		
11		
12		
13		
14		
15		

Section G—Business Component Information (continued). Complete lines 50 through 56 for each business component. If you have more than fifteen business components, see instructions.

BC	50 Direct research wages for qualified services	51 Direct supervision wages for qualified services	52 Direct support wages for qualified services	53 Total qualified wages (add line 50, line 51, and line 52)
1				
2				
3				
4				
5				
6				
7				
8				
9				
10				
11				
12				
13				
14				
15				
Total from attachments				
Total				

BC	54 Cost of supplies	55 Rental or lease cost of computers	56 Applicable amount of contract research expenses (see instructions for reporting basic research payments)
1			
2			
3			
4			
5			
6			
7			
8			
9			
10			
11			
12			
13			
14			
15			
Total from attachments			
Total			

CPE POLLING QUESTION #4



Are you a member of the Buffalo Niagara Manufacturing Alliance (BNMA)?

- Yes
- No

KEY TAKEAWAYS



- The Federal R&D credit can provide a Federal income tax credit. The credit can be carried back 1 year or carried forward 20 years.
- The Federal R&D credit can be refundable through a payroll tax credit if certain criteria are met.
- Your company may already be conducting qualified activities!

OTHER CONSIDERATIONS



- R&D in other countries
- Section 174 Impact
- Use of R&D tax credits even with net operating losses
 - Section 382 limitations
 - 80% NOL limitation



QUESTIONS

CONTACT US



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