



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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1

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
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2

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
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3

BENEFIT

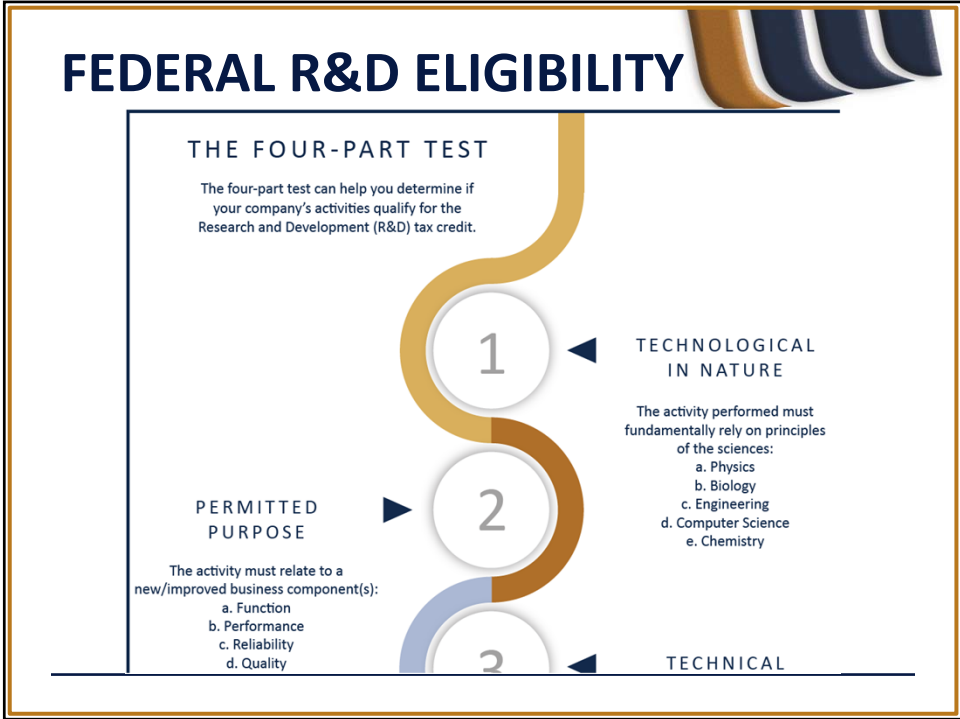
- Generally, credit equates to approximately 6-8.5% of qualified research expenditures
 - Unused credits carryback 1 year, carryforward 20 years
 - Eligible taxpayers may be able to offset the employer portion of FICA taxes
 - Flow-through entities – offsets owners' personal income tax attributable to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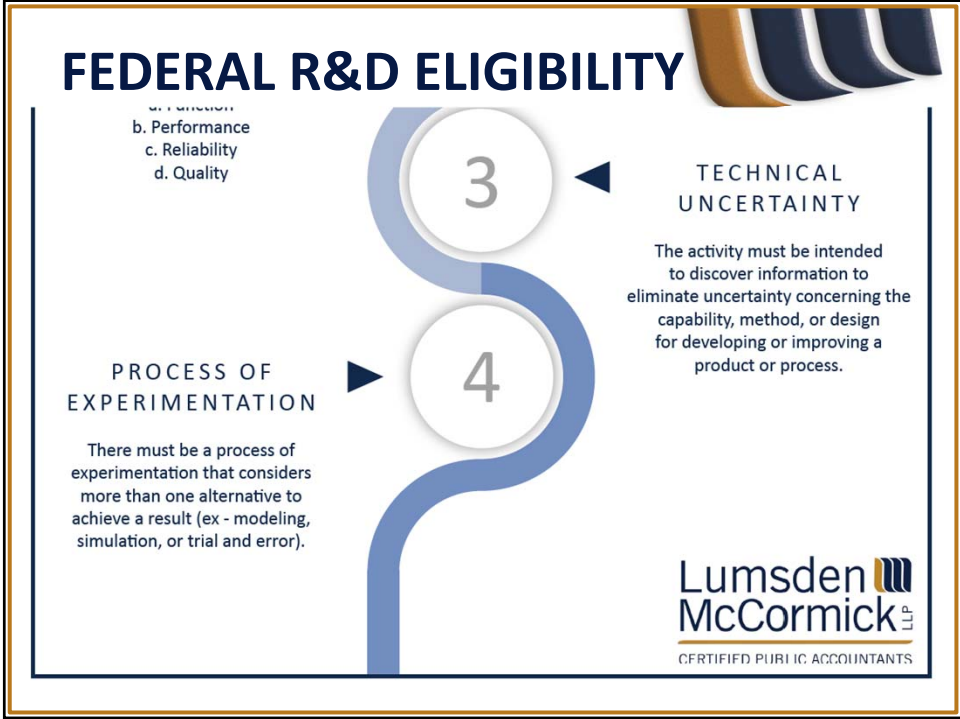
R&D ACTIVITY MISCONCEPTIONS

- 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
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5



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7

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
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8

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
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9

CPE POLLING QUESTION #1

Why are you attending this webinar?

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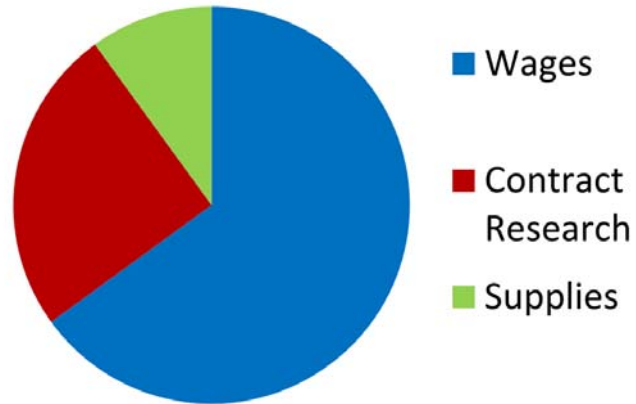
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SOFTWARE DEVELOPMENT

- 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
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11

QUALIFYING RESEARCH EXPENDITURES



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

12

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

13

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)

14

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

15

CPE POLLING QUESTION #2

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

- Yes
 - No
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16

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
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17

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

18

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.

19

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.

20

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.

21

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
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22

CPE POLLING QUESTION #3




- Does your company have qualified research expenses?
 - Yes
 - No
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23




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

25

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.
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26

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.
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27

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.

28

PROPOSED DRAFT FORM 6765

Form 6765 (Rev. 12-2024) Page 2

Section C – Current Year Credit

27 Enter the portion of the credit from Form 8922, line 2, that is attributable to wages that were also used to figure the credit on line 12 or line 20 (whichever applies) **27**

28 Subtract line 27 from line 13 or line 20 (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**

31 Estimated QREs, plus line 31 **31**

32 Enter the number of business components electing the payroll tax credit, 800 New and report this amount on Schedule K the amount on this line reduced by the amount on line 28 **32**

33 Enter and attach business 1121 from line 20. For eligible other businesses, report the credit on Form 3800, Part II, line 8. See instructions. If more than 50 business components are reported, report the credit on Form 3800, Part III, line 10 **33**

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.

34 Check this box if you are a qualified small business electing the payroll tax credit. See instructions. **34**

35 Enter the portion of line 33 selected as a payroll tax election (do not enter more than \$500,000, the maximum limit) **35**

36 General business credit carryforward from the current year. See instructions. Partnerships and S corporations, enter the amount on line 20 or line 34. All others, enter the smallest of the 28, the 35, or line 20. Enter here and on the applicable line of Form 9774, Part 1, column (b) Members of controlled groups or affiliated service groups. 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? Yes No **39**

40 Did you include any new categories of expenses as current year QREs? Yes No **40**

41 Did you determine any of the QREs on line 5 or line 20 following the ASC 730 Directive? Yes No **41**

If "Yes," enter the amount from Appendix C Line 19 you may attach your Appendices A, B, C, and D here. The 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 accepted Financial Statement R&D. See instructions.

Section F – Qualified Research Expenses Summary. See instructions.

42 Are you required to complete Section F? 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 Yes No **42**

43 Total wages for qualified services for all business components (do not include any wages used in figuring the work opportunity credit) **43**

44 Total costs of supplies for all business components **44**

45 Total rental or lease cost of computers for all business components **45**

46 Total applicable amount of contract research for all business components (do not include basic research payments) **46**

47 Enter the applicable amount of all basic research payments. See instructions **47**

48 Add lines 42, 43, 44, and 47. Then enter line 48 on other line 5 or line 20, whichever is appropriate **48**

Form 6765 (Rev. 12-2024)

29

Form 6765 (Rev. 12-2024) Page 3

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.

49(a) BC	49(b) EIN of the controlled group member (including the member address if applicable)	49(c) Controlled group member's principal business activity code	49(d) Business component's name or alias (specify code number)	49(e) Business component type (check one from applicable column)
1				
2				
3				
4				
5				
6				
7				
8				
9				
10				
11				
12				
13				
14				
15				
16				
Total from attachments				
Total				

Form 6765 (Rev. 12-2024)

Form 6765 (Rev. 12-2024) Page 4

Section D – Business Component Information (continued). Complete lines 50 through 55 for each business component. If you have more than fifteen business components, see instructions.

50	51	52	53
BC	Direct revenue (gross) for qualified services	Direct expense (gross) for qualified services	Total qualified (gross) (add the 50, the 51, and the 52)
1			
2			
3			
4			
5			
6			
7			
8			
9			
10			
11			
12			
13			
14			
15			
Total from attachments			
Total			

Form 6765 (Rev. 12-2024)

30

CPE POLLING QUESTION #4

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

- Yes
- No

31

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!
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32

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
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33



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35