Rödl & Partner

R&D TAX CREDITS

2025

The Federal Research & Development Tax Credit represents a powerful tool passed by Congress in 1981 to incentivize and reward companies for investment in U.S. based research activities. The tax credit is a dollar-for-dollar reduction of a company's tax liability and represents an effective tool to help reduce both current and future tax liabilities.

The requirements for this incentive have been modified over the years, but legislation passed under the Protecting Americans from Tax Hikes Act of 2015 made three significant changes to the R&D tax credit. First, the credit was made permanent. Second, permitted eligible small businesses to utilize the R&D credit against a portion of payroll taxes. Lastly, companies with an average of $50 million or less of gross receipts over the company's prior three tax years would be permitted to utilize the credits to offset Alternative Minimum Tax ("AMT").

The Path Act legislative changes significantly broadened the scope for taxpayers and produced a more effective tool to help reduce company's current and future tax liabilities, provide a source of cash flow to meet the needs of businesses.

Creditable Activities – IRS 4-Part Test

Generally, qualified research involves a taxpayer (either directly or through direct funding of a third party on the taxpayer's behalf) conducting an activity or undertaking a project that independently passes all four of the following tests:

- (§41) The activity must be for a "**Permitted Purpose.**" A permitted purpose is an activity related to developing and experimenting on a new or improved business component. A business component is defined as a new product, process, technique, formula, invention, or computer software that is held for sale, lease, license or used by the taxpayer in a trade or business.

- (§41) The activity must be "**Technological in Nature.**" The activity performed must fundamentally rely on the principles of physical or biological sciences, computer sciences, or engineering.

- (§174) The activity must be intended to discover information to "**Eliminate Uncertainty**" at the onset of the development activity concerning the:
  - Capability – if the product/process can be developed or achieved.
  - Method – how to go about developing the product or process.
  - Design – what the appropriate design of the product or process should be.

- (§41) The activity must have a "**Process of Experimentation**," whereby the company must evaluate one or more alternatives to achieve a desired result or outcome. The process of experimentation defines the process for how the company seeks to eliminate or reduce the technological uncertainty. Examples of a process of experimentation include the following: modeling, simulation, prototyping, systematic trial and error, and production trial runs.

Some common examples of creditable activities for our clients include (I.) new product design and development; (II.) enhancements/improvements to an existing product such as making the product lighter/smaller, more resilient, increased efficiency, or producing with less costly source materials; and (III.) process improvement initiatives include researching, testing, and evaluating ways to improve production processes to reduce scrap costs or increase throughput.

Examples of non-qualifying activities include:

(I.) Foreign Research;
(II.) Funded Research;
(III.) Routine testing, quality control, and maintenance related activities;
(IV.) Adaptation of an existing product or reverse engineering;
(V.) Market research and fiscal feasibility studies;
(VI.) End user support and/or documentation.

Qualifying Costs

Upon identifying qualified activities a company performs; the next step is to determine the costs associated with each activity. Qualifying research expenses ("QREs") are classified within the following categories:

- **Qualifying Wages**: Identifying the personnel and their corresponding wages who were directly performing, supervising, and/or supporting qualified research activities are eligible.

- **Qualifying Supplies**: Identifying the cost of any supplies and/or materials consumed in the development or testing of a new/improved business component. Examples of eligible supplies include:
  - Raw materials such as steel, plastic components, nuts, bolts, screws, and other consumables used to develop a working prototype.
  - Raw materials consumed during the testing of a new or improved product/process.

- **Qualifying Contractors**: Identifying any expenses incurred for development outsourced to a third party for development or testing services. The IRS stipulates that businesses utilizing third party contractors must:
  1. Maintain substantial rights to the research performed by the contractor; and
  2. Bear the economic risk of the research performed by the contractor.

State R&D Credits

The following states offer research and development credits that often piggy-back off the federal research and development tax credit. While each of the states below offer some form of incentive, the requirements for these state-based incentives can vary significantly.

- Arizona
- Arkansas
- California
- Colorado
- Connecticut
- Delaware
- Florida
- Georgia
- Hawaii
- Idaho
- Illinois
- Indiana
- Iowa
- Kansas
- Kentucky
- Louisiana
- Maine
- Maryland
- Massachusetts
- Minnesota
- Missouri
- Nebraska
- New Hampshire
- New Jersey
- New Mexico
- New York
- North Dakota
- Ohio
- Pennsylvania
- Rhode Island
- South Carolina
- Texas
- Utah
- Vermont
- Virginia
- Wisconsin

Other Legislative Matters

Section 174

Section 13206 of the Tax Cuts and Jobs Act (TCJA) of 2017, Public Law 115-97, included amendments to Section 174 for mandatory amortization of research or experimental (R&E) expenditures. Specifically, the amendments require taxpayers to amortize domestic R&E expenditures ratably over five years and foreign R&D expenditures ratably over 15 years effective for tax years beginning after December 31, 2021. Under this law, amortization of these Section 174 expenses is mandatory regardless of whether a client performs a research and development tax credit study or not. It should be noted that many of these expenses are not R&D credit eligible expenses; however, are subject to capitalization & amortization requirements under the law. Common examples of these non-credit eligible expenses include patents and associated attorney's fees, operation costs, depreciable asset expense for equipment utilized for R&D related activities. Rödl & Partner will help your company identify and capture these costs to ensure compliance with the applicable law.

Our Services

Rödl & Partner's R&D credit team will work with your company to gather and prepare the necessary supporting documentation to quantify and claim R&D tax credits at the federal and state levels. Our experts can advise on maximizing the efficiency and effectiveness of the internal accounting systems of your business to capture the information necessary to take full advantage of these credits. Should your credits claimed be challenged under IRS examination at some point in the future, Rödl & Partner is available to assist with audit defense at the federal and state levels as necessary. Rödl & Partner is pleased to support your company in whatever capacity necessary to enable your business to realize this valuable tax benefit.

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