

The R&D Tax Credit

IRC SECTION 41

Federal Credit

A dollar-for-dollar reward for the everyday problem-solving your business already does.

The federal R&D tax credit is one of the most valuable, and most underused, incentives in the tax code. Unlike a deduction, which only reduces taxable income, a **credit reduces the tax you owe dollar for dollar**. You don't need a laboratory or a breakthrough invention to qualify. If your team solves technical problems through trial and error, you may already be doing qualifying work.

What spending counts?

The credit is calculated on **Qualified Research Expenditures (QREs)**. Wages for engineers, developers, and technical staff typically make up the largest share, followed by:

Employee wages

For those performing or directly supporting research

Supplies

Materials consumed in experimentation

Contract research

U.S. contractors: 65% eligible if you keep the rights & risk

Cloud computing

Costs tied to running the research

The four-part test

Qualification is judged **activity by activity**, not company-wide. To count, an activity must clear all four prongs; failing any one disqualifies it.

1 Permitted purpose

Improve a product, process, software, or technique, raising its function, performance, reliability, or quality (not looks).

2 Technical uncertainty

At the outset you didn't know whether or how you could achieve the result.

3 Process of experimentation

A systematic effort: prototyping, modeling, testing alternatives. Failed attempts still count.

4 Technological in nature

Grounded in a hard science: engineering, physics, biology, or computer science.

What generally qualifies (and what doesn't)

USUALLY QUALIFIES

- New or improved software functionality
- Engineering new manufacturing processes
- Prototyping & resolving performance issues
- Automating workflows with custom solutions
- Testing and validating technical designs

USUALLY DOESN'T

- Routine production or quality control
- Cosmetic or aesthetic changes
- Market or customer-preference research
- Reverse engineering without uncertainty
- Administrative or operational work

How much is it worth?

Exact amounts depend on your facts, but the federal credit commonly lands in this range:

ANNUAL QUALIFIED R&D SPENDING	POTENTIAL CREDIT RANGE
\$100,000	\$5,000 - \$10,000
\$500,000	\$25,000 - \$50,000
\$1,000,000	\$50,000 - \$100,000
\$5,000,000	\$250,000 - \$500,000

Two firms with identical spending can earn different amounts, depending on the mix of activities and expenses, the calculation method used, and historical spending patterns.

Putting the credit to work

Offset income tax	Most established businesses apply the credit directly against their current-year federal income tax liability.
Carry back & forward	Credit beyond this year's liability carries back 1 year and forward up to 20 years, so value isn't lost in lean years.
Payroll offset for startups	Qualified small businesses can apply up to \$500,000 per year against payroll tax, capturing value before they turn a profit.

Documentation is the backbone

Keep **contemporaneous** records: project notes, design docs, test results, and time tracking. Courts and the IRS reward evidence captured during the work, not reconstructed after.

Rights & risk decide who claims it

The credit belongs to the party that **bears the financial risk and keeps the rights** to the results. This matters most in contract and funded-research arrangements.

THE BOTTOM LINE

The R&D credit is broader than most owners expect. You don't have to invent something new; you have to solve technical problems systematically, and that happens across software, manufacturing, construction, and beyond. Don't overlook **state credits**, either; many mirror the federal rules and add meaningful savings.

Curious whether your work qualifies? **Reach out to your Larson Gross advisor** to talk through your activities and see what your credit could be worth.

START WITH A CONVERSATION
800.447.0177