

A GUIDE FOR BUSINESS OWNERS & CFOS

How to Maximize Your Tax Savings

The Research and Development Tax Credit

A plain-English guide to qualifying, claiming, and defending the credit.

Most companies that qualify never claim it

The federal Research and Development tax credit has been part of the tax code since 1981. It is permanent, it is available to companies of nearly every size, and it reduces what you owe dollar for dollar. And yet a large share of eligible businesses never claim a cent of it.

The reason is rarely complexity. It is assumption. Owners and finance leaders hear "research and development" and picture a laboratory, a team of PhDs, a line item on the budget called R&D. Their company has none of those things, so they conclude the credit is not for them and move on.

The law is far broader than the name suggests. If your team spends time solving technical problems, such as making a product more durable, a process faster, or a software platform more reliable, you may be funding qualified research already, and simply calling it engineering, product development, or Tuesday.

This guide is written for the person signing the return, not for the tax department. No jargon without a definition, no citations you have to chase, no assumptions about what you already know.

WHAT YOU WILL KNOW BY THE END

- Whether the work your team already does likely meets the IRS standard
- Which costs count toward the credit, and which do not
- What documentation an examiner expects to see, and who produces it
- What a first conversation with a specialist should cost you: nothing

What is the R&D tax credit?

A credit, not a deduction

A deduction lowers the income you are taxed on. A credit lowers the tax itself, dollar for dollar. That distinction is the whole point: a qualifying dollar of research spending is worth materially more to you than an ordinary business expense.

Why Congress created it

The credit exists to keep technical work, and the jobs attached to it, inside the United States. It is an incentive, not a loophole. Claiming it is exactly what the statute was written to encourage, which is why it has survived four decades of tax reform and was made permanent in 2015.

What the law actually rewards

Section 41 of the Internal Revenue Code, the provision that creates the credit, rewards the work of developing or improving four things:

A product What you sell or build	A process How you make or deliver it
Software Internal tools or customer-facing platforms	A technique or formula A method, recipe, or design approach

Industry does not decide eligibility

Nothing in the statute limits the credit to technology or pharmaceutical companies. Manufacturers, food and beverage producers, contractors, engineering and architecture firms, agriculture, and software businesses all claim it routinely. What matters is the nature of the work, not the label on your industry code. Most states offer their own credit on top of the federal one, and the two are usually claimed from the same underlying study.

The four-part test, explained simply

The IRS applies one test to every project you claim. It has four parts, and a project must satisfy all four. Read them as four questions about a single piece of work, not four separate hurdles. The test is applied project by project, so one qualifying project is enough to file.

01 Permitted purpose

The question: Was the work intended to improve a product or process in function, performance, reliability, quality, or cost?

Improvement is the bar, not invention. You do not need a patent, a first-to-market breakthrough, or a product that is new to your industry. Making your own existing product measurably better counts. Cosmetic changes and seasonal restyling do not.

EXAMPLE

A manufacturer redesigns a bracket that has been failing in the field. The goal is a lower failure rate under load: a performance and reliability improvement to an existing product.

02 Technological in nature

The question: Did the work rely on a hard science such as engineering, physics, chemistry, biology, or computer science?

This part rules out work grounded in economics, market research, or aesthetics. It does not require a scientist on staff. A machinist applying materials and structural principles is relying on engineering, whether or not anyone in the room uses that word.

EXAMPLE

That same redesign draws on load calculations and the properties of an alternative alloy. The reasoning is engineering, not preference.

The two parts companies forget

03 Elimination of uncertainty

The question: At the start, was it unclear whether you could achieve the result, or how you would achieve it?

Uncertainty is measured against your own knowledge at the time, not against the state of the art worldwide. If someone somewhere has solved the problem but your team still had to work out capability, method, or design, the uncertainty was real.

EXAMPLE

Before starting, the manufacturer does not know whether a thinner geometry in a stronger alloy will hold, or which of three candidate designs will survive cycling.

04 Process of experimentation

The question: Did you evaluate alternatives systematically rather than simply picking one and hoping?

Modeling, simulation, prototyping, testing, and structured trial and error all qualify. The process does not have to be documented in a lab notebook, and it does not have to succeed. Abandoned projects are claimable; failure is evidence that uncertainty existed.

EXAMPLE

Three designs are modeled, two are prototyped, both are tested to failure, and the results drive a fourth iteration that ships.

Putting it together

A purpose, a technical basis, a genuine unknown, and a structured attempt to resolve it. Most companies fail the test on paper only because no one has ever asked them these four questions about the work they did last year.

What counts as a qualified expense

Once a project passes the four-part test, the credit is calculated from the costs attached to it. Those costs are called qualified research expenses, or QREs. There are three categories, and the first is almost always the largest.

01 Wages

Taxable wages paid to US employees for time spent on qualified work. Three kinds of time count:

- **Doing the work:** engineers, developers, technicians, machinists, scientists.
- **Directly supervising it:** the manager guiding the technical effort, not the executive approving the budget.
- **Directly supporting it:** the shop hand building a prototype or running a test.

Time is allocated by percentage, so an employee who spends part of the year on qualified projects contributes part of their wages. Owners' wages can qualify when the owner is doing or directing the technical work.

02 Supplies

Tangible materials consumed in the research: prototype stock, test parts, raw material scrapped during trial runs, tooling that is used up rather than capitalized. What does not count is equipment you depreciate, land, buildings, and general overhead such as rent or utilities. If it survives the project as a fixed asset, it is not a supply.

Outside help, and credits before profit

03 Contract research

Payments to US-based third parties doing qualified work for you: contract engineers, prototype shops, testing labs, outside developers. Two conditions apply:

- **You bear the financial risk.** If the work fails, you still pay. A fixed-fee contract that pays only on success generally points the other way.
- **You keep substantial rights** to the results, so you can use what was developed without paying for permission.

Qualifying contract costs count at 65% of what you paid. Work performed outside the United States does not count.

IF YOU ARE NOT YET PROFITABLE

The payroll tax offset

A credit against income tax is worth nothing to a company with no income tax to pay. Congress addressed that: a qualified small business can apply the credit against the employer portion of its federal payroll taxes instead, up to \$500,000 a year. That is cash back on payroll you are already running.

You generally qualify with gross receipts under \$5 million in the election year and no gross receipts before the five-year period ending with it. The election is made on Form 6765 with a timely filed original return, including extensions, so the deadline matters.

Source: IRS, Instructions for Form 6765 and "Qualified small business payroll tax credit for increasing research activities." The \$500,000 cap applies to tax years beginning after December 31, 2022; earlier years were capped at \$250,000.

One more timing note: if you have not claimed before, amended returns can generally reach back three years. Credits you cannot use in the current year carry forward.

Common misconceptions

Four beliefs keep more money on the table than any technical provision in the statute. Each one is reasonable. None of them is correct.

“We don't have a formal R&D department.”

Nothing in the law requires a department, a budget line, or a job title. The test asks what the work was, not where it sat on the org chart.

In most companies that qualify, the qualifying work is spread across operations, engineering, and production: people solving problems as part of their day. A specialist's job is to find that activity and map it to projects. Yours is not to reorganize around the tax code.

“We already tried and got rejected.”

Claims are rarely disallowed because the work did not qualify. They are disallowed because the claim was not supported: no project-level detail, no technical narrative, and time allocations that could not be traced to anything.

A poorly documented claim and an ineligible company look identical on an examiner's desk. They are not the same thing, and the difference is fixable going forward.

Two more that cost real money

“Our industry isn't techy enough.”

The credit follows activity, not sector. A bakery reformulating a product for a longer shelf life, a metal fabricator developing a fixture to hold a tighter tolerance, a specialty contractor engineering a method for an unusual site condition: all are doing the kind of work the statute describes.

Manufacturing, food and beverage, construction and engineering, agriculture, aerospace, and software are among the most consistent claimants. If your competitors think the same thing you do, that is an advantage, not a verdict.

“We do government-funded work, so we're out.”

Government work is not excluded. What is excluded is *funded* research, meaning work where you carry no financial risk and retain no rights to the result. That is a contract-terms question, not a customer question.

Many federal and state contracts leave the contractor bearing risk on technical performance and holding usable rights to what it develops. Cost-plus arrangements often do point to funded research; fixed-price contracts frequently do not. The contract language decides it, and it is worth reading before you assume.

The pattern behind all four: companies disqualify themselves on the strength of a word: "research," "department," "techy," "funded," rather than on the statute. Eligibility is a factual question about your work, and it takes one conversation to answer.

What documentation actually looks like

"Audit-ready" sounds like a filing cabinet you were supposed to have been keeping for years. In practice it means something narrower: a claim an examiner can follow from a dollar on the return back to a specific project and the people who worked on it.

A claim that connects, end to end

Three links have to hold: the project passed the four-part test; these specific costs belong to that project; and this is the evidence. Where claims fall apart is the middle link: a credible total with no way to trace it to the work.

Technical narratives

A short written account of each qualifying project: what you were trying to improve, what was uncertain at the outset, what alternatives you evaluated, and how it turned out. A page or two, in the language of the work rather than the language of tax.

These are built from interviews with your technical people, typically an hour each, once a year. You do not write them.

Time allocation by project

The wage portion of the credit rests on who spent what share of their year on which project. Timesheets coded to projects are the strongest form of support. Most companies do not have them.

The accepted alternative is a reasonable, documented estimate: allocations established through interviews and corroborated by job titles, project records, and payroll data. What matters is that the method is consistent and explainable, not that it was captured to the minute.

Contemporaneous records, and who produces them

Contemporaneous means "created while the work happened"

Records made during the project carry more weight than anything assembled afterward. The good news is that your team already generates them in the course of doing the work. They are not tax documents and they were never meant to be.

RECORDS YOU ALMOST CERTAINLY ALREADY HAVE

- | | |
|--|--|
| Design drawings and revision histories | Test reports and failure analyses |
| Prototype and scrap records | Project plans and status updates |
| Commit histories and issue tickets | Engineering change orders |
| Meeting notes on technical decisions | Vendor and contractor statements of work |

You are not the one building the file

A properly run study produces the documentation as a deliverable. The work on your side is bounded and predictable: payroll and general ledger data, a list of projects, and a few hours of your technical team's time for interviews.

Everything else, from project qualification and narratives to allocation methodology, credit computation, and the study itself, is produced for you and held ready in case anyone asks. If an examiner does ask, the study is the answer, and your advisor stands behind it.

Documentation is not what makes the credit available to you. It is what makes the credit defensible once you claim it. Those are two different problems, and only one of them is yours.

How to get started

The next step is a conversation, not a commitment. A short eligibility discussion tells you whether there is something here worth pursuing, and if there is not, you will hear that plainly.

01

A 30-minute conversation

We ask about your work, your team, and the past few years. No documents required.

02

A no-cost assessment

A straight answer on whether you qualify, which years are open, and an estimated range.

03

Your decision

If you move forward, we run the study and deliver it audit-ready. If not, you owe nothing.

What to bring

Nothing, for the first call. Later, a study runs on payroll data, your general ledger, a list of projects, and a few hours with the people who did the technical work. Most of it your accounting team can export in an afternoon.

This guide is general information, not tax advice. Eligibility, credit amounts, and filing deadlines depend on your specific facts and the law in effect for the year in question. Primary sources: IRC Section 41; IRS Instructions for Form 6765, Credit for Increasing Research Activities; and IRS, “Qualified small business payroll tax credit for increasing research activities” ([irs.gov](https://www.irs.gov)). Speak with a qualified tax advisor before filing.

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