

# R&D Tax Credit Basics

The R&D credit is available to businesses investing in new or improved products or processes. Businesses in many industries may qualify for the R&D credit. The Federal rules and the new Michigan R&D credit are discussed below.

The maximum credit amount is approximately 10% of the Qualified Research Expenses or QREs. QREs consist of wages, supplies, and contract development expenses. To qualify, expenses need to be related to Qualified Research Activities or QRAs. The taxpayer must bear the economic burden and have the legal rights to the results of the activities to qualify. Also, they must meet the Four-Part Test as follows:

## 1. Permitted Purpose

Intended to develop or improve a product or process

- Functionality and performance
- Quality and reliability
- Cost reduction
- Not aesthetics

## 2. Technical Uncertainty

Determined at the beginning of a project

- Capability or methodology uncertainty for developing or improving a product or process
- Design uncertainty
- Can we reach our goal? How are we going to reach our goal?

## 3. Process of Experimentation

Evaluation of alternatives

- Prototyping/Testing/Modeling
- Simulation

## 4. Technological in Nature

Activity must rely on principles of one of the hard sciences

- Engineering
- Physical sciences
- Computer sciences
- Biological sciences
- Not soft science, i.e. marketing, social, economic or psychological sciences

## Potential QRAs

Engineering & designing new or improved products or processes, prototypes, materials testing, tooling design, software development, drug research, quality assurance, FEA, and modeling.

## Potential Industries

Any manufacturing with an engineering activity such as plastics, metal stamping & forging, tool builders, machine & equipment builders, and/or chemicals and electronics. Companies involved with software development, life & food sciences, architecture, construction, and pharmaceuticals.

## Small Business Payroll Tax Election

Qualifying small businesses can elect up to \$500,000 of the R&D credit to be applied to payroll taxes. Start-ups can claim this election for up to 5 years or until revenue hits \$5 million.

## Increased IRS Documentation

Starting in 2025, the IRS has increased documentation requirements to claim the R&D credit. QREs will now need to be broken out by qualified business component directly on Form 6765 in Section G – Business Component Information.

## New Michigan R&D Credit

A new Michigan R&D credit of 3% of the company's QREs takes effect in 2025, along with an extra credit of 10 to 15% of the company's expenses that could be received depending on the number of employees in the business. To qualify, companies must submit their tentative claim for QREs incurred during the current calendar year before their annual return is filed.

For more information on R&D Tax Credit Basics, or how MRPR can assist you, please contact:

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