



FAQs about the research credit

Companies that engage in research and development activities may qualify for a federal tax credit for some of those expenses. The credit is complicated to calculate, and not all research activities are eligible — but the tax savings can be significant. Here are answers to questions you might have about this potentially lucrative tax break.

What's it worth?

The federal research credit — sometimes referred to as the research and development (R&D) credit — is for *increasing* research activities. Generally, it's equal to 20% of the amount by which qualified research expenditures (QREs) in a tax year exceed a base amount derived from your company's historical research expenditures. (There are alternative computation methods for start-ups and other companies without sufficient historical data.) QREs include wages, supplies, and certain consulting and contract research fees related to qualified research activities.

The credit is nonrefundable — that is, it can't be used to generate a loss — but unused credits may be carried back one year or forward up to 20 years. Limits on general business credits also prevent companies from using tax credits to erase their tax liability entirely.

In addition, start-ups may elect to offset research credits against up to \$500,000 in employer-paid payroll taxes. For this purpose, “start-ups” are generally businesses in operation for less than five years with less than \$5 million in gross receipts.

And sole proprietors and owners of small pass-through entities (including S corporations, partnerships and most limited liability companies) can use the credit to reduce their alternative minimum tax liability. For this purpose, “small” businesses are generally those with average gross receipts of no more than \$50 million for the three preceding tax years.

What costs qualify?

The research credit isn’t just for scientific research. Generally, to qualify for the credit, a research activity must:

- Relate to the development or improvement of a “business component,” such as a product, process, technique or software program,
- Strive to eliminate uncertainty over how (and whether) the business component can be developed or improved,
- Involve a “process of experimentation,” using techniques such as modeling, simulation or systematic trial and error, and
- Be technological in nature — that is, it must rely on “hard science,” such as engineering, computer science, physics, chemistry or biology.

To claim the credit, you must bear the financial risk associated with the research and enjoy substantial rights to the results. Otherwise, it will be considered “funded research,” which is ineligible for the credit.

These criteria are broad enough to encompass a wide range of business activities. Examples include developing new products, improving processes (including business or financial processes that involve computer technology) and developing software for internal use.

Finally, only *domestic* research costs qualify for the federal research credit. Foreign research expenses are excluded and must instead be capitalized and amortized over 15 years.

Can businesses claim the research credit for deductible R&E costs?

Research-related expenses may qualify for two tax breaks. The first is the research credit; the second is the *deduction* for research and experimental (R&E) costs. Businesses can immediately deduct domestic R&E expenditures paid or incurred in tax

years beginning after December 31, 2024. However, you can't claim both breaks for the same expenses.

In general, the expenses that qualify for the research credit are narrower than those that qualify for the R&E deduction. If you claim the research credit, you must reduce the amount otherwise deductible (or capitalized) for R&E expenditures by the amount of the credit. However, under the One Big Beautiful Bill Act, the amount deducted or charged to a capital account for R&E costs is reduced by the full amount of the research credit, as opposed to being subject to a more complex calculation in effect under prior law.

Next steps

Many businesses overlook the federal research credit because of its complexity. But the tax savings can be substantial — and many states offer research tax incentives in addition to those available at the federal level. If your business invests in developing or improving products, processes or software, we can help you assess eligibility, quantify potential benefits and ensure your research-related tax breaks are properly supported. Contact us for more information.

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