

THE REFERENCE

YOUR SPECIALTY
TAX SOLUTION

“

McGuire Sponsel's approach to each engagement demonstrates our deep appreciation for the CPA – client relationship. We bring additional value to that relationship.

”

– TJ Sponsel
Director
McGuire Sponsel

SECTION 41 RESEARCH & EXPERIMENTATION TAX CREDIT

Summary of Research Credit Criteria

1. Qualification – In order to qualify for the federal tax credit, a company's research expenditures must pass the following four-part test:
 - a. Technological in Nature
 - i. The research must rely upon principles of hard sciences, which include biology, chemistry, engineering and physics
 - ii. Activities centered around marketing, economics, humanities, management and social sciences do not qualify
 - iii. Research must be intended to discover new information
 - b. Uncertainty
 - i. The information sought must be intended to eliminate uncertainty concerning the development or improvement of the product, process, technique or formula
 - ii. Uncertainty exists if, at the conceptual phase, information available to the taxpayer does not establish the company's capability, method or functional design of the product or process
 - c. Process of Experimentation
 - i. Evaluation of one or more alternatives to a company's original design objective(s)
 - ii. Involves developing one or more hypotheses, testing and analyzing the hypotheses, and refining or discarding the hypotheses as part of the development
 - iii. Term of art – “Trial and Error”

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Summary of Research Credit Criteria *(page 2)*

d. Permitted Purpose

- i. Activities must relate to the development of a new or improved function, performance, reliability or quality of the product, process or formula
- ii. Pursuit of government or industry certification
- iii. Activities relating to style, taste or preference factors do not qualify

2. Quantification – Qualified Research Expenditures (“QREs”) consist of the following components:

a. Wages

- i. Box 1, W-2 wages
- ii. Engaging in qualified research
- iii. Direct supervision or support of qualified research
- iv. “Substantially All” rule

b. Supplies

- i. Raw materials consumed during the process of qualified research
- ii. Prototypes and samples (for certain cases)

c. Contract Research

- i. Outside consultants'/companies' costs incurred by the taxpayer for qualified research. Includable up to 65% of the total cost
- ii. Taxpayer must bear the economic risk of the qualified research

3. Calculation – Depending on the company's date of formation, documentation retention policies and historical dedication to research and development, one of the following calculation methods would apply:

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**Summary of Research Credit
Criteria** *(page 3)*

- a. Standard Calculation
 - i. For companies formed prior to January 1, 1984
 - ii. 1984 – 1988 base period

- b. Start-Up Method
 - i. For companies formed after December 31, 1983
 - ii. Standard IRS base percentage for first five years

- c. Alternative Simplified Calculation Method
 - i. Effective January 1, 2007
 - ii. Reduces dependency on base period documentation
 - iii. Utilizes previous three years' QREs to determine current year's tax credit opportunity