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Tax Benefits of Research and Development



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Overview of the R&D tax credit

The Credit for Increasing Research Activities (Internal Revenue Code §41), commonly referred to as the Research and Development (R&D) or Research and Experimentation (R&E) tax credit, is a federal incentive that provides companies with a dollar-for-dollar tax credit for performing activities related to the development, design, or improvement of products, processes, formulas, or software. The credit amount generally equals 20 percent of qualified research expenditures (QREs) that exceed a specified base amount, which is determined using the taxpayer's historical qualified research expenditures and gross receipts. The credit was made permanent by the Protecting Americans from Tax Hikes Act of 2015 (PATH Act).

The research tax credit rewards businesses for conducting qualified research activities (QRAs), offering a credit based on a portion of the QREs incurred in such activities. Although the credit remains in effect, the Tax Cuts and Jobs Act of 2017 (TCJA) altered the deductibility of research expenses. As of 2025, Internal Revenue Code §174 requires that research and experimental (R&E) expenditures be capitalized and amortized over five years (15 years for research conducted outside the United States). This does not affect the availability of the §41 R&D credit, but it does impact the timing of the associated deductions. While legislative proposals have been introduced to restore immediate expensing under §174, none have been enacted into law.

What are qualified research expenditures?

QREs include wages paid to employees who perform, supervise, or support research activities; supplies used in research; and a portion (generally 65%) of contract research expenses paid to third parties. For an activity to qualify, it must:

- Be undertaken to eliminate technical uncertainty in the development or improvement of a product or process;
- Involve a process of experimentation to evaluate one or more alternatives;
- Rely on the principles of hard sciences, such as engineering, biology, or computer science; and
- Have a goal of developing a new or improved product or process.

Eligible activities include, but are not limited to:

- Meetings to consider alternatives and progress.
- Computer-aided design work.
- Testing new materials.
- Supervising research.
- Developing new or improved products, processes, or formulas.
- Designing prototypes, models, and tooling.
- Developing or applying for patents.
- Conducting testing and analysis.
- Improving manufacturing processes or facilities.
- Developing, implementing, or upgrading software systems.
- Engaging consultants to support any of the above activities.

The following activities are specifically excluded under IRC §41 and do not qualify for the credit:

- Research conducted after commercial production begins.
- Customization of products for specific customers.
- Duplication of existing products or processes.
- Surveys, studies, or market research.
- Internal-use software (unless it meets the high threshold of innovation test).
- Research performed outside the United States or its territories.
- Research in social sciences, arts, or humanities.
- Research funded by third parties or governmental entities.

Who can claim the credit and how is it reported?

To claim the credit, taxpayers must file IRS Form 6765, Credit for Increasing Research Activities. The credit may be claimed using either the regular or the alternative simplified method. If the R&D credit is part of a larger general business credit or is carried forward or back, it is also reported on Form 3800, General Business Credit.

Partnerships and S corporations must complete Form 6765 to claim the credit at the entity level. Other taxpayers can generally report the credit directly on Form 3800 if their only source is a flow-through entity. Estates and trusts must complete Form 6765 and may allocate the credit among beneficiaries. Unused credits may be carried back one year and forward 20 years. If unused after 20 years, the remaining amount may be deducted in year 21.

This tax-related discussion reflects an understanding of generally applicable rules and was prepared to assist in the promotion or marketing of the transactions or matters addressed. It is not intended (and cannot be used by any taxpayer) for the purpose of avoiding any IRS penalties that may be imposed upon the taxpayer. New York Life Insurance Company, its agents and employees may not give legal, tax or accounting advice. Individuals should consult their own professional advisors before implementing any planning strategies. These materials are prepared by The Nautilus Group®, a service of New York Life Insurance Company, and are made available to all Nautilus Group member agents, and as a courtesy, to select agents of New York Life Insurance Company. SMRU 5018765 Exp. 6.30.2028