

# Research & Development Credits, Cases, TCJA.2, and More

41<sup>st</sup> Annual TEI-SJSU High Tech Tax Institute  
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## Agenda

- OBBB Updates re: 174
- Case Law & IRS Enforcement Trends
- Form 6765 Updates
- State R&D Updates



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# OBBB Act & Rev. Proc. 2025-28

## Why It Matters

- TCJA §174 amortization effective 2022 reduced cashflow and increased compliance complexity
- OBBBA (July 2025) added §174A: domestic R&E deductible for years after 12/31/2024
- Transition rules and elections affect 2025 return prep and prior-year adjustments
- Coordination with §41 credit and §280C is required under amended law

# Legislative Timeline

- 2017: TCJA enacted
- 2022: §174 amortization begins (5-year domestic / 15-year foreign)
- 2025: OBBBA introduces §174A for domestic R&E; foreign remains under §174
- Rev. Proc. 2025-28: Elections, method changes, deadlines



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## Domestic vs. Foreign Rules

- Domestic R&E: deductible under §174A for tax years beginning after 12/31/2024
- Optional amortization  $\geq 60$  months under §174A(c) (annual election on timely return)
- Foreign R&E: remains under §174; 15-year amortization
- Software development: treated as R&E; domestic software follows §174A



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# §174A Basics & Software

- Applies to tax years beginning after 12/31/2024
- Election to amortize (§174A(c)) made on timely filed original return
- Software development costs treated as R&E; domestic software deductible or amortizable under §174A
- Foreign research remains subject to §174 and 15-year amortization



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## Transition Rules (2022–2024 Amounts)

- Applies to unamortized domestic R&E from 2022–2024
- Three options for 2025 return:
  - Deduct remaining amount in full in 2025
  - Amortize remaining amount over 2025–2026 (two years)
  - Continue original TCJA 5-year schedule
- Short-year relief window closed (9/15/2025)
- Confirm remaining basis (TCJA mid-year convention applies)



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# Small-Business Retroactive Election

- Eligibility: Average annual gross receipts  $\leq$  \$31M (per §448(c)); not a tax shelter
- Election applies §174A to 2022–2024; requires amended returns or AARs
- Deadline: July 6, 2026 or earlier statute of limitations
- Irrevocable; must also apply amended §280C rules for those years



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## Method Change Summary

- Automatic consent available for changes under Rev. Proc. 2025-28
- Statement in lieu of Form 3115 allowed for certain 2024 changes
- Cut-off basis for §174A adoption; no §481(a) adjustment for post-2024 changes
- Separate procedures for recovery of unamortized amounts and small-business retroactive method



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## §59(e) 10-Year Amortization

- Election to amortize domestic R&E over 10 years (alternative to immediate deduction)
- Elect on timely filed original return; irrevocable without consent
- Applies to expenditures otherwise deductible under §174A
- Separate from §174A(c) amortization election



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## Key Deadlines & Actions

- 2025 return: Elect recovery method for 2022–2024 amounts; make any §174A(c) or §59(e) elections
- July 6, 2026: Deadline for small-business retroactive election and related §280C elections
- Ongoing: Segregate domestic vs. foreign R&E for compliance
- Method changes follow Rev. Proc. 2025-28 procedures



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# Amendment to §41(d)(1)(A)

## Why It Matters

- **Prior** language: QREs “**may be treated**” as §174 R&E
- **New** language: QREs “**are treated**” as domestic §174A R&E
- Effective: Tax years beginning after 12/31/2024
- Implications:
  - Original returns: Domestic QREs must be treated under §174A–
  - Amended returns: Method changes not allowed on amended returns for this purpose



# §174 vs. §41

## Key Differences

- §174A: Deduction/amortization for domestic R&E; broad scope
- §41: Credit for qualified research; must meet §174 test plus:
  - Technological in nature
  - Process of experimentation
  - Permitted purpose (new or improved function, performance, reliability, or quality)
- All §41 QREs qualify under §174, but not all §174 costs qualify for §41



# §41 Credit

## Four-Part Test

- Meets §174 test
- Technological in nature (physical/biological sciences, engineering, computer science)
- Process of experimentation
- Permitted purpose: Improve product, process, software, formula, or technique



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# QREs & Credit Computation

- QRE categories:
  - Wages
  - Supplies
  - Computer leasing
  - Contract research (65%)
- Credit methods:
  - Regular: 20% of QREs above base amount
  - ASC: 14% of QREs above 50% of prior 3-year average
- Payroll tax offset: Up to \$500K for qualified small businesses



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# §280C Coordination & Late Election

- Default: Reduce §174A deductions by credit amount
- Alternative: Reduced credit election under §280C(c)(2)
- Late election/revocation allowed only with small-business retroactive election
- Deadline: July 6, 2026; requires amended return/AAR with revised Forms 6765 and 3800



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## Key Elections (Expense + Credit)

- Expense-side:
  - §174A(c) amortization ( $\geq 60$  months)
  - §59(e) 10-year amortization
  - Small-business retroactive election
- Credit-side:
  - ASC election
  - Reduced credit election (§280C(c)(2))
  - Payroll tax offset (§41(h))



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# Wrap-Up & Next Steps

- §174A applies to domestic R&E for years after 12/31/2024; foreign remains under §174
- Transition elections and method changes governed by Rev. Proc. 2025-28
- Key deadline: July 6, 2026 for small-business retroactive election and related §280C actions
- Immediate action: Review unamortized balances, confirm method elections, and ensure compliance with amended §41(d)(1)(A)



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## Case Law & IRS Enforcement Trends

# Federal R&D Opinions Cases Since 2019

| # | Year | Case Name                | Court | Main Issues                                       | Result for TP |
|---|------|--------------------------|-------|---------------------------------------------------|---------------|
| 1 | 2019 | Siemer Milling           | TC    | POE in wheat milling projects                     | Loss          |
| 2 | 2019 | Populous Holdings        | TC    | Funded research exclusion                         | Win           |
| 3 | 2020 | Meyer, Borgman & Johnson | TC    | Funded research exclusion                         | Loss          |
| 4 | 2020 | Tangel                   | TC    | Funded research exclusion                         | Loss          |
| 5 | 2021 | Little Sandy Coal        | TC    | 174 /POE, pilot models, substantiation            | Loss          |
| 6 | 2021 | Leon Max                 | TC    | 174/POE in garment making                         | Loss          |
| 7 | 2022 | Grigsby                  | DC    | BC test; funded research exclusion                | Loss          |
| 8 | 2023 | Moore                    | TC    | Substantiation of qualified services              | Loss          |
| 9 | 2023 | Betz                     | TC    | 174 /POE, pilot models, substantiation, penalties | Loss          |



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# Federal R&D Opinions Cases Since 2019

| #  | Year | Case Name                | Court               | Main Issues                                                      | Result for TP |
|----|------|--------------------------|---------------------|------------------------------------------------------------------|---------------|
| 10 | 2023 | Little Sandy Coal        | 7 <sup>th</sup> Cir | 174 /POE, pilot models, substantiation                           | Loss          |
| 11 | 2023 | Grigsby                  | 5 <sup>th</sup> Cir | BC test; funded research exclusion                               | Loss          |
| 12 | 2024 | Moore                    | 7 <sup>th</sup> Cir | Substantiation of qualified services                             | Loss          |
| 13 | 2024 | Meyer, Borgman & Johnson | 8 <sup>th</sup> Cir | Funded research exclusion                                        | Loss          |
| 14 | 2024 | Phoenix Design Group     | TC                  | 174/POE in electrical/mechanical engineering projects; penalties | Loss          |

**Government Record: 13-1**

**Taxpayer Record: 1-13**

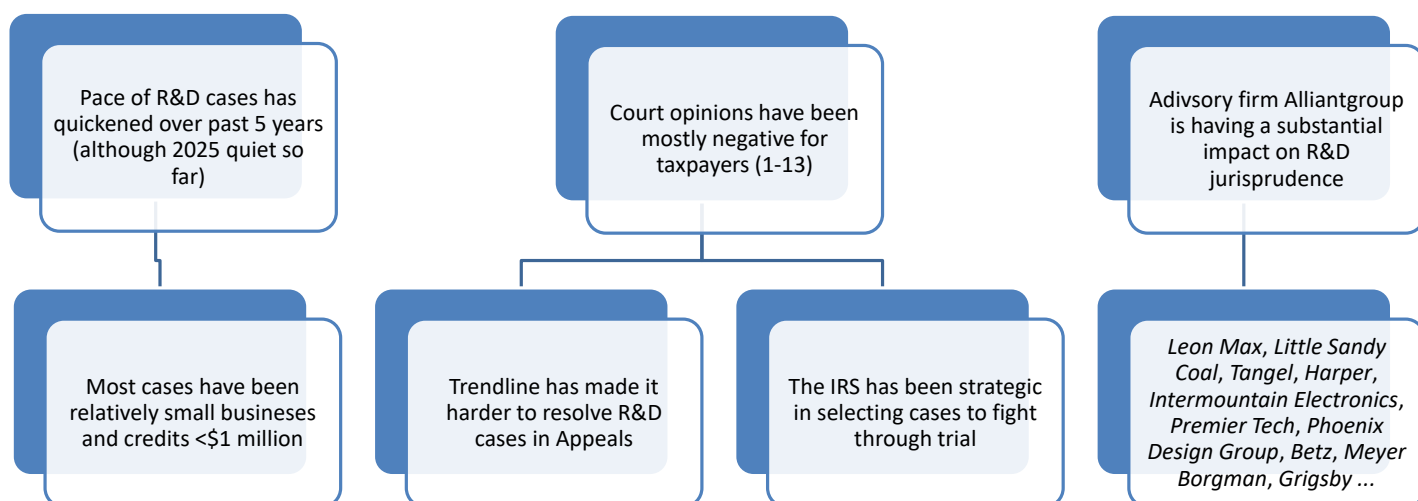


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# High-Level Practitioner Observations



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## Federal R&D Cases to Watch

### Park-Ohio v. United States, No. 1:25-cv-752 (N.D. Ohio)

- Automotive parts supplier filed R&D credit refund claim for costs of product development activities using 1120X and Form 6765
- In response to IRS correspondence that the refund claim was inadequate, Park-Ohio provided additional qualitative information about its projects
- After the IRS rejected the claim as inadequate, Park-Ohio filed a refund suit in district court contending that (1) its refund claim provided due notice to the IRS; (2) it was entitled to the claimed credit; and (3) the IRS's administratively imposed disclosure requirements were invalid
- This August, Park-Ohio and DOJ filed, and the court granted, a motion to stay the case for 15 months "to allow the [IRS] to review and consider the merits of Park-Ohio's tax refund claim that is the subject of this action."



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# Federal R&D Cases to Watch Cont'd

## **J.G. Boswell Corp. v. Comm'r, No. 2408-19 (U.S. Tax Ct.)**

- California farming company claimed \$17 million in QREs (2014) for costs of agronomic trials on research acres (versus production acres) to test changes to improve crop quality or yield and/or production operations
- A 2022 Tax Court order held that whether claimed supply and labor costs are QREs depends on whether the business component was a new or improved product (allowable) or production process (not allowable)
- Scheduled for trial in Los Angeles to begin on November 17, 2025

## **Facebook Inc. v. Commissioner, No. 12738-18 (U.S. Tax Ct.)**

- Issue is whether \$4.1 billion in stock compensation paid to Mark Zuckerberg in 2012-13 (~\$355 million in credits) should look to grant year (2005) or vesting period (2008-10) to determine qualified services
- Cross-motions for summary judgment filed in May 2025



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# IRS Changes Affecting R&D Cases

## **Leadership changes this year**

- 6 Commissioners (currently vacant)
- 4 Chief Counsels (D. Korb nominated)
- Significant LB&I and Appeals departures
- Many IRS org chart positions vacant or acting

## **Downsizing this year**

- Hiring freeze, 2 DRFs, RIF, recent layoffs
- Estimated that IRS headcount will fall from ~100k to ~60-70k IRS headcount by year end
- LB&I down ~25%, Appeals ~27%, and former DOJ Tax ~30%

## **Observed implications for R&D cases**

- More audit-level resolutions
- MITRE contract terminated
- Selected cases still receiving hard look with dedicated engineers and typical fact-finding and issues (e.g., substantiation)
- Increased use of Fast Track Settlement to resolve cases with Exam
- Delays and continued headwinds in Appeals
- Uptick in litigation



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# Key Exam Issues

## Business Components

- Four-Part Test Criteria
  - Technical Uncertainty
  - Process of Experimentation
- Substantially-All

## Employee Testing

- Nexus of Employee to Business Components to Activities

**Substantiation!**  
**Substantiation!**  
**Substantiation!**



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# Form 6765 Overhaul

# Revised Form 6765

## Timeline

- September 2023 - IRS released a preview of proposed changes to draft Form 6765
- June 2024 – IRS Released revised draft Form 6765 based on feedback
- December 2024 – IRS Released second revised draft Form 6765 based on feedback
- February 13, 2025 – Final form and instructions released
- October 1, 2025 – Delays Section G (Business Component) to tax year 2026.  
Comment period for the draft instructions extended until March 31, 2026. Updated instructions for tax year 2025 expected to be released in January 2026.
- Also extended through January 10, 2027 the research credit refund claim transition period, which gives taxpayers 45 days to perfect a research credit claim for refund prior to the IRS's final determination on the claim.



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# Revised Form 6765

## Key Changes

- **Section A:** Are you a member of a controlled group?
  - If Yes, a statement is required to be attached
- **Section E: *Required for 2024***
  - How many business components are generating QRE?
  - Reporting wages for officers
  - Acquired/Disposed of any major portion of a trade or business
  - New expense categories generating QREs
    - Consistency is being looked at closer



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# Revised Form 6765

## Key Changes Cont'd

- **Section F: *Required for 2024***
  - QRE summary for all business components
- **Section G: *Now required for 2026***
  - Reporting is limited to minimum 80% of total QREs, or a maximum of 50 business components
  - Listed in descending order by QRE amount
  - Special instructions for taxpayers filing under the ASC 730 directive
  - A substantial amount of new BC information is required, including:
    - Business component type
    - Information sought to be discovered by the research activities (*only required if you are claiming a refund or credit on an amended return that includes a section 41 credit*)



# Revised Form 6765

Form **6765**  
(Rev. December 2024)  
Department of the Treasury  
Internal Revenue Service

**Credit for Increasing Research Activities**  
Attach to your tax return.  
Go to [www.irs.gov/Form6765](https://www.irs.gov/Form6765) for instructions and the latest information.

OMB No. 1545-0619  
Attachment  
Sequence No. **676**

Name(s) shown on return

Identifying number

**A** Are you electing the reduced credit under section 280C? See instructions.

☐ Yes ☐ No

**B** Are you a member of a controlled group or business under common control?

☐ Yes ☐ No

If "Yes," complete and attach the required statement. See instructions for required attachment.

**Section A—Regular Credit.** Skip this section and go to Section B if you are electing or previously elected (and are not revoking) the alternative simplified credit.

|                                                         |                                                                                                                                                                                                   |           |   |
|---------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|---|
| <b>1</b>                                                | Certain amounts paid or incurred to energy consortia (see instructions)                                                                                                                           | <b>1</b>  |   |
| <b>2</b>                                                | Basic research payments to qualified organizations (see instructions)                                                                                                                             | <b>2</b>  |   |
| <b>3</b>                                                | Qualified organization base period amount                                                                                                                                                         | <b>3</b>  |   |
| <b>4</b>                                                | Subtract line 3 from line 2. If zero or less, enter -0-                                                                                                                                           | <b>4</b>  |   |
| <b>Note:</b> Complete Section F before going to line 5. |                                                                                                                                                                                                   |           |   |
| <b>5</b>                                                | <b>Total qualified research expenses (QREs). Enter amount from line 48</b>                                                                                                                        | <b>5</b>  |   |
| <b>6</b>                                                | Enter fixed-base percentage, but not more than 16% (0.16). See instructions                                                                                                                       | <b>6</b>  | % |
| <b>7</b>                                                | Enter average annual gross receipts. See instructions                                                                                                                                             | <b>7</b>  |   |
| <b>8</b>                                                | Multiply line 7 by the percentage on line 6                                                                                                                                                       | <b>8</b>  |   |
| <b>9</b>                                                | Subtract line 8 from line 5. If zero or less, enter -0-                                                                                                                                           | <b>9</b>  |   |
| <b>10</b>                                               | Multiply line 5 by 50% (0.50)                                                                                                                                                                     | <b>10</b> |   |
| <b>11</b>                                               | Enter the smaller of line 9 or line 10                                                                                                                                                            | <b>11</b> |   |
| <b>12</b>                                               | Add lines 1, 4, and 11                                                                                                                                                                            | <b>12</b> |   |
| <b>13</b>                                               | If you elect to reduce the credit under section 280C, then multiply line 12 by 15.8% (0.158). If not, multiply line 12 by 20% (0.20) and see instructions for the statement that must be attached | <b>13</b> |   |





# Revised Form 6765 – Section E & F

**Section E—Other Information.** See instructions.

|           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |           |  |
|-----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|--|
| <b>37</b> | Enter the number of business components generating the QREs on line 5 or line 20 . . . . .                                                                                                                                                                                                                                                                                                                                                                                                                                                   | <b>37</b> |  |
| <b>38</b> | Enter the amount of officers' wages included on line 42 . . . . .                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | <b>38</b> |  |
| <b>39</b> | Did you acquire or dispose of any major portion of a trade or business in the tax year? <input type="checkbox"/> Yes <input type="checkbox"/> No                                                                                                                                                                                                                                                                                                                                                                                             |           |  |
| <b>40</b> | Did you include any new categories of expenses as current year QREs? . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No                                                                                                                                                                                                                                                                                                                                                                                                      |           |  |
| <b>41</b> | Did you determine any of the QREs on line 5 or line 20 following the ASC 730 Directive? . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No<br>If "Yes," enter the amount from Appendix C Line 19 (you may attach your Appendices A, B, C, and D here)<br>This ASC 730 Directive only applies to taxpayers with assets equal to or greater than \$10,000,000 who follow U.S. GAAP to prepare their Certified Audited Financial Statements showing the amount of currently expensed Financial Statement R&D. See instructions. | <b>41</b> |  |

**Section F—Qualified Research Expenses Summary.** See instructions.

|           |                                                                                                                                                                                                                                                                 |           |  |
|-----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|--|
| <b>A</b>  | Are you required to complete Section G? See instructions to determine if you are required to complete Section G, and how to complete Section F if you are not required to complete Section G . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No |           |  |
| <b>42</b> | Total wages for qualified services for all business components (do not include any wages used in figuring the work opportunity credit) . . . . .                                                                                                                | <b>42</b> |  |
| <b>43</b> | Total costs of supplies for all business components . . . . .                                                                                                                                                                                                   | <b>43</b> |  |
| <b>44</b> | Total rental or lease cost of computers for all business components . . . . .                                                                                                                                                                                   | <b>44</b> |  |
| <b>45</b> | Total applicable amount of contract research for all business components (do not include basic research payments). . . . .                                                                                                                                      | <b>45</b> |  |
| <b>46</b> | Enter the applicable amount of all basic research payments. See instructions . . . . .                                                                                                                                                                          | <b>46</b> |  |
| <b>47</b> | Add line 45 and line 46 . . . . .                                                                                                                                                                                                                               | <b>47</b> |  |
| <b>48</b> | Add lines 42, 43, 44, and 47, then enter line 48 on either line 5 or line 20, whichever is appropriate . . . . .                                                                                                                                                | <b>48</b> |  |

Form **6765** (Rev. 12-2024)

# Revised Form 6765 – Section G

**Section G—Business Component Information.** Complete lines 49(a) through 49(f) for each business component you are required to report. See instructions. Attach additional sheets if necessary to capture all business components.

| <b>BC</b> | <b>49(a)</b><br>EIN of the controlled group member conducting the research activities on this business component | <b>49(b)</b><br>Controlled group member's principal business activity code | <b>49(c)</b><br>Business component's name or unique alphanumeric identifier (see instructions) | <b>49(d)</b><br>Business component type (select one from available options) |
|-----------|------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------|
| <b>1</b>  |                                                                                                                  |                                                                            |                                                                                                |                                                                             |
| <b>2</b>  |                                                                                                                  |                                                                            |                                                                                                |                                                                             |

| <b>BC</b> | <b>49(e)</b><br>Software (if applicable, select from the available options) | <b>49(f)</b><br>Describe the information sought to be discovered. Use the space provided. |
|-----------|-----------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|
| <b>1</b>  |                                                                             |                                                                                           |
| <b>2</b>  |                                                                             |                                                                                           |

# Revised Form 6765 – Section G Cont'd

Form 6765 (Rev. 12-2024)

Page **4**

**Section G – Business Component Information** (*continued*). Complete lines 50 through 56 for each business component. If you have more than fifteen business components, see instructions.

| BC | 50<br>Direct research wages for qualified services | 51<br>Direct supervision wages for qualified services | 52<br>Direct support wages for qualified services | 53<br>Total qualified wages (add line 50, line 51, and line 52) |
|----|----------------------------------------------------|-------------------------------------------------------|---------------------------------------------------|-----------------------------------------------------------------|
| 1  |                                                    |                                                       |                                                   |                                                                 |
| 2  |                                                    |                                                       |                                                   |                                                                 |

| BC | 54<br>Cost of supplies | 55<br>Rental or lease cost of computers | 56<br>Applicable amount of contract research expenses (see instructions for reporting basic research payments) |
|----|------------------------|-----------------------------------------|----------------------------------------------------------------------------------------------------------------|
| 1  |                        |                                         |                                                                                                                |
| 2  |                        |                                         |                                                                                                                |



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## Takeaways

### Key Takeaways

- Key changes will have an impact on the 2024 tax filings for Form 6765, so clients should start planning for this soon.
- The heightened documentation requirements will require additional effort for companies claiming R&D in 2024, regardless of their tax position.



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# State R&D Updates

## Updated State R&D Credits

### California

- Proposed Changes

### Texas

- Updates to eligibility, calculation

### Michigan

- New Credit

### Iowa

- Updates to expenses captured in current year and base period, calculation

### Arizona

- Updates to calculation, application process

### Minnesota

- Credit now partially refundable – capped at 25M per year
- ASC 730 Directive

### Oklahoma

- New R&D Rebate fund

### Connecticut

- Expanded R&D credits
- Biotech Refund increased to 90%

### Massachusetts

- ASC method now allowed on amended returns

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# California - Proposed Legislation

- Introduction of ASC method for Tax years beginning Jan 1, 2022
- Retroactive repeal of AIRC to 2022
- ASC Calculation
  - 3% credit for QREs that exceed 50% average QREs from 3 prior years
  - 1.3% credit for taxpayers with no QREs in prior three years
- Electing and revoking ASC would be similar to current process which requires approval
- If enacted by September 12, 2025, it will take immediate effect
- NTR Comment
  - ASC rate is very low. California regular credit is 75% of the federal regular credit. ASC credit is 21% of the Federal ASC credit
  - Regular credit method is significantly more beneficial than ASC credit than it is federally
  - Taxpayers should consider reevaluating regular credit and not just switch to ASC if they were on the AIRC method



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# California - Exam Environment

- FTB has been issuing AIPS disallowing credits in full with minimal IDRs
- Software clients seem to be a big focus
- Multiple exams are currently open where the FTB did key word searches in Jira tickets for “bugs” “QA” and disallowed the entire business component
  - Likely due to lack of engineers in the FTB
- Documentation is a big focus
  - Architecture drawings, testing logs
- Ask questions during the study to understand and document how Jira is used
  - Example: Customer service techs log “bugs” that are true routine maintenance. Developers/Engineers log “bugs” during new feature development due to regressions caused by adding/improving components of the system
- FTB will still accept Federal exam results and apply to CA audit
  - Must be able to show a detailed exam was performed
  - Final NOPA with no IDRs not enough. Must have IDRs, 886-A or Revenue Agent Report (RAR)

# Texas R&D Credit History

- Texas R&D credit – Prior to 2019 – Simple credit to claim. Audits were usually desk audits which involved a simple review of the credit workpapers, no BC or documentation was generally requested
- In 2019, Texas began auditing more frequently and aggressively. The Texas credit at this time had last been updated in 2011 and referenced 2011 Federal regulations for qualification
- Texas argued that any changes to the regulations post 2011 did not apply to Texas law – IUS and Pilot model regs came out after 2011
- Auditors began broadly denying industries



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# Texas R&D Credit History

- Texas released its own R&D regulations that differed from Fed regulations
  - Examples of Qualified and Non-Qualified Software were provided. Any software that was an improvement was listed in the likely not qualified section
  - Documentation standard of “clear and convincing” was added. Higher documentation standard than federal
  - Service companies were not qualified. While not explicitly mentioned, engineering, architecture, and construction companies were likely the target of this language



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# Texas - TY 2025 Changes

- **Federal Alignment:** The definition of "qualified research expense" is now tied to line 48 of federal Form 6765, aligning Texas more closely with the federal R&D credit and simplifying administration
  - Current Fed regulations are applicable
- **Extension of R&D Credit:** The R&D credit, previously set to expire December 31, 2026, is now extended indefinitely (no expiration date specified)
- **Repeal of Sales Tax Exemption:** The sales and use tax exemption for certain property used in R&D activities under Texas Tax Code Sec. 151.3182 is repealed effective January 1, 2026. Taxpayers will no longer need to choose between the franchise tax credit and the sales tax exemption



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# Texas - TY 2025 Changes

- **Increased Franchise Tax Credit:** The credit for qualified R&D expenses increases from 5% to 8.722%.
  - For research conducted in partnership with Texas public or private higher education institutions, the credit increases to 10.903%
  - A taxpayer with historically 50k in Texas credits will now have 87K in credits. Significant increase to the benefit
- **Refundable Credit for No-Tax Due Entities:** Businesses that qualify for the credit but owe no franchise tax may be eligible for a refundable credit
- **Administrative Procedures:** The bill details procedures for determining credit eligibility including:
  - federal audit results
  - statistical sampling
  - ASC 730 – may be used as evidence of qualified research expenses. Not automatically accepted as it must be validated by IRS or Comptroller as sufficient evidence



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# Texas - TY 2025 Changes - Unknowns

- Unclear if current exams will follow certain parts of this new legislation
  - Using federal exams results as support
- Comptroller can still provide their own regulations. Unknown at this time if the prior regulations (documentation standards, stricter software qualification and service companies) will be unapplicable going forward



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## Michigan - 2025

- Michigan has introduced a refundable R&D tax credit effective for tax years beginning on or after Jan 1, 2025
  - Unlike most state credits and federal credits, if the credit exceeds your tax liability, you can receive the excess as a cash refund
- Available to businesses conducting qualifying R&D activities in Michigan and current year R&D expense must exceed the base amount
- Credit Structure:
  - Fewer than 250 Employees
    - 3% of R&D expenses up to the base amount (average QREs of 3 prior years)
    - 15% of R&D expenses above the base amount
    - Limited to \$250,000 per taxpayer
  - More than 250 Employees
    - 3% of R&D expenses up to the base amount (average QREs of 3 prior years)
    - 10% of R&D expenses above the base amount
    - Limited to \$2,000,000 per taxpayer



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# Michigan - 2025

- Collaborative Research bonus:
  - Additional 5% credit (up to 200,000/year) for research conducted with Michigan universities
- Credit follows section 41 criteria but only for expenses incurred within Michigan
- Base amount must be calculated using calendar-year data, even for fiscal-year filers
  - Treasury will develop an optional method for fiscal year filers to convert their fiscal year R&D expenses into calendar year expenses for the base amount years before 2025
- Eligibility
  - Available to corporate income taxpayers and flow-through entities
    - Flow-throughs will claim the credit on its annual withholding return for the tax year in which their tentative claim was filed



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# Michigan - 2025

- Claim Submission and deadlines
  - To benefit from these credits, business must adhere to strict submission guidelines. Regardless of a taxpayer's year end, tentative claims must be filed by March 15 in the previous calendar year, except for calendar year 2025
    - Calendar year 2025: April 1, 2026
    - Calendar year 2026 & beyond: March 15 of the following year
- The total amount of all credits that may be claimed by all claimants for a calendar year is limited to \$100 million. If tentative claims exceed this amount, statutory proration provisions will apply to reduce the allowed credit for all or certain claimants. Treasury will publish a notice on its website notifying claimants whether adjustments are required to the tentative claims for the calendar year and the amount of any such adjustments. Once Treasury has published this notice, taxpayers will be eligible to claim the credit, adjusted as necessary, on their annual returns filed after the end of the taxpayer's tax year



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# Michigan - Limited or Forthcoming Guidance

- Employee count criteria – Still unclear whether the count includes Michigan only, all US employees, or global headcount
  - Ambiguity around whether to use FTE or total employees
- Required documentation: Still developing forms, instructions, and a Revenue Administrative Bullet (RAB) to guide submissions
- Additional clarity for fiscal filers
- Department of Treasury notice “The new credit only looks to IRC section 41 (26 USC 41, the federal research credit) for the definition of ‘qualified research expenses.’ Claimants should not apply any other IRC provisions, federal regulations, or federal concepts, other than those that may be applicable under the Michigan Income Tax Act, in determining their state credit”
  - Does this mean no IUS or Pilot Models?



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## Michigan - 2025 - Example Calculation

- Background facts:
  - If a taxpayer (more than 250 employees) had the following Michigan-qualified R&D expenses:
    - 2022: \$400,000
    - 2023: \$500,000
    - 2024: \$600,000
  - Then the base amount for 2025 would be  $(400,000 + 500,000 + 600,000)/3 = 500,000$
- Scenario 1: If the Taxpayer incurs \$700,000 in Michigan QREs in 2025
  - First \$500,000 get a 3% credit = \$15,000
  - Excess \$200,000 gets a 10% credit = \$20,000
  - Total Credit = \$35,000
- Scenario 2: If the Taxpayer incurs \$500,000 in Michigan QREs in 2025
  - The Taxpayer is not considered an authorized business (as the current year R&D expenses are not greater than the base amount); therefore, the Taxpayer does not qualify for the MI R&D credit



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# Iowa Changes – TY 2023

- Background
  - Refundable research activities credit equal to 6.5% of Iowa's apportioned share of qualifying expenditures for increasing research activities that exceed the larger of a base amount or 50% of qualifying research expenditures
  - Taxpayers also can elect to calculate their research activities credit using the federal ASC, which is equal to 4.55% of expenditures occurring in Iowa that exceed 50% of the average of the prior three-year qualified research expenses
  - Limited to manufacturing, life sciences, agriscience, software engineering, aviation, aerospace
- Reduction in Refundable Credit (HF 2317):
  - Refundable portion of the credit exceeding a taxpayer's liabilities will be reduced incrementally over five years by 10% each year
  - 90% of excess credit in 2023, 80% in 2024, 70% in 2025, 60% in 2026 and 50% in 2027 and onwards
  - Taxpayer can elect to credit overpayment credited to next year's tax liability
  - HF 2317 does not allow taxpayers to carry forward the unused portion of their refundable credits

# Iowa Changes – TY 2023

- Alternative Simplified Method
  - Taxpayer using ASC method for federal method must use if for Iowa
- Reduction in QREs
  - Supply expenses phased out over 5 years, 80% actual costs in 2023, 60% 2024, 40% 2025, 20% 2026, no longer eligible in 2026
  - Cloud computing expenses excluded from QREs
  - "Substantially all" rule removed; 100% of research activities must involve experimentation (no supervision or support that isn't POE)
  - "Majority Work" limitation
    - 50% of employee/ contractor time must be spent on qualifying BC in Iowa to be Included in QREs
    - "Wages paid to an employee for qualified research services performed in Iowa will only qualify as Iowa qualified research expenses if, during the period of the tax year that the business is engaging in one or more research projects, a majority (greater than 50%) of the total services performed by that employee are directly related to those research projects"
  - Noted: These expenses can also be removed from the base period

# Arizona Changes – TY 2023 Changes

- Alternative Simplified Credit Method Introduced
  - Option to calculate credit using ASC method, mirroring federal approach
  - Requires federal ASC election
    - Ineligible if no QREs in any of the prior 3 years
- Nonrefundable Credit rates Unchanged
  - 24% on first \$2.5M QREs, 15% on excess
- Refundable Credit for Eligible Small Businesses
  - Taxpayer must have <150 full-time employees
  - Taxpayer must apply to the Arizona Commerce Authority (ACA) for a Certificate of Certification to be eligible for a refund
  - Refundable amount is based on lesser of:
    - 75% of excess credit; or
    - The maximum refund amount specified on the Certificate



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# Arizona Changes – TY 2023 Changes

- Refundable Credit for Eligible Small Businesses (Continued)
  - The excess credit refers to the current year's credit minus the current year's tax liability
    - 75% refund pertains exclusively to the current year's excess credit for increased research activities
    - The decision to make this credit refundable must be declared when originally filing the tax return to claim the current year's credit



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# Arizona Changes – TY 2024 Changes

- Refundable claims are no longer “first come, first serve”
  - Arizona caps the refundable allocation for the year at \$5 million for all taxpayers
  - Prior to 2024, taxpayers were allocated portions of the \$5 million based on when their application was submitted to the ACA
  - Beginning in 2024, the applications are treated on a lottery basis
    - Note: It is still important to submit the application as soon as possible
    - “Because of the volume of Applications historically received on the first business day of the calendar year and the level of the program cap, Substantially Complete Applications received on the first business day of a calendar year will be prioritized by means of a random selection process that includes all Substantially Complete Applications received by 11:59 p.m. (Arizona time) on that day. Thereafter, for the remainder of the calendar year, Substantially Complete Applications will be prioritized based on the time received”



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## Minnesota - 2025

- Tax years starting January 1, 2025
- MN R&D credit is partially refundable
  - 2025 - refundability rate is 19.2%
  - 2026-2027 - refundability rate is 25%
  - 2028 - refundability rate will be determined with formula developed by the state. State is required to determine formula by December of 2027
  - Total refunds limited to approximately \$25 million
- Reminder on ASC 730
  - Generally follow the 2020 ASC 730 Directive and allow use of US GAAP expenditures for calculating MN R&D credit
  - Will not follow part II C in the 2020 Directive, which requires federal auditors to receive approval before requesting additional information not listed in the 2020 directive. MN auditors do not need to receive approval before requesting other relevant documentation during an audit



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# Oklahoma - 2025

- Not a traditional R&D tax credit
- Passed bill on May 29, 2025, establishing Research and Development Rebate Fund and Program
- Limited to a \$20 million cap
- High Tech investments and innovation
- Qualifying businesses receive a 5% rebate for QREs. First-come, first-served basis
- Submit application and supporting documentation to the Oklahoma Department of Commerce (DOC)
- Provide additional documentation to support R&D expenditures were performed in OK
- Taxpayers whose claims are not approved by the DOC due to the cap being reached could be approved in future years
- Application and process could be similar to Arkansas



# Connecticut - 2025

- Credit Refund value for qualifying small biotechnology companies to 90% of the credit. Previous amount was 65%
  - C Corporation with less than \$70M in sales and not yet profitable
- Qualifying small businesses that are not biotech sector may receive a refund of 65%
- \$1.5 million dollar refund cap per company
- Currently, only C corporations may participate in R&D program
- Proposed legislation to allow pass-throughs to claim R&D credits. If passed, effective date would be tax years starting on or after Jan 1, 2026



# Massachusetts - ASC update

- Department of Revenue allows all business corporation to use ASC method on amended returns
- Amended returns still within statute, Department of Revenue will process claims that were previously denied because it was amended using ASC



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## 2024-2025 State-Level R&D Cases



### California

**Pending Case:** 2024-OTA-679P  
– Office of Tax Appeals

**Summary:** Research and development (R&D) credit (IRC 41); calculation of fixed-based percentage (qualified research expenses)



### Florida

**No directly litigated and no pending R&D tax credit cases**

**Summary:** To claim the Florida R&D credit, a corporation must first claim and be allowed the federal R&D tax credit under IRC § 41. This means that most eligibility disputes are resolved at the federal level with the IRS or in U.S. Tax Court.



### Texas

**No directly litigated and no pending R&D tax credit cases**



### Wisconsin

**Pending Case:** 2023AP125 – Wisconsin Supreme Court

**Summary:** This case involves a dispute over the interpretation of Wisconsin's R&D tax credit eligibility criteria, particularly regarding the treatment of software development expenses. The taxpayer challenges the Department of Revenue's denial of credits for certain internal-use software projects, arguing they meet the statutory definition of qualified research.

# State Exam Environment

- Texas
  - Very difficult environment for several industries and documentation standards have made exams challenging
  - Recommended clients either not claim R&D (software) or significantly reduce expenses
  - Could be changing soon
- Wisconsin
  - Actively auditing several claims
  - Big focus on Business Components and supply costs
- California
  - Lack of software engineer expertise
  - Difficult exam environment due to stretched resources and inexperience
  - Software claims blindly reliant on Jira tickets



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## Thank you