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best the procedures for acquiring the credit and applying it. So below are some important areas to consider, along with some common mistakes, to make sure your business can fully use these tax credits to support their organizations.

Only Qualified Activities Count

A common misconception about the R&D Tax Credit surrounds the types of activities of that qualify for the credit. Only qualified research and development activities, as defined by the IRS are eligible to count towards the credit. To determine this, the IRS uses the following four-part test where the activity must meet the following criteria.

1. The activity must be related to developing or improving the functionality, quality, reliability or performance of a product, process, formula, technique or software.
2. The business component's development must be based on the principles of a hard science, such as engineering, physics and chemistry, or the life, biological or computer sciences.
3. The organization must have faced technological uncertainty when designing or developing the product, process, formula, technique or software.
4. The company must have evaluated multiple design alternatives or employed a systematic trial and error approach to overcome the technological uncertainties.

Enforcement

To keep certain regulatory standards and to ensure proper allocation of funds, the IRS has penalties in place to make sure businesses are compliant. For example, in situations where expenses are incorrectly classified as R&D expenses to claim the tax credits, the IRS can disallow the credits. Though rare, R&D credits that are egregiously overstated in blatant disregard of the controlling law may even be subject to penalties and fines of up to 20% of the overstatement.

As a business manager, the easiest way to avoid putting yourself in a precarious

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the qualified R&D spending that an organization records and not the size of the business' payroll or receipts.

Furthermore, many organizations choose not to claim R&D credits because they believe that their research isn't eligible. If a project meets the criteria defined above for a qualified activity, eligible expense tied to that project are includable in the credit calculation even if the project is ultimately unsuccessful. Whether it's developing IP or redesigning a product, the scale of the project is irrelevant to qualifying for the credit.

Navigating different tax credits can be a complicated and difficult process for organizations. But developing a better understanding of tax credits like the federal research and development credit, can help your business significantly in the long run.

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