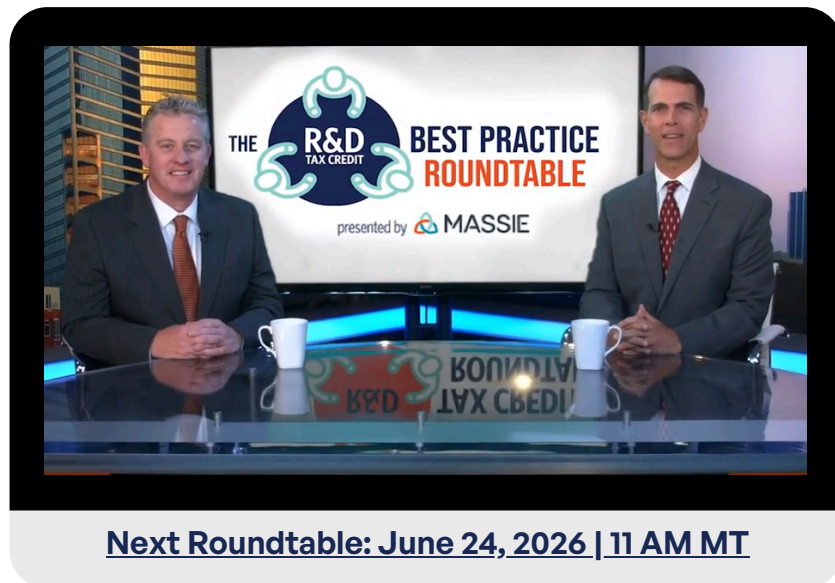


# TEI Arizona White Paper

February 17, 2026

# Table of Contents

 <b>Our Message to YOU</b>	.....	<b>3</b>
 <b>Ins and Outs of the R&amp;D Tax Credit for 2026</b> <b><u>Jason Massie</u></b>	.....	<b>4-6</b>
 <b>IRS Enforcement Update: Signs of a Turning Point</b> <b><u>Matthew Lerner</u></b>	.....	<b>7-9</b>
 <b>Optimizing Your R&amp;D Tax Credit Process Using Technology You Already Own</b> <b><u>Taylor Eiselin</u></b>	.....	<b>10-13</b>
 <b>Conclusion</b>	.....	<b>13</b>



## Our Message to YOU

We want to thank the TEI Portland Chapter members and their leadership for inviting us to speak on such a timely topic. We know it isn't easy balancing your day job with being a TEI leader, so we recognize Daniel Reeves being a pleasure to work with and help make the event a success.

During the sessions, we covered important topics like the new Form 6765, cases, controversy, and technology that impact R&D tax credits. If you have questions as you review this white paper, please contact [info@massietaxcredits.com](mailto:info@massietaxcredits.com), and we will be glad to guide you.

The research credit landscape has entered a period of significant transformation. Between evolving IRS enforcement strategies, heightened documentation expectations, and the introduction of Form 6765 Section G requirements, companies must adapt their R&D tax credit processes to meet new compliance standards. This whitepaper synthesizes key insights from MASSIE R&D Tax Credits and Sidley Austin on how to navigate these changes while optimizing internal processes through modern technology.

# Ins and Outs of the R&D Tax Credit for 2026

Jason Massie, MASSIE R&D Tax Credits

## OBBBA and State 174 Conformity

We received a question before the Webinar from Jeff Davis of Zion's Bancorporation regarding state conformity with OBBBA for section 174. As such, we have attached many charts from the Council on State Taxation ("COST") that were prepared by that group as of October 31, 2025. Please see the Zoom Toolbar in the Resources area for that handout.

## State R&D Tax Credit Landscape

Currently, 39 states offer R&D credits that can be claimed in addition to the federal credit. While many state credits align closely with federal requirements, some states have implemented unique provisions and incentives that require careful attention.

## Recent State Developments

Several states have recently enacted significant legislation affecting their R&D credit programs:

- Connecticut expanded and enhanced R&D credits under H.B. 7287, effective June 30, 2025. Single-member LLCs may now qualify if they meet specific size and manufacturing criteria.
- California introduced a new Alternative Simplified Credit election starting with 2025 tax years, allowing 3% of QREs over 50% of the prior three-year average.
- Iowa repealed its former Research Activities Credit and replaced it with a more stringent application program effective for 2026, restricting eligibility to specific industries such as advanced manufacturing and bioscience.
- Michigan enacted a new state R&D tax credit.
- Minnesota made its R&D credit partially refundable beginning in 2025, with refundability set at 19.2% for 2025 and increasing to 25% for 2026-2027.
- Oklahoma created the R&D Rebate Fund and Program through S.B. 324, offering a 5% rebate on QREs capped at \$20 million per fiscal year.
- Texas consolidated its R&D incentives into a single franchise tax credit effective January 1, 2026, increasing the credit rate to 8.722% with an enhanced 10.903% rate for university-based research.
- Virginia R&D tax credits have expired for taxable years beginning on or after January 1, 2025.

## New Wage Classification Requirements

Form 6765 is undergoing its most significant redesign in years. Section G, which requests business component-level reporting, is optional for tax year 2025 but becomes mandatory for tax year 2026. The IRS opened draft instructions for feedback through March 31, 2026, signaling that this reporting structure will continue to evolve. Companies must now report the top 80% of QREs across no more than 50 business components, ranked in descending order by QRE amount.

For each business component, taxpayers must identify the type (product, process, software, technique, formula, or invention) and provide detailed breakdowns of qualified research expenses including wages by job function.

Form 6765 requires the addition of new wage classification categories. Companies must now identify when individuals are performing Direct Research, Direct Supervision, or Direct Support. These classifications link directly to the experiments, uncertainties, and activities performed and are likely to influence how IRS exam teams evaluate claims. Teams will need clear strategies for defining business components and documenting related activities and costs.

## Business Components and Activity-Level Information

The IRS is focusing more heavily on the connection between the activity level of individuals and the qualified research they perform. Documentation should clearly demonstrate which business components generated the most QREs, how activities satisfied the four-part test, how the process of experimentation was carried out, and which individuals performed which activities.

Business components should be defined at an appropriate level of granularity. A business component that is too broad, such as defining an entire automobile as a single component rather than breaking it down into engine systems, electronics, or battery technology, will not provide the level of detail the IRS expects. Companies should consider their product development lifecycle and identify natural breakpoints where qualified research activities occur.

## The Critical Role of Documentation

Interviews continue to be useful in supporting the factual record, but recent cases reinforce that interviews alone do not satisfy the burden of proof. Courts have repeatedly emphasized the need for contemporaneous documentation demonstrating technical uncertainty and experimentation

## Lessons from Kyocera

The Kyocera case serves as a stark example of the consequences of insufficient documentation. The multinational manufacturer filed a 2018 claim of \$400,000, later amended after a PwC study to \$1.7 million. The IRS filed a motion for summary judgment, arguing there was no genuine issue of material fact and that the law supported their position since Kyocera bore the burden of proof. The court found that Kyocera failed to retain technical documentation supporting their credit claim. Subject matter expert testimony provided to PwC was deemed unreliable since it was gathered after the fact.

The court also determined that SMEs opined on an unreasonable number of employees, activity-level information was insufficient to prove the 80% substantially-all threshold, and business components were too broadly defined. Nearly all projects were disallowed.

## Key Takeaways from Kyocera

- Documentation must take precedence over interviews
- SMEs must provide opinions on a reasonable number of employees
- After-the-fact testimony is not considered reliable
- Activity-level information and documentation are needed to prove the 80% substantially-all test
- Technical documentation must be retained contemporaneously
- Business components must be appropriately defined with sufficient granularity

# IRS Enforcement Update: Changes Impacting R&D Examinations

Matthew Lerner, Sidley Austin

## IRS Enforcement Update: Signs of a Turning Point

After several years of increasingly adversarial R&D audits, there are meaningful signals that the IRS may be returning to a more balanced approach. Matt Lerner of Sidley Austin walked the group through what's driving this shift and what it means for your audit strategy today.

## A Shift at the National Office

After several years of increasingly adversarial R&D audits, there are meaningful signals that the IRS may be returning to a more balanced approach.

The LB&I Division Commissioner appointed an ad hoc ombudsman whose role is to field taxpayer complaints, ensure exam positions are reasonable and supportable at Appeals, and push for resolution. Engineers describe him as a dotted-line report. He is actively working to clear the docket.

- Engineering and Territory Managers now have more authority to negotiate “rough justice” settlements.
- Fast Track Settlement is being used to reach hazards-based resolutions at the exam level.
- Any disallowance of more than 50% of a credit for a technology-driven company reportedly must be approved up the chain.
- Disallowing the entire credit based on business component definition disputes is no longer favored.

**Key takeaway:** Weak or vague documentation leaves taxpayers vulnerable. Interviews alone will not suffice. The IRS is no longer relying on MITRE, but it is not letting claims through easily either.

## Common Challenges Still Raised by Exam Teams

Despite the improving climate, not every exam team has gotten the message. Silver-bullet tactics still in circulation:

- Rejecting statistical sampling over minor or contrived “foot faults” in the sample plan.
- Demanding arithmetic proof of the 80% “substantially all” test, even when qualifying research is obvious.
- Disputing business component definitions as a gating issue to disallow the entire credit.
- Applying 2004-era software audit guidelines and broadly misdefining internal-use software.
- Refusing interviews or site visits, then disallowing claims for lack of contemporaneous documentation.
- Being notably more hostile to refund claims than to credits filed with the original return.

## IDR Trends: Returning to Reasonable

For two to three years, many exam teams issued a single broad IDR, then immediately jumped to an Acknowledgment of Facts and NOPA, disallowing everything because the taxpayer “failed to prove” things they were never asked to prove. That approach is fading.

Exam teams are returning to risking: identifying high-risk items, asking follow-up questions, and leaving clearly qualifying work alone. That’s how audits are supposed to work.

- Ask for IDRs to be issued in draft so you can discuss scope before the clock starts.
- Gather not just what’s asked for, but any documents that affirmatively support your position.
- Organize your production: cover pages, summaries, Bates stamping. Exam teams want roadmaps.
- If your team is headed down the silver-bullet path, escalate early. The ombudsman will intervene.
- If your team is conducting a fair, risk-based audit, cooperate fully. Don’t squander a good team.

## Interviews, Site Visits, and Statistical Samples

Two years ago the IRS declared documents should “pave the road” and interviews merely “fill the potholes.” That position has reversed. We are now seeing SME presentations and site visits where IRS engineers are genuinely engaged and using the information to narrow adjustments.

- A well-prepared witness can do more for your case than any document. The dry-run prep session should be harder than the actual interview.
- Key witness rules: always tell the truth, listen to the full question, don't adopt false premises, don't speculate, be comfortable saying “I don't know.”
- Help witnesses connect their work to the Four-Part Test. Identify words to avoid: “simple,” “basic,” “easy.”
- For site visits: map the route, set ground rules, brief your employees in advance, do not let the exam team wander unaccompanied.
- On statistical sampling: business-component-based samples are still preferable, but employee-based samples are being accepted again, as long as you can connect employees to the projects they worked on.

## Preparing for IRS Appeals

The goal is to resolve cases at exam. But if you can't, build the record before you get to Appeals. If supporting material isn't in the record, Appeals may refuse to consider it or send the case back to Exam. Provide declarations, project summaries, and presentations, even if not asked for.

Matt's bottom line: “As long as the ombudsman remains on duty and continues to work with exam teams, we may have seen a turning point. I'm cautiously optimistic.”

# Optimizing Your R&D Tax Credit Process Using Technology You Already Own

Taylor Eiselin, MASSIE R&D Tax Credits

Modern research credit compliance depends on integrating existing collaboration tools into processes that are intuitive for SMEs and structured for tax teams. Companies increasingly expect to manage R&D documentation within platforms they already use.

## The Shift Toward Better User Experience

After interviewing and studying over 200 of America's top companies, MASSIE identified consistent pain points in traditional R&D credit processes: too much work for tax departments, money left on the table, poor SME interaction and response rates, and inadequate documentation for audit preparedness.

Many companies are rethinking their R&D processes by focusing on user experience first. Teams want workflows that fit how SMEs naturally communicate, simple guidance with examples, video tutorials and visual aids, automated reminders, and dashboards that provide real-time visibility.

## Modern Collaboration Tools

Companies are successfully leveraging tools such as Microsoft Teams and Slack for R&D collaboration hubs, Planner tasks with automated reminders, Google Workspace for communication and forms, Power BI dashboards for progress tracking, video libraries with sample responses, and documentation mapping checklists.

## Microsoft Teams Example

A customized Microsoft Teams hub can serve as the central collaboration space for R&D credit documentation. Key features include:

- Simple Planner tasks assigned to SMEs with clear instructions and due dates
- Instant messaging for real-time questions and answers
- Video training sessions demonstrating what good responses look like
- Real-time analytics showing project progress by business component
- Customized questionnaires tailored to specific departments
- Documentation mapping that provides checkbox lists of likely supporting documents

When SMEs upload documentation through the collaboration hub, files automatically organize into the proper SharePoint folder structure based on business component and documentation type, eliminating the typical inbox overload tax departments experience.

## The User Experience Testing Process

Before rolling out questionnaires to 100 SMEs, companies should conduct user experience testing with five representatives. This testing process involves detailed question review, determining internal terminology, implementing company-specific and industry-specific FAQs, utilizing existing systems and data to eliminate unnecessary questions, and refining language based on feedback. Taking time with five SMEs saves significant time when scaling to 100.

## Leveraging Existing Data Sources

Many companies already track data required for R&D credit calculations. JIRA data can provide activity-level information showing which employees worked on which projects, time allocations, and technical descriptions of work performed. Product lifecycle management systems document design iterations and testing protocols. Version control systems like GitHub demonstrate the process of experimentation through commit histories.

Companies should identify these existing systems during the architecture phase and extract data programmatically rather than asking SMEs to recreate information that already exists in structured form.

## AI-Powered Documentation

Tax departments are experimenting with internal AI deployed behind the firewall to improve documentation quality, classify technical activities, and structure unstructured engineering data. AI tools can identify patterns in JIRA tickets that indicate experimentation, extract technical uncertainties from design documents, and suggest appropriate business component classifications.

However, companies should be aware of risks associated with AI in R&D credit work. AI should augment human judgment rather than replace it. All AI-generated content should be reviewed by qualified SMEs and tax professionals. The IRS has also begun using AI in their examination process, making it critical that taxpayer documentation is accurate and defensible rather than simply AI-generated narratives.

## Results: The 98% Response Rate

In 2025, companies using modern collaboration tools and user-centered design achieved an average SME response rate of 98.43%. This dramatic improvement from typical response rates of 60-70% results from making the process genuinely easier for SMEs.

When the process is easier, greater participation generates larger credits while ensuring smoother audits. SMEs appreciate the simplified approach, tax departments gain visibility and control, and the entire process becomes more efficient and defensible.

## The Three-Phased Approach

### Phase 1: Architecture

The architecture phase involves finding existing systems that can provide commonly requested data, learning about the product or software development lifecycle, identifying innovation and SMEs, discovering the best methods for user interaction, agreeing on the project plan, and developing collaboration tools customized to the organization.

### Phase 2: SME Interaction

This phase focuses on process and tools that make interaction easier and more efficient. As Steve Jobs noted, you must start with the customer experience and work backward into the technology. The SME interaction phase implements custom collaboration tools, provides video guides with sample responses, offers documentation mapping with checkbox lists, simplifies time allocation reporting through existing data sources, and conducts user experience testing before full rollout.

### Phase 3: Tax Department Visibility

The final phase ensures tax departments have visibility and control over project progress and final report documentation. Real-time Power BI analytics show completion rates by business component, department, and individual SME. Electronic final reports organize all documentation for smooth audits. Post-project reviews identify improvements for the following year.

### Action Steps for 2026

As companies prepare for the 2026 tax year, several action steps can help ensure compliance with new requirements while optimizing internal processes:

- Develop a business component strategy that identifies the top 80% of QREs across no more than 50 components
- Gather product or software development lifecycle documentation showing phases, qualified activities, resources, and supporting documentation
- Establish why SMEs are qualified to provide opinions on business components and employee activities, while keeping the number of employees assigned to each SME at a reasonable level

- Value documentation over interviews by retaining and organizing technical documentation contemporaneously rather than waiting until an examination
- Review your current SME engagement process and identify pain points that reduce response rates or documentation quality
- Evaluate technology tools your organization already owns—such as Microsoft Teams, Slack, Google Workspace, or JIRA—and determine how they can be leveraged for R&D credit compliance
- Conduct user experience testing with a small group of SMEs before rolling out questionnaires or processes to the entire organization
- Consider whether Fast Track Settlement may be appropriate for any ongoing or anticipated examinations, while carefully gauging the exam team's willingness to compromise
- Review state-specific R&D credit changes that may impact your organization's multi-state credit calculations
- Ensure coordination between tax, engineering, and IT departments on documentation retention policies

## Conclusion

The research credit environment continues to evolve as the IRS increases its expectations for transparency, documentation, and substantiation of activity levels. Form 6765 Section G requirements, heightened documentation standards following cases like Kyocera, and shifts in IRS enforcement strategies all point toward a more rigorous compliance environment.

However, companies that invest in proper documentation processes, leverage modern collaboration tools, and maintain contemporaneous records will be well-positioned to defend their credits while maximizing their benefits. The key is to make R&D credit compliance easier for SMEs, more transparent for tax departments, and more defensible for examinations.

Organizations should view 2026 as an opportunity to modernize their approach to research credits by using technology they already own, focusing on user experience, and building processes that generate better documentation with less work.

If you are exploring ways to modernize your R&D credit process or stay ahead of IRS expectations, [reach out to MASSIE](#) or join our next [R&D Best Practice Roundtable](#) for practical insights and peer discussion.