

ROUNDTABLE WHITE PAPER

WEDNESDAY, FEBRUARY 23RD, 2022 | 3:00-4:00PM ET

Q1 ROUNDTABLE
FEBRUARY 2022

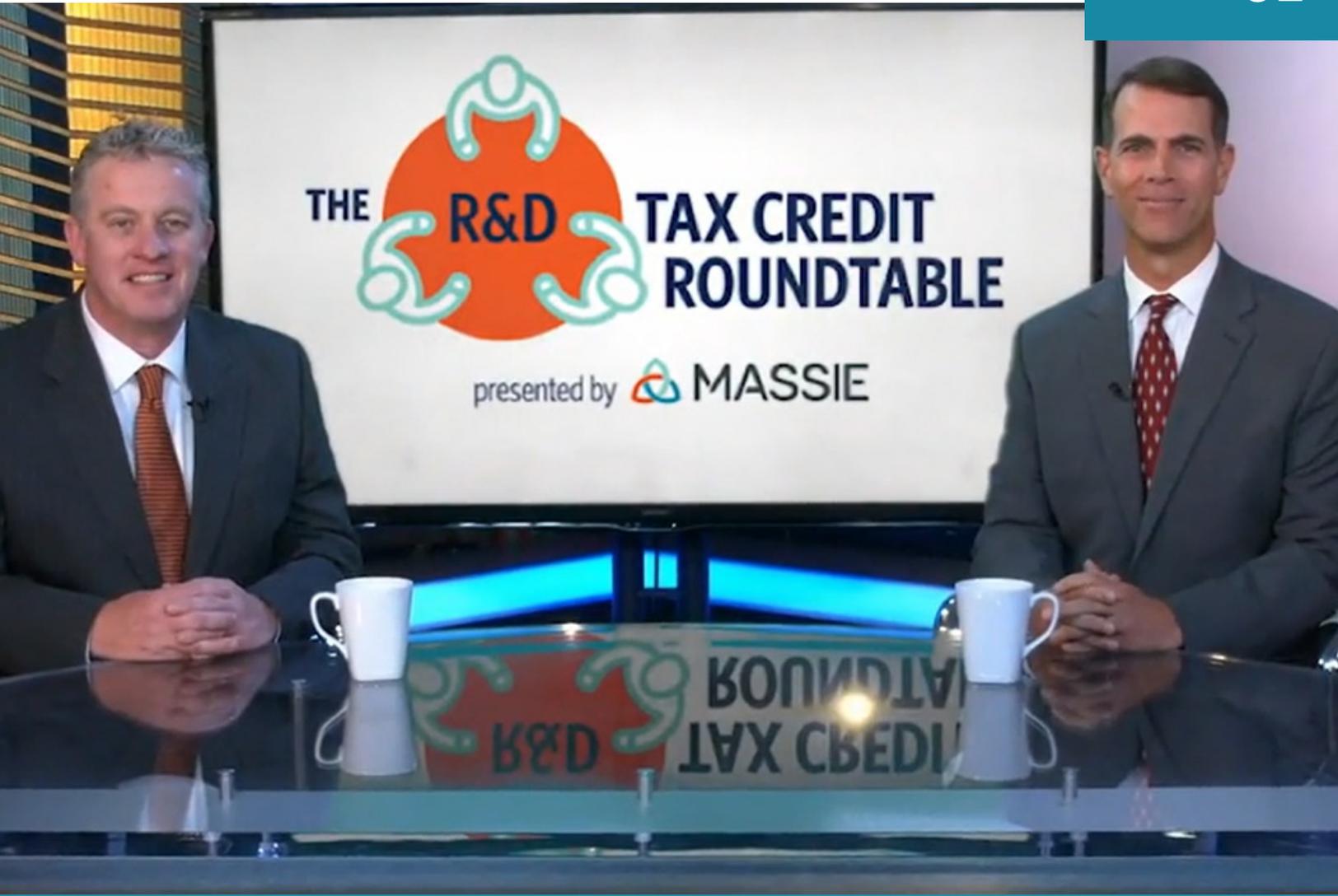
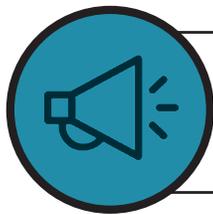


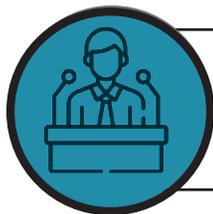
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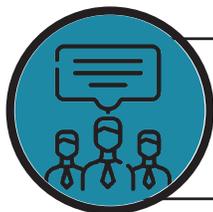
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Washington, DC Update on the Latest Cases, and IRS Pronouncements

Alex Sadler, Morgan Lewis

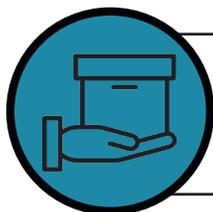
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Spotlight Speakers

Peter De Nicola, FujiFilm Holdings America
Kay Kousek, IHG

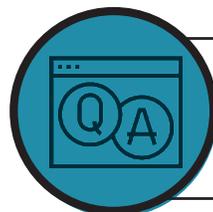
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174 Practical Application

Jason Massie and Paige Riordon, MASSIE R&D Tax Credits

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Upcoming R&D Best Practice Roundtable

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Companies Who Attended

ADX Labs
Alexion
Alexion Pharmaceuticals
Alorica
AMD
American Express Company
Anika Therapeutics
Autodesk
Aveanna
Avnet
Bridgestone Americas
Brunswick Corporation
C Spire Wireless
Cargill
Carpenter Co.
Centrus Energy Corp.
Cisco Systems
Clark Equipment Company
Conagra Brands
Corteva
Covestro
Cummins Inc.
Curative
Deere & Co.
Dell Technologies
DOW
Ducommun Incorporated
Eastman Chemical Company
Eli Lilly and Company
Emc2 Partners
Enascor Capital
Encompass Health Corporation
Entegris
Envestnet
Envision Health
EQUINIX
Exyte
Fedex corporation
FujiFilm North America Corporation
General Mills
GlobalFoundries U.S.
Granite Telecommunications
GreenSky
Harley-Davidson
Hella Corporate Center USA
Hollister Incorporated
Huntington Ingalls Industries
Illinois Tool Works
Intellicentrics
InterContinental Hotels Group

International Vitamin Corp
IPG
ITW
Koch Industries
Konecranes
Leggett & Platt
Legrand North America
Lockheed Martin
Lumen
MACOM Technology
Macy's
Mayne Pharma Inc
Midmark Corporation
Milliken & Company
Monster.com
Musco
Nauts Medical inc
Neenah Inc
Nestle USA
Nexteer Automotive
Novocure
OnSolve
Optiver
Oshkosh Corporation
Parker Hannifin
PCA
Quadient
Randstad North America
Rehrig Pacific Company
Safelite
SDPO
Siemens
SSF LLLP
Stanley Black & Decker, Inc.
Starkey Hearing Technology
Suntory International Corp.
SWM
Target
TEL US Holdings
The Coca Cola Company
The Suddath Companies
Tomana
ULA
Valvoline
Vertex Pharmaceuticals
Viasat
Western Digital Corporaton
Weyerhaeuser
Zoom Video Communications



MASSIE Notes



Introductions and Announcements

Jason Massie and Peter Green, MASSIE R&D Tax Credits

- MASSIE is excited to be a “Platinum Level” TEI National Sponsor for 2022. We look forward to the Midyear Conference coming up in DC. If you are in attendance, stop by our booth and say hello. There will be a Roundtable dinner on Monday night. Reach out to Peter or Jason if you’d like to attend. Make plans to hear Jason’s panel discussion on Tuesday morning.
- In May and June, we are sponsoring and presenting at TEI events in La Jolla, CA and Hilton Head, SC.
- If you would like for Peter and Jason to speak to your TEI group, please reach out to Kimberly or Ilona (events@massietaxcredits.com).



Jason Massie



Peter Green



R&D Hot Topics: Business Components & New Sec. 174

Alex Sadler, Morgan Lewis

- Thank you Peter and Jason for having me. I always enjoy speaking on your Roundtable.
- There are two items I plan to discuss.
 1. **Business Components.** The IRS is currently focusing on having taxpayers present R&D claims by business component (“B/C”). They appear to be using B/C as a ‘gating’ issue for refund claims. This is a significant change in how refund claims are supported.
 2. **New 174 capitalization.** We are now in 2022, which means there is a new section 174 capitalization and amortization regime (5/15 year requirements). TCJA changed the 174 rules. Taxpayers now need to identify 174 costs. Later on I will tell you whether Congress will fix this (or my best guess)?



Alex Sadler

Let’s start with last fall. The IRS issued field advice, called an FAA or CCM for short, under the heading of 20214101F, Sept 17, 2021. This FFA deals with taxpayers filing refund claims related to R&D credits:

- The IRS wants taxpayers to identify the following: list out all B/Cs as part of the refund request, state what activities employees performed, declare what each employee sought to discover, spell out QREs by B/C.
- My feeling is taxpayers must include all this information or the IRS may (will) reject the refund claim.



- The FAA is “only” a field advice prepared by IRS attorneys to fellow IRS employees. It has no statutory weight, but it represents the IRS’ “legal position.” It cannot be cited or used as precedent. It may be right, it may be wrong, but it is something taxpayers need to consider when filing refund claims.
- The Field Advice is contrary to three cases: McFerrin, Bayer and Premier Tech.
- I believe this will likely play out in court. We are probably going to see the IRS deny a valid refund claim for lack of specificity. Then a taxpayer will sue, and courts will need to decide if the FAA is valid or invalid.
- In the meantime, my recommendation is for taxpayers to do their best.
- Unfortunately, I am seeing FAA language in IDRs now, and even in NOPAs. I am seeing verbatim language from the FAA appear in those examination documents.
- It appears the IRS decided to use a tactical approach to put pressure on taxpayers who don’t have B/C information. One possible goal is to stop taxpayers from filing refund claims as the Service is behind or lacking resources to process claims timely.
- It is also likely the IRS believes some taxpayers are taking advantage of claiming the credit without gathering supporting documentation.
- As a practical matter, taxpayers may want to consider stat sampling or stand your ground and use a “reasonable methodology.” Either way, the IRS is here to fight and you’d better be prepared before filing your refund claims without considering the FAA.

Let’s shift over to 174.

- TCJA amended 174, and now taxpayers have to capitalize and amortize 174 expenditures over 5 or 15 years (domestic or foreign). So you still get to deduct the costs, but rather than expense them all currently, you have a timing issue.
- My Magic 8 Ball says there are a lot of different outcomes here in Congress. The Build Back Better Act doesn’t seem likely now. So the options are more likely that an omnibus spending bill could restore the expensing regime as early as March/April. Might see 174 sneak into the US Innovation and Competition Act of 2021 later in the year, or possibly a last minute item in the extenders bill in December (with retroactive application back to January).
- What do we do now? Need to get started.
- R&E Expenditures are not defined in the code/regulation.
- I would suggest taxpayers look at the nature of the activities and see if these were historically included in the financials or on the tax return? Maybe start with R&D study to look at 174 in that context.
- For the research credit, taxpayers now need to identify section 174 costs, and the IRS is likely to hold taxpayers to that capitalized bucket for the 41 credit. Taxpayers have to make a choice as to whether they claim 174 and capitalize because they are also 41, or expense them under some other provision like 162 but then they are not part of the 41 analysis.
- More to come I’m sure on this topic during the year. At least I hope so.



MASSIE Notes



Spotlight Speakers

Peter De Nicola, FujiFilms

Kay Kousek, IHG

Next up is Peter De Nicola from FUJI FILM

- We are a 3/31 company, so we are waiting a little bit on 174. We aren't relaxing, but do have an extra 3 months and hope Congress will act!
- Prior to COVID times, we would "divide and conquer" related to our research credit. We would send out tax people to the field to talk about tax and the research credit. We always found this method to be very effective. But the last few years have been challenging. As people work remotely from home, they are on calls all day long. They aren't as available or eager to talk R&D with us. In fact, we found when we scheduled those in-person meetings, then the engineers would show up prepared and ready to go. Now, it is easier for them to not show up for a zoom call or they aren't prepared.
- With the new cycle, we are trying to set up SME meetings more contemporaneously.
- Engineers may not be in the office right now, so we need to go with plan B.
- Our resources are spending less time on the credit because they aren't traveling, so they are spending more time exploring QRE areas like PPE products. We have also modified manufacturing processes for safety, so that has brought on new R&D opportunities as well.
- Our current exams in CA, TX and WISC are still out there, but moving very slowly.



Peter De Nicola

Next up is Kay Kousek from IHG to talk about 174

- We have new law change, and even though we'd like it changed back, we are stuck for now. For many companies Q1 isn't a big deal, but by Q2 we need to have this sorted out. We want to have a descent number to start with as soon as we can. We don't want to wait until the last minute and hope this all goes away.
- IHG is taking capital projects and looking at those, as well as Op Ex.
- The two big areas that are challenges is that projects are that are immediately expensed.
- IHG has Clarity, a robust time tracking system. We are relying on Clarity, but now we need to look at the rest of 2022. We need to grab budgets and forecasts from the Global Technology Team.
- We need to understand which projects in 2022 are going to meet section 174 and 41. We need to identify where these costs are going to hit our financials. Are they in a cost center? How do we hone in on forecast costs?



Kay Kousek



- Q1, will take a very high level approach. But for Q2, hope to get monthly forecasts and monthly trial balances for the GT group.
- In the future, technology team will need to fill out better “work intake” forms. The business requirements document will include a 4 part test. It will also talk about US/Foreign time. Based on the answers of the questionnaire, the time tracking will be flagged as 174/R&D. On a quarterly basis tax will be able to drill down further.
- Would recommend talking to your R&D advisors about 174 since they need to understand them anyway due to the R&D credit.
- Our outside auditing firm says we are far ahead of the game. We are “on the leading edge” and we did some modeling last year. But the work we need to do now is labor intensive. The dollars are significant. SOX documentation is what the outside auditor wants to start with in their analysis: drilling down into cost centers and department costs.



174 Practical Tips

Jason Massie and Paige Riordon
 MASSIE R&D Tax Credits

NOTE: If you want to learn more about 174 for your organization, or schedule a call with Jason/Paige, please contact us. We are available to help.

- Goal for tax people is to make sure your AUDIT goes smoothly, so if your auditor is asking for 174 information, you don’t want to hold up the process. So you need to start thinking about this NOW.
- Back in 1954, all “costs” incident to your R&D was included as an R&E cost. This is a very broad provision. Only in 1981 did section 41 come in. So you have to think about the net being HUGE for 174, and then it is whittled down for 41. “How much did it cost to run my R&D department?”
- This is still a very subjective area. R&E are not defined in the tax code.
- Probably want to start with the 174 code section language.
- What about overhead, depreciation, patent costs? Those can be significant costs. We don’t look at those for the 41 credit. We focus on W/S/Contractors. For 174 there are more categories. Need to look at overhead and G&A.
- Trend is going back to GAAP R&D. ASC 730 Directive started with that as well. Now we need to step back.
- Also need to focus on “non-core” employees that have added to your 41 credit. It is logical to say that your core R&D folks are 174. But non-core could be 162 deductions or possibly included in 174.
- Also need to look at accounting methods and issues related to how you change your methods.
- 174 impacts 263A, Bonus Depreciation, BEAT, 861 allocations. This has many different areas that it will touch. Outside auditing firms will task the tax department to come up with the 174 amount.
- Also need to point out that R&E costs cannot be written off when the underlying project is abandoned.
- How do we track 174? It is a big exercise.



Jason Massie



Paige Riordon



MASSIE Notes

Examples of Activities

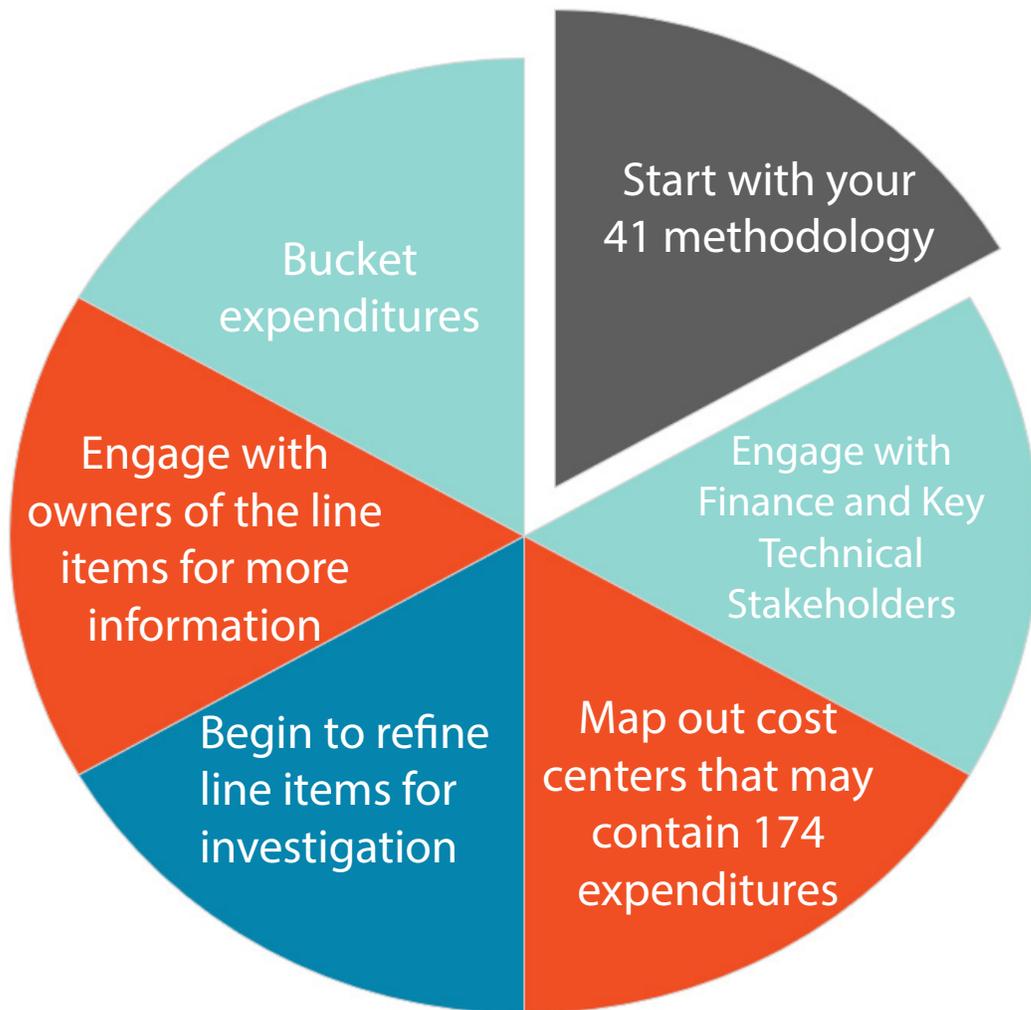
Allowed under:

Section 174

Section 41

W-2 Wages	Yes	Yes
Non-taxable employee benefits	Yes	No
401(k) contributions	Yes	No
Any amount paid or incurred for supplies	Yes	Yes
Contract research expense	Yes (100%)	Yes (65%)
Land	No	No
Improvements to land	No	No
Construction of property of a character subject to depreciation	No	No
Design and development of property of a character subject to depreciation	Yes	Yes
Prototype or pilot model construction	Yes	No
Depreciation expense	Yes	No
Acquisition of capital goods or property with useful life? 12 months	Yes	No
Overhead	Yes	No
Travel, meals, lodging, auto rental & fuel	Yes	No
G&A allocation	Yes	No
Extraordinary utilities	Yes	Yes
Ordinary utilities	Yes	No
Indirect expense	Yes	No
Rent	Yes	No
Patent expense (perfecting/administration)	Yes	No
Patent expense (technical research)	Yes	Yes
Contract research conducted prior to the start of the trade or business	Yes	No
Discovery of non-technological information to eliminate design uncertainty	Yes	No
Expenditures incurred in connection with a trade or business	Yes	No
Funded research performed pursuant to contract or agreement	Yes	No
Indirect support	Yes	No
Internal development conducted prior to the start of the trade or business	Yes	Maybe
Internal-use software development that does not meet heightened criteria	Yes	No
Patent (perfecting, filing, paperwork)	Yes	No
Patent technical research	Yes	Maybe
Research after commercial production	Yes	No
Research conducted outside the US	Yes	No
Research related to social sciences and mathematics	Yes	No
Research related to style, taste, cosmetic, or seasonal design factors	Yes	No
Research where the taxpayer does not retain substantial rights	Yes	No
Reverse engineering	Yes	No
Routine software development	Yes	No
Supervision greater than first-line manager	Yes	No





Upcoming R&D Best Practice Roundtable



presented by  MASSIE

Wednesday, June 22nd at 3pm ET

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