

# MASSIE ALERT:

RESEARCH CREDIT  
ADDED TO LIST OF IRS CAMPAIGNS

MARCH 2020



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## WHY IS THIS IMPORTANT TO YOU?

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*A Message From Jason Massie*

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### POST-SIEMER MILLING CO.: LB&I ADDS RESEARCH CREDIT TO LIST OF CAMPAIGNS

Back in 2016, Douglas W. O'Donnell, IRS Commissioner for Large Business and International (“LB&I”), announced examinations would move away from a model where returns are scored based upon risk to one where the combined intellect of LB&I would be used to determine where they would focus the time of their resources and leadership. He called these new focus areas “Campaigns” and promised the change in approach would allow his resources to better mobilize around areas of “observed or perceived noncompliance.”

When I first heard the announcement, and all the references of an enemy going on the attack, I immediately began speaking around the country on Sun Tzu’s Art of War and “How to Win the Battle” against the IRS. All this was tongue in cheek at that time because the research credit wasn’t an official Campaign then. But I warned taxpayers that the time was near, and that I fully expected the research credit to become an official Campaign in the future. Well, that time has come!

LB&I announced last week that the “Research Issues Campaign” will focus on both the research credit and research and experimental expenditures.

**The campaign will employ various treatment streams including issue-based examinations, form updates, and requests for guidance. Other treatment streams will be considered as the campaign progresses. The campaign objective is to promote voluntary compliance, focus resources on the highest risk research issues and increase consistency of examinations.**

One of Sun Tzu’s more famous quotes is “If you know the enemy and know yourself, you need not fear the result of a hundred battles.”



## What do we know about the enemy?

Campaigns in general are intended to not only identify specific areas of noncompliance, but also:

- Identify intended compliance outcomes,
- Identify specific, tailored treatment streams to achieve those outcomes,
- Identify the resources needed to execute those tailored treatment streams,
- Identify training, guidance, mentors, and other support needed, and
- Effectively use feedback from employees to quickly modify the approach as needed.

While we don't know how the IRS is going to assemble the troops, train the army, and march forward, we can look back to when the research credit was a Tier I issue for a good idea of what to expect.

Back then, which pre-dates 2012 when the tiering program was ended, the IRS identified issue owners and counsel, they published directives and guidance, and created a mandatory "Research Credit Claims IDR." Examiners were directed to be weary of estimates, to review nexus between expenditures and activities, and responses to the mandatory IDR determined whether claims were disallowed completely or where the focus of the examination should move forward. The IRS began to focus on the base period, substantiation, stat sampling, contingency fees, and 280C elections. These were all new areas for the IRS. Prior to that time, my experience was that the IRS looked at calculations, read through provider write-ups, and largely ignored base period percentages, 280C elections and even documentation. They sure didn't look at acquisition or disposition adjustments to gross receipts or base period. The Tier I process brought about a whole new level of concern among taxpayers and providers in that examinations seemed to be much more structured, rigid, and even dare I say, comprehensive.

In some ways the Tier I program was a good thing. Prior to that, we had the Wild West in that every examiner would review research claims differently. Every agent was given carte blanche to issue their own IDRs, thus inflicting taxpayers with no objective measures as to what are eligible research activities and expenditures. You had hundreds if not thousands of agents each applying their own filter on what qualifies. It was more of a "I'll know it when I see it" standard. As an expert in this area, I found myself educating more agents on the elimination of the discovery test, advising them on recent case law, and having to overcome individual bias rather than winning over hearts with the facts. If you were pharma or aerospace you won, if you were retail you lost, and everybody in between was just at the luck of the draw based on which agent was assigned to their claim.

When Tier I was around, local agents lost control over research credit exams. They lost power. Years of developing relationships between taxpayer and examiner were thrown out the window. At that time, IDR responses were sent up to LB&I research credit team members. Cases that moved out of exam would go to special Appeals Officers who handled claims and followed national settlement guidelines. Cases got stalled as claims mounted for the specialty teams. Taxpayers and providers alike were frustrated.



### What have we learned from the past?

The takeaway here is that we are going to enter another area of uncertainty regarding research credit claim examinations. I fully expect LB&I to dust off Tier I mandatory IDRs. I expect local examiners will no longer have power to settle claims. I'm thinking examinations will take longer as we wait on specialists to review IDR responses. I'm guessing Appeals will get backed up and national settlement percentages may be used again.

### What should you do now? Know yourself.

Back when Tier I came out, I advised taxpayers to do a few things, and they hold true again under the Campaigns.

- Review the cases that have come out in the past two years. Last month at our quarterly R&D Tax Credit Roundtable (sign up on our website for Q2) we focused on the 2019 Tax Court case styled *Siemer Milling Co. v. Commissioner*, T.C. Memo 2019-37. We thought the case was so important for our Roundtable members that during the entire hour, we discussed the case with legal experts from Morgan Lewis and taxpayer representatives from Caterpillar and Arbor Pharmaceuticals. I even issued a case brief going into more details and recommendations on what the case means and what you need to do (email Jillian Holmes for a copy at [jholmes@massietaxcredits.com](mailto:jholmes@massietaxcredits.com)). The long and short of it is that they are focusing on evidence related to the uncertainty and process of experimentation prongs. Hard evidence like contemporaneous documentation that describes in detail the who, what, where, when, why, and how related to both items.
- Google the Mandatory Tier I IDR questions. It's still on the IRS website from 2009. Make sure you can answer the questions or change your process accordingly.
- Do not wait until exam to gather proper documentation. These Campaign audits are going to be nasty and less-taxpayer friendly than the past.

### Prepare for Battle

At MASSIE, we assist taxpayers in preparing for battle. We perform a "Reverse Audit" where we come in and review your workpapers, your calculations, your documentation, and we then issue you a SWOT analysis of things you need to improve. With *Siemer Milling Co.*, and the Campaign, now is the time to review, assess, prepare, make changes or improvements. Don't wait. Do a critical evaluation of your case and facts and evidence.

As Sun-Tzu said in the Art of War, "Don't depend on the enemy not coming; depend rather on being ready for him."

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