



Q4 ROUNDTABLE WHITE PAPER

December 14, 2023

BECAUSE
TODAY IS
DIFFERENT

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Upcoming R&D Tax Credit Best Practice Roundtable

Thursday, March 28, 2024 | 3 PM ET

Companies THAT ATTENDED

8x8, Inc
 Adidas
 Advancion Corporation
 Advisor360
 Ahold Delhaize
 Air Products & Chemicals
 Allied Motion
 Amazon
 Amcor
 AMD
 Andersen Corporation
 Autodesk, Inc
 Aveanna
 AVI-SPL
 BAE Systems
 BASF Corporation
 Bazaarvoice
 BeyondTrust
 Bombardier Inc
 Builders FirstSource
 Cambia Health Solutions
 Cambium Learning Group
 Caterpillar
 Circor International
 CommScope
 Comstock Resources
 Corteva
 Corvel Corporation
 CURTIS INSTRUMENTS INC
 CVS Health
 Deckers Outdoor Corporation
 Deere & Co
 Deluxe Corporation
 DMCL

Eastman Chemical Company
 Finance
 Flexi-Van
 FormFactor
 Fresenius Kabi USA
 Freudenberg Group
 Freudenberg North America
 FUJIFILM Holdings America
 Corporation
 Generac
 Gulfstream Aerospace Corporation
 HF Sinclair
 Hitachi Energy USA
 Hunter Douglas
 impact.com
 Ingevity Corporation
 Interpublic
 IPG
 ITW
 J.R. Simplot Company
 Jack Henry & Associates
 John Deere
 Johnson Electric North America
 JSO Logistics
 Kemira
 Kimberly-Clark Corporation
 KOSTAL
 Leggett & Platt
 Lhoist
 Lion Resources
 Lockheed Martin Corporation
 MACOM Technology
 Macy's
 Magna

Mars
 Maxar
 McWane
 MEDHOST
 Medtronic
 Midmark Corporation
 Milliken
 Navistar
 Nestle USA
 Newly Weds Foods
 Nexteer Automotive
 Northrop Grumman
 Oerlikon Metco US
 Oshkosh Corporation
 Ovivo
 PACCAR
 Packaging Corporation of America
 Phibro
 Plexus Corp
 Powell Industries
 Precisely Software Incorporated
 Principal Financial Group
 Randstad
 Reiter Affiliated Companies
 Saint-Gobain Corporation
 Sanofi
 SAS Institute
 Shaw Industries Group
 Shell
 Siemens Corpertaion
 SM Energy Company
 Snap-on Incorporated
 Snyk
 Solera

Standard Insurance Company
 Stanley Black & Decker
 Starkey Hearing Technologies
 Starkey Laboratories
 Stripe
 Suddath
 Sun Life Financial
 TDS
 The Standard
 The Toro Company
 The Wonderful Company
 Tokyo Electron US Holdings
 Topgolf Callaway Brands Corp
 Toyko Electron
 Two Sigma Investments
 ULA
 USANA Health Sciences
 VF Corporation
 Vista Outdoor
 Zapier



Introductions and Announcements

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

- Welcome to the fourth and final Roundtable of 2023.
- If you want Peter and Jason to speak to your TEI group, please email ilyubashevsky@massietaxcredits.com.
- We wish you and yours a happy holiday and a prosperous start to 2024.

United States v. Grigsby, 635 F. Supp. 3d 467 (M.D. La. 2022), aff'd No. 22-30764 (5th. Cir Nov. 13, 2023)

Alex Sadler & Doug Norton

Morgan Lewis

In the Grigsby case, taxpayers were shareholders of Cajun, an S corporation engaged in civil construction. Cajun, specializing in services across various sectors, including oil, gas, and infrastructure, hired AlliantGroup (“AG”) for a research credit study. Based on 105 projects, AG’s study concluded that Cajun was entitled to over \$1.3 million in additional research credits. Following this, Cajun amended its tax return, leading to the taxpayers filing an amended return to claim a refund based on the K-1 forms.

The IRS initially issued a refund but, two years later, contested the claim. The Department of Justice (“DOJ”) subsequently filed a lawsuit to recover the refund. The Middle District of Louisiana ruled in favor of the government, concluding that Cajun did not perform qualified research and that the research, even if qualified, fell under the funded research exception, disqualifying the taxpayers from a refund.



Key Points from the District Court's Decision

The court found no competent evidence that Cajun performed "qualified research." Specifically, the taxpayers failed to demonstrate that the research was intended to develop a new or improved business component. The taxpayers' argument that Cajun developed new construction processes was rejected due to a lack of specificity and evidence.

Analysis of Specific Projects

- Methanex Project: Cajun acted as a subcontractor, providing facilities for Methanex USA's methanol plant relocation from Chile to Louisiana.
- Chevron Project: Cajun's role involved expanding a refinery, including tasks like surveying and installing piping. The engineer of record retained authority over field issues.
- Claiborne Project: Construction of an underground canal by Cajun.
- East Bank Project: Cajun provided comprehensive services to modify a flood protection system.

Key Observations and Legal Interpretations

The case underscores that merely asserting the existence of a new or improved business component is insufficient for claiming research credits. Describing the business component and linking it to the research activity is crucial. In contract-based projects, credit eligibility depends on the allocation of rights and risks in the contract, such as research rights retention, funding source, and financial risk-bearing.

The Fifth Circuit affirmed the lower court's ruling, agreeing that:

- Cajun's products did not constitute business components.
- The taxpayer's construction processes argument was procedurally barred.
- Cajun's research was considered "funded" and therefore not credit eligible, based on contract analysis.

In the East Bank project, the contract was not contingent on the success of the research. Payments to Cajun were not dependent on research activities, thus deeming the expenses as 'funded.' The court referenced Treasury Regulation 1.41-2(e)(2) and cases like Fairchild and Geosyntec to support its decision.

Conclusion

The Grigsby case sets a significant precedent in the realm of research credit claims. It emphasizes the importance of concrete evidence and specific descriptions of qualifying research activities. The case also highlights how contractual terms play a pivotal role in determining the eligibility for research credits. This case serves as a crucial reference for corporations seeking to understand the nuances of claiming research credits, particularly in industries where the distinction between research and routine development is often blurred.



Spotlight Speaker

Brian Kaufamn, Capital One

Form 6765 Proposed Changes

The Internal Revenue Service (“IRS”) is significantly altering its audit strategy, particularly in the realm of business component audits. This change represents a substantial shift from its previous practices, signaling a new era in tax compliance and auditing. At the same time, the role of the Large Business and International (“LB&I”) Working Group, which was initially envisioned as a collaborative platform for open discussion and exchange, has undergone a transformation. It has progressively become a forum dominated by the IRS, where it primarily communicates its plans and directives rather than fostering a two-way dialogue. This evolution marks a notable change in how the IRS interacts with taxpayer representatives and sets the tone for future engagements.

Key Challenges

- Administrative Issues with the Refund Directive: The IRS struggles with tracking claims and ensuring consistent treatment, especially concerning the 45-day rule for corrections.
- Introduction of New Form 6765: The IRS released a revised Form 6765, emphasizing business-provided documentation and detailed descriptions of business components.

Taxpayer Burdens and Compliance Challenges

- Detailed Documentation Requirements: The new form asks for extensive details about each business component, posing significant challenges for taxpayers, especially in the technology and software sectors.
- Practical Difficulties in Compliance: Taxpayers face daunting tasks in documenting thousands of components, an almost impossible feat for many.

IRS's Focus on Documentation Over Substance

- Shift Towards Documentation-Centric Auditing: The IRS increasingly emphasizes detailed documentation over the substantive nature of the claims.
- Implications for Taxpayers: There is a rising trend of significant claim disallowances due to inadequate documentation at the granular level required by the IRS.



Spotlight Speaker

Brian Kaufman, Capital One

The Challenge with Auditing Business Components

- Difficulty in Defining 'Business Components': The IRS shows uncertainty in auditing business components, especially in software, where the scope of what constitutes a component is unclear.
- Potential for Litigation: Given the IRS's uncertain stance, litigation may be necessary to establish clearer guidelines.

Recommendations for Taxpayers

- Develop a Robust Methodology: Taxpayers should establish a consistent method for calculating and documenting business components.
- Prepare for Detailed IRS Inquiries: Anticipate detailed information requests in audits and be prepared with comprehensive documentation.

Conclusion

In light of the evolving practices of the IRS, particularly concerning Form 6765 and business component audits, taxpayers now face a pressing need to adopt more detailed and proactive strategies for compliance. These changes underscore the importance of thorough preparation and documentation in meeting the new IRS requirements.



MASSIE was present and gave talks at the Morgan Lewis R&D Symposiums held in Washington, D.C. and Chicago. Here are the key highlights from the Symposium. The seven topics mentioned correspond to a discussion panel focused on these subjects. Notably, Jason Massie and Catie Ely were part of the panel discussing Refund Claims.

1. Insights on Section 174 and 41

The panel highlighted statements from Paul Coates, the IRS LB&I 174 technical advisor, who anticipates that expenses under Section 174 will be double those of 41 Qualified Research Expenses (“QREs”). For instance, if 41 QREs amount to \$100,000,000, the expected capitalized 174 expenses would be about \$200,000,000. Additionally, Scott Vance, Associate Chief Counsel of the IRS, commented at the TEI Annual Meeting that severance costs were not intended to be excluded from Section 41. This topic has prompted the IRS to plan the release of new regulations in the upcoming Spring.

2. Refund Claims Process and Strategies

The panel discussed the extension of the deadline to perfect research credit claims for refunds to January 10, 2025. They advised making responses to the IRS as clear as possible. They noted that providing more detail than required by the Comprehensive Case Memorandum (“CCM”) might be beneficial for refund claims. The panel also recommended faxing responses to the number on the 45-day letter and keeping proof of mailing for original documents.

3. Proposed Changes to Form 6765

The new Form 6765 will focus on identifying specific activities by various departments and functions, and it requires listing all business components. However, the IRS has indicated that completing the new form is not mandatory and won't invalidate return filings. The old form will still be processed, but it may increase the risk of an audit. This raises questions about whether taxpayers will complete every aspect of the form and if the IRS has the resources to audit those who do not.

4. IRS Updates

The IRS is undergoing significant changes with the appointment of Randy Soper as the first-ever Chief of AI, a move by Commissioner Danny Werfel that signals a shift towards more advanced technology and efficiency. Soper's background in human-machine learning, AI assurance, digital transformation, and data science-mission integration suggests a potential new direction for the IRS. Additionally, the IRS's increased budget, specifically targeted at the LB&I sector, indicates a heightened focus on enforcement in this area.



5. Strategies for IRS Exams

When it comes to IRS examinations, the panel recommended a set of best practices for effective handling. These include initiating the audit process by meeting with the Exam team to discuss the methodology and approach and providing detailed walkthroughs of any Information Document Request (“IDR”) responses. The panel observed that the IRS is not focusing as much on base period issues currently. Instead, there is an increased emphasis on dual-function software, funded research, and the process of experimentation. Supplies, particularly in the context of product or process research, are also garnering attention. The IRS is applying the Little Sandy Tax Court decision selectively, using the 11th Circuit formula only in that circuit. Given this backdrop, the panel advises providing comprehensive documentation that establishes a clear nexus between qualified employees and business component activities, as demonstrated in the Little Sandy case.

6. Legal Cases and Their Implications

Recent court cases have shown a bias towards the credit. Notable cases like Little Sandy Coal and Phoenix Design Group highlighted the need for specific documentation and the IRS's inconsistency in project reviews. In the Meyer case, the presumption for contractors is that their contracts are for a product, not research. The Betz case emphasized the importance of not relying solely on oral testimony and clarified criteria for qualifying expenses.

7. State Tax Credit Updates

The panel noted updates in state tax credits: Missouri introduced a new credit capped at \$10 million for 2023, Kansas increased its credit rate from 6.5% to 10%, and in Texas, the process for approving credits has become more challenging for examiners. They suggested that offering to help complete the approval memo for examiners in Texas could increase the likelihood of credit approval.

The Form 6765 Solution

Peter Green, MASSIE R&D Tax Credits

The MASSIE Experience

- Focus: To make the R&D tax credit process more “user friendly.”
- Goal: To claim and sustain the maximum credit possible with the least amount of work for our clients.
- How: Incorporate today’s proven best practice solutions to deliver an R&D tax credit experience that is easier on the subject matter expert (“SME”) and the Tax Department.

Recap of IRS Proposed Changes to Form 6765

These proposed changes to Form 6765 require more detailed reporting on business components and expenses, reflecting a deeper dive into the specifics of R&D tax credit claims.

Section E: Introduction of Five New Questions

1. Number of Business Components (“BCs”) in the Credit: Quantifying the total BCs involved.
2. Inclusion of Officers’ Wages: Clarifying if officers’ wages are factored into the credit calculation.
3. Business Acquisitions or Dispositions Reporting: Detailing any recent business acquisitions or dispositions.
4. New Categories of Qualified Research Expenses (“QREs”): Identifying additional categories of QREs.
5. Reliance on the ASC 730 Directive: Whether the ASC 730 accounting standard was used.

Section F: Detailed Information on Each Business Component - 14 New Data Points

- Entity Identification: EIN and business activity code.
- Business Component Specifics:
 - Name and description of the Business Component.
 - Nature of the information sought, and alternatives evaluated in the experimentation process.
 - Classification as new or improved.
 - Type categorization (product, process, software, etc.).
 - Designation of end-use (sale, lease, license, business use).
 - Software-specific details (internal use, dual function, non-internal use).

Cost Details Per Business Component:

- Wages and Support Costs: Direct research, supervision, and support wages.
- Supply and Equipment Expenses: Cost of supplies, rented/leased computers.
- Contract-Related Expenses: Amount spent on contract expenses.

MASSIE has created the Business Component Solution to combat the challenges associated with the proposed changes to Form 6765.

A recurring challenge many companies face is the low participation from SMEs. Often, tax directors feel burdened with administrative tasks such as constantly scheduling and rescheduling meetings. With this in mind, MASSIE has created a portal (using Microsoft Teams) to provide a seamless experience and address some new Form 6765 challenges.

Architecture – Developing a Business Component Strategy

Key Steps in Strategy Development

- Identify Innovation and SMEs: Pinpoint where innovation occurs and locate the experts involved.
- Utilize Existing Systems for Data Collection: Find systems already in place that can gather data usually requested from SMEs.
- Optimize Communication Methods: Determine the most effective communication channels like email, MS Teams (including tasks, chats, video calls), and specific Teams Channels.

The Form 6765 Solution

Peter Green, MASSIE R&D Tax Credits

User Experience (“UX”) Testing

- Efficiency Through Detailed Testing:
 - Spending time testing with a few (like five people) can save time for many (like a hundred).
 - Deep dive into each question to ensure clarity and relevance.
 - Consider using internal jargon and industry-specific terms.
- Creating Helpful Resources:
- Develop FAQs tailored to each industry or company.
- Identify existing documents or artifacts that can simplify or eliminate questions.
- Craft sample answers to guide users.

Tool Development for Ease of Use

- Creating User-Friendly Tools:
 - Develop resources like self-guided videos, MS Forms, MS Bookings, printable guidebooks, model answers, and documentation mapping.
 - Offer various meeting options to accommodate different needs and preferences.
- Finalizing Project Plan and Timeline: Agree on a comprehensive project plan and establish a clear timeline.

The Teams R&D Collaboration Hub

The Teams R&D Collaboration Hub is designed with the SME user experience in mind. It serves as an efficient, one-stop platform for data collection essential for R&D studies. The primary aim is to make the user's interaction with the tool as straightforward and hassle-free as possible.

Key Features:

- Group Video Kick-Off Meetings:
 - Options for both small and large groups
 - Multiple viewing opportunities for MS Teams training
- Planner Tasks:
 - Easy-to-follow instructions for SMEs
 - A checklist of tasks with automated reminder emails from MS Teams as deadlines approach or pass
- Innovation Workbook:
 - Tools for calculating QRE percentages and BC allocation
- TEAMS Forms and Model Answers:
 - Structured forms and standard answers for the four-part test
- Documentation Mapping:
 - SMEs can easily track and locate R&D-related documentation
- FAQs and Real-Time Support:
 - Centralized FAQs for quick reference
 - A help desk for detailed response analysis
 - Real-time chat feature for instant messaging with SMEs
 - Option to arrange immediate 1:1 support calls

Visibility & Control:

The tax department maintains full oversight and control throughout the process, ensuring a transparent and managed workflow.



presented by  MASSIE

**Mark your calendars for
our next Roundtable**

**March 28, 2024
3 PM ET**