



# TEI Portland Chapter ROUNDTABLE

February 21, 2024

White Paper

BECAUSE  
TODAY IS  
DIFFERENT

 **MASSIE**  
R&D Tax Credits  
*Experience Best Practices*

# Table OF CONTENTS

## **Top Ten Things You Need to Know Right Now about the Research Credit**

Jason Massie, MASSIE R&D Tax Credits

Elizabeth Chic, MASSIE R&D Tax Credits

Page 4 - 9

## **Using Technology to Address 6765 Changes for the Future**

Taylor Eiselin, MASSIE R&D Tax Credits

Jason Massie, MASSIE R&D Tax Credits

Page 10 - 13



presented by  MASSIE

**Mark your calendars for  
our next Roundtable**

**March 28, 2024  
12 PM PT**

# Companies THAT ATTENDED

**adidas America, Inc.**  
**Avangrid Renewables**  
**Cambia Health Solutions**  
**Columbia Helicopters, Inc**  
**Corvel Corporation**  
**Daimler Truck North America**  
**Esri**  
**Flint Group**  
**FormFactor**  
**Fortive Corporation**  
**Hampton Lumber**  
**KinderCare Education LLC**  
**Lattice Semiconductor**  
**Mars Inc.**  
**Nike**  
**NW Natural**  
**Ocean Oil Construction and Services**  
**Oregon Tool, Inc.**  
**PacifiCorp**  
**Precision Castparts Corp**  
**Qorvo**  
**Redesign Health Inc**  
**Roseburg Forest Products Co.**  
**Tektronix**  
**The Weir Group**  
**Visa**  
**Weir Group PLC**  
**ZoomInfo**

# Top Ten Things You Need to Know Right Now About the Research Credit

Jason Massie  
Elizabeth Chic

## 10. Section 174 Legislation and Implications

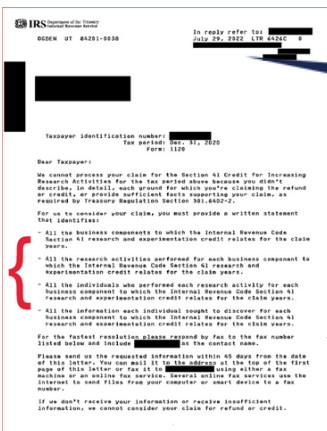
- Legislative Update: H.R. 7024 Passage - The Tax Relief for American Families and Workers Act of 2024, passed with significant support, revises the treatment of Section 174 costs. It uniquely permits taxpayers to retroactively expense domestic Section 174 costs to 2022, signaling substantial relief and a shift in tax planning strategies.
- Senate Consideration Pending - Despite its passage in the House, the bill awaits the Senate's consideration, where it requires 60 votes. The delay underscores the importance of monitoring legislative developments closely for strategic tax planning.
- Insights from TEI Annual Meeting - Paul Coates, the IRS LB&I 174 technical advisor, highlighted expectations for Section 174 expenses to double those of Section 41 Qualified Research Expenses (QREs), estimating capitalized 174 expenses at \$200 million against 41 QREs of \$100 million. Scott Vance, Associate Chief Counsel IRS, also hinted at forthcoming regulations clarifying severance treatment under Section 41.
- 174 Tips and Considerations - The scope of entities involved in R&D activities and the impact of intercompany agreements, beyond just Section 482 cost-sharing arrangements, are critical areas for attention. It's essential to distinguish that all Section 41 QREs qualify as Section 174 R&D expenditures, but the inverse does not apply. Taxpayers should also be vigilant about material book-to-tax differences and comprehend financial statement software capitalization policies.

## 9. Navigating the Process of Refund Claims

- Overview of Requirements for Valid R&D Credit Refund Claims - A successful refund claim must comprehensively identify all business components, detail research activities for each, name the individuals involved, outline the information sought, and summarize QREs.
- Content of Submissions - The IRS employs "classifiers" for reviewing submissions, who, if deeming a submission insufficient, will issue Ltr 6426C. However, direct feedback from classifiers is not accessible, creating a layer of complexity in addressing claim deficiencies.

# Top Ten Things You Need to Know Right Now About the Research Credit

- Strategies for Effective Claim Submission
  - Do - Prepare a detailed memorandum that specifically addresses the critical 5 Items of Information, ensuring each business component and the related research is described with enough clarity for classifiers.
  - Avoid - Attaching overly broad studies or using vague descriptions that fail to concretely specify the research activities and their relevance.
- Insights into Classifier Operations - The training and instructions provided to classifiers, along with the metrics used by the IRS to evaluate the adequacy of claims, remain largely opaque. This lack of transparency underscores the importance of precision and clarity in claim documentation.



LTR 6426C



- All the business components to which the Internal Revenue Code Section 41 research and experimentation credit relates for the claim years.
- All the research activities performed for each business component to which the Internal Revenue Code Section 41 research and experimentation credit relates for the claim years.
- All the individuals who performed each research activity for each business component to which the Internal Revenue Code Section 41 research and experimentation credit relates for the claim years.
- All the information each individual sought to discover for each business component to which the Internal Revenue Code Section 41 research and experimentation credit relates for the claim years.

# Top Ten Things You Need to Know Right Now About the Research Credit

## 8. ASC 730/Stat Sampling and Its Impact on R&D Tax Credits

- ASC 730 Directive Overview - Issued by the IRS's Large Business and International Division (LB&I) in 2017 and revised in 2020, the ASC 730 Directive aims to streamline the determination of QREs by providing an efficient methodology for both taxpayers and the IRS.
- Directive Requirements - Applicable to taxpayers with assets  $\geq$  \$10 million and mandates reporting ASC 730 R&D expenses in audited financial statements.
- Benefits of the Directive - Facilitates a simplified approach for capturing ASC 730 R&D costs, allowing these expenses to be treated as a single Business Component line item, making statistical sampling a viable option.
- Detailed Breakdown of Eligible Expenses
  - Wages - Identification of R&D personnel is critical, with specific categorizations for Qualified Individual Contributors, First Level Supervisor Managers, and Upper-Level Managers, each qualifying at different rates under the Directive.
  - Supplies and Computer Rentals - Expenses must be directly tied to R&D activities and expensed under ASC 730 to qualify.
  - Contractor Expenses - Excluded from the Directive but can still contribute to the research credit under traditional methods.
- Statistical Sampling Pros and Cons - Offers the advantage of reviewing fewer projects for credit calculation but introduces uncertainties, especially with interpretations of new Form 6765 requirements by the IRS.

**EXAMPLE**

Source	Number of Projects	Sampled Projects
IT Software	150	24
Manufacturing	225	28
Manufacturing Process Improvement	1500	30
R&D Enhancements (Existing Market)	3000	35
Hardware/Software Development	4000	40
<b>Total</b>	<b>8875</b>	<b>157</b>

# Top Ten Things You Need to Know Right Now About the Research Credit

## 7. Pre-filing Agreements (PFAs)

PFAs are a strategic tool for taxpayers to secure certainty in their R&D tax credit claims. The IRS's PFA program allows for the review of a taxpayer's process, methods, and study for a specific year. Upon agreement, a taxpayer might receive a five-year pass, covering the reviewed year and the next four, providing a significant advantage in tax planning and compliance. This approach not only fosters a proactive relationship with the IRS but also offers an opportunity for taxpayers to extend the benefits of a PFA across multiple years, enhancing tax credit utilization.

For more detailed information on the PFA program, visit the [IRS's official page](#).

## 6. Little Sandy Coal Case Insights

- Overview - The case revolved around R&D credits for 11 vessels, including the Apex Tanker and a floating dry dock, challenging the breadth of activities qualifying as experimental under the tax code.
- Court's Decision
  - Tax Court Memo 2021-15 Findings - Highlighted a failure to establish that a significant portion of the activities were experimental.
  - Substantiality Test Interpretation- Emphasized that support or supervisory roles in research activities do not automatically qualify for the R&D tax credit.
- 7th Circuit's Affirmation and Disagreement
  - Affirmation - Agreed with the Tax Court on the need for sufficient substantiation of the process of experimentation (POE) activities.
  - Disagreement - Noted that direct support and supervision could sometimes be integral to the experimentation process, contradicting the Tax Court's narrower view.
- Implications for Taxpayers
  - Documentation Best Practices - Stresses the importance of detailed documentation of all research activities, especially those involving direct research, supervision, and support.
  - Role Classification - Advises on classifying POE activities based on substance over job titles, suggesting even high-level roles involved in experimentation should be documented as such.
  - Scientific Method Application - Encourages the delineation of research activities using a scientific method framework (hypothesis formation, testing, and refinement) for stronger claim support.

# Top Ten Things You Need to Know Right Now About the Research Credit

- Navigating Beyond the 7th Circuit
  - Geographical Considerations - Cautions that the IRS may not extend the 7th Circuit's interpretation to other jurisdictions, underlining the need for robust, universally applicable documentation strategies.
  - Sub-Component Research - Recommends documenting research activities at sub-component levels if broader business component experimentation cannot be demonstrated.

## 5. Key Takeaways from Other Research Credit Cases

- Phoenix Design Group, Inc. v Commissioner - Demonstrates the IRS's scrutiny of statistical sampling methods for determining QREs, emphasizing the necessity for agreement on the scope of review.
- Betz v. Commissioner - Highlights the pitfalls of relying solely on oral testimony for substantiation and the importance of bridging project challenges with investigative activities documentation.
- Moore v. Commissioner - Points out the consequences of inadequate documentation, even when some activities clearly qualify as R&D, underscoring the need for comprehensive records. Documentation was insufficient to prove the full extent of the COO's involvement in R&D activities even though his name was on the patent.
- United Therapeutics Corp. v. Commissioner - Illustrates the complexities of accurately reporting qualified expenses, stressing the significance of including all relevant costs in both the base and current year calculations.

## 4. Navigating Federal Updates and Controversy

- IRS Updates
  - Chief of AI Appointment - The IRS aims for automation and efficiency, with Randy Soper's hire marking a significant step towards integrating AI and data science into tax administration.
  - Enforcement Budget Increase - Specifically targets the LB&I division, indicating a heightened focus on large business and international tax compliance.
- IRS Exams – Best Practices
  - Early Engagement - Advised to meet with IRS examiners early to understand the audit's scope and methodology.
  - Draft IDRs - Requesting information document requests (IDRs) in draft form allows for clarification and setting realistic deadlines.
  - Focus Areas - Emphasis on dual-function software and funded research, alongside the process of experimentation, suggests a comprehensive approach to documenting all business components involved in R&D.



# Top Ten Things You Need to Know Right Now About the Research Credit

## 3. State Controversy and Introduction of New State Credits

- Missouri's Introduction of a New Credit - In 2023, Missouri introduces a tax credit with a cap of \$10 million, which can be transferred, sold, or assigned.
- Kansas Increases Its Credit - Kansas enhances its R&D tax credit from 6.5% to 10% in 2023, with provisions for credit transfer.
- Texas's Examination Process - In Texas, the approval process for tax credits is notably rigorous. To facilitate approval, taxpayers might consider drafting an "approval memo" for examiners, providing essential information to support the claim.
- Legislative Feedback in Texas - Reports indicate that the Texas legislature has advised the Department of Revenue to ease the disallowance of claims, aiming to fulfill the credit's intended benefit.

## 2. A Shifting Dynamic at the IRS LB&I Taxpayer Roundtables

The IRS's LB&I Division holds roundtables with taxpayers, offering a platform for dialogue on critical tax issues like Section 174, refund claims, and new form changes. Brian Kaufman, Sr. Tax Counsel at Capital One, represents taxpayers in these discussions, providing valuable insights.

- January 2023 Roundtable - The initial meeting was encouraging, suggesting a collaborative approach to addressing taxpayer concerns and upcoming changes.
- May 2023 Shift - The tone became more one-sided, indicating a departure from the earlier collaborative dialogue.
- October 2023 Update - The discussion focused on the IRS's new form and approach to Section 174, with a less interactive format.

## 1. Anticipating Changes to Proposed Form 6765

The evolution of Form 6765 is critical for taxpayers. Keep reading to find out more.

[\\*Inspired by David Letterman's classic Top Ten segment.](#)



# Using Technology to Address 6765 Changes for the Future

## IRS Proposed Changes to Form 6765

- Overview of Proposed Changes
  - Section E – Introduction of 5 New Questions - Targets critical aspects such as the enumeration of business components (BCs), inclusion of officers' wages, business acquisitions or dispositions, the emergence of new QRE categories, and reliance on the ASC 730 directive. These additions aim to refine the accuracy of reported R&D activities and expenses.
  - Section F – Expansion with 14 New Data Points - Demands detailed documentation for each BC, including its name, purpose, evaluation processes, status (new or improved), and classification (product, process, etc.). Additionally, specifics on software use, EIN, business activity code, and the disposition of the BC are required. This section significantly increases the depth of information the IRS seeks about each BC's R&D activities.
- Detailed Analysis
  - Business Component Focus - The emphasis on defining and detailing BCs marks a shift towards more granular reporting. The challenge for taxpayers lies in accurately identifying and classifying their BCs, a task that has historically been ambiguous and subjective.
  - Quantification and Qualification of Expenses - The form now requires detailed breakdowns of costs associated with direct research, supervision, support, supplies, and contracted services for each BC. This level of detail aims to provide a clearer picture of R&D expenditures, enabling the IRS to assess the validity and magnitude of claims more effectively.
- Technological Adaptation for Compliance - The introduction of these new sections underscores the need for robust data management and documentation systems. Leveraging technology, such as R&D management software or platforms like Microsoft Teams or Google Workspace, becomes indispensable for organizing, tracking, and reporting the required information efficiently.
- Implications for Taxpayers - The proposed changes reflect the IRS's intent to mitigate abuse and ensure that R&D tax credits are accurately claimed. Taxpayers must adapt to these changes by enhancing their R&D documentation processes, potentially re-evaluating their project categorization strategies, and ensuring that their technological infrastructure can support the detailed reporting requirements.



# Using Technology to Address 6765 Changes for the Future

- Strategic Considerations
  - Taxpayers should consider a strategic review of their R&D activities in light of these changes, potentially redefining what constitutes a BC to align with the new IRS expectations.
  - For instance, if examining Tesla, consider what constitutes a BC: Is it the entire car, specific parts like the steering wheel, LED screen, battery, or even down to the ball bearing? This determination is essential not only for internal clarity but also for effectively communicating with the IRS. Reflect on how engineers and project teams identify and categorize BCs, then translate these internal definitions into terms that align with IRS expectations and requirements.
  - Implementing or upgrading technological solutions to streamline data collection and documentation processes will be crucial for compliance and efficient management of R&D tax credit claims.
- 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

- 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.



# Using Technology to Address 6765 Changes for the Future

## 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 include:

- 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

# Using Technology to Address 6765 Changes for the Future

- 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.

Interested in discovering how the MASSIE R&D Collaboration Hub can benefit your organization? Contact us to explore its features and advantages.

13



**Mark your calendars for  
our next Roundtable**

**March 28, 2024  
12 PM PT**