

Q1 ROUNDTABLE WHITE PAPER

March 28, 2024

BECAUSE
TODAY IS
DIFFERENT



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Upcoming R&D Tax Credit
Best Practice Roundtable

Thursday, June 27, 2024 | 3 PM ET

Companies THAT ATTENDED

10x Genomics, Inc.
 Acxiom + IPG
 Adobe
 Advancion Corporation
 Advisor360, LLC
 Ahold Delhaize
 Air Products & Chemicals, Inc.
 Albertsons Companies, Inc.
 Amazon
 Amcor
 AMD
 American Financial Group, Inc.
 AstraZeneca
 Asurion
 Autodesk
 Ball Corporation
 BASF Corporation
 Bayer US LLC
 Bazaarvoice
 Big Lots
 Biogen
 Bioventus
 Bridgestone Americas, Inc.
 Brunswick Corporation
 Buckman
 Cambia Health Solutions
 Cambium Learning Group, Inc.
 Caterpillar
 CBRE
 Charter
 CommScope
 Cook Group Incorporated
 Cornerstone OnDemand

Corteva Agriscience
 Cisco Systems, Inc.
 Cummins Inc.
 CVS Health
 Daktronics, Inc.
 Deckers Outdoor Corp
 Deluxe Corporation
 DLL
 Domtar
 Doosan Bobcat North America,
 Eastman Chemical Company
 EBSI
 Eli Lilly and Company
 Encompass Health Corporation
 esco technologies inc.
 Esri
 FBIN
 FiscalNote
 Flint Group
 Fluidra North America
 Fresenius Kabi USA
 Freudenberg North America, LP
 GA
 Gap Inc
 Generac Power Systems
 Green Plains Inc
 Hitachi Energy USA Inc.
 Illinois Tool Works Inc.
 Ingevity Corporation
 Integer Holdings
 Intuit
 IOC Consulting
 ITW

J R Simplot Company
 Jack Henry
 John Deere
 Karl Storz
 Kemira
 Kimberly-Clark Corporation
 Knowles Corporation
 Leggett & Platt, Inc.
 Lion Resource, Inc.
 Lockheed Martin
 Lundbeck LLC
 MACOM Technology
 Macys
 Maxar Technologies
 MEDHOST
 Medtronic
 MGM Studios
 Microsoft
 Milliken & Company
 Monster.com
 Mozarc Medical
 Musco
 NextGen Healthcare
 Nordstrom, Inc.
 Northrop Grumman
 Novartis
 Occidental Petroleum Corporation
 Oracle
 Oshkosh Corporation
 Oxford Industries, Inc.
 PACCAR
 Packaging Corporation of America
 Playcore

Principal Financial
 GroupRandstad
 Reiter Affiliated Companies
 Resideo Technologies
 Rheem Manufacturing
 Saft America Inc
 Shaw Industries Group, Inc.
 Shell Oil
 SM Energy Company
 Snap-on Incorporated
 SPX Technologies
 Superior Essex, Inc.
 Target Corporation
 TDS Inc.
 TEL US Holdings
 Tennant Company
 The Standard
 The Toro Company
 The Walt Disney Company
 Tokyo Electron
 Travers Therapeutics, Inc.
 UHG
 ULA
 Unilever US
 United
 UnitedHealthGroup
 USANA
 Veeva Systems Inc
 Verizon Communications Inc.
 VSP
 Walmart
 Weber Metals
 Wellmark, Inc.



Introductions and Announcements

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

- At the TEI Midyear event in D.C., Jason connected with the IRS's Scott Vance to dive into the updates on Section 174 and the rollout of the new Form 6765. Inspired by these changes, we've engineered a custom solution for large taxpayers. Curious to learn more or see it in action? Reach out to [Peter Green](#).
- Recently, we've energized the Portland and Seattle Chapters of TEI with one-day events and are excited to continue our journey to Regions 8, 9, and 10, alongside the Tax Technology Seminar in Orlando and the new Tax Symposium in Chicago. If your event is in search of dynamic speakers or sponsors, we'd love to contribute. Please get in touch with [Ilona Lyubashevsky](#).
- [Southern Jobs Tax Credits](#), a dedicated branch of MASSIE, is on a mission to assist our clients in leveraging job creation tax credits available in the Southeast. Are your operations extending into Georgia, Mississippi, or South Carolina? Discover how to capitalize on these credits by connecting with [Ilona Lyubashevsky](#).

Washington D.C. Updates

Matthew Lerner, Sidley Austin

- Research credit audits are becoming increasingly confrontational, with Exam Teams quickly disqualifying credits for minor mistakes or on weak legal grounds.
 - It's noted not all Exam Teams are confrontational; some prioritize thorough investigation and fair application of the law.
- The advice is to initially trust your Exam Team to conduct a fair review and to foster a positive, cooperative relationship.
- Starting with an uncooperative attitude can lead to a reciprocal response from the Team.
- It's essential to communicate in a way that considers how an IRS agent or engineer might interpret your words, not just your intended meaning.

Washington D.C. Updates

Matthew Lerner, Sidley Austin

The Substantially All Test Concerns

- The "substantially all" requirement is met if 80% (or more) of the research activities, based on cost or another consistent method, are part of an experimentation process.
- Exam Teams often ignore a crucial ruling by the 7th Circuit in Little Sandy Coal, which includes direct support and supervision as part of the experimentation process.
- Some teams insist on seeing the Process of Experimentation ("POE") ratio for each business element, unfairly excluding support and supervision from the positive side while keeping them in the overall calculation.
- There's a common demand for proof of a quantitative POE test for each component claiming credits, even when statistical sampling is used.
- Some teams apply the test but rely too much on numerical fractions to deny credits.
- This approach overlooks critical legal precedents and may weaken cases in Appeals.

Trend: IRS Challenging the Use of Sampling

- Many taxpayers rely on statistical sampling due to their yearly project volume.
- The IRS frequently disputes the validity of sampling in research credit cases.
 - According to the IRS, every business component must have individual documentation, making sampling invalid.
 - The IRS contends that handling documentation for thousands of projects isn't overly burdensome.

- The IRS believes more convincing evidence exists beyond just the sample analysis.
- There was an instance where the IRS claimed only they could use sampling methods.
- The IRS meticulously searches for errors in the sample plan, often flagging issues that align with their own sampling guidelines.

Trend: Overly-Broad IDRs with No Follow-Up

- The IRS often issues broad Information Document Requests ("IDRs") without requesting specific proof, site visits, or interviews.
- Taxpayers are later criticized in the Acknowledgement of Facts ("AOF") for not providing the evidence the IRS requested.

Trend: Examiners Refusing to Develop the Facts

- Instances continue where the IRS deems provided documents too extensive to review despite being a curated selection.
- Exam Teams frequently request roadmaps to navigate to crucial document sections.
- Exam Teams regularly decline offers for subject matter expert interviews or site visits.

Washington D.C. Updates

Matthew Lerner, Sidley Austin

Spotlight Speaker

Stephen Whiteaker, MASSIE R&D Tax Credits

What Taxpayer Can Do

- Identify every business component clearly.
- Collect all necessary data for the POE test and document it.
- Even if all work seems to be part of POE, properly document the calculation.
- Assemble information proactively during return preparation.
- Use sampling by business component when beneficial.
- Sampling isn't legally required, but it aligns with the [Audit Handbook's](#) guidelines.
- Ensure sampling plans comply with [Rev. Proc. 2011-42](#) and seek IRS endorsement if under audit.
- If the Exam Team is cooperative, work together and provide information in a digestible format.
- If uncooperative, create a comprehensive record for potential Appeals.
- Offer guides, narratives, and presentations to clarify project details.
- Document each instance of the Exam Team's failure to fact-find.

LB&I Audit Tips

Overview

- The Research Credit can be reviewed by either an IRS agent or engineer.
- Approach communication with agents and engineers professionally, avoiding aggression.
- Agents and engineers often aim to disallow part of the credit; understanding their motivation is crucial.
- IRS employees are trained to work collaboratively and value transparency in the LB&I Examination Process (“LEP”).
- Audit steps, timelines, and appropriate personnel for the examination are established early on.
- Decision-makers in LB&I audits are known as issuing managers, while case managers oversee the audit responsibilities.

Spotlight Speaker

Stephen Whiteaker, MASSIE R&D Tax Credits



If You're Audited

- Remain honest and cooperative; avoid confrontational behavior.
- Effective communication with your IRS agent or engineer is essential.
- Proactively explain documentation processes and correct any past mistakes within 30 days.
- If guidelines are not being followed, escalate to a manager or territory manager.

The Three Phases of the Examination Process

1. Planning: Understand the IRS's review of your records and clarify your credit determination.
2. Execution: Engage in discussions around draft IDRs, timelines, and information requests.
3. Resolution: Address any proposed adjustments with factual disagreements through documentation.

MASSIE Controversy Services

You may not be aware, but MASSIE can provide taxpayers with many controversy services:

- Reverse Audits- SCOT Analysis
- Process Improvements under a Kovel Agreement
- Business Components Strategy
- Documentation
- IDR Assistance- SME Outreach
- Full Power of Attorney Representation
- Drafting of Protests, assistance with Mediation
- Appeals Services with outside counsel

MASSIE R&D Loan Staff

MASSIE also has expert resources to assist you in case:

- Your people are out on medical or maternity leave.
- We can take over R&D tasks when you lose a full-time resource.
- We can provide bandwidth for SME Outreach / Help-Desk.
- We will perform technical reviews of Calculations and Documentation.

Top Five in the World of R&D

Jason Massie, MASSIE R&D Tax Credits

Jason is seeing a lot of activity in the world of R&D right now.

Here are five ideas worth considering:

5. Section 174 Legislation Updates

- H.R. 7024, known as The Tax Relief for American Families and Workers Act of 2024, passed in the House.
- It allows taxpayers to expense domestic Section 174 costs back to 2022 retroactively.
- The bill awaits consideration by the Senate or its Committee on Finance.
- Scott Vance indicates that regulations related to the bill are expected to be released in June.

4. State Updates

- Missouri introduced a new tax credit in 2023 with a cap of \$10 million, and these credits can be transferred, sold, or assigned.
- Kansas raised its tax credit from 6.5% to 10% in 2023, and these credits can also be transferred.
- In Texas, examiners find it more labor-intensive to approve credits than to reject them; taxpayers might consider offering to draft the "approval memo" to facilitate the process.
- There have been settlements in Texas, and it's reported that the state legislature has advised the Department of Revenue to cease the practice of routinely disallowing claims, as it negates the incentive's intent.

3. Pre-filing Agreements ("PFAs")

- PFAs are a strategic option for taxpayers to gain certainty with R&D tax credit claims.
- The IRS's PFA program reviews the taxpayer's process and study for a particular year.
- Successful agreement on a PFA can yield a five-year period of certainty, including the review year plus the following four years.
- This offers a proactive way to engage with the IRS and can aid in long-term tax planning and compliance.
- Utilizing a PFA can maximize tax credit benefits over multiple years.
- For more detailed information on the PFA program, visit the [IRS's official page](#).

2. ASC 730/Stat Sampling

- The ASC 730 Directive, issued by the IRS LB&I in 2017 and revised in 2020, simplifies Qualified Research Expenditures ("QRE") calculations for taxpayers and the IRS.
- It applies to taxpayers with assets of \$10 million or more, requiring them to report ASC 730 R&D expenses in their audited financial statements.
- The Directive allows a streamlined method for claiming ASC 730 R&D costs as a single Business Component, which enables statistical sampling.
- Eligible expenses under the Directive include:
 - Wages for R&D staff, with varying qualifications for individual contributors and managers.
 - Supply and computer rental costs directly related to R&D and expensed under ASC 730.
 - The Directive does not cover contractor expenses but may qualify for research credits through other means.
- Statistical sampling can reduce the number of projects to review but may lead to uncertainties with the IRS's interpretation of the new Form 6765 requirements.

Top Five in the World of R&D

Jason Massie, MASSIE R&D Tax Credits

1. Refund Claims

- For a valid R&D credit refund claim, you must identify all business components, detail each research activity, list involved individuals, explain the purpose of the research, and summarize QREs.
- IRS classifiers review submissions and may issue Ltr 6426C for insufficient claims; direct feedback from classifiers is not typically available.
- Effective claim submission strategies:
 - Create a detailed memorandum addressing the five critical information categories for clarity.
 - Avoid attaching unspecific studies or using vague language that doesn't clearly define research activities.
- Classifier operations are not transparent, with unclear IRS training and metrics for claim evaluation, making detailed and precise documentation crucial.

- Regulations coming out on 174 in June
- New proposed Form 6765 discussions
- Continued IRS activity
- Business Components
- Sub All Calculations (Little Sandy Coal)
- Nexus between Activities and Expenditures
- Uncertainty, POE, Iterations, Results



presented by  MASSIE

**Mark your calendars for
our next Roundtable**

**June 27, 2024
3 PM ET**