

Q3 ROUNDTABLE WHITE PAPER

October 2, 2024

BECAUSE
TODAY IS
DIFFERENT



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Upcoming R&D Tax Credit
Best Practice Roundtable

Thursday, December 12, 2024

Companies ATTENDED

8x8, Inc
Acxiom + IPG
ADM
Advancion Corporation
Air Products & Chemicals, Inc.
Alexion
Amazon
Amcor
AMD
AstraZeneca
Aveanna Healthcare
AVI-SPL LLC
Big Lots
Bioventus
Boston Scientific Corporation
Bottomline Technologies
Bridgestone Americas, Inc.
Brunswick Corporation
Buckle
Cambia Health Solutions
Cambium Learning Group
Caterpillar Inc.
Cedar
CGI Federal
Charter Communications
Cimpress
Clorox
Cohere Health, Inc.
Cornerstone Building Brands
Corteva Agriscience

Coupa Software, Inc.
Daimler Truck North America
Deckers Outdoor Corporation
Deere & Co
DMCL
Ducommun Incorporated
Encompass Health Corporation
ESCO Technologies Inc.
Exyte
FBIN
Ferguson Enterprises
First Bank
FJ Management
Fresenius Kabi USA
FUJIFILM Holdings America
GE Appliances
Google
Great Clips, Inc.
Gulfstream Aerospace Corporation
Hitachi Energy USA Inc.
Home Depot
Huntington Ingalls Industries, Inc.
Hydrite Chemical Co
Imerys
Ingevity Corporation
Jack Henry & Associates
Johnson Electric North America Inc
KARL STORZ United States
Kemin Industries
Kiewit Corporation

Kimberly-Clark Corporation
Knowles Corporation
Land O' Lakes
Leidos
Lockheed Martin Corp
Loram Maintenance of Way
MACOM Technology
Macy's
Magna Int.
Masco Corporation
Mativ Holdings, Inc
MEDHOST
MGM Studios
Microsoft
Midmark Corporation
Milliken & Company
Musco
Navistar
NCH Corporation
Nemak
Nestle USA
Northrop Grumman
Nihon Kohden America
Ocean Oil Construction
onSemi
Oshkosh Corporation
Ovivo
Packaging Corporation of America
Persefoni AI Inc.
Principal Financial Group
PulteGroup

Quadient Inc.
Randstad
Reddit Inc
Robert Bosch LLC
Rockwell Automation
S.C. Johnson & Son, Inc.
SAS Institute Inc
Schwabe North America/Nature's Way
Siemens Corporation
Sitecore USA, Inc.
Starkey Hearing Technologies
Stripe Inc
Target Corporation
Tennant Company
The Clorox Company
The Toro Company
The Walt Disney
TKC Holdings, Inc.
Tolko Industries Ltd
Two Sigma
Unilever US
United Launch Alliance
UnitedHealth Group
USANA
Verizon Communications Inc.
Walmart
Warner Bros Discovery
Yelp Inc



Introductions and Announcements

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

- Welcome to the third Roundtable of 2024.
- If you want Peter and Jason to speak to your TEI group, please email [Ilona Lyubashevsky](#).
- Interested in being a speaker? Reach out to [Ilona](#).
- We are still eager to assist companies that made the 280C election for 2022. If you have questions, please email [Jason](#).
- MASSIE has been harnessing the power of Teams to improve the SME experience and accelerate the R&D study. If you're interested in hearing about how the Teams Collaboration Hub can work for you in your environment, schedule some time with [Taylor Eiselin](#).
- Southern Jobs Tax Credits exist to support job-creation credits for states in the Southeast. Do you have any employees in Georgia, Mississippi, or South Carolina? Learn how to claim those credits by talking to [Tanja Spivey](#).

Recent R&D Cases and Controversy from Washington, D.C.

Alex Sadler, Morgan Lewis

Evolving Landscape of Research Credit Cases: Trends, Challenges, and Legal Precedents

Research credit cases have become increasingly difficult for taxpayers, with courts taking a largely negative stance in recent years. The cases tend to involve small claims with facts that are often unfavorable to the taxpayer. Several pressure points have emerged.

Key Pressure Points for Taxpayers

- Proof at the Business Component Level: Taxpayers face the burden of proving their research credit claims down to the business component level, requiring detailed documentation and often involving numerous projects.

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- Pilot Models: The IRS has increased scrutiny of claims involving pilot models, questioning whether the costs qualify under section 174 as part of research activities.
- Fixed-Price Contracts: Fixed-price contracts, once seen as inherently risky for contractors and thus unfunded for research purposes, are being reevaluated by courts, injecting new risks for disqualification.

Proving Research Credit at the Business Component Level: A Critical Requirement

Taxpayers claiming research credits face an ongoing challenge in proving their entitlement to the credit for each business component. The courts have consistently refused to allow the use of sampling to ease this burden, requiring taxpayers to prove each project in its entirety.

Recent Key Cases

- Feller v. Comm’r, Docket No. 11581-20 (2023): In this case, taxpayers sought to limit the scope of discovery to a sample of projects, which the court rejected. Judge Weiler emphasized the taxpayer’s obligation to prove each business component and encouraged the IRS to cooperate in streamlining the case.
- Phoenix Design Group v. Comm’r, Docket No. 4759-22 (2023): Similarly, the court ruled that the burden of proof remains on the taxpayer for every project, rejecting attempts to rely on sampling in complex engineering claims.

- Kapur v. Commissioner, T.C. Memo. 2024-28: In this case, the court reiterated that each business component must be individually documented, again ruling against the use of sampling.
- Betz v. Comm’r, T.C. Memo. 2023-84 (Nega, J.): The court further emphasized that project sampling improperly relieves the taxpayer of its burden of proof, highlighting the necessity for comprehensive project-specific evidence.
- U.S. v. Grigsby, 86 F.4th 602 (5th Cir. 2023): The court rejected an attempt by a construction company to change its argument mid-case regarding business components, ruling that the taxpayer must maintain consistent positions and provide detailed evidence for each project.

The Evolving Role of Pilot Models in Research Credit Claims

Pilot models are a frequent point of contention in research credit cases. These models are used to test new processes or products, but the IRS often challenges whether their associated costs qualify under section 174.

The Role of Pilot Models in Betz v. Commissioner

- Betz v. Commissioner, T.C. Memo. 2023-84: The court addressed whether 19 product development projects undertaken by Catalytic Products International, Inc. (“CPI”) could qualify for research credit. CPI’s projects involving thermal and catalytic oxidizers required a thorough review of each project, with no sampling allowed. The court highlighted that some projects were straightforward, while others involved more novel elements, such as testing failures and redesigns.

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- Pilot Model Exception: The court introduced the concept of a “pilot model exception,” stating that production costs could qualify under section 174 only if the product is shown to be a pilot model — a distinct prototype used for testing. However, the court noted that CPI failed to sufficiently argue that its oxidizers were pilot models and rejected the claim for research credit based on production costs.

Key Considerations for Pilot Models

- New and innovative elements
- Risk factors associated with the project
- The intent behind developing the model
- Whether the project was replicable or pioneering within the industry

Fixed-Price Contracts: Shifting Understanding and New Risks

Fixed-price contracts, once seen as inherently unfunded and eligible for research credit, are now under scrutiny. Courts have increasingly ruled that these contracts may not be unfunded simply because they involve economic risk, and specific contract provisions can disqualify them from research credit eligibility.

Shifting Court Perspectives

- U.S. v. Grigsby, 86 F.4th 602 (5th Cir. 2023): In this case, the court ruled that Cajun’s work on the East Bank project was funded, as the company was compensated for all incurred expenditures. The decision underlined that not all fixed-price contracts are inherently unfunded, especially when payments are not contingent on research success.

- Meyer, Borgman & Johnson, Inc. v. Comm’r, 100 F.4th 986 (8th Cir. 2024): The court found that the contracts in question did not make payment contingent on research success, further eroding the earlier understanding that fixed-price contracts were inherently risky and thus unfunded.

Implications for Fixed-Price Contracts

- Erosion of Geosyntec and Populous Holdings Precedents: The risk once associated with fixed-price contracts for research credit purposes has begun to shift. Courts are focused on specific contract provisions, such as whether the customer has the right to inspect or reject deliverables before payment and whether the contractor is obligated to refund payments or remedy defects.

IRS Filing Updates

In 2024, the IRS introduced significant changes to streamline the research credit filing process and reduce taxpayer burdens. These updates include a revision of Form 6765 and a scaling back of the stringent requirements outlined in the Chief Counsel Memorandum (“CCM”).

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Negotiating MOUs for Audits and MITRE IDR for Software

Stephen Whiteaker, MASSIE R&D Tax Credits

Revised Form 6765 (Effective 2025)

- Reduction in Reportable Business Components: Taxpayers must now report 80% of their total qualified research expenses (“QREs”) in descending order by the amount of total QREs per business component, with a maximum of 50 components. This change significantly reduces the reporting burden.
- Simplified Reporting: The IRS has eliminated the requirement to indicate whether a business component is new or improved, whether it was sold, licensed, or leased, and has removed the narrative requirement for describing research activities on original returns.

Scaling Back CCM Requirements (Effective June 2024)

- Reduced Disclosure: Taxpayers are no longer required to disclose the names of individuals involved in research activities or the specific information those individuals sought to discover. However, the other reporting requirements, such as identifying each business component and outlining the qualified activities, remain in effect.
- Ongoing Relevance in Audits: Despite the reduced reporting requirements, the IRS retains the right to request detailed information during an examination, ensuring that taxpayers still maintain adequate documentation for their claims.

Navigating Research Credit Audits

It is crucial to understand the negotiation of Memorandums of Understanding (“MOUs”) and the role of MITRE in software audits. These tools help both taxpayers and the IRS establish clear expectations and ensure that the audit process is streamlined and well-documented.

Memorandums of Understanding (“MOUs”): Establishing the Basis for Audits

An MOU is a mutual agreement between a taxpayer and the IRS outlining the framework for completing an audit. While not a legal contract, an MOU can be highly beneficial for both parties, as it clarifies the scope of the audit and sets expectations for how adjustments will be applied. The MOU can address specific business components under examination, especially in cases involving many projects grouped under a single business component. The taxpayer can request an MOU.

Negotiating MOUs for Audits and MITRE IDR for Software

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Key Elements of an MOU in Research Credit Audits

1. Scope of Business Components: It's essential to outline which business components are under examination for the audit cycle. If a business component includes multiple projects, both parties should agree on which specific projects will be reviewed.
2. Adjustment Application: Taxpayers should negotiate whether adjustments will apply to the entire business component or only to individual projects within the component. Including an example in the MOU can provide clarity on how these adjustments will be applied.
3. Appeals Rights: A critical aspect of any MOU is preserving the taxpayer's right to go to Appeals if disagreements arise. It's important to review the MOU thoroughly to ensure that it does not inadvertently limit this right.
4. Clear Communication: MOUs should be written in clear and understandable terms, without technical jargon that could lead to misinterpretation. Both parties must review the document carefully to ensure there are no hidden stipulations that could cause issues later in the audit process.

MITRE: Analytical Support for IRS Software Audits

MITRE, a non-profit organization established in 1958, plays a significant role in research credit audits, particularly in software-related cases. MITRE provides analytical support to the IRS, offering recommendations on how to evaluate software projects for research credits. Keep in mind that the IRS pays MITRE. Though they're an independent organization, there are patterns of them very regularly disallowing the credit.

MITRE's Role in Research Credit Audits

1. Data Analysis and Interviews: MITRE conducts data analysis and interviews with key personnel involved in software development. Their goal is to assess the complexity of the software projects, including the design, coding, and testing phases, to determine whether the taxpayer's claims meet the criteria for research credits.
2. IRS Collaboration: MITRE collaborates closely with the IRS to evaluate software-related research credit claims, focusing on the specific technical challenges and uncertainties faced during software development.

Negotiating MOUs for Audits and MITRE IDR for Software

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Responding to MITRE IDRs: Best Practices for Software-Related Audits

When involved in a research credit audit for software projects, taxpayers must be prepared to respond to MITRE's Information Document Requests ("IDRs"). These requests typically focus on gathering detailed information about the software projects under audit and require input from individuals with direct, first-hand knowledge of the software's development and implementation.

Key Components of MITRE IDR Requests

1. Identifying Interviewees

- MITRE typically requests interviews with individuals who have direct, first-hand knowledge of the software's design, coding, or testing processes. These individuals should be able to speak about the technical challenges and uncertainties encountered during the software's development.
- Common roles that MITRE seeks to interview include:
 - **Chief Architect:** Responsible for the overall design of the software.
 - **Project Leader:** Oversees the day-to-day technical decisions made by the programming team.
 - **Lead Programmer:** The individual who led the technical development of a portion of the project.

2. Interview Focus

- The interviews will focus solely on the tax year for which the research credit is claimed. Interviewees will be asked open-ended, detailed questions about the project's timeline, major milestones (e.g., design and testing phases), and the specific technical uncertainties the project faces.
- A thorough understanding of both hardware and software components, as well as any interfaces between this project and other systems, will be required. Diagrams showing these components are highly recommended.

3. Providing Documentation

- Taxpayers are required to provide documentation that the interviewees have reviewed to refresh their memories about the software project. This documentation may include project specifications, design documents, and testing results.
- If the required documentation has already been provided to the IRS, taxpayers must clearly indicate this in their response. Any additional follow-up questions will likely be based on the documentation provided.

Negotiating MOUs for Audits and MITRE IDR for Software

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4. Scheduling Interviews

- MITRE requests that all interviews for a given project be scheduled consecutively, where possible, to maintain focus and efficiency. Each interview will last approximately 2-3 hours, depending on the complexity of the project.
- Only one interviewee can be interviewed at a time, and no other individuals are allowed in the room during the interview. This ensures that the focus remains solely on the interviewee's knowledge and experience

5. Interview Schedules and Deadlines

- Taxpayers must provide a complete interview schedule, including the name, date, time, and location for each interview, at least two weeks before the start of the interviews. If the information is incomplete or provided late, the interviews will be canceled and must be rescheduled according to the IDR requirements.
- A complete response to the IDR is only considered finished once all requested interviews have been conducted according to the agreed-upon schedule.

Practical Tips for Managing MITRE IDR Requests

- Prepare Thoroughly: Ensure that all individuals selected for interviews are well-prepared and have reviewed all relevant documentation in advance.
- Maintain Clear Communication: Keep lines of communication open with MITRE and the IRS to avoid any confusion regarding interview schedules, documentation requirements, or project details.
- Stay Organized: Keeping meticulous records of the interview schedule, interviewee qualifications, and supporting documentation will help ensure that the process goes smoothly.



IDRs and SME Witnesses during an Audit

Catie Ely, MASSIE R&D Tax Credits

Jason Massie, MASSIE R&D Tax Credits

The IRS's approach to research credit audits has become increasingly adversarial, with a heightened demand for documentation and greater specificity in claims. This trend stems from perceived taxpayer abuse, a bias against software claims, and a string of recent IRS wins in court. As a result, the IRS is demanding more robust proof from taxpayers and applying stricter standards during audits.

Best Practices for Handling IDRs

Effectively managing IDRs can be crucial in determining the outcome of a research credit audit. A proactive approach can help ensure that documentation is provided in an organized manner and that communication with the IRS is clear and consistent.

Tips for Managing IDRs

1. Request Draft IDRs: Asking for IDRs in draft form allows time to review the request and negotiate the scope of the question and timeline. This helps avoid agreeing to provide documents that may not exist.
2. Internal Document Review: Before submitting any documents, conduct an internal review to ensure you can provide everything requested. This avoids submitting incomplete documentation and surprises later in the audit.
3. Organized Submission: Provide organized documents with cover pages that summarize the contents. Exam Teams appreciate “roadmaps” that help them navigate the materials efficiently.
4. Proactive Communication: Be proactive in communicating with the IRS and meeting deadlines. Ask for clarification if the IRS requests broad information, and don't hesitate to explain if certain records are not available.

IDRs and SME Witnesses during an Audit

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Planning and Preparing for IRS Witness Interviews

IRS witness interviews are a critical component of research credit audits, especially when the IRS is seeking specific technical expertise. Careful planning and preparation can help ensure these interviews go smoothly and contribute to a favorable outcome.

Key Considerations for Planning IRS Witness Interviews

1. Negotiating Ground Rules: Set clear expectations for the interviews by negotiating how many Subject Matter Experts (“SMEs”) can participate, the duration of interviews, and whether questions will be provided in advance.
2. Admin Logistics: Confirm logistical details such as who will send the invites, which platform will be used, whether the interviews will be recorded, and what format (e.g., audio) will be employed.

Preparing SMEs for Interviews

1. Select All-Star SMEs: During your annual study, identify key SMEs who are knowledgeable and articulate. These individuals will be the best representatives during interviews.
2. Set Expectations: Hold a pre-interview meeting with the SMEs to explain the IRS’s objectives and what is expected from the interviewees. Ensure they are familiar with the relevant business component information and documentation.
3. Ease and Honesty: Make sure SMEs are comfortable with the process and understand that while they are not under oath, their answers may be recorded. Encourage honesty and clarity—it’s important they don’t guess or feel intimidated by the IRS or MITRE.

If you’re looking for Tax Controversy support, please feel free to reach out to [Stephen Whiteaker](#).



presented by  MASSIE

**Mark your calendars for
our next Roundtable.**

**December 12, 2024
3 PM ET**