

Q4 ROUNDTABLE WHITE PAPER

December 12, 2024

BECAUSE
TODAY IS
DIFFERENT



Table OF CONTENTS

Introductions and Announcements

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

Page 4

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

Matt Lerner, Sidley Austin

Pages 4 - 6

Refund Claim Considerations

Stephen Whiteaker, MASSIE R&D Tax Credits

Page 7

R&D Planning for 2025

Catie Ely, MASSIE R&D Tax Credits

Page 8 - 9

Upcoming R&D Tax Credit
Best Practice Roundtable

Thursday, February 27, 2025

Companies ATTENDED

Accushield
Adobe Inc.
Advancion Corporation
Ahold Delhaize
Air Products & Chemicals, Inc.
Allegiant Travel Company
Allient Inc.
Altria Client Services
AMD
Applied Medical Corporation
Aramark
Arvest Bank
ASML
Autodesk
Aveanna
Aviagen
AVI-SPL LLC
Azurity Pharmaceuticals, Inc.
BAE Systems
Big Lots
Bioventus
Brunswick
Builders FirstSource
Cabot Corporation
Caterpillar Inc.
Cedar
Cisco
Clorox
Compass Strategic Investments
Corteva
Cummins Inc

Daimler Truck North America
Danfoss
Deckers Outdoor Corporation
Deere & Co
Domo
Domtar
Ducommun Incorporated
Eastman Chemical
Edwards Lifesciences
Encompass Health Corporation
Entegris, Inc.
Esri
FormFactor, Inc.
Fresenius Kabi USA
FUJIFILM Holdings America Corporation
Great Clips, Inc.
Hitachi energy
Hoffmaster
Hunter Douglas
International Motors, LLC
InterSystems Corporation
J.R. Simplot Company
Jack Henry
Kemira Water Solutions, Inc.
Kiewit
Lattice Semiconductor
Lear Corporation
leidos
Lockheed Martin Corporation
Lumen Technologies

MACOM Technology
Macy's
Mars, Incorporated
MasterBrand
Mativ Holdings, Inc
McWane, Inc.
MDU Resources Group, Inc.
MEDHOST
Medtronic
Menasha Corporation
Microsoft
Milliken
Mozarc Medical
Nestle USA
Noom
Northrop Grumman
Occidental Petroleum
Ocean Oil Construction
Oracle
Oshkosh Corporation
OSI Group, LLC
PACCAR
Pinterest
Plexus Corp
Premera
Principal Financial Group
Prysmian
PulteGroup
Randstad
Range Resources
Rehrig

REI
Reiter Affiliated Companies
Robert Bosch LLC
RRD
Saltchuk Resources
Schwan's
Sealed Air Corporation
Servco Pacific
Simplot
Snap-on Incorporated
Southwire Company
Stanley Black & Decker
Target Corporation
Tate & Lyle Americas LLC
TEL
The Home Depot
The Clorox Company
The Suddath Companies
Two Sigma Investments, LP
United Launch Alliance
Under Armour
United Health Group
Varian Medical Systems, Inc
Verint Systems
Verizon Communications Inc.
Walgreens
Wellmark, Inc.
Western Digital
Zapier Inc.



Introductions and Announcements

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

- Welcome to the fourth Roundtable of 2024.
- If you want Peter and Jason to speak to your TEI group, please email [Ilona Lyubashevsky](#).
- Interested in being a future Roundtable speaker? Reach out to [Ilona](#).

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

Matt Lerner, Sidley Austin

Research credits have been increasingly adversarial, but there are some positive signs it's starting to lessen. The IRS might be lightening up, but it's unclear yet if this will lead to improved audit processes. Holly Paz, the commissioner for the Large Business & International ("LB&I") Division of the IRS, has been unhappy with the pace of audits and positions being taken. There are some extreme cases, and questions are raised about whether the pendulum has swung too far to disallow too much. To aid in this, new roles are being added for LB&I to assess if the positions being taken are entirely fair in certain cases.

The IRS's Personnel Screening and Investigation ("PS&I") Division is trying to move away from statistical sampling, but this is not gaining traction. Taxpayers have to contend with some resistance to the R&D Tax Credit.

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

Matt Lerner, Sidley Austin

Substantially All Test

- Some Exam Teams are willing to agree with the 7th Circuit's determination in Little Sandy Coal that one cannot assume that direct support and direct supervision can be elements of a process of experimentation ("POE") and can't be automatically excluded.
- Others insist the Tax Court was correct and demand that taxpayers present the POE fraction for each business component, removing support and supervision from the numerator and leaving them in the denominator.
- Most teams are still asking taxpayers to show an actual computation proving that a project satisfies the 80% substantially all test, taking into account all personnel who worked on the business component. Seeing some exam teams pivot back to determine a lengthier process for if a project meets the 4-part test. This includes looking at the discovery, doing site visits, etc.

The Course of Audits

There are still instances where Exam Teams ask for a short description of projects and then move directly to an Acknowledgment of Facts ("AOF") IDR without asking for documents, site visits, or interviews, expecting the taxpayer to guess as to the issues in dispute and fill the record with all needed material, rather than responding to targeted questions.

Key Components of the IRS's View of Audit Defense

- It is imperative to have as comprehensive a list of business components as possible and to be able to allocate costs and work effort to those components.
- Taxpayers who continue to focus solely on employees without reference to their projects are suffering the least favorable audit outcomes.
- Taxpayers who indicate that their research credit studies did not focus on business components or who use employee statistical samples without relating work to projects face significant challenges, even getting Exam Teams to audit their credits rather than issuing disallowances.
- Exam teams continue to ask for documentation to be supplied, though some don't seem as accommodating of how different teams use and develop documentation.
- Exam Teams also regularly demand specific lists of uncertainties addressed and processes of experimentation undertaken.
- They tend to look for examples where they believe the information was already known based on work done in the past by the taxpayer or others. This can become an issue as technology changes and grows rapidly, and the solutions from solutions done in the past may no longer be relevant.
- They also focus intently on whether the work highlighted was performed during the years at issue. The documents you provide must relate to the years in issue, that they do not highlight only work done in prior years, and that they are dated.

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

Matt Lerner, Sidley Austin

SME Witness Interviews and Site Visits

Taxpayers do not view SME witness interviews favorably, as they are time-consuming, disruptive, and contain heavy risk. However, these interviews can be good for nailing down specific four-part test questions. This depends on how prepared and knowledgeable the SMEs are. An effective site visit requires an emphasis on honesty and preparing an SME for the questions that will be asked.

Site visits can also effectively show off the research performed, and IRS engineers generally appreciate such visits. An effective site visit requires substantial preparation. The tour guide is essentially a witness and must understand the issue and be trained to present effectively and respond to questions truthfully and appropriately. The tour should highlight the work described in your documents and show the research process. You must set effective ground rules with Exam Teams to control the situation.

What Taxpayers Can Do: Preparing Audit Defense

Key Components:

- Be sure you can identify all business components.
- Make every effort to ensure you have data that allows you to apply the POE test. Even if you believe all work is part of a POE, set up the fraction in your workpapers and save the background support.
- Gather as much information as possible, including supporting documents, when preparing your returns and when the information is most readily available.
- Use sampling, if at all, on a business component basis instead of an employee basis. Be sure your sampling plan satisfies Rev. Proc. 2011-42, and where you are currently under audit, try to get the IRS to sign off on the plan.
- Understand that developing the record is for your benefit.
- Provide narrative project overviews with documents produced, provide guides that point to the guide or record, and build the record as completely as possible.
- If interviews are not being done, make a record and prepare videos and evidence.

Refund Claim Considerations

Stephen Whiteaker, MASSIE R&D Tax Credits

A chief counsel memo published on October 15, 2021, made research credits more difficult. Requirements to request more information went into effect in January 2022.

On January 10, 2022, the IRS started requesting a lot of information about business components when filing refund claims. These changes included requesting taxpayers to:

- Identify all business components
- The activities performed for each business component
- The individuals who performed the research activities
- The information sought to discover
- Wages, supplies, and contract labor for each business component

Taxpayers now have until January 10, 2026, to submit claims, and the IRS will issue 45-day letters to perfect the claim. Claims rejected after your additional information is sent in will likely require a taxpayer to file suit.

For claims postmarked after June 18, 2024, the IRS is waiving the following:

- The names of the individuals who performed research and
- The information each individual sought to discover
- Taxpayers still need to identify business components and research activities performed

Should a claim be filed?

Whether or not a taxpayer should file a claim depends on multiple factors—for example, reasons for amending, such as missing a cost center or group of employees. If there is a good reason, it needs to be evaluated to see if there is good documentation supporting the amendment. The further back, the harder it can be to collect documentation. Another factor is how much the claim is worth, as there are expenses related to audit protection that need to be evaluated compared to the worth of the claim. If there is a pilot model, be aware that there is heavy scrutiny from the IRS for these activities. If the claim is rejected, the entire claim may be rejected.

Even if a claim is accepted, it can still be subjected to an audit. The risk team that evaluates audits and other issues can be audited or examined. Taxpayers need to evaluate their audit history, IRS history, and relationship with the IRS. If a company has been audited before and has had a difficult time with the IRS, it can be difficult to make further claims.

Once the claim is filed, ensure that there is a way to track the information about when it was filed. Ensure that the application and claim are comprehensive but concise and readable.

If a 45-day letter is issued, provide ample information and not just resubmit the information provided before.

R&D Planning for 2025

Catie Ely, MASSIE R&D Tax Credits

Jason Massie, MASSIE R&D Tax Credits

Key Components of the Big Picture

Taxpayers need a good business component strategy.

- Pilot models/prototypes are more contentious for the IRS than software. Manufacturing a new product, for example, can have less documentation, and keeping track of projects in a plant or on the field is not as easy. One-size-fits-all doesn't work for these companies.
- Some companies group business components into families, but the IRS finds this a contentious practice. They can't apply the Little Sandy Coal logic to grouped business components, so grouping them is not advised. When the new form 6765 comes out, and businesses are required to list the top 50, it will be difficult to split up those families to provide the information the IRS is looking for.
- Taxpayers must ensure their projects meet the Little Sandy Coal regulations and meet the 80% qualification.

Taxpayer studies must be designed to gather “activity-level” information and documentation.

- Documentation is crucial to support the activities. Taxpayers need to determine what each individual sought to discover by job title, cost center, or department. The taxpayer must provide information on which employees do direct research versus supervision or support.
- To ensure this is met, it is strongly recommended that activities be identified by job title, cost center, or department.

A study must be able to stand on documentation.

- The taxpayer needs to ensure that contemporaneous documentation is available to show the project expenses and activities. These include things like lifecycles, emails, testing results, etc. Ideally, the documentation needs to showcase different alternatives and options for the POE.
- Highlight what area the documentation is proving in the 4-part test.
- The interview approach is discouraged as the documentation isn't shown or provided through this method.

Form 6765 Changes

Planning Tips for Taxpayers

1. Study the form and the new requirements to discuss with key R&D Stakeholders.
2. Re-examine the Business Component Strategy to ensure:
 - The top 80% of business components (up to 50) can be listed with QREs.
 - Each employee has information on what they sought to be discovered.
 - Documentation can be provided to support each business component and element of the 4-part test.
3. Gather Direct Research, Support, and Supervision information. Ensure the 80% POE formula based on Little Sandy Coal is met.

R&D Planning for 2025

Catie Ely, MASSIE R&D Tax Credits

Jason Massie, MASSIE R&D Tax Credits

Key Components of Lessons Learned from Court Cases

1. The Devil is in the details!
2. The IRS wants a lot of factual information about business components, people and activities, and documentation, and taxpayers need to organize it in a way the IRS will understand.
3. Oral testimony and provider interview notes are not of equal weight compared to engineering documentation and artifacts.
4. Taxpayers may need to redesign their study approach to prepare for better controversy outcomes.

[If you're looking for Tax Controversy support, click here to contact us.](#)

Case	Business Component	Winner	Reasoning
Genecure, L.L.C. v. Comm'r, 123 T.C.M. (CCH) 1271 (T.C. 2022)	Product / Formula	Taxpayer won on 61% of claimed QREs	Taxpayer substantiated expenses for lab supplies, contracted research services, and amounts paid for a collaboration research were incurred in connection with qualified services but did not substantiate amounts paid for meals, premiums for unidentified insurance policies, and airfare.
Kellett v. Comm'r, 123 T.C.M. (CCH) 1327 (T.C. 2022), vacated, No. 22-2266, 2023 WL 4697250 (4th Cir. July 17, 2023) (based on parties' agreement)	Software	IRS	Taxpayer was not entitled to deduct payments made to remove computer engineers for a website's interactive features because Taxpayer did not encounter requisite uncertainty.
Leon Max v. Comm'r, 121 T.C.M. (CCH) 1250 (T.C. 2021)	Process	IRS	Clothing design activities related to actual construction of the product were not investigative in nature.
United Therapeutics Corp. v. Comm'r, No. 10210-21, 2023 WL 3496208 (T.C. May 17, 2023)	Simplified credit calculation	IRS	When Taxpayer claims orphan drug credit, both sections 41(c)(6) and 45C(c)(2) are given effect, which marginally reduces the overall benefit of both credits. Taxpayer could not exclude expenses treated as qualified clinical testing expenses for base period.
Betz v. Comm'r, T.C.M. (RIA) 2023-084 (T.C. 2023)	Product	IRS	Taxpayer failed to establish that wages QREs for systems or systems' components were incurred in connection with qualified services. Other research projects were not creditable because Taxpayer did not retain substantial rights in the results of the research under customer contracts.
Harper v. Comm'r, T.C.M. (RIA) 2023-057 (T.C. 2023)	Process; Technique; Invention	Taxpayer won on IRS's summary judgment motion	There was a genuine dispute of material fact as to whether Taxpayer established the business component element to claim QRE tax credits.
Little Sandy Coal Co., Inc. v. Comm'r, 121 T.C.M. (CCH) 1113 (T.C. 2021), aff'd, 62 F.4th 287 (7th Cir. 2023)	Product	IRS	Taxpayer was not entitled to credit for expenses incurred in development of a tanker and a dry dock prototype because they did not meet the process of experimentation requirement.
Populous Holdings, Inc. v. Comm'r, No. 405-17, 2019 WL 13032526 (T.C. Dec. 6, 2019)	Product	Taxpayer won on summary judgment	Taxpayer's contract research was not "funded research" because payment was contingent on research success and contractor retained substantial rights in the research.
Moore v. Comm'r, T.C.M. (RIA) 2023-020 (T.C. 2023)	Process	IRS	Taxpayer failed to establish that corporation's president engaged in QR or directly supervised or supported persons performing QR.
Siemer Milling Co. v. Comm'r, 117 T.C.M. (CCH) 1196 (T.C. 2019)	Process	IRS	Taxpayer failed to establish (1) what business component it sought to develop regarding a wheat hybrids project, (2) that there was uncertainty regarding a machine development project, and (3) that the flour heat-treatment project met process of experimentation element because it did not set out how it intended to develop new products.
Tangel v. Comm'r, 121 T.C.M. (CCH) 1001 (T.C. 2021)	Product	IRS won on summary judgment	Taxpayer did not retain substantial rights in research performed for another company when its contract conferred exclusive right to exploit the results of the research on that company.



presented by  MASSIE

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

**February 27, 2025
3 PM ET**