



R&D Credit Overview,
Qualifications, and Current Events

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ACCOUNTING • TAX • ADVISORY

AGENDA

- History of the Credit
- Overview of the Credit
- Legislative Update
- Regulation Updates
- Relevant and Recent Case Law
- Preparing for the R&D Credit Analysis



HISTORY OF THE CREDIT

- The R&D Credit is a general business credit under IRC 41.
- Meant to encourage R&D in the United States.
- Enacted in the Economic Recovery Tax Act of 1981.
- Has expired numerous times and then extended.
- PATH Act of 2015 made R&D Credit permanent!!
- The biggest credit benefit for U.S. taxpayers.
- Numerous court cases and regulations to clarify technical issues.



OVERVIEW OF THE CREDIT:
THE 4-PART TEST

Permitted Purpose

Develop a new or improve an existing function, performance, reliability, quality, or significant cost reduction.
IRC §41(d)(1)(B)(ii)

“We were trying to...”

Eliminate Uncertainty

Eliminate uncertainty concerning capability, methodology, or appropriateness of design.
IRC §41(d)(1)(A)

“We didn’t know how to...”

Qualified Research Activity

Technological In Nature

Discover information that fundamentally relies on the principles of physical science, biological science, computer science, or engineering.
IRC §41(d)(1)(B)(i)

“We used the science of...”

Process of Experimentation

Substantially all of the activity constitutes elements of a process of experimentation.
IRC §41(d)(1)(C)

“We tested...”

OVERVIEW OF THE CREDIT: PROCESS OF EXPERIMENTATION

- Substantially, all of the activities of the research must constitute **elements** of a process of experimentation related to a new or improved function, performance, or reliability or quality.
- The term process of experimentation means: **“A process involving the evaluation of more than one alternative designed to achieve a result where the means of achieving that result is uncertain at the outset.”**
- A taxpayer is not engaged in a process of experimentation if the solution to the research is readily known at the outset.



EXAMPLE

Taxpayer is trying to develop a retina scanning computer security product using the embedded camera on laptop units.

- Hardware design and development team:
 - Team of 10 Mechanical / Electrical Engineers @ \$100,000 wage each @ 75%
 - Developing specs, requirements, design iterations, prototypes, testing...
- Software design and development team:
 - Team of 5 Developers @ \$100,000 wage each @ 85% (substantially all)
 - Developing specs, requirements, architecture, coding, testing....
- Manufacturing development / improvement team:
 - Team of 5 Manufacturing Engineers @ \$100,000 wage each @ 50%
 - Developing specs, requirements, equipment/process design iterations, running small test batches, etc....



	Hardware 10 @ 75%	Software 5 @ 80%	Manufacturing 5 @ 50%	Tax Year 2017 12/31/2017	
Qualified Research Expenditures					
Wages	\$ 750,000	\$ 500,000	\$ 250,000	\$ 1,500,000	
Supplies (Prototypes & First Batch Runs)	\$ 200,000	\$ -	\$ 250,000	\$ 450,000	
Computer Rental (Amazon Web Services)	\$ -	\$ 50,000	\$ -	\$ 50,000	
Contract Research @65% (Outside Testing)	\$ 65,000	\$ 227,500	\$ 325,000	\$ 617,500	
Total Current Year QRE	\$ 1,015,000	\$ 777,500	\$ 825,000	\$ 2,617,500	
Regular Credit					
Base Amount and Limitations					
Average Annual Gross Receipts				\$ 25,000,000	
Fixed Base Percentage				8.49%	
Base Amount				\$ 2,122,500	
Excess Current Year QRE over Base Amount				\$ 495,000	
50% of Current Year QRE				\$ 1,308,750	
Smaller of Current Year QRE or Excess QRE over Base Amount				\$ 495,000	
Credit Percentage				20%	
Gross Research Credit				\$ 99,000	
Reduced Research Credit (280C Election)				\$ 64,350	2.46%
Alternative Simplified Credit (ASC)					
Prior Year QREs (3 PYs)					
12/31/2014				\$ 2,100,000	
12/31/2015				\$ 2,250,000	
12/31/2016				\$ 2,400,000	
Total 3PY QRE				\$ 6,750,000	
Average 3 PY QREs				\$ 2,250,000	
1/2 Average 3 PY QREs				\$ 1,125,000	
Current Year QRE over Base Amount				\$ 1,492,500	
Credit Percentage				14%	
Gross Research Credit				\$ 208,950	
Reduced Research Credit (280C Election)				\$ 135,818	5.19%

OVERVIEW OF THE CREDIT: BUSINESS COMPONENT

- The four-part test is applied separately to each business component.
- A business component is any product, process, computer software, technique, formula, or invention.
- Business component identification is key to a successful R&D engagement.

OVERVIEW OF THE CREDIT: BUSINESS COMPONENT – THE SHRINK BACK RULE

- The shrinking back rule is applicable if a taxpayer does not meet the four-part test with respect to the overall business component.
- The requirements of the four-part test are to be applied first at the level of the discrete business component.
- If the four-part test is not met at that level, then apply the four-part test to the next most significant subcomponent.
- This “shrinking back” of the product continues until either a subcomponent of the product that satisfies the four-part test or the most basic element of the product is reached and the subcomponent fails to satisfy the test.

OVERVIEW OF THE CREDIT: EXAMPLES OF QUALIFIED ACTIVITY

- Product development (new or improved)
 - Designing new products
 - Prototyping new products
 - Modifications to meet changes in government regulations
 - Software development
- Manufacturing process improvements
 - Introducing new technology into an existing production process
 - Process changes designed to accommodate new materials
 - Designing a new process for production of a new product
 - Creating specialized tools, machinery, or fixtures using new technology
 - Process to increase quality, output, or reduce costs
 - Using computers or robotics to automate tasks previously performed by humans
 - Manufacturing efforts in support of new product development

OVERVIEW OF THE CREDIT: EXAMPLES OF QUALIFIED ACTIVITY (cont.)

- Evaluation of technology from a third party within an existing manufacturing process
- Developing product improvements to increase the shelf life or stability of an existing product
- Developing software code for core engines that use algorithms to automate manufacturing processes
- Developing new or improved designs, prototype development, and validation activities
- Establishing a new factory or production line where new technology

OVERVIEW OF THE CREDIT: EXAMPLES OF QUALIFIED ACTIVITY (cont.)

- Developing software for mobile applications, digital imaging compression, interactive online app purchases (micro transactions)
- Using hardware and software in new and innovative ways to produce more realistic graphics for video games (simultaneous multithreading)
- Software development (sold, licensed, or for internal use)
 - Writing, programming, or testing new code
 - Creating development tools
- Basic research

OVERVIEW OF THE CREDIT: EXAMPLES OF NON-QUALIFIED ACTIVITY

- **Research after commercial production**
- Adaptation to a particular customer
- **Reverse engineering**
- Management activities, efficiency surveys, or market research
- Training
- Routine data collection
- Routine quality control testing
- Research conducted outside the U.S.
- Social science, arts, or humanities research
- **Funded research**

OVERVIEW OF THE CREDIT: COMMERCIAL PRODUCTION

Commercial Production

- Ready for commercial sale or use, or
- Meets basic functional and economic requirements for sale or use

Generally, certain activities occur after commercial production:

- Preproduction planning
- Tooling up for production
- Trial production runs
- Troubleshooting faults in production equipment or processes
- Data accumulation
- Debugging flaws

OVERVIEW OF THE CREDIT: REVERSE ENGINEERING

- Recreating an existing product from plans, blueprints, detailed specifications, or publicly available information is NOT qualified research.
- Looking at and evaluating another's product or process is OK, as long as your intent is to make a better product or process.

QUESTION FOR THE AUDIENCE

Do any of you get paid to do
R&D on behalf of your
customers?

(Someone engages your company to “figure it out for them”)

OVERVIEW OF THE CREDIT: FUNDED RESEARCH

- One of the specific exclusions from qualified research is "any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity)."
- Taxpayer must be "at risk" for the cost of the development and its success or failure and retain "substantial rights" to their research efforts.
- Contracts are reviewed to determine funding.

Questions:

- Are you paid regardless of effort, success, or completion?
- Are your payments received contingent upon you being successful in your research?
- Does your contract say you may have to return the payment received (no money for you) if the product doesn't meet specifications?

OVERVIEW OF THE CREDIT: FUNDED RESEARCH – FAIRCHILD

Fairchild Industries v. U.S., 71 F. 3d 868 (Fed. Cir. 1995)

- Taxpayer entered in to a fixed-price contract with the Air Force to develop an aircraft.
- To get paid, taxpayer had to meet the government's milestones.
- Taxpayer kept substantial rights to the design resulting from the research.
- Taxpayer claimed a credit for these expenses.

Lower courts ruled against the taxpayer, but the court of appeals ruled in favor of Fairchild, refining the criteria for substantiating financial risk and establishing that research performed under a customer contract may qualify for the R&D tax credit.

OVERVIEW OF THE CREDIT: FUNDED RESEARCH – FAIRCHILD (cont.)

- Court: "The inquiry turns on who bears the research costs upon failure, not on whether the researcher is likely to succeed in performing the project."
- Key contract clauses noted by the court:
 - Contract required Fairchild to meet specific design, construction, quality, and performance standards.
 - All work subject to inspection and testing before acceptance.
 - Payment under contract made only after acceptance.
 - The government could terminate the contract for default or for convenience of the government.
 - Progress payments made, but Fairchild did not have the right to retain unless contract line items were delivered and accepted.

OVERVIEW OF THE CREDIT: FUNDED RESEARCH – LOCKHEED

Lockheed Martin Corp. v. U.S., 210 F. 3d 1366 (Fed. Cir. 2000)

- Summary judgment on whether Lockheed retained substantial rights to the research.
- Court of Federal Claims ruled against Lockheed; court of appeals reversed decision in favor of Lockheed.
- Right to use the research in its business constitutes substantial rights:
 - "The right to use the research results, even without the exclusive right, is a substantial right."
 - "Lockheed Martin still retains substantial rights in the subject matter even when others do as well."
- Substantial rights are maintained by an entity conducting research as long as that entity does not have to pay for the use of the resulting knowledge.

OVERVIEW OF THE CREDIT: ASK YOURSELF ...

- Are you improving your products at all?
- Have you improved your manufacturing process, ever?
- Are you developing new or improved software?
- Do you have patents?
- Do you have engineers on staff? Why?
- What would you say is your competitive advantage?

OVERVIEW OF THE CREDIT: SOUNDS EASY, BUT CONSIDER...

- Subjective determination
- Exam agents either know too little or have specialized expertise
- How to support this claim with appropriate documentation
- Numerous court cases
- Mechanics of the credit calculation
- Don't throw in the kitchen sink

OVERVIEW OF THE CREDIT: QUALIFIED COSTS

- Wages:
 - Form W-2, Box 1: Subject to withholding
 - Not 401(k), fringe benefits, O/H
- Supplies:
 - Any tangible property other than land, improvements to land, or property of a character subject to the allowance for depreciation
- Computer Rental:
 - Cloud hosting (Amazon Web Services)
- Contract Research (65%):
 - Payments to third parties to perform Qualified Research
 - Consultants and/or special testing facilities
 - Taxpayer must bear risk and retain substantial rights

OVERVIEW OF THE CREDIT: METHODOLOGIES

- Section 41 – Credit for **Increasing** Research Activities:
 - Comparative analysis
 - More research = more credit, no limits
- Regular Credit:
 - Enacted under the Economic Recovery Tax Act of 1981
 - Originally IRC Sec. 44G, changed to IRC Sec. 41 in 1986
- Alternative Simplified Credit (ASC):
 - Enacted under the Tax Relief and Health Care Act of 2006

OVERVIEW OF THE CREDIT: REGULAR CREDIT METHOD

- Equal to 20% of the lesser of one-half the current year QRE or QRE that exceeds a calculated Base Amount.
 - Thus, the Regular Credit will never be larger than 10% QRE (50% of QREs X 20%).
- Fixed Base Percentage - Start-Up vs. Historical
- Base Amount:
 - Equals Fixed Base Percentage x Average Annual Gross Receipts for the prior four years.
- Gross Receipts

OVERVIEW OF THE CREDIT: START-UP VS. HISTORICAL FB%

- Base Amount = Threshold
- Two ways to compute Base Amount (Start-up or Historical).
- **Start-up** company meets one of the following conditions:
 - There were fewer than three tax years beginning after 12/31/1983 and ending before 1/1/1989 in which the taxpayer had GR and QRE.
 - FB% = 3% for first five taxable years beginning after 12/31/1993.
 - FB% then adjusts to statutory scheme in years 6 – 10.
 - Example:

$$\text{Year 7 FB\%} = 1/3 \left[\frac{\text{Year 5 QRE} + \text{Year 6 QRE}}{\text{Year 5 GR} + \text{Year 6 GR}} \right]$$

OVERVIEW OF THE CREDIT: START-UP VS. HISTORICAL FB% (cont.)

- **Historical** company had GR and QRE during “1984 – 1988.”
- $FB\% = \left[\begin{array}{l} 1984 - 1988 \text{ QRE} \\ 1984-1988 \text{ GR} \end{array} \right]$
- “Got Documents?”
- For both the Start-up and Historical FB% calculations, the FB% is maxed out at 16%.
- Adjustments need to be made for acquisitions and dispositions of trades or businesses.

OVERVIEW OF THE CREDIT: REGULAR CREDIT METHOD – GROSS RECEIPTS

- All sources – Total amount derived under the taxpayer’s method of accounting from all activities and all sources before COGS.
- **Examples:** Product sales, service revenue, dividends, interest, royalties, net gain/loss from Form 4797 Sales of Business Property.
- Excluded:
 - Returns and allowances
 - Sale or exchange of capital assets
 - Repayments of loans
 - Sales tax where taxpayer only collects and remits
 - De minimus rule: Amounts received prior to the first year TP has >\$25,000
 - Receipts from sale or exchange that is NOT in the ordinary course of business

OVERVIEW OF THE CREDIT: ALTERNATIVE SIMPLIFIED METHOD

- Credit equal to 14% of the amount of current year QRE that exceeds one-half of the average QRE for the three prior years. Use 6% for those who do not have QRE in any one of the 3 prior years.
- Does not require Gross Receipts in the computation. No looking back to “the beginning of time.”
- **Good opportunity when there is little or no benefit or documentation in older years.**
- Was an original return item. Couldn't amend return and select ASC.
- Final regulations published in February 2015 allow taxpayers to amend returns and select ASC for all open tax years. However, rules stipulate that a taxpayer that previously claimed a REGULAR credit for a tax year may not make an ASC election for that tax year on an amended return.

Same example as earlier but we changed the FBP%. If documentation is weak, we would need to take the smaller credit.

	Hardware 10 @ 75%	Software 5 @ 80%	Manufacturing 5 @ 50%	Tax Year 2017 12/31/2017	
Qualified Research Expenditures					
Wages	\$ 750,000	\$ 500,000	\$ 250,000	\$ 1,500,000	
Supplies (Prototypes & First Batch Runs)	\$ 200,000	\$ -	\$ 250,000	\$ 450,000	
Computer Rental (Amazon Web Services)	\$ -	\$ 50,000	\$ -	\$ 50,000	
Contract Research @65% (Outside Testing)	\$ 65,000	\$ 227,500	\$ 325,000	\$ 617,500	
Total Current Year QRE	\$ 1,015,000	\$ 777,500	\$ 825,000	\$ 2,617,500	
Regular Credit					
Base Amount and Limitations					
Average Annual Gross Receipts				\$ 25,000,000	
Fixed Base Percentage				1.57%	8.49%
Base Amount				\$ 392,500	
Excess Current Year QRE over Base Amount				\$ 2,225,000	
50% of Current Year QRE				\$ 1,308,750	
Smaller of Current Year QRE or Excess QRE over Base Amount				\$ 1,308,750	
Credit Percentage				20%	
Gross Research Credit				\$ 261,750	
Reduced Research Credit (280C Election)				\$ 170,138	6.50%
Alternative Simplified Credit (ASC)					
Prior Year QREs (3 PYs)					
12/31/2014				\$ 2,100,000	
12/31/2015				\$ 2,250,000	
12/31/2016				\$ 2,400,000	
Total 3PY QRE				\$ 6,750,000	
Average 3 PY QREs				\$ 2,250,000	
1/2 Average 3 PY QREs				\$ 1,125,000	
Current Year QRE over Base Amount				\$ 1,492,500	
Credit Percentage				14%	
Gross Research Credit				\$ 208,950	
Reduced Research Credit (280C Election)				\$ 135,818	5.19%

OVERVIEW OF THE CREDIT: OTHER CONSIDERATIONS – THE CONSISTENCY RULE

Qualified research expenses used to compute the **base period** should be determined on a basis consistent qualified research expenses for the **credit year**.

OVERVIEW OF THE CREDIT: OTHER CONSIDERATIONS – THE CONSISTENCY RULE (cont.)

Research, Inc. v. United States

- Taxpayer was denied the research credit because it could not quantify the base period QREs attributable to its “special system projects.”
- These expenses were included in the credit year and the taxpayer incurred the same type of expenses in the base period but had destroyed relevant documentation to substantiate them.
- Credit disallowed because the relative increase in qualified research expenses could not be measured (**lack of documentation**) without considering the expenses incurred during the base period for the same type of projects included in the credit year.

OVERVIEW OF THE CREDIT: OTHER CONSIDERATIONS – 280C

- Taxpayers cannot take a Sec. 174 deduction and a Sec. 41 credit on the same expense.
- Thus, the Sec. 174 deduction is reduced by the amount of the R&D Credit for that year.
- Reduces the value of the credit from 20% to approximately 13%.
- Sec. 280C does this mechanic for you through a reduced credit rate known as the Net Credit.
- Once made, it is irrevocable for the tax year.
- This is an original return item. **A Section 280C reduced credit election cannot be made on an amended return.**

OVERVIEW OF THE CREDIT: OTHER CONSIDERATIONS - UTILIZATION

- Through 2015, the Research Credit can only offset regular tax, not AMT.
- Good news – The PATH Act.
- Credit carries back 1 year and forward 20 years.
- Planning idea for NOL companies – The multi-year look back.
- IRC 41(g) – Limitation on individual owners of pass through entities

OVERVIEW OF THE CREDIT: OTHER CONSIDERATIONS

- Trade or Business
- Ownership Structure
- Adaptation / Duplication
- Controlled Groups
- Stock Options
- Short Years
- Acquisitions / Dispositions



Legislative Update

The graphic features a dark blue background with several overlapping, semi-transparent, light blue curved shapes that create a sense of motion and depth. The text 'Legislative Update' is centered in a light orange color.

LEGISLATIVE UPDATE: THE PATH ACT OF 2015

- Finally made permanent, retroactively as of January 1, 2015.
- Enhancements for certain small businesses:
 - **Can offset AMT:**
 - New law – “Eligible small businesses” can now use against AMT. Eligible small business is \$50 million or less in AAGR for 3PYs.
 - **Can offset employer FICA:**
 - “Qualified small businesses” can offset up to \$250,000 of the FICA employer portion of the payroll tax.
 - Qualified small business is less than \$5 million in credit year gross receipts and within first 5 years of earning gross receipts of nearly any kind (including grants, interest income, etc.).
- What to watch out for:
 - Controlled group (must consider AAGR of entire controlled group)
 - Spin off of a major portion of a trade or business

Regulation Updates

REGULATION UPDATES: IUS PROPOSED REGULATIONS

- In January 2015, IRS issued updated rules.
- IUS is limited to software providing general and administrative functions, financial and human resource management, and general support services.
- Software is NOT internal use if it:
 - Developed for sale, lease, or license, or
 - Enables taxpayers to interact with third parties or allows third parties to initiate functions or review data on the taxpayers system (purchase tickets, execute transactions, track progress of delivery of goods, receive services over internet, etc.).
- Dual-Function Computer Software: Software developed for both internal use and to enable interaction with third parties; rules allow bifurcation of software to meet less stringent four-part test.

REGULATION UPDATES: HIGH THRESHOLD OF INNOVATION TESTS

Development of Internal Use Software

Innovation

Software would result in a reduction in cost or improvement in speed or other measurable improvement, that is substantial and economically significant, if the development is or would have been successful.

Prop. Treas. Regs. IRC §1.41-4(c)(6)(v)(A)(1)

Significant Economic Risk

Software must have substantial resources committed to development and must have substantial uncertainty, because of technical risk, that resources may not be recovered within a reasonable period.

Prop. Treas. Regs. IRC §1.41-4(c)(6)(v)(A)(2)

Not Commercially Available

Software cannot be purchased, leased, or licensed and used for taxpayers intended purpose without (substantial) modifications.

Prop. Treas. Regs. IRC §1.41-4(c)(6)(v)(A)(3)

REGULATION UPDATES: SEC. 174 FINAL REGULATIONS

- In July 2014, IRS issued final regulations on the Section 174 deduction for research and experimentation expenditures.
- Costs to build and test pilot models are Section 174 expenses.
- Pilot models are fully functioning models constructed to evaluate and resolve uncertainty.
- More than one pilot model is often needed to test various conditions.
- It doesn't matter if the pilot model is ultimately sold, treated as cost of goods sold, or placed in service.
- Examiners are applying these regulations to Section 41 even though they were issued under Section 174.

Relevant and Recent Case Law

RELEVANT AND RECENT CASE LAW: *SUDER V. COMMISSIONER*, T.C. MEMO 2014-201

- Taxpayers were shareholders of an S-Corp.
- Development effort centered around telecommunication hardware and software.
- IRS asserted:
 - Time survey methodology lacks nexus.
 - Development was merely entailed “routine engineering / programming,” nothing unique or novel.
 - Regression testing and beta testing disallowed.
 - Unreasonable compensation under Sec. 174(e).

RELEVANT AND RECENT CASE LAW: *SUDER V. COMMISSIONER*, T.C. MEMO 2014-201 (cont.)

- Court held:
 - Survey method was sufficient, and credible testimony was helpful.
 - Documentation was “proper, complete, and adequate.”
 - Patent attorney expenses allowed. See FSA 2001311007 that advises examiners to disallow patent-related QRE because it does not support the research effort.
 - Sustained 75% of CEO’s time:
 - Credible testimony, 13 patents
 - Led product development
- Take away:
 - Survey method is valid.
 - Documentation is key.
 - High-level employees can qualify.

RELEVANT AND RECENT CASE LAW:
DYNETICS V. US, NO. 12-576T (CT. OF
 FED. CLAIMS, MAY 31, 2015)

- Engineering firm that conducted research for U.S. military under contracts.
- IRS did not challenge “fixed price contracts” but the “fixed-price-level-of-effort” contracts (a type of cost reimbursement contract).
 - Payment was a fixed amount, but Dynetics was merely required to provide a report showing the research results achieved through a stipulated level-of-effort.
 - Contract was deemed funded: Payment was contingent upon the level-of-effort, not the results of the research.
- Course of dealing: Taxpayer argued that while the contract said one thing, what actually happened was entirely different. The Court held that this was parole evidence, not needed in an unambiguous contract.

RELEVANT AND RECENT CASE LAW:
DYNETICS V. US, NO. 12-576T (CT. OF
 FED. CLAIMS, MAY 31, 2015) (cont.)

- Inspection clauses: Court found that the taxpayer’s contract did not require delivery of a product and there was no rejection clause allowing government to withhold payment for rejected deliverables.
- Warranty clause: The taxpayer argued that under the controlling state law, a violation of a warranty would expose the taxpayer to risk. Court rejected this argument on the grounds that the taxpayer’s exposure to liability depends on the terms of the contract and not by the operation of a state law that isn’t even in the contract.
- Termination clause: Court held that upon cancellation by the government, taxpayer would still be paid for all work performed up to date of termination.

RELEVANT AND RECENT CASE LAW:
DYNETICS V. US, NO. 12-576T (CT. OF
 FED. CLAIMS, MAY 31, 2015) (cont.)

- Substantial Rights: Taxpayer retained the right to patented work; it could not patent the top secret work it was doing under the terms of the agreement – therefore Dynetics did not have substantial rights.
- Take away:
 - Provide insight on types of contract clauses the IRS may review.
 - Contracts need to show risk and rights.

RELEVANT AND RECENT CASE LAW:
GEOSYNTEC CONSULTANTS V. US, 112 AFTR2d
 5488 (SD Fla 2013, affd 776 F3d 1330 (11th
 CIR. 2015)

- Engineering firm that contracts with clients to provide environmental and infrastructure design and engineering services.
- At issue is whether the contracts were funded.
- Lower Court ruled that fixed-price contracts were not funded.
- However, the lower Court ruled that contracts providing cost reimbursement in an amount not to exceed a capped amount is funded. Taxpayer appealed.
- 11th Circuit affirmed lower court ruling.

RELEVANT AND RECENT CASE LAW:
GEOSYNTEC CONSULTANTS V. US, 112 AFTR2d
5488 (SD Fla 2013, affd 776 F3d 1330 (11th
CIR. 2015) (cont.)

- Appeals Court disagreed with taxpayer's arguments that it faced substantial financial risk under the capped contracts because its compensation was fixed.
- Need a dispute clause, not an "invoice" clause – Court concluded that the right to dispute the invoiced sums was not the same as requiring that the work product be evaluated and accepted prior to payment.
- Take away:
 - While fixed-price contracts are deemed not to fund research, it is necessary to evaluate ALL contracts to consider terms related to inspection and acceptance, performance requirements, standards of care, warranties, and guaranties.

Preparing for the R&D Credit
Analysis

PREPARING FOR THE R&D CREDIT ANALYSIS

- Phased Approach:
 - Phase 1: Feasibility – Determines at a high level if there is Qualified Activity and estimates the credit by year by jurisdiction.
 - Phase 2: Calculation and Report – Detailed review of documentation, discussions with SMEs, gathering cost details, and drafting method report.
 - Compute federal and state credits together.
- Important:
 - Determine business components.
 - Documentation vs. self-serving documents.
 - Documentation: More isn't always better.
 - Documentation: You'd be surprised what you actually have.
 - Don't go at this alone! Ask for professional help.

QUESTIONS?

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