

Morgan Lewis

SEVENTH ANNUAL
**RESEARCH &
DEVELOPMENT TAX
CREDIT SYMPOSIUM**

Symposium Co-Chairs: Alex Sadler and Doug Norton
November 8-12, 2021

SESSION 3

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*Welcome
Remarks*

Faculty Firms



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Special Thank You



Welcome to Session 3!

- BUT, FIRST:
THANK YOU to all who have joined us throughout this week as attendees at our second virtual R&D Tax Credit Symposium!
 - **Session 1 (Monday, 11/8): 601** virtual attendees
 - **Session 2 (Wednesday, 11/10): 539** virtual attendees
- NEXT: quick run-through of answers to Wednesday's quiz, followed by live raffle to pick Session 2 winners...



Answers to Wednesday's Quiz

(Session 1: Questions 1-5)

1. Who is the author of Legal Guide to the Research Credit?
Alex Sadler
2. The numerator of a fraction is
The number on the top
3. What percentage of a taxpayer's research activities can fail to constitute elements of a process of experimentation before the activities fail the four-part test?
<20%
4. Which of the following is NOT an example in the regulations of excluded "social science" research?
Finance
5. How many gold Olympic medals has Michael Phelps won?
23

Answers to Wednesday's Quiz

(Session 1: Questions 6-10)

6. Under the statute and regulations, a taxpayer claiming a credit under section 41 must maintain records **In sufficiently usable form and detail to substantiate that the expenditures claimed are eligible**
7. Uncertainty exists if the information available to the taxpayer does not establish the capability or method for developing or improving the business component, or the appropriate _____ of the business component.
Design
8. For purposes of section 41(d) and this section, information is technological in nature if the process of experimentation used to discover such information _____ relies on principles of the physical or biological sciences, engineering, or computer science.
Fundamentally
9. From 1977-2011, this country's flag consisted of a single color with no design
Libya
10. For purposes of the research credit, what regulation governs the definition of a parent-subsidary group under common control?
Treas. Reg. § 1.52-1

Answers to Wednesday's Quiz

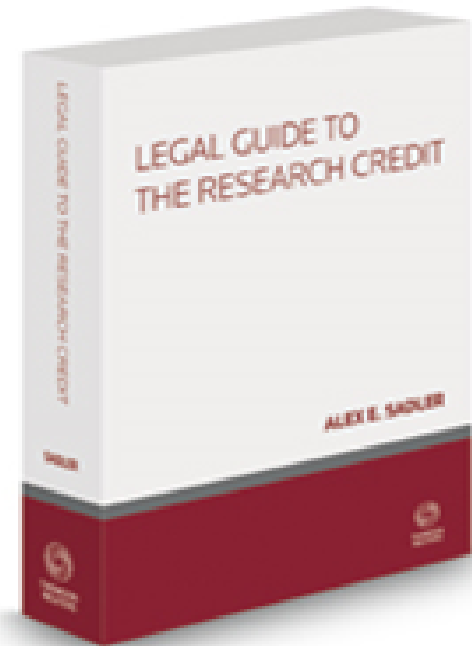
(Session 1: Questions 11-15)

11. In *Snow v. Commissioner*, 416 U.S. 500 (1974), which addressed the trade or business requirement under section 174, the taxpayer was a partner in a partnership which invested in the development of a special purpose incinerator. What was the name of the partnership?
Burns Investment Company
12. What rule governs a motion to dismiss for failure to state a claim, like those filed by the government in *Intermountain Electronics* and *PremierTech*?
Federal Rule of Civil Procedure 12(b)(6)
13. Which of these US Supreme Court Justices was NOT born in New York?
Samuel Alito
14. What is the most recent tax case to cite *Mayrath* for the principle that section 174 applies to the cost of developing the concept of a product but not the cost of building it?
Leon Max
15. Now that the IRS Appeals pilot program has ended, in large case Appeals
Can invite Exam to participate in the taxpayer's presentation at the discretion of Appeals

And Wednesday's Session 2 raffle winners are...




**KEEP
CALM
IT'S
RAFFLE
TIME!**



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Friday's Program – November 12, 2021

12:00 pm – 12:05 pm

Welcome Remarks

Morgan Lewis: Alex Sadler and Doug Norton

12:05 pm – 1:35 pm

Virtual Studies, A.I. Technology, and Appeals Conferences Best Practices

Morgan Lewis: Jennifer Breen and Sheri Dillon

SPRX Technologies: Mark Andrus

DHG: John Chennoor

1:35 pm – 1:40 pm

BREAK

1:40 pm – 2:40 pm

Federal Exams and Audit Defense Tactics

Morgan Lewis: Tom Linguanti

PwC: Joe Maselli and Christi Schenzel

2:40 pm – 2:45 pm

BREAK

2:45 pm

Faculty Q&A and Wrap-up / Closing Remarks

Morgan Lewis: Alex Sadler, Tom Linguanti, and Doug Norton

EY: Alexa Claybon

Tanner: Shawn Marchant

Alvarez & Marsal Taxand: Kathleen King

DHG: Adam Quattlebaum



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**SEVENTH ANNUAL
RESEARCH &
DEVELOPMENT TAX
CREDIT SYMPOSIUM**

**VIRTUAL STUDIES, A.I. TECHNOLOGY, AND APPEALS CONFERENCES
BEST PRACTICES**

Presenters: Mark Andrus (SPRX Technologies), Jennifer Breen (Morgan Lewis), John Chennoor (DHG), and Sheri Dillon (Morgan Lewis)

Friday, November 12, 2021

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Presenters



Mark Andrus

Chief Customer Officer,
SPRX Technologies
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Jennifer Breen

Partner, Morgan Lewis
Washington, DC



John Chennoor

Director, DHG
Washington, DC



Sheri Dillon

Partner, Morgan Lewis
Washington, DC

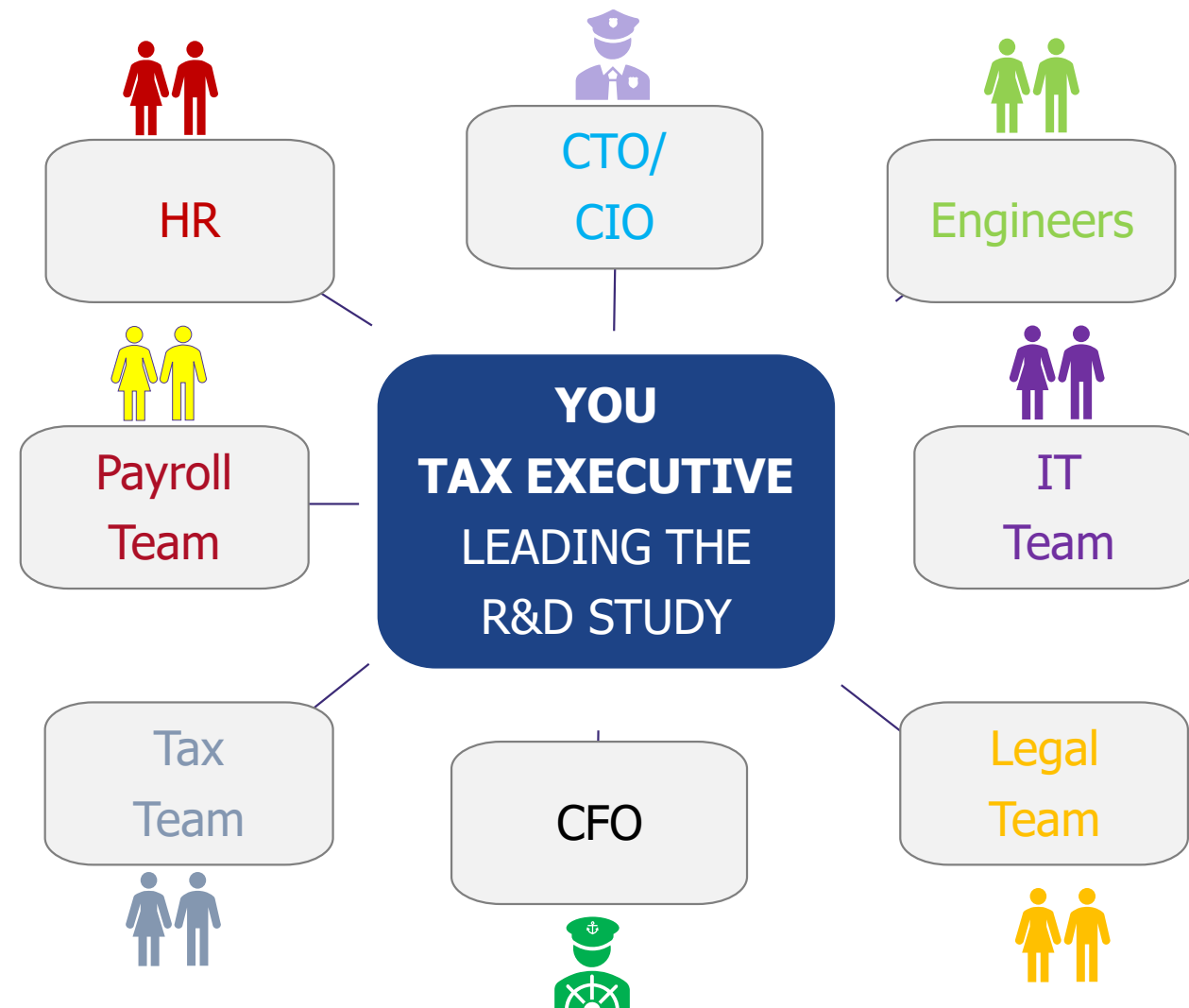
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Virtual Studies – R&D Credit

The background of the slide is a dark blue gradient. It features a complex, organic pattern of thin, branching orange lines that radiate from a central point on the right side. Scattered throughout the image are numerous semi-transparent circles in various colors, including orange, yellow, blue, and green, creating a bokeh effect.

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Virtual Studies | R&D Credit | Lay of the Land



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TAX EXECUTIVE – YOUR ROLE

1. **Get the buy-in** – From the CFO/CTO/CIO / Engineers
2. **Simplify Your Interactions** – Be brief (emails, tables, PPTs)
3. **Keep the CIO/CTO Close** – Provide frequent updates
4. **Use the Right Team** – Diverse team (CPAs + Engineers+ Attorneys)

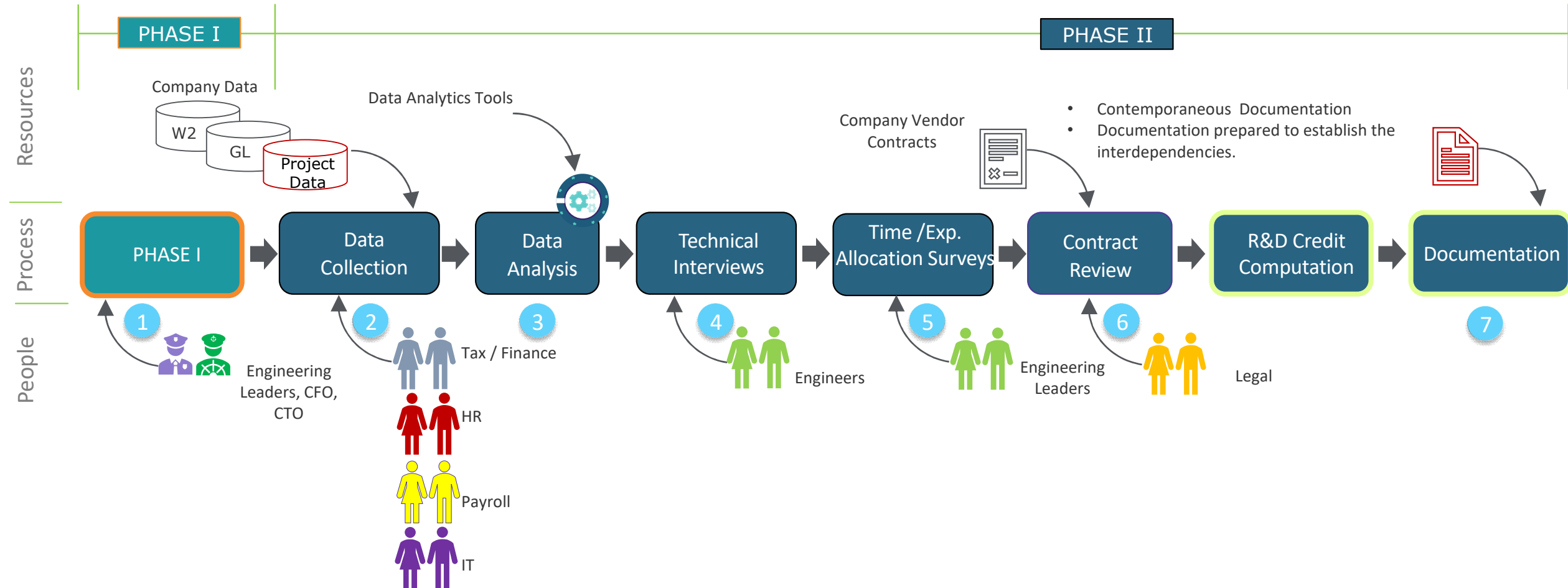
REACTIONS FROM YOUR ORGANIZATION – NOT SO POSITIVE

1. "No! No! We do no R&D; we just develop software / we just manufacture XYZ etc."
2. "Too many questions, we are too busy developing our product."
3. "You guys bother my engineers? STOP THIS PLS!"
4. "Your team does not understand engineering/technology/science. "

POSITIVE REACTIONS!!

1. "Oh, I see! This is money in our pocket! I LIKE YOU TAX LEADER!"
2. "OK, the Engineering Department is generating tax credits that will save the day! I LIKE YOU MORE, TAX LEADER!!"
3. "So, I get to ask for more budget, because what we do generate tax credits? YOU ARE MY SUPERHERO!"

Virtual Studies | R&D Credit | People, Process, Resources

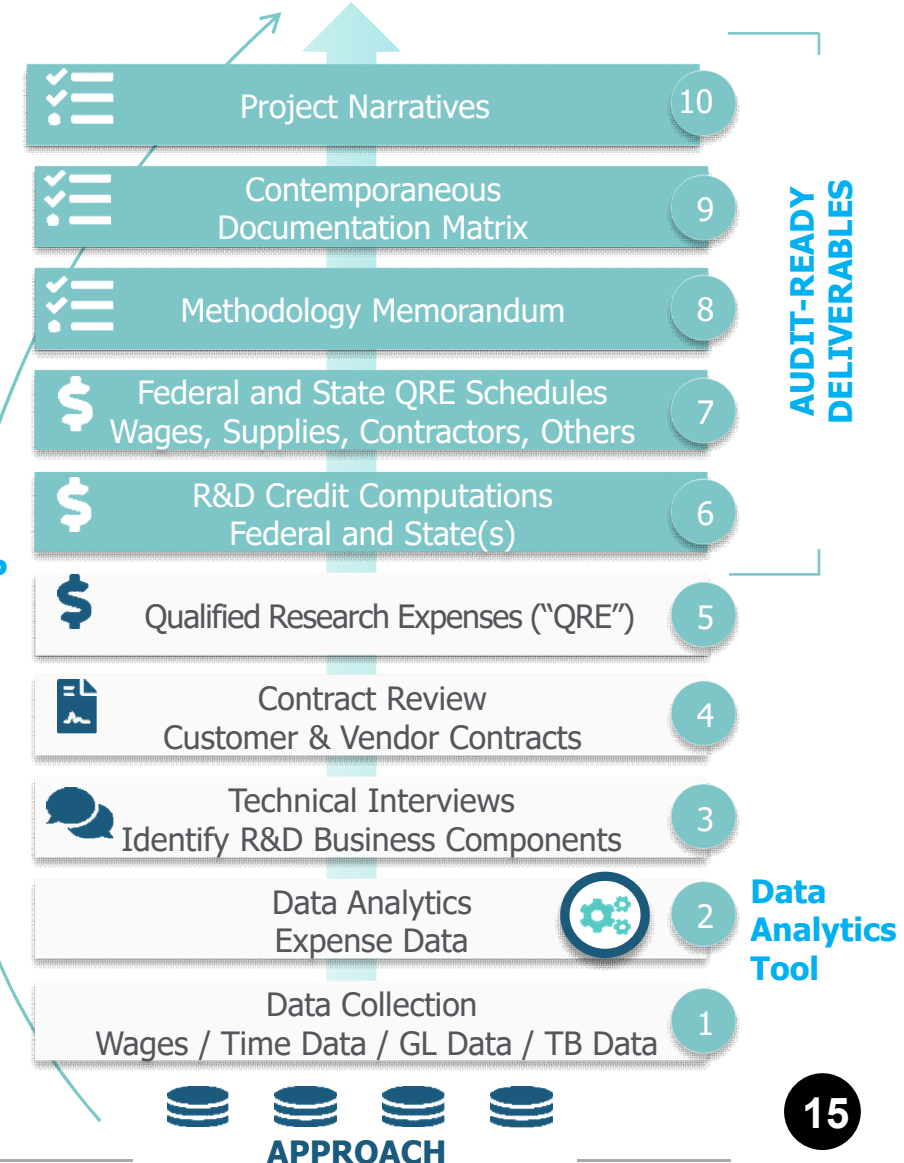


Virtual Studies | R&D Credit | Project Approach

1. **Data Collection** – Collect relevant data to R&D activity.
2. **Data Analytics** – Analyze wage data, time data, trial balance, and select GL data to compute R&D activity.
3. **Technical Interviews** – Discuss with engineers to obtain details of R&D activities.
4. **Contract Review** – Review relevant contract agreements to ensure that the company retains the rights and bears the risks for the R&D activities.
5. **Compute QRE** – Compute the federal/state Qualified Research Expenses (“QRE”).
6. **Compute R&D Credit** – Compute the federal and state R&D credits.
7. **QRE Schedules** – Prepare the QRE schedules to support an IRS/State audit.
8. **Methodology Memorandum** – Prepare methodology memo to support an IRS/state audit.
9. **Contemporaneous Documentation (“CD”)** – Collect and organize documentation and prepare CD matrix.
10. **Project Narratives** – Prepare Narratives to substantiate i) permitted purpose; ii) technical uncertainties; and iii) the process of experimentation related to Business Components.

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**BOTTOM-UP
APPROACH**



Polling Question 1

Which among the below is your biggest challenge in your R&D Credit Study?

- A. Data Collection
- B. Technical Interviews
- C. Time and Expense Surveys / Allocations
- D. Documentation

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Artificial Intelligence in the R&D Credit Industry

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The Race to Embrace A.I.

A.I. has crossed the line...

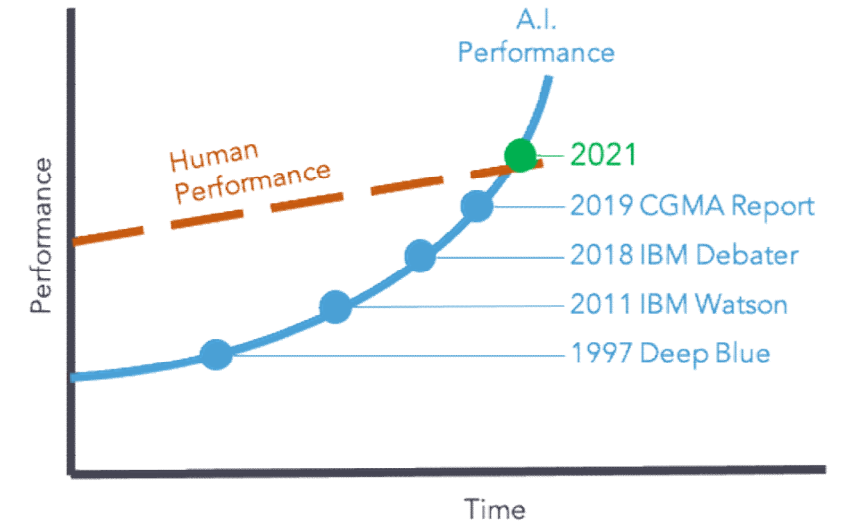
Today, A.I. systems can perform many business tasks better than humans.

CGMA & AICPA, January 2019

...and leaders can't get enough

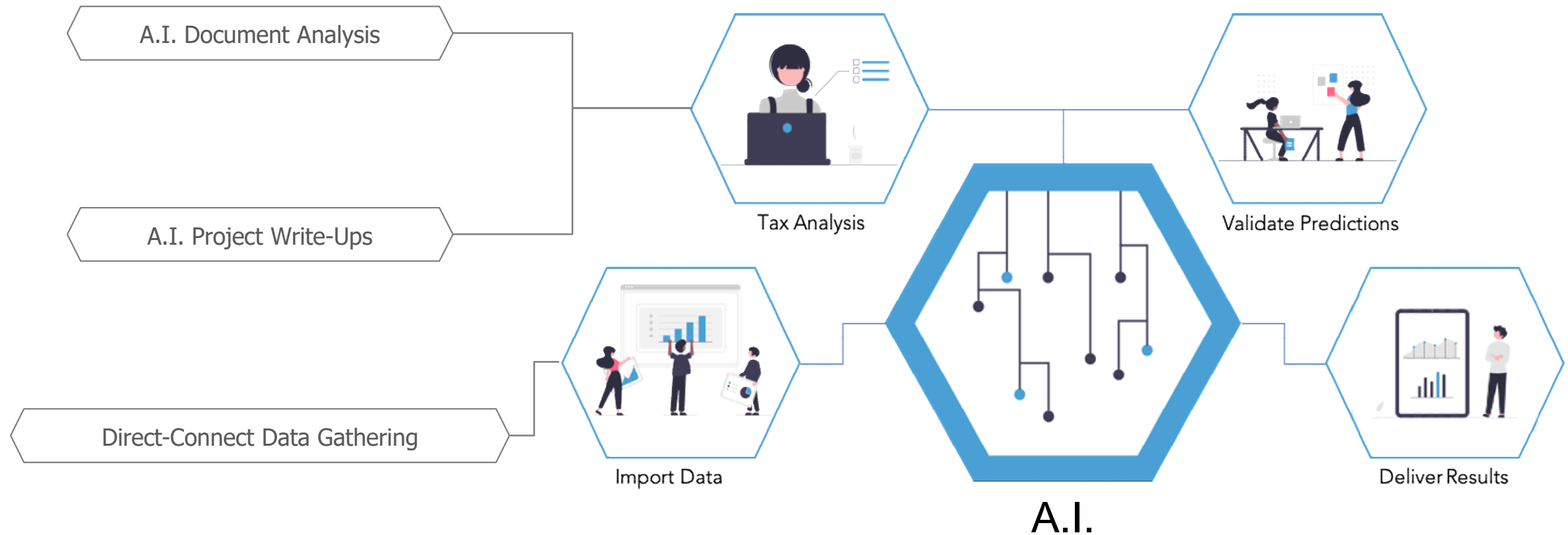
Ninety-five percent of business leaders believe that their organizations will benefit from embedding A.I. into business operations, products, and services.

Juniper Networks, April 2021



95%

R&D Credit Technologies Available Today

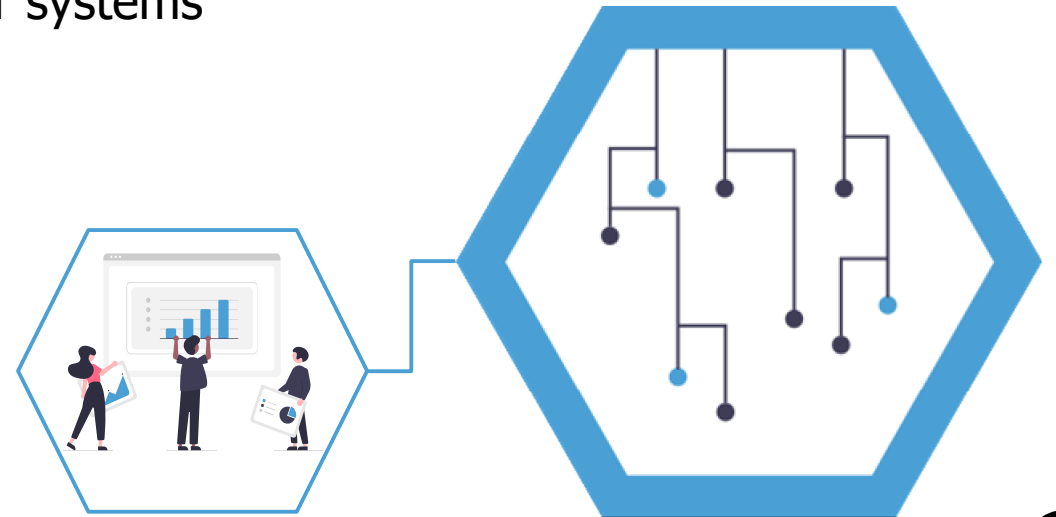


Direct-Connect Data Gathering

Today's Technology:

- Provider sends taxpayer an asymmetric bi-lateral encryption key
- Taxpayer enters system authentication codes
- A.I. has read-only access to:
 - Payroll systems
 - General ledger systems
 - Document retention systems
- A.I. extracts relevant data located throughout taxpayer systems
- A.I. processes, structures, and heals all relevant data
- A.I. makes predictions and presents data to Provider

Total Time = a few minutes

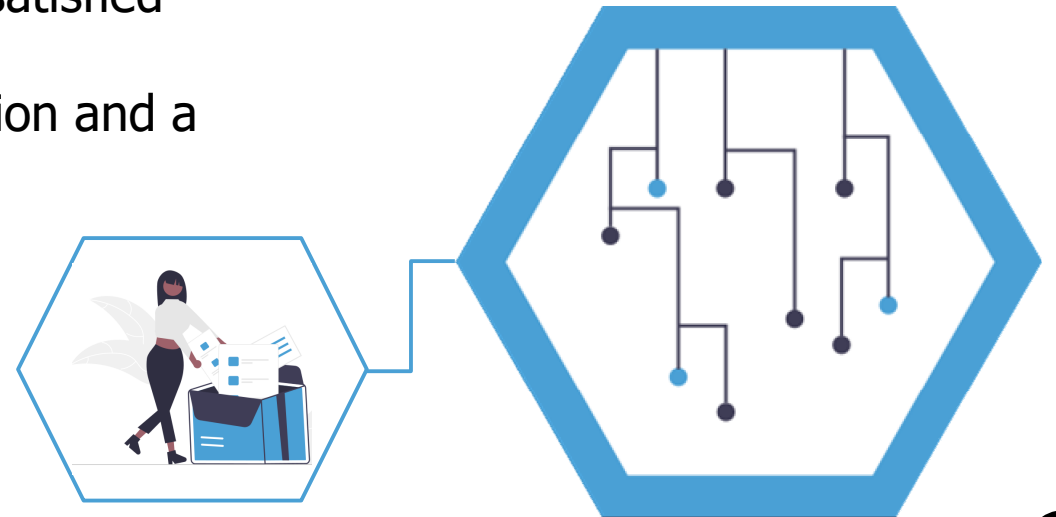


A.I. Document Analysis

Today's Technology:

- System acquires ALL research documentation
- A.I. extracts the content from documents, audio files, video files
- A.I. reads and understands the sentiment and meaning
(this is NOT word search)
- A.I. compares the content to the R&D credit qualification tests
- A.I. assigns a persuasion score indicating how useful the document will be in persuading the government the tests have been satisfied
- A.I. writes a summary of each document
- A.I. presents Provider with report containing a description and a persuasion score for each document

Total Time = a few minutes per document

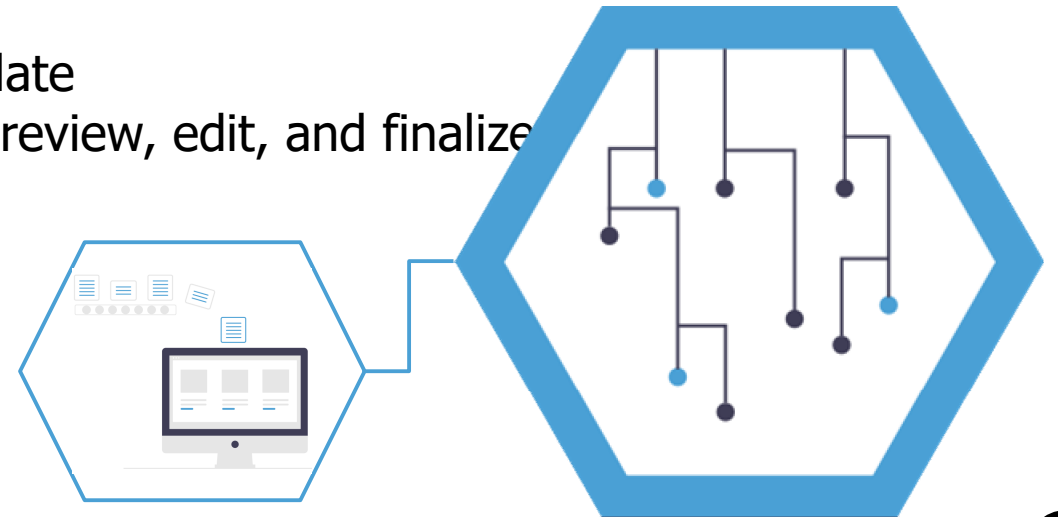


A.I. Project Write-ups

Today's Technology:

- Provider enters a 2 or 3 sentence description of the project (or this comes from the document analysis described above)
- A.I. creates 3 to 5 pages of original content including:
 - Complete project description
 - Uncertainty test analysis
 - Permitted purpose test analysis
 - Technological in nature test analysis
- A.I. inserts the new content to a project write up template
- A.I. presents the draft to the Provider and Taxpayer to review, edit, and finalize

Total Time = a few minutes per write-up



Polling Question 2

Which statement best describes your opinion of A.I. technology?

- A. I willingly use A.I. everyday (Alexa, Park Assist, Netflix, etc.)
- B. I grudgingly interact with A.I. everyday (see examples above)
- C. I choose to reject A.I. as much as possible
- D. A.I. is a myth and doesn't exist

The background is a dark blue gradient. It features a complex network of thin, branching orange lines that resemble a neural network or a root system, originating from a central point on the right and spreading outwards. Scattered throughout the image are numerous semi-transparent circles in shades of blue, yellow, and orange, some of which overlap with the orange lines.

Virtual Appeals Conferences: Best Practices

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Agenda

- What's Happened in Appeals Since 2019?
 - IRS Ends the Appeals Conference Pilot Program
 - Congress Passes the Taxpayer First Act
 - COVID-19 Shuts Down the IRS and Taxpayers Alike
- Virtual Appeals Conferences
 - Best Practices
 - Pros and Cons of a Virtual Appeals Conference
- What's Next?

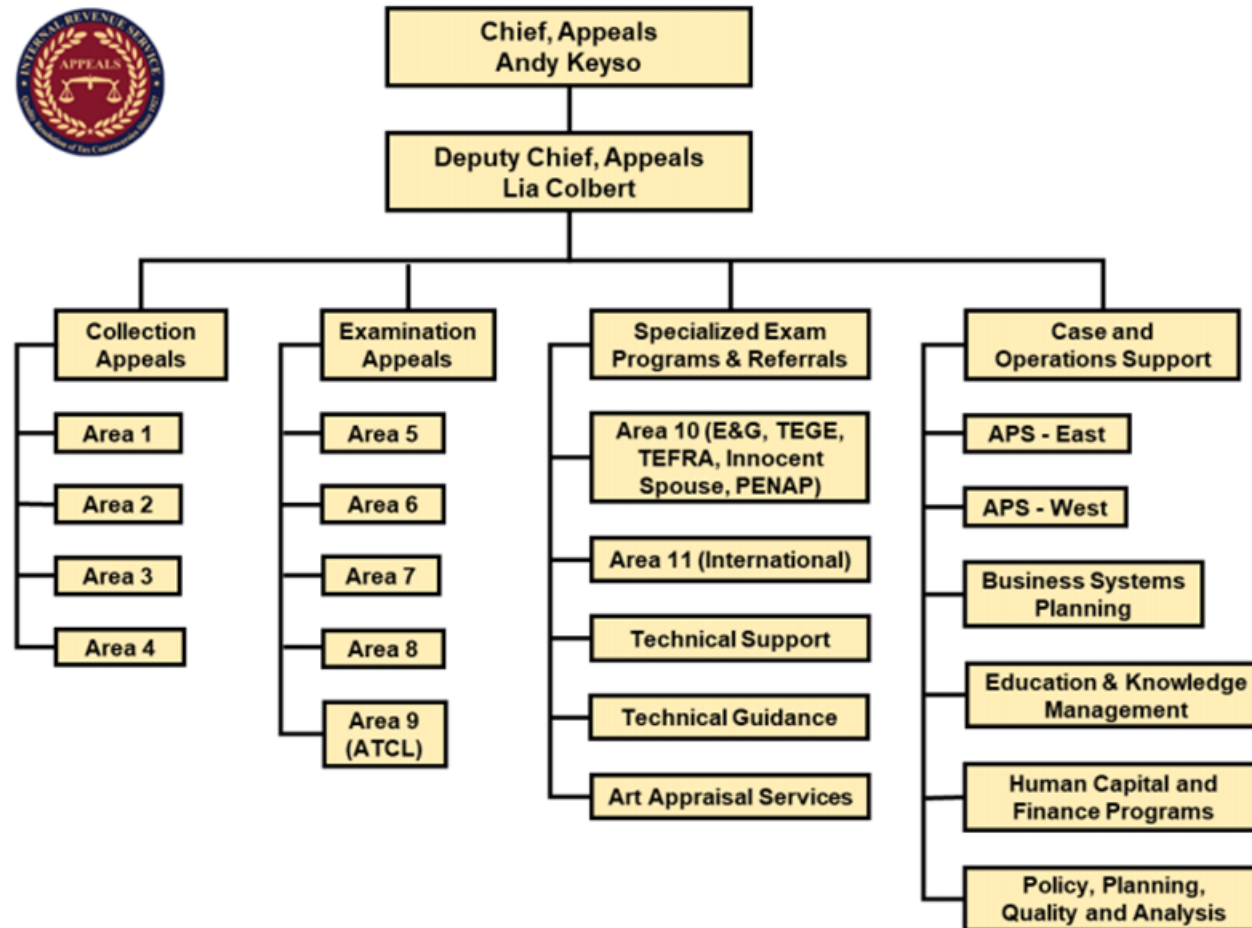
If We Have To Say “Independent” Office of Appeals, Isn’t There a Problem?

- There is a difference between taxpayer perception of Appeals’ independence and reality.
- Taxpayers have expressed concerns about whether they received a truly independent and impartial “second look” by Appeals because of:
 - Inconsistent experiences with Appeals.
 - Appeals’ inclusion of compliance personnel and their counsel in the conferences.

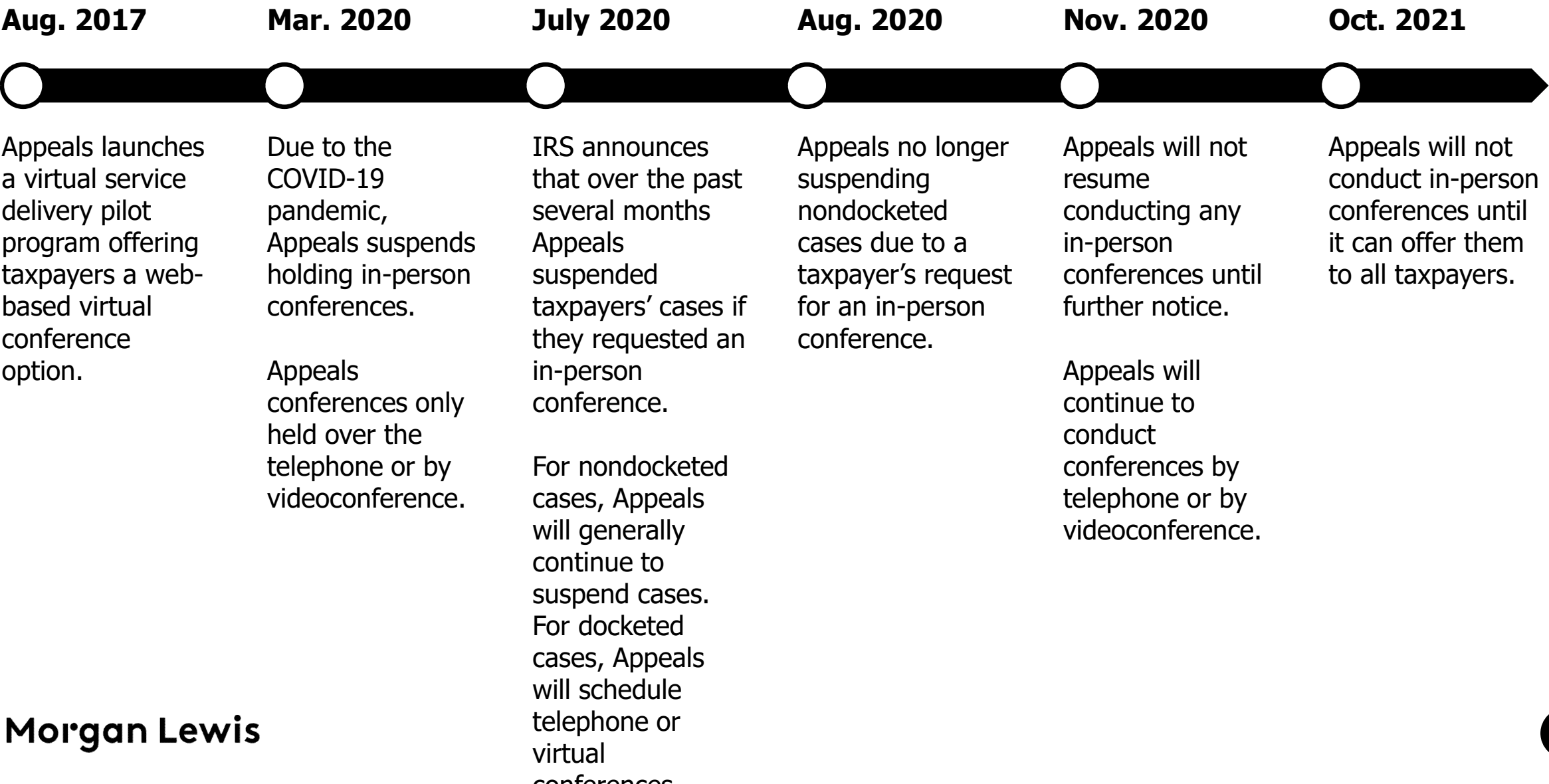
Congress Passes the Taxpayer First Act

- The Taxpayer First Act, enacted in July 2019, added section 7803(e) to the IRC and established the “Internal Revenue Service Independent Office of Appeals,” which is under the supervision and direction of the “Chief of Appeals.”
- Section 7803(e)(3) codifies Appeals’ mission and charges it to resolve controversies without litigation on a fair and impartial basis.
- Section 7803(e)(4) provides that the appeals process “shall be generally available to all taxpayers.”
 - Not all disputes must be referred to Appeals. *See* Rev. Proc. 2016-22, Sec. 3.03. However, section 7805(e)(5) provides certain taxpayers with a process to protest the IRS’ decision to deny access to Appeals.
- On February 5, 2021, the IRS named Heather Maloy to the position of Director, Taxpayer First Act Office.
- Appeals also recently created a new position: Senior Advisor to the Chief of Appeals.

IRS Independent Office of Appeals



Virtual Appeals Conference Timeline



Polling Question 3

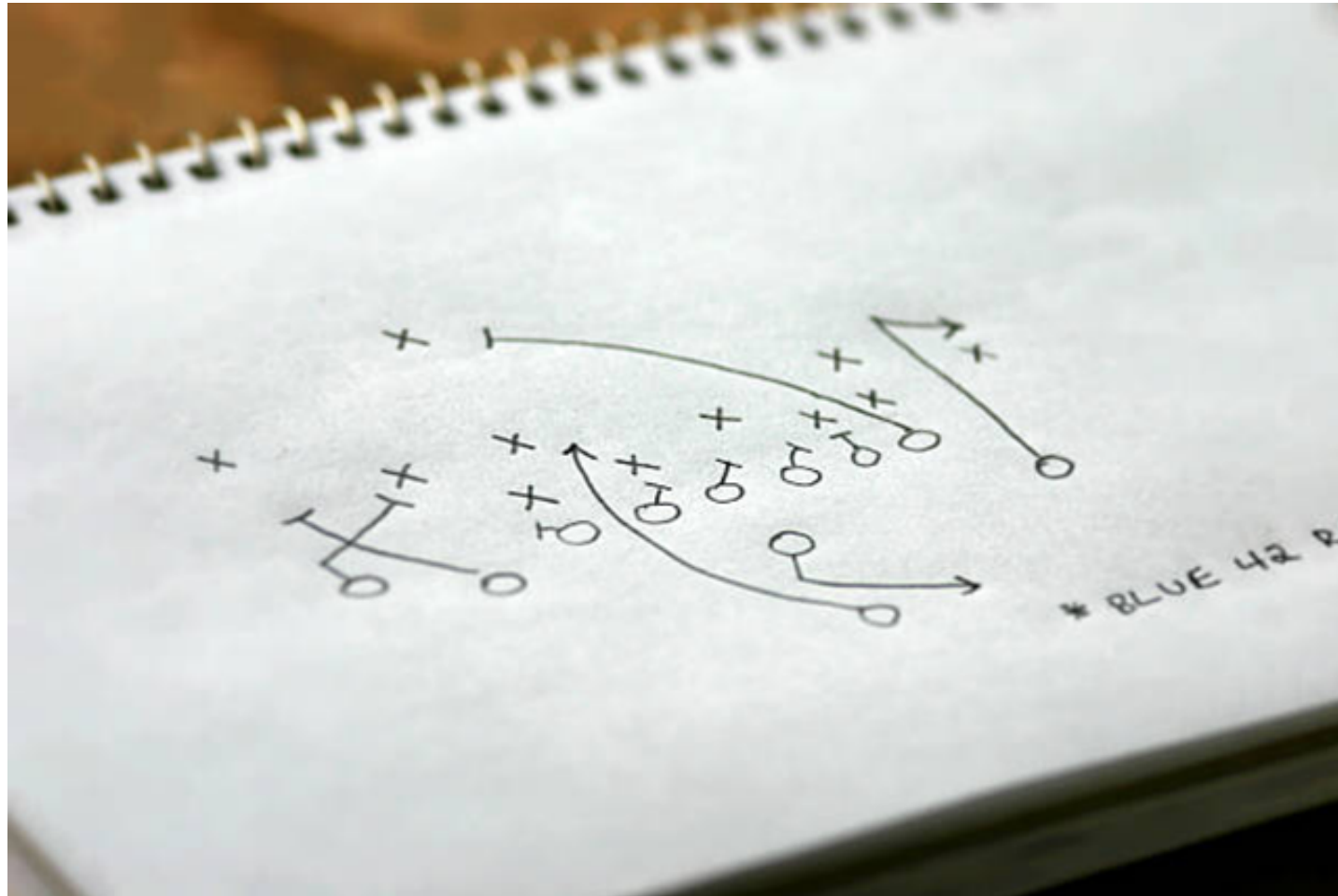
Have you attended a Virtual Appeals Conference?

- A. Yes, and all participants turned their cameras on for the entirety of the conference.
- B. Yes, and only some participants turned on their cameras during the conference.
- C. Yes, and no one turned on their cameras.
- D. No, I have not attended a virtual appeals conference.

Best Practices to Ensure a Smooth Virtual Appeals Conference

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1. Establish Rules of the Road with Appeals



Establish Rules of the Road with Appeals

- Establish rapport with the ATCL and discuss scheduling of conferences and pre-conferences.
- Consider timing for the delivery of materials to Appeals and the provision of each party's materials to the other party.
- Discuss who will be attending the conference from Appeals and Exam.
- Ask Appeals to start the conference 15-30 minutes before the scheduled start time and to create a back-up plan in the likely event of technical issues with WebEx or ZoomGov.
- Ask the ATCL to instruct all parties to join the conference via video.
 - A video conference is supposed to enable taxpayers to meet “face-to-face” with Appeals.
- Ensure that discussions with Exam do not bleed into substantive settlement discussions with Appeals.

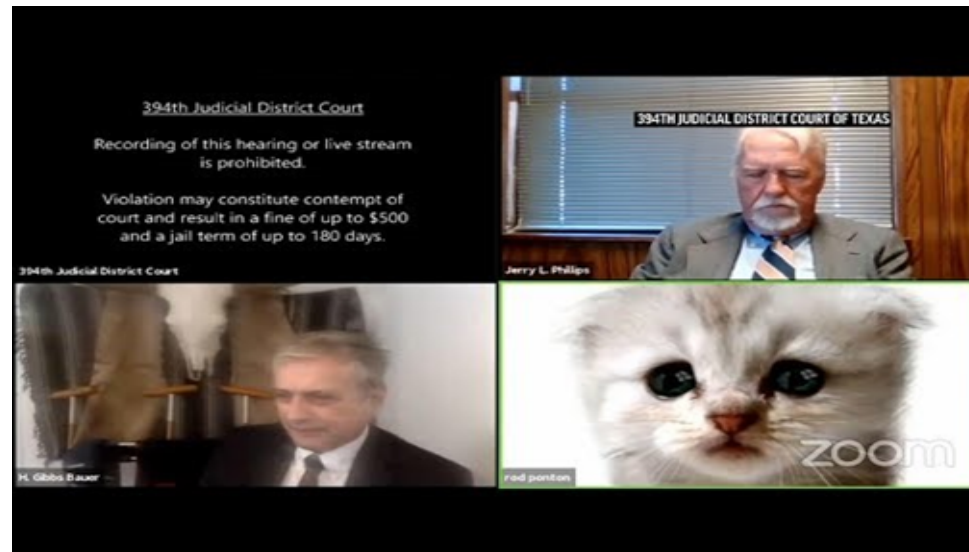
2. Consider the Medium for Presentation as You Develop Materials



Consider the Medium for Presentation as You Develop Materials

- A virtual conference may call for a different approach than a classic in-person appeals presentation.
 - The virtual setting makes it more difficult to read body language the way you can in person.
 - Holding attendees' attention virtually often for 8-hour meetings, may require a different approach from the typical setting where just one spokesperson speaks from a slide deck.
- Consider the inclusion of business unit executives to provide the factual portion of the presentation, if appropriate.
- Use graphics, consider breaking the presentation down into parts to allow for mini-breaks throughout and sharing presentation responsibilities among more than one speaker.

3. Undertake Testing of Technology in Advance and Create a Back-up Plan



Undertake Testing of Technology in Advance and Create a Back-up Plan

- Ask Appeals to conduct a practice session to identify any issues before the conference.
- Practice using the selected platform before the conference to ensure that all participants are familiar with the application.
- REMOVE any preset filters. If you select a filter, choose one that is not distracting.
- Make sure you understand how and the best way to share the documents (share application versus share screen).
- Dial-into the selected platform instead of using computer audio because you will not be disconnected from the conference if your internet connection is interrupted.

4. Organize Materials for Ease of Presentation



Organize Materials for Ease of Presentation

- Plan for who will take the lead in controlling the slide presentation.
- If using PDF or other documentary exhibits, organize them all for easy access.
- Be sure that Appeals has all relevant documents as so they can refer back to them easily, and remember AJAC (Appeals Judicial Approach and Culture).

5. Manage Your Logistics



Manage Your Logistics

- Consider a mechanism to confer with your team behind the scenes to ensure you don't talk over each other or miss making an important point.
- Assign a point person to handle technical issues and communicate with participants who will be joining at a later point in the proceeding, such as a witness or tax return preparer.
- If you have multiple witnesses, time their presentation and establish a schedule for when they will join and leave the conference to minimize the number of participants on the selected platform at any given time.
- Build in time for mini-breaks during the presentation.

Pros and Cons of a Virtual Appeals Conference

Pros

- Allows taxpayers to be seen and heard and to share documents in real time
- Permits Appeals to evaluate credibility of the evidence from both the taxpayer and exam
- Saves taxpayers and the IRS time and travel expenses
- Permits taxpayers to get face-to-face service from anywhere the parties have internet access
- Ensures engagement and facilitates communication more effectively than a teleconference

Cons

- Technical issues, i.e., a slow internet connection can result in the loss/interruption of audio and visual functionality
- Difficult to read body language the way you can in person
- Exam and Appeals personnel may not join by video
- Holding attendees' attention virtually can often be difficult
- May not be as effective as in-person communications
- Difficult to coordinate schedules and negotiate remotely

Polling Question 4

After travel resumes, what type of conference will you be most interested in having?

- A. Virtual Appeals Conference
- B. Telephone Appeals Conference
- C. In-Person Appeals Conference
- D. I'm Undecided

Are Virtual Conferences the Wave of the Future?



“Regardless of the miracles of automation, our type of tax system cannot operate effectively without the human element.”

Mortimer Caplin, Former IRS Commissioner



“Virtual conferences will not be for everyone – I want to be clear about that.” “Virtual conference is just one additional way in which taxpayers and representatives can interface with . . . Appeals.”

Former IRS Appeals Chief Donna Hansberry



“[I]t’s a lot easier to say no to somebody over the phone than when you’re in person.”

July 7, 2020 TEI webinar (Andrew R. Roberson, McDermott Will & Emory, conversation with an IRS Appeals officer)

Conclusion

- Appeals needs to restore taxpayer confidence in the appeals process by providing greater consistency in taxpayer experiences and by limiting the involvement of compliance personnel and their counsel in appeals conferences.
- The virtual setting has highlighted the importance of engaging experienced advisors who can navigate the appeals process and persuasively present the facts and law to Appeals.
- BE FLEXIBLE, enjoy not traveling for the conference and wearing slippers (but still dress for this conference just as you would for an in-person conference).

Biography



Mark Andrus

SPRX Technologies
Chief Customer Officer
Provo, Utah
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Mark is the chief customer officer at SPRX Technologies responsible for all aspects of an exceptional customer experience. He retired as the Grant Thornton Global R&D Incentives Leader and U.S. R&D Credit Leader and began his career with a MACC from BYU.

Mark is one of the original R&D credit experts in the United States having started working on R&D credit issues in 1994 at Coopers & Lybrand. He has a long and successful history of serving clients, shaping regulations, and training many of today's industry leaders.

Now at SPRX Technologies, Mark is pioneering new R&D credit technologies for both service providers and taxpayers. SPRX Technologies offers several A.I. products. Visit [SPRX.tax](https://sprx.tax) and [SPRX.app](https://sprx.app) for more information.

Biography



Jennifer E. Breen

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Jennifer Breen is a partner in the tax practice of Morgan Lewis and concentrates her practice on tax controversy and planning matters, with an emphasis on audits and controversies and Internal Revenue Service (IRS) administrative proceedings. Jennifer routinely handles matters involving US federal income tax, foreign tax, state and local corporate and business tax, and sales and use tax. She has experience representing major corporations, partnerships, S corporations, and individuals in resolving domestic and international compliance and controversy issues before the IRS.

Prior to joining Morgan Lewis, Jennifer served as director of tax controversy at Mattel, Inc., where she developed and executed audit strategies, responded to information requests from respective tax authorities, and negotiated and resolved controversy matters. She was also responsible for accounting for income taxes under ASC 740, managing the company's global reportable transaction compliance, and ensuring compliance under the Foreign Account Tax Compliance Act.

Biography



John Chennoor

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John Chennoor is a director with Dixon Hughes Goodman's Research & Development (R&D) tax credit consulting group. With over 17 years of experience in consulting, trained in engineering, technology, management and tax, John is a leader in the R&D credit consulting space.

A graduate of Florida International University, Miami. John holds dual master's degrees in Industrial Systems Engineering & Information Systems and Engineering Construction Management. John also holds several technology certifications, including the Certified Information Systems Security Professional (CISSP). He is also an authorized tax advisor (Enrolled Agent) with the U.S. Internal Revenue Services (IRS).

John brings to the table - his unique ability to leverage his tax, engineering and technology expertise to deeply understand client's development processes, which can enhance the R&D credit for his clients. John has served clients in satellite communication, internet registry operators, global distribution systems, software product, power systems manufacturers and life sciences industries.

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Biography



Sheri A. Dillon

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Sheri Dillon is a partner in the tax practice of Morgan Lewis. She focuses on federal tax controversy matters, guiding clients through IRS examinations and appeals, the administrative claims process, and litigation. Sheri also counsels clients on a variety of tax-planning matters that involve acquisitions, dispositions, combinations, and debt restructuring and reorganizations, with a special focus on partnership transactions and closely held businesses.

Sheri has tax litigation experience and has appeared before the US Tax Court, US district and appellate courts, and the US Court of Federal Claims. She represents corporate taxpayers, Tax Equity and Fiscal Responsibility Act (TEFRA) and Bipartisan Budget Act partnerships, partners, tax-exempt organizations, and global, high-wealth taxpayers in the financial services, private equity, real estate, energy, manufacturing, and consumer products industries.

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5 MINUTE BREAK...WE WILL RESUME SHORTLY



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**SEVENTH ANNUAL
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FEDERAL EXAMS AND AUDIT DEFENSE TACTICS

Presenters: Tom Linguanti (Morgan Lewis), Joe Maselli (PwC), and Christi Schenzel (PwC)

Friday, November 12, 2021

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Presenters



Tom Linguanti
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Director of Tax Controversy
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Christi Schenzel
Partner of Specialized Tax
Services, PwC
Atlanta, GA

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Polling Question 1

Have you experienced a recent IRS audit on the research credit?

- A. Yes, my company has/had its R&D credits audited
- B. Yes, I'm a service provider who assists with R&D audit defense
- C. It's been a while...
- D. No, I haven't had the pleasure

Where is the IRS's focus, and what can we do about it?

- Increased training for IRS agents and engineers
 - fundamental legal requirements of the research credit
 - how to conduct site tours
 - conducting witness interviews
 - requirements related to internal use software
 - funded research
 - statistical sampling
 - report writing
 - base period
 - supply issues

Where is the IRS's focus, and what can we do about it (cont.)?

- IDR's and Audit Techniques
 - Substantially all (Little Sandy Coal)
 - "All" Business components (tied to QREs)
 - Prior studies done by client for original returns
 - Book R&D / tax return classification of Section 174 expenses as an indicator of proper credit amount
 - Use of two audit streams: review survey methodology while also drawing a statistical sample
- Centralized Risk Assessment Teams and Directives
 - Apply available IRS resources to "high risk" cases (potential for significant adjustments)
 - Two "riskers" for each case
 - CAP case are subject to risk assessment

Polling Question 2

How many “riskers” are typically assigned to “high risk” cases?

- A. One
- B. Two
- C. Three
- D. Four

Where is the IRS's focus, and what can we do about it (cont.)?

- Development of Audit Technique Guides (timing TBD)
- Re-focus on statistical sampling (i.e., Is a sample an appropriate methodology). Factors to consider:
 - The time required to analyze large volumes of data;
 - The cost of analyzing data;
 - Whether other books and records that may independently exist or have greater probative value

Where is the IRS's focus, and what can we do about it (cont.)?

- Revamping the use of MITRE
 - IRS is seeking to monitor the use of MITRE
 - Previous memo that outlined a dollar threshold for MITRE involvement has been eliminated
 - Determination of whether MITRE is used relates to whether the case will “benefit” from the use of MITRE
 - MITRE would be used on software cases that appear to be high risk and may relate to the type of software that the taxpayer was claiming

Polling Question 3

The IRS recently released new guidance on what R&D topic?

- A. Documentation for refund claims
- B. Internal use software
- C. Definition of a business component
- D. Inclusion of contract research expenses

Where is the IRS's focus, and what can we do about it (cont.)?

- IRS Assessment of Refund Claims
 - Review of the current claim process
 - Examine and provide guidance to the field on the expectations for a taxpayer to explain the claim it is making for the credit, monitor recent court cases to determine what the courts view as significant issues in the claim environment and to improve the selection of the cases selected for audit.
 - IRS News Release – October 15, 2021
 - Field Attorney Advice (FAA 20214101F) – Purported legal support for news release

Where is the IRS's focus, and what can we do about it (cont.)?

- IRS FAA 20214101F – IRS outlines
 - Information to include at the time the refund claim is filed with the IRS to be valid under Treas. Reg. § 301.6402-2(b)(1)
 - Format to use when providing information referenced to the IRS
 - Considerations regarding the statutes of limitations for a refund claim
- Taxpayer Considerations
 - Methodology, quantitative and qualitative documentation, timing, etc.

Polling Question 4

Any topics you'd like more information on?

- A. Additional audit defense updates/strategies
- B. Technology tools to improve the R&D credit process
- C. Statistical sampling
- D. Ideas for fun weekend plans

Biography



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Tom is a partner in the tax group of Morgan Lewis. He represents clients in complex tax controversies and tax litigation, and assists clients in determining the appropriate strategy in disputes with the IRS during audits, alternative dispute resolution proceedings, and trial and appellate litigation. Tom represents both US and non-US corporations, as well as individuals. He began his tax litigation career as a trial and appellate attorney in the Tax Division of the US Department of Justice.

Tom has nearly three decades of experience representing clients before the US Tax Court, federal district and bankruptcy courts, federal appeals courts, and the US Court of Federal Claims, and in briefing matters before the US Supreme Court. He earned his JD from Fordham University and his BS cum laude from Central Michigan University.

Biography



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Joe is a director in the NY Metro Tax Controversy and Dispute Resolution Team Practice. He provides advice to clients and formal written submissions to the IRS on a wide variety of procedural, administrative, and technical issues including issue resolution techniques (pre-filing agreements, fast track Appeals and regular Appeals), witness preparation, preparation of protests to IRS Appeals, post Appeals mediation submissions, 9100 relief, and numerous tax controversy matters.

His most recent work involves extensive experience with the research credit, section 199 matters, transferee liability, economic substance, penalty defense, unreasonable compensation, bankruptcy, summons procedures, closing agreements, and unreported income. His research credit experience includes supervision of IRS trial teams while with the IRS and the audit defense of numerous cases involving the research credit and internal use software since coming to PwC. Recent work has involved R&D support for software development companies, defense contractors, satellite/aerospace companies, manufacturing companies and companies with large research supply costs and prototype expenses.

Biography



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Christi is a partner within PwC's Specialized Tax Services ("STS") practice and a member of PwC's R&D Technical Committee. She has over 15 years of expertise related to the R&D tax credit, including extensive experience in assisting clients with defending large R&D tax credit claims during IRS examinations. Christi has led numerous R&D tax engagements for Fortune 100 and Fortune 500 companies. Christi has managed R&D tax credit engagements for clients in the following industries: Manufacturing, Technology, Computer Hardware and Software, Consumer Products, Financial Services, Pharmaceutical, Food and Beverage, Chemical, Automotive, Aerospace and Defense and Forestry and Paper Products. She has extensive experience in performing R&D tax credit projects to identify qualified R&D activities and expenses, develop documentation and provide support for clients in the event of an IRS or state audit.

Christi has led PwC's Research Credit Solution ("RCS") implementations for numerous companies of varying sizes and industries. Her deep expertise in RCS and technology tools enables her clients to realize significant project efficiencies and achieve company goals.

THANK YOU

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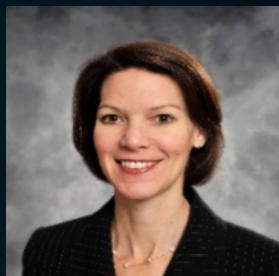
FACULTY Q&A AND WRAP-UP / CLOSING REMARKS

Friday, November 12, 2021

Faculty Q&A Panelists



Alex Sadler
Partner, Morgan Lewis
Washington, DC



Alexa Claybon
Principal, EY
Washington, DC



Kathleen King
Managing Director and National
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Doug Norton
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Tom Linguanti
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Shawn Marchant
Tax Principal, Tanner
Salt Lake City, UT



Adam Quattlebaum
Partner, DHG
Greenville, SC

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Polling Question 1

The consistency requirement applies at which level?

- A. Taxpayer
- B. Controlled group
- C. Legal entity
- D. Project

Q: How does the 30 day grace period to "perfect" the claim work? 30 days from the date of filing the amended return? Or 30 days from when the IRS sends an inquiry?

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IRS Press Release: "The IRS will provide a grace period (until January 10, 2022) before requiring the inclusion of this information with timely filed Section 41 research credit claims for refund. Upon the expiration of the grace period, there will be a one-year transition period during which taxpayers will have 30 days to perfect a research credit claim for refund prior to the IRS' final determination on the claim. Further details will be forthcoming; however, taxpayers may begin immediately providing this information."

Morgan Lewis

Q: Does the CCA apply to tax years after the date specified or is it for all refund claims submitted after that date regardless of the tax year it related to?

CCA 20214101f: “Rejecting a deficient refund claim before initiating an audit (or otherwise actively considering the refund claim on its merits) is recommended and should eliminate the likelihood that a court will find the Service waived the specificity requirement under Treas. Reg. § 301.6402–2(b)(1). Rejecting a deficient refund claim may preclude a taxpayer from amending or perfecting their refund claim if the refund claim failed to follow procedural requirements and the statute of limitations to file a new refund claim has expired.”

Morgan Lewis



Q: Do taxpayers have the ability to challenge the Chief Counsel Memo on refund claims?

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Q: Any insight on whether the CCA applies to partnerships under the BBA centralized partnership audit regime? Will the AAR process constitute a "claim" that will require the info outlined in the CCA?

Morgan Lewis

Q: The CCA analysis indicated that the CCA made novel use of the specificity requirement in requiring taxpayers to show a “nexus” between activities and research employees. Isn’t nexus a requirement for a valid claim?

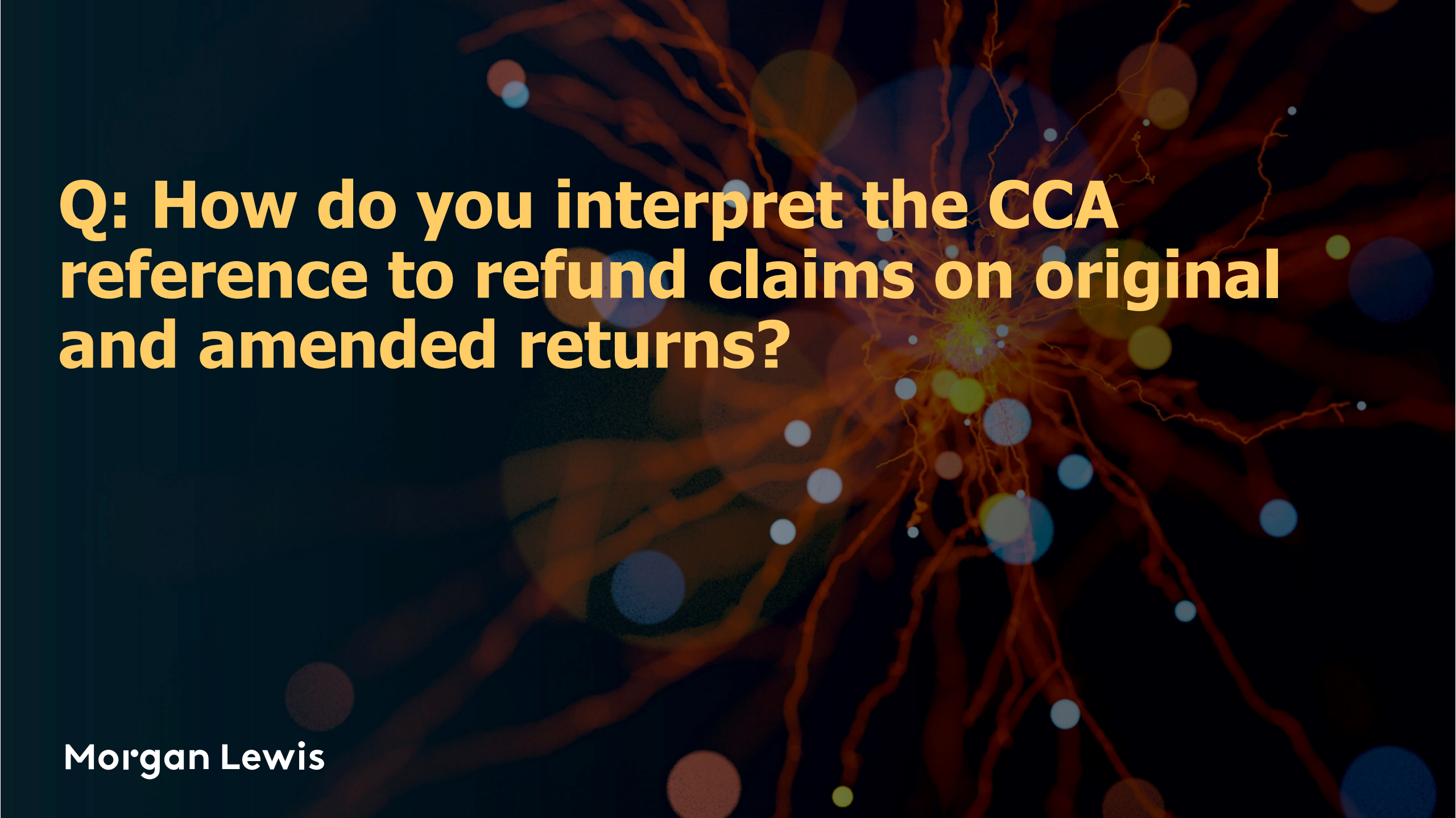
Q: How can a company that uses cost center accounting and does not track costs on a project-by-project basis comply with the CCA?

CCA 20214101f: To be considered sufficient, a refund claim for an I.R.C. § 41 research credit must, at a minimum:

- 1) Identify all the business components to which the I.R.C. § 41 research credit claim relates for that year.**
- 2) For each business component:**
 - identify all research activities performed;**
 - identify all individuals who performed each research activity;**
 - and**
 - identify all the information each individual sought to discover.**
- 3) Provide the total qualified employee wage expenses, total qualified supply expenses, and total qualified contract research expenses for the claim year (this may be done using Form 6765, Credit for Increasing Research Activities).**

Morgan Lewis

Q: What does a taxpayer who uses a statistical sample under Rev. Proc. 2011-42 have to do to comply with the requirements of the CCA?

The background of the slide is a dark blue gradient. It is decorated with a complex network of thin, branching orange lines that resemble a neural network or a microscopic structure. Scattered throughout the scene are numerous semi-transparent circles in shades of blue, orange, and yellow, some of which are larger and more prominent than others, creating a bokeh effect.

**Q: How do you interpret the CCA
reference to refund claims on original
and amended returns?**

Morgan Lewis

CCA 20214101f: Refund claims may be made on either original returns or amended returns. This memorandum is directed at the specificity requirement of the Treasury Regulations, and how taxpayers may meet the requirement, as discussed below.

Treas. Reg. § 301.6402-3(a)(5): A properly executed individual, fiduciary, or corporation original income tax return or an amended return (on 1040X or 1120X if applicable) shall constitute a claim for refund or credit within the meaning of section 6402 and section 6511 for the amount of the overpayment disclosed by such return (or amended return).... A return or amended return shall constitute a claim for refund or credit if it contains a statement setting forth the amount determined as an overpayment and advising whether such amount shall be refunded to the taxpayer or shall be applied as a credit against the taxpayer's estimated income tax for the taxable year immediately succeeding the taxable year for which such return (or amended return) is filed.

Treas. Reg. § 301.6402-4(a): “If the IRS determines that the payments by the taxpayer that are made within the period prescribed for payment and before the filing of the return exceed the amount of tax shown on the return (for example, excessive estimated income tax payments or excessive withholding), the IRS may credit or refund such overpayment without awaiting examination of the completed return and without awaiting the filing of a claim for refund. The provisions of §§ 301.6402-2 and 301.6402-3 are applicable to such overpayment, and taxpayers should submit claims for refund (if the income tax return is not itself a claim for refund, as provided in § 301.6402-3) to protect themselves in the event the IRS fails to make such determination and credit or refund. The provisions of section 6405 (relating to reports of refunds in excess of the statutorily prescribed threshold referral amount to the Joint Committee on Taxation) do not apply to the overpayments described in this section.”

Q: What are you recommending, or what are your clients doing, in terms of data gathering in response to the CCA?

Q: Should a company that cannot fully comply with the requirements of the CCA file a refund claim at all?

CCA 20214101f:

“For a taxpayer to seek judicial review of a disallowed refund claim, the taxpayer must have first timely submitted a refund claim that complied with all of the regulatory requirements, i.e., a valid refund claim. Otherwise, the federal courts do not have jurisdiction to review the Service’s denial... A deficient claim does not provide the basis necessary to confer jurisdiction on a district court.”

“Rejecting a deficient refund claim before initiating an audit (or otherwise actively considering the refund claim on its merits) is recommended and should eliminate the likelihood that a court will find the Service waived the specificity requirement under Treas. Reg. § 301.6402–2(b)(1).”

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Polling Question 2

In which case, litigated by Morgan Lewis partner Tom Linguanti when he was a fledgling DOJ attorney, did the government defeat the taxpayer's research credit claims on the basis that it had not substantiated base period QREs?

- A. Union Carbide
- B. Lockheed Martin
- C. Research Inc.
- D. Fudim

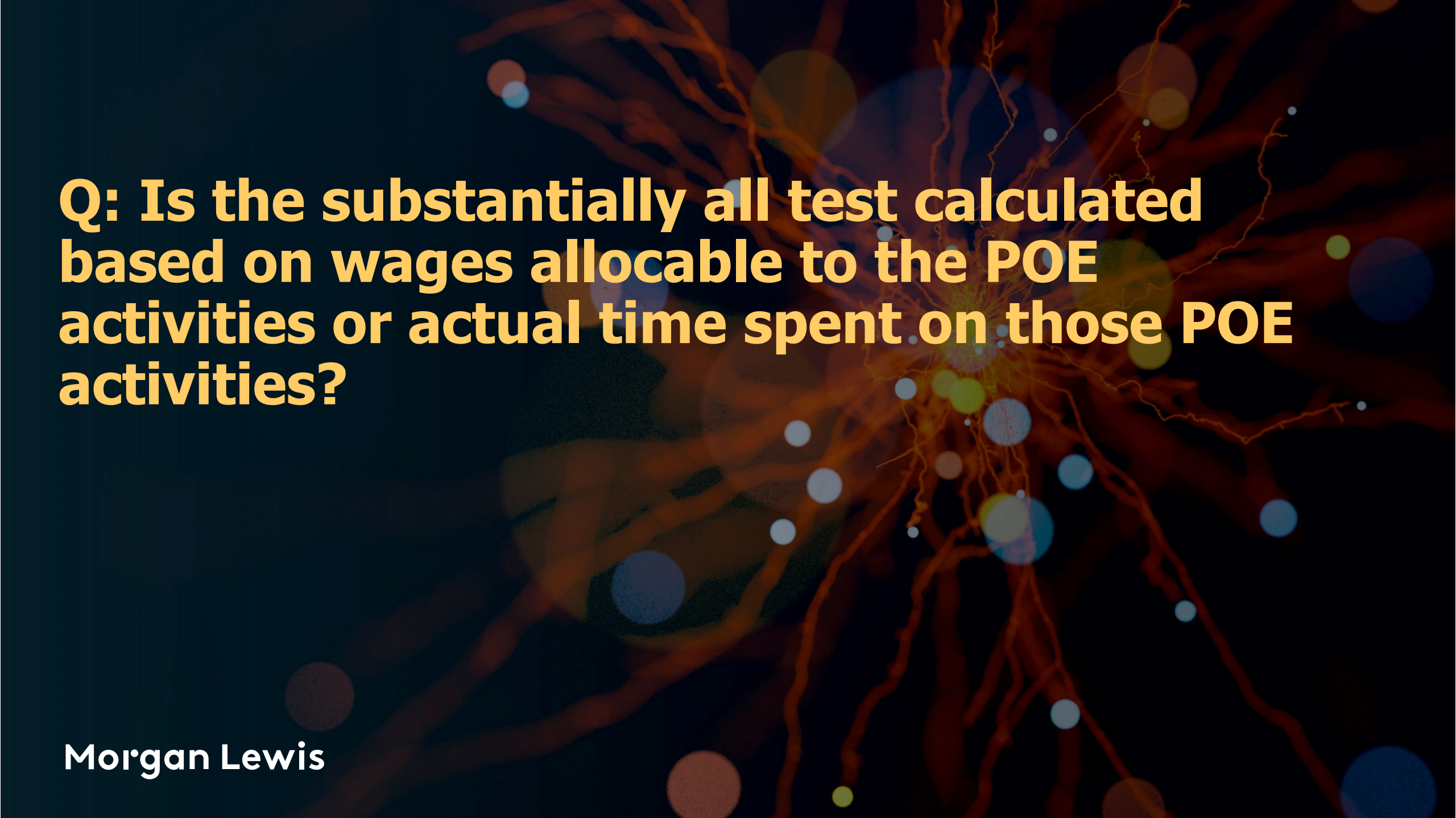


Q: How will the new 174 rules affect the taxpayers' capabilities in being eligible to claim the R&D credit under Sec. 41?

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**Section 41: “The term ‘qualified research’ means research—
(A) with respect to which expenditures may be treated
as specified research or experimental expenditures
under section 174...”**

**Section 174(a): “In the case of a taxpayer’s specified research
or experimental expenditures for any taxable year—
(1) except as provided in paragraph (2), no deduction
shall be allowed for such expenditures, and
(2) the taxpayer shall—
(A) charge such expenditures to capital
account...”**



Q: Is the substantially all test calculated based on wages allocable to the POE activities or actual time spent on those POE activities?

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Treas. Reg. § 1.41-4(a)(6): “In order for activities to constitute qualified research under section 41(d)(1), substantially all of the activities must constitute elements of a process of experimentation that relates to a qualified purpose. The substantially all requirement of section 41(d)(1) (C) and paragraph (a)(2)(iii) of this section is satisfied only if 80 percent or more of a taxpayer's research activities, measured on a cost or other consistently applied reasonable basis (and without regard to section 1.41-2(d)(2)), constitute elements of a process of experimentation for a purpose described in section 41(d)(3).”

Polling Question 3

Which funded research case did Alex Sadler and Doug Norton litigate with mixed results?

- A. Dynetics
- B. Geosyntec Consultants
- C. Meyer Borgman & Johnson
- D. Fairchild Industries, Inc.

Polling Question 4

In which cases did different Tax Court judges reach diametrically opposing conclusions?

- A. Fudim and Union Carbide
- B. Eustace and Shami
- C. Siemer Milling and Leon Max
- D. Populous Holdings and Meyer Borgman & Johnson

Q: Suppose a taxpayer pays a fixed fee to a contractor and receives digital blueprints or software code. Could we argue it's a tangible supply because it's built of electricity? (1's & 0's?) Can electricity be a supply cost?

Section 41(b)(2)(A)(ii): in-house research expenses include “any amount paid or incurred for supplies used in the conduct of qualified research.”

Section 41(b)(2)(C): “The term ‘supplies’ means any tangible property other than
 (i) land or improvements to land, and
 (ii) property of a character subject to the allowance for depreciation.”

Treas. Reg. 1.41-2(b)(1): “Supplies... are used in the conduct of qualified research if they are used in the performance of qualified services”



Q: Would blueprints and formal work products be considered intellectual property?

Q: Does delivery of such items deprive the contractor of substantial rights?

Q: Thoughts on taking purchased data/images used for machine learning as a supply? If I purchase a database of images to train an AI software on recognition, etc., is that a supply cost?

Q: Would payment to use the research database be akin to a cloud hosting type cost? We've seen this with companies running clinical trials and using specific software systems to help run their trials, would that be considered a type of "research database"?

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Q: Any feedback on using the directive ? Has it saved time? good audit outcome?

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