LB&I Directive-R&D Credit

Guidance on Allowance of Credit for Increasing Research Activities under IRC 41 for Taxpayers that Expense R&D Costs on their Financial Statements pursuant to ASC 730

Panel Members

Kimberly Edwards – IRS Director, Western Compliance Practice Area
Nora Beltran – IRS Team Manager, SF Bay Area
Janine Jones – IRS Subject Matter Expert, GBC Practice Network
Paul Zamolo – IRS LB&I Deputy Area Counsel
Barry Slivinsky – Silicon Valley Tax Directors Group Co-Chair
Jeffery Jones – PWC R&D Services Leader
GOAL

Strategically reduce the deployment of resources related to the examination of research credit issues.

Background

- IRS audits in this area of the country (Silicon Valley) typically focus on R&D Credit.
- Companies spend considerable time documenting and calculating the R&D credit.
- There is no consistent method followed by companies in calculating the R&D credit.
- There is no uniformity amongst companies in how the support is presented.
Background (cont’d)

- The total resources expended between filing and auditing the credit were burdensome.
- The Silicon Valley Tax Directors Group & PWC approached the IRS to collectively find a solution.

- Joint effort between IRS and external stakeholders.
- Several meetings both face-to-face and via phone conference.
- Capital IQ data research to determine affected population.
- Empirical data testing using live taxpayer information from volunteer companies.
Applies to LB&I taxpayers only.
Applies to original returns (including extensions) filed on or after 9/11/2017.
Provides guidance to LB&I examiners regarding examination of qualified research expenditures (QREs).

If not attached to tax returns, completed disclosure statements will be provided to the exam team at the beginning of the exam process.
Taxpayer must retain and make available upon request the underlying books and records as listed on Part IV of the Directive.
Examiners may request the underlying books and records to verify compliance with the certification requirements.
Eligible Participants

- LB&I Taxpayers with:
  - Certified Audited Financial Statements; \textit{and}
  - Followed ASC 730 GAAP Accounting; \textit{and}
  - Separately stated “Research & Development” line item on income statement; \textit{or}
  - “Research & Development” expenses quantified on the notes to the financial statement.

Certified Audited Financial Statements

- Reliance on audit procedures and due diligence performed by the financial auditors.
- Reliance on audited financial statements
  - Audit procedures performed by financial auditors.
  - Governed by GAAS (generally accepted auditing standard).
  - Code of Professional Conduct
  - Public companies
    - PCAOB—Public Company Accounting Oversight Board
    - SEC—Securities and Exchange Commission
    - SOX—Sarbanes Oxley Act of 2002
Rely on ASC 730 for companies with separately stated line item or footnoted on Certified Audited Financial Statement.

Reliance on Accounting Standard Codification 730 (ASC 730).

- Similarities between types of activities under ASC 730 and IRC 41 & 174.
- Similarities between types of cost under ASC 730 and IRC 41 & 174.
- Interactions with other accounting pronouncements e.g. ASC 985 and 350.

Requirements

Follow template included in the Directive to compute “safe harbor” QREs.

Documentation requirement

- Objective starting point in QRE review,
- Validate accounts added/subtracted on the template using financial statement details, and
- Adherence to the documentation requirements.
### Appendix B – Reconciliation of Form 6765 QREs to Adjusted ASC 730 Financial Statement R&D

<table>
<thead>
<tr>
<th>Form 6765 Line Number</th>
<th>Description</th>
<th>Adjusted ASC 730 Financial Statement R&amp;D</th>
<th>Additional QRE Amounts from ASC 730 Accounts Not Included in Adjusted ASC 730 Financial Statement R&amp;D</th>
<th>Additional QRE Amounts from ASC 730 Accounts</th>
<th>Total QRE Amounts Claimed on Form 6765</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 or 24</td>
<td>Wage for qualified personnel (does not include wages paid in figuring the work expeditiously needed)</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
</tr>
<tr>
<td>6 or 20</td>
<td>Cost of supplies</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
</tr>
<tr>
<td>7 or 26</td>
<td>Rental or lease costs of commodities (see instructions)</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
</tr>
<tr>
<td>8 or 27</td>
<td>Enter the applicable percentage of research expenses (see Form 6765 Instructions)</td>
<td>N/A</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
<td>xx,xxx,xxx</td>
</tr>
</tbody>
</table>

Total: xx,xxx,xxx

### Appendix C – Reconciliation of Adjusted ASC 730 Financial Statement R&D

#### Step 1
- ASC 730 Financial Statement R&D
- Subtotal All Amounts Related to Foreign Entities
- U.S. ASC 730 Financial Statement R&D
- The Subtotal U.S. amount (see instructions)

#### Step 2
- Subtractions from U.S. ASC 730 Financial Statement R&D
- Subtotal U.S. ASC 730 Financial Statement R&D After Subtractions

#### Step 3
- W-2 Wages for employee compensation related to U.S. ASC 730 Financial Statement R&D

#### Step 4
- Subtotal U.S. ASC 730 Financial Statement R&D Wage and Wages Related Amounts not already excluded from the wage base
- Subtotal U.S. ASC 730 Financial Statement R&D Stock-Based Compensation not already excluded in the base claims

#### Step 5
- ADJUSTED ASC 730 Financial Statement R&D

### ADJUSTED ASC 730 Financial Statement R&D: GQE AMOUNTS

<table>
<thead>
<tr>
<th>Line 11</th>
<th>Value</th>
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<tbody>
<tr>
<td>1</td>
<td>Step 1 (XX,XXX,XXX)</td>
</tr>
<tr>
<td>2</td>
<td>Step 2 (XX,XXX,XXX)</td>
</tr>
<tr>
<td>3</td>
<td>Step 3 (XX,XXX,XXX)</td>
</tr>
<tr>
<td>4</td>
<td>Step 4 (XX,XXX,XXX)</td>
</tr>
<tr>
<td>5</td>
<td>Step 5 (XX,XXX,XXX)</td>
</tr>
</tbody>
</table>

### ADJUSTED ASC 730 Financial Statement R&D: GQE AMOUNTS

<table>
<thead>
<tr>
<th>Line 16</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Step 1 (XX,XXX,XXX)</td>
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<td>2</td>
<td>Step 2 (XX,XXX,XXX)</td>
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<tr>
<td>3</td>
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<td>4</td>
<td>Step 4 (XX,XXX,XXX)</td>
</tr>
<tr>
<td>5</td>
<td>Step 5 (XX,XXX,XXX)</td>
</tr>
</tbody>
</table>

**This Amount should equal [ ] above**
### BENEFITS

- Uniform verified starting point for determining QREs.
- Mechanical computation of QREs.
- Reduce exam and taxpayer resources devoted to examining issue.
- Audit of books & records vs. review of qualified activities.
- Provide consistent process for taxpayer to identify expenses outside of ASC 730.
BENEFITS (cont’d)

- Reduce costs and burden of conducting surveys.
- Reduce audit risk.
- If only safe-harbor QREs claimed:
  - No Schedule UTP and
  - No Fin 48 Disclosure.
- Risk assessment tool.

Questions