

Litigating R&D Cases

Insights, Strategies, and Traps for the Unwary

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The Research Credit: A 2-Minute Primer

- Qualified research – IRC § 41(d); Reg. § 1.41-4
 - Satisfies four primary definitional tests
 - Section 174 test (undertaken to eliminate uncertainty regarding capability, method, or design)
 - Technological in nature test
 - Process of experimentation test
 - Business component test
 - Primary tests are applied at business component level (*i.e.*, product, process, software, etc.)
 - Must not be an excluded activity (*i.e.*, post-commercial production, duplication, funded research, etc.)
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The Research Credit: A 2-Minute Primer

- QREs – IRC § 41(b); Reg. § 1.41-2
 - Wages – amounts paid to employees performing or directly supervising or supporting qualified research
 - Supplies – non-depreciable property used in the conduct of qualified research
 - Contract research expenses – 65 percent of amounts paid to non-employees to perform qualified research

The Research Credit: A 2-Minute Primer

- Credit computation – IRC § 41(c); Reg. §§ 1.41-3, -9
 - Traditional computation – reference point is taxpayer's QREs in 1984-88
 - Alternative simplified credit (ASC) – reference point is taxpayer's QREs in three prior years
 - Consistency requirement – QREs must be determined in credit years and reference years on a consistent basis
 - Taxpayer must make timely IRC § 280C(c) election to avoid disallowance of deductions in amount of credit

Recent Developments

- Congress – Pres. Obama
- Courts
 - *Union Carbide* appeal
 - *FedEx* reconsideration motion
 - *Trinity Industries* trial
 - *Bayer* sampling motion

Recent Developments

- IRS
 - Plans to move research credit claims from Tier I to an IPG, but they will remain a compliance priority
 - Review/concurrence removed at Appeals
 - IRS/tax practitioner meetings
 - Issues coming up in the field

Common Areas of Dispute

- Substantiation
 - Burden of proof
 - How a typical research credit study is prepared
 - Project versus cost center accounting and the “nexus” issue
 - Base period issues
 - Document retention and collection
 - Use of SMEs, experts, and estimates (*Cohan*) in the absence of contemporaneous documentation

Common Areas of Dispute

- Sampling
 - The problem
 - Judgment versus statistical samples
 - IRS guidance
 - Judicial guidance
 - Recent experiences

Common Areas of Dispute

- Primary qualified research tests
 - Identifying specific business components
 - Section 174 test
 - Process of experimentation

Common Areas of Dispute

- Excluded activities
 - Research after commercial production
 - Adaptation/duplication of existing business component
 - Funded research
 - Internal use software
- Dual-purpose supplies

Litigating Insights and Strategies

- Discovery
 - Fact-intensive nature of R&D disputes
 - Tax Court versus refund tribunals
 - What to expect from IRS and DOJ
 - Discovery taxpayers may want from the government

Litigating Insights and Strategies

- Partial summary judgment
 - Qualified research exclusions
 - Applicable legal standards
 - Computational issues
 - Eligibility of types of costs
- Stipulations
 - Tax Court versus refund tribunals
 - Potential uses

Litigating Insights and Strategies

- Experts
 - Tax Court versus refund tribunals
 - Potential uses
 - Qualified research eligibility
 - What is state of the art?
 - Accounting for QREs
 - Identifying base period activities and costs
 - Statistical sampling
 - Identifying testifying experts

Litigating Insights and Strategies

- Other trial strategy considerations
 - Fact witnesses
 - Demonstrative exhibits
 - Electronic courtroom technology

Q & A