

# Manufacturers **ALLIANCE**

## Bolster R&D Tax Credits with Automation Webinar

# WHO IS GLOBAL TAX MANAGEMENT?

Serving Multinational Corporations in all Industries



Life Sciences



Manufacturing



Technology



Chemicals



Energy/Utilities



Retail

Founded in 1995  
100% employee owned (ESOP)

25 YEARS

**100%** focused on corporate tax services

We help companies build, operate, and manage tax department functions

**OUR SERVICES** bring practical approaches to address the complexities of direct and indirect taxation

- Tax Provision
- Income Tax Compliance
- Indirect Tax
- Tax Automation
- International Tax
- Transfer Pricing
- State & Local Tax
- Tax Consulting & Planning

## HOW WE DELIVER



Project-Based



Co-Sourced



Outsourced



Transitional

## GLOBAL REACH

wts global

GTM is a U.S. member firm of the WTS Global international tax network.

# Agenda

1. Introduction
2. R&D Credit Basics
3. The ASC 730 Directive
4. Automating the Process
5. Alternatives
6. Wrap-Up

# Introduction



# Introduction



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# R&D Credit Basics

# R&D Credit Basics - Qualified Research Activities

Activities are qualified if they are:

1. Technological in nature – rely on the principals of engineering, biological, chemical, physical, or computer science - and
2. Intended to develop or improve the functionality, performance, quality, or reliability of a product, process, software, invention, formula, or technique (“Business Component”) where
3. There is technological uncertainty at the outset in either capability, method, or appropriate design that must be eliminated (or attempted to be eliminated)
4. Through a systematic process of experimentation (development lifecycle)

They do not qualify if they are:

- Conducted outside the United States
- Related to surveys, studies, etc. (efficiency, management functions or techniques, market research/studies/testing, routine data collection, or routine testing/inspection or quality control
- Based on the principals of social sciences
- Funded by a 3<sup>rd</sup> party
- ...

# R&D Credit Basics - Qualified Research Expenses

Qualified Research Expenses (“QREs”):

1. Wages
  - Performing qualified services
  - Directly supervising qualified services
  - Directly supporting qualified services
2. Supplies
  - Tangible, non-depreciable
3. Contract Research
  - Performing qualified services
  - 65% of the amount paid (or 75% or 100% in some cases)
4. Computer Use
  - Rental or lease computer costs, e.g. hosting services.

# The ASC 730 Directive



# ASC 730 Directive

- Introduced in 2017, updated in 2020.
- Applicable only to:
  - LB&I taxpayers who
  - Reconcile book to tax income using the same U.S. GAAP financial statements on their M-3 as used to determine their ASC 730 R&D amount.
- Intended to provide a “safe” approach to claim R&D credits and reduce the burden on both taxpayers and the IRS

# ASC 730 Directive

- How to implement (Appendix C):
  - Use ASC 730 GAAP R&D expenses as starting point, and subtract:
    - Non-U.S. entities
    - Non-eligible expenses (e.g., foreign, specifically excluded, overhead, ...)
    - Contract research
    - Expenses for software not for sale, lease, or license
    - Work performed outside the U.S.
    - Prototype overhead costs, patent expenses, severance pay
    - U.S.-based W-2 wages and stock options
  - Add back:
    - 95% of U.S.-based W-2 wages and stock options for directly engaged and 1st level supervisors
    - A % (at most 10% of wages above) of upper-level supervisors.

# ASC 730 Directive

## What else is needed?

- Documentation of methodology
  - Taxpayers must have a narrative description of the methodology used to follow the directive as well as and their calculations
  - Documentation must demonstrate they followed the guidelines of Appendix C and made a reasonable effort to calculate non-ASC 730 R&D.
- Substantiation of internal controls
  - Taxpayers must now provide substantiation in writing or by presentation of their internal controls to mitigate material misstatement of expenses reported per financial statements

# ASC 730 Directive

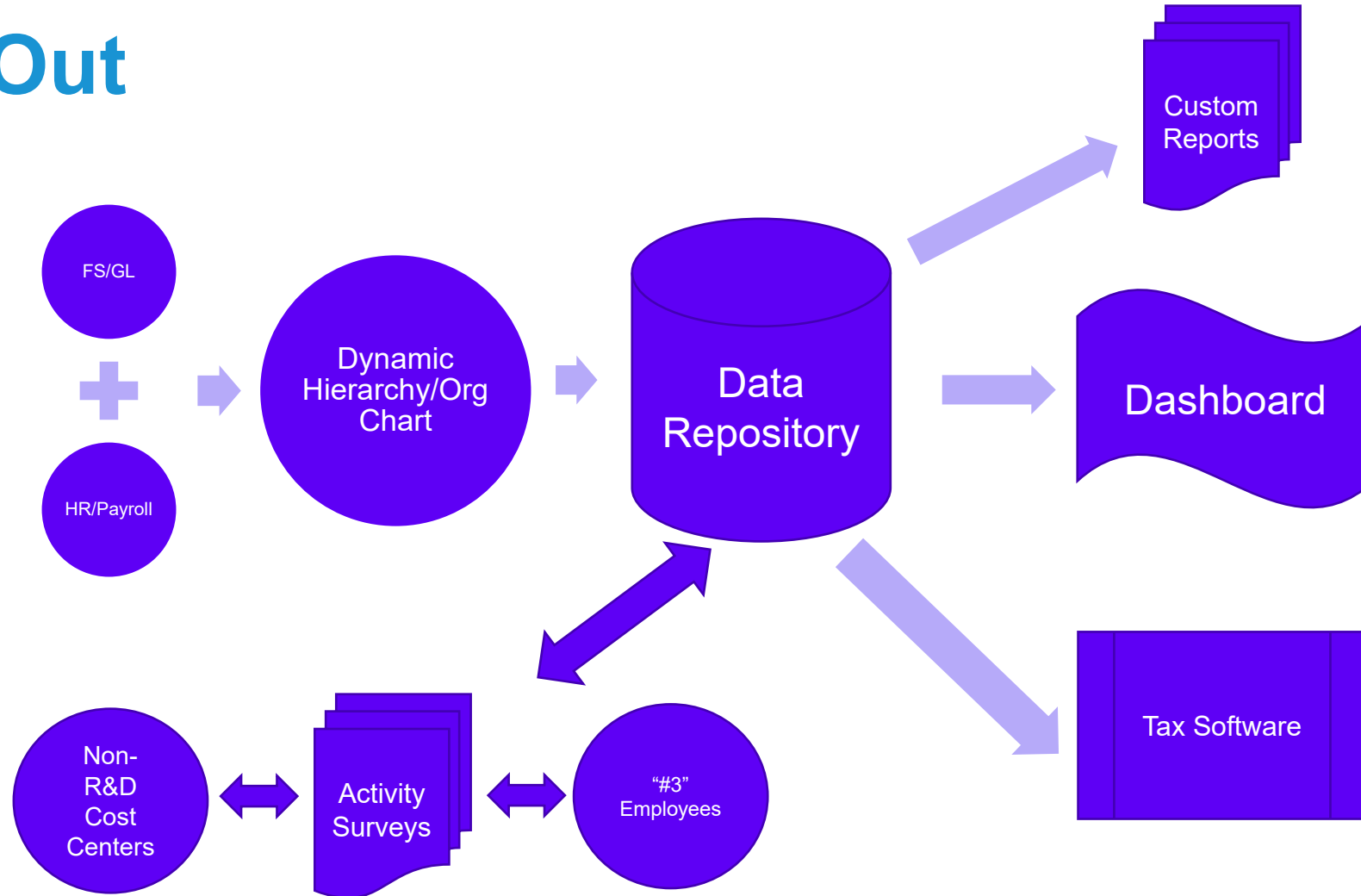
## Why Use It?

- Predictability and certainty:
  - By following the Directive, taxpayers have confidence that their credits will not be challenged. This simplifies:
    - Provision preparation
    - Setting/releasing reserves
- Pick & choose
  - It's not all or none. A traditional approach can be used for above 1st level supervisors and cost centers not included in the ASC 730 calculation
- More control of exam teams. Territory manager approval required to:
  - Request additional documentation not prescribed by the directive
  - Deem a taxpayer ineligible to use the directive
- Resource/time savings
  - Business component documentation: Gone!
- Potential automation...

# Automating the Process



# Data In/Out



# Process Overview

## ASC-730

- Levels 1 & 2 at 95% (no additional documentation)
- Level 3+ at 10% of levels 1 and 2 (no additional documentation), or calculated outside directive
- Non-core R&D calculated outside directive (traditional survey/documentation)

## R&D Mapping Exercise

- Validate/document book R&D accounts
- Identify/analyze contributing account codes

## Alteryx workflows tie account data and HR/Payroll data

- Create dynamic org chart/hierarchy to identify Levels 1-3
  - Unique ID, Name, Title, Level, Cost Center, Department, Supervisor, State, W2 Wage
  - Manual overrides as necessary
- Populate data repository that is the platform for the rest of the process
  - rollover in future years with exception-based changes

# Process Overview

## Survey Redesign – SharePoint/DataFlow/... design/distribution

- Activity-based and customized to Process of Experimentation (“PoE”) stages
- Two stages (ideally webinar-based):
  - Stage 1: Project/area leads/managers
  - Stage 2: Level 3 and non-core R&D (identified by stage 1)
- Identifies/validates contract research/supply accounts
  - Added bonus – can flow to other tax processes (e.g., Sales & Use exemptions)
- Captures applicable documentation (see below) tied to PoE

## Documentation

- Attached via surveys
- Directly relevant to stages of a PoE

## Process management

- Automated distribution and collection of data with workflow.
- Power BI dashboards
- Reporting
  - On demand
  - Custom reports by any captured metric

# Surveys: Process of Experimentation Focus

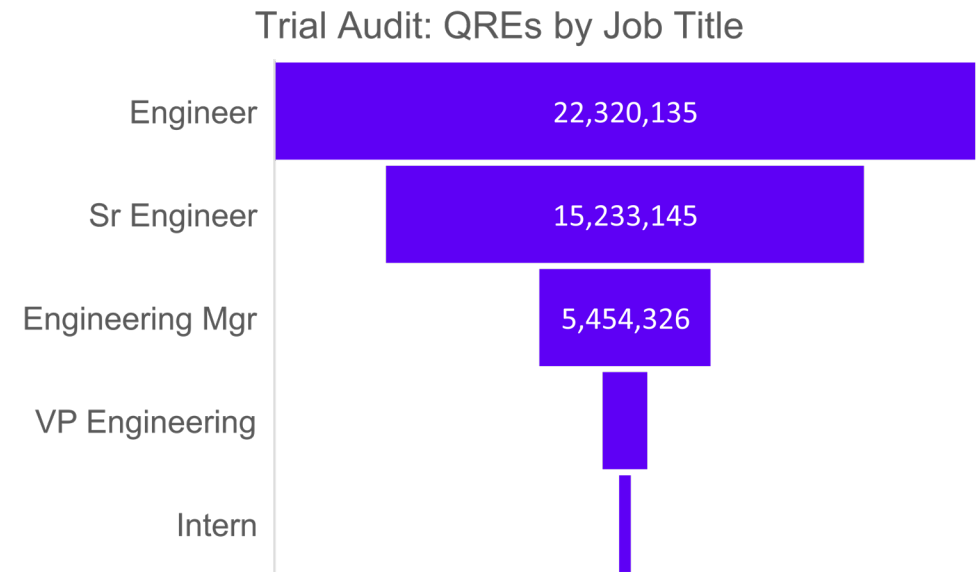
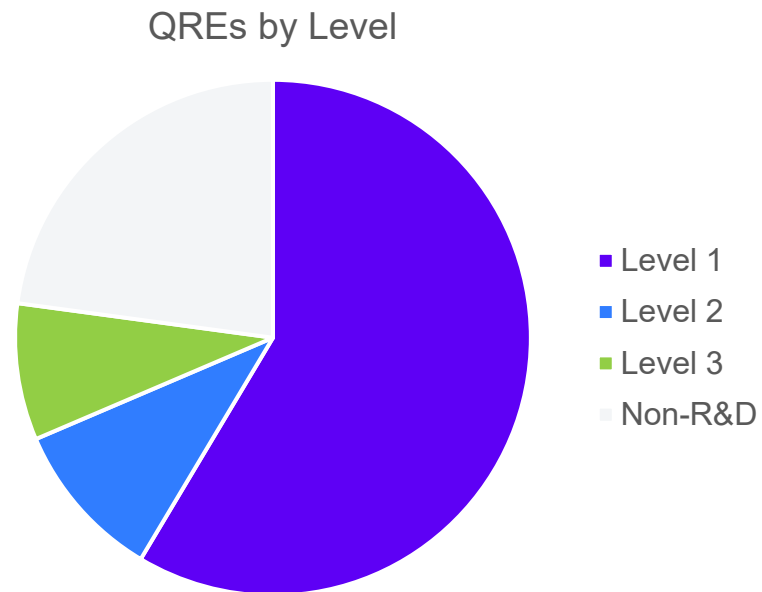
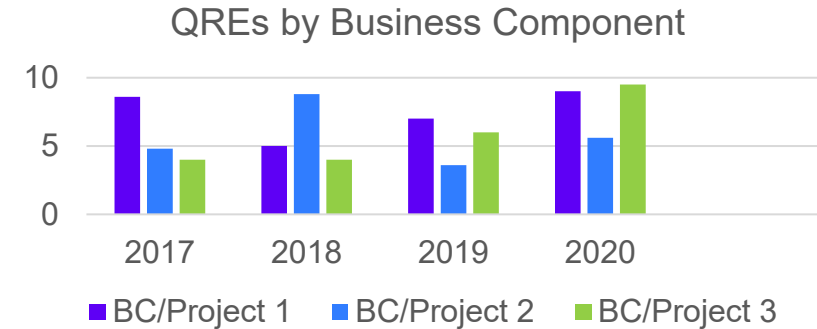
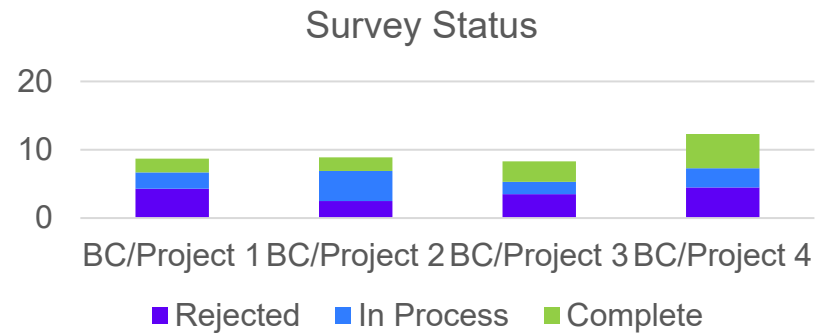
- Qualified activity should be identified based on the PoE
  - Eliminates debates about how much time on a project meets the PoE requirement (e.g., Little Sandy Coal Company)
  - Allows the inclusion and support of non-core R&D (see matrix)
- Activity should be defined as scientists/engineers/developers recognize it, not as “four-part test” language
- All activity should be captured, not just qualified activity
- Documentation should match the categorization
- We then map the data to the four-part test to satisfy the IRS.

# Surveys: Process of Experimentation Focus

Facts		Law		Documentation	
Development Process		→	Process of Experimentation ("POE")	←	(Examples)
1.	Design Requirements & Specs	→	1. Business purpose/permitted purpose	←	1. Design Requirements/Specs
2.	Technical Design	→	2. POE and uncertainty	←	2. Design plans, initial formulations.
3.	Development	→	3. POE	←	3. Drawings; models; code.
4.	Testing	→	4. POE and technological in nature	←	4. Test plans/results; bug databases.
5.	Iterations	→	5. POE and uncertainty	←	5. Revised code or test plans/results.

	Stages of Development Process / Elements of Process of Experimentation					
Department	Design Requirements/Specs	Technical Design	Development	Testing	Iterations	Production
Marketing	x			x		x
Customer Service	x			x	x	x
R&D/Architecture	x	x	x	x	x	
Manufacturing/Programming		x	x	x	x	
Quality Assurance			x	x	x	x
Field Applications	x	x	x	x	x	x
Etc.						

# Dashboard Example



# Alternatives



# Alternatives

- What if you don't qualify for the ASC 730 Directive?
  - Not LB&I
  - No US GAAP audited R&D number
- What if you don't want to use the ASC 730 Directive?

... Automation is still an option.

# Alternatives

- Premise: Engineers engineer, Software developers develop software, scientists conduct research: these activities are generally qualified activities.
- Adopt a risk-focused “pseudo” ASC-730 Directive approach
- Warning:
  - Lacks the certainty of using the Directive
  - IRS has the flexibility to ask for additional documentation
  - Requires additional work – though not significantly more

# Alternatives

- Identify “core” R&D departments, job titles, functions
- Follow the same flow as the ASC 730 Directive approach
- “Sanity check” core-R&D job titles with surveys
- Survey/document:
  - Non-Core R&D
  - Above 1<sup>st</sup> level supervisors
  - High-income employees

# Wrap-Up



# Wrap-Up/Questions

- HR, payroll, accounting, and R&D systems contain most of the information needed to prepare an R&D credit claim
- A combination of technology tools and refined process can eliminate much of the time/resources needed to claim R&D
- Data elements gathered as part of the R&D process and stored in a tax data store can be used for other purposes
- R&D credit claims can be made efficient through automation whether electing the ASC 730 Directive or not

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**Thank You!**