



Exhibit D - Research Credit Computational Issues (May 2008)

Exhibit D

Computation Check sheet

REVIEW STEPS FOR EVALUATING RESEARCH CREDIT COMPUTATIONAL ISSUES		
Review Step	Description	Data Source
<p>Consistency Rule. Compare the fixed-base percentage reported on original return to the fixed-base percentage reported on the claim. The fixed-base percentage is the percentage which the aggregate QREs for the base years is of the aggregate gross receipts for the base years. Note that there is a separate regime for computing the fixed-base percentage for "start-up" companies. See section 41(c)(3)(B).</p>	<p>If a taxpayer claims a certain type of expense as a QRE in the claim year that it did not include as a QRE in the fixed base percentage calculation, it must adjust its fixed-base percentage to reflect similar QREs that were paid or incurred during the base period years. Identification of additional QREs in the base period years will in turn increase the fixed-base percentage. See page 27 of the Research Credit ATG.</p>	<p>Form 6765, Section A (Fixed-Base Percentage); Base Year Work papers</p>
<p>Substantiation. Determine if there was a change in the base years QREs. Calculate the percentage change in the base years' QREs from the amended to the original return.</p>	<p>No change indicates that the taxpayer may not have considered the consistency requirement. A flat increase in amount or percentage from year to year may identify the use of estimates or extrapolations in applying the consistency rule. Failure to maintain sufficient records to accurately substantiate the base period expenditures may be grounds for disallowance of claim. Research, Inc. v. United States, 95-2 USTC ¶ 50,407 (D.Minn. 1995)</p>	<p>Base Year Work papers</p>
<p>Aggregation Rules. Identify all corporations or trades or businesses that must file as members of a controlled group of corporations or trades or businesses under common control.</p>	<p>All corporations or trades or business under common control (more than 50% ownership), are treated as a single taxpayer in determining the amount of the research credit.</p>	<p>From 6765, Section A (Fixed-Base Percentage); Annual Reports & Base Year Work papers.</p>
<p>Adjustments for Certain Acquisitions</p>	<p>The base amount (product of the fixed base percentage and the</p>	<p>From 6765, Section A</p>

<p>and Dispositions. Identify all significant acquisitions and dispositions of trades or businesses.</p>	<p>average annual gross receipts of the taxpayer for the 4 taxable years preceding the taxable year for which the credit is being determined) should account for all acquisitions and dispositions of members of controlled group from the base years to the current years. See the Base Amount Spreadsheet on the Research Credit Technical Advisor page under Reference Materials.</p>	<p>(Fixed-Base Percentage); Form 6765, Section A and B (Average Annual Gross Receipts); Annual Reports; Base Year Work papers</p>
<p>Invalid 280C(c)(3) Election. Verify whether the taxpayer properly elected the reduced credit under I.R.C. 280C(c)(3) on its original timely filed return.</p>	<p>Retroactive 280C(c)(3) elections are not allowed for research credit claims. If a taxpayer did not properly elect the reduced credit on its the original return, it may not do so for the first time in an amended return. See 280C Directive and also 280C Legal Advice</p>	<p>Form 6765, Section A and B (Credit Percentage) attached to and made a part of a timely filed original return</p>

REVIEW STEPS FOR EVALUATING POSSIBLE CHANGES TO TAXABLE INCOME AND OTHER TAX ITEMS RESULTING FROM RESEARCH CREDIT CLAIM		
Review Step	Description	Data Source
<p>General Treatment of Research and Experimental Expenditures. Establish whether the taxpayer also made all necessary adjustments to taxable income, deductions and other tax items as a result of the research credit claim.</p>	<p>The research credit is an expense based credit. In order for the taxpayer to claim additional QREs for purposes of the research credit, the cost of the activity must first qualify as a research and experimental expenditure under section 174. For that reason, the taxpayer's claim that it understated QREs most likely means that the taxpayer did not claim these expenses as research and experimental expenditures in its original return. Determine if taxpayer's reclassification of these expenses as section 174 expenses results in any change to taxable income, tax, or overpayment (refund) amount. The deduction under 174 for research and experimental expenses must be reduced by the amount of research credit. An annual irrevocable election is available to claim a reduced research credit and thereby avoid reducing the 174 expense deduction. See Section 280C for additional information.</p>	<p>Form 1120X and supporting work papers</p>
<p>Capitalized R&E Expenditures. Establish whether the additional QRE amount includes costs that were chargeable to a capital account.</p>	<p>Generally, taxpayers elect to treat research and experimental expenditures as current expenses under section 174(a). If the taxpayer claimed additional QREs that were improperly charged to assets contrary to the taxpayer's accounting method of treating research and experimental expenditures as current expenses, then the taxpayer should make the necessary claim adjustments to net income and deductions for the additional research and experimental expenditures and corresponding adjustments to gains or losses on sale of assets, interest capitalization and depreciation. However, taxpayer's change may be an unauthorized change in accounting method. See the</p>	<p>Form 1120X and the supporting work papers for research credit claim; Form 1120, Line 26 Other Deductions</p>

	IRC 174 Technical Advisor page for more information.	
<p>Other Tax Items – Foreign Tax Credit Limitation.</p> <p>Compare the QRE amount to the total amount of IRC 174 expenditures shown on Form 1118, Foreign Tax Credit, Schedule H. (The QRE amount should not be greater than the amount shown on Form 1118.)</p>	<p>Given the fact that many code sections take into account IRC §174 expenditures in the computation of separate tax benefits and limitations, it is important that an examiner determine whether the taxpayer properly took into account any possible change to the amount and extent of R&E expenditures. A change in the amount of R&E expenditures may affect other tax items, including foreign tax credits, domestic manufacturing deduction, and cost sharing agreements.</p>	<p>Form 1120, Line 26 Other Deductions, Form 118, Schedule H</p>
<p>IRC 280C. Verify that the taxpayer made an adjustment to taxable income (reduced its IRC 174 deduction) by the credit amount.</p>	<p>IRC §280C(c) (1) provides that when research credit is claimed at the regular rate, the amount of the IRC §174 deduction must be reduced by the amount of the credit. This and other changes in R&E deductions resulting from additional QREs may effect taxpayer’s AMT computation.</p>	<p>Form 6765, Section A and B (Credit Percentage) attached to and made a part of a timely filed original return</p>