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Changes to the Research Credit Reporting Requirements

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The federal research credit rules have recently changed in two important ways. First, currently deductibility of the underlying expenses is no longer permitted and, second, the reporting requirements for research credit refund claims have been substantially expanded. Our recent [blog](#) covers the basics of the research credit. This analysis examines the new reporting requirements.

MANDATORY CAPITALIZATION

Prior to 2022, taxpayers could claim the research credit in addition to deducting the underlying expenses in the year incurred. Tax Cuts and Jobs Act changed that starting with tax year 2022. Research expenditures are now required to be capitalized and amortized over a five-year period (15 years for research performed outside of the U.S.).

ENHANCED REPORTING REQUIREMENTS

Taxpayers will generally claim the research credit on a timely filed current income tax return. However, for various reasons, it is common for taxpayers to claim the credit on a later filed amended return refund claim. On January 3, 2022, the IRS released changes to the Internal Revenue Manual, outlining five criteria to be used to determine whether a refund claim meets the specificity requirement of Treasury Regulation §301.6402-2. This regulation requires a taxpayer to “set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof.” Put simply, when a refund claim is filed, the IRS should be able to determine on its face whether the claim is valid.

The five criteria are:

- Identify all the business components that form the factual basis of the research credit claim
- Include a description of what was done and how by component
- Detail all individuals who performed each research activity by component
- Provide all the information each individual sought to discover by component
- Tabulate the total amount of each wage, supply, and contract expense reported on Form 6765

A Chief Counsel Memorandum (“CCM”) issued by the IRS in October of 2021 (#20214101F) further expounds on the required form and content of a research credit refund claim. The CCM indicates that a declaration, signed under penalty of perjury, verifying that the facts provided are accurate is required.

Generally, signatures on the amended return are sufficient, but there are cases where a separate signature will be required (this will be covered later). The CCM also states that if a credit study is done, the taxpayer must specify the exact page(s) that support a specific fact(s), and that a mere volume of documents will not suffice.

TIMING AND POSSIBLE REJECTION OR DENIAL

Generally, to file refund claims for previously filed returns taxpayers have three years from the date the return was filed, or two years from the time the tax was paid, whichever is later. The IRS has the authority to reject or deny refund claims that are not valid or not filed in a timely manner. Refund claims filed between January 10, 2022, and January 9, 2023 (i.e., the transition period) will have a 45-day grace period to complete claims that were initially submitted incomplete.

The IRS will determine if credit claims are complete for claims filed during the transition period. If they are determined to be complete, they will then be tested for validity. If not valid, the claim will be audited or denied. If not complete, a Letter 6428 will be issued to the taxpayer. The taxpayer will then have 45 days from the date of issuance to provide the missing information. As alluded to above, any information provided subsequent to the initial claim will require a declaration, signed under penalty of perjury, verifying that the facts provided are accurate. In the event the required information is not submitted within 45 days, or the IRS rejects or denies the claim, a Letter 6430 will be issued to notify the taxpayer that no refund will be allowed.

Refund claims filed after the transition period will not be afforded the same 45-day grace period. If claims are not complete when filed, they will be rejected. The CCM clearly states that deficient claims, which are rejected, will not be allowed judicial review for lack of jurisdiction. The memorandum indicates the basis for this conclusion is that a proper claim for a refund has not been filed, which precludes judicial review.

CONCLUSION

Notwithstanding the new cost capitalization requirement, the research credit is extremely advantageous for qualifying taxpayers. The expanded reporting and documentation requirements do, however, make qualification more onerous. The IRS has the authority to reject refund claims that are not complete, so it is important to get it right the first time. Claims filed prior to January 9, 2023, will have a chance to provide missing information to complete the claim. Claims filed after that date will not be afforded the same flexibility.

If you are claiming a research credit, please reach out to your Berdon advisor to ensure the initial reporting or refund claim follows the proper procedures. You can reach Geoffrey Kayton at 212-331-7525 | gkayton@berdonllp.com or reach out to your [Berdon Advisor](#).

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