NATIONAL ASSOCIATION OF Manufacturers

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Vice President,
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Ms. Holly Paz
Commissioner
Large Business & International Division
Internal revenue Service
1111 Constitution Ave. NW
Washington, DC 20224

Ms. Jennifer Best
Deputy Commissioner
Large Business & International Division
Internal Revenue Service
1111 Constitution Ave. NW
Washington, DC 20224

Re: Proposed Changes to Form 6765, Credit for Increasing Research Activities

Dear Ms. Paz and Ms. Best:

The National Association of Manufacturers respectfully submits this letter in response to proposed changes for Form 6765, Credit for Increasing Research Activities, announced by the IRS in IR-2023-173 on September 15, 2023.[1]

The NAM is the largest manufacturing association in the United States, representing manufacturers of all sizes in every industrial sector and all 50 states. Manufacturing employs more than 13 million men and women who make things in America, contributes more than $2.91 trillion to the U.S. economy annually, pays workers over 18% more than the average for all businesses and has one of the largest sectoral multipliers in the economy.

Driving more innovation than other sectors, research and development is the lifeblood of manufacturing. Manufacturers perform 53% of all private-sector R&D. The industry's ability to pursue first-in-the-world research would be seriously threatened by the unprecedented proposed new reporting requirements for the R&D tax credit which would impose extraordinary compliance costs on taxpayers. In other words, these new requirements will greatly frustrate efforts for taxpayers to claim the R&D tax credit, particularly by small manufacturers, which will hurt innovation and the high-paying jobs supported by slightly more than $300 billion the sector spent on R&D in 2022.[2] Moreover, manufacturers would be impacted disproportionately by proposed changes given that manufacturing corporations "claimed nearly 60 percent of the total dollar value of research credits in 2017," according to the Joint Committee on Taxation.[3]

As the proposed Form 6765 changes are at odds with the statutory mandate to limit the compliance burden for claiming the research credit and will significantly increase the compliance burden on taxpayers claiming the research credit, the NAM respectfully requests

[1] https://www.irs.gov/newsroom/irs-requests-feedback-on-preview-of-proposed-changes-to-form-6765-credit-for-increasing-research-activities
[2] U.S. Bureau of Economic Analysis. Retrieved from https://apps.bea.gov/iTable/?reqid=19&step=2&isuri=1&categories=survey.
[3] Joint Committee on Taxation, Tax Incentives for Domestic Manufacturing (JCX-15-21) at 54 (March 12, 2021).

that the proposed changes to Form 6765 be withdrawn. In the event the IRS does not see fit to withdraw the Form 6765 changes, the NAM suggests certain modifications and clarifications to simplify the compliance process for claiming the research credit as well as delaying the proposed 2024 effective date by at least a year.

Background on the R&D Tax Credit

Generally speaking, the R&D tax credit comes in the form of either a regular[4] or alternative simplified tax credit[5] with both designed to incentivize R&D investments above a base amount. While each of these tax credits is computed differently, both are governed by a four-part test[6] and limit qualifying costs to the same types of expenses for purposes of computing the credit. The four-part test, which involves a fact-intensive analysis, is as follows:

1. Credit-eligible expenditures may be treated as specified research expenses under Section 174; meaning the expenditures are incurred for research activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. Uncertainty exists if the information available to the taxpayer does not establish the capability or method for developing the product or the appropriate design of the product.[7]
2. Activities are undertaken to discover information that is "technological in nature."[8]
3. Activities are "intended to be useful in the development of a new or improved business component of the taxpayer."[9]
4. Substantially all the activities constitute elements of a process of experimentation, meaning a process designed to evaluate one or more alternatives for achieving a result where the capability or the method of achieving the result, or the appropriate design of the result is uncertain.[10]

The four-part test is applied separately to each business component, which is defined as product, process, computer software, technique, formula or invention that is held for sale, lease, or license, or used by the taxpayer in a trade or business.[11] The types of expenses that are used in computing the credit include wages of individuals who are performing qualified work (e.g., direct research, supervising research, supporting research), supplies, contract research and computer rental costs.

Congress has long been concerned about "unnecessary and costly taxpayer recordkeeping burdens" and has noted that "eligibility for the credit is not intended to be contingent on meeting unreasonable recordkeeping requirements."[12] While taxpayers must retain records to substantiate the expenditures claimed are eligible for the credit, the tax code mandates that the Secretary of Treasury issue "regulations to minimize compliance and recordkeeping burdens."[13]

[4] I.R.C. § 41(a).
[5] I.R.C. §41(c)(4).
[6] I.R.C. §41(d)(1).
[7] Treas. Reg. § 1.174-2(a)(1).
[8] I.R.C. § 41(d)(1)(B)(i).
[9] I.R.C. § 41(d)(B)(ii)
[10] I.R.C. § 41(d)(1)(C); Treas. Reg. § 1.41-4(a)(5).
[11] I.R.C. § 41(d)(2).
[12] Rept. No. 106-478 at p. 132 (November 17, 1999).
[13] I.R.C. §41(h)(6)(B).

Currently, taxpayers claiming the R&D credit on Form 6765 are not required to include quantitative or qualitative information at a business component level. The current Form 6765 only requires disclosure of total qualified research expenses by type (e.g., total wages, supplies, computer rental and contract research expenses). Importantly, the current reporting requirements are consistent with the statutory mandate that the compliance burden for claiming the R&D credit should be minimal.

The Proposed Form 6765 Changes Impose an Undue Compliance Burden, Threatening the Ability of Taxpayers to Legitimately Claim the R&D Tax Credit

According to the IRS, taxpayers will need to provide the following types of information to file a valid claim:

- A new Section E has been added with the following fields:
  - Number of business components generating the credit;
  - Amount of officers' wages included in QREs; and
  - Yes or no questions around whether the taxpayer:
    - Acquired or disposed of a major portion of a trade or business;
    - Identified any new categories of expenditures in the current year not included in the base year; and
    - Determined any of the QREs following the ASC 730 directive (i.e. GAAP standard of accounting for R&D).
- A new Section F has been added, which requires taxpayers to provide the following information:
  - Controlled group member's name, employee identification number, and principal business activity code; and
  - For each business component:
    - A description of the information sought to be discovered and the alternatives evaluated in the process of experimentation;
    - Whether the business component was new or improved;
    - Business component type (product, process, computer software, technique, formula, or invention);
    - Business component use (sale, lease, license, or used by the taxpayer);
    - Software type, if applicable; and
    - A breakdown of QREs for each business component by direct research wages, direct supervision wages, direct support wages, supplies, and contract research expenses.

The proposed changes require a significant amount of very detailed quantitative and qualitative information at each business component level including some information that may be proprietary or subject to non-disclosure. Currently, taxpayers who timely file research credit claims are only required to provide detailed quantitative and qualitative information at a business component level in the event of an IRS exam. The current process provides an avenue for the IRS and taxpayers to reasonably agree on the amount of information and records needed to support the qualification of the business components that generate a credit.

The practical reality is that the requirements outlined in the new Sections E and F would impose an undue compliance burden and cost to taxpayers, especially smaller taxpayers, who may be discouraged from claiming the credit to which they are entitled. It is not unusual for

taxpayers to work on hundreds or thousands of business components each year. Moreover, requiring taxpayers to report detailed information at a business component level is improper because the requirement is contrary to congressional intent to limit the compliance burden for claiming the research credit as expressed in the Paper Reduction Act and the tax code.[14]

The IRS Should Delay the Effective Date of Any Changes to the R&D Tax Credit Form

The new reporting requirements are anticipated to go into effect for the 2024 tax year. If the IRS proceeds to make changes, even if they are less onerous than those currently proposed, the NAM respectfully recommends that the IRS delay the effective date of any changes until at least tax year 2025 in order to give taxpayers time to implement the necessary processes and systems.

The IRS Should Consider Fundamental Simplification with Its Proposed Approach

The NAM provides below a number of recommendations designed to either simplify or clarify and thus ultimately lessen the burden associated with the IRS's proposed changes.

The IRS Should Remove Section F, Question 50(d) from the Form

Section F question 50(d), asks for a description of the information sought to be discovered and the alternatives evaluated in the process of experimentation for each business component generating a research credit. This is akin to requiring taxpayers to detail the legal basis for each deduction or credit claimed with their tax return. Supplying the level of detail and specificity required with Section F, Question 50(d) imposes a substantial compliance burden and cost on taxpayers, which could ultimately discourage eligible taxpayers from claiming the credit. Further, Section F, Question 50(d) is inconsistent with Section 41 which mandates the IRS to minimize compliance and recordkeeping burdens to claim the research credit. It also makes credit eligibility contingent on unreasonable recordkeeping requirements. Accordingly, the NAM respectfully recommends that the IRS remove question 50(d) from the proposed changes.

The IRS Should Limit the Number of Business Components Reported in Section F

The IRS specifically has asked for feedback on whether Section F should be optional if qualified research expenses are less than a certain dollar amount at a controlled-group level, if the research credit being claimed is less than a certain dollar amount at a controlled-group level, or if the taxpayer is a qualified small business eligible to claim the payroll tax credit.

As previously noted, the proposed changes will create a significant compliance burden for all taxpayers and may discourage some taxpayers from claiming the credit. Therefore, the IRS should limit the number of business components reported in Section F for all taxpayers to the

[14] 44 U.S.C. § 3506(c)(3)(C) (requiring certification that the information to be collected "reduces to the extent practicable and appropriate the burden on persons who shall provide information to or for the agency"); *Cf. Nat'l Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979) ("In determining whether a particular regulation carries out the congressional mandate in a proper manner, we look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose."); *NAM v. Dep't of Treasury*, 10 F.4th 1279, 1281 (Fed. Cir. 2021) (overturning Treasury rule that was "contrary to the clear intent of Congress"); *Boulez v. Commissioner*, 810 F.2d 209, 213-14 (D.C. Cir. 1987) ("The Supreme Court has consistently declared that a Treasury regulation must be complied with unless the taxpayer can demonstrate that it is 'unreasonable and plainly inconsistent with the revenue statutes.'") (quoting Commissioner v. Portland Cement Co., 450 U.S. 156, 169 (1981)); Prescott *v. Commissioner*, 561 F.2d 1287, 1291 (8th Cir. 1977) ("One ground for finding a Treasury regulation invalid is inconsistency with the Internal Revenue Code itself. A regulation which is 'plainly inconsistent' with the governing statute is invalid as an improper exercise of the power delegated to the Secretary by Congress.").

lesser of:

- 75 percent of the total number business components or
- The 10 largest business components determined on a QRE basis.

In other words, the IRS should limit the number of business components described to a sample of business components that make up a representative sample of the overall QREs.

Clarification Needed with Respect to Consistency Rule

Line 47 and Line 48 of proposed Section E, as currently drafted, appear to seek information regarding a taxpayer's compliance with the consistency rule in Section 41(c)(5) and Treas. Reg. 1.41-9(2)(c). However, as currently drafted, line 47 asks about acquisitions and dispositions, while Line 48 asks for any new categories of expenditures included in the current year QREs.

The way the questions are currently drafted, taxpayers may interpret "new categories of expenditures" differently. For example, some taxpayers may interpret the request to encompass three types of potentially eligible expenditure categories: wages paid or incurred to an employee for qualified services, amounts paid or incurred for supplies used in the conduct of qualified research; computer rentals, or amounts paid or incurred to another by the taxpayer to any person (other than an employee of the taxpayer) for qualified research.

As currently written, the language in Line 48 suggests that taxpayers should only indicate whether any of these "new categories of expenditures" are included in the current year QREs. Furthermore, such language invites additional confusion in instances where there is a multi-year project that spans both the base year and the credit year and a new project in the credit year which may not have existed in the base year. If this new project existed, but generated no QREs in the base period, would there be a higher level of risk if the taxpayer checked "yes" to the as currently drafted Line 48? Additionally, as cited above, taxpayers could check "no" if the "categories of expenditures" (i.e., wages, supplies, computer rentals, and contract research) existed in both the base as well as the current year expenditures. Accordingly, the NAM recommends that the IRS clarify whether it is asking about the consistency rule and whether any base adjustments were made in one question.[15]

Clarification Needed with Respect to Request for Business Component Descriptive Name

Section F 50(c) asks for the "business component's descriptive name" which does not align with the tax code or the regulations and more importantly, would likely not match the books and records of the taxpayers that were utilized to determine the qualification of a business component. For many manufacturing companies, their books and records could contain SKUs, unique project codes or even confidential naming conventions to denote specific projects undertaken in a given year. If a taxpayer was required to create a descriptive name for the sake of filling out this form, this could result in undue confusion when the IRS attempts to tie these descriptive names back to the books and records. Accordingly, the NAM respectfully requests that the IRS change the proposed 50(c) to simply "business component name," which would offer taxpayers the ability to reflect how projects are recorded in their own books and records.

[15] 44 U.S.C. § 3506(c)(3)(D) (requiring certification that each collection of information "is written using plain, coherent, and unambiguous terminology and is understandable to those who are to respond").

Other Clarifications

Section F Questions 50(f), 50(e), 50(h) and Questions 58-64

Several of the proposed Section F questions are redundant and thus it is unclear what benefit the IRS would derive from asking taxpayers such information.[16] For example, it is unclear how the IRS would benefit from obtaining whether a business component is new or improved (proposed Question 50(e)) given that both categories would be qualified. Similarly, 50(f) asks about business component type. According to the proposed instructions, the potential answers are "product, process, computer software, technique, formula or invention." Again, all of these categories are qualifying categories, so it appears to add an administrative burden that would provide minimal information that is of worth to the IRS. Separately, Section F 50(h) offers taxpayers 10 options to identify software. The NAM recommends consolidating the available options to (1) IUS, (2) DFS and (3) non-IUS. Finally, Questions 58-64 repeat information previously requested in Sections A & B. There seems to be limited value to including the same information in two different places on the form which could lead to confusion among taxpayers.

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Thank you for the opportunity to comment. If you have questions or would like to discuss these issues further, please contact me and David Eiselsberg, Senior Director of Tax Policy.

Sincerely,

Charles Crain
Vice President, Domestic Policy

[16] 44 U.S.C. § 3506(c)(3)(B) (requiring certification that information collected by a government agency "is not unnecessarily duplicative of information otherwise reasonably accessible to the agency").