



Research and Development Tax Credit

AGREED UPON PROCEDURES REPORT

PURPOSE:

Louisiana Revised Statutes 47:6015, as revised in the 2013 Legislative session, concerns the Louisiana Research and Development Tax Credit Program (“Program”). In order to document actual qualifying research activities were conducted by the Program participants, the statute requires the Program participant that has not filed the federal Research and Development tax credit to submit an analysis and report prepared in accordance with AT sections 101 and 201 by an independent Louisiana Certified Public Accountant (CPA). Such report includes procedures performed and the CPA’s findings. The CPA’s engagement is to comply with the “agreed upon procedures” established by the office of business incentives in the Department of Economic Development (“Department”), and its Secretary. The engagement must also be conducted in accordance with Statements on Standards for Attestation Engagements (“SSAE”) established by the American Institute of Certified Public Accountants (“AICPA”). When the CPA completes their analysis and agreed upon procedures report relating to the Qualified Research Activities, they are to prepare a report in the form of procedures and findings which must be submitted as part of the report to the Department for consideration of tax credit certification.

The required agreed upon procedures relate to engagement acceptance, reporting of the results of the analysis, and the underlying detail analysis of program participant activities. The following are minimum procedures that must be completed by the CPA as part of the required analysis; however, the CPA shall gather evidence to support the subject matter or the written assertion and objectively assess the measurements and communications of the applicant. These agreed upon procedures require CPAs to utilize analytical, critical, and investigative skills and should be concerned with the basis and support for the subject matter and the written assertions and perform whatever additional procedures deemed necessary to ensure fair reporting of Program participant activities within the intent of the statutes. References to AICPA Professional Standards, SSAE Numbers 10 and 11, or Auditing Standard, are presented by “AT” or “AU” section and paragraph numbers, respectively.

AGREED UPON ATTEST PROCEDURES

- A. The CPA shall obtain a written assertion from the program participant describing the company’s activities for each new or improved business component that qualify for research and development credits under the Internal Revenue Code.
- B. The CPA shall report under AT sections 101 and 201 the agreed-upon procedures performed and the findings related to the company’s activities for each new or improved business component that would qualify for research and development credits under the Internal Revenue Code. Additionally, the CPA shall report on any new or improved business component which the program participant claimed was qualifying but which the CPA determined did not meet the requirements under the Internal Revenue Code.
- C. The CPA, CPA firm or an affiliate of the CPA or CPA firm shall not accept the research and development agreed-upon procedures engagement if:
 1. The CPA, CPA firm or affiliate of the CPA or CPA firm performed any other services outside the agreed-upon-procedures related to the underlying application for the same tax year. These activities would include all attest and non-attestation services; including, but not limited to identification and quantification analysis, quantified benefits projection, application preparation, etc; or
 2. The CPA, CPA firm or an affiliate of the CPA or CPA firm has any financial interest in the issuance of credits on a company’s application.

OVERVIEW OF R&D TEST

In order to qualify for the LA R&D tax credit, applicants must meet all four R&D tests necessary to qualify for the credit. The CPA must obtain sufficient documentation to support the program participant’s written assertion of project activities that qualify as R&D under U.S.C 26 – Section 41(b). This four part test must be applied to each project (business component) the applicant is seeking credits.

The following are excluded under IRC SS 41(d)(3)(B) or SS 41 (d)(4). Activities related to any of the following are non-qualified.

- Research relating to style, taste, cosmetic, or seasonal design factors
- Research after commercial production
- Adaptation of an existing product to a particular customer
- Duplication of an existing business component
- Efficiency surveys
- Research related to management functions or techniques
- Market surveys, research and testing (includes advertising and promotions)
- Routine data collection
- Routine testing or inspection for quality control
- Research conducted outside the U.S., Puerto Rico, or any possession of the U.S.
- Research in the social sciences, arts, or humanities
- Funded research
- Internal use software (additional criteria)

TEST I – QUALIFIED PURPOSE –One of Section 41’s four criteria for the tax credit is that the research activities are conducted for a Qualified Purpose. Section 41 defines the Qualified Purpose test in two parts; **both** must be satisfied:

A research activity must be intended useful in the development or improvement of a business component Under Section 41 (d)(2)(B), the term business component refers to any product process, computer software, technique, formula, or invention to be held for sale, lease, or license in the taxpayer’s trade or business or used herein. The written assertion by the program participant must identify the following:

A) Did this project involve the development of a

(Select one) New or Improved

- (Select one) Product
 Process
 Technique
 Formula
 Invention
 Software item

B) Research and Development must relate to a new or improved function, performance, or reliability or quality of a business component (the “function over style” requirement). Excluded are activities relating to style, taste, and cosmetic or seasonal design factors.

The written assertions by the program participant must identify which area(s) was (were) new or improved (select all that apply):

function performance reliability quality

The written assertions by the program participant must include a description of the nature and measurable goals of this project. The documentary narrative would include a description of:

- Why the project was undertaken, identification of the uncertainty eliminated and the quantifiable goal of the research.
- What was created or improved by the project, identify the intended target and explain how it relates to the design hypothesis.
- What were the measures/targets for functional, performance, reliability, and/or quality goals the program participant was trying to meet?

The CPA should determine if the program participant provided substantial documentation to support the company met this test according to the Internal Revenue Code, pertinent IRS regulations, and applicable case law.

TEST II - TECHNOLOGICAL IN NATURE: DID THIS PROJECT RELY ON THE HARD SCIENCES?

Section 41 requires activities to meet three additional criteria for research activities to qualify for the R&D tax credit. Any activity must meet **all** three criteria to qualify. The first of these is the information sought by the activities in question must be Technological in Nature.

Treasury regulations define information as technological in nature if the process of experimentation used to discover such information fundamentally relies on principles of the physical or biological sciences, engineering, or computer science. The program participant must identify and document which science was used.

▪ What was the scientific nature of the project? (Select all that apply)

- Physics Chemistry Metallurgy Biology, Engineering Mechanical Electrical Civil
 Chemical Other _____ Computer Science

The CPA should determine if the program participant provided substantial documentation to support the company met this test according to the Internal Revenue Code, pertinent IRS regulations, and applicable case law.

TEST III – UNCERTAINTY: AT THE OUTSET OF THE PROJECT, WAS THERE UNCERTAINTY RELATED TO METHOD, CAPABILITY AND/OR DESIGN?

The third criteria and the primary requirement for Qualified Research Expenditures under Sec. 41 requires some level of “uncertainty” to exist in capability, method, or design at the outset of the project related to a new or improved business function (i.e., product or process). Uncertainty exists if the information available to a taxpayer at the project outset did not establish the capability or method for developing or improving the product or process, or the appropriate design for the product or process. Lack of sufficient information for any one of the three (design, capability, or method) constitutes “uncertainty”. Activities undertaken in order to gain information intended to eliminate such “uncertainty” qualify as R&D under I.R.C. Sec. 174.

- The written assertion by the program participant must explain how the experimentation related to the capability, methodology or appropriateness of design. Please note that simply stating that it relates to one of these three is not sufficient documentation to support the test.
- The written assertion by the program participant must list all technical uncertainties identified at the beginning of the project. (Be specific and use approximate measures of conditions)
- The written assertion by the program participant must list all technical uncertainties identified during the project. (Be specific and use approximate measures of conditions)
- The written assertion by the program participant must describe how this was unique or different from previous work or projects? The program participant must explain if the company already has similar products, designs, etc. and, if so, describe how this is not an adaptation of an existing business component.

The CPA should determine if the program participant provided substantial documentation to support the company met this test according to the Internal Revenue Code, pertinent IRS regulations, and applicable case law.

TEST IV – PROCESS OF EXPERIMENTATION – WAS THE RESEARCH PROCESS USED DESIGNED TO EVALUATE ONE OR MORE ALTERNATIVES TO ACHIEVE A RESULT WHERE THE CAPABILITY, METHOD OR DESIGN FOR ACHIEVING THAT RESULT IS UNCERTAIN AT THE TIME RESEARCH ACTIVITIES COMMENCE?

The fourth criteria and Section 41’s final requirement for the tax credit is that substantially all of the research activities in question must constitute a Process of Experimentation. Treasury regulations state that a process of experimentation is designed to evaluate one or more alternatives to achieve a result where the capability, method, or design for achieving that result is uncertain at the time research activities commence.

Further the experimentation process must evaluate and must generally be capable of evaluating more than one alternative. The program participant must identify in detail the process of experimentation utilized to eliminate the uncertainty to include the following points:

- What was the hypothesis developed by the applicant for the new or improved business component?
- How was that hypothesis tested in a scientific manner by the applicant?
- What did the analysis of the testing show?
- Explain how the hypothesis was refined or discarded in favor of a new hypothesis.
- For the refined or new hypothesis listed in (d), repeat the above steps.

The CPA should determine if the program participant provided substantial documentation to support the company met this test according to the Internal Revenue Code, pertinent IRS regulations, and applicable case law.

Additional Procedures for the CPA to perform:

- Obtain and describe the type of records the researchers/developers have kept.
- Obtain a list and job description of each employee on the project(s) that have independent technical and/or professional certifications and obtain documentation to substantiate.
- Obtain and describe any documents used as support for the R&D application also required for other regulatory requirements or processes (examples here would include items such as a consumer product safety certification, a FDA approval process, a patent application process, etc.).
- Obtain and describe a list of all Louisiana tax incentive programs participated in by the applicant and verify that the same expenditure has not been claimed in another LED administered program.