

### District Court Clarifies Calculation of Gross Receipts for Research Credit

On June 25, 2010, the United States District Court for the Southern District of Ohio granted partial summary judgment in favor of the taxpayer, holding that for purposes of the research credit calculation, the computation of gross receipts does not include receipts from intercompany transactions with foreign affiliates. See *Procter & Gamble Co. and Subsidiaries v. United States*, No. 1:08-cv-00608-TSB (S.D. Ohio June 25, 2010).

#### Background

Internal Revenue Code section 41(f) requires members of a controlled group to be treated as a single taxpayer for purposes of calculating the research credit. Taxpayers eligible for the research credit who are part of a controlled group aggregate all controlled group members' gross receipts but disregard those received through intercompany transactions with foreign affiliates for purposes of the credit computation. Chief Counsel Advice 200233011 supported this method of computation. This is the position that Baker Tilly has taken in its research credit studies.

The IRS later issued Chief Counsel Advice 200620023, which reversed Chief Counsel Advice 200233011 and required inclusion of gross receipts received through intercompany transactions with foreign affiliates. Many tax practitioners questioned the logic behind the approach; inclusion of gross receipts by any affiliate carries the potential for duplication. The United States District Court for the Southern District of Ohio was the first court presented with this issue.

#### Court holding

The court made clear that the computation of gross receipts for purposes of the research credit excludes intercompany transactions from foreign affiliates. Baker Tilly's position has been confirmed by the court's decision.

The determination as to the eligibility of internal and external patent expenses that may be defined as qualified research expenditures (QREs) remains at issue. Whether expenses incurred in pursuing patents for discoveries made during qualified research activities qualify as research expenditures under Internal Revenue Code section 41 has yet to be decided by the court.

If you have questions or require further information, please contact your Baker Tilly tax advisor or send an e-mail to [tax@bakertilly.com](mailto:tax@bakertilly.com).