Office of Chief Counsel
Internal Revenue Service

memorandum

CC:WR:NCA:SF:TL-N-4519-00
AJKim

BY REGULAR MAIL

date: SEP 22 2000

to: Examination Division
Northern California District
Internal Revenue Service
185 Lennon Lane, Suite 200
Walnut Creek, CA 94598
Attn: Luis R. Martinez, Team Coordinator

from: District Counsel, Northern California, San Francisco

subject: [redacted]
Form 906 - Closing Agreement on Final Determination Covering Specific Matters

U.I.L. #: 41.00-00
6405.01-00
7121.00-00

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

This advice relies on facts provided by you to our office. If you find that any facts are incorrect, please advise us immediately so that we may modify and correct this advice. This advice is subject to 10-day post review by the National Office. CCDM 35.3.19.4. Accordingly, we request that you do not act on this advice until we have advised you of the National Office's comments, if any, concerning this advice.

This memorandum is in response to your request for our assistance in drafting a closing agreement (Form 906) so that the Internal Revenue Service and the taxpayer may conclusively resolve the dispute relating to the allowable amounts of I.R.C. §41 research credits with respect to the [redacted]'s taxable years [redacted], [redacted], [redacted], [redacted], [redacted] and [redacted].

FACTS

The Examination Division ("IRS Exam") conducted audits of [redacted] years relating to the taxpayer's consolidated returns filed for the period [redacted] through [redacted]: cycle one ([redacted] and [redacted]) and cycle two ([redacted] and [redacted]). The [redacted] (hereafter "taxpayer") claimed $[redacted] of alternative incremental research credit in its return filed for tax period [redacted]. However, the taxpayer did not claim any other amount of section 41 research credit in its tax returns filed for the period [redacted] through [redacted]. IRS Exam completed it audit of cycle one. It is continuing its audit of cycle two and plans to begin the audit of the taxpayer's [redacted], [redacted] and [redacted] tax years in or about [redacted].

During Exam's audit of the second cycle, the taxpayer filed timely claims for refund for the tax periods [redacted], [redacted] and [redacted] arguing that it qualified for research credit in these years. The taxpayer's refund claims for tax periods [redacted], [redacted] and [redacted] do not involve research claims under I.R.C. §41 for internal use computer software. See N(35)000-161. During discussions between the taxpayer and IRS Exam regarding the refund claims filed for years [redacted], [redacted] and [redacted], the parties addressed the proper amount of research credit available to the taxpayer in the taxable years [redacted], [redacted] and [redacted]. From its refunds claims and discussions with IRS Exam, the taxpayer argued that it qualified for research credits in the following amounts:

Year	Research Credit Claimed
[redacted]	$[redacted]
[redacted]	$[redacted]
[redacted]	$[redacted]

Year	Research Credit Claimed
[redacted]	$ [redacted]
[redacted]	$ [redacted]
[redacted]	$ [redacted]

Based on its review of the taxpayer's refund claims, IRS Exam determined that the taxpayer qualified for section 41 research credits in the taxable years [redacted], [redacted] and [redacted] in the following amounts:

Year	Research Credit Claimed	Research Credit Allowed
[redacted]	$ [redacted]	$ [redacted]
[redacted]	$ [redacted]	$ [redacted]
[redacted]	$ [redacted]	$ [redacted]

Additionally, IRS Exam reviewed sample binders supplied by the taxpayer relating to research expenditures made in taxable years [redacted], [redacted] and [redacted]. As a result, IRS Exam tentatively agreed that the taxpayer qualified for section 41 research credits in the following amounts:

Year	Research Credit Claimed	Research Credit Allowed
[redacted]	$ [redacted]	$ [redacted]
[redacted]	$ [redacted]	$ [redacted]
[redacted]	$ [redacted]	$ [redacted]

ANALYSIS

Based on our review of the facts involved in this matter, we have prepared a closing agreement for your review which proposes to conclusively resolve the amount of section 41 credit available to the taxpayer for years [redacted] through [redacted] inclusive. See

enclosure.[1] We have, however, excluded taxable years [redacted] through [redacted] from the terms of the closing agreement. The basis for our recommendation with respect to tax years [redacted] - [redacted] and [redacted] - [redacted] is set forth, below.

I. Years [redacted] - [redacted]

Pursuant to I.R.C. § 6405(a), IRS Exam's determination relating to the [redacted]'s refund claims for tax years [redacted] - [redacted] must be reviewed by the Joint Committee on Taxation (hereafter referred to as "Joint Committee"). Section 6405(a) provides, in part, that:

> No refund or credit of income, war profits, excess profits, estate, or gift tax, or any tax imposed with respect to public charities, private foundations, ... in excess of $1,000,000 shall be made until after the expiration of 30 days from the date upon which a report giving the name of the person or credit is to be made, the amount of such refund or credit, and a summary of the facts and the decision of the Secretary, is submitted to the Joint Committee on Taxation.

Internal Revenue Manual 4.3.5.1.4.4 (Computing Jurisdictional Amount in Multi-Year Exam with Deficiency) provides that in a multiple-year case an aggregate overpayment in excess of $1,000,000 for any of the refund types (I.R.C. § 6405(a), (b), and (c)) requires a report to the Joint Committee. In this matter, the closing agreement would allow research credits for the taxable years [redacted], [redacted] and [redacted] in the aggregate amount $[redacted]. Accordingly, this closing agreement falls within the jurisdiction of the Joint Committee and **may not be signed on behalf of the Service** until a summary of the facts and the decision of IRS Exam with respect to the taxpayer's refund claims are submitted to the Joint Committee for review and the District Office is notified that the Joint Committee has no objection to the determination. IRM 4.3.11.

Since the substantive provisions set forth in the closing agreement must be reviewed by the Joint Committee, we recommend that IRS Exam present the taxpayer with a copy of the closing agreement in the form of a "draft" only. Further, IRS Exam should advise the taxpayer that the Service's determination with respect to the allowable research credits in taxable years [redacted],

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[1]Please note that the enclosed closing agreement recommends that IRS Exam prepare and include as Exhibit A a list of the [redacted]'s subsidiaries during years [redacted] through [redacted].

[redacted] and [redacted] is subject to Joint Committee review, and therefore, the parties cannot proceed to execute the Form 906 until the Northern California District is notified that the Joint Committee has no objection to the Service's determination as set forth in the closing agreement.

II. Years [redacted] - [redacted]

Based on our analysis, it is our opinion that the closing agreement with the taxpayer relating to research credits should not include taxable years [redacted] through [redacted], as proposed by IRS Exam. Treas. Reg. § 301.7121-1(a) provides:

> A closing agreement may be entered into in any case in which there appears to be an advantage in having the case permanently and conclusively closed, or if good and sufficient reasons are shown by the taxpayer for desiring a closing agreement and it is determined by the Commissioner that the United States will sustain no disadvantage through the consummation of such an agreement.

Rev. Proc. 68-16, section 3.01, states that subject to the guidelines provided by the regulations, "whether or not an agreement will be entered into is a matter within the Commissioner's discretion..." Rev. Proc. 68-16 further provides that:

> In practice if the taxpayer shows good reasons for requesting the agreement and furnishes necessary facts and documentation, and the Government will suffer no disadvantage therefrom, a closing agreement will ordinarily be entered into provided the content of the agreement can be satisfactorily agreed upon.

In this case, IRS Exam has informed us that the taxpayer has provided the Service with only sample binders of documents supporting its research and development projects conducted during the years [redacted] through [redacted].[2] Moreover, the taxpayer has not filed refund claims with supporting documentation with respect to the taxable years [redacted] through [redacted]. Accordingly, it remains unclear whether the taxpayer has "furnishe[d] necessary facts and documentation" on the research credit issue for the Service to enter into a closing agreement at this time. Rev. Proc. 68-16, section 3.01.

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[2]On August 28, 2000, we requested that IRS Exam provide our office with a copy of the supporting documents submitted by the taxpayer with respect to its qualified research expenditures for taxable years [redacted], [redacted] and [redacted]. To date, we have not received responsive documents.

Based on our understanding that the taxpayer has failed to provide sufficient documentation, it is our opinion that the tax years [redacted] through [redacted] should be excluded from the closing agreement especially since the Examination team will begin conducting a full audit of these years in or about [redacted]. Therefore, we believe that the most prudent course of action with respect to addressing the research credit issue relating to taxable years [redacted], [redacted] and [redacted] would be to include this issue in the audit plan for the taxpayer's upcoming cycle.

For your convenience, we are enclosing a computer disk which contains a copy of the closing agreement which we have prepared for your use in this matter. Should you have any questions, please contact attorney Anthony J. Kim at (415) 744-9217 ext. 144.

BARBARA M. LEONARD
Acting District Counsel

/s/ THOMAS G. SCHLEIER

By: _____
THOMAS G. SCHLEIER
Assistant District Counsel

Enclosures: As stated

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