

Tax Alert

November 23, 2009

Favorable R&D Case Opens Opportunities On Supply Costs

Tax Court ruling in *TG Missouri Corp. v. Commissioner*, 133 T.C. No. 13 (Nov. 12, 2009) is highly favorable for taxpayers looking to claim the R&D tax credit.

The Tax Court has issued a new ruling, *TG Missouri Corp. v. Commissioner*, 133 T.C. No. 13 (Nov. 12, 2009), that is highly favorable for taxpayers looking to claim the R&D tax credit. In a case of first impression, the Tax Court ruled that molds used for production, if not depreciable by the taxpayer, may be eligible for the credit. The IRS had previously disallowed the cost of such supplies for the R&D credit.

TG Missouri made automotive parts on a contract manufacturing basis. For each part that it manufactured, TG Missouri made a mold. Often, the company contracted with outside manufacturers to produce an initial mold. TG Missouri then altered these molds to suit its needs. In many instances, once the mold was finished, TG Missouri's customers would take title to the mold while TG Missouri retained possession of the mold in order to produce the relevant part.

Under § 41(b)(2)(C), the cost of property that is of a character subject to depreciation cannot be claimed as a qualified research expense. The IRS has long contended that depreciable property is not allocable to the R&D tax credit, regardless of who owns the depreciable property. The taxpayer in this case contended that § 41(b)(2)(C) applies only if the property is depreciable in the hands of the taxpayer claiming the credit.

The Court sided with taxpayers in ruling that TG Missouri could claim the cost of molds owned by its customers for the research credit because the property was not depreciable in TG Missouri's hands. In doing so, the Court effectively overruled previous IRS guidance on the interpretation of the phrase "property of a character subject to depreciation."

The *TG Missouri* case is big news for contract manufacturers, tool and die shops, and anyone else that uses property depreciable in the hands of another taxpayer in their R&D activities. Furthermore, the case disputes the IRS' notion that supplies must be consumed or destroyed in order to qualify for the credit. The molds at issue were sold to customers and used in TG Missouri's production operations. Thus, the Tax Court's ruling with respect to supplies should cause many taxpayers to reevaluate the costs that they have claimed for the R&D credit.

According to Dean Zerbe, alliantgroup National Director in Washington, D.C., "I expect that taxpayers may be eligible for an even bigger credit thanks to this new ruling. This decision may have a wide-ranging impact on all industries in determining supply costs that are eligible for the R&D tax credit. Continuing a trend of taxpayer-friendly R&D cases that have been issued this year, *TG Missouri* represents another step forward for taxpayers seeking to claim the research credit under § 41."

For more information on this important case and what it will mean to taxpayers claiming the R&D tax credit, please contact Jeremy Fingeret at 800.564.4540, or email info@alliantgroup.com.