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Appendix A

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 22-30764

UNITED STATES OF AMERICA,
Plaintiff-Appellee,
v.
LEONARD L. GRIGSBY; BARBARA F. GRIGSBY,
Defendants-Appellants.

Appeal from the United States District Court
for the Middle District of Louisiana
USDC No. 3:19-CV-596

Before Higginbotham, Smith, and Elrod, *Circuit Judges*.

PATRICK E. HIGGINBOTHAM, *Circuit Judge:*

Today, we visit the classic congressional practice of using its taxing powers to achieve permissible policy goals; here, the lure of a tax credit to incentivize creative research. Leonard L. Grigsby and Barbara F. Grigsby appeal the judgment of the United States District Court for the Middle District of Louisiana which rejected research and development tax credits

claimed by Cajun Industries LLC and upheld the resulting tax deficiency.

We AFFIRM.

I.

Cajun Industries LLC ("Cajun") claimed tax credits for the 2013 tax year pursuant to § 41 of the Internal Revenue Code, 26 U.S.C. § 41. First, the Code provision at issue in this case, § 41 offers a tax credit for "qualified research expenses" including wages and expenditures incurred in pursuit of qualified research.[1]

The Internal Revenue Code provides a tax credit for qualified research activities, as defined by the Code.[2] To constitute "qualified research," the research must satisfy the four tests laid out in § 41(d)(1): "(1) the expense must be of the type deductible under § 174 of the Code (i.e., R & D expenses that are reasonable under the circumstances), (2) the research must be undertaken for the purposes of discovering information that is 'technological in nature,' (3) the information must be 'intended to be useful in the development of a new or improved business component of the taxpayer,' and (4) 'substantially all of the activities [must] constitute elements of a process of experimentation.'"[3] Relevant here,

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[1] 26 U.S.C. § 41(b).

[2] *See generally, Id.*

[3] *Shami v. Comm'r*, 741 F.3d 560, 563 (5th Cir. 2014) (*citing* 26 U.S.C. § 41(d)(1)). The full text of 26 U.S.C. § 41(d)(1) reads:

"business components" are defined as "any product, process, computer software, technique, formula, or invention which is to be (i) held for sale, lease, or license, or (ii) used by the taxpayer in a trade or business of the taxpayer."[4]

However, qualified research expressly excludes so-called "funded" research.[5] Funded research include "any research to the extent funded by any grant, contract, or otherwise by another person (or

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(d) Qualified research defined.--For purposes of this section—

(1) In general.--The term "qualified research" means research—

(A) with respect to which expenditures may be treated as specified research or experimental expenditures under section 174,

(B) which is undertaken for the purpose of discovering information—

(i) which is technological in nature, and

(ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and

(C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph (3).

Such term does not include any activity described in paragraph (4).

26 U.S.C. § 41(d)(1).

[4] *Id.* § 41(d)(2)(B).

[5] *Id.* § 41(d)(4)(H) ("(4) Activities for which credit not allowed. -- The term 'qualified research' shall not include any of the following . . . (H) Funded research.--Any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).").

governmental entity)."[6] Treasury Regulations further explain that research is funded if, in any agreement to perform research (1) the researcher retains no substantial rights to their research; or (2) payment is not contingent upon the research's success.[7]

A. Claimed Credits

Cajun provides construction services throughout the Gulf Coast Region and engaged in over one hundred construction projects during the time period in question. In 2015, Cajun hired a consulting firm to evaluate its projects and advise whether Cajun was eligible for research credits under § 41. Based on the firm's report, Cajun, believing it was entitled to a $1,341,420 research credit, filed an amended Form 1120S for the 2013 tax year claiming the $1,341,420 credit.

As an S-Corporation, Cajun's income, losses, deductions, and credits pass through to its shareholders for income tax purposes. At all relevant times, Appellant Leonard Grigsby owned a 73% interest in Cajun and was thus entitled to a pro rata allocation of Cajun's tax credit, which amounted to $979,237. The $979,237 credit reduced Mr. and Mrs. Grigsby's tax liability for 2013 and indicated the couple overpaid their federal income taxes by $576,756. Appellants filed an amended 2013 tax return and sought a refund of $576,756 plus statutory overpayment interest in the amount of $73,633.38

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[6] *Id.*

[7] 26 C.F.R. § 1.41-4A(d).

(the "Contested Refund"). On September 15, 2017, the Internal Revenue Service ("IRS") issued Appellants a refund of $671,071.38, comprised of the Contested Refund and an additional $20,652 not at issue in this case.[8]

However, on August 13, 2019, the IRS notified Appellants that the Contested Refund was issued erroneously and challenged Cajun's claimed credit. The Commissioner demanded Appellants repay the amount and warned that if Appellants did not do so, the IRS would recommend "an action be commenced in District Court to recover the erroneous refund, as permitted by I.R.C. § 6532(b) and 7405." Shortly thereafter, the United States initiated this suit.

B. The Representative Projects

Before the District Court, the Parties agreed that four projects adequately represented Cajun's research activities: (1) Project 13-020 (the "Methanex Project"); (2) Project 12-051 (the "Chevron Project"); (3) Project 12-001 (the "Claiborne Project"); and (4) Project 12-023 (the "East Bank Project") (together, the "Representative Projects"). Thus, Cajun's eligibility for the tax credit, and Appellants' by extension, hinged on whether it performed qualified research while completing these projects.

1. The Methanex Project

[8] Of the $671,071, $576,756 was "solely due" to Cajun's tax credit and $73,663.38 stemmed from the statutory overpayment interest.

In 2012, Jacobs Field Services North America, Inc. ("Jacobs") hired Cajun as a subcontractor on a project to relocate a Methanex USA, LLC methanol plant from Chile to Louisiana. Cajun was originally tasked with creating temporary facilities at the new site. According to the Scope of Work provisions of the contract, Cajun's responsibilities included:

> 3.0 GENERAL SCOPE OF SERVICES (WORK)
>
> 3.1 [Cajun] shall complete the Work and support functions required to effectively manage and report on the status of the Work as specified.
>
> 3.2 [Cajun] shall provide all management, supervision, labor, consumable materials, construction equipment, construction aids, tools, services, testing devices, warehousing, supplies, inspections, insurance, fully furnished and equipped offices, communication devices, and all other necessary items to successfully accomplish the construction described by the Scope of Work. This includes, but is not limited to, on and off site transportation, receiving, loading and unloading, storing, maintenance, and distribution of construction materials, installation of such materials into the Work, proper care of materials, testing and final construction punch list completion and turnover of the Work Scope as specified.[9]

[9] "Work" was defined as the "work, services, deliverables, duties and activities to be performed or provided by, or on behalf of, [Cajun] under this Subcontract."

In executing these tasks, Cajun was "solely responsible for and have [sic] control over construction means, methods, techniques, sequences and procedures and for coordinating all portions of the Work." This included obtaining approval for materials, identifying and coordinating vendors, offering design input, and participating in "a lot of review processes." However, Jacobs retained "ultimate authority to resolve issues in the field."

The contract was subject to a capped price of $6,485,000 and payment was conditioned on Cajun's completion of "all Work."[10] Cajun accepted payment "as full compensation for doing all Work and furnishing all material contemplated by and embraced in this Subcontract," "for all loss or damage arising out of the nature of the Work," "from any unforeseen or unknown difficulties or obstructions which may arise or be encountered in the prosecution of the Work," and "for all risks of every description connected with the Work."

Section 26 of the contract addressed ownership of any work product and provided that all "Work Product prepared by [Cajun] shall be 'works made for hire,' and all rights, title and interest to the Work

[10] This price included "billed actual manhours and actual cost of other cost reimbursable items in accordance with the agreed labor wage rates, construction equipment rates, mobilization and demobilization rates as included in this Exhibit D." Cajun was also entitled to additional compensation if Jacobs modified its scope of work. By the end of the project, the contract price rose from $6 million to approximately $90 million because of 65 work scope modifications.

Product . . . shall be owned by [Methanex]." To the extent any "work product" was not considered work for hire, "or if ownership of all right, title and interest in the Work Product shall not otherwise vest in [Methanex]," Cajun agreed that ownership of said "Work Product . . . shall be automatically assigned from [Cajun] to [Methanex] without further consideration, and [Methanex] shall thereafter own all right, title and interest in the Work Product."[11]

The contract defined "work product" as "all documents, data, analyses, reports, plans, procedures, manuals, drawings, specifications, calculations, or other technical tangible manifestations of [Cajun]'s efforts (whether written or electronic) created by [Cajun] in the performance of the Work, including but not limited to all Documents." In turn, "documents" included "any or all tracings, designs, drawings, field notes . . . specifications, electronic information . . . and other documents or records developed or acquired by [Cajun] and its suppliers or sub-subcontractors in performing the Work."

2. The Chevron Project

In 2011, Chevron Products Company, a division of Chevron U.S.A., Inc., contracted with Cajun to provide construction services to expand Chevron's Pascagoula Refinery (the "Chevron Project"). Cajun's responsibilities included providing "all labor, supervision, quality control, administration,

[11] The contract defined Methanex as the "Owner."

document control, equipment, [and] tools," in addition to completing specific civil tasks such as surveying, excavation and backfill, installing piping, and performing field inspections. Appellants maintain that Cajun also offered "constructability reviews" of the engineer's designs and specifications. However, the engineer of record, who was not a Cajun employee, retained "ultimate authority to resolve any issues that arose in the field."

The Chevron contract was a fixed-price contract and compensated Cajun for all work described in Exhibit B of the contract, the "Schedule of Compensation for Work." Exhibit B detailed all costs covered by the contract price, including craft labor, non-manual, and equipment costs in addition to all overhead and profit. Furthermore, according to the "Pricing" section of the contract, Chevron paid for "performance of all Work" and the contract prices were "all inclusive" of Cajun's "supply and services including without limitation; salaries and wages . . . the cost of supervision and support services from personnel other than those permanently assigned to the Contract . . . employee income tax and statutory payroll deductions, social security charges, [and] all taxes (except sales and use taxes) . . . ." Cajun agreed that payment "constituted full payment for the performance of the Work, and completion of [Chevron]'s payment obligations under the Contract."

The contract designated Chevron as the owner of all work product generated during the project and provided:

> 2.20.3. All drawings, documents, engineering and other data prepared or furnished by [Cajun] in performing the Work are considered to be [Chevron's] work for hire and shall become [Chevron's] property from the time of preparation and may be used by [Chevron] for any purpose whatsoever without obligation or liability whatsoever to [Cajun]. [Cajun] assigns all rights in the above referenced drawings, documents, engineering and other data to [Chevron], including copyrights.
>
> [. . .]
>
> 18.4. All inventions, discoveries and improvements (patentable and unpatentable) that are made or conceived by [Cajun] or [Cajun]'s employees in performing the Services and all domestic and foreign patent rights based thereon shall belong to [Chevron] or an Affiliate designa1ed by [Chevron]. [Cajun] shall promptly and fully disclose all such inventions, discoveries and improvements to [Chevron] or the designated Affiliate.

Furthermore, Cajun agreed that all "Technical Information will be used only for performance of the Services for [Chevron]" and that it would not disclose this information without Chevron's express written consent.[12] This obligation remained in force even after the Chevron Project concluded.

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[12] Section 1.1.31 of the contract defined "technical information" as:

3. The Claiborne Project

In September 2011, Cajun contracted with the U.S. Army Corps of Engineers to construct a "box culvert," or an underground canal, as part of the Southeast Louisiana Urban Flood Control Project (the "Claiborne Project"). In doing so, Cajun was responsible for selecting the means and methods of construction, including equipment selection, personnel decisions, and "how to produce the work in accordance with the plans and specifications." The Claiborne contract was a "fixed price" contract valued at $25,971,694.50.

The contract incorporates various provisions of the Federal Acquisition Regulations ("FAR"), Title 48 of the Code of Federal Regulations, either "by reference" or by "full text." Relevant here, the contract incorporates FAR 52.232. FAR § 52.232-5(f) dictates the ownership rights of any material generated throughout the contract's performance and states "all material and work covered by progress payments made shall, at the time of payment, become the sole property of the Government."[13] "Work" includes

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> [A]ny and all information, data and knowledge which is either made available to [Cajun] by [Chevron] relating to the performance of the Work, or developed by [Cajun] as a consequence or arising out of this Contract. Technical Information includes all inventions, discoveries or improvements (patentable or otherwise) that are made or conceived with by [Cajun] in performing the Work and all patent rights associated these inventions, discoveries or improvements.

[13] FAR § 52.232-5(f), codified as 48 C.F.R. § 52.232-5(f).

"construction activity . . . [including] buildings, structures, and improvements of all types."[14]

4. The East Bank Project

In January 2012, the Sewerage and Water Board of New Orleans ("SWBNO") awarded Cajun a construction contract to modify the flood protection system at the East Bank Wastewater Treatment Plant in New Orleans. Cajun's scope of work included providing "all labor, materials, supervision, construction equipment, [and] mechanical and electrical equipment."[15]

The East Bank contract was a "firm, fixed-price contract" originally valued just under $24.4 million, although the contract eventually totaled $29.4 million due to changes in the scope of work. Cajun's compensation included payment for "all general

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[14] Section 00700 of the contract "incorporate[s] by reference" FAR 52.202-1, which provides that "when a solicitation provision or contract clause uses a word or term that is defined in the Federal Acquisition Regulation (FAR), the word or term has the same meaning as the definition in FAR 2.101 in effect at the time the solicitation was issued . . . ." *See* FAR 52.202-1, codified as 48 C.F.R. § 2.101. Thus, the reference to 48 C.F.R. § 52.202-1 effectively incorporates all definitions provided in FAR 2.101. Section 2.101 defines "work" as noted.

[15] Unlike the Methanex, Chevron, and Claiborne projects, Cajun was not solely responsible for the means and methods of executing these tasks. SWBNO hired an engineering firm, Burk-Kleinpeter, Inc. ("BKI") to design the system modification(s). BKI oversaw Cajun's daily construction activities and was required to approve Cajun's means and methods and any materials Cajun selected for permanent features of the project.

foremen, foremen, labor, teams and trucks actually engaged on such specific work for the time actually so employed at the rates actually paid." Compensation also included a "fee for [Cajun's] superintendence, general expense and profit," which "shall be understood also to reimburse [Cajun] for any sub-contractor's general expense and profit which [Cajun] may allow to one or more sub-contractors."

Cajun accepted payment as "full compensation for furnishing all the labor, materials, tools, equipment, etc., needed to complete the whole work of the contract" and also "as full compensation for all loss, damages or risks of every description, connected with or resulting from the nature of the work, or from any obstructions or difficulties encountered, of any sort or nature whatsoever[.]"

The East Bank contract contained no provisions relating to ownership of work product or research developed during the project.

C. District Court Proceedings

Throughout discovery, Appellants claimed Cajun engaged in research which led to the development of four new "products:" two oil refineries and two flood control systems. When the United States moved for summary judgment, the Government argued these products failed the "business component[s]" test and, as such, that Cajun did not perform qualified research. Furthermore, the Government claimed the Representative Projects were otherwise ineligible for the credit because they were "funded."

Appellants responded that Cajun had also developed "processes" that amounted to business components, in addition to the "products" identified during discovery. Appellants claimed their new "processes" encompassed the various "construction means and methods" Cajun used to perform on its contracts and develop these products. Appellants also disputed that the Representative Projects were funded, and maintained that Cajun retained substantial rights to its "research results." Alternatively, Appellants contended that the contracts were contingent upon Cajun's provision of deliverables and were not funded, as set out in 26 C.F.R. § 1.41- 4A(d).

The District Court granted the United States's motion for summary judgment on three bases. First, the District Court rejected Appellants' "processes" argument pursuant to Federal Rule of Civil Procedure 37(c)(1) because this argument was inconsistent with Cajun's prior discovery disclosures which, instead, "unequivocally state that, as to each Representative Project, Cajun developed a 'product.'"[16] The District Court further found that Appellants' construction processes claim failed for lack of specificity because Appellants "fail[ed] to specifically identify even one

[16] "If a party fails to provide information or identify a witness as required by Rule 26(a) or (e), the party is not allowed to use that information or witness to supply evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless." FED. R. CIV. P. 37(c)(1).

new or improved process that resulted from Cajun's work on the Representative Projects."

Second, the District Court found that Appellants' briefing "fail[ed] to cite any evidence or offer any argument establishing that Cajun's work on the Representative Projects resulted in new 'products.'" Because the excluded evidence of any construction processes was the "only evidence (and argument) offered to establish the business component element of their QRTC claim," the court concluded the Representative Projects failed to establish a business component.

Third, as an alternative basis for its holding, the District Court held that the Representative Projects were "funded." In particular, the District Court determined that the Methanex, Chevron, and Claiborne Projects failed the substantial rights prong of the "funded research exclusion," and that the East Bank contract was funded because Cajun was fully compensated for any research performed or risk incurred.

Appellants timely appealed. This Court has jurisdiction under 28 U.S.C. § 1291.

II.

We review a district court's grant of summary judgment de novo, applying the same standard as the district court.[17] Grants of summary judgment may be affirmed for any reason raised to the district court and

[17] *Roberts v. City of Shreveport*, 397 F.3d 287, 291 (5th Cir. 2005).

supported by the record, and we are not bound by the grounds articulated by the district court.[18] Decisions to exclude evidence under Federal Rule of Civil Procedure 37 are reviewed for abuse of discretion.[19]

III.

Appellants advance three arguments on appeal. None are persuasive.

A. Burden on Summary Judgment

The District Court granted summary judgment after finding Appellants did not "offer competent evidence or argument establishing that Cajun performed qualified research," namely on the business components element. Appellants argue that this improperly placed the burden on Appellants as the non-moving party at summary judgment.

It is well established that the IRS's assessment of tax liability may be presumed correct so long as it is not "without rational foundation and excessive."[20]

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[18] *Chevron U.S.A., Inc. v. Traillour Oil Co.,* 987 F.2d 1138, 1146 (5th Cir. 1993).

[19] *CQ, Inc. v. TXU Min. Co., L.P.,* 565 F.3d 268, 277 (5th Cir. 2009).

[20] *United States v. Janis*, 428 U.S. 433, 441 (1976); *Portillo v. Comm'r*, 932 F.2d 1128, 1133 (5th Cir. 1991) ("[W]e begin with the well settled principle that the government's deficiency assessment is generally afforded a presumption of correctness . . . The tax collector's presumption of correctness has a herculean muscularity of Goliathlike reach, but we strike an Achilles' heel when we find no muscles, no tendons, no ligaments of fact.") (internal citations omitted); *Sealy Power, Ltd. v. Comm'r*, 46 F.3d 382, 386 (5th Cir. 1995) ("A determination of deficiency

The Government satisfies this burden by "specify[ing] the amount of the deficiency or provid[ing] the information necessary to compute the deficiency."[21] Once an assessment is presumed correct, the burden shifts to the taxpayer to rebut the presumption.[22]

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issued by the Commissioner is generally given a presumption of correctness, which operates to place on the taxpayer the burden of producing evidence showing that the Commissioner's determination is incorrect.").

[21] *Sealy*, 46 F.3d at 386. At oral argument, Appellants' counsel argued that the IRS assessment was insufficient because it did not result from an administrative proceeding. However, Appellants provided no citations for this proposition and the Court has found none in support of this position. To the contrary, this Court in *Portillo* recognized that "there is no prescribed form for a deficiency notice," *Portillo*, 932 F.2d at 1132 (*citing Donley v. Comm'r*, 791 F.2d 383 (5th Cir. 1986)), and such notice must merely evince "a thoughtful and considered determination that the United States is entitled to an amount not yet paid," *Id.* (*quoting Scar v. Comm'r*, 814 F.2d 1363, 1369 (9th Cir. 1987)).

[22] *Portillo*, 932 F.2d at 1133 ("This presumption is a procedural device that places the burden of producing evidence to rebut the presumption on the taxpayer."). The presumption is consistent with the general principle that taxpayers must demonstrate their entitlement to any refund, deduction, or credit as well as the taxpayer's record-keeping obligations imposed by the Revenue Code. *See Id.* at 1134 ("The taxpayer clearly bears the burden of proof in substantiating claimed deductions."); *United States v. McFerrin*, 570 F.3d 672, 675 (5th Cir. 2009) ("Tax credits are a matter of legislative grace, are only allowed as clearly provided for by statute, and are narrowly construed."); 26 U.S.C. § 6001 ("Every person liable for any tax imposed by this title, or for the collection thereof, *shall keep such records*, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.") (emphasis added); 26 C.F.R. § 1.6001-1(a) ("Except [for farmers and wage-earners], any person subject to tax under

Importantly, the taxpayer bears this burden regardless of whether the case is a refund suit initiated by the taxpayer or a collection suit brought by the Government.[23] Thus, ultimately, "[t]he burden and the presumption, which are for the most part but the opposite sides of a single coin, combine to require the taxpayer always to prove by a preponderance of the evidence that the Commissioner's determination was erroneous."[24]

The IRS assessment in this case was entitled to the presumption of correctness. This burden is a low one; the assessment must merely "advise the taxpayer that the [IRS] has determined that a deficiency exists for a particular year," and "specify the amount of the deficiency or provide the information necessary to compute the deficiency."[25] The IRS's August 13, 2019, letter to Appellants (the

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subtitle A of the Code . . . or any person required to file a return of information with respect to income, shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of *gross income, deductions, credits*, or other matters required to be shown by such person in any return of such tax or information.") (emphasis added); 26 C.F.R. § 1.41-4(d)("Recordkeeping for the research credit. A taxpayer claiming a credit under section 41 must retain records in sufficiently usable form and detail to substantiate that the expenditures claimed are eligible for the credit.").

[23] *Carson v. United States*, 560 F.2d 693, 696 (5th Cir. 1977) ("This burden applies whether the proceeding is in Tax Court for redetermination of a deficiency or in district court upon a refund claim or a government counterclaim.").

[24] *Id.* at 695–96.

[25] *Portillo*, 932 F.2d at 1132 (5th Cir. 1991) (internal citation omitted); *see also Sealy*, 46 F.3d at 386 (same).

"Letter") met these requirements.[26] Thus, the burden shifted to Appellants to refute the IRS's determination. Therefore, the District Court properly required Appellants to introduce evidence on this point to establish a genuine dispute meriting trial.

Moreover, even if the IRS's assessment was not entitled to the presumption of correctness, the Government still met its burden of production at summary judgment. As the moving party, the Government needed to show that there was no genuine dispute as to any material fact and that it was entitled to judgment as a matter of law.[27] The Government could do so by submitting evidence negating the existence of some material element of Appellants' claim or defense; alternatively, because taxpayers must demonstrate their entitlement to credits, the Government could have pointed out that the evidence in the record was insufficient to support

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[26] The Letter recounted that Appellants requested a tax credit of $576,756 for the 2013 tax year and received a total refund of $671,071.38, which was comprised of Appellants' $576,756 claimed research credit plus $73,663.38 in statutory interest and an additional, undisputed, refund of $20,652. It further explained that the $576,756 refund was "solely due to information" reported on Appellants' amended return which, in turn, was based on Cajun's Amended Form 1120S. Because the IRS "determined that Cajun Industries, LLC & Subsidiaries is not entitled to the Research Credit claimed," the Letter concluded that the "refund resulting from the Research Credit should not have been allowed and the refund paid to [Appellants] was erroneous."

[27] FED. R. CIV. P. 56(a).

Appellants' claim that they performed qualified research.[28]

The Government did so by providing approximately forty exhibits— including excerpts from the Representative Projects' contracts, Appellants' 2013 amended tax return, and corporate representative depositions from parties to the Methanex, Chevron, Claiborne, and the East Bank Projects— that refuted Appellants' entitlement to the credit. At that point, the District Court was correct in offering Appellants the opportunity to rebut this evidence and thus create a genuine issue of fact. The District Court did not err on this basis.

B. Business Components Determination

Research must satisfy the so-called "business components" test in order to qualify for the tax credit.[29] The business components test requires that research be "undertaken for the purpose of discovering information (i) which is technological in nature, and (ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer."[30] The test must be applied separately to each business component, defined as "any product, process, computer software, technique, formula, or invention which is to be (i) held

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[28] *See Little v. Liquid Air Corp.*, 952 F.2d 841, 847 (5th Cir. 1992), *on reh'g en banc*, 37 F.3d 1069 (5th Cir. 1994) (*citing Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986)).
[29] 26 U.S.C. § 41(d)(1)(B).
[30] *Id.*

for sale, lease, or license, or (ii) used by the taxpayer in a trade or business of the taxpayer."[31]

During discovery, Appellants stated that they developed four new "products:" two oil refineries and two flood control systems. At summary judgment, however, Appellants claimed Cajun also created new business processes, a separate type of business component, which Appellants define as the "means and methods of construction," "the means and methods of performing [] construction services," and "construction processes." The District Court found that the asserted products and processes did not satisfy the business components test because Appellants put forth no evidence of the alleged products, any assertions of new construction processes were inconsistent with their prior disclosures and excludable under Federal Rule of Civil Procedure 37, and notwithstanding those inconsistencies, Appellants did not specifically identify the new construction processes at issue.[32]

Appellants now argue that the District Court's determinations were in error.

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[31] *Id.* § 41(d)(2)(B).

[32] *See* FED. R. CIV. P. 37(c)(1) ("If a party fails to provide information or identify a witness as required by Rule 26(a) or (e), the party is not allowed to use that information or witness to supply evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless.").

1. Business Components: Products

Appellants argue they presented sufficient evidence that Cajun developed four business component products and cite to the "Taxpayers' Response to Proposed Statement of Facts" (the "Response") as support. However, cited provisions primarily describe Cajun's "means and methods," i.e., their processes, and not the products. While Appellants may be correct that their construction processes led to the final product, the Revenue Code requires this Court to evaluate each business component separately.[33]

Accordingly, Appellants have not created a genuine dispute as to whether the four products constitute business components.

2. Business Components: Processes

Appellants further assert the District Court erred in excluding their construction processes argument because the "development processes and techniques" used on the Representative Projects were "almost inextricably intertwined with the tangible deliverables," the final product.

We are not persuaded that the District Court's decision to exclude Appellants' construction processes

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[33] 26 U.S.C. § 41 (d)(2)(A); *see also Id.* § 41(d)(2)(C) ("Special rule for production processes.--Any plant process, machinery, or technique for commercial production of a business component shall be treated as a separate business component (and not as part of the business component being produced).").

claim was an abuse of discretion.[34] Federal Rule of Civil Procedure 37(c)(1) provides that "if a party fails to provide information . . . as required by Rule 26(a) or (e), the party is not allowed to use that information . . . to supply evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless."[35] To evaluate whether a Rule 26 violation was harmless, and "thus whether the district court was within its discretion in allowing the evidence to be used at trial," this Court weighs four factors: (1) the importance of the evidence; (2) the prejudice to the opposing party of including the evidence; (3) the possibility of curing such prejudice by granting a continuance; and (4) the explanation for the party's failure to disclose.[36]

First, the argument that Cajun developed new construction processes is important because it provided Appellants with a wholly new basis by which to claim the tax credit. By raising this argument for the first time at summary judgment, Appellants effectively asserted a new defense that was neither disclosed nor explored during discovery. Moreover, as the District Court noted, "evidence of Cajun's new construction processes is plainly important to [Appellants] insofar as it is the only evidence (and argument) offered to establish the business component element of their QRTC claim."

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[34] *CQ, Inc.,* 565 F.3d at 277.
[35] FED. R. CIV. P. 37(c)(1).
[36] *Texas A&M Rsch. Found. v. Magna Transp., Inc.,* 338 F.3d 394, 401–02 (5th Cir. 2003).

Second, this omission was highly prejudicial to the Government given the procedural posture of the case. The record reflects that Cajun's initial discovery responses described the business components for the Representative Projects as "products." Appellants' supplemental disclosures likewise describe the Projects as producing "product[s]." By raising the processes argument at summary judgment, Appellants deprived the Government of the opportunity investigate this claim.

Third, although the District Court acknowledged that reopening discovery would mitigate prejudice to the Government, the case was "more than three years old" and one month from trial. The District Court was entitled to weigh the value of reopening discovery against providing a timely resolution of the case.[37]

Finally, Appellants failed to explain their change in argument before the District Court and, before this Court, deny that any change occurred. In doing so, Appellants direct the Court to their "pretrial briefing" as evidence that Appellants' position has remained consistent. However, the cited pretrial briefing is the Parties' Joint Pretrial Order, which was filed over one month after the Government moved for summary judgment and three weeks after Appellants responded raising the construction process argument

[37] A district court has "broad discretion in all discovery matters," and "such discretion will not be disturbed ordinarily unless there are unusual circumstances showing a clear abuse." *Kelly v. Syria Shell Petroleum Dev. B.V.*, 213 F.3d 841, 855 (5th Cir. 2000) (internal citation omitted).

for the first time. Appellants have not directed the Court to any previous statements indicating that the claimed business components involved processes. This explanation is thus unpersuasive.

Given these facts, the District Court did not abuse its discretion in excluding Appellants' arguments about construction processes. However, even if the District Court abused its discretion, the error was harmless because the court nonetheless evaluated the merits of Appellants' claim. Ultimately, the District Court determined that Appellants put forth "vague" and "conclusory" statements regarding their construction processes without identifying "even one new or improved process that resulted from Cajun's work on the Representative Projects."

The District Court did not abuse its discretion in excluding evidence of Cajun's construction processes. Alternatively, Appellants did not offer sufficient evidence to create a genuine dispute as to whether Cajun's products or processes constituted business components. Without a viable business component, the Representative Projects are not eligible for the tax credit, and the Government is entitled to summary judgment as a matter of law.

C. Funding Exclusion

Qualified research excludes "funded" research projects.[38] Funded research include "any research to the extent funded by any grant, contract, or otherwise

[38] 26 U.S.C. § 41 (d)(4)(H).

by another person (or governmental entity)."[39] To determine whether research was funded, courts must first evaluate "all agreements (not only research contracts) entered into between the taxpayer performing the research and other persons."[40] Research is funded if: (1) the researcher retains no substantial rights in its research;[41] or (2) payment is not contingent upon the research's success.[42]

The District Court determined that "the Methanex, Chevron, and Claiborne Projects each fail the 'substantial rights' prong of the 'funded research' exclusion because in each instance Cajun transferred all rights to any new or improved 'construction processes' to its contracting counterpart." The Court found that the East Bank contract was funded because "SWBNO plainly *paid* Cajun for whatever alleged research Cajun may have performed."

On appeal, Appellants dispute this finding and argue (1) that Cajun retained substantial rights in its research, and (2) that the Representative contracts

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[39] *Id.*

[40] 26 C.F.R. § 1.41-4A(d)(1).

[41] *Id.* § 41-4A(d)(2)("If a taxpayer performing research for another person retains no substantial rights in research under the agreement providing for the research, the research is treated as fully funded for purposes of section 41(d)(4)(H), and no expenses paid or incurred by the taxpayer in performing the research are qualified research expenses.").

[42] *Id.* § 1.41-4A(d)(1)("Amounts payable under any agreement that are contingent on the success of the research and thus considered to be paid for the product or result of the research (see § 1.41–2(e)(2)) are not treated as funding.").

were "contingent" upon delivery of a product and, as such, are not funded as defined by Treasury Regulation 26 C.F.R. § 1.41-4A(d).

1. Methanex, Chevron, and Claiborne Projects

Researchers cannot claim the tax credit if they retain no "substantial rights in research under the agreement providing for the research."[43] A researcher retains no "substantial rights" if the agreement or contract "confers on another person the exclusive right to exploit the results of the research."[44] Whether Cajun retained substantial rights to its research is determined by the contracts for each Representative Project.[45]

Even assuming Cajun satisfied the business components test, by the express terms of the Methanex, Chevron, and Claiborne contracts, Cajun gave up its rights to any research performed under the contracts. Pursuant to section 26 of the Methanex contract, Methanex retained "all rights, title and interest" in any "work product" prepared by Cajun. The provision applies to all "works made for hire" as well as any work "not considered a work made for hire." By contracting away "all right, title and interest" in its work product, Cajun gave up its rights

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[43] 26 C.F.R. §1.41-4A(d)(2).

[44] *Id.*

[45] *Id.* § 1.41-4A(d)(1) ("All agreements (not only research contracts) entered into between the taxpayer performing the research and other persons shall be considered in determining the extent to which the research is funded.").

to all "documents, data, analyses, reports, plans, procedures, manuals, drawings, specifications, calculations, or other technical tangible manifestations of [Cajun]'s efforts (whether written or electronic)" created while performing the contract, as well as "any or all tracings, designs, drawings, field notes, requisitions, purchase orders, specifications, electronic information . . . and other documents or records developed or acquired by [Cajun] and its suppliers or sub-subcontractors in performing the Work."

Similarly, Cajun assigned to Chevron "all rights" to any "drawings, documents, engineering and other data prepared or furnished by [Cajun]" under the Chevron contract. These items became "[Chevron's] property from the time of preparation and may be used by [Chevron] for any purpose whatsoever without obligation or liability whatsoever to [Cajun]." Furthermore, the contract also states that Chevron owns all "inventions, discoveries and improvements (patentable and unpatentable) that are made or conceived by [Cajun] or [Cajun's] employees" during the Project. Cajun was permitted to use this information "only for performance of the Services for [Chevron]," and pledged not to disclose such information "to any third party without [Chevron's] express written consent." Importantly, this obligation persists "notwithstanding the termination of this Contract."

Finally, by incorporating various provisions of the Federal Acquisition Regulations, the Claiborne

contract provides that "all material and work covered by progress payments made shall, at the time of payment, become the sole property of the Government."[46] "Work" is defined broadly and includes "construction activity," "buildings, structures, and improvements of all types."

Ultimately, "it is hard to see what rights—much less what substantial rights" Cajun retained in its undefined research.[47] After assigning away all rights to work developed during each Representative Project, Cajun retained no substantial rights in its research.[48]

2. East Bank Project

Treasury Regulation 26 C.F.R. § 1.41-4A(d) defines "funded" research.[49] Relevant here, the Regulation explains that "amounts payable under any agreement that are contingent on the success of the

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[46] FAR § 52.232-5(f), codified as 48 C.F.R. § 52.232-5.

[47] *Tangel v. Comm'r of Internal Revenue*, 121 T.C.M. (CCH) 1001, 2021 WL 81731, at *6 (T.C. 2021) (internal quotations omitted).

[48] Appellants argue Cajun retained substantial rights to its research because "there is nothing [in the contracts] that precludes Cajun from performing the same types of activities and utilizing the same means and methods on other projects, or building other flood structures, or modifying refineries." However, Appellants provided no specific examples of these "means and methods," leaving the district court and this Court to guess what Cajun could bring to future projects aside from additional experience in its field. "[I]ncreased experience in a field of research" does not constitute substantial rights to research. 26 C.F.R. § 1.41-4A(d)(2).

[49] 26 C.F.R. § 1.41-4A(d).

research and thus considered to be paid for the product or result of the research (see § 1.41–2(e)(2)) are not treated as funding . . . ."[50]

Appellants offer three reasons why the East Bank Project was not funded. First, Appellants rely on 26 C.F.R. § 1.41-4A(d) and 26 C.F.R. § 1.41-2(e) to argue the East Bank Project was not funded because payment was contingent upon Cajun delivering a "result or product," the refineries and flood systems. Second, and relatedly, Appellants maintain they are entitled to the credit simply because SWBNO, the payor on the East Bank Project, was not. Finally, Appellants argue that the Project was not funded

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[50] *Id.* § 1.41-4A(d)(1). Together, 26 C.F.R. §§ 1.41-2(e) and 1.41-4A(d) provide "mirror image" rules "for determining when the customer for the research, rather than the researcher, is entitled to claim the tax credit." *Fairchild Indus., Inc. v. United States*, 71 F.3d 868, 870 (Fed. Cir. 1995), *modified* (Feb. 23, 1996). *Fairchild* interpreted 26 C.F.R § 1.41-5, which was redesignated as § 1.41-4A in 2001. See Credit for Increasing Research Activities, 66 Fed. Reg. 280, 295 (2001). Section § 1.41-4A addresses when a researcher can claim the credit, whereas § 1.41-2(e) addresses when the payor to a contract can (or cannot) claim it.

Accordingly, § 1.41-2(e)(2) explains that payors cannot claim expenses for research contracts "if an expense is paid or incurred pursuant to an agreement under which payment is contingent on the success of the research" because "the expense is considered paid for the product or result rather than the performance of the research." 26 C.F.R. § 1.41-2(e)(2). In doing so, "the regulations implement allocation of the tax credit to the person that bears the financial risk of failure of the research to produce the desired product or result." *Fairchild,* 71 F.3d at 870.

because it was "inherently risky." These arguments miss the mark.

Appellants' argument that all contracts "for the product or result" are not funded improperly conflates "amounts payable under any agreement that are contingent on the success of the research" with contracts for products or services. This argument ignores the operative portion of the sentence: "amounts payable under any agreement that are contingent on the success of the research." Structurally, the phrase "and thus considered to be paid for the product or result of the research" merely describes or modifies "amounts payable . . . contingent on the success of the research." It does not, as Appellants urge, stand on its own to establish an additional type of contract "not treated as funding."

More to the point, § 1.41-4A(d)(1) only concerns agreements contingent upon the success of research. Simply put, the East Bank contract was not contingent on the success of the research because Appellants admit that "none of Cajun Industries' payment was for merely conducting research." Indeed, Appellants' briefing admits "payments to Cajun Industries were not contingent upon whether Cajun Industries conducted research activities." Consequently, this argument lacks merit.

Furthermore, Appellants are not entitled to the research credit merely because SWBNO could not

claim the credit. The Regulations do not require that a tax credit be allocated in every contract.[51]

Third, Appellants assert the East Bank Project was not funded because it was a fixed price contract and "inherently risky." This argument stands on more solid ground and finds some support in a line of cases including *Fairchild Industries, Inc. v. United States* and *Geosyntec Consultants, Inc. v. United States*.[52] *Fairchild* explained that sections 1.41-2 and 1.41-4A "implement allocation of the tax credit to the person that bears the financial risk of failure of the research to produce the desired product or result."[53] Because fixed price contracts may not fully compensate researchers if their research is unsuccessful, the researcher bears the financial risk of failure, and fixed price contracts are more likely to be deemed unfunded.

However, *Fairchild* and *Geosyntec* do not stand for the proposition that all fixed price contracts are per se not funded. Indeed, Geosyntec found that the fixed

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[51] *See* 26 C.F.R. § 1.41-A(d)(2) (addressing a scenario in which "a taxpayer performing research for another person retains no substantial rights in the research and if the payments to the researcher are contingent upon the success of the research, *neither the performer nor the person paying for the research* is entitled to treat any portion of the expenditures as qualified research expenditures.") (emphasis added).

[52] *Fairchild*, 71 F.3d at 870*; Geosyntec Consultants, Inc. v. United States*, 776 F.3d 1330 (11th Cir. 2015).

[53] *Fairchild*, 71 F.3d at 870.

price contract at issue was funded.[54] Furthermore, even if this Court agreed that the Regulations allocate the tax credit to the party bearing the risk of unsuccessful research, Cajun was compensated for all risks associated with the East Bank Project. According to the express terms of the contract, Cajun accepted payment "as full compensation for all loss, damages or risks of every description, connected with or resulting from the nature of the work, or from any obstructions or difficulties encountered, of any sort or nature whatsoever . . . ."

Finally, the East Bank Project was funded for the simple reason that Cajun was compensated for all expenditures incurred and claimed when it sought the tax credit. According to Cajun's IRS Form 6765, Cajun claimed the research credit entirely for "wages" incurred in pursuit of qualified services.[55] However, Cajun was compensated under the East Bank contract for "all general foremen, foremen, labor, [and] teams" as well as Cajun's "superintendence,

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[54] *Geosyntec,* 776 F.3d at 1339 ("[W]e find that both the Cherry Island Contract and the WM Contract were 'funded' as that term is used in § 41 and Treasury Regulation § 1.41– 4A(d).").

[55] Although Appellants' brief claims that "Cajun Industries included portions of employee wages, contractor costs, and supply costs incurred for various construction projects as part of the computation of the R&D tax credits," their tax filings indicate otherwise. In its Form 6567, Cajun left blank spots next to the "cost of supplies" category. To the extent Appellants argue Cajun claimed the credit for the difference between compensation received and wages paid, Appellants bore the burden of demonstrated this value before the District Court and on appeal. They provided no such calculations.

general expense and profit." Cajun accepted this payment as "full compensation for furnishing all the labor, materials, tools, equipment, etc., needed to complete the whole work of the contract." Therefore, Cajun was fully compensated for all wages and labor, making these expenditures funded under any plain meaning of the term.[56]

IV.

Based upon the record before the District Court and arguments made on appeal, the Court finds that the Representative Projects yielded no viable business components and were funded. Appellants are ineligible for the research tax credit provided by 26 U.S.C. § 41.

Therefore, the District Court's grant of summary judgment is AFFIRMED.

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[56] *See also* 26 C.F.R. § 1.41-4A (Example 1, indicating if a researcher is wholly compensated for otherwise qualified expenditures, the researcher is not entitled to the credit, notwithstanding any rights retained in the research).

Appendix B

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF LOUISIANA

CIVIL ACTION
No. 19-00596-BAJ-SDJ

UNITED STATES OF AMERICA,
Plaintiff,
v.
LEONARD L. GRIGSBY, ET AL.
Defendants.

Filed October 19, 2022

RULING AND ORDER

The United States seeks to recover a $576,756 tax refund (plus interest) paid to Defendants Leonard and Barbara Grigsby, which, allegedly, resulted from the Internal Revenue Service erroneously granting a $1.3 million research expenses tax credit to Defendants' S-Corporation, Cajun Industries, LLC ("Cajun").

Now the Government moves for summary judgment **(Doc. 64, the "Motion")**, arguing that undisputed evidence establishes that Cajun, a construction company, did not conduct any qualified

research activities during the tax year in question, and, by extension, Defendants are not entitled to the resulting refund. Defendants oppose the Government's Motion. (Doc. 71). For reasons to follow, the Government's Motion will be granted, and judgment will be entered in the United States' favor.

I. BACKGROUND

A. Summary Judgment Evidence

The following facts are undisputed, as set forth in the parties' statements of undisputed facts supporting their respective memoranda (Doc. 64-2 ("USA SOF"), Doc. 71-1 ("Defendants SOF"), Doc. 79-1 ("USA Reply SOF")), the parties' Joint Statement Of Undisputed Facts submitted with their proposed joint Pretrial Order (Doc. 82-1, "Joint PTO"), and the record evidence submitted in support of these pleadings.

i. Relevant Tax History

Cajun is a civil construction company headquartered in Baton Rouge, Louisiana. Cajun contracts with hundreds of private and public clients throughout the Gulf South to provide a wide-range of construction services in various markets, including oil and gas; chemical processing; power and utilities; infrastructure; communications; and water quality. Cajun is organized as a Subchapter S Corporation ("S-Corp") for federal income tax purposes, which means that Cajun's income, losses, deductions, and credits pass through to its shareholders on a *pro rata* basis. Cajun's tax year runs from October 1st through

September 30th. At all relevant times, Defendant Leonard Grigsby owned a 73 percent interest in Cajun. (Joint PTO ¶¶ 2-4, 15, 17).

In 2015, Cajun hired alliantgroup LP [sic], a consulting firm, to analyze whether Cajun was entitled to amend its prior tax returns to claim additional credits for the 2011 through 2016 tax years. Specifically, alliantgroup reviewed whether (and to what extent) Cajun was entitled to a tax credit "for increasing research activities" under 26 U.S.C. § 41 (the "qualified research tax credit" or "QRTC"). Based on a sampling of 105 projects from Cajun's 2012 tax year, alliantgroup determined that Cajun was entitled to claim additional research credits exceeding $1.3 million. Thereafter, Cajun amended its tax return for the year ending September 30, 2013, claiming a QRTC in the amount of $1,341,420. Cajun had never before claimed the QRTC. (Joint PTO ¶¶ 5-6, 9, 19).

In conjunction with its amended return, Cajun issued an amended Form K-1 to its shareholders, including Mr. Grigsby. Mr. Grigsby's amended K-1 reported a *pro rata* allocation of Cajun's QRTC in the amount of $979,237. (Joint PTO ¶¶ 7-8). Upon receiving the amended Form K-1, Defendants filed an amended federal income tax return for the 2013 tax year on which they reported Cajun's QRTC. Defendants' QRTC claim generated a tax credit in the amount of $954,527 and, after the credit was applied to reduce Defendants' 2013 tax liability, an overpayment in the amount of $576,756 *plus*

statutory overpayment interest in the amount of $73,663.38 (collectively, the "Contested Refund"). (Joint PTO ¶¶ 10-11).

On September 15, 2017, the IRS issued a tax refund check to the Defendants for the 2013 tax year, which included the Contested Refund.[1] (Joint PTO ¶¶ 12-14).

ii. Relevant Activities Resulting in Cajun's Claimed QRTC

The parties agree that a sampling of four of Cajun's projects during the tax year ending September 2013 is determinative of the outcome of this dispute: Project 12-001 (the "Claiborne Project"); Project 12-023 (the "East Bank Project"); Project 12-051 (the "Chevron Project"); and Project 13-020 (the "Methanex Project") (collectively, the "Representative Projects"). (Joint PTO ¶ 20; see also (Doc. 52 at p. 5 ("Pursuant to an agreement between the parties, Defendants' discovery responses are limited to a sample of four projects from Cajun's tax year ending September 30, 2013.")).

To follow is a brief description of each Representative Project, with particular attention to the terms of the underlying contracts.[2] *See Tangel v.*

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[1] The IRS issued Defendants a refund check in the amount of $671,071.38, comprised of the Contested Refund ($576,756.00 principal plus $73,663.38 interest), *plus* an additional refund of $20,652.00 that is not at issue in this case. (Joint PTO ¶¶ 12-14).

[2] The parties have each submitted excerpts of the underlying contracts, focusing on the contractual terms most relevant to the

Comm'r of Internal Revenue, 121 T.C.M. (CCH) 1001, 2021 WL 81731 at *4 (T.C. 2021) (instructing that "the parties' contract" determines who is entitled to the QRTC (citing authorities)); *Populous Holdings, Inc. v. Comm'r of Internal Revenue*, No. 405-17, 2019 WL 13032526, at *2 (T.C. Dec. 6, 2019) (instructing that courts consider "payment procedures, quality and performance standards, termination clauses, and warranty and default provisions" when determining entitlement to the QRTC).

a. The Methanex Project

In 2012, Cajun executed a construction services subcontract (Doc. 64-1, the "Methanex Subcontract" or "Mx Subcontract") with Jacobs Field Services ("Jacobs") to perform site preparation for the relocation of Methanex USA, LLC's methanol plant from Chile to Geismar, Louisiana. Cajun's original scope of work was broadly defined, and subject to a "capped"[3] (not-to-exceed) price of $6,485,000. (Mx

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instant dispute. There is substantial overlap among the parties' excerpts, though, in all instances, the Government's excerpts are more inclusive than Defendants' excerpts. For simplicity, the Court cites to the Government's excerpts only, except to the extent that a critical contract term is included only in the excerpts provided by Defendants.

[3] A "capped" contract is a contract under which the contractor is paid for labor and other expenses, plus a mark-up, subject to an agreed upon maximum price. Under a capped contract, the contractor typically bills the client for labor and other expenses incurred up until the maximum amount is reached. By contrast, a "fixed-price" contract is a contract under which the contractor agrees to perform contracted work for a fixed total price that is specified at contract formation. Typically, under a fixed-price

Subcontract at Recitals ¶¶ 3, 10; *Id*. at Ex. "A" (Scope of Work)). Through dozens of written change orders, Cajun's scope of work gradually expanded to include site establishment, construction of temporary facilities, earthwork, underground piping, and concrete foundations, for which Cajun was ultimately paid $90 million. Cajun performed its work according to plans provided by Jacobs, (*see* USA SOF ¶ 40; Defendants SOF ¶ 40), and completed the Methanex Project in December 2014. (Joint PTO ¶¶ 36-38, 51, 62-63).

The Methanex Subcontract is composed of a Construction Services Agreement ("CSA") and 10 Exhibits ("Ex."). Most relevant here, the Exhibits include a detailed scope of work (Ex. A); terms of monthly payment (including additional payment for changes to Cajun's original scope of work) (Ex. C); line-item pricing for Cajun's labor costs (including "Project Cost Engineer" wages), services and materials (Ex. D); and quality control standards, including standards for Jacobs' review and approval of Cajun's work (Ex. G).

As stated, Jacobs originally agreed to pay Cajun a "NOT TO EXCEED PRICE [of] **$6,485,000**" to

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contract, the contractor submits invoices based upon completing particular milestones or percentages of work. A third type of contract is an uncapped "cost-plus" contract, under which the contractor is paid for all time and material costs incurred for the project. *See Geosyntec Consultants, Inc. v. United States*, No. 12-cv-80334, 2013 WL 5328479, at *5 (S.D. Fla. Apr. 17, 2013), *aff'd*, 776 F.3d 1330 (11th Cir. 2015). As set forth below, this case involves capped and fixed-price contracts only.

perform "the Scope of Work as outlined in Ex. A," with compensation "based on billed actual manhours and actual cost of other cost reimbursable items in accordance with the agreed … rates as included in this Ex. D." (Mx Subcontract at Ex. D §§ 2.1-2.2; *see also id.* at Recitals ¶ 10). However, the Methanex Subcontract makes additional compensation available to Cajun in stated circumstances. Specifically, General Conditions ("GC") § 8 ("Changes") provides that if Jacobs demands an adjustment to Cajun's scope of work, Cajun is entitled to submit a "prior written change order" negotiating a new contract price. (Mx Subcontract GC § 8A). In such instances, "[a]dditional compensation for changes shall, at [Jacob's] sole discretion, be determined by … (i) negotiated lump sum; (ii) time and materials; (iii) unit price; or (iv) any combination of the foregoing." (*Id.*).

The Methanex Subcontract requires Cajun to submit "an application for payment … on or before the tenth day of each month, for Work completed during the preceding month." (Mx Subcontract GC § 9(A)). Cajun's monthly applications are subject to Jacobs' "approval," and Jacobs is entitled to demand "supporting documentation … reasonably require[d] to evidence … [Cajun's] entitlement to the amounts claimed." (*Id.* at §§ 9(A), (E)). Upon approval, Jacobs must pay Cajun within 10 days of Jacobs' "receipt of the corresponding payment from [Methanex USA]," less a 10 percent retainage. (*Id.* at § 9(A)). Payment of the retainage is due after Jacobs' final acceptance of Cajun's work. (*Id.*). Jacobs' final acceptance is

conditioned on Cajun's delivery of a lien waiver showing that Cajun performed its work "completely … and that there are no unsatisfied or undischarged claims, demands, losses, liens, attachments or encumbrances arising out of the Subcontract." (*Id.*).

Cajun's work under the Methanex Subcontract is subject to quality assurances and controls set forth in Exhibit G. Among these assurances, Cajun is required to bear the cost of remediating any work that fails to conform to "Project requirements":

> Subcontractor [Cajun] shall remain totally responsible for the quality and accuracy of its Work which shall at all times conform to Project requirements. In the event that the results of tests performed are not in accordance with Project requirements, Subcontractor shall be responsible for any repair, rework, re-testing and/or additional testing required as a result of the Work not being compliant with Project requirements. The costs associated with any repair, rework, re-testing, and/or additional testing required as a result of the Work not being compliant with Project requirements shall be to Subcontractor's account.

(Mx Subcontract Ex. G at § 1.9). Essentially the same term is repeated at Exhibit A (Scope of Work) Section 23.6.

Finally, and importantly, the Methanex Subcontract sets forth detailed terms regarding Cajun's right (or lack thereof) to its "Work Product,"

stating that all Cajun's Work Product under the Methanex Contract is "work made for hire" owned by Methanex USA:

> 26. OWNERSHIP OF WORK PRODUCT, DRAWING AND TECHNICAL DOCUMENTATION BY OWNER.
>
> A. All Work Product prepared by Subcontractor [Cajun] shall be "works made for hire," and all rights, title and interest to the Work Product, including any and all copyrights in the Work Product, shall be owned by Owner [Methanex USA, LLC] irrespective of any copyright notices or confidentiality legends to the contrary which may have been placed in or on such Work Product by Subcontractor. If, for any reason, any part of or all of the Work Product is not considered a work made for hire for Owner or if ownership of all right, title and interest in the Work Product shall not otherwise vest in Owner, then Subcontractor agrees that such ownership and copyrights in the Work Product, whether or not such Work Product is fully or partially complete, shall be automatically assigned from Subcontractor to Owner without further consideration, and Owner shall thereafter own all right, title and interest in the Work Product, including all copyright interests.

(Mx Subcontract GC § 26(A)).

"Work Product" is defined expansively, and means:

> all documents, data, analyses, reports, plans, procedures, manuals, drawings, specifications, calculations, or other technical tangible manifestations of Subcontractor's [Cajun's] efforts (whether written or electronic) created by Subcontractor in the performance of the Work, including but not limited to all Documents.

(Mx Subcontract GC § 1). This definition incorporates two additional expansively-defined terms, "Documents" and "Work":

> "Documents" means any or all tracings, designs, drawings, field notes, requisitions, purchase orders, specifications, electronic information (including but not limited to data files, operating codes, executable computer programs, output therefrom, and other software in any form), and other documents or records developed or acquired by Subcontractor and its suppliers or sub-subcontractors in performing the Work.
>
> […]
>
> "Work" means the work, services, deliverables, duties, and activities to be performed or provided by, or on behalf of, Subcontractor under this Subcontract as more fully described in the Scope of Work [Ex. A].

(Mx Subcontract GC § 1).

b. The Chevron Project

In 2011, Cajun contracted with Chevron (Doc. 64-24 *and* Doc. 77-25, collectively the "Chevron

Contract") to perform construction services as part of Chevron's expansion of its refinery in Pascagoula, Mississippi. The Chevron Project was multi-phase, and Cajun's scope of work included backfill, concrete, excavation, earthwork, piling installation and testing, concrete foundations, underground piping and utilities, road work, soil remediation, and tank testing. (Joint PTO ¶¶ 71, 90-91). Cajun performed its work according to plans provided by Chevron, and completed the Chevron Project in April 2013. (Joint PTO ¶¶ 97, 112).

The Chevron Contract includes of 44 pages of Terms and Conditions ("T&C"), and 11 Exhibits. Relevant here, Exhibit A provides a detailed Scope of Work, and Exhibit B provides an expansive Schedule of Compensation.

Like the Methanex Subcontract, the Chevron Contract is "capped," setting a not-to-exceed amount[4] that Chevron agrees to pay Cajun "in accordance with Exhibit B – Schedule of Compensation for Work conforming to Contract requirements." (USA SOF ¶ 86; Defendants SOF ¶ 86; Chevron Contract T&C § 7.1). In turn, Exhibit B sets forth a table specifically allocating certain costs among the parties (Chevron Contract Ex. B-1 (Allocation of Cost)), and line-item pricing for Cajun's labor, services, and materials (Chevron Contract Exhibits B-2 through B-8). Exhibit B provides that Cajun shall be reimbursed for wages

[4] The parties agree that the Chevron Contract is capped, but do not specify the Contract's not-to-exceed amount here. (*See* USA SOF ¶ 86; Defendants SOF ¶ 86).

of all Cajun employees (including "Project Engineers") "performing … Work" on the Chevron Project (*see* Chevron Contract Ex. B-1 §3.1(A), Ex. B-2 Item # 11), and that Cajun shall also be reimbursed "the cost of testing the completed Facility or parts thereof, if necessary" (*see* Chevron Contract Ex. B-1 §7.6).

Despite being "capped," the Chevron Contract also provides that additional compensation is available to Cajun in stated circumstances. Specifically, Terms and Conditions § 4 ("Changes") states that if Chevron demands an increase "in the quantity, character, kind or execution of the Work," Cajun may respond with "a written estimate … based upon the rates established in Exhibit B … for the cost of performing the [additional] Work." (Chevron Contract T&C §§ 4.1-4.2). The parties will then execute a written change order allowing Cajun to proceed with the additional work at the new price. (*Id.* at § 4.2). Additionally, if Chevron demands an adjustment to Cajun's scope of work, Cajun may respond with a "written notice" seeking "price adjustment" for labor, services, and materials. (Chevron Contract T&C § 4.3).

The Chevron Contract requires Cajun to submit weekly invoices to Chevron for "craft labor," and monthly invoices for "all other reimbursable costs," supported by "evidence [of] receipted bills, expense accounts …, third party invoices, releases and waivers of lien rights, or other specific and detailed documentation." (Chevron Contract T&C §§ 8.2-8.3). Thereafter, within 30 days, Chevron must pay Cajun "the [undisputed] compensation provided under a

Work Authorization," subject to a 5 percent retainage. (*Id.* at §§ 8.3, 8.5). Chevron is only allowed to withhold payment to the extent that Chevron disputes Cajun's supporting documentation, and even then only until such time that Cajun "amends the invoice in satisfaction of the dispute or provides the required documentation to substantiate invoice details." (*Id.* at § 8.5.2). Cajun is entitled to payment of the retainage "after 90 days from Mechanical Completion, provided that there are no undischarged or unsecured liens, attachments or claims in connection with the Work." (*Id.* at § 8.3).

Cajun's work under the Chevron Contract is subject to Chevron's "provisional" and "final" acceptance. "Provisional Acceptance" is conditioned on three factors: "(i) actual, Contract-compliant completion of the Subject system or Work authorization; (ii) the subject Work is tight, internally, and externally clean, and (as applicable) has been properly precommissioned [sic], adjusted, and tested; and (iii) all of [Cajun's] Construction Equipment, other supplies, personnel and debris has been removed from the Work Areas." (Chevron Contract T&C § 6.1). "Final Acceptance" is conditioned on Chevron's receipt of: "all Technical Information" (discussed below); releases; materials audits/reconciliations; and documentation supporting government permits. (*Id.* at § 6.5).

Additionally, the Chevron Contract states that Cajun's work is subject to Cajun's guarantee(s) that it will perform "in a safe, diligent, skillful and

workmanlike manner, in accordance with generally accepted industry practices and sound engineering principles," and, further that Cajun's "services … Materials or processes" will not "violate or otherwise infringe upon any third party's intellectual property rights." (*Id.* at § 13.1).

Finally, like the Methanex Contract, the Chevron Contract sets forth detailed terms regarding Cajun's right (or lack thereof) to its "Work Product"—and, specifically its "Technical Information"—stating, in relevant part:

> 18. CONFIDENTIALITY AND WORK PRODUCT
>
> 18.1. CONTRACTOR [Cajun] agrees that Technical Information will be used only for performance of the Services for COMPANY [Chevron].
>
> 18.2. Technical Information shall not be disclosed to any third party without COMPANYs express written consent, […] [excluding Technical Information that is "[a]vailable generally to the public through no act or omission of CONTRACTOR."] […]
>
> 18.3. Article 18 shall remain in force and effect and binding on CONTRACTOR notwithstanding the termination of this Contract in all other respects. […]
>
> 18.4. All inventions, discoveries and improvements (patentable and unpatentable)

that are made or conceived by CONTRACTOR or CONTRACTOR's employees in performing the Services and all domestic and foreign patent rights based thereon shall belong to COMPANY or an Affiliate designated by COMPANY. CONTRACTOR shall promptly and fully disclose all such inventions, discoveries and improvements to COMPANY or the designated Affiliate. CONTRACTOR shall cooperate as may reasonably be required in order to obtain patent protection therefore, including the signing of any proper affidavits, patent applications and the like. Furthermore. CONTRACTOR and employees of CONTRACTOR shall assign any and all patent applications resulting therefrom to the designated Affiliate. The cost of obtaining patent protection shall be borne by COMPANY.

[…]

18.5. Equitable Relief. CONTRACTOR acknowledges and agrees that due to the unique nature of the Technical Information there may be no adequate remedy at law for any breach of the obligations set out in this Article 18, and that any breach of these obligations may allow CONTRACTOR or another person to compete unfairly with COMPANY resulting in irreparable harm to COMPANY. Accordingly, CONTRACTOR agrees that upon a breach (or threat of a breach), COMPANY is entitled to immediate equitable relief, including a restraining order and preliminary injunction,

> and COMPANY may seek indemnification from CONTRACTOR for any loss or harm in connection with any breach or enforcement of CONTRACTOR's obligations provided in this Article 18 or for the unauthorized use or release of Technical Information. CONTRACTOR shall notify COMPANY immediately upon the occurrence of any unauthorized release of Technical Information or other breach of this Article 18.

(Chevron Contract T&C § 18).

"Technical Information" is defined expansively, and means:

> any and all information, data and knowledge which is either made available to CONTRACTOR by COMPANY relating to the performance of the Work, or developed by CONTRACTOR as a consequence or arising out of this Contract. Technical Information includes all inventions, discoveries or improvements (patentable or otherwise) that are made or conceived by CONTRACTOR in performing the Work and all patent rights associated with these inventions, discoveries or improvements.

(Chevron Contract T&C § 1.1.31). This definition incorporates one additional expansively-defined term, "Work":

> "Work" and "Services" are interchangeable and mean (unless the context requires otherwise) all work, services, operations or activities identified

> as Contractor's scope of work under this Contract and in each relevant Work Authorization and all other activities that are required for Contractor's full performance of its obligations under this Contract.

(Chevron Contract T&C § 1.1.36).

c. The Claiborne Project

In September 2011, the United States Army Corps of Engineers (the "Corps") awarded Cajun a federal public-bid contract (Doc. 64-18, the "Claiborne Contract") to construct a box culvert (underground canal), as part of a flood control system at South Claiborne Avenue in New Orleans, Louisiana. (Joint PTO ¶ 156). The Claiborne Contract described Cajun's work as "construction of a pile founded concrete box culvert, clearing and grubbing, excavation, construction, dewatering, driving sheet piles, driving timber piles, utility relocations, maintenance and diversions of storm water, box culvert construction, asphalt road work, fertilizing and seeding, backfilling, and other incidental work as specified in the specifications and as indicated on the drawings." (Claiborne Contract Solicitation, Offer, and Award ("SOA") § 10). Cajun performed its work according to plans provided by the Corps; the Corps accepted Cajun's work on the Claiborne Project in September 2017. (Joint PTO ¶¶ 160-161, 172, 188).

The Claiborne Contract was a "firm fixed price contract" (Joint PTO ¶ 158), bid by Cajun for a total amount of $25,971,694.50. (Claiborne Contract SOA §

22). The Claiborne Contract sets forth Cajun's line-item deliverables, and anticipated costs for each deliverable priced by unit or by lump sum. (Joint PTO ¶ 158; (Claiborne Contract Bidding Schedule – Alternate 1)).

Importantly, the Claiborne Contract incorporates numerous provisions of the Federal Acquisition Regulations (FAR)—both "by reference" and "by full text." (Claiborne Contract pp. 25-30).

FAR 52.232-5 (Sept. 2002)[5]—incorporated by reference (Claiborne Contract at p. 27)—governs "Payment Under Fixed-Price Construction Contracts," and requires the Corps to pay Cajun "the contract price as provided in this contract" pursuant to monthly progress payments. FAR 52.232-5(a), (b). Cajun is required to support its monthly payment requests with "[a]n itemization of the amounts requested, related to the various elements of work required by the contract covered by the payment requested"—including detailed information related to any subcontractor retained by Cajun—as well as a certification stating that "[t]he amounts requested are only for performance in accordance with the specifications, terms, and conditions of the contract." *Id.* at §§ (b)(1), (c). Upon receipt, the Corps determines whether Cajun has made "satisfactory progress," and, if so, pays Cajun "in full." *Id.* at § (e). If, however, "satisfactory progress has not been made," the Corps

[5] All citations and references herein to FAR 52.232-5 are to the September 2002 version.

may withhold a 10 percent retainage "until satisfactory progress is achieved." (*Id.*).

Despite being "fixed price," the Claiborne Contract allows for additional compensation to Cajun in stated circumstances. Specifically, FAR 52.243-4 (June 2007)[6]—incorporated in "full text" (Claiborne Contract at p. 41)—governs "Changes" and requires the Corps to "make an equitable adjustment and modify [the price of] the contract in writing" in the event the Corps changes the "specifications," the "method or manner of performance of the work," or other factors that result in increased cost or time required for the Claiborne Project. FAR 52.243-4(a), (d). Additionally, the Claiborne Contract allows Cajun to recover ownership and operating costs for "construction and marine plant [sic] and equipment in sound workable condition," as well as "[e]quipment rental costs." (Claiborne Contract at p. 39). The Corps also agrees to reimburse Cajun "the amount of premiums paid for performance and payment bonds (including coinsurance and reinsurance agreements, when applicable) after [Cajun] has furnished evidence of full payment to the surety." FAR 52.232-5(g).

The Claiborne Contract conditions final payment on Cajun's satisfaction of three requirements: "(1) Completion and acceptance of all work; (2) Presentation of a properly executed voucher; and (3) Presentation of release of all claims against the

[6] All citations and references herein to FAR 52.243-4 are to the June 2007 version.

Government arising by virtue of this contract." FAR 52.232-5(h).

Finally, the Claiborne Contract sets forth terms regarding Cajun's right (or lack thereof) to its "material and work," stating, in relevant part:

> (f) Title, liability, and reservation of rights. All material and work covered by progress payments made shall, at the time of payment, become the sole property of the Government[.]

FAR 52.232-5(f). This provision incorporates the term "work," which, under the applicable (2011) FAR 2.101[7], is defined as follows (in relevant part):

> Building or work means construction activity as distinguished from manufacturing, furnishing of materials, or servicing and maintenance work. The terms include, without limitation, buildings, structures, and improvements of all types, such as bridges, dams, plants, highways, parkways, streets, subways, tunnels, sewers, mains, power lines, pumping stations, heavy generators, railways, airports, terminals, docks, piers, wharves, ways, lighthouses, buoys, jetties,

[7] The Claiborne Contract incorporates by reference FAR 52.202-1 Definitions (July 2004), (Doc. 64-18 at p. 25), which states that "[w]hen a … contract clause uses a word or term that is defined in the [FAR], the word or term has the same meaning as the definition in FAR 2.101 in effect at the time the solicitation was issued." FAR 52.202-1 (July 2004). The Corps solicited the Claiborne Contract in August 2011. (Claiborne Contract SOA § 3). Accordingly, the 2011 version of FAR 2.101 applies, and all references herein to FAR 2.101 are to the 2011 version.

> breakwaters, levees, canals, dredging, shoring, rehabilitation and reactivation of plants, scaffolding, drilling, blasting, excavating, clearing, and landscaping.

FAR 2.101 Definitions (2011).

d. The East Bank Project

In January 2012, the Sewerage and Water Board of New Orleans ("SWBNO") awarded Cajun a state public-bid construction contract (Doc. 64-29, the "East Bank Contract") as part of SWBNO's improvements to the flood protection system at the East Bank Wastewater Treatment Plant in New Orleans. (*See* East Bank Contract § 1-03(A) (Scope And Extent Of Contract)). Cajun's work under the East Bank Contract consisted of installing/repaving an access road; relocating pipelines and utilities; excavation; demolition; driving piles; constructing "concrete footing and T-wall"; and installing three metal floodgates, drainage, and "entrance stairs and emergency exit stairs." (*See Id.*). Cajun performed its work according to plans provided by SWBNO (*see* East Bank Contract ¶ 30 (Drawings and Specifications); *see also* § 1-02 (Scope And Extent Of Contract)); SWBNO accepted Cajun's work on the East Bank Project in October 2015. (Joint PTO ¶ 150).

The East Bank Contract is also a "fixed price contract," (Joint PTO ¶ 126), bid by Cajun for the "full sum" of $24,391,466.00. (*See* East Bank Contract p. 3; Joint PTO ¶ 126). Nonetheless, the East Bank Contract provides that additional compensation is

available to Cajun when "clearly shown that such special construction is beyond the scope and intent of the original plans and specifications." (East Bank Contract ¶ 31 (Drawings and Specifications)). The parties agree that through various change orders, the East Bank Contract "increased by more than $5 million for a total value of $29.4 million." (Joint PTO ¶ 127).

The East Bank Contract provides that Cajun will be paid on a monthly basis for "work actually performed, at the prices bid in [Cajun's] proposal, plus whatever payments for extra work may be approved […] as full compensation for furnishing all the labor, materials, tools. equipment, etc., needed to complete the whole work of the contract, well and faithfully done, in accordance with the drawings and specifications, and meeting the requirements of the Engineer." (*See* East Bank Contract ¶ 52 (Monthly Payments)). Critically, Cajun's monthly payments expressly *include* "full compensation for all loss, damages or risks of every description, connected with or resulting from the nature of the work, or from any obstructions or difficulties encountered, of any sort or nature whatsoever, or from the action of the elements; also for all expenses in consequence of the suspension or discontinuance of the work as provided for in the contract." (*Id.*).

Additionally, the East Bank Contract makes express allowances for payment of "laboratory inspection and testing," stating that if SWBNO's Engineer determines that such inspection or testing

is required, SWBNO pays the cost, and Cajun will "not bear any part of the cost of the inspection and testing service." (East Bank Contract ¶ 29 (Laboratory Inspection)).

The Claiborne Contract conditions final payment for Cajun's work on SWBNO's inspection and verification. (East Bank Contract ¶ 56 (Completion Of Contract And Final Payment)). "If no defects are discovered, or when any defects found to exist have been repaired by the Contractor at his own expense, so that all the structures built by him, under this contract, and all the paved or unpaved surfaces disturbed by the work of this contract, are in acceptable conditions … the Engineer will recommend that the contract be accepted by [SWBNO]." (*Id.*). The East Bank Project Contract does not contain any terms restricting Cajun's right to its research or work product developed in the course of the East Bank Project.

B. Procedural History

On September 11, 2019, the United States initiated this action seeking to recover the Contested Refund pursuant to 26 U.S.C. § 7405. (Doc. 1; *see also* Doc. 14).

On April 21, 2022, the Court granted the parties' joint motion to bifurcate this matter, allowing the parties to proceed first with a determination of whether Defendants are entitled to the disputed QRTC and, in turn, the Contested Refund (the "Qualification Phase"), and leaving for later (as

necessary) the amount of any such QRTC/Refund (the "Quantification Phase"). (Doc. 55). Thereafter, again at the parties' invitation (Doc. 59), the Court issued a revised scheduling order governing the Qualification Phase, setting a fact discovery deadline of August 1, 2022, an expert discovery deadline of October 7, 2022, a dispositive motion deadline of August 15, 2022, and a ten-day trial commencing November 14, 2022. (Doc. 69).

On August 15, 2022, the United States timely submitted the instant Motion for Summary Judgment (Doc. 64). Defendants timely submitted their opposition (Doc. 71), to which the United States timely submitted a reply (Doc. 79). For reasons set forth below, the United States' Motion will be granted and judgment will be entered in the United States' favor on the issue of Defendants' qualification for the QRTC, obviating the need to proceed to the Quantification Phase.

II. ANALYSIS

A. Standard

Federal Rule of Civil Procedure ("Rule") 56(a) provides that the Court may grant summary judgment only "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). If the movant bears its burden, the nonmoving party "must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith*

Radio Corp., 475 U.S. 574, 586 (1986). "Where the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no 'genuine issue for trial.'" *Id.* at 587. Stated differently, "[i]f the party with the burden of proof cannot produce any summary judgment evidence on an essential element of [its] claim, summary judgment is required." *Geiserman v. MacDonald*, 893 F.2d 787, 793 (5th Cir. 1990).

B. Applicable Law

The issue presently before the Court is a narrow one: whether Cajun is entitled to the QRTC for the tax year ending September 2013, which, in turn, resulted in the Contested Refund to Defendants. If Cajun is not entitled to the disputed QRTC, Defendants are not entitled to the Contested Refund, and the matter is resolved.

The U.S. Court of Appeals for the Fifth Circuit instructs that "[i]n an action to recover an improperly paid refund, the United States, as plaintiff, bears the ultimate burden of proof to show … that some amount has been erroneously refunded." *United States v. McFerrin*, 570 F.3d 672, 675 (5th Cir. 2009) (*hereinafter McFerrin II*) (quotation marks and alterations omitted). To carry its burden, the Government must "prove either that the [taxpayers] were not entitled to any refund … or prove how much of the refund was paid in error." *United States v. McFerrin*, 492 F. Supp. 2d 695, 701 (S.D. Tex. 2007) (*hereinafter McFerrin I*) (citing authorities).

When a disputed refund derives from a claimed tax credit, the Circuit instructs that the taxpayer must produce evidence "to substantiate [the] claimed credit":

> Tax credits are a matter of legislative grace, are only allowed as clearly provided for by statute, and are narrowly construed. Taxpayers are required to retain records necessary to substantiate a claimed credit.

McFerrin II, 570 F.3d at 675 (citations omitted); *see also Bubble Room, Inc. v. United States*, 159 F.3d 553, 561 (Fed. Cir. 1998) ("In a tax refund case, the ruling of the Commissioner of Internal Revenue is presumed correct. To rebut this presumption of correctness, the taxpayer must come forward with enough evidence to support a finding contrary to the Commissioner's determination. In addition, the taxpayer has the burden of establishing entitlement to the specific refund amount claimed." (citations omitted)); 26 C.F.R. § 1.41-4(d) (providing substantiation requirement to claim the qualified research credit).

C. Discussion

i. Defendants fail to offer competent evidence or argument establishing that Cajun performed "qualified research".

The QRTC provides a credit for increasing research activities. 26 U.S.C. § 41.

> "Qualified research" has four separate and independent requirements: (1) the expenses must be of the type deductible under [26 U.S.C.] § 174; (2) the research must be undertaken "for the purpose of discovering information ... which is technological in nature;" (3) the application of that information must be "intended to be useful in the development of a new or improved business component of the taxpayer;" and (4) substantially all of the research activities must "constitute elements of a process of experimentation."

McFerrin II, 570 F.3d at 676 (quoting 26 U.S.C. § 41(d)(1)).

Most relevant here, the third element—"development of a new or improved business component"—requires proof of a "product, process, computer software, technique, formula, or invention which is to be […] (i) held for sale, lease, or license, or (ii) used by the taxpayer in a trade or business of the taxpayer." 26 U.S.C. § 41(d)(2)(B).

Defendants contend that a dispute exists regarding the "business component element" because for each of the Representative Projects, Cajun "develop[ed] construction processes which Cajun used to construct items for its clients." (Doc. 71 at p. 3). This argument fails for two reasons.

First, as noted in the Government's reply memorandum, Defendants' invocation of new "processes" flies in the face of their November 17,

2021 verified supplemental interrogatory responses, which unequivocally state that, as to each Representative Project, Cajun developed a "product." (*See* Doc. 64-15 at pp. 1-2 (Defendants' Supplement To The United States' First Set Of Interrogatories For Interrogatories One And Two)). A "product" is plainly *not* a "process"—under any common understanding[8] or the Tax Code[9]—and the Government was entitled to rely on Defendants' interrogatory responses when preparing its case—and, more specifically, its motion for summary judgment. *Cf. Bradley v. Allstate Ins. Co.*, 620 F.3d 509, 527 (5th Cir. 2010) ("Although interrogatory responses are not binding judicial

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[8] A "product" is "[s]omething produced by human or mechanical effort," or "[a] direct result; a consequence." PRODUCT, AMERICAN HERITAGE COLLEGE DICTIONARY (3d ed. 1997) Conversely, a "process" is "[a] series of actions, changes, or functions bringing about a result," or "[a] series of operations performed in the making or treatment of a product." PROCESS, *Id.* Put simply, a "process" is the means, whereas a "product" is the *end*.

[9] The QRTC defines the "business component" to include both a "product" and a "process." 26 U.S.C. § 41(d)(2)(B). The Treasury Regulations advise that a "product" and a "production process for the product" are separate business components. See 26 C.F.R. § 1.41-4(b)(1). Additionally, canons of construction require that "different words within the same statute should, if possible, be given different meanings." *BNSF Ry. Co. v. United States*, 775 F.3d 743, 755 n.86 (5th Cir. 2015) (quoting *Firstar Bank, N.A. v. Faul*, 253 F.3d 982, 991 (7th Cir.2001)). To depart from this rule here—that is, to equate "product" with "process" for the purposes of the QRTC—would violate "the rule against superfluities," which holds that "a statute should be interpreted so as not to render one part inoperative." *See Id.* at 759 & n.120 (quoting *Colautti v. Franklin*, 439 U.S. 379, 392 (1979)).

admissions, they may be used as evidence for assessing summary judgment." (citations omitted)).

Rule 26(e) obliged Defendants to supplement their interrogatory responses to "correct" their earlier disclosure, and to inform the Government that they intended to prove the business component element through evidence of a "process." No such supplementation occurred. The question that follows is whether Defendants' undisputed failure to supplement their discovery responses bars them from relying on evidence of Cajun's purported new or improved "construction processes" to establish a contested issue of fact as to the business component element. *See* Fed. R. Civ. P. 37(c)(1) ("If a party fails to provide information or identify a witness as required by Rule 26(a) or (e), the party is not allowed to use that information or witness to supply evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless.").

The answer to this question is determined by the balance of four factors: "(1) the importance of the evidence; (2) the prejudice to the opposing party; (3) the possibility of curing such prejudice by granting a continuance; and (4) the explanation for the party's failure to disclose." *Frey v. Bd. of Supervisors of Louisiana State University,* No. 16-cv-00489, 2018 WL 4089356, at *3 (M.D. La. Aug. 27, 2018) (Jackson, J.) (quoting *Texas A&M Research Foundation v. Magna Transp. Inc.,* 338 F.3d 394, at 402 (5th Cir. 2003)). Here, the balance of these factors heavily favors rejecting Defendants' late-game substitution.

First, evidence of Cajun's new construction processes is plainly important to Defendants, insofar as it is the *only* evidence (and argument) offered to establish the business component element of their QRTC claim.[10] At the same time, however, the significance of such evidence is substantially minimized by Defendants' failure to specifically identify even *one* new or improved "construction process" that Cajun developed while working on the Representative Projects (an independent basis for granting the Government's Motion, as set forth below).

Second, the Government is obviously prejudiced by Defendants' about-face. Relying on Defendants' prior interrogatory responses, the Government focused its summary judgment evidence and argument exclusively on whether Cajun developed new or improved "products" (arguing, in each instance, that Cajun did *not* develop any such products). (*See* Doc. 64-1 at pp. 12-13). Now Defendants have effectively pulled the rug from under the Government's case, depriving the Government of an opportunity to

[10] Notably, Defendants' opposition memorandum fails to cite any evidence or offer any argument establishing that Cajun's work on the Representative Projects resulted in new "products." Under this Court's Local Civil Rules, Defendants' failure to address the issue of whether Cajun's work resulted in a new or improved products acts as a waiver. *See Johnson v. Cooper T. Smith Stevedoring Co., Inc.*, No. 20-cv-00749, 2022 WL 2679436, at *3 n.7 (M.D. La. July 11, 2022) (Jackson, J.) (citing authorities).

develop evidence contradicting Defendants' re-stated position.

Third, an eleventh hour continuance to re-open discovery would obviously mitigate prejudice to the Government. Any such continuance, however, would disturb the November 2022 trial date. Additionally, a continuance would necessarily include yet another round of summary judgment briefing—to allow the Government a fair chance to address Defendants' new arguments prior to trial—delaying trial for months, at minimum. This case is already more than three years old, and all sides deserve a resolution.

Finally, Defendants have offered no explanation whatsoever for their change of tack. Even now—weeks after the Government raised the issue of Defendants' surprise substitution in its reply brief (Doc. 79 at p. 3)—Defendants have not addressed the issue, much less sought leave to supplement their discovery responses.

Balancing these factors, the Court easily determines that the proper sanction for Defendants' failure to supplement their discovery responses is to preclude Defendants from relying on evidence (and related argument) that Cajun developed "processes" capable of satisfying the business component element of the QRTC. Fed. R. Civ. P. 37(c)(1); *see Alldread v. City of Grenada*, 988 F.2d 1425, 1436 (5th Cir. 1993) (district court properly excluded evidence based on offering party's failure to supplement interrogatory responses (citing authorities)); *Guidry v. Aventis Pharms., Inc.,* No. 03-cv-493, 2005 WL 8155425, at *2

(M.D. La. Dec. 20, 2005) (excluding evidence offered in opposition to summary judgment based on offering party's failure to supplement its Rule 26 disclosures). As a result, Defendants have failed to produce any competent evidence supporting an essential element of their QRTC claim, and summary judgment is required. *Geiserman,* 893 F.2d at 793.

But even if the Court looks past Defendants' dilatory tactics, their belated reliance on "construction processes" fails for yet another reason: lack of specificity. As indicated above, Defendants vaguely reference new "construction processes" throughout their opposition memorandum, yet fail to specifically identify even *one* new or improved process that resulted from Cajun's work on the Representative Projects. Instead, as to each Project, Defendants equate new or improved "processes" with Cajun's "methods of construction," stating without elaboration that "Cajun performed engineering analyses that fundamentally relied on engineering principles, which allowed Cajun to determine the proper method of construction." (*See* Doc. 71 at pp. 19-21). As a result, the Court is left to guess what "construction processes" (if *any*) Defendants contend are new or improved.

Vague and conclusory statements cannot create an issue of fact capable of withstanding summary judgment. *E.g., Allen v. Our Lady of the Lake Hosp., Inc.,* No. 19-cv-00575, 2022 WL 2921001, at *5 n.9 (M.D. La. July 25, 2022) (Jackson, J.) ("As a rule, summary judgment evidence 'must be particularized,

not vague or conclusory.'" (*quoting: Guzman v. Allstate Assurance Co.*, 18 F.4th 157, 161 (5th Cir. 2021)). Moreover, this Court has repeatedly admonished that that it "will not speculate on arguments that have not been advanced, or attempt to develop arguments on a party's behalf." *Johnson*, 2022 WL 2679436, at *3 n.7. Defendants' obfuscation deprives the Court of any meaningful criteria by which to measure whether Cajun's alleged "construction processes" were, in fact, new or improved, as required to establish the business component element. For present purposes, the result is the same: Defendants fail to create a contest as to a material element of their QRTC claim, and summary judgment is required. *Geiserman,* 893 F.2d at 793.

ii. Any "qualified research" that Cajun performed fails the "funded research" exclusion.

Defendants' QRTC claim fails for another reason: Cajun's alleged research was "funded" within the meaning of the Tax Code, and thus expressly *excluded* from eligibility for the QRTC.

"Funded research" is one of eight express exclusions to the QRTC, and means "[a]ny research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity)." 26 U.S.C. § 41(d)(4)(H). The U.S. Tax Court recently explained that the rationale for the "funded research" exception is to prevent two parties from claiming the same QRTC:

> Section 41 allows a credit to taxpayers who increase their research expenses above a base amount. Sec. 41(a), (c). "Qualified research expenses" include in-house research expenses and contract research expenses. Sec. 41(b)(1). "In-house research expenses" include wages paid to employees who engage in (or directly supervise) qualified research and amounts paid or incurred for supplies used in the conduct of qualified research. Sec. 41(b)(2). "Contract research expenses" are amounts paid by a taxpayer to a person other than an employee to perform qualified research. See sec. 41(b)(3).
>
> When a contractor … performs research in fulfilling a contract with its customer, each party may have a possible claim to the research credit: [the contractor's] credit would be based on its in-house research expenses and [the customer's] would be based on its contract research expenses. To prevent double claiming of the credit and to determine which contracting party is entitled to the credit, the statute provides that qualified research does not include "funded research." Sec. 41(d)(4)(H).

Tangel, 2021 WL 81731 at *3.

To determine whether research is "funded," the Tax Regulations direct the Court to focus on the underlying contract(s). 26 C.F.R. § 1.41-4A(d)(1) ("All agreements (not only research contracts) entered into between the taxpayer performing the research and other persons shall be considered in determining the

extent to which the research is funded."); see *Tangel,* 2021 WL 81731 at *4; *Fairchild Indus., Inc. v. United States*, 71 F.3d 868, 870 (Fed. Cir. 1995) ("In an accordance with Treasury Regulation § 1.41–2(e)(2) the contractual arrangement is the factor that determines who is entitled to the tax benefit[.]"), *modified* (Feb. 23, 1996).

When it is not obvious from the underlying contract(s) whether the claimed research was "funded," the Regulations instruct the Court to consider two main factors: First, "[a]mounts payable under any agreement that are contingent on the success of the research … are not treated as funding." *Id.* In such circumstances the party performing the research is entitled to the QRTC because it bears the risk of failure. *See* 26 C.F.R. § 1.41-2(e)(2); *see also Fairchild Indus.,* 71 F.3d at 870.

Second, a taxpayer is entitled to the QRTC only if it "retains substantial rights in the research." 26 C.F.R. § 1.41-4A(d)(3)(i). "If a taxpayer performing research for another person retains no substantial rights in research under the agreement providing for the research, the research is treated as fully funded…, and no expenses paid or incurred by the taxpayer in performing the research are qualified research expenses." *Id.* at § 1.41-4A(d)(2). The Regulations further advise that a contractor does *not* maintain substantial rights where the underlying contract "confers on another person the exclusive right to exploit the results of the [contractor'] research." *Id.* In other words, the contractor "does not

retain substantial rights in the research if the [contractor] must pay for the right to use the results of the research." *Id.* at § 1.41-4A(d)(3)(i); *see Tangel*, 2021 WL 81731 at *4.

"Incidental benefits to the taxpayer from performance of the research (for example, increased experience in a field of research) do not constitute substantial rights in the research." 26 C.F.R. §1.41-4A(d)(2).

In sum,

> If the taxpayer does not have the right to use or exploit the results of the research, its expenditures are not entitled to the tax credit regardless whether there is an agreement that the research will be paid for only if successful, and regardless whether the taxpayer receives some "incidental benefit" such as increased experience.

Lockheed Martin Corp. v. United States, 210 F.3d 1366, 1374–75 (Fed. Cir. 2000).

Importantly, at summary judgment, Defendants must establish a plausible contractual basis to conclude that Cajun retained substantial rights in its research. *Dynetics, Inc. & Subsidiaries v. United States*, 121 Fed. Cl. 492, 523 (2015) ("Dynetics bears the burden of showing it had substantial rights in the results of the research."). For each Representative Project, Defendants assert that payment was contingent on the success of Cajun's research *and* that Cajun retained substantial rights in its research.

(Doc. 71 at pp. 24-27). Defendants' arguments, however, are not convincing. For reasons explained below, the plain terms of the contracts underlying the Representative Projects dictate *either* that Cajun relinquished its right to any research or was paid for its research, such that if even if Cajun engaged in qualified research, the resulting QRTC can be claimed only by Cajun's contracting counterpart. *See Tangel*, 2021 WL 81731 at *3.

a. Cajun relinquished all rights to its research under the Methanex, Chevron, and Claiborne Contracts.

As stated, Defendants stake their QRTC claim solely on new or improved "methods of construction"—"construction processes"—developed by Cajun while working on the Representative Contracts. (*See* Doc. 71 at pp. 19-21). The Methanex, Chevron, and Claiborne Projects each fail the "substantial rights" prong of the "funded research" exclusion because in each instance Cajun transferred *all* rights to any new or improved "construction processes" to its contracting counterpart.

Again, to retain "substantial rights" Cajun must, at minimum, maintain the right to use or exploit its research without having to pay for it. 26 U.S.C. § 1.41-4A(d)(2); *Lockheed Martin*, 210 F.3d at 1374–75. Cajun plainly retained no such right under the Methanex contract, which states that Cajun's "Work Product" is "work[] made for hire," *and*, further, expressly transfers ownership of *all* Cajun's Work Product to Methanex USA.

Cajun's express consent to a "work for hire" contract is significant of itself, because it strongly signals that Cajun relinquished ownership of any new or improved methods of construction to Methanex USA. "Work for hire" is a term of art derived from Copyright law; for 120 years it has meant "work … produced at the instance and expense of [an] employer." *See Brattleboro Pub. Co. v. Winmill Pub. Corp.*, 369 F.2d 565, 567 (2d Cir. 1966) (*discussing Bleistein v. Donaldson Lithography Co.,* 188 U.S. 239, 248 (1903)). Under the modern Copyright Act, "work for hire" means *both* work produced by an employee within the scope of employment, *and* work produced by an independent contractor under a written agreement. 17 U.S.C. § 101. Under a "work for hire" contract, "the … person for whom the work was prepared is considered the author …, and, unless the parties have expressly agreed otherwise in a written instrument signed by them, owns all of the rights comprised in the copyright." 17 U.S.C. § 201(b). Put simply, "work for hire" is work that is ordered, paid for, and owned by the party that commissions it.

Cajun's execution of a contract expressly stating that *all* Cajun's "Work Product"—defined expansively to include all "data, analyses, reports, plans, procedures, manuals, drawings, specifications, calculations, or other technical tangible manifestations of [Cajun's] efforts … created by [Cajun] in the performance of the [work, services, deliverables, duties and activities to be performed or provided … under this Subcontract]" (Mx Subcontract GC § 1 (definition of "Work Product," incorporating

the defined terms "Work" and "Documents")—is "work[] made for hire" substantially weakens any claim that Cajun can somehow avoid paying Methanex USA for the right to use or exploit its new construction methods developed in the course of the Methanex Project.[11]

The nail in the coffin is Cajun's express transfer of all "rights, title and interest" to its Work Product to Methanex USA. Together, the Methanex Contract's "work for hire" and transfer of title provisions eliminate any plausible reading under which Cajun retains the right to use new or improved "methods of construction" developed on the Methanex Project without paying for it. *See Dynetics*, 121 Fed. Cl. at 517-519 (engineering firm lacked substantial rights under "work for hire" contract that transferred "all rights, title, and interest" to the results of its work); *Tangel*, 2021 WL 81731 at *4 (engineering firm lacked

[11] Indeed, Cajun's express acknowledgment that its Work Product under the Methanex Contract is "work for hire" supports a determination that Cajun's QRTC claim fails both prongs of the "funded research" exclusion. For reasons stated above, Cajun's claim fails the "substantial rights" prong because it transferred all ownership of new or improved (copyrightable) construction processes to Methanex. 17 U.S.C. § 201(b). Additionally, Cajun's agreement to a "work for hire" contract supports a finding that Cajun's QRTC claim fails the "payment contingent on success" prong because whatever new construction processes it produced were "at the instance and expense of [Methanex]," *Brattleboro*, 369 F.2d at 567. In any event, having determined that Cajun fails the "substantial rights prong" of the funded research exclusion, the Court does not reach the issue of whether the Methanex Contract also fails the "payment contingent on success" prong. *See also infra* n.12.

"substantial rights" under contract that transferred ownership of all "technical information" "supplied" or "designed" under the contract).

The same conclusion obviously applies to the Chevron Project. Under the plain terms of the Chevron Contract, Cajun agreed to use "Technical Information"—i.e., "all inventions, discoveries or improvements (patentable or otherwise) that are made or conceived by [Cajun] in performing the Work"—only "for performance of the Services for [Chevron]"; further, Cajun agreed not to disclose "Technical Information … to any third party without [Chevron's] express written consent." (Chevron Contract T&C §§ 18.1-18.2, incorporating the defined term "Technical Information"). If that wasn't enough, Cajun *also* expressly agreed: (1) to forfeit to Chevron any claim to any "inventions, discoveries and improvements "(patentable and unpatentable) that are made or conceived by [Cajun] … in performing the Services"; (2) to "promptly and fully disclose all such inventions, discoveries and improvements to [Chevron]"; (3) to "cooperate as may reasonably be required in order to obtain patent protection"; *and* (4) to *consent* to "a restraining order and preliminary injunction" in the event of Cajun's "unauthorized use or release of Technical Information." (Chevron Contract T&C § 18). Again, there is no room for debate as to the meaning of these provisions: Cajun retained no right to any new or improved methods of construction it may have developed working on the Chevron Project. *See, supra, Dynetics*, 121 Fed. Cl. at 517- 519; *see also Id.* at 519-523 (engineering firm

lacked substantial rights under contract that required contractor to seek approval prior to using or releasing any "materials" or information acquired under the contract).[12]

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[12] A separate issue is whether the Methanex and Chevron Projects also fail the "payment contingent on success" prong of the "funded research" analysis. *See* 26 C.F.R. § 1.41-2(e)(2). As set forth above, the Methanex and Chevron Contracts are each "capped" contracts under which Cajun agreed to an original not-to-exceed price for labor, material, and expenses. In *Geosyntec Consultants, Inc. v. United States*, the U.S. Court of Appeals for the Eleventh Circuit provided substantial guidance for determining when "capped" contracts fail the "contingent on success" prong. 776 F.3d 1330, 1338 (11th Cir. 2015). Ultimately, the Eleventh Circuit held that the capped contracts in dispute *were* "funded"—and rejected an engineering firm's claim to the QRTC—due to multiple contract terms, which, in sum, ultimately conditioned payment on the engineering firm's "performance … regardless of the success of its research." *See Id.* at 1339. These contract terms included: (1) the engineering firm was entitled to additional compensation in specified circumstances; (2) the underlying contracts did *not* make payment contingent on the success of the firm's research, but instead required payment for the firm's work product even if it did not produce the desired outcome; and (3) the underlying contracts' inspection, acceptance and approval terms were not mandatory prerequisites to payment, instead the firm's invoices were payable upon invoicing unless an item on the invoice was disputed. *See Id.* at 1339-43.

Notably, in conducting this analysis, the Eleventh Circuit expressly rejected the engineering firm's argument that its research was not funded because "under the capped contracts … its compensation was fixed," and thus "it ran the risk of not receiving the full ceiling price or, conversely, of exceeding its own budget," explaining:

The Claiborne Project follows suit. Under the Claiborne Contract, "[a]ll material and work covered by progress payments … [became] the sole property of the Government" at the time of payment. FAR 52.232-5(f). Again, the term "work" is defined broadly to mean *all* "construction activity." FAR 2.101 (2011). Logically, any new or improved "method of

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these cost-of-performance arguments focus on the amount Geosyntec would be paid and/or the likelihood that its contracts would be profitable, which is of no matter here. Cost-of-performance is not the financial risk with which we are concerned because "the only issue is whether payment was contingent on the success of the research"—that is, the financial risk of failure.

Id. at 1339 (*quoting Fairchild Indus.*, 71 F.3d at 872).

The capped Methanex and Chevron Contracts share many of the key characteristics driving the analysis and result in *Geosyntec*. In its principal brief, the Government cites repeatedly to *Geosyntec,* and relies on *Geosyntec* to argue that "[e]ven if Cajun had substantial rights in the projects, the contracts are funded because Cajun's right to payment was not contingent on the success of any research." (Doc. 64-1 at pp. 23-25). Significantly, Defendants fail to even mention *Geosyntec* in their opposition, *much less* distinguish the case, begging the question whether the same result should follow here as to the Methanex and Chevron Projects. Defendants' failure in this regard is conspicuous because they elsewhere criticize the Government for omitting authorities from its "funded research" exclusion argument. (Doc. 71 at p. 23 n. 107 ("Given the limited number of decisions on the funded research issue, it would be surprising if Plaintiff was unaware of the *Lockheed* rule – particularly since a case Plaintiff cites to in its argument … cites to that case as well."). Regardless, the Court does not reach the issue of whether the Methanex and Chevron Projects also fail the "payment contingent on success" prong, having already determined that these Projects fail the "substantial rights" prong.

construction" is part of Cajun's "construction activity." Defendants ignore the obvious question of how Cajun maintained substantial rights to its new methods of construction if all Cajun's construction activities became the sole property of the Government. (*See* Doc. 71 at p. 27). Defendants' failure in this regard is a tacit admission that they cannot overcome the Claiborne Contract's transfer of title provision. *See Johnson*, 2022 WL 2679436, at *3 n.7 (a party's failure to address an issue, acts as a waiver); *e.g. Dynetics*, 121 Fed. Cl. at 521 (engineering firm's QRTC claim failed the substantial rights prong where engineering firm failed to address "the obvious question of how it could have substantial rights in the results of the research, if it needed the government's 'authorization' to use those results.").[13]

In sum, Defendants have failed to show any plausible basis to conclude that Cajun retained

[13] In *Dynetics, Inc. & Subsidiaries v. United States*, cited above, the U.S. Court of Federal Claims provided extensive guidance regarding the contours of the "substantial rights" prong of the "funded research" exclusion. 121 Fed. Cl. 492, 521 (2015). Not surprisingly, the Government cites *Dynetics* in its opening memorandum, and relies on it to argue that "Cajun did not retain substantial rights in the Methanex, Chevron, or Claiborne Projects." (Doc. 64- 1 at pp. 22-23). Surprisingly, Defendants fail to meaningfully address *Dynetics* in their opposition, choosing instead to deflect attention from the case in a footnote. (Doc. 71 at p. 23 n.107). And again, Defendants' failure is particularly galling given their criticism that the Government omitted certain authorities from its opening memorandum. *See supra* n. 12. Going forward, Defendants would do well to avoid hoisting themselves with their own petard.

substantial rights to any research it may have performed on the Methanex, Chevron, and Claiborne Projects. Rather, the plain terms of the underlying contracts dictate the opposite conclusion: Cajun did not maintain substantial rights to any research it may have performed under the Methanex, Chevron, or Claiborne Contracts. Again, summary judgment is required. *Geiserman*, 893 F.2d at 793; *e.g., Dynetics*, 121 Fed. Cl. at 523.

b. Cajun was paid for its research under the East Bank Contract.

The East Bank Contract is silent as to Cajun's ownership of construction processes developed during the course of the East Bank Project. Still, the East Bank Project fails the "payment contingent on success" prong of the "funded research" exclusion. Why? Because SWBNO plainly *paid* Cajun for whatever alleged research Cajun may have performed.

The East Bank Contract was a fixed price contract. Fixed priced contracts are presumed to be "unfunded research, qualifying the contractor for the credit." *See Populous Holdings*, 2019 WL 13032526, at *2 (citing authorities). The rationale behind this presumption is easily understood:

> Fixed price contracts are inherently risky for the contractor if the research is unsuccessful. Under fixed price contracts, the contractor must remedy failed research at its own expense. Fixed price contracts "generally place maximum economic risk on contractors who ultimately

> bear responsibility for all costs and resulting profit or loss.

Id. (citing authorities).

But whatever initial presumption may attach to the East Bank Contract, it is definitively rebutted by the Contract's express terms, which provide that Cajun's monthly payments *include*:

> full compensation for all loss, damages or risks of every description, connected with or resulting from the nature of the work, or from any obstructions or difficulties encountered, of any sort or nature whatsoever, or from the action of the elements; also for all expenses in consequence of the suspension or discontinuance of the work as provided for in the contract.

(East Bank Contract ¶ 52 (Monthly Payments). Additionally, the East Bank Contract obligated SWBNO and *only* SWBNO to pay the costs of unanticipated "laboratory inspection and testing." (East Bank Contract ¶ 29 (Laboratory Inspection)).

The upshot is that Cajun was compensated for any risk and attendant costs "connected with or resulting from the nature of [its] work" on the East Bank Project, and bore no risk that it would be required to pay the costs of additional research or testing. Accordingly, any research Cajun may have performed was "funded" under a plain reading of the "funded research" exclusion, and cannot qualify for the QRTC. 26 U.S.C. § 41(d)(4)(H) ("Funded Research" is "[a]ny research to the extent funded by any grant, contract,

or otherwise by another person (or governmental entity).").

III. CONCLUSION

In sum, Defendants have failed to produce competent evidence or argument creating a substantial issue of fact that Cajun performed qualified research on the Representative Projects. Additionally, even assuming Cajun performed qualified research on the Representative Projects, the underlying contracts dictate that all such research falls within the "funded research" exclusion. Having now established that Cajun is not entitled to the disputed QRTC, and, in turn, that Defendants are not entitled to the Contested Refund, final judgment will be entered in favor of the United States. *See McFerrin* I, 492 F. Supp. 2d at 701.

Accordingly,

IT IS ORDERED that United States' **Motion For Summary Judgment** (Doc. 64) be and is hereby **GRANTED**.

IT IS FURTHER ORDERED that the parties' pending **Motions *In Limine* (Docs. 86, 87, 88, 89, 90, 91, 92, 93, and 94)** be and are hereby **TERMINATED AS MOOT.**

Final judgment in favor of the United States shall issue separately.

Baton Rouge, Louisiana, this
19th day of October, 2022

[handwritten signature]
JUDGE BRIAN A. JACKSON
UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF LOUISIANA

Appendix C

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 22-30764

UNITED STATES OF AMERICA,
Plaintiff-Appellee,
v.
LEONARD L. GRIGSBY; BARBARA F. GRIGSBY,
Defendants-Appellants.

Appeal from the United States District Court
for the Middle District of Louisiana
USDC No. 3:19-CV-596

ON PETITION FOR REHEARING

Before Higginbotham, Smith, and Elrod, *Circuit Judges.*

Per Curiam:

IT IS ORDERED that the petition for rehearing is DENIED.

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 22-30764

UNITED STATES OF AMERICA,
Plaintiff-Appellee,
v.
LEONARD L. GRIGSBY; BARBARA F. GRIGSBY,
Defendants-Appellants.

Appeal from the United States District Court
for the Middle District of Louisiana
USDC No. 3:19-CV-596

Before Higginbotham, Smith, and Elrod, *Circuit Judges*.

JUDGMENT

This cause was considered on the record on appeal and was argued by counsel.

IT IS ORDERED and ADJUDGED that the judgment of the District Court is AFFIRMED.

IT IS FURTHER ORDERED that Appellants pay to Appellee the costs on appeal to be taxed by the Clerk of this Court.

PATRICK E. HIGGINBOTHAM, *Circuit Judge:*

Today, we visit the classic congressional practice of using its taxing powers to achieve permissible policy goals; here, the lure of a tax credit to incentivize creative research. Leonard L. Grigsby and Barbara F. Grigsby appeal the judgment of the United States District Court for the Middle District of Louisiana which rejected research and development tax credits claimed by Cajun Industries LLC and upheld the resulting tax deficiency.

We AFFIRM.

I.

Cajun Industries LLC ("Cajun") claimed tax credits for the 2013 tax year pursuant to § 41 of the Internal Revenue Code, 26 U.S.C. § 41. First, the Code provision at issue in this case, § 41 offers a tax credit for "qualified research expenses" including wages and expenditures incurred in pursuit of qualified research.[1]

The Internal Revenue Code provides a tax credit for qualified research activities, as defined by the Code.[2] To constitute "qualified research," the research must satisfy the four tests laid out in § 41(d)(1): "(1) the expense must be of the type deductible under § 174 of the Code (i.e., R & D expenses that are reasonable under the circumstances), (2) the research must be undertaken for the purposes of discovering

[1] 26 U.S.C. § 41(b).

[2] *See generally id.*

information that is 'technological in nature,' (3) the information must be 'intended to be useful in the development of a new or improved business component of the taxpayer,' and (4) 'substantially all of the activities [must] constitute elements of a process of experimentation.'"[3] Relevant here, "business components" are defined as "any product, process, computer software, technique, formula, or invention which is to be (i) held for sale, lease, or license, or (ii) used by the taxpayer in a trade or business of the taxpayer."[4]

However, qualified research expressly excludes so-called "funded" research.[5] Funded research include

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[3] *Shami v. Comm'r,* 741 F.3d 560, 563 (5th Cir. 2014) (citing 26 U.S.C. § 41(d)(1)). The full text of 26 U.S.C. § 41(d)(1) reads:

> (d) Qualified research defined.--For purposes of this section-
> (1) In general.-The term "qualified research" means research-
> (A) with respect to which expenditures may be treated as specified research or experimental expenditures under section 174,
> (B) which is undertaken for the purpose of discovering information--
> (i) which is technological in nature, and
> (ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and
> (C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph (3).
> Such term does not include any activity described in paragraph (4).

[4] *Id.* § 41(d)(2)(B).

[5] *Id* § 41(d)(4)(H) ("(4) Activities for which credit not allowed. -- The term 'qualified research' shall not include any of the

"any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity)."[6] Treasury Regulations further explain that research is funded if, in any agreement to perform research (1) the researcher retains no substantial rights to their research; or (2) payment is not contingent upon the research's success.[7]

A. Claimed Credits

Cajun provides construction services throughout the Gulf Coast Region and engaged in over one hundred construction projects during the time period in question. In 2015, Cajun hired a consulting firm to evaluate its projects and advise whether Cajun was eligible for research credits under § 41. Based on the firm's report, Cajun, believing it was entitled to a $1,341,420 research credit, filed an amended Form 1120S for the 2013 tax year claiming the $1,341,420 credit.

As an S-Corporation, Cajun's income, losses, deductions, and credits pass through to its shareholders for income tax purposes. At all relevant times, Appellant Leonard Grigsby owned a 73% interest in Cajun and was thus entitled to a *pro rata* allocation of Cajun's tax credit, which amounted to $979,237. The $979,237 credit reduced Mr. and Mrs.

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following . . . (H) Funded research.--Any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).").

[6] *Id.*

[7] 26 C.F.R. § 1.41-4A(d).

Grigsby's tax liability for 2013 and indicated the couple overpaid their federal income taxes by $576,756. Appellants filed an amended 2013 tax return and sought a refund of $576,756 plus statutory overpayment interest in the amount of $73,633.38 (the "Contested Refund"). On September 15, 2017, the Internal Revenue Service ("IRS") issued Appellants a refund of $671,071.38, comprised of the Contested Refund and an additional $20,652 not at issue in this case.[8]

However, on August 13, 2019, the IRS notified Appellants that the Contested Refund was issued erroneously and challenged Cajun's claimed credit. The Commissioner demanded Appellants repay the amount and warned that if Appellants did not do so, the IRS would recommend "an action be commenced in District Court to recover the erroneous refund, as permitted by I.R.C. § 6532(b) and 7405." Shortly thereafter, the United States initiated this suit.

B. The Representative Projects

Before the District Court, the Parties agreed that four projects adequately represented Cajun's research activities: (1) Project 13-020 (the "Methanex Project"); (2) Project 12-051 (the "Chevron Project"); (3) Project 12-001 (the "Claiborne Project"); and (4) Project 12 023 (the "East Bank Project") (together, the "Representative Projects"). Thus, Cajun's eligibility

[8] Of the $671,071, $576,756 was "solely due" to Cajun's tax credit and $73,663.38 stemmed from the statutory overpayment interest.

for the tax credit, and Appellants' by extension, hinged on whether it performed qualified research while completing these projects.

1. The Methanex Project

In 2012, Jacobs Field Services North America, Inc. ("Jacobs") hired Cajun as a subcontractor on a project to relocate a Methanex USA, LLC methanol plant from Chile to Louisiana. Cajun was originally tasked with creating temporary facilities at the new site. According to the Scope of Work provisions of the contract, Cajun's responsibilities included:

> 3.0 GENERAL SCOPE OF SERVICES (WORK)
>
> 3.1 [Cajun] shall complete the Work and support functions required to effectively manage and report on the status of the Work as specified.
>
> 3.2 [Cajun] shall provide all management, supervision, labor, consumable materials, construction equipment, construction aids, tools, services, testing devices, warehousing, supplies, inspections, insurance, fully furnished and equipped offices, communication devices, and all other necessary items to successfully accomplish the construction described by the Scope of Work. This includes, but is not limited to, on and off site transportation, receiving, loading and unloading, storing, maintenance, and distribution of construction materials, installation of such materials into the Work, proper care of materials, testing and final

construction punch list completion and turnover of the Work Scope as specified.[9]

In executing these tasks, Cajun was "solely responsible for and have [sic] control over construction means, methods, techniques, sequences and procedures and for coordinating all portions of the Work." This included obtaining approval for materials, identifying and coordinating vendors, offering design input, and participating in "a lot of review processes." However, Jacobs retained "ultimate authority to resolve issues in the field."

The contract was subject to a capped price of $6,485,000 and payment was conditioned on Cajun's completion of "all Work."[10] Cajun accepted payment "as full compensation for doing all Work and furnishing all material contemplated by and embraced in this Subcontract," "for all loss or damage arising out of the nature of the Work," "from any unforeseen or unknown difficulties or obstructions which may arise or be encountered in the prosecution

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[9] "Work" was defined as the "work, services, deliverables, duties and activities to be performed or provided by, or on behalf of, [Cajun] under this Subcontract."

[10] This price included "billed actual manhours and actual cost of other cost reimbursable items in accordance with the agreed labor wage rates, construction equipment rates, mobilization and demobilization rates as included in this Exhibit D." Cajun was also entitled to additional compensation if Jacobs modified its scope of work. By the end of the project, the contract price rose from $6 million to approximately $90 million because of 65 work scope modifications.

of the Work," and "for all risks of every description connected with the Work."

Section 26 of the contract addressed ownership of any work product and provided that all "Work Product prepared by [Cajun] shall be 'works made for hire,' and all rights, title and interest to the Work Product . . . shall be owned by [Methanex]." To the extent any "work product" was not considered work for hire, "or if ownership of all right, title and interest in the Work Product shall not otherwise vest in [Methanex]," Cajun agreed that ownership of said "Work Product . . . shall be automatically assigned from [Cajun] to [Methanex] without further consideration, and [Methanex] shall thereafter own all right, title and interest in the Work Product."[11]

The contract defined "work product" as "all documents, data, analyses, reports, plans, procedures, manuals, drawings, specifications, calculations, or other technical tangible manifestations of [Cajun]'s efforts (whether written or electronic) created by [Cajun] in the performance of the Work, including but not limited to all Documents." In turn, "documents" included "any or all tracings, designs, drawings, field notes . . . specifications, electronic information . . . and other documents or records developed or acquired by [Cajun] and its suppliers or sub-subcontractors in performing the Work."

[11] The contract defined Methanex as the "Owner."

2. The Chevron Project

In 2011, Chevron Products Company, a division of Chevron U.S.A., Inc., contracted with Cajun to provide construction services to expand Chevron's Pascagoula Refinery (the "Chevron Project"). Cajun's responsibilities included providing "all labor, supervision, quality control, administration, document control, equipment, [and] tools," in addition to completing specific civil tasks such as surveying, excavation and backfill, installing piping, and performing field inspections. Appellants maintain that Cajun also offered "constructability reviews" of the engineer's designs and specifications. However, the engineer of record, who was not a Cajun employee, retained "ultimate authority to resolve any issues that arose in the field."

The Chevron contract was a fixed-price contract and compensated Cajun for all work described in Exhibit B of the contract, the "Schedule of Compensation for Work." Exhibit B detailed all costs covered by the contract price, including craft labor, non-manual, and equipment costs in addition to all overhead and profit. Furthermore, according to the "Pricing" section of the contract, Chevron paid for "performance of all Work" and the contract prices were "all inclusive" of Cajun's "supply and services including without limitation; salaries and wages . . . the cost of supervision and support services from personnel other than those permanently assigned to the Contract . . . employee income tax and statutory payroll deductions, social security charges, [and] all

taxes (except sales and use taxes) . . . ." Cajun agreed that payment "constituted full payment for the performance of the Work, and completion of [Chevron]'s payment obligations under the Contract."

The contract designated Chevron as the owner of all work product generated during the project and provided:

> 2.20.3. All drawings, documents, engineering and other data prepared or furnished by [Cajun] in performing the Work are considered to be [Chevron's] work for hire and shall become [Chevron's] property from the time of preparation and may be used by [Chevron] for any purpose whatsoever without obligation or liability whatsoever to [Cajun]. [Cajun] assigns all rights in the above referenced drawings, documents, engineering and other data to [Chevron], including copyrights.
>
> [. . .]
>
> 18.4. All inventions, discoveries and improvements (patentable and unpatentable) that are made or conceived by [Cajun] or [Cajun]'s employees in performing the Services and all domestic and foreign patent rights based thereon shall belong to [Chevron] or an Affiliate designa1ed by [Chevron]. [Cajun] shall promptly and fully disclose all such inventions, discoveries and improvements to [Chevron] or the designated Affiliate.

Furthermore, Cajun agreed that all "Technical Information will be used only for performance of the Services for [Chevron]" and that it would not disclose this information without Chevron's express written consent.[12] This obligation remained in force even after the Chevron Project concluded.

3. The Claiborne Project

In September 2011, Cajun contracted with the U.S. Army Corps of Engineers to construct a "box culvert," or an underground canal, as part of the Southeast Louisiana Urban Flood Control Project (the "Claiborne Project"). In doing so, Cajun was responsible for selecting the means and methods of construction, including equipment selection, personnel decisions, and "how to produce the work in accordance with the plans and specifications." The Claiborne contract was a "fixed price" contract valued at $25,971,694.50.

The contract incorporates various provisions of the Federal Acquisition Regulations ("FAR"), Title 48 of the Code of Federal Regulations, either "by reference"

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[12] Section 1.1.31 of the contract defined "technical information" as:

> [A]ny and all information, data and knowledge which is either made available to [Cajun] by [Chevron] relating to the performance of the Work, or developed by [Cajun] as a consequence or arising out of this Contract. Technical Information includes all inventions, discoveries or improvements (patentable or otherwise) that are made or conceived with by [Cajun] in performing the Work and all patent rights associated these inventions, discoveries or improvements.

or by "full text." Relevant here, the contract incorporates FAR 52.232. FAR § 52.232-5(f) dictates the ownership rights of any material generated throughout the contract's performance and states "all material and work covered by progress payments made shall, at the time of payment, become the sole property of the Government."[13] "Work" includes "construction activity . . . [including] buildings, structures, and improvements of all types."[14]

4. The East Bank Project

In January 2012, the Sewerage and Water Board of New Orleans ("SWBNO") awarded Cajun a construction contract to modify the flood protection system at the East Bank Wastewater Treatment Plant in New Orleans. Cajun's scope of work included providing "all labor, materials, supervision, construction equipment, [and] mechanical and electrical equipment."[15]

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[13] FAR § 52.232-5(f), codified as 48 C.F.R. § 52.232-5(f).

[14] Section 00700 of the contract "incorporate[s] by reference" FAR 52.202-1, which provides that "when a solicitation provision or contract clause uses a word or term that is defined in the Federal Acquisition Regulation (FAR), the word or term has the same meaning as the definition in FAR 2.101 in effect at the time the solicitation was issued . . . ." *See* FAR 52.202-1, codified as 48 C.F.R. § 2.101. Thus, the reference to 48 C.F.R. § 52.202-1 effectively incorporates all definitions provided in FAR 2.101. Section 2.101 defines "work" as noted.

[15] Unlike the Methanex, Chevron, and Claiborne projects, Cajun was not solely responsible for the means and methods of executing these tasks. SWBNO hired an engineering firm, Burk-Kleinpeter, Inc. ("BKI") to design the system modification(s).

The East Bank contract was a "firm, fixed-price contract" originally valued just under $24.4 million, although the contract eventually totaled $29.4 million due to changes in the scope of work. Cajun's compensation included payment for "all general foremen, foremen, labor, teams and trucks actually engaged on such specific work for the time actually so employed at the rates actually paid." Compensation also included a "fee for [Cajun's] superintendence, general expense and profit," which "shall be understood also to reimburse [Cajun] for any sub-contractor's general expense and profit which [Cajun] may allow to one or more sub-contractors." Cajun accepted payment as "full compensation for furnishing all the labor, materials, tools, equipment, etc., needed to complete the whole work of the contract" and also "as full compensation for all loss, damages or risks of every description, connected with or resulting from the nature of the work, or from any obstructions or difficulties encountered, of any sort or nature whatsoever[.]"

The East Bank contract contained no provisions relating to ownership of work product or research developed during the project.

C. District Court Proceedings

Throughout discovery, Appellants claimed Cajun engaged in research which led to the development of

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BKI oversaw Cajun's daily construction activities and was required to approve Cajun's means and methods and any materials Cajun selected for permanent features of the project.

four new "products:" two oil refineries and two flood control systems. When the United States moved for summary judgment, the Government argued these products failed the "business component[s]" test and, as such, that Cajun did not perform qualified research. Furthermore, the Government claimed the Representative Projects were otherwise ineligible for the credit because they were "funded."

Appellants responded that Cajun had also developed "processes" that amounted to business components, in addition to the "products" identified during discovery. Appellants claimed their new "processes" encompassed the various "construction means and methods" Cajun used to perform on its contracts and develop these products. Appellants also disputed that the Representative Projects were funded, and maintained that Cajun retained substantial rights to its "research results." Alternatively, Appellants contended that the contracts were contingent upon Cajun's provision of deliverables and were not funded, as set out in 26 C.F.R. § 1.41-4A(d).

The District Court granted the United States's motion for summary judgment on three bases. First, the District Court rejected Appellants' "processes" argument pursuant to Federal Rule of Civil Procedure 37(c)(1) because this argument was inconsistent with Cajun's prior discovery disclosures which, instead, "unequivocally state that, as to each Representative

Project, Cajun developed a 'product.'"[16] The District Court further found that Appellants' construction processes claim failed for lack of specificity because Appellants "fail[ed] to specifically identify even *one* new or improved process that resulted from Cajun's work on the Representative Projects."

Second, the District Court found that Appellants' briefing "fail[ed] to cite any evidence or offer any argument establishing that Cajun's work on the Representative Projects resulted in new 'products.'" Because the excluded evidence of any construction processes was the "*only* evidence (*and* argument) offered to establish the business component element of their QRTC claim," the court concluded the Representative Projects failed to establish a business component.

Third, as an alternative basis for its holding, the District Court held that the Representative Projects were "funded." In particular, the District Court determined that the Methanex, Chevron, and Claiborne Projects failed the substantial rights prong of the "funded research exclusion," and that the East Bank contract was funded because Cajun was fully compensated for any research performed or risk incurred.

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[16] "If a party fails to provide information or identify a witness as required by Rule 26(a) or (e), the party is not allowed to use that information or witness to supply evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless." FED. R. CIV. P. 37(c)(1).

Appellants timely appealed. This Court has jurisdiction under 28 U.S.C. § 1291.

II.

We review a district court's grant of summary judgment de novo, applying the same standard as the district court.[17] Grants of summary judgment may be affirmed for any reason raised to the district court and supported by the record, and we are not bound by the grounds articulated by the district court.[18] Decisions to exclude evidence under Federal Rule of Civil Procedure 37 are reviewed for abuse of discretion.[19]

III.

Appellants advance three arguments on appeal. None are persuasive.

A. Burden on Summary Judgment

The District Court granted summary judgment after finding Appellants did not "offer competent evidence or argument establishing that Cajun performed qualified research," namely on the business components element. Appellants argue that this improperly placed the burden on Appellants as the non-moving party at summary judgment.

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[17] *Roberts v. City of Shreveport*, 397 F.3d 287, 291 (5th Cir. 2005).
[18] *Chevron U.S.A., Inc. v. Traillour Oil Co.*, 987 F.2d 1138, 1146 (5th Cir. 1993).
[19] *CQ, Inc. v. TXU Min. Co., L.P.*, 565 F.3d 268, 277 (5th Cir. 2009).

It is well established that the IRS's assessment of tax liability may be presumed correct so long as it is not "without rational foundation and excessive."[20] The Government satisfies this burden by "specify[ing] the amount of the deficiency or provid[ing] the information necessary to compute the deficiency."[21] Once an assessment is presumed correct, the burden shifts to the taxpayer to rebut the presumption.[22]

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[20] *United States v. Janis*, 428 U.S. 433, 441 (1976); *Portillo v. Comm'r*, 932 F.2d 1128, 1133 (5th Cir. 1991) ("[W]e begin with the well settled principle that the government's deficiency assessment is generally afforded a presumption of correctness . . . The tax collector's presumption of correctness has a herculean muscularity of Goliathlike reach, but we strike an Achilles' heel when we find no muscles, no tendons, no ligaments of fact.") (internal citations omitted); *Sealy Power, Ltd. v. Comm'r*, 46 F.3d 382, 386 (5th Cir. 1995) ("A determination of deficiency issued by the Commissioner is generally given a presumption of correctness, which operates to place on the taxpayer the burden of producing evidence showing that the Commissioner's determination is incorrect.").

[21] *Sealy*, 46 F.3d at 386. At oral argument, Appellants' counsel argued that the IRS assessment was insufficient because it did not result from an administrative proceeding. However, Appellants provided no citations for this proposition and the Court has found none in support of this position. To the contrary, this Court in *Portillo* recognized that "there is no prescribed form for a deficiency notice," *Portillo*, 932 F.2d at 1132 (citing *Donley v. Comm'r*, 791 F.2d 383 (5th Cir. 1986)), and such notice must merely evince "a thoughtful and considered determination that the United States is entitled to an amount not yet paid," *id.* (quoting *Scar v. Comm'r*, 814 F.2d 1363, 1369 (9th Cir. 1987)).

[22] *Portillo*, 932 F.2d at 1133 ("This presumption is a procedural device that places the burden of producing evidence to rebut the presumption on the taxpayer."). The

Importantly, the taxpayer bears this burden regardless of whether the case is a refund suit initiated by the taxpayer or a collection suit brought by the Government.[23] Thus, ultimately, "[t]he burden and the presumption, which are for the most part but the opposite sides of a single coin, combine to require the taxpayer always to prove by a preponderance of

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presumption is consistent with the general principle that taxpayers must demonstrate their entitlement to any refund, deduction, or credit as well as the taxpayer's record-keeping obligations imposed by the Revenue Code. *See id*. at 1134 ("The taxpayer clearly bears the burden of proof in substantiating claimed deductions."); *United States v. McFerrin*, 570 F.3d 672, 675 (5th Cir. 2009) ("Tax credits are a matter of legislative grace, are only allowed as clearly provided for by statute, and are narrowly construed."); 26 U.S.C. § 6001 ("Every person liable for any tax imposed by this title, or for the collection thereof, *shall keep such records,* render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.") (emphasis added); 26 C.F.R. § 1.6001-1(a) ("Except [for farmers and wage-earners], any person subject to tax under subtitle A of the Code . . . or any person required to file a return of information with respect to income, shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of *gross income, deductions, credits,* or other matters required to be shown by such person in any return of such tax or information.") (emphasis added); 26 C.F.R. § 1.41 4(d)("Recordkeeping for the research credit. A taxpayer claiming a credit under section 41 must retain records in sufficiently usable form and detail to substantiate that the expenditures claimed are eligible for the credit.").

[23] *Carson v. United States*, 560 F.2d 693, 696 (5th Cir. 1977) ("This burden applies whether the proceeding is in Tax Court for redetermination of a deficiency or in district court upon a refund claim or a government counterclaim.").

the evidence that the Commissioner's determination was erroneous."[24]

The IRS assessment in this case was entitled to the presumption of correctness. This burden is a low one; the assessment must merely "advise the taxpayer that the [IRS] has determined that a deficiency exists for a particular year," and "specify the amount of the deficiency or provide the information necessary to compute the deficiency."[25] The IRS's August 13, 2019, letter to Appellants (the "Letter") met these requirements.[26] Thus, the burden shifted to Appellants to refute the IRS's determination. Therefore, the District Court properly required Appellants to introduce evidence on this point to establish a genuine dispute meriting trial.

Moreover, even if the IRS's assessment was not entitled to the presumption of correctness, the

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[24] *Id*. at 695–96.

[25] *Portillo*, 932 F.2d at 1132 (5th Cir. 1991) (internal citation omitted); *see also Sealy*, 46 F.3d at 386 (same).

[26] The Letter recounted that Appellants requested a tax credit of $576,756 for the 2013 tax year and received a total refund of $671,071.38, which was comprised of Appellants' $576,756 claimed research credit plus $73,663.38 in statutory interest and an additional, undisputed, refund of $20,652. It further explained that the $576,756 refund was "solely due to information" reported on Appellants' amended return which, in turn, was based on Cajun's Amended Form 1120S. Because the IRS "determined that Cajun Industries, LLC & Subsidiaries is not entitled to the Research Credit claimed," the Letter concluded that the "refund resulting from the Research Credit should not have been allowed and the refund paid to [Appellants] was erroneous."

Government still met its burden of production at summary judgment. As the moving party, the Government needed to show that there was no genuine dispute as to any material fact and that it was entitled to judgment as a matter of law.[27] The Government could do so by submitting evidence negating the existence of some material element of Appellants' claim or defense; alternatively, because taxpayers must demonstrate their entitlement to credits, the Government could have pointed out that the evidence in the record was insufficient to support Appellants' claim that they performed qualified research.[28]

The Government did so by providing approximately forty exhibits—including excerpts from the Representative Projects' contracts, Appellants' 2013 amended tax return, and corporate representative depositions from parties to the Methanex, Chevron, Claiborne, and the East Bank Projects—that refuted Appellants' entitlement to the credit. At that point, the District Court was correct in offering Appellants the opportunity to rebut this evidence and thus create a genuine issue of fact. The District Court did not err on this basis.

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[27] FED. R. CIV. P. 56(a).

[28] *See Little v. Liquid Air Corp.*, 952 F.2d 841, 847 (5th Cir. 1992), *on reh'g en banc*, 37 F.3d 1069 (5th Cir. 1994) (citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986)).

B. Business Components Determination

Research must satisfy the so-called "business components" test in order to qualify for the tax credit.[29] The business components test requires that research be "undertaken for the purpose of discovering information (i) which is technological in nature, and (ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer."[30] The test must be applied separately to each business component, defined as "any product, process, computer software, technique, formula, or invention which is to be (i) held for sale, lease, or license, or (ii) used by the taxpayer in a trade or business of the taxpayer."[31]

During discovery, Appellants stated that they developed four new "products:" two oil refineries and two flood control systems. At summary judgment, however, Appellants claimed Cajun also created new business processes, a separate type of business component, which Appellants define as the "means and methods of construction," "the means and methods of performing [] construction services," and "construction processes."

The District Court found that the asserted products and processes did not satisfy the business components test because Appellants put forth no evidence of the alleged products, any assertions of

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[29] 26 U.S.C. § 41(d)(1)(B).
[30] *Id*.
[31] *Id*. § 41(d)(2)(B).

new construction processes were inconsistent with their prior disclosures and excludable under Federal Rule of Civil Procedure 37, and notwithstanding those inconsistencies, Appellants did not specifically identify the new construction processes at issue.[32]

Appellants now argue that the District Court's determinations were in error.

1. Business Components: Products

Appellants argue they presented sufficient evidence that Cajun developed four business component products and cite to the "Taxpayers' Response to Proposed Statement of Facts" (the "Response") as support. However, cited provisions primarily describe Cajun's "means and methods," i.e., their processes, and not the products. While Appellants may be correct that their construction processes led to the final product, the Revenue Code requires this Court to evaluate each business component separately.[33]

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[32] *See* FED. R. CIV. P. 37(c)(1) ("If a party fails to provide information or identify a witness as required by Rule 26(a) or (e), the party is not allowed to use that information or witness to supply evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless.").

[33] 26 U.S.C. § 41 (d)(2)(A); *see also id*. § 41(d)(2)(C) ("Special rule for production processes.--Any plant process, machinery, or technique for commercial production of a business component shall be treated as a separate business component (and not as part of the business component being produced).").

Accordingly, Appellants have not created a genuine dispute as to whether the four products constitute business components.

2. Business Components: Processes

Appellants further assert the District Court erred in excluding their construction processes argument because the "development processes and techniques" used on the Representative Projects were "almost inextricably intertwined with the tangible deliverables," the final product.

We are not persuaded that the District Court's decision to exclude Appellants' construction processes claim was an abuse of discretion.[34] Federal Rule of Civil Procedure 37(c)(1) provides that "if a party fails to provide information . . . as required by Rule 26(a) or (e), the party is not allowed to use that information . . . to supply evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless."[35] To evaluate whether a Rule 26 violation was harmless, and "thus whether the district court was within its discretion in allowing the evidence to be used at trial," this Court weighs four factors: (1) the importance of the evidence; (2) the prejudice to the opposing party of including the evidence; (3) the possibility of curing such prejudice

[34] *CQ, Inc.*, 565 F.3d at 277.
[35] FED. R. CIV. P. 37(c)(1).

by granting a continuance; and (4) the explanation for the party's failure to disclose.[36]

First, the argument that Cajun developed new construction processes is important because it provided Appellants with a wholly new basis by which to claim the tax credit. By raising this argument for the first time at summary judgment, Appellants effectively asserted a new defense that was neither disclosed nor explored during discovery. Moreover, as the District Court noted, "evidence of Cajun's new construction processes is plainly important to [Appellants] insofar as it is the *only* evidence (*and* argument) offered to establish the business component element of their QRTC claim."

Second, this omission was highly prejudicial to the Government given the procedural posture of the case. The record reflects that Cajun's initial discovery responses described the business components for the Representative Projects as "products." Appellants' supplemental disclosures likewise describe the Projects as producing "product[s]." By raising the processes argument at summary judgment, Appellants deprived the Government of the opportunity investigate this claim.

Third, although the District Court acknowledged that reopening discovery would mitigate prejudice to the Government, the case was "more than three years old" and one month from trial. The District Court was

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[36] *Texas A&M Rsch. Found. v. Magna Transp., Inc.*, 338 F.3d 394, 401–02 (5th Cir. 2003).

entitled to weigh the value of reopening discovery against providing a timely resolution of the case.[37]

Finally, Appellants failed to explain their change in argument before the District Court and, before this Court, deny that any change occurred. In doing so, Appellants direct the Court to their "pretrial briefing" as evidence that Appellants' position has remained consistent. However, the cited pretrial briefing is the Parties' Joint Pretrial Order, which was filed over one month *after* the Government moved for summary judgment and three weeks *after* Appellants responded raising the construction process argument for the first time. Appellants have not directed the Court to any previous statements indicating that the claimed business components involved processes. This explanation is thus unpersuasive.

Given these facts, the District Court did not abuse its discretion in excluding Appellants' arguments about construction processes. However, even if the District Court abused its discretion, the error was harmless because the court nonetheless evaluated the merits of Appellants' claim. Ultimately, the District Court determined that Appellants put forth "vague" and "conclusory" statements regarding their construction processes without identifying "even *one*

[37] A district court has "broad discretion in all discovery matters," and "such discretion will not be disturbed ordinarily unless there are unusual circumstances showing a clear abuse." *Kelly v. Syria Shell Petroleum Dev. B.V.*, 213 F.3d 841, 855 (5th Cir. 2000) (internal citation omitted).

new or improved process that resulted from Cajun's work on the Representative Projects."

The District Court did not abuse its discretion in excluding evidence of Cajun's construction processes. Alternatively, Appellants did not offer sufficient evidence to create a genuine dispute as to whether Cajun's products or processes constituted business components. Without a viable business component, the Representative Projects are not eligible for the tax credit, and the Government is entitled to summary judgment as a matter of law.

C. Funding Exclusion

Qualified research excludes "funded" research projects.[38] Funded research include "any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity)."[39] To determine whether research was funded, courts must first evaluate "all agreements (not only research contracts) entered into between the taxpayer performing the research and other persons."[40] Research is funded if: (1) the researcher retains no

[38] 26 U.S.C. § 41 (d)(4)(H).
[39] *Id*.
[40] 26 C.F.R. § 1.41-4A(d)(1).

substantial rights in its research;[41] or (2) payment is not contingent upon the research's success.[42]

The District Court determined that "the Methanex, Chevron, and Claiborne Projects each fail the 'substantial rights' prong of the 'funded research' exclusion because in each instance Cajun transferred *all* rights to any new or improved 'construction processes' to its contracting counterpart." The Court found that the East Bank contract was funded because "SWBNO plainly *paid* Cajun for whatever alleged research Cajun may have performed."

On appeal, Appellants dispute this finding and argue (1) that Cajun retained substantial rights in its research, and (2) that the Representative contracts were "contingent" upon delivery of a product and, as such, are not funded as defined by Treasury Regulation 26 C.F.R. § 1.41-4A(d).

1. Methanex, Chevron, and Claiborne Projects

Researchers cannot claim the tax credit if they retain no "substantial rights in research under the

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[41] *Id*. § 41-4A(d)(2)("If a taxpayer performing research for another person retains no substantial rights in research under the agreement providing for the research, the research is treated as fully funded for purposes of section 41(d)(4)(H), and no expenses paid or incurred by the taxpayer in performing the research are qualified research expenses.").

[42] *Id*. § 1.41-4A(d)(1)("Amounts payable under any agreement that are contingent on the success of the research and thus considered to be paid for the product or result of the research (see § 1.41–2(e)(2)) are not treated as funding.").

agreement providing for the research."[43] A researcher retains no "substantial rights" if the agreement or contract "confers on another person the exclusive right to exploit the results of the research."[44] Whether Cajun retained substantial rights to its research is determined by the contracts for each Representative Project.[45]

Even assuming Cajun satisfied the business components test, by the express terms of the Methanex, Chevron, and Claiborne contracts, Cajun gave up its rights to any research performed under the contracts. Pursuant to section 26 of the Methanex contract, Methanex retained "all rights, title and interest" in any "work product" prepared by Cajun. The provision applies to all "works made for hire" as well as any work "not considered a work made for hire." By contracting away "all right, title and interest" in its work product, Cajun gave up its rights to all "documents, data, analyses, reports, plans, procedures, manuals, drawings, specifications, calculations, or other technical tangible manifestations of [Cajun]'s efforts (whether written or electronic)" created while performing the contract, as well as "any or all tracings, designs, drawings, field notes, requisitions, purchase orders, specifications, electronic information . . . and other documents or

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[43] 26 C.F.R. §1.41-4A(d)(2).

[44] *Id*.

[45] *Id*. § 1.41-4A(d)(1) ("All agreements (not only research contracts) entered into between the taxpayer performing the research and other persons shall be considered in determining the extent to which the research is funded.").

records developed or acquired by [Cajun] and its suppliers or sub-subcontractors in performing the Work."

Similarly, Cajun assigned to Chevron "all rights" to any "drawings, documents, engineering and other data prepared or furnished by [Cajun]" under the Chevron contract. These items became "[Chevron's] property from the time of preparation and may be used by [Chevron] for any purpose whatsoever without obligation or liability whatsoever to [Cajun]." Furthermore, the contract also states that Chevron owns all "inventions, discoveries and improvements (patentable and unpatentable) that are made or conceived by [Cajun] or [Cajun's] employees" during the Project. Cajun was permitted to use this information "only for performance of the Services for [Chevron]," and pledged not to disclose such information "to any third party without [Chevron's] express written consent." Importantly, this obligation persists "notwithstanding the termination of this Contract."

Finally, by incorporating various provisions of the Federal Acquisition Regulations, the Claiborne contract provides that "all material and work covered by progress payments made shall, at the time of payment, become the sole property of the Government."[46] "Work" is defined broadly and includes "construction activity," "buildings, structures, and improvements of all types."

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[46] FAR § 52.232-5(f), codified as 48 C.F.R. § 52.232-5.

Ultimately, "it is hard to see what rights—much less what substantial rights" Cajun retained in its undefined research.[47] After assigning away all rights to work developed during each Representative Project, Cajun retained no substantial rights in its research.[48]

2. East Bank Project

Treasury Regulation 26 C.F.R. § 1.41-4A(d) defines "funded" research.[49] Relevant here, the Regulation explains that "amounts payable under any agreement that are contingent on the success of the research and thus considered to be paid for the product or result of the research (see § 1.41–2(e)(2)) are not treated as funding . . . ."[50]

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[47] *Tangel v. Comm'r of Internal Revenue*, 121 T.C.M. (CCH) 1001, 2021 WL 81731, at *6 (T.C. 2021) (internal quotations omitted).

[48] Appellants argue Cajun retained substantial rights to its research because "there is nothing [in the contracts] that precludes Cajun from performing the same types of activities and utilizing the same means and methods on other projects, or building other flood structures, or modifying refineries." However, Appellants provided no specific examples of these "means and methods," leaving the district court and this Court to guess what Cajun could bring to future projects aside from additional experience in its field. "[I]ncreased experience in a field of research" does not constitute substantial rights to research. 26 C.F.R. § 1.41-4A(d)(2).

[49] 26 C.F.R. § 1.41-4A(d).

[50] *Id.* § 1.41-4A(d)(1). Together, 26 C.F.R. §§ 1.41-2(e) and 1.41-4A(d) provide "mirror image" rules "for determining when the customer for the research, rather than the researcher, is entitled to claim the tax credit." *Fairchild Indus., Inc. v. United States*, 71 F.3d 868, 870 (Fed. Cir. 1995), *modified* (Feb. 23, 1996).

Appellants offer three reasons why the East Bank Project was not funded. First, Appellants rely on 26 C.F.R. § 1.41-4A(d) and 26 C.F.R. § 1.41-2(e) to argue the East Bank Project was not funded because payment was contingent upon Cajun delivering a "result or product," the refineries and flood systems. Second, and relatedly, Appellants maintain they are entitled to the credit simply because SWBNO, the payor on the East Bank Project, was not. Finally, Appellants argue that the Project was not funded because it was "inherently risky." These arguments miss the mark.

Appellants' argument that all contracts "for the product or result" are not funded improperly conflates "amounts payable under any agreement that are contingent on the success of the research" with contracts for products or services. This argument ignores the operative portion of the sentence:

Fairchild interpreted 26 C.F.R § 1.41-5, which was redesignated as § 1.41-4A in 2001. *See* Credit for Increasing Research Activities, 66 Fed. Reg. 280, 295 (2001). Section § 1.41-4A addresses when a researcher can claim the credit, whereas § 1.41-2(e) addresses when the payor to a contract can (or cannot) claim it.

Accordingly, § 1.41-2(e)(2) explains that payors cannot claim expenses for research contracts "if an expense is paid or incurred pursuant to an agreement under which payment is contingent on the success of the research" because "the expense is considered paid for the product or result rather than the performance of the research." 26 C.F.R. § 1.41-2(e)(2). In doing so, "the regulations implement allocation of the tax credit to the person that bears the financial risk of failure of the research to produce the desired product or result." *Fairchild*, 71 F.3d at 870.

"amounts payable under any agreement that are contingent on the success of the research." Structurally, the phrase "and thus considered to be paid for the product or result of the research" merely describes or modifies "amounts payable . . . contingent on the success of the research." It does not, as Appellants urge, stand on its own to establish an additional type of contract "not treated as funding."

More to the point, § 1.41-4A(d)(1) only concerns agreements contingent upon the success of research. Simply put, the East Bank contract was not contingent on the success of the research because Appellants admit that "none of Cajun Industries' payment was for merely conducting research." Indeed, Appellants' briefing admits "payments to Cajun Industries were not contingent upon whether Cajun Industries conducted research activities." Consequently, this argument lacks merit.

Furthermore, Appellants are not entitled to the research credit merely because SWBNO could not claim the credit. The Regulations do not require that a tax credit be allocated in every contract.[51]

Third, Appellants assert the East Bank Project was not funded because it was a fixed price contract

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[51] *See* 26 C.F.R. § 1.41-A(d)(2) (addressing a scenario in which "a taxpayer performing research for another person retains no substantial rights in the research and if the payments to the researcher are contingent upon the success of the research, *neither the performer nor the person paying for the research* is entitled to treat any portion of the expenditures as qualified research expenditures.") (emphasis added).

and "inherently risky." This argument stands on more solid ground and finds some support in a line of cases including *Fairchild Industries, Inc. v. United States* and *Geosyntec Consultants, Inc. v. United States*.[52] *Fairchild* explained that sections 1.41-2 and 1.41-4A "implement allocation of the tax credit to the person that bears the financial risk of failure of the research to produce the desired product or result."[53] Because fixed price contracts may not fully compensate researchers if their research is unsuccessful, the researcher bears the financial risk of failure, and fixed price contracts are more likely to be deemed unfunded.

However, *Fairchild* and *Geosyntec* do not stand for the proposition that all fixed price contracts are per se not funded. Indeed, *Geosyntec* found that the fixed price contract at issue *was* funded.[54] Furthermore, even if this Court agreed that the Regulations allocate the tax credit to the party bearing the risk of unsuccessful research, Cajun was compensated for all risks associated with the East Bank Project. According to the express terms of the contract, Cajun accepted payment "as full compensation for all loss, damages or risks of every description, connected with or resulting from the nature of the work, or from any

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[52] *Fairchild*, 71 F.3d at 870; *Geosyntec Consultants, Inc. v. United States*, 776 F.3d 1330 (11th Cir. 2015).

[53] *Fairchild*, 71 F.3d at 870.

[54] *Geosyntec*, 776 F.3d at 1339 ("[W]e find that both the Cherry Island Contract and the WM Contract were 'funded' as that term is used in § 41 and Treasury Regulation § 1.41–4A(d).").

obstructions or difficulties encountered, of any sort or nature whatsoever . . . ."

Finally, the East Bank Project was funded for the simple reason that Cajun was compensated for all expenditures incurred and claimed when it sought the tax credit. According to Cajun's IRS Form 6765, Cajun claimed the research credit entirely for "wages" incurred in pursuit of qualified services.[55] However, Cajun was compensated under the East Bank contract for "all general foremen, foremen, labor, [and] teams" as well as Cajun's "superintendence, general expense and profit." Cajun accepted this payment as "full compensation for furnishing all the labor, materials, tools, equipment, etc., needed to complete the whole work of the contract." Therefore, Cajun was fully compensated for all wages and labor, making these expenditures funded under any plain meaning of the term.[56]

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[55] Although Appellants' brief claims that "Cajun Industries included portions of employee wages, contractor costs, and supply costs incurred for various construction projects as part of the computation of the R&D tax credits," their tax filings indicate otherwise. In its Form 6567, Cajun left blank spots next to the "cost of supplies" category. To the extent Appellants argue Cajun claimed the credit for the difference between compensation received and wages paid, Appellants bore the burden of demonstrated this value before the District Court and on appeal. They provided no such calculations.

[56] *See also* 26 C.F.R. § 1.41-4A (Example 1, indicating if a researcher is wholly compensated for otherwise qualified expenditures, the researcher is not entitled to the credit, notwithstanding any rights retained in the research).

IV.

Based upon the record before the District Court and arguments made on appeal, the Court finds that the Representative Projects yielded no viable business components and were funded. Appellants are ineligible for the research tax credit provided by 26 U.S.C. § 41. Therefore, the District Court's grant of summary judgment is AFFIRMED.

Appendix D

TITLE 26—INTERNAL REVENUE CODE

SUBPART D—Business Related Credits

§ 41. Credit for increasing research activities

(a) GENERAL RULE

For purposes of section 38, the research credit determined under this section for the taxable year shall be an amount equal to the sum of—

(1) 20 percent of the excess (if any) of—

(A) the qualified research expenses for the taxable year, over

(B) the base amount,

(2) 20 percent of the basic research payments determined under subsection (e)(1)(A), and

(3) 20 percent of the amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year (including as contributions) to an energy research consortium for energy research.

(b) QUALIFIED RESEARCH EXPENSES

For purposes of this section—

(1) Qualified research expenses – The term "qualified research expenses" means the sum of the following amounts which are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer—

(A) in-house research expenses, and

(B) contract research expenses.

(2) In-house research expenses

(A) In general – The term "in-house research expenses" means—

(i) any wages paid or incurred to an employee for qualified services performed by such employee,

(ii) any amount paid or incurred for supplies used in the conduct of qualified research, and

(iii) under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of qualified research.

Clause (iii) shall not apply to any amount to the extent that the taxpayer (or any person with whom the taxpayer must aggregate expenditures under subsection (f)(1)) receives or accrues any amount from any other person for the right to use substantially identical personal property.

(B) Qualified services – The term "qualified services" means services consisting of—

(i) engaging in qualified research, or

(ii) engaging in the direct supervision or direct support of research activities which constitute qualified research.

If substantially all of the services performed by an individual for the taxpayer during the taxable year consists of services meeting the requirements of clause (i) or (ii), the term

"qualified services" means all of the services performed by such individual for the taxpayer during the taxable year.

(C) Supplies – The term "supplies" means any tangible property other than—

(i) land or improvements to land, and

(ii) property of a character subject to the allowance for depreciation.

(D) Wages

(i) In general – The term "wages" has the meaning given such term by section 3401(a).

(ii) Self-employed individuals and owner-employees – In the case of an employee (within the meaning of section 401(c)(1)), the term "wages" includes the earned income (as defined in section 401(c)(2)) of such employee.

(iii) Exclusion for wages to which work opportunity credit applies – The term "wages" shall not include any amount taken into account in determining the work opportunity credit under section 51(a).

(3) Contract research expenses

(A) In general – The term "contract research expenses" means 65 percent of any amount paid or incurred by the taxpayer to any person (other than an employee of the taxpayer) for qualified research.

(B) Prepaid amounts – If any contract research expenses paid or incurred during any taxable year are attributable to qualified research

to be conducted after the close of such taxable year, such amount shall be treated as paid or incurred during the period during which the qualified research is conducted.

(C) Amounts paid to certain research consortia –

(i) In general – Subparagraph (A) shall be applied by substituting "75 percent" for "65 percent" with respect to amounts paid or incurred by the taxpayer to a qualified research consortium for qualified research on behalf of the taxpayer and 1 or more unrelated taxpayers. For purposes of the preceding sentence, all persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as related taxpayers.

(ii) Qualified research consortium – The term "qualified research consortium" means any organization which—

(I) is described in section 501(c)(3) or 501(c)(6) and is exempt from tax under section 501(a),

(II) is organized and operated primarily to conduct scientific research, and

(III) is not a private foundation.

(D) Amounts paid to eligible small businesses, universities, and Federal laboratories

(i) In general – In the case of amounts paid by the taxpayer to—

(I) an eligible small business,

(II) an institution of higher education (as defined in section 3304(f)), or

(III) an organization which is a Federal laboratory,

for qualified research which is energy research, subparagraph (A) shall be applied by substituting "100 percent" for "65 percent".

(ii) Eligible small business – For purposes of this subparagraph, the term "eligible small business" means a small business with respect to which the taxpayer does not own (within the meaning of section 318) 50 percent or more of—

(I) in the case of a corporation, the outstanding stock of the corporation (either by vote or value), and

(II) in the case of a small business which is not a corporation, the capital and profits interests of the small business.

(iii) Small business – For purposes of this subparagraph—

(I) In general – The term "small business" means, with respect to any calendar year, any person if the annual average number of employees employed by such person during either of the 2 preceding calendar years was 500 or fewer. For purposes of the preceding sentence, a preceding calendar year may be taken into account only if the person was in existence throughout the year.

(II) Startups, controlled groups, and predecessors – Rules similar to the rules of subparagraphs (B) and (D) of section 220(c)(4) shall apply for purposes of this clause.

(iv) Federal laboratory – For purposes of this subparagraph, the term "Federal laboratory" has the meaning given such term by section 4(6) of the Stevenson-Wydler Technology Innovation Act of 1980 (15 U.S.C. 3703(6)), as in effect on the date of the enactment of the Energy Tax Incentives Act of 2005.

(4) Trade or business requirement disregarded for in-house research expenses of certain startup ventures – In the case of in-house research expenses, a taxpayer shall be treated as meeting the trade or business requirement of paragraph (1) if, at the time such in-house research expenses are paid or incurred, the principal purpose of the taxpayer in making such expenditures is to use the results of the research in the active conduct of a future trade or business—

(A) of the taxpayer, or

(B) of 1 or more other persons who with the taxpayer are treated as a single taxpayer under subsection (f)(1).

(c) BASE AMOUNT

(1) In general – The term "base amount" means the product of—

(A) the fixed-base percentage, and

(B) the average annual gross receipts of the taxpayer for the 4 taxable years preceding the taxable year for which the credit is being determined (hereinafter in this subsection referred to as the "credit year").

(2) Minimum base amount – In no event shall the base amount be less than 50 percent of the qualified research expenses for the credit year.

(3) Fixed-base percentage

(A) In general – Except as otherwise provided in this paragraph, the fixed-base percentage is the percentage which the aggregate qualified research expenses of the taxpayer for taxable years beginning after December 31, 1983, and before January 1, 1989, is of the aggregate gross receipts of the taxpayer for such taxable years.

(B) Start-up companies –

(i) Taxpayers to which subparagraph applies – The fixed-base percentage shall be determined under this subparagraph if—

(I) the first taxable year in which a taxpayer had both gross receipts and qualified research expenses begins after December 31, 1983, or

(II) there are fewer than 3 taxable years beginning after December 31, 1983, and

before January 1, 1989, in which the taxpayer had both gross receipts and qualified research expenses.

(ii) Fixed-base percentage – In a case to which this subparagraph applies, the fixed-base percentage is—

(I) 3 percent for each of the taxpayer's 1st 5 taxable years beginning after December 31, 1993, for which the taxpayer has qualified research expenses,

(II) in the case of the taxpayer's 6th such taxable year, ⅙ of the percentage which the aggregate qualified research expenses of the taxpayer for the 4th and 5th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(III) in the case of the taxpayer's 7th such taxable year, ⅓ of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th and 6th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(IV) in the case of the taxpayer's 8th such taxable year, ½ of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, and 7th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(V) in the case of the taxpayer's 9th such taxable year, ⅔ of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, 7th, and 8th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(VI) in the case of the taxpayer's 10th such taxable year, ⅚ of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, 7th, 8th, and 9th such taxable years is of the aggregate gross receipts of the taxpayer for such years, and

(VII) for taxable years thereafter, the percentage which the aggregate qualified research expenses for any 5 taxable years selected by the taxpayer from among the 5th through the 10th such taxable years is of the aggregate gross receipts of the taxpayer for such selected years.

(iii) Treatment of de minimis amounts of gross receipts and qualified research expenses – The Secretary may prescribe regulations providing that de minimis amounts of gross receipts and qualified research expenses shall be disregarded under clauses (i) and (ii).

(C) Maximum fixed-base percentage – In no event shall the fixed-base percentage exceed 16 percent.

(D) Rounding – The percentages determined under subparagraphs (A) and (B)(ii) shall be rounded to the nearest 1/100th of 1 percent.

(4) Election of alternative simplified credit

(A) In general – At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to 14 percent of so much of the qualified research expenses for the taxable year as exceeds 50 percent of the average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined.

(B) Special rule in case of no qualified research expenses in any of 3 preceding taxable years

(i) Taxpayers to which subparagraph applies – The credit under this paragraph shall be determined under this subparagraph if the taxpayer has no qualified research expenses in any one of the 3 taxable years preceding the taxable year for which the credit is being determined.

(ii) Credit rate – The credit determined under this subparagraph shall be equal to 6 percent of the qualified research expenses for the taxable year.

(C) Election – An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.

(5) Consistent treatment of expenses required

(A) In general – Notwithstanding whether the period for filing a claim for credit or refund has expired for any taxable year taken into account in determining the fixed-base percentage, the qualified research expenses taken into account in computing such percentage shall be determined on a basis consistent with the determination of qualified research expenses for the credit year.

(B) Prevention of distortions – The Secretary may prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or gross receipts caused by a change in accounting methods used by such taxpayer between the current year and a year taken into account in computing such taxpayer's fixed-base percentage.

(6) Gross receipts – For purposes of this subsection, gross receipts for any taxable year shall be reduced by returns and allowances made during the taxable year. In the case of a foreign corporation, there shall be taken into account only gross receipts which are effectively connected with the conduct of a trade or business within the United States, the Commonwealth of Puerto Rico, or any possession of the United States.

(d) QUALIFIED RESEARCH DEFINED
For purposes of this section—

(1) In general – The term "qualified research" means research—

(A) with respect to which expenditures may be treated as specified research or experimental expenditures under section 174,

(B) which is undertaken for the purpose of discovering information—

(i) which is technological in nature, and

(ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and

(C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph (3).

Such term does not include any activity described in paragraph (4).

(2) Tests to be applied separately to each business component – For purposes of this subsection—

(A) In general – Paragraph (1) shall be applied separately with respect to each business component of the taxpayer.

(B) Business component defined – The term "business component" means any product, process, computer software, technique, formula, or invention which is to be—

(i) held for sale, lease, or license, or

(ii) used by the taxpayer in a trade or business of the taxpayer.

(C) Special rule for production processes – Any plant process, machinery, or technique for commercial production of a business component shall be treated as a separate business component (and not as part of the business component being produced).

(3) Purposes for which research may qualify for credit – For purposes of paragraph (1)(C)—

(A) In general – Research shall be treated as conducted for a purpose described in this paragraph if it relates to—

(i) a new or improved function,

(ii) performance, or

(iii) reliability or quality.

(B) Certain purposes not qualified – Research shall in no event be treated as conducted for a purpose described in this paragraph if it relates to style, taste, cosmetic, or seasonal design factors.

(4) Activities for which credit not allowed – The term "qualified research" shall not include any of the following:

(A) Research after commercial production – Any research conducted after the beginning of commercial production of the business component.

(B) Adaptation of existing business components – Any research related to the

adaptation of an existing business component to a particular customer's requirement or need.

(C) Duplication of existing business component – Any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component.

(D) Surveys, studies, etc. – Any—

(i) efficiency survey

(ii) activity relating to management function or technique

(iii) market research, testing, or development (including advertising or promotions)

(iv) routine data collection, or

(v) routine or ordinary testing or inspection for quality control.

(E) Computer software – Except to the extent provided in regulations, any research with respect to computer software which is developed by (or for the benefit of) the taxpayer primarily for internal use by the taxpayer, other than for use in—

(i) an activity which constitutes qualified research (determined with regard to this subparagraph), or

(ii) a production process with respect to which the requirements of paragraph (1) are met.

(F) Foreign research – Any research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States.

(G) Social sciences, etc. – Any research in the social sciences, arts, or humanities.

(H) Funded research – Any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

(e) CREDIT ALLOWABLE WITH RESPECT TO CERTAIN PAYMENTS TO QUALIFIED ORGANIZATIONS FOR BASIC RESEARCH

For purposes of this section—

(1) In general – In the case of any taxpayer who makes basic research payments for any taxable year—

(A) the amount of basic research payments taken into account under subsection (a)(2) shall be equal to the excess of—

(i) such basic research payments, over

(ii) the qualified organization base period amount, and

(B) that portion of such basic research payments which does not exceed the qualified organization base period amount shall be treated as contract research expenses for purposes of subsection (a)(1).

(2) Basic research payments defined – For purposes of this subsection—

(A) In general – The term "basic research payment" means, with respect to any taxable year, any amount paid in cash during such taxable year by a corporation to any qualified organization for basic research but only if—

(i) such payment is pursuant to a written agreement between such corporation and such qualified organization, and

(ii) such basic research is to be performed by such qualified organization.

(B) Exception to requirement that research be performed by the organization – In the case of a qualified organization described in subparagraph (C) or (D) of paragraph (6), clause (ii) of subparagraph (A) shall not apply.

(3) Qualified organization base period amount – For purposes of this subsection, the term "qualified organization base period amount" means an amount equal to the sum of—

(A) the minimum basic research amount, plus

(B) the maintenance-of-effort amount.

(4) Minimum basic research amount – For purposes of this subsection—

(A) In general – The term "minimum basic research amount" means an amount equal to the greater of—

(i) 1 percent of the average of the sum of amounts paid or incurred during the base period for—

(I) any in-house research expenses, and

(II) any contract research expenses, or

(ii) the amounts treated as contract research expenses during the base period by reason of this subsection (as in effect during the base period).

(B) Floor amount – Except in the case of a taxpayer which was in existence during a taxable year (other than a short taxable year) in the base period, the minimum basic research amount for any base period shall not be less than 50 percent of the basic research payments for the taxable year for which a determination is being made under this subsection.

(5) Maintenance-of-effort amount – For purposes of this subsection—

(A) In general – The term "maintenance-of-effort amount" means, with respect to any taxable year, an amount equal to the excess (if any) of—

(i) an amount equal to—

(I) the average of the nondesignated university contributions paid by the taxpayer during the base period, multiplied by

(II) the cost-of-living adjustment for the calendar year in which such taxable year begins, over

(ii) the amount of nondesignated university contributions paid by the taxpayer during such taxable year.

(B) Nondesignated university contributions –For purposes of this paragraph, the term "nondesignated university contribution"

means any amount paid by a taxpayer to any qualified organization described in paragraph (6)(A)—

(i) for which a deduction was allowable under section 170, and

(ii) which was not taken into account—

(I) in computing the amount of the credit under this section (as in effect during the base period) during any taxable year in the base period, or

(II) as a basic research payment for purposes of this section.

(C) Cost-of-living adjustment defined

(i) In general – The cost-of-living adjustment for any calendar year is the cost-of-living adjustment for such calendar year determined under section 1(f)(3), by substituting "calendar year 1987" for "calendar year 2016" in subparagraph (A)(ii) thereof.

(ii) Special rule where base period ends in a calendar year other than 1983 or 1984 – If the base period of any taxpayer does not end in 1983 or 1984, section 1(f)(3)(A)(ii) shall, for purposes of this paragraph, be applied by substituting the calendar year in which such base period ends for 2016. Such substitution shall be in lieu of the substitution under clause (i).

(6) Qualified organization – For purposes of this subsection, the term "qualified organization" means any of the following organizations:

(A) Educational institutions – Any educational organization which—

(i) is an institution of higher education (within the meaning of section 3304(f)), and

(ii) is described in section 170(b)(1)(A)(ii).

(B) Certain scientific research organizations – Any organization not described in subparagraph (A) which—

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a),

(ii) is organized and operated primarily to conduct scientific research, and

(iii) is not a private foundation.

(C) Scientific tax-exempt organizations – Any organization which—

(i) is described in—

(I) section 501(c)(3) (other than a private foundation), or

(II) section 501(c)(6),

(ii) is exempt from tax under section 501(a),

(iii) is organized and operated primarily to promote scientific research by qualified organizations described in subparagraph (A) pursuant to written research agreements, and

(iv) currently expends—

(I) substantially all of its funds, or

(II) substantially all of the basic research payments received by it,

for grants to, or contracts for basic research with, an organization described in subparagraph (A).

(D) Certain grant organizations – Any organization not described in subparagraph (B) or (C) which—

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a) (other than a private foundation),

(ii) is established and maintained by an organization established before July 10, 1981, which meets the requirements of clause (i),

(iii) is organized and operated exclusively for the purpose of making grants to organizations described in subparagraph (A) pursuant to written research agreements for purposes of basic research, and

(iv) makes an election, revocable only with the consent of the Secretary, to be treated as a private foundation for purposes of this title (other than section 4940, relating to excise tax based on investment income).

(7) Definitions and special rules – For purposes of this subsection—

(A) Basic research – The term "basic research" means any original investigation for the advancement of scientific knowledge not having a specific commercial objective, except that such term shall not include—

(i) basic research conducted outside of the United States, and

(ii) basic research in the social sciences, arts, or humanities.

(B) Base period – The term "base period" means the 3-taxable-year period ending with the taxable year immediately preceding the 1st taxable year of the taxpayer beginning after December 31, 1983.

(C) Exclusion from incremental credit calculation – For purposes of determining the amount of credit allowable under subsection (a)(1) for any taxable year, the amount of the basic research payments taken into account under subsection (a)(2)—

(i) shall not be treated as qualified research expenses under subsection (a)(1)(A), and

(ii) shall not be included in the computation of base amount under subsection (a)(1)(B).

(D) Trade or business qualification – For purposes of applying subsection (b)(1) to this subsection, any basic research payments shall be treated as an amount paid in carrying on a trade or business of the taxpayer in the taxable year in which it is paid (without regard to the provisions of subsection (b)(3)(B)).

(E) Certain corporations not eligible – The term "corporation" shall not include—

(i) an S corporation,

(ii) a personal holding company (as defined in section 542), or

(iii) a service organization (as defined in section 414(m)(3)).

(f) SPECIAL RULES

For purposes of this section—

(1) Aggregation of expenditures

(A) Controlled group of corporations – In determining the amount of the credit under this section—

(i) all members of the same controlled group of corporations shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such member shall be determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into account by such controlled group for purposes of this section.

(B) Common control – Under regulations prescribed by the Secretary, in determining the amount of the credit under this section—

(i) all trades or businesses (whether or not incorporated) which are under common control shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such person shall be determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into

account by all such persons under common control for purposes of this section.

The regulations prescribed under this subparagraph shall be based on principles similar to the principles which apply in the case of subparagraph (A).

(2) Allocations

(A) Pass-thru in the case of estates and trusts – Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply.

(B) Allocation in the case of partnerships – In the case of partnerships, the credit shall be allocated among partners under regulations prescribed by the Secretary.

(3) Adjustments for certain acquisitions, etc. – Under regulations prescribed by the Secretary—

(A) Acquisitions

(i) In general – If a person acquires the major portion of either a trade or business or a separate unit of a trade or business (hereinafter in this paragraph referred to as the "acquired business") of another person (hereinafter in this paragraph referred to as the "predecessor"), then the amount of qualified research expenses paid or incurred by the acquiring person during the measurement period shall be increased by the amount determined under clause (ii), and the gross receipts of the acquiring

person for such period shall be increased by the amount determined under clause (iii).

(ii) Amount determined with respect to qualified research expenses – The amount determined under this clause is—

(I) for purposes of applying this section for the taxable year in which such acquisition is made, the acquisition year amount, and

(II) for purposes of applying this section for any taxable year after the taxable year in which such acquisition is made, the qualified research expenses paid or incurred by the predecessor with respect to the acquired business during the measurement period.

(iii) Amount determined with respect to gross receipts – The amount determined under this clause is the amount which would be determined under clause (ii) if "the gross receipts of" were substituted for "the qualified research expenses paid or incurred by" each place it appears in clauses (ii) and (iv).

(iv) Acquisition year amount – For purposes of clause (ii), the acquisition year amount is the amount equal to the product of—

(I) the qualified research expenses paid or incurred by the predecessor with respect to the acquired business during the measurement period, and

(II) the number of days in the period beginning on the date of the acquisition and ending on the last day of the taxable year in which the acquisition is made,

divided by the number of days in the acquiring person's taxable year.

(v) Special rules for coordinating taxable years – In the case of an acquiring person and a predecessor whose taxable years do not begin on the same date—

(I) each reference to a taxable year in clauses (ii) and (iv) shall refer to the appropriate taxable year of the acquiring person,

(II) the qualified research expenses paid or incurred by the predecessor, and the gross receipts of the predecessor, during each taxable year of the predecessor any portion of which is part of the measurement period shall be allocated equally among the days of such taxable year,

(III) the amount of such qualified research expenses taken into account under clauses (ii) and (iv) with respect to a taxable year of the acquiring person shall be equal to the total of the expenses attributable under subclause (II) to the days occurring during such taxable year, and

(IV) the amount of such gross receipts taken into account under clause (iii)

with respect to a taxable year of the acquiring person shall be equal to the total of the gross receipts attributable under subclause (II) to the days occurring during such taxable year.

(vi) Measurement period – For purposes of this subparagraph, the term "measurement period" means, with respect to the taxable year of the acquiring person for which the credit is determined, any period of the acquiring person preceding such taxable year which is taken into account for purposes of determining the credit for such year.

(B) Dispositions – If the predecessor furnished to the acquiring person such information as is necessary for the application of subparagraph (A), then, for purposes of applying this section for any taxable year ending after such disposition, the amount of qualified research expenses paid or incurred by, and the gross receipts of, the predecessor during the measurement period (as defined in subparagraph (A)(vi), determined by substituting "predecessor" for "acquiring person" each place it appears) shall be reduced by—

(i) in the case of the taxable year in which such disposition is made, an amount equal to the product of—

(I) the qualified research expenses paid or incurred by, or gross receipts of, the predecessor with respect to the acquired

business during the measurement period (as so defined and so determined), and

(II) the number of days in the period beginning on the date of acquisition (as determined for purposes of subparagraph (A)(iv)(II)) and ending on the last day of the taxable year of the predecessor in which the disposition is made,

divided by the number of days in the taxable year of the predecessor, and

(ii) in the case of any taxable year ending after the taxable year in which such disposition is made, the amount described in clause (i)(I).

(C) Certain reimbursements taken into account in determining fixed-base percentage – If during any of the 3 taxable years following the taxable year in which a disposition to which subparagraph (B) applies occurs, the disposing taxpayer (or a person with whom the taxpayer is required to aggregate expenditures under paragraph (1)) reimburses the acquiring person (or a person required to so aggregate expenditures with such person) for research on behalf of the taxpayer, then the amount of qualified research expenses of the taxpayer for the taxable years taken into account in computing the fixed-base percentage shall be increased by the lesser of—

(i) the amount of the decrease under subparagraph (B) which is allocable to taxable years so taken into account, or

(ii) the product of the number of taxable years so taken into account, multiplied by the amount of the reimbursement described in this subparagraph.

(4) Short taxable years – In the case of any short taxable year, qualified research expenses and gross receipts shall be annualized in such circumstances and under such methods as the Secretary may prescribe by regulation.

(5) Controlled group of corporations – The term "controlled group of corporations" has the same meaning given to such term by section 1563(a), except that—

(A) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a)(1), and

(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

(6) Energy research consortium

(A) In general – The term "energy research consortium" means any organization—

(i) which is—

(I) described in section 501(c)(3) and is exempt from tax under section 501(a) and is organized and operated primarily to conduct energy research, or

(II) organized and operated primarily to conduct energy research in the public interest (within the meaning of section 501(c)(3)),

(ii) which is not a private foundation,

(iii) to which at least 5 unrelated persons paid or incurred during the calendar year in which the taxable year of the organization begins amounts (including as contributions) to such organization for energy research, and

(iv) to which no single person paid or incurred (including as contributions) during such calendar year an amount equal to more than 50 percent of the total amounts received by such organization during such calendar year for energy research.

(B) Treatment of persons – All persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as related persons for purposes of subparagraph (A)(iii) and as a single person for purposes of subparagraph (A)(iv).

(C) Foreign research – For purposes of subsection (a)(3), amounts paid or incurred for any energy research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States shall not be taken into account.

(D) Denial of double benefit – Any amount taken into account under subsection (a)(3)

shall not be taken into account under paragraph (1) or (2) of subsection (a).

(E) Energy research – The term "energy research" does not include any research which is not qualified research.

(g) SPECIAL RULE FOR PASS-THRU OF CREDIT

In the case of an individual who—

(1) owns an interest in an unincorporated trade or business,

(2) is a partner in a partnership,

(3) is a beneficiary of an estate or trust, or

(4) is a shareholder in an S corporation,

the amount determined under subsection (a) for any taxable year shall not exceed an amount (separately computed with respect to such person's interest in such trade or business or entity) equal to the amount of tax attributable to that portion of a person's taxable income which is allocable or apportionable to the person's interest in such trade or business or entity. If the amount determined under subsection (a) for any taxable year exceeds the limitation of the preceding sentence, such amount may be carried to other taxable years under the rules of section 39; except that the limitation of the preceding sentence shall be taken into account in lieu of the limitation of section 38(c) in applying section 39.

(h) TREATMENT OF CREDIT FOR QUALIFIED SMALL BUSINESSES

(1) In general – At the election of a qualified small business for any taxable year, section 3111(f) shall apply to the payroll tax credit portion of the credit otherwise determined under subsection (a) for the taxable year and such portion shall not be treated (other than for purposes of section 280C) as a credit determined under subsection (a).

(2) Payroll tax credit portion – For purposes of this subsection, the payroll tax credit portion of the credit determined under subsection (a) with respect to any qualified small business for any taxable year is the least of—

(A) the amount specified in the election made under this subsection,

(B) the credit determined under subsection (a) for the taxable year (determined before the application of this subsection), or

(C) in the case of a qualified small business other than a partnership or S corporation, the amount of the business credit carryforward under section 39 carried from the taxable year (determined before the application of this subsection to the taxable year).

(3) Qualified small business – For purposes of this subsection—

(A) In general – The term "qualified small business" means, with respect to any taxable year—

(i) a corporation or partnership, if—

(I) the gross receipts (as determined under the rules of section 448(c)(3), without regard to subparagraph (A) thereof) of such entity for the taxable year is less than $5,000,000, and

(II) such entity did not have gross receipts (as so determined) for any taxable year preceding the 5-taxable-year period ending with such taxable year, and

(ii) any person (other than a corporation or partnership) who meets the requirements of subclauses (I) and (II) of clause (i), determined—

(I) by substituting "person" for "entity" each place it appears, and

(II) by only taking into account the aggregate gross receipts received by such person in carrying on all trades or businesses of such person.

(B) Limitation – Such term shall not include an organization which is exempt from taxation under section 501.

(4) Election

(A) In general – Any election under this subsection for any taxable year—

(i) shall specify the amount of the credit to which such election applies,

(ii) shall be made on or before the due date (including extensions) of—

(I) in the case of a qualified small business which is a partnership, the

return required to be filed under section 6031,

(II) in the case of a qualified small business which is an S corporation, the return required to be filed under section 6037, and

(III) in the case of any other qualified small business, the return of tax for the taxable year, and

(iii) may be revoked only with the consent of the Secretary.

(B) Limitations

(i) Amount

(I) In general – The amount specified in any election made under this subsection shall not exceed $250,000.

(II) Increase – In the case of taxable years beginning after December 31, 2022, the amount in subclause (I) shall be increased by $250,000.

(ii) Number of taxable years – A person may not make an election under this subsection if such person (or any other person treated as a single taxpayer with such person under paragraph (5)(A)) has made an election under this subsection for 5 or more preceding taxable years.

(C) Special rule for partnerships and S corporations – In the case of a qualified small business which is a partnership or S corporation, the election made under this subsection shall be made at the entity level.

(5) Aggregation rules

(A) In general – Except as provided in subparagraph (B), all persons or entities treated as a single taxpayer under subsection (f)(1) shall be treated as a single taxpayer for purposes of this subsection.

(B) Special rules – For purposes of this subsection and section 3111(f)—

(i) each of the persons treated as a single taxpayer under subparagraph (A) may separately make the election under paragraph (1) for any taxable year, and

(ii) each of the $250,000 amounts under paragraph (4)(B)(i) shall be allocated among all persons treated as a single taxpayer under subparagraph (A) in the same manner as under subparagraph (A)(ii) or (B)(ii) of subsection (f)(1), whichever is applicable.

(6) Regulations – The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including—

(A) regulations to prevent the avoidance of the purposes of the limitations and aggregation rules under this subsection through the use of successor companies or other means,

(B) regulations to minimize compliance and record-keeping burdens under this subsection, and

(C) regulations for recapturing the benefit of credits determined under section 3111(f) in cases where there is a subsequent adjustment to the payroll tax credit portion of the credit determined

under subsection (a), including requiring amended income tax returns in the cases where there is such an adjustment.

(Added Pub. L. 97–34, title II, § 221(a), Aug. 13, 1981, 95 Stat. 241, § 44F; amended Pub. L. 97–354, § 5(a)(3), Oct. 19, 1982, 96 Stat. 1692; Pub. L. 97–448, title I, § 102(h)(2), Jan. 12, 1983, 96 Stat. 2372; renumbered § 30 and amended Pub. L. 98–369, div. A, title IV, §§ 471(c), 474(i)(1), title VI, § 612(e)(1), July 18, 1984, 98 Stat. 826, 831, 912; renumbered § 41 and amended Pub. L. 99–514, title II, § 231(a)(1), (b), (c), (d)(2), (3)(C)(ii), (e), title XVIII, § 1847(b)(1), Oct. 22, 1986, 100 Stat. 2173, 2175, 2178–2180, 2856; Pub. L. 100–647, title I, § 1002(h)(1), title IV, §§ 4007(a), 4008(b)(1), Nov. 10, 1988, 102 Stat. 3370, 3652; Pub. L. 101–239, title VII, §§ 7110(a)(1), (b), (b)[(c)], 7814(e)(2)(C), Dec. 19, 1989, 103 Stat. 2322, 2323, 2325, 2414; Pub. L. 101–508, title XI, §§ 11101(d)(1)(C), 11402(a), Nov. 5, 1990, 104 Stat. 1388–405, 1388–473; Pub. L. 102–227, title I, § 102(a), Dec. 11, 1991, 105 Stat. 1686; Pub. L. 103–66, title XIII, §§ 13111(a)(1), 13112(a), (b), 13201(b)(3)(C), Aug. 10, 1993, 107 Stat. 420, 421, 459; Pub. L. 104–188, title I, §§ 1201(e)(1), (4), 1204(a)–(d), Aug. 20, 1996, 110 Stat. 1772–1774; Pub. L. 105–34, title VI, § 601(a), (b)(1), Aug. 5, 1997, 111 Stat. 861; Pub. L. 105–277, div. J, title I, § 1001(a), Oct. 21, 1998, 112 Stat. 2681–888; Pub. L. 106–170, title V, § 502(a)(1), (b)(1), (c)(1), Dec. 17, 1999, 113 Stat. 1919; Pub. L. 108–311, title III, § 301(a)(1), Oct. 4, 2004, 118 Stat. 1178; Pub. L. 109–58, title XIII, § 1351(a), (b),

Aug. 8, 2005, 119 Stat. 1056, 1057; Pub. L. 109–135, title IV, § 402(l), Dec. 21, 2005, 119 Stat. 2615; Pub. L. 109–432, div. A, title I, § 104(a)(1), (b)(1), (c)(1), Dec. 20, 2006, 120 Stat. 2934, 2935; Pub. L. 110–172, §§ 6(c), 11(e)(2), Dec. 29, 2007, 121 Stat. 2479, 2489; Pub. L. 110–343, div. C, title III, § 301(a)(1), (b)–(d), Oct. 3, 2008, 122 Stat. 3865, 3866; Pub. L. 111–312, title VII, § 731(a), Dec. 17, 2010, 124 Stat. 3317; Pub. L. 112–240, title III, § 301(a)(1), (b), (c), Jan. 2, 2013, 126 Stat. 2326, 2328; Pub. L. 113–295, div. A, title I, § 111(a), Dec. 19, 2014, 128 Stat. 4014; Pub. L. 114–113, div. Q, title I, § 121(a)(1), (c)(1), Dec. 18, 2015, 129 Stat. 3049; Pub. L. 115–97, title I, §§ 11002(d)(1)(F), (2), 13206(d)(1), Dec. 22, 2017, 131 Stat. 2060, 2061, 2112; Pub. L. 115–141, div. U, title I, § 101(c), title IV, § 401(b)(6), Mar. 23, 2018, 132 Stat. 1160, 1202; Pub. L. 117–169, title I, § 13902(a), (c), Aug. 16, 2022, 136 Stat. 2013, 2014.)

Appendix E

TITLE 26—INTERNAL REVENUE CODE

SUBCHAPTER E—Burden of proof

§ 7491. Burden of proof

(a) Burden Shifts Where Taxpayer Produces Credible Evidence.

(1) General Rule. -- If, in any court proceeding, a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer for any tax imposed by subtitle A or B, the Secretary shall have the burden of proof with respect to such issue.

(2) Limitations. -- Paragraph (1) shall apply with respect to an issue only if--

> **(A)** the taxpayer has complied with the requirements under this title to substantiate any item;
> **(B)** the taxpayer has maintained all records required under this title and has cooperated with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews; and
> **(C)** in the case of a partnership, corporation, or trust, the taxpayer is described in section 7430(c)(4)(A)(ii).

Subparagraph (C) shall not apply to any qualified revocable trust (as defined in section 645(b)(1)) with respect to liability for tax for any taxable year ending after the date of the decedent's death and before the applicable date (as defined in section 645(b)(2)).

(3) Coordination. -- Paragraph (1) shall not apply to any issue if any other provision of this title provides for a specific burden of proof with respect to such issue.

(b) Use Of Statistical Information On Unrelated Taxpayers.

In the case of an individual taxpayer, the Secretary shall have the burden of proof in any court proceeding with respect to any item of income which was reconstructed by the Secretary solely through the use of statistical information on unrelated taxpayers.

(c) Penalties.

Notwithstanding any other provision of this title, the Secretary shall have the burden of production in any court proceeding with respect to the liability of 115a any individual for any penalty, addition to tax, or additional amount imposed by this title.

(Added Pub. L. 105-34, title III, Sec. 3001(a), Aug. 5, 1997, 111 Stat 788; as amended by Pub. L. 105-277, title IV, Sec. 4002(b), Oct. 21, 1998, 112 Stat 2681.)

AMENDMENTS

1998 - Subsec. (a)(2). Pub. L. 105-277, Sec. 4002(b), amended par. (2) by adding the flush sentence at the end.

EFFECTIVE DATE OF 1998 AMENDMENTS

Amendment by Sec. 4002(b) of Pub. L. 105-277 effective as if included in the provisions of the IRS Restructuring and Reform Act of 1998 to which it relates.

EFFECTIVE DATE

Section 3001(c) of Pub. L. 105-206 provided that:

"(1) IN GENERAL. -- The amendments made by this section shall apply to court proceedings arising in connection with examinations commencing after the date of the enactment of this Act [enacted: July 22, 1998].

"(2) TAXABLE PERIODS OR EVENTS AFTER DATE OF ENACTMENT. -- In any case in which there is no examination, such amendments shall apply to court proceedings arising in connection with taxable periods or events beginning or occurring after such date of enactment."