

Court Case Impacts Eligibility of Capped Contracts for R&D Tax Credits

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On January 29, 2015, the United States Court of Appeals for the Eleventh Circuit affirmed a federal district court's decision in *Geosyntec Consultants, Inc. v. United States*, No. 14-11107, disallowing the R&D tax credit for research expenditures linked to capped contracts. Capped contracts are cost-plus arrangements subject to a maximum limit in which the contractor generally submits separate invoices for reimbursement of materials and labor costs, however, if the scope of the contract changes, the fee may be adjusted. In making its decision, the appeals court applied the standard set in the *Fairchild* case in determining which party has the general economic risk in a contract. Geosyntec contended that it faced substantial financial risk under the capped contracts because it was only being paid for expenses incurred, eliminating any opportunity to make a profit on the research should it come in under budget. Geosyntec further argued that it bore the financial risk that its expenses would exceed the ceiling price or the cap for each contract. The appeals court dismissed this argument stating that "because payment to Geosyntec was not contingent on the success of its research, Geosyntec did not bear the financial risk of its own failure." In other words, the court agreed with a lower court ruling that the research had been funded by the firm's clients and therefore did not qualify for the

R&D tax credit.

The ruling did not impact research expenses associated with fixed-price contracts, which a prior court decision already determined will qualify for R&D tax credits. Going forward, taxpayers will have to pay close attention to the structure and wording of their agreements and contracts in order to keep them in consideration for potential R&D tax credits. Despite the ruling, R&D tax credits remain severely underutilized by eligible companies and are a great way to increase cash flows and earnings per share.

To discuss how the court case may affect your R&D tax credit calculation, or for more information, please contact Yair Holtzman, Partner and Practice Leader of Anchin's Research and Development Tax Credits Group at 914.860.5599.