

## Appendix E – Directive Definitions

The following definitions apply solely for the purposes of this Directive:

“1<sup>st</sup> Level Supervisor Managers” means: Managers that directly manage only Qualified Individual Contributors and whose wages are charged to U.S. ASC 730 Financial Statement Cost Centers.

“Adjusted ASC 730 Financial Statement R&D” means: Financial Statement R&D adjusted pursuant to the methodology shown in Appendix C of this Directive and the definitions contained in this Appendix E.

“ASC 730” means: The FASB Accounting Standards Codification (“ASC”) is the source of authoritative GAAP recognized by the FASB to be applied to nongovernmental entities. ASC 730 establishes standards of financial accounting and reporting for research and development costs. It specifies:

- a. those activities that shall be identified as research and development for financial accounting and reporting purposes;
- b. the elements of costs that shall be identified with research and development activities;
- c. the accounting for research and development costs; and
- d. the financial statement disclosures related to research and development costs.

“Base W-2 Wages” means: “wages” as defined by section 3401(a) not including taxable stock options included in the W-2 Box 1 wages.

“Certified Audited Financial Statement” means: A financial statement that is accompanied by the report of an independent (as defined in the American Institute of Certified Public Accountants Professional Standards, Code of Professional Conduct, Rule 101 and its interpretations and rulings) Certified Public Accountant. A financial statement is “certified audited” for purposes of this Directive if it is:

- (A) Certified to be fairly presented (an unqualified or “clean” opinion),
- (B) Subject to a qualified opinion that such financial statement is fairly presented subject to a concern about a contingency (a qualified “subject to” opinion) other than a concern relating to ASC 730 reporting,
- (C) Subject to a qualified opinion that such financial statement is fairly presented, except for a method of accounting with which the accountant disagrees (a qualified “except for” opinion) where such disagreement does not relate to ASC 730, or
- (D) Subject to an adverse opinion not relating to ASC 730, but only if the accountant discloses the amount of the disagreement with the statement.

Any other statement or report, such as a review statement or a compilation report that is not subject to a full audit is not a certified audited statement.

“Chart of Accounts” means: A listing of the names of the accounts that a company has identified and made available for recording transactions in its general ledger.

### **Appendix E – Directive Definitions (cont’d)**

“Contract Research” means: Any expense paid or incurred in carrying on a trade or business to any person other than an employee of the taxpayer for the performance on behalf of the taxpayer of: (i) Qualified research as defined in sections 1.41–4 or 1.41–4A, whichever is applicable, or (ii) Services which, if performed by employees of the taxpayer, would constitute qualified services within the meaning of section 41(b)(2)(B).

“Credit Year” means: The taxable year for which the Research Credit is being determined.

“Financial Statement” means: A financial statement that is prepared in accordance with U.S. GAAP; that is given to creditors for purposes of making lending decisions, given to equity holders for purposes of evaluating their investment in the taxpayer, or provided for other substantial non-tax purposes; and that the taxpayer reasonably anticipates will be directly relied on for the purposes for which it was given or provided.

“Financial Statement R&D” means: Research and development costs currently expensed for U.S. GAAP purposes and shown as a line item on the taxpayer’s Certified Audited Financial Statements’ income statement or separately stated in a note to its Certified Audited Financial Statements.

“Foreign Entity” means: Any entity which is not a U.S. person.

“Funded Research” means: Research to the extent it is funded by any grant, contract, or otherwise by another person (including any governmental entity) where amounts payable to taxpayer are not contingent upon the success of the research and the taxpayer does not retain a substantial right in the research. See section 1.41-4A(d).

“GL Accounts” means: The master set of general ledger accounts that summarize all transactions occurring within an entity. The general ledger is comprised of all the individual accounts needed to record the assets, liabilities, equity, revenue, expense, gain, and loss transactions of a business.

“Person” shall be construed to mean and include an individual, trust, estate, partnership, association, company or corporation.

“Prototype” or “Pilot Model” means: Any representation or model of a product that is produced to evaluate and resolve uncertainty concerning the product during the development or improvement of the product. The term includes a fully-functional representation or model of the product or a component of the product. See section 1.174-2(a)(4).

“Prototype Overhead” means: All costs other than direct labor and direct materials allocated to a Prototype.

“Qualified Individual Contributors” means: Employees of the taxpayer who do not manage any taxpayer employees and whose wages are charged to U.S. ASC 730 Financial Statement Cost Centers.

## **Appendix E – Directive Definitions (cont’d)**

“Quality Control Testing” means: Testing or inspection to determine whether particular units of materials or products conform to specified parameters. However, Quality Control Testing does not include testing to determine if the design of the product is appropriate. See section 1.174-2(a)(7).

“R&D GL Accounts” means: The GL Accounts which make up Financial Statement R&D.

“Rental and Lease Costs of Computers” means: The amount paid or incurred to another person for the right to use (time-sharing) computers in the conduct of qualified research. The computer must be owned and operated by someone other than the taxpayer, located off the taxpayer's premises, and the taxpayer must not be the primary user of the computer. See section 1.41-2(b)(4).

“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. See sections 1.41-2(b)(1) & (2).

“Taxpayer” means: Person/entity choosing to follow this Directive.

“Upper Level Managers” means: Managers that directly supervise any employee other than Qualified Individual Contributors and whose wages are charged to U.S. ASC 730 Financial Statement Cost Centers. For example, a manager that directly supervises a 1<sup>st</sup> Level Supervisor Manager and/or another Upper Level Manager is an Upper Level Manager. Also, a manager that supervises another manager and directly supervises Qualified Individual Contributors is an Upper Level Manager.

“U.S.” means: The United States, the Commonwealth of Puerto Rico, or any possession of the United States.

“U.S. ASC 730 Financial Statement Cost Centers” means: Organizational units (e.g. business units, departments, cost centers) where the costs paid or incurred by those units are charged to U.S. ASC 730 Financial Statement R&D GL Accounts.

“U.S. ASC 730 Financial Statement R&D” means: U.S. Financial Statement R&D adjusted by removal of all expenses for software development activities paid or incurred in the development of software not for sale, lease, or otherwise marketed and for expenses incurred in activities listed in ASC 730-10-55-2 and other non-ASC 730 expenses.

“U.S. ASC 730 Financial Statement R&D GL Accounts” means: GL Accounts which make up U.S. ASC 730 Financial Statement R&D.

“U.S. ASC 730 Financial Statement R&D In-House Research” means: U.S. ASC 730 Financial Statement R&D adjusted by removal of Contract Research.

“U.S. ASC 730 Financial Statement R&D Stock Based Compensation” means: U.S. GAAP stock based compensation included in U.S. ASC 730 Financial Statement R&D.

“U.S. ASC 730 Financial Statement R&D Wage and Wage Related Accounts” means: U.S. GAAP Wage and Wage related accounts included in U.S. ASC 730 Financial Statement R&D and that are not U.S. ASC 730 Financial Statement R&D Stock Based Compensation.

### **Appendix E – Directive Definitions (cont’d)**

“U.S. Financial Statement R&D” means: Financial Statement R&D adjusted by removal of all R&D GL Accounts relating to Foreign Entities.

“U.S. Financial Statement R&D GL Accounts” means: GL Accounts which make up U.S. Financial Statement R&D.

“U.S. GAAP” means: U.S. Generally Accepted Accounting Principles, which are updated regularly to reflect the latest accounting methodologies, are the definitive source of accounting guidelines that companies rely on when preparing their financial statements. The standards are established and administered by the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board (FASB).

“Wage” means: Compensation paid by the taxpayer to an employee of the taxpayer for services rendered by the employee to the taxpayer.

“W-2 Wages” means: “Wages” as defined by section 3401(a).