

# Changes in Sec. 174 Make it a Good Time to Review Your R&E Strategy

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It's been several years since the Tax Cuts and Jobs Act (TCJA) of 2017 was signed into law, but it's still having an impact. Several provisions in the law have expired or will expire in the next few years. One provision that took effect last year was the end of current deductibility for research and experimental (R&E) expenses.

### R&E expenses

Starting in 2022, Internal Revenue Code Section 174 R&E expenditures must be capitalized and amortized over five years (15 years for research conducted outside the United States). Previously, businesses had the option of deducting these costs immediately as current expenses.

The TCJA also expanded the types of activities that are considered R&E for purposes of IRC Sec. 174. For example, software development costs are now considered R&E expenses subject to the amortization requirement.

### Potential strategies

Businesses should consider the following strategies for minimizing the impact of these changes:

- Analyze costs carefully to identify those that constitute R&E expenses and those that are properly characterized as other types of expenses (such as general business expenses under IRC Sec. 162) that continue to qualify for immediate deduction.
- If cost-effective, purchase software that's immediately deductible, rather than developing it in-house, which is now considered an amortizable R&E expense.
- Revisit the R&E credit if you haven't been taking advantage of it.

## **Recent IRS guidance**

For 2022 tax returns, the IRS recently released guidance for taxpayers to change the treatment of R&E expenses (Revenue Procedure 2023-11). The guidance provides a way to obtain automatic consent under the tax code to change methods of accounting for specified research or experimental expenditures under Sec. 174, as amended by the TCJA.

The recent revenue procedure also provides a transition rule for taxpayers who filed a tax return on or before January 17, 2023.

## **Planning ahead**

We can advise you how to proceed. There have also been proposals in Congress that would eliminate the amortization requirements. However, so far, they've been unsuccessful. We're monitoring legislative developments and can help adjust your tax strategies if there's a change in the law.

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