



## RESEARCH CREDITS AND INCENTIVE SERVICES

# Section 174 Expenditures

## Section 174 – Capitalization and Amortization

### → What is Section 174 Activity?

Activities that represent research and development costs in the experimental or laboratory sense



Intention to discover information

Uncertainty concerning the development or improvement of a product or process

Software development

#### Domestic Section 174 Expenditures

- Must be capitalized and amortized over 5 years
- 1<sup>st</sup> year is a mid-year convention

#### Foreign Section 174 Expenditures

- Must be capitalized and amortized over 15 years
- 1<sup>st</sup> year is a mid-year convention



As a result of the Tax Cuts and Jobs Act (TCJA), beginning with tax years after December 31, 2021, Section 174 requires taxpayers to capitalize and amortize research and experimental expenditures. The TCJA also expanded the scope of research expenditures subject to section 174 to include software development costs, which means businesses no longer have the option to immediately expense those costs or use alternative amortization rules.

### → Typical Costs?

Section 174 includes all costs incident to the development or improvement of a product, such as:



Personnel costs

Contract services

Materials

Facility Costs (e.g., rent, utilities)

Below is a comparison of the impact of the capitalization and amortization requirements:

Section 174 R&E Expenditures	Deductible in 2021	Deductible in 2022
Domestic Expense	\$6,500,000	\$650,000
Foreign Expense	<u>\$1,000,000</u>	<u>\$33,333</u>
Total Deduction	\$7,100,000	\$683,333



Rev. Proc. 2023-11 provides streamlined automatic consent for taxpayers to comply with the new Section 174 requirements. A streamlined approach allows taxpayers to attach a statement to the 2022 tax return in lieu of the actual Form 3115.



## → Considerations



The new capitalization rules for Section 174 expenses can have significant tax implications on foreign tax attributes such as GILTI, FDII, and BEAT. The expanded definitions of Section 174 activities and identification of expenses that are 'incident to' research and experimentation have to be considered carefully. In addition, if you are claiming the R&D credit, the new interplay with the 280C election has to be thoroughly analyzed.

Reach out to our A&M Taxand Section 174 experts today to schedule an initial assessment where we discuss how this will impact your business.

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