Capitalizing R&E Expenditures is Odd for Many Reasons

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Overview of Guidance to Date

- Scope of Costs – Section 4, Notice 2023-63
  - How much facilities and overhead should be included?
  - Does intangible amortization get included?
  - Are all severance costs the same?
  - What about indirect or second-level supervision?
- Software Development Costs – Section 5, Notice 2023-63
  - What is software versus integration costs?
  - When does maintenance cost become software?
- Disposition, Retirement or Abandonment – Section 7, Notice 2023-63
  - Do I really have amortization on assets I don’t own?
- Capitalization and Amortization – Section 3, Notice 2023-63

- Research Performed under Contract - Section 6 & 8, Notice 2023-63
  - Single capitalization or double capitalization?
  - How much rights is too much?
  - Risk elements and consistency with 41?
  - Exceptions to rights and risk?
  - Are special rules needed for government contıtes 7rlosk (sk)

R&D Capitalization in the Cost-Sharing Context

R&D: Cost Sharing

Suppose:

- US Parent (USP) pays its US R&D employees in 2022 $10

R&D: CSA (cont'd)

- Does $10 billion have to be capitalized?

AND

- Does USP have an immediate income inclusion of $8 billion?

OR

- Do the $10 billion and the $8 billion net?

AND thus:

- Only $2 billion need be capitalized?

R&D: CSA (Cont'd)

- Some Firms were advising that the amounts did NOT net out – very taxpayer unfavorable.
- Notice 2023-63 clarified: "CST Payments owed to a controlled participant reduce … The amount of the category of IDCs borne directly by that participant that are required to be charged to capital account."

Potential bad news …

Section 951A GILTI: USP has an immediate income inclusion based on CFC's Global Intangible Low-Taxed Income.

Questions:

- In calculating the GILTI amount from CFC, would the $8 billion have to be capitalized?
  - If YES, then the GILTI inclusion could massively spike upwards.
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- Practical implications
  - Adjusting prior imperfections in computation/no 174 computed
  - Audit protection considerations
  - Implications for start-

Section 280C(c)
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Plain Language?

Section 280C(c) Background

- Research Credit Claimants had a choice:
  - EITHER claim a full/gross $100 credit, and lose $100 of deductions
  - OR – 280C(c)(3) election to claim a reduced $79 credit and NO loss of deductions.

Section 280C(c) Background (cont'd)

- Pre-TCJA: Research Credit Claimants that could almost always made a 280C(c) election for a reduced credit
- 2018-2021: Most taxpayers usually still made a 280C(c) election, but not always …

Section 280C(c) Conforming Changes

- I.R.C. § 280C(c)(1) In General —
  - If—
    - (A) — the amount of the credit determined for the taxable year under section 41(a)(1), exceeds
    - (B) — ***the amount allowable as a deduction*** for such taxable year for qualified research expenses or basic research expenses,
  - the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.

Illustration of the New Section 280C(c) (cont'd)

- NO, the credit equals the deduction, thus 280C(c)(1) does nothing.
- And will usually do nothing.
- Thus, the question becomes: Would you prefer a $100 credit, or a $79 credit?

Implication

- In almost all cases, it will be better not to make the 280C(c) election for a reduced credit.

But Not So Fast!

Lastly: Will Congress Fix Section 174?

- i.e., has the last 89 minutes been a waste of your time (other than the CPE)?

- Maybe in December Congress will restore full, immediate deductibility of R&D expenditures for a temporary amount of time?
  - Retroactive?
  - Foreign as well as domestic?
  - And un-