

# Capitalizing R&E Expenditures is Odd for Many Reasons

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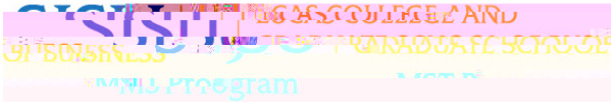
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## Overview of Guidance to Date

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- 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

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- 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 contracts? (sk)

## R&D Capitalization in the Cost-Sharing Context

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### R&D: Cost Sharing

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Suppose:

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

## R&D: CSA (cont'd)

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- 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?
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## R&D: CSA (Cont'd)

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- 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.”
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## Potential bad news ...

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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) — Plain Language?

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### Section 280C(c) Background

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- 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)

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- 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 ...

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## Section 280C(c) Conforming Changes

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- 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.

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

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- 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?



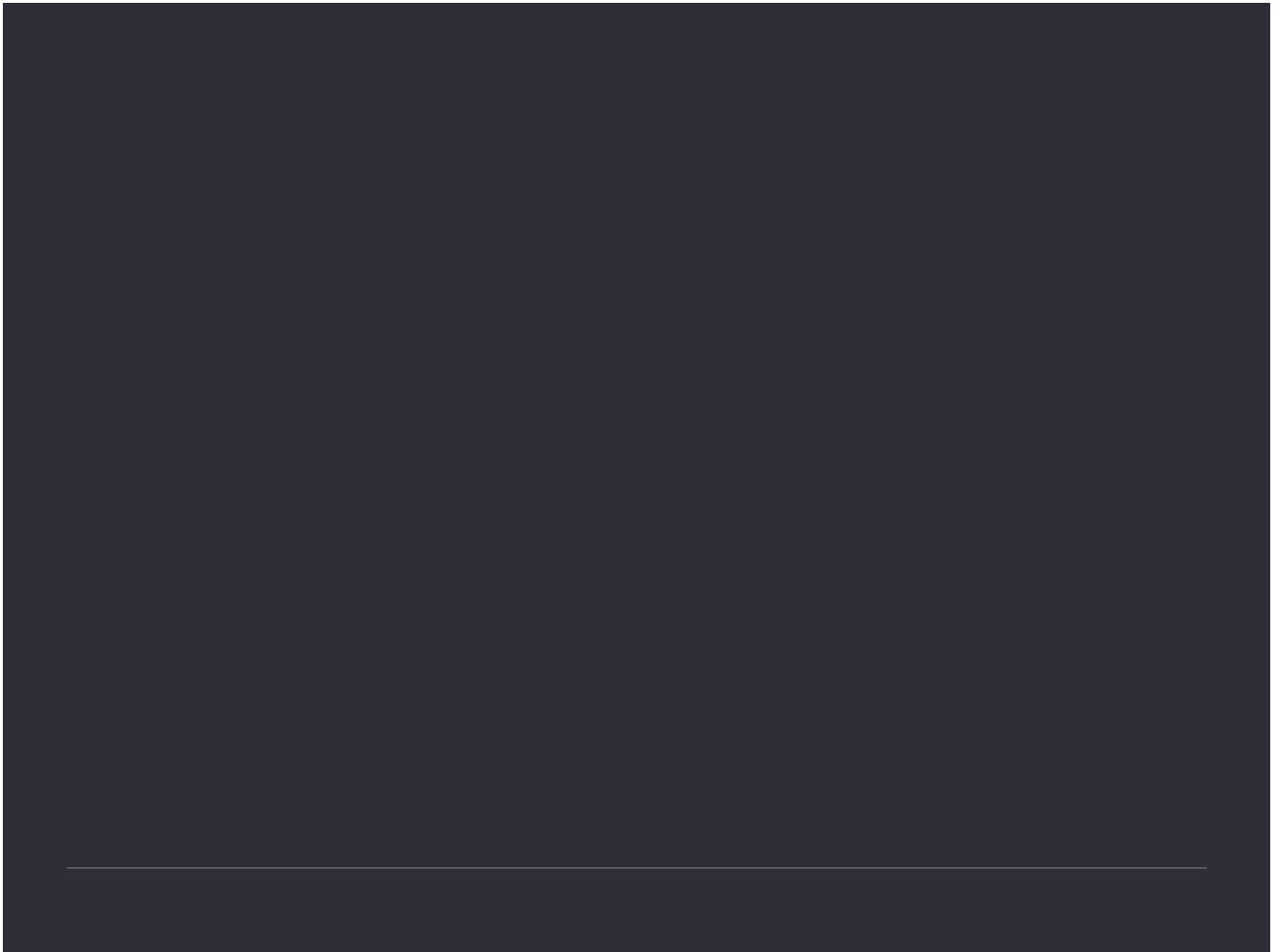
## Implication

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

## But Not So Fast!

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## Lastly: Will Congress Fix Section 174?

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- 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-