

UPCOMING CHANGES TO SECTION 174 STATUS, PLANNING AND ACTION

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Presenters



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Agenda

Today's agenda

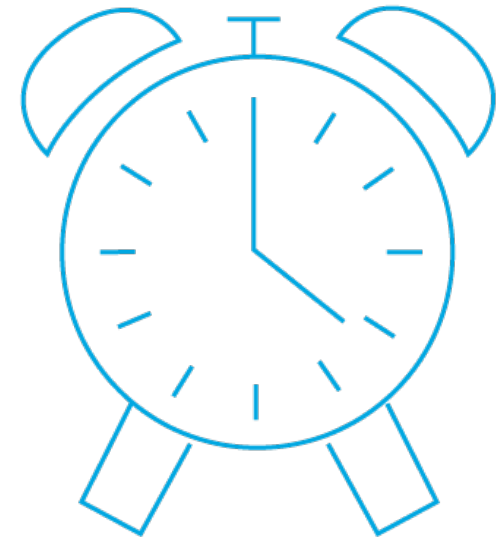
Section 174 – What is it? What is changing?

Political landscape

Planning considerations

Taking Action

Q&A



What is Section 174? What are research & experimentation costs?

- Expenditures represent research and experimental costs if they are for activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a “product” (i.e. pilot model, process, formula, invention, technique)
- Gateway to R&D tax credits
- Exempt from many other provisions
- Changed by the Tax Cuts & Jobs Act... but deferred implementation

Current state v. potential future state

Pre-2022	Post 1/1/2022
Options	No options
<ul style="list-style-type: none">• Direct expense• Capitalize & amortize• Capitalize indefinitely	Required capitalization
Software development – separate options	Required capitalization
Abandonment deductions	No immediate abandonment loss

Impact of TCJA on tax due

Income statement	Pre-12/31/2021	2022
Net Margin	10,000,000	10,000,000
R&E Expenditures (Domestic)	1,500,000	150,000
R&D Expenditures (Foreign)	1,500,000	50,000
Other deductible OpEx	<u>3,000,000</u>	<u>3,000,000</u>
Taxable Income	4,000,000	6,800,000
Tax Due	1,000,000	1,700,000
Less: R&D Tax Credit	<u>170,000</u>	<u>170,000</u>
Net Tax Due	830,000	1,530,000

*Note, in first year half-year convention will apply

**Assumes 25% blended tax rate

Perspective question #1

If these changes were to go into effect, how significant of an impact on your business would you expect these changes to be?

- A. Very significant
- B. Significant
- C. Minimally significant
- D. Not significant

JCT Estimate in TCJA for Amortizing R&E (in billions)

JOINT COMMITTEE ON TAXATION
December 18, 2017
JCX-67-17

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT"

Fiscal Years 2018 - 2027

[Billions of Dollars]

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
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II. Business Tax Reform

8. Applicable recovery period for real property.....	ppisa 12/31/17	-0.1	-0.1	-0.3	-0.4	-0.5	-0.7	-0.6	-0.7	-0.9	-0.6	-1.4	-4.9
9. Amortization of research and experimental expenditures.....	apoi tyba 12/31/21	---	---	---	---	24.2	32.9	26.0	18.9	11.4	6.3	24.2	119.7
10. Expensing of certain costs of replacing citrus plants lost by reason of a casualty (sunset 12/22/27).....	apoia DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]

Proposed legislation

H.R.1304 - American Innovation and R&D Competitiveness Act of 2021

Introduced in House 2/24/21

Sponsor: Rep. John Larson (D-CT)

73 Cosponsors (41 Republicans; 32 Democrats)

- Eliminates the five-year amortization requirement and restores current deductibility of R&E expenses

S. 749 - American Innovation and Jobs Act

Introduced in Senate 3/15/21

Sponsor: Sen. Margaret Hassan (D-NH)

15 Cosponsors – (8 Republicans; 7 Democrats)

- Allows immediate expensing of R&E expenditures.
- Allows the amortization over a period of at least 60 months of certain other types of research and experimental expenditures not treated as expenses
- Increases the maximum amount eligible for the tax credit for new and small businesses
- Increases to 20% the rate of the credit for business startups.

Weighing the factors for/against potential action by Congress to restore immediate deductibility of R&E expenses

Headwinds

- Not expressly included in Made in America Plan, American Families Plan, Treasury Green Book
- Repeal comes at a cost
- Broader hunt for revenue could hinder

Tailwinds

- Strong bipartisan support
- Alignment with wide-ranging R&D investment in Biden's Build Back Better Plan
- Impact on US innovation, competitiveness

What should companies be doing to prepare

- Maybe Congress will act to restore full R&E expensing ...
- But maybe it won't ...
 - Would the expenditure otherwise be deductible as ordinary/necessary?
 - Would this harm the Section 41 Research Credit claim?
 - Will this harm foreign tax credit R&E apportionment?
 - New deferred taxes
 - Process/tracking updates
 - Cash flow/liquidity planning
 - Onshore/offshore decisions
 - Acquiring/licensing rather than developing?
 - Accounting method changes
- Is Congress hearing your voice?

Section 174 – Taking Action

Engaging on Capitol Hill

- RSM Comment Letter
- Member Meetings
- Ongoing RSM Involvement and Engagement


Perspective question #2

Which of the following Sec. 174-related activities would potentially be of interest to you?

- A. Including your signature on RSM's Sec. 174 comment letter
- B. Participating in a virtual meeting with your U.S. Congressman/Senator's office to share your perspectives
- C. Participating in an in-person meeting with your U.S. Congressman/Senator's office to share your perspectives
- D. Participating in future RSM events (webcasts, roundtable discussions, etc.)

QUESTIONS AND ANSWERS

THANK YOU FOR
YOUR TIME AND
ATTENTION



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