

THE POWER OF BEING UNDERSTOOD

TAKE ACTION ON SECTION 174 R&E COMPLIANCE

Feb. 23, 2023

With you today



Dave Kautter

Tax Advisory Leader, RSM US

david.kautter@rsmus.com

202-221-8848



Justin Silva

Practice leader, Credits,
Incentives, and Methods, RSM US

justin.silva@rsmus.com

954-356-5669



Dan Ginsburg

Public Affairs Leader, RSM US

dan.ginsburg@rsmus.com

203-391-0432

Take action on Section 174 compliance

Today's agenda

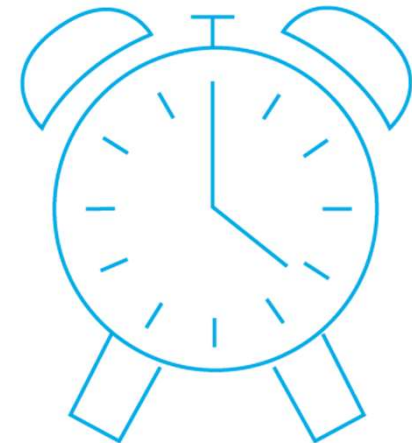
Background: How did we get here?

Broad impacts

Unexpected impacts

Planning considerations

Take action



Background

Two types of “research and experimentation” tax incentives

Deductibility
(Section 174)

Credits
(Section 41)

Dec. 2017

Winter/Spring/
Summer
2022

Fall/Winter 2022

- President Trump signs into law Tax Cuts and Jobs Act, which changed the ability to immediately deduct research expenses
- Requires capitalization and amortization over 5 or 15 years, depending on where research is conducted
- Research cost capitalization provision has deferred effective date
- Required capitalization for research costs begins (for tax years beginning after Dec. 31, 2021)
- Various legislation introduced to repeal or defer required capitalization of research costs
- Broad bi-partisan support in Congress for repeal/deferral
- Research expense changed tied to interest expense change, capital equipment change and child tax credit change
- Congress adjourns in December without changing the capitalization rules

Current state

- Uncertain prospects for legislative action in the current Congress
 - Bi-partisan support but same political dynamic as in prior Congress
 - Research change is still currently tied to changes in interest expense, capital equipment expensing and the child tax credit
 - If there is a change, will it be prospective or retroactive?
- Administrative response
 - Change to required capitalization is an accounting method change
 - IRS procedural guidance recently issued
 - Substantive guidance coming

Background

- 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
- Carve out from other sections – start-up accounting, inventory accounting

Background

Pre-2022

- Direct expense (under 174 or Rev. Proc. 2000-50)
- Capitalize & amortize
 - Sec. 174 – no less than 60 months
 - Rev. Proc. 2000-50 – 36 months under Sec. 167(f), eligible for bonus
- Capitalize indefinitely
- Options for software development with Rev. Proc. 2000-50

Post Jan. 1, 2022 (tax years beginning on/after)

- Significant changes to the treatment of R&E expenditures in 2022 as a result of Tax Cuts and Jobs Act (TCJA)
 - Required capitalization and amortization
 - Domestic – five years (SL, HY)
 - Foreign – 15 years (SL, HY)
 - Limited options for software development
- No abandonment!

Broad impacts

- Estimated taxes (2022 and 2023) & underpayments
- Tax extensions
- Interplay with other changing provisions – business interest expense
- Utilization of other tax attributes – NOLs/limitations; transaction costs; credits
- Tax provisions – change in law & auditable documentation
- Federal consistency – 263A, prior section 199, foreign tax credit, R&D credit
- State conformity to both TCJA and federal accounting method changes
- E&P-based international taxes (GILTI; FDII; BEAT; subpart F)
- 2022 short period returns (acquisition/disposition)

Unexpected impacts

- Operating without guidance presents challenges
- Where is the R&D
- Who owns the R&D?
- Is it even R&D?
- Software, really?
- Construction-in-progress/similar
- Long-term contract accounting
- Book accounting – methods and data
- Positions & documentation
- Real liquidity
- PE clawbacks

Planning considerations

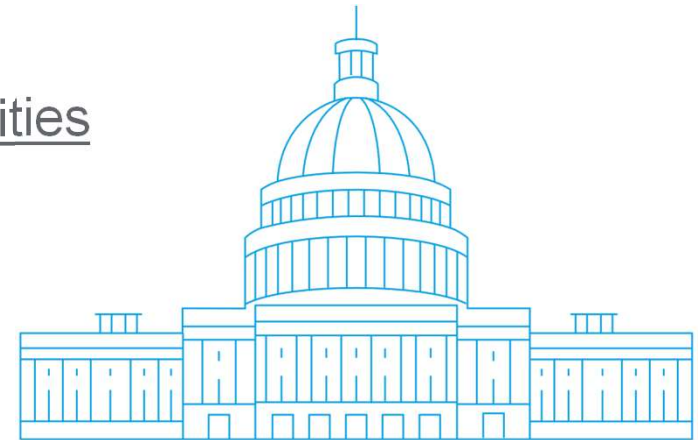
- Accounting methods reviews/changes
- Transaction cost analyses
- Net operating loss limitations
- Interest expense tracing
- Indirect taxes!
 - Sales & use
 - Value-add
 - Tariffs
 - Excise
- When did I incur the costs?
- Fixed assets

Section 174 – Take action

Congress must take action to address unintended Section 174 changes

Make *your* voice heard on Capitol Hill –Two opportunities

1. RSM Section 174 comment letter – sign on!*
2. Share your comments directly with your local Congressional representatives



*Note RSM audit clients are precluded from signing RSM's comment letter due to independence requirements

THANK YOU FOR
YOUR TIME AND
ATTENTION

RSM US LLP

One South Wacker Drive, Suite 800
Chicago, IL 60606
312.634.3400

+00 (1) 800 274 3978
www.rsmus.com

This document contains general information, may be based on authorities that are subject to change, and is not a substitute for professional advice or services. This document does not constitute audit, tax, consulting, business, financial, investment, legal or other professional advice, and you should consult a qualified professional advisor before taking any action based on the information herein. RSM US LLP, its affiliates and related entities are not responsible for any loss resulting from or relating to reliance on this document by any person. Internal Revenue Service rules require us to inform you that this communication may be deemed a solicitation to provide tax services. This communication is being sent to individuals who have subscribed to receive it or who we believe would have an interest in the topics discussed.

RSM US LLP is a limited liability partnership and the U.S. member firm of RSM International, a global network of independent audit, tax and consulting firms. The member firms of RSM International collaborate to provide services to global clients, but are separate and distinct legal entities that cannot obligate each other. Each member firm is responsible only for its own acts and omissions, and not those of any other party. Visit rsmus.com/aboutus for more information regarding RSM US LLP and RSM International.

RSM, the RSM logo and *the power of being understood* are registered trademarks of RSM International Association.

© 2023 RSM US LLP. All Rights Reserved.

