Research & Experimentation Expenses Update

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R&E Brief History

- Prior to Tax Cuts and Jobs Act (TCJA)
  - IRC Section 174 research and experimentation (R&E) expenses currently deductible
    - At the election of the taxpayer could amortize over 5 years
    - Or under IRC 59(e) could amortize over 10 years
- As part of TCJA (January 1, 2018)
  - IRC Section 174 R&E expenses now subject to 5-year amortization (for domestic expenses) and 15-year amortization (for foreign expenses)
    - Assumes "asset" placed in service mid year, so it actually takes 6 tax years (in the case of domestic expenses) to fully recover
  - While most TCJA provisions (e.g., 21% corporate tax rate, $10K SALT cap) were effective back in 2018, this TCJA provision became effective for tax years beginning after 12/31/21

Recent Legislative History

- Taxpayer unfriendly on both sides of the aisle
- Legislative proposals with bipartisan support have tried to delay / repeal the amortization of R&E expenses
  - House passed version of Build Back Better delayed effective date to tax years after 12/31/25 (kick the can)
    - Ultimately the Inflation Reduction Act passed in August 2022 did not delay / repeal the rule change
  - Early version of CHIPS and Science Act included a repeal provision
    - Also passed in August 2022
    - Meant to drive domestic research and manufacturing of semiconductors in the U.S.

2022 Impact / Considerations

- Higher taxable income
  - How to estimate for estimated tax payments
    - 2021 expenses or 2021 expenses plus $YYY
  - State taxable income
- C to S Corp transition period
- Impact on research and development (R&D) credit under IRC Section 41
  - IRC Section 174 is starting point for IRC Section 41 credit
  - Still makes sense to pursue R&D credit
- How much longer can Congress wait to act / can it be retroactively changed?
  - IRC Section 41 history

Contact Information

- Jaron Lariviere
- jlariviere@pkfod.com
- 781-937-5706