

CLIENT ALERT

House Tax Bill Proposes to Make Five-Year Amortization of Research and Experimental Expenditures Mandatory

November 13, 2017

In addition to the research and experimentation tax credit (Internal Revenue Code section 41), the other principal Code provision fostering research activities has been section 174. Since the Internal Revenue Code of 1954, section 174 has permitted expensing of research and experimental expenditures. (In the alternative, taxpayers are currently allowed to elect to amortize such expenditures over a period of not less than 60 months.)

In the Ways and Means Chairman's November 9th markup of H.R. 1, the tax bill introduced recently in the House of Representatives, section 174 would be amended to make the amortization of research and experimental expenditures, including software development costs, over five years mandatory for amounts paid or incurred beginning in 2023. This surprising change reverses more than 60 years of tax policy and is inconsistent with the expansion of expensing pursuant to sections 179 and 168(k), which are well-publicized aspects of the House bill. Why research expenses should be treated *worse* than the purchase of certain tangible personal property is not clear. Moreover, this change will require many taxpayers to create accounting systems to track research expenditures in order to implement the new five-year rule.

Notably, should the House's proposed amendment to section 174 be adopted, the research and experimentation tax credit under section 41, which is determined, in part, by reference to "qualified research," would be affected. "Qualified research" under current law is defined as research with respect to which expenditures may be treated as expenses under section 174. If the provision in the House bill discussed above becomes law, the amount of research and experimental expenditures treated as expenses under section 174 might be reduced, possibly to zero depending on how the cross-reference is interpreted.

Currently, neither the Ways and Means Chairman's November 9th markup of H.R. 1 nor the Senate Finance Chairman's November 9th mark for tax reform proposes any amendment to section 41, which signals an intent to keep that credit as is. If the revisions to section 174 in the House bill become law, the definition of "qualified research" might have to be adjusted.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

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