Overview of Research and Experimental Expenditures: Section 174

Prepared by the Staff of the Joint Committee on Taxation
May 2023
Different Definitions of Research and Experimental ("R&E") Costs

- **Financial reporting**
  - Discovery of new knowledge and translation of research findings into a plan or design

- **Sec. 174 costs**
  - Eliminate uncertainty

- **Sec. 41 R&E costs**
  - Subset of Sec. 174 R&E costs
    - Must relate to new or improved business component
    - Technological in nature
    - Eliminate uncertainty
    - Process of experimentation
    - Conducted within the U.S., Puerto Rico, or any possession of the U.S.
What are Sec. 174 R&E Costs?

- Sec. 174 R&E costs must:
  - Be paid or incurred in a trade or business
  - Represent a R&E cost in the experimental or laboratory sense
    - Must be incurred to discover information that eliminates uncertainty concerning product development or improvement
    - Uncertainty exists if the information available to the taxpayer does not establish either:
      - The capability or method for developing or improving the product, or
      - The appropriate design of the product
Types of Sec. 174 R&E Costs

- Sec. 174 R&E expenditures include all costs incident to product development or improvement
  - Wages
  - Fringe benefits
  - Indirect costs
    - Overhead (rent, depreciation, utilities, etc.)
    - Mixed service costs (human resources, payroll, legal, IT, etc.)
  - Contract research
# Recovery of Sec. 174 R&E Costs

<table>
<thead>
<tr>
<th></th>
<th>Tax Years Beginning Before January 1, 2022</th>
<th>Tax Years Beginning After December 31, 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic R&amp;E expenditures</td>
<td>□ Deduct,</td>
<td>□ Capitalize and amortize over 5 years (half-year convention)</td>
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<tr>
<td></td>
<td>□ Capitalize and amortize over 5 years, or</td>
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<td></td>
<td>□ Capitalize and amortize over 10 years</td>
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<tr>
<td>Foreign R&amp;E expenditures</td>
<td>□ Same as domestic treatment</td>
<td>□ Capitalize and amortize over 15 years (half-year convention)</td>
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<tr>
<td>Software development</td>
<td>□ Deduct,</td>
<td>□ Domestic: Capitalize and amortize over 5 years (half-year convention)</td>
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<td></td>
<td>□ Capitalize and amortize over 3 years, or</td>
<td>□ Foreign: Capitalize and amortize over 15 years (half-year convention)</td>
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<tr>
<td></td>
<td>□ Capitalize and amortize over 5 years</td>
<td></td>
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<tr>
<td>Deduction of unamortized amount if related property or project disposed of, retired or abandoned</td>
<td>□ Yes</td>
<td>□ No (must continue amortizing)</td>
</tr>
</tbody>
</table>

- Domestic: Domestic expenditures
- Foreign: Foreign expenditures
# Revenue Estimate to Permanently Extend R&E Expensing

Note: Assumes date of enactment of July 1, 2023

<table>
<thead>
<tr>
<th>Provision</th>
<th>Effective</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
<th>2027</th>
<th>2028</th>
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<th>2031</th>
<th>2032</th>
<th>2033</th>
<th>2025-20</th>
<th>2023-33</th>
</tr>
</thead>
</table>
Additional Resources

- Joint Committee on Taxation, *General Explanation of Public Law 115-97* (JCS-1-18), December 2018, pages 142-145
- Joint Committee on Taxation, *Tax Incentives for Domestic Manufacturing* (JCX-15-21), March 2021, pages 18-21