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Subject: R&D Credit: Upcoming changes to capitalization and amortization rules.

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OPTIONS FOR CHANGES TO THE CAPITALIZATION AND AMORTIZATION RULES

The Tax Cut and Jobs Act (TCJA) was passed in 2017, but parts of the act do not take effect until years later. One of these is that R&D costs will have to be capitalized and amortized over a five-year period for domestic expenses and a fifteen-year period for foreign expenses. This results in proper planning needing to take place years in advance of this regulation becoming active.

Currently there are two options taxpayers may take:

- Direct expensing of R&D costs in the year those expenses are incurred, expensing them immediately and seeing a reduction in taxable income; or
- Costs can be capitalized and amortized over sixty months from when the benefit of the research is realized.

Under TCJA, taxpayers will not have these options and little ability to treat expenditures in a way that has immediate tax savings.

Starting in 2022, companies will have to capitalize and amortize all R&D costs incurred in connection with their trade or business over a five-year period for domestic research and a fifteen-year period for foreign research. The midpoint of the tax year is utilized as the convention for the first year of amortization. These expenses must continue to be amortized over the full five-year period even if the research is abandoned or scrapped. Unlike assets the remaining basis cannot be written off upon the abandonment.

On the planning side it is important to take these changes into account. Understanding there will be a dip in research expense relief on taxable income and planning for that is important. Businesses will also need to file Form 3115 – Change in Accounting Method to begin the capitalization and amortization of R&D expenses incurred after December 31, 2021.

These changes will result in added administrative burden as well. The research expenses will need to be tracked and amortization schedules created in order to comply. It is likely that more detailed information will need to be prepared on the part of the taxpayer to substantiate expense claims.

This is a substantial change and will be the first time since 1954 that companies will not be able to deduct the full amount of R&D expenses immediately. The good news is that it does not prevent the taxpayer from taking a deduction for R&D, but rather changes the timing of when the benefit can be seen. Additionally, this is still a couple years off and there is hope that another round of tax reform will take place and the capitalization and amortization rules for R&D expenses will not come to fruition.