



TaxNewsFlash

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Rev. Proc. 2023-8: Automatic changes to accounting methods to comply with section 174

The IRS today released an advance version of Rev. Proc. 2023-8, modifying Rev. Proc. 2022-14 to provide procedures to obtain automatic consent to change methods of accounting for specified research or experimental (R&E) expenditures to comply with section 174, as amended by Pub. L. No. 115-97 (the “Tax Cuts and Jobs Act” (TCJA)).

Read [Rev. Proc. 2023-8](#) [PDF 133 KB]

Background

Prior to the amendment of section 174 under the TCJA, a taxpayer could expense R&E expenditures under section 174(a) or elect to treat R&E expenditures as deferred expenses under section 174(b), and such deferred expenditures were allowed as a deduction ratably over such period of not less than 60 months as selected by the taxpayer (beginning with the month in which the taxpayer first realizes benefits from such expenditures).

However, section 174 was amended under the TCJA to provide that specified R&E expenditures paid or incurred in tax years beginning after December 31, 2021 must be capitalized and amortized ratably over a five-year period, beginning with the midpoint of the tax year in which the specified R&E expenditures were paid or incurred. Specified R&E expenditures attributable to research that is conducted outside of the United States must be capitalized and amortized ratably over a period of 15 years, beginning with the midpoint of the tax year in which such expenditures are paid or incurred. Specified R&E expenditures subject to capitalization include expenditures for software development.

The application of this amended rule is treated as a change in the taxpayer’s method of accounting for purposes of section 481, initiated by the taxpayer, and made with the consent of the Secretary. This rule will be applied on a cutoff basis to R&E expenditures paid or incurred in tax years beginning after December 31, 2021 (hence there is no adjustment under section 481(a) for R&E expenditures paid or incurred in tax years beginning before January 1, 2022).

For a taxpayer’s first taxable year beginning after December 31, 2021, a statement in lieu of a Form 3115 (Application for Change in Accounting Method) will need to be attached to the taxpayer’s income tax return. The Rev. Proc. provides:

Except as otherwise provided in section 7.05 of this revenue procedure, the requirement of § 1.446-1(e)(3)(i) to file a Form 3115, Application for Change in Accounting Method, is waived and a statement in lieu of a Form 3115 is authorized for the change in method of accounting under section 7.02 of this revenue procedure for which the year of change is the first taxable year beginning after December 31, 2021. Notwithstanding the definition of Form 3115 in section 3.07 of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, the statement in lieu of a Form 3115 that is permitted under this section 7.02(4)(b) is considered a Form 3115 for purposes of the automatic consent procedures of Rev. Proc. 2015-13. The requirement to file the duplicate copy, under section 6.03(1)(a) of Rev. Proc. 2015-13, is waived. The statement must include the following information for each applicant:

(A) the name and employer identification number or social security number, as applicable, of the applicant that has paid or incurred specified research and experimental expenditures after December 31, 2021;

(B) the beginning and ending dates of the first taxable year in which the change to the required § 174 method takes effect for the applicant (year of change);

(C) the designated automatic accounting method change number for this change (see section 7.02(8) of this revenue procedure);

(D) a description of the type of expenditures included as specified research or experimental expenditures;

(E) the amount of specified research or experimental expenditures paid or incurred by the applicant during the year of change; and

(F) a declaration that the applicant is changing the method of accounting for specified research or experimental expenditures to capitalize such expenditures to a specified research or experimental capital account, and amortize such amount over either a 5-year period for domestic research or 15-year period for foreign research (as applicable) beginning with the mid-point of the taxable year in which such expenditures are paid or incurred in accordance with the method permitted under § 174 for the year of change. Also, the declaration must state that the applicant is making the change on a cut-off basis.

This methodology is different if the year of change is later than the first taxable year beginning after December 31, 2021. The Rev. Proc. states:

(b) Year of change later than the first taxable year beginning after December 31, 2021.

(i) Modified § 481(a) adjustment. The change under section 7.02 of this revenue procedure for a year of change later than the first taxable year beginning after December 31, 2021, is made with a modified § 481(a) adjustment, and should take into account only specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021. (ii) Form 3115. In completing a Form 3115, Application for Change in Accounting Method, to make the change in method of accounting under section 7.02 of this revenue procedure with respect to any year of change later than the first taxable year beginning after December 31, 2021, a taxpayer must include on an attachment to Form 3115:

(A) a description of the type of expenditures included as specified research or experimental expenditures;

(B) the taxable year(s) in which the specified research or experimental expenditures subject to the change were paid or incurred by the applicant; and must state that the applicant is making the change with a modified § 481(a) adjustment that takes into account only specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021.

A transition rule also provides:

(5) Transition rule. A taxpayer who filed a Federal tax return on or before January 9, 2023, for a taxable year beginning after December 31, 2021, is deemed to have complied with the § 446 method change procedures and section 7.02 of this revenue procedure to change its method of accounting for specified research or experimental expenditures paid or incurred in the first taxable year beginning after December 31, 2021, to the required § 174 method to comply with § 174 if the taxpayer:

(a) reported the amount of specified research or experimental expenditures paid or incurred for such taxable year on Part VI of Form 4562, Depreciation and Amortization, filed with the Federal tax return, and

(b) properly capitalized and amortized such specified research or experimental expenditures in accordance with the required § 174 method for such taxable year.

The Rev. Proc. notes that certain eligibility rules are not applicable:

(6) Certain eligibility rule temporarily inapplicable. The eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, does not apply to changes to the required § 174 method for the taxpayer's first taxable year beginning after December 31, 2021.

Rev. Proc. 2022-14 provided the most recent list of accounting method changes for which the automatic change procedures of Rev. Proc. 2015-13 applied. Read [TaxNewsFlash](#). However, Rev. Proc. 2022-14 specifically provided that it did not apply with respect to a change in method of accounting for the treatment of expenditures that qualify as R&E expenditures under section 174 as in effect following amendment by the TCJA. Under Rev. Proc. 2023-8, the IRS provides guidance regarding the application of the automatic change procedures to accounting method changes for R&E expenditures under section 174 as in effect following amendment by the TCJA.

Regarding audit protection, the Rev. Proc. provides:

(7) A taxpayer that changes its method of accounting for specified research or experimental expenditures under section 7.02 of Rev. Proc. 2022-14, as modified by section 3 of this revenue procedure, will receive limited audit protection under section 8.01 of Rev. Proc. 2015-13. Specifically, audit protection will not apply for expenditures paid or incurred in taxable years beginning before January 1, 2022. Additionally, notwithstanding the audit protection rules under section 8.01 of Rev. Proc. 2015-13, the IRS may change the characterization or classification of expenditures as specified research or experimental expenditures as defined in § 174(b) in order to apply § 174 as well as the change under section 7.02 of Rev. Proc. 2022-14, as modified by section 3 of this revenue procedure, to the proper amount of expenditures paid or incurred in each taxable year beginning after December 31, 2021.

* * *

No audit protection for expenditures paid or incurred in taxable years prior to the first taxable year in which § 174 becomes effective. A taxpayer does not receive audit protection under section 8.01 of Rev. Proc. 2015-13 for the change under section 7.02 of this revenue procedure with respect to expenditures paid or incurred in taxable years beginning on or before December 31, 2021. See section 8.02(2) of Rev. Proc. 2015-13.

The designated automatic accounting method change number for a change under section 7.02 of the revenue procedure is "265.". Rev. Proc. 2023-8 will be published in the Internal Revenue Bulletin 2023-2 dated January 9, 2023.

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