

Part III – Administrative, Procedural, and Miscellaneous

Clarifications and Modification to Initial Interim Guidance on Amortization of Specified Research or Experimental Expenditures under Section 174

Notice 2024-12

SECTION 1. OVERVIEW

This notice clarifies and modifies Notice 2023-63, 2023-39 I.R.B. 919, which announced that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue proposed regulations (forthcoming proposed regulations) addressing (1) the capitalization and amortization of specified research or experimental (SRE) expenditures under § 174 of the Internal Revenue Code (Code),¹ as amended by Public Law 115-97, 131 Stat. 2054 (Dec. 22, 2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA), (2) the treatment of SRE expenditures under § 460, and (3) the application of § 482 to cost sharing arrangements involving SRE expenditures, and provided interim guidance that taxpayers may rely on until the forthcoming proposed regulations are published in the *Federal Register*. Specifically, this notice clarifies and modifies Notice 2023-63 regarding (1) the treatment of costs paid or incurred by a research provider for research performed under contract, (2) the requirement that a taxpayer that chooses to rely on any of the rules described in Notice

¹ Unless otherwise specified, all “section” or “§” references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

2023-63 must rely on all the rules described in sections 3 through 9 of the notice, and (3) the obsolescence of section 5 of Rev. Proc. 2000-50, 2000-2 C.B. 601.

The guidance in this notice does not apply for purposes of determining whether an expenditure paid or incurred for taxable years beginning before January 1, 2022, is a research or experimental expenditure under § 174 as in effect for taxable years beginning before January 1, 2022 (former § 174). Unless otherwise provided, the definitions in Notice 2023-63 apply for purposes of this notice.

SECTION 2. BACKGROUND

.01 Treatment of research and experimental expenditures under former § 174.

Former § 174 allowed taxpayers to deduct research or experimental expenditures paid or incurred in connection with a trade or business as current expenses, to capitalize and amortize such expenditures over a period of not less than 60 months, or to charge such expenditures to capital account.

.02 Treatment of SRE expenditures under § 174.

Section 13206(a) of the TCJA amended former § 174 for amounts paid or incurred in taxable years beginning after December 31, 2021. Section 174(a)(1) disallows deductions for amounts that meet the definition of SRE expenditures under § 174(b), except as provided in § 174(a)(2). Section 174(a)(2) requires taxpayers to charge SRE expenditures to capital account and allows amortization deductions of such capitalized expenditures ratably over a 5-year period in the case of SRE expenditures attributable to domestic research, or a 15-year period in the case of SRE expenditures attributable to foreign research, beginning with the midpoint of the taxable year in which such expenditures are paid or incurred. Section 13206(a) of the TCJA made other

amendments to former § 174, including amendments to treat any amount paid or incurred in connection with the development of any software as an SRE expenditure and to prevent the accelerated recovery of unamortized SRE expenditures on account of the disposition, retirement, or abandonment of property with respect to which such expenditures were paid or incurred. For additional background on former § 174 and the TCJA amendments to former § 174, see section 2 of Notice 2023-63. Section 6001 and the regulations thereunder require taxpayers to maintain such books and records as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown in any return, including for research or experimental expenditures that a taxpayer deducts under former § 174, or capitalizes and amortizes under former § 174 or § 174 as in effect for amounts paid or incurred in taxable years beginning after December 31, 2021.

.03 Interim Guidance under Notice 2023-63. Notice 2023-63 was issued on September 8, 2023, and announced that the Treasury Department and the IRS intend to issue forthcoming proposed regulations addressing (1) the capitalization and amortization of SRE expenditures under § 174, (2) the treatment of SRE expenditures under § 460, and (3) the application of § 482 to cost sharing arrangements involving SRE expenditures. Notice 2023-63 provided interim guidance under such sections upon which taxpayers may rely until the forthcoming proposed regulations are published in the *Federal Register*, including a rule that would provide that SRE expenditures must be treated consistently for purposes of all provisions under subtitle A of the Code and therefore may not, for example, be treated as ordinary and necessary expenses under § 162. The Treasury Department and the IRS anticipate that the forthcoming proposed

regulations will provide rules consistent with the rules described in Notice 2023-63 and will consider further clarifications or modifications to the rules described in the interim guidance based on submitted written comments for purposes of the forthcoming proposed regulations. The aspects of Notice 2023-63 that are relevant to this notice are discussed in sections 2.04, 2.05, and 2.06 of this notice.

.04 Research performed under contract.

(1) Section 6 of Notice 2023-63 provides interim guidance regarding whether costs paid or incurred for research performed under contract are SRE expenditures. Section 6.02 includes definitions of the terms “research provider,” “research recipient,” “financial risk,” and “SRE product.” Section 6.03 explains that the treatment of costs paid or incurred by the research recipient is governed by the principles set forth in § 1.174-2(a)(10) and (b)(3).

(2) Section 6.04 of Notice 2023-63 provides rules for the treatment of costs paid or incurred by a research provider. Section 6.04 provides that if the research provider bears financial risk under the terms of the contract with the research recipient, then costs paid or incurred by the research provider that are incident to the SRE activities (as described in section 4.03 of Notice 2023-63) performed by the research provider under the contract are SRE expenditures. Section 6.04 also provides that even if the research provider does not bear financial risk under the terms of the contract with the research recipient, if the research provider has an “SRE product right” (that is, a right to use any resulting SRE product in a trade or business of the research provider or otherwise exploit any resulting SRE product through sale, lease, or license), then costs paid or incurred by the research provider that are incident to the SRE activities performed by

the research provider under the contract are SRE expenditures of the research provider for which no deduction is allowed except as provided in § 174(a)(2). This is the case regardless of whether the research recipient's costs are required to be treated as SRE expenditures under section 6.03 of Notice 2023-63. Lastly, section 6.04 provides that a research provider will not be treated as having an SRE product right if such right is available to the research provider only upon obtaining approval from another party to the research arrangement that is not related to the research provider within the meaning of § 267 or § 707.

(3) The Treasury Department and the IRS are aware that section 6.04 of Notice 2023-63 could be interpreted to require a research provider that does not bear financial risk under the terms of the contract with the research recipient to improperly treat as SRE expenditures the costs paid or incurred by the research provider to perform SRE activities on behalf of the research recipient under such contract if the research provider obtains an SRE product right that (1) is separately bargained for (that is, an SRE product right that arose from consideration other than the cost paid or incurred by the research provider to perform SRE activities under that contract) or (2) was acquired for the limited purpose of performing SRE activities under that contract or another contract with the research recipient.

(4) Consistent with the intent of section 6.04 of Notice 2023-63, section 3 of this notice clarifies that if a research provider that does not bear financial risk under the terms of the contract with the research recipient obtains an "excluded SRE product right" (that is, an SRE product right described in section 2.04(3) of this notice) but does not obtain any other SRE product right under the terms of such contract, then the costs

paid or incurred by the research provider to perform SRE activities on behalf of the research recipient under such contract are not SRE expenditures.

.05 Applicability date of Notice 2023-63. Section 10.01 of Notice 2023-63 provides that taxpayers may rely on the rules described in sections 3 through 9 of Notice 2023-63 prior to the publication date of the forthcoming proposed regulations in the *Federal Register* for expenditures paid or incurred in taxable years beginning after December 31, 2021, provided the taxpayer relies on all the rules described in sections 3 through 9 of Notice 2023-63 and applies them in a consistent manner. Section 10.01 also provides that taxpayers may not rely on the rules described in section 7 of Notice 2023-63 regarding the treatment of SRE expenditures paid or incurred with respect to property that is contributed to, distributed from, or transferred from a partnership.

The Treasury Department and the IRS are aware of situations in which a taxpayer that intends to consistently rely on all the rules described in sections 3 through 9 of the notice for expenditures paid or incurred in taxable years beginning after December 31, 2021, may be required to amend a tax return that was filed before or shortly after Notice 2023-63 was issued to do so. This is because the taxpayer may not be able to change, through a change in method of accounting, certain positions taken on such return that were inconsistent with certain sections of Notice 2023-63. To facilitate reliance on the rules described in Notice 2023-63 in a more administrable manner, section 4 of this notice modifies section 10.01 of Notice 2023-63 to remove the requirement that a taxpayer must rely on all the rules described in sections 3 through 9 of the notice if it chooses to rely on any of the rules described in sections 3 through 9 of the notice.

.06 Obsolescence of Rev. Proc. 2000-50, section 5.01. Section 12 of Notice 2023-63

provides that as a result of the TCJA amendments to § 174 and the rules described in sections 3 through 5 of Notice 2023-63, section 5 of Rev. Proc. 2000-50 is obsolete. Section 5 of this notice clarifies section 12 of Notice 2023-63 to reflect that section 5 of Rev. Proc. 2000-50 is obsoleted only for expenditures paid or incurred in taxable years beginning after December 31, 2021, and not for expenditures paid or incurred for taxable years beginning on or before December 31, 2021.

.07 Procedural guidance under Rev. Proc. 2024-9. On December 22, 2023, the Treasury Department and the IRS released Rev. Proc. 2024-9, this Bulletin, modifying sections 7 and 19 of Rev. Proc. 2023-24, 2023-28 I.R.B. 1207, to provide procedures under § 446 and § 1.446-1(e) for obtaining automatic consent of the Commissioner of Internal Revenue (Commissioner) to change methods of accounting for expenditures paid or incurred in taxable years beginning after December 31, 2021, in reliance on interim guidance under §§ 174 and 460 provided in Notice 2023-63. Rev. Proc. 2024-9 also clarified section 9 of Rev. Proc. 2023-24 to provide that section 5 of Rev. Proc. 2000-50 is obsoleted for costs of developing computer software paid or incurred in any taxable year beginning after December 31, 2021, and continues to apply to costs of developing computer software paid or incurred in any taxable year beginning on or before December 31, 2021.

SECTION 3. CLARIFICATION OF SECTION 6.04 OF NOTICE 2023-63 REGARDING RESEARCH PERFORMED UNDER CONTRACT

For purposes of applying section 6.04 of Notice 2023-63, if a research provider that does not bear financial risk under the terms of the contract with the research recipient obtains an excluded SRE product right (that is, an SRE product right described in section 2.04(3) of this notice) and does not obtain any other SRE product right under

the terms of such contract, then the costs paid or incurred by the research provider to perform SRE activities on behalf of the research recipient under such contract are not SRE expenditures.

SECTION 4. MODIFICATION OF SECTION 10.01 OF NOTICE 2023-63 REGARDING RELIANCE REQUIREMENT

Section 10.01 of Notice 2023-63 is modified to read as follows:

.01 In general. It is anticipated that the forthcoming proposed regulations will provide that rules consistent with the rules described in sections 3 through 9 of this notice would apply for taxable years ending after September 8, 2023. Except as otherwise provided in this section 10.01, prior to the publication date of the forthcoming proposed regulations in the *Federal Register*, a taxpayer may choose to rely on the rules described in sections 3 through 9 of Notice 2023-63 for expenditures paid or incurred in taxable years beginning after December 31, 2021, provided the taxpayer relies on them in a consistent manner. Taxpayers are not required, however, to rely on all the rules described in sections 3 through 9 of Notice 2023-63. Taxpayers may not rely on the rules described in section 7 of Notice 2023-63 for SRE expenditures paid or incurred with respect to property that is contributed to, distributed from, or transferred from a partnership.

SECTION 5. CLARIFICATION OF SECTION 12 OF NOTICE 2023-63 REGARDING OBSOLETION OF SECTION 5 OF REV. PROC. 2000-50

For amounts paid or incurred in taxable years beginning after December 31, 2021, section 5 of Rev. Proc. 2000-50 is removed as obsolete. Section 5 of Rev. Proc. 2000-50 continues to apply to amounts paid or incurred in taxable years beginning on or before December 31, 2021.

SECTION 6. EFFECTIVE DATE

This notice clarifies and modifies Notice 2023-63 and is effective as of September 8, 2023. Until the forthcoming proposed regulations are published in the *Federal Register*, taxpayers may rely on sections 3 and 4 of this notice for expenditures paid or incurred in taxable years beginning after December 31, 2021.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Sections 6.04 and 12 of Notice 2023-63 are clarified. Section 10.01 of Notice 2023-63 is modified.

SECTION 8. DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Bruce Chang of the Office of the Associate Chief Counsel (Income Tax and Accounting). Other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice, please contact Mr. Chang at (202) 317-4870 (not a toll-free number).