

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B07 – GENIN-165838-03

Date:

December 19, 2003

In Re:

Dear : [REDACTED]

This is in response to your letter, dated October 8, 2003, on behalf of [REDACTED], in which you seek to defer and amortize research and experimental expenditures (R&E expenditures) relating to the design, manufacture, and testing of vehicles under section 174(b) of the Internal Revenue Code. The following information is provided to you pursuant to section 2 of Revenue Procedure 2003-1, 2003-1 I.R.B. 1 (January 6, 2003). This information letter is advisory only and has no binding effect on the Internal Revenue Service (IRS).

Section 174(a) provides that a taxpayer may elect to treat R&E expenditures as expenses not chargeable to capital account. Expenditures to which the election applies are allowed as a deduction. The taxpayer may elect this method without the consent of the Secretary of the Treasury for the taxpayer's first taxable year in which R&E expenditures are paid or incurred. If the taxpayer elects this method, the method will apply to all R&E expenditures paid or incurred by the taxpayer for the tax year and must be adhered to for all subsequent years unless, with permission of the Secretary, a change is authorized with respect to all or part of such R&E expenditures. The statute also provides that a taxpayer may adopt this method at any time with the consent of the Secretary.

Section 174(b) provides that a taxpayer may elect, under regulations, to amortize (treat as deferred expenses) R&E expenditures over a period of not less than 60 months. The taxpayer may elect this method without the consent of the Secretary for the taxpayer's first taxable year in which R&E expenditures are paid or incurred. If the taxpayer elects this method, the method and the period selected must be adhered to for the tax year of the election and all subsequent years unless, with the approval of the Secretary, a change is authorized with respect to part or all of such R&E expenditures.

The election under section 174(b) will not apply to any expenditure paid or incurred in a tax year before the year for which the election is made.

Section 1.174-1 of the Income Tax Regulations provides that, if the taxpayer does not elect to expense under section 174(a) or defer and amortize expenses under section 174(b) for the first taxable year in which R&E expenditures are paid or incurred, then R&E expenditures must be charged to capital account. Section 1.174-1 also clarifies that R&E expenditures to which section 174 applies may relate to a general research program or to a particular project.

Section 1.174-4 of the regulations provides rules for making the election to defer and amortize R&E expenditures under section 174(b) and for requesting permission to change to or from that method.

In summary, with the exception of an initial election to defer and amortize R&E expenditures in the first year they are paid or incurred, all changes require the consent of the Secretary and all changes are effective for the tax year of the change and must be adhered to for all subsequent years. A taxpayer who does not elect to defer and amortize R&E expenditures in the first year in which R&E expenditures are paid or incurred may only adopt the deferral method with permission. A taxpayer may not adopt or change a method for any expenditure made prior to the year for which the adoption or change is requested and may not utilize, in the same tax year, more than one method for any particular project.

In Revenue Procedure 2002-9, 2002-3 I.R.B. 327, the IRS provides procedures under which a taxpayer may obtain the automatic consent of the Commissioner of Internal Revenue to change certain methods of accounting, including procedures for taxpayers to obtain automatic consent to change their treatment of R&E expenditures. See section 6 of Revenue Procedure 2002-9, and section 2A of the Appendix to Revenue Procedure 2002-9. We have enclosed a copy of Revenue Procedure 2002-9 for your information.

This letter should not be regarded as a private letter ruling, nor relied upon as such. If you have any questions, you may contact \_\_\_\_\_ at \_\_\_\_\_.

Sincerely,  
*/s/*  
Leslie Finlow  
Chief, Branch 7  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure