



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

July 2, 2003

Number: **INFO 2004-0059**
Release Date: 3/31/04
UIL: 174.00-00

CC:PSI:B07: [REDACTED]
GENIN-154901-02

[REDACTED]

[REDACTED]

Dear [REDACTED]:

This letter responds to your letter, dated September 13, 2002, on behalf of [REDACTED], requesting permission for [REDACTED] to deduct currently under § 174(a) of the Internal Revenue Code research and experimental (R&E) expenditures, effective for the first taxable year ending 2002. The following information is being provided pursuant to section 2.04 of Rev. Proc. 2003-1, 2003-1 I.R.B. 1, 7 (January 6, 2003). This information letter is advisory only and has no binding effect on the Internal Revenue Service.

Section 174(a) provides that a taxpayer may elect to treat R&E expenditures as expenses that are not chargeable to capital account. R&E expenditures to which the election applies are allowed as a deduction. A taxpayer may elect this method without the consent of the Secretary for the taxpayer's first taxable year for which R&E expenditures are paid or incurred. Also, with the consent of the Secretary, a taxpayer may adopt this method at any time. If the taxpayer adopts this method, the method must be adhered to in computing taxable income for the taxable year in which the election is made and all subsequent tax years unless, with approval of the Secretary, a change to a different method is authorized with respect to all or part of the R&E expenditures.

Section 174(b) provides that a taxpayer may elect, in accordance with the regulations, to amortize R&E expenditures over a period of not less than 60 months, as may be selected by the taxpayer, beginning with the month in which the taxpayer first realizes benefits from the expenditures. If a taxpayer elects this method, the method and the period selected by the taxpayer must be adhered to in computing taxable income for the taxable year in which the election is made and all subsequent taxable years unless, with the approval of the Secretary, a change to a different method or to a

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different period is authorized with respect to part or all of the R&E expenditures. The election under IRC § 174(b) will not apply to any expenditure paid or incurred during any taxable year before the taxable year for which the taxpayer makes the election.

Section 1.174-1 of the Income Tax Regulations provides that R&E expenditures that are neither treated as current expenses nor deferred and amortized under § 174 must be charged to capital account. Section 1.174-1 also provides that the expenditures to which § 174 applies may relate either to a general research program or to a particular project.

Section 1.174-3 provides rules for the election to expense R&E expenditures under IRC § 174(a) and for requesting permission to change to or from that method. In summary, except for an initial election to deduct R&E expenditures in the first tax year they are paid or incurred, all changes require the permission of the Commissioner. In addition, all changes are effective for the taxable year of the change and must be adhered to for all subsequent taxable years. The regulations also make clear that a taxpayer may, with permission, adopt any of the authorized methods (current deduction, deferral, or capitalization) with respect to any particular project. A taxpayer may not, however, adopt or change a method for any expenditure made prior to the taxable year for which the adoption or change is requested and may not utilize, in the same taxable year, more than one method for any particular project.

Section 1.174-4 provides rules for making the election to defer and amortize R&E expenditures under IRC § 174(b) and for requesting permission to change to or from that method. In summary, except for an initial election to defer and amortize R&E expenditures in the first year they are paid or incurred, all changes require the permission of the Commissioner. In addition, all changes are effective for the year of change and must be adhered to for all subsequent taxable years. A taxpayer who does not elect to defer and amortize R&E expenditures in the first year in which they 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 taxable year, more than one method for any particular project.

Rev. Proc. 2002-9, 2002-1 C.B. 327, provides procedures under which a taxpayer may obtain the automatic consent of the Commissioner to change certain methods of accounting. Rev. Proc. 2002-9 provides procedures for taxpayers to obtain automatic consent to change their treatment of R&E expenditures. See section 6 of Rev. Proc. 2002-9 and section 2A of the Appendix to Rev. Proc. 2002-9. We have enclosed a copy of Rev. Proc. 2002-9 for your information.

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This letter should not be regarded as a private letter ruling, nor relied upon as such. If you have any questions, you may contact [REDACTED]

Sincerely,

Joseph H. Makurath

Joseph H. Makurath
Senior Technician Reviewer, Branch 7
Office of Associate Chief Counsel
(Passthroughs and Special Industries)