

New Requirements on How to Treat R&D Expenditures

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Companies in various industries increasingly incur research and development (R&D) costs in search of new products and services or to improve existing ones. In some sectors, like biotech and software and other startup companies, the research and experimental budget has a significant impact on the bottom line. Thus, proper tax treatment of these expenses is critical. Starting with tax years beginning after 2021, there are some drastic changes with the tax treatment of these costs which could impact year-end projects and tax liabilities.

Pre-2022 Treatment

Before 2022, businesses could elect to deduct research and experimental expenses, amortize them over a period of at least five years, or capitalize them to the related property. The ability to deduct these expenses incentivized companies to invest in creating new products and services. The ability to amortize the costs over five years (or greater) also provided flexibility for companies to potentially match the expense with the revenue generated.

Additionally, if an expenditure was capitalized but the property was later abandoned or otherwise disposed of, the taxpayer could write off the remaining costs.

What has changed?

Beginning in 2022, amendments made by the 2017 Tax Cuts and Jobs Act require taxpayers to amortize research and experimentation expenditures over five years. Taxpayers' R&D spending will no longer be incentivized by the tax code. Additionally, many companies will struggle with losing the simplicity of deducting the costs without any specific analysis especially as this is a departure from generally accepted accounting principal (GAAP) financials.

Finally, when an expenditure is capitalized and is disposed of before the five year amortization period expires, a taxpayer can no longer write off the remaining basis and must continue to amortize the costs.

Next Steps

Taxpayers who incur R&D expenses will need to calculate the tax impact to them under these new rules. For example, additional estimated tax payments may be required to catch up estimates based on prior law. In some cases, taxpayers who have always been in a loss or no tax situation may owe taxes for 2022. It should be noted that there are current bills in Congress that seek to reverse this impact and revert back to pre-2022 treatment. Until these are made law, taxpayers should continue to operate under the current rules. Please reach out to a member of your client service team with any questions or if we can be of assistance. We are here to help you achieve your goals while minimizing the tax impact.

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