Part III – Administrative, Procedural, and Miscellaneous

Guidance on Amortization of Specified Research or Experimental Expenditures under Section 174

Notice 2023-63

SECTION 1. OVERVIEW

This notice announces 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. The Treasury Department and the IRS intend to propose rules in the forthcoming proposed regulations consistent with the interim guidance provided in sections 3 through 9 of this notice. Section 10 of this notice provides that taxpayers may rely on the interim guidance provided in sections 3 through 9 of this notice prior to the publication date of the forthcoming proposed

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

regulations in the Federal Register. Section 11 of this notice requests comments, including comments on specific issues and issues not addressed in this notice.

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). This notice provides guidance regarding expenditures that are treated as SRE expenditures under § 174 and, therefore, affects expenditures that may be treated as SRE expenditures for purposes of § 41(d)(1)(A) and § 1.41-4(a)(2)(i). However, this notice is not intended to change the rules for determining eligibility for or computation of the research credit under § 41 and the regulations thereunder, including rules for "research with respect to computer software," and the definitions of "qualified research" and "qualified research expenses."

SECTION 2. BACKGROUND

.01 Prior law treatment of research or experimental expenditures.

(1) In general. Former § 174 was first enacted in 1954 to provide certainty to taxpayers regarding the treatment of otherwise capitalizable research or experimental expenditures with no determinable useful life. See H.R. Rep. No.1337, 83d Cong., 2d Sess. 28 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 33 (1954). Before the enactment of former § 174, courts consistently held that the law required capitalization of product research and development costs, including production costs of tangible property used in the research process. Under such prior law, expenditures related to a taxpayer's research and experimentation generally were capitalized and held in suspense until the taxpayer could determine (1) whether

or not the research had failed; and (2) if the research was successful, whether or not the research resulted in property that had a useful life determinable with reasonable accuracy.

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

(2) Definition of research or experimental expenditures under former § 174.

The provisions of § 1.174-2 address the scope and definition of research or experimental expenditures under former § 174. Specifically, § 1.174-2(a)(1) provides that the term "research or experimental expenditures" means those expenditures incurred in connection with a taxpayer's trade or business that represent research and development costs in the experimental or laboratory sense, and generally includes all such costs incident to the development or improvement of a product or a component or subcomponent of the product, as well as the costs of obtaining a patent. Expenditures represent research and development costs in the experimental or laboratory sense if they are for activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. Section 1.174-2(a)(3) defines the term "product" to include any pilot model, process, formula, invention, technique, patent, or similar property, and includes products to be used by the taxpayer in its trade or business as well as products to be held for sale, lease, or license.

Section 1.174-2(a)(10) and (b)(3) generally provide that former § 174 also

applies to expenditures paid or incurred by a taxpayer for research or experimentation carried on by another person or organization (such as a research institute, foundation, engineering company, or similar contractor) on behalf of the taxpayer, provided that such expenditures are made at the taxpayer's order and risk. However, § 1.174-2 does not explicitly address expenditures paid by a contractor for research or experimentation carried on for another person or organization.

Section 1.174-2(a) also provides guidance on expenditures that are not subject to former § 174, including costs paid or incurred in the production of a product after the elimination of uncertainty concerning the development or improvement of the product, and expenditures for: quality control testing, efficiency surveys, management studies, consumer surveys, advertising or promotions, the acquisition of another's product, and research in connection with literary, historical or similar projects. In addition, § 1.174-2(b) and former § 174(c) provide that any expenditure for the acquisition or improvement of land or depreciable property to be used in connection with the research or experimentation and of a character which is subject to the allowance under section 167 or section 611 are not research or experimental expenditures. However, allowances for depreciation and depletion with respect to such property are treated as research or experimental expenditures. Finally, § 1.174-2(c) and former § 174(d) provide that the provisions of former § 174 are not applicable to any expenditures paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore, oil, gas, or other mineral.

(3) Software development. Prior to the effective date of the TCJA amendments to former § 174, section 5 of Rev. Proc. 2000-50, 2000-2 C.B. 601, permitted

taxpayers to treat costs to develop computer software that were not otherwise treated as research or experimental expenditures under former § 174 as currently deductible expenses or capital expenditures that are amortized over 60 months or 36 months. Accordingly, under section 5 of Rev. Proc. 2000-50, costs to develop computer software that did not otherwise meet the definition of research or experimental expenditures under former § 174 were afforded generally similar treatment to research or experimental expenditures under former § 174. Rev. Proc. 2000-50 does not define software development or otherwise describe software development activities. See also Kellett v. Commissioner, T.C. Memo. 2022-62 (discussing, and questioning the statutory support for, deduction of software development expenditures under Rev. Proc. 2000-50).

.02 Treatment of research or experimental expenditures under the TCJA.

(1) Requirement to capitalize and amortize SRE expenditures. Section 13206(a) of the TCJA amended former § 174 for amounts paid or incurred in taxable years beginning after December 31, 2021. For such amounts, § 174(a)(1) disallows deductions for SRE expenditures, 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 the applicable § 174 amortization period, beginning with the midpoint of the taxable year in which such expenditures are paid or incurred. As used in this notice, the term “applicable § 174 amortization period” refers to a 5-year (60-month) period in the case of SRE expenditures attributable to domestic research or a 15-year (180-month) period in the case of SRE expenditures attributable to foreign research, as defined in section 3.03 of

this notice.

(2) Definition of SRE expenditures. Section 174(b), as amended by section 13206(a) of the TCJA, defines "SRE expenditures" to mean, with respect to any taxable year beginning after December 31, 2021, research or experimental expenditures that are paid or incurred by the taxpayer during such taxable year in connection with the taxpayer's trade or business. See Snow v. Commissioner, 416 U.S. 500 (1974) ("in connection with" a trade or business is broader than "in carrying on" a trade or business).

(3) Software development. Section 13206(a) of the TCJA added new § 174(c)(3) to require that any amount paid or incurred in connection with the development of any software in taxable years beginning after December 31, 2021, be treated as a research or experimental expenditure (and thus an SRE expenditure to the extent paid or incurred by the taxpayer during the taxable year in connection with the taxpayer's trade or business).

(4) Amortization deductions for disposed of, retired, or abandoned property. Section 13206(a) of the TCJA added new § 174(d) to provide that deductions of SRE expenditures may not be taken on account of the disposition, retirement, or abandonment of property with respect to which such SRE expenditures are paid or incurred. If such property is disposed of, retired, or abandoned during the applicable § 174 amortization period, § 174(d) requires that the amortization deductions for such SRE expenditures continue over that period.

(5) Other changes to former § 174. Section 13206(a) of the TCJA redesignated former § 174(c) to § 174(c)(1) and former § 174(d) to § 174(c)(2), removed former

§ 174(e), which provided that only reasonable expenditures are considered research or experimental expenditures under former § 174, and also removed former § 174(f), which contained cross-references to basis adjustments under § 1016(a)(14) and to an election for 10-year amortization under § 59(e).

(6) Change in method of accounting.

(a) TCJA requirement. Section 13206(b) of the TCJA requires taxpayers to apply the provisions of § 174, as amended by section 13206(a) of the TCJA, as a change in method of accounting for purposes of § 481, initiated by the taxpayer and made with the consent of the Secretary of the Treasury or her delegate, and applied on a cutoff basis to SRE expenditures paid or incurred in taxable years beginning after December 31, 2021. Thus, no adjustments under § 481(a) are permitted or required with respect to research or experimental expenditures paid or incurred in taxable years beginning before January 1, 2022.

(b) Procedural guidance. On December 12, 2022, the Treasury Department and the IRS issued Rev. Proc. 2023-8, 2023-3 I.R.B. 407, to provide procedures for taxpayers to obtain automatic consent to change methods of accounting to comply with § 174, as amended by the TCJA. On December 29, 2022, the Treasury Department and the IRS issued Rev. Proc. 2023-11, 2023-3 I.R.B. 417, to modify and supersede Rev. Proc. 2023-8. The change in method of accounting provided by Rev. Proc. 2023-11 was subsequently included in section 7.02 of Rev. Proc. 2023-24, 2023-28 I.R.B. 1207. Section 7.02 of Rev. Proc. 2023-24 implements the requirement imposed by § 13206(b) of the TCJA that a taxpayer must make this change in method of accounting on a cutoff basis if the change was made during the taxpayer's first taxable year

beginning after December 31, 2021. However, section 7.02 of Rev. Proc 2023-24 provides that a taxpayer making the change for a taxable year subsequent to the taxpayer's first taxable year beginning after December 31, 2021, is required to make that change with a modified § 481(a) adjustment that takes into account only SRE expenditures paid or incurred in taxable years beginning after December 31, 2021. Section 7.02(7) of Rev. Proc. 2023-24 also provides that a taxpayer that changes its method of accounting for SRE expenditures under the revenue procedure will receive limited audit protection. Specifically, audit protection will not apply for expenditures paid or incurred in taxable years beginning before January 1, 2022. Audit protection also will not apply for expenditures paid or incurred in taxable years beginning after December 31, 2021, if a change in method of accounting is made for the taxable year immediately subsequent to the first taxable year beginning after December 31, 2021. See section 10.02 of this notice for additional procedural guidance the Treasury Department and IRS intend to issue.

SECTION 3. CAPITALIZATION AND AMORTIZATION OF SRE EXPENDITURES

.01 Purpose. The Treasury Department and the IRS intend to propose rules in forthcoming proposed regulations consistent with the interim guidance provided in this section 3, which provides taxpayers with clarity regarding the requirement in § 174(a) to capitalize and amortize SRE expenditures and the treatment of short taxable years.

.02 Requirement to capitalize and amortize SRE expenditures. Taxpayers are required to capitalize SRE expenditures (as defined in section 4.02(2) of this notice) and amortize such expenditures ratably over the applicable § 174 amortization period beginning with the midpoint of the taxable year in which such expenditures are paid or

incurred.

.03 Definition of foreign research. The term foreign research means any research conducted outside the United States, the Commonwealth of Puerto Rico, or any U.S. territory or other possession of the United States. See §§ 174(a)(2)(B) and 41(d)(4)(F).

.04 SRE expenditures attributable to foreign research. Taxpayers must look to where the SRE activities (as defined in section 4.02(4) of this notice) are performed to determine whether the corresponding SRE expenditures are attributable to foreign research for purposes of section 3.02 of this notice.

.05 Definition of midpoint. Except as provided in section 3.06 of this notice, for purposes of determining when amortization begins under § 174(a)(2)(B) and section 3.02 of this notice, the term midpoint means the first day of the seventh month of the taxable year in which the SRE expenditures are paid or incurred. See section 7.03 of this notice for interim guidance with respect to SRE expenditures that relate to property disposed of before the midpoint of the taxable year in which such SRE expenditures are paid or incurred.

.06 Short taxable years.

(1) In general. The amortization deduction for a short taxable year is based on the number of months in the short taxable year. If a short taxable year includes part of a month, the entire month is included in the number of months in the taxable year, but the same month may not be counted more than once. If a taxpayer has two successive short taxable years and the first short taxable year ends in the same month that the second short taxable year begins, the taxpayer should include that month in the first short taxable year and not in the second short taxable year.

(2) Midpoint for short taxable years. The midpoint of a short taxable year is the first day of the midpoint month. In the case of a short taxable year with an even number of months (as determined under section 3.06(1) of this notice), the midpoint month is determined by dividing the number of months in the short taxable year by two and then adding one (for example, for a short taxable year consisting of ten months, the midpoint month is the sixth month of the short taxable year ((10 / 2) + 1 = 6)). In the case of a short taxable year with an odd number of months (as determined under section 3.06(1) of this notice), the midpoint month is the month for which there are an equal number of months before and after such month (for example, for a short taxable year consisting of seven months, the mid-point month is the fourth month of the short taxable year).

.07 Example.

(1) Facts. Taxpayer is a calendar-year taxpayer that incorporated and began operations on October 17, 2022. In 2022, Taxpayer paid or incurred $60,000 in SRE expenditures that were not attributable to foreign research. Taxpayer has no short taxable years after its initial taxable year.

(2) Analysis. Taxpayer has a short taxable year that begins on October 17, 2022, and ends on December 31, 2022, and thus is treated as having a three-month taxable year under section 3.06(1) of this notice. The midpoint month is November, and thus November 1, 2022, will be treated as the midpoint under section 3.06(2) of this notice. In 2022, Taxpayer amortizes $2,000 of SRE expenditures ($60,000 / 60 months × 2 months). In taxable years 2023 through 2026, each a full 12-month taxable year, Taxpayer amortizes $12,000 ($60,000 / 60 months × 12 months) each year, or $48,000 total. In 2027, Taxpayer amortizes the remaining $10,000 ($60,000 / 60 months × 10

months).

SECTION 4. SCOPE OF SECTION 174

.01 Purpose. The Treasury Department and the IRS intend to propose rules in forthcoming proposed regulations consistent with the interim guidance provided in this section 4, which provides taxpayers with clarity in determining whether expenditures are SRE expenditures subject to capitalization and amortization under § 174.

.02 Definition of SRE expenditures and other relevant terms. For purposes of this notice:

(1) Terms used in § 1.174-2. Unless otherwise provided, all terms used in this notice have the same meaning as those in § 1.174-2. For example, the term product has the meaning set forth in § 1.174-2(a)(3).

(2) SRE expenditures defined. The term SRE expenditures means, with respect to any taxable year beginning after December 31, 2021, research or experimental expenditures (as defined in section 4.02(3) of this notice), which are paid or incurred by the taxpayer during such taxable year in connection with the taxpayer's trade or business.

(3) Research or experimental expenditures defined. The term research or experimental expenditures means expenditures that--

(a) satisfy the requirements under § 1.174-2 to be research or experimental expenditures, or

(b) are paid or incurred in connection with the development of any computer software (as provided in section 5 of this notice), regardless of whether such expenditures are research or experimental expenditures under § 1.174-2.

See section 6 of this notice for rules to determine whether expenditures paid or incurred pursuant to a contract meet the definition of research or experimental expenditures under this section 4.02(3).

(4) SRE activities defined. The term SRE activities means—

(a) software development activities described in section 5.03 of this notice, or

(b) research or experimental activities described in § 1.174-2 (that is, activities in the experimental or laboratory sense intended to discover information that would eliminate uncertainty concerning the development or improvement or appropriate design of a product or a component or subcomponent of a product).

.03 Identification and allocation of SRE expenditures. As provided in section 4.02(2) and (3) of this notice, SRE expenditures include expenditures that satisfy the requirements under § 1.174-2 or are paid or incurred in connection with the development of any computer software, regardless of whether such software expenditures satisfy the requirements under § 1.174-2. Section 1.174-2(a)(1) and (5) provide that research or experimental expenditures under § 1.174-2 include all costs incident to the development or improvement of a product, a component of a product, or subcomponent of a product, as applicable (that is, research or experimental expenditures under § 1.174-2 include all costs incident to SRE activities described in section 4.02(4)(b) of this notice). Section 4.03(1) of this notice provides a non-exhaustive list of examples of the types of costs that are incident to SRE activities described in section 4.02(4)(b) of this notice or paid or incurred in connection with software development activities described in sections 4.02(4)(a) and 5.03 of this notice. In other words, section 4.03(1) of this notice provides a non-exhaustive list of examples

of the types of costs that are SRE expenditures. Section 4.03(2) of this notice provides a list of costs that are not permitted or required to be treated as SRE expenditures, regardless of whether they may be incident to SRE activities described in section 4.02(4) of this notice. Section 4.03(3) of this notice provides interim guidance addressing the allocation of costs, including those described in section 4.03(1) of this notice, to SRE activities.

(1) Examples of costs that are SRE expenditures. The types of costs that are considered incident to SRE activities described in section 4.02(4)(b) of this notice or paid or incurred in connection with software development activities described in sections 4.02(4)(a) and 5.03 of this notice include but are not limited to:

(a) Labor costs. Labor costs of full-time, part-time, and contract employees and independent contractors who perform, supervise, or directly support SRE activities. Labor costs include all elements of compensation other than severance compensation, such as basic compensation, stock-based compensation, overtime pay, vacation pay, holiday pay, sick leave pay, payroll taxes, pension costs, employee benefits, and payments to a supplemental unemployment benefit plan.

(b) Materials and supplies costs. Costs of materials and supplies, including tools and equipment that are not depreciable under § 168, which are used or consumed in the performance of SRE activities or in the direct support of SRE activities. For example, a cost described in § 1.162-3, relating to the cost of a material or supply, may be an SRE expenditure.

(c) Cost recovery allowances. Depreciation, amortization, or depletion allowances with respect to property used in the performance of SRE activities or in the

direct support of SRE activities, including property placed in service in a taxable year that begins on or before December 31, 2021. For example, depreciation with respect to a test bed used in the performance of SRE activities, or allocable depreciation with respect to a facility in which SRE activities, or services that directly support SRE activities, are performed.

(d) Patent costs. Costs of obtaining a patent, such as attorneys' fees expended in making and perfecting a patent application.

(e) Certain operation and management costs. Rent, utilities, insurance, taxes, repairs and maintenance costs, security costs, and similar overhead costs with respect to facilities, equipment and other assets used in the performance of SRE activities or in the direct support of SRE activities.

(f) Travel costs. Travel costs for the performance of SRE activities or the direct support of SRE activities.

(2) Costs that are not treated as SRE expenditures. The following costs are not permitted or required to be treated as SRE expenditures, regardless of whether they may be incident to SRE activities described in section 4.02(4)(b) of this notice or paid or incurred in connection with software development activities described in sections 4.02(4)(a) and 5.03 of this notice:

(a) Costs paid or incurred by general and administrative service departments (or functions) that only indirectly support or benefit SRE activities (for example, services of payroll personnel in preparing salary checks of research personnel, services of human resources personnel who hire research personnel, or services of accounting personnel who account for research expenses);

(b) Interest on debt to finance SRE activities;

(c) Costs paid or incurred for activities described in section 5.05 of this notice;

(d) Costs to input content into a website;

(e) Costs for website hosting that involve the payment of a specified, periodic fee to an Internet service provider in return for hosting a website on its server(s) connected to the Internet;

(f) Costs to register an Internet domain name or trademark;

(g) Costs listed in § 1.174-2(a)(6)(i)-(vii);

(h) Amounts representing amortization of SRE expenditures; and

(i) Amounts representing amortization of research or experimental expenditures paid or incurred in taxable years beginning before January 1, 2022.

(3) Allocation method. To determine total SRE expenditures for a taxable year, taxpayers must allocate costs, including the types of costs described in section 4.03(1) of this notice, to SRE activities on the basis of a cause-and-effect relationship between the costs and the SRE activities or another relationship that reasonably relates the costs to the benefits provided to the SRE activities. The allocation method used for one type of cost may be different than the allocation method used for another type of cost. However, the allocation method used for each type of cost must be applied on a consistent basis. For example, a taxpayer that consistently allocates labor costs described in section 4.03(1)(a) of this notice to SRE activities by multiplying such labor costs by the ratio of the total time the person or people actually spent performing, supervising, or directly supporting SRE activities during the taxable year to the total time the person or people spent performing all services for the taxpayer during the taxable

year, meets the requirements in this section 4.03(3). Similarly, a taxpayer that consistently allocates facility cost recovery allowances described in section 4.03(1)(c) of this notice to SRE activities by multiplying such cost recovery allowances by the ratio of the square footage of the area used to conduct or directly support SRE activities to the total square footage of the facility, meets the requirement of this section 4.03(3). An allocation method for a particular type of cost that meets the requirements of this section 4.03(3) may not be appropriate for purposes of allocating that same type of cost under other sections of the Code.

(4) Example. The following example illustrates the rules set forth in section 4.03 of this notice.

(a) Facts. Company A, a calendar year taxpayer, is engaged in the business of manufacturing chemical products. On January 1, 2023, Company A begins a research project to develop a new product. This research project constitutes an SRE activity. Company A does not undertake any other SRE activities during its 2023 taxable year. Company A is comprised of six departments: (1) the Manufacturing Department, (2) the Research Department, (3) the Engineering Department, (4) the Legal Department, (5) the Personnel Department, and (6) the Accounting Department. The Manufacturing Department does not provide any support services to the Research Department. The Personnel Department provides indirect support services to the Research Department by hiring research personnel and preparing their paychecks but does not directly support any aspect of the research project. The Accounting Department provides indirect support services to the Research Department by paying Research Department invoices and accounting for research costs but does not directly support any aspect of

the research project. The Engineering Department provides direct support services to the Research Department with respect to the research project by collaborating with the Research Department to develop the new product. The Legal Department provides direct support services to the Research Department with respect to the research project by preparing patent applications for the new product. Company A owns the following assets, each of which is used, in whole or in part, to perform research or directly support the research project:

Description	**Department(s)**	**Depreciation for 2023**
10,000 square foot facility	The Manufacturing Department occupies 5,000 square feet of the facility. The other departments each occupy 1,000 square feet.	$200,000
Computers, furniture, and equipment used exclusively for the research project	Research Department	$150,000
Computers, furniture, and equipment used by the Engineering Department	Engineering Department	$100,000
Computers and furniture used by the Legal Department	Legal Department	$20,000

In addition to interest on debt used to finance operations and research and costs specific to the Manufacturing, Personnel, and Accounting Departments, Company A incurs the following costs during its 2023 taxable year:

Description	**Department(s)**	**Total Cost**
Materials and supplies used exclusively for the research project	Research Department	$50,000
Materials and supplies used by the Engineering Department	Engineering Department	$40,000
Materials and supplies used by the Legal Department	Legal Department	$10,000

Labor costs of Research Department employees and their direct supervisor, each of which spends 100% of their time on the research project	Research Department	$600,000
Labor costs of all Engineering Department employees, each of which spends 20% of their time on the research project	Engineering Department	$200,000
Labor costs of all Legal Department employees, each of which spends 10% of their time on the research project	Legal Department	$100,000
Electricity for the facility	The Research Department and the Manufacturing Department consume large amounts of electricity relative to the other departments. The Research Department uses 100,000 kilowatt-hours of electricity. The Manufacturing Department uses 220,000 kilowatt-hours of electricity. The other departments each use 20,000 kilowatt-hours of electricity.	$200,000
Other utilities and overhead costs for the facility	All departments benefit from such costs in proportion to square footage occupied	$100,000
Other miscellaneous overhead costs incurred by the Research Department	Research Department	$50,000
Other miscellaneous overhead costs incurred by the Engineering Department	Engineering Department	$50,000
Other miscellaneous overhead costs incurred by the Legal Department	Legal Department	$50,000

(b) Analysis. Pursuant to section 4.03(1) of this notice, Company A determines that the costs described in the tables in section 4.03(4)(a) are the types of costs that are incident to SRE activities described in section 4.02(4) of this notice. Pursuant to section

4.03(2)(a) of this notice, Company A determines that the costs incurred by the Manufacturing, Personnel, and Accounting Departments are not treated as SRE expenditures because the activities of those departments are not SRE activities and such costs either do not, or only indirectly, support or benefit SRE activities. Similarly, pursuant to section 4.03(2)(b) of this notice, Company A determines that interest on debt used to finance operations and research is not treated as an SRE expenditure. Pursuant to section 4.03(3) of this notice, Company A determines its total SRE expenditures for 2023 by allocating the costs described in the tables in section 4.03(4)(a) of this notice to its SRE activities on the basis of a cause-and-effect relationship between the costs and the SRE activities or another relationship that reasonably relates the costs to the benefits provided to the SRE activities as provided in the following table. This allocation method generally relates the costs described in the tables in section 4.03(4)(a) of this notice to SRE activities on the basis of total labor hours spent on such activities; however, for certain costs, Company A determines that a different allocation method more appropriately relates the costs to the benefits that they provide to the SRE activities, such as an allocation method based on the relative square footage of each department. As noted in section 4.03(4)(a), employees in the Research Department spent 100% of their time on SRE activities, employees in the Engineering Department spent 20% of their time on SRE activities, and employees in the Legal Department spent 10% of their time on SRE activities.

Description	**Allocation Method**	**Amount of SRE Expenditure**
Depreciation on facility - $200,000	Research Department: $20,000 ($200,000 × 1,000/10,000 square feet × 100% of time spent by Research Department on research project) + Engineering Department: $4,000 ($200,000 × 1,000/10,000 square feet × 20% of time spent by Engineering Department on research project) + Legal Department: $2,000 ($200,000 × 1,000/10,000 square feet × 10% of time spent by Legal Department on research project)	$26,000
Depreciation on computers, furniture, and equipment used by the Research Department exclusively for the research project - $150,000	$150,000 × 100% use for research project	$150,000
Depreciation on computers, furniture and equipment used by the Engineering Department - $100,000	$100,000 × 20% of time spent by Engineering Department employees on the research project	$20,000
Depreciation on computers and furniture used by the Legal Department - $20,000	$20,000 × 10% of time spent by Legal Department employees on the research project	$2,000
Materials and supplies used exclusively by the Research Department for the research project - $50,000	$50,000 × 100% use for research project	$50,000
Materials and supplies used by the Engineering Department - $40,000	$40,000 × 20% of time spent by Engineering Department employees on the research project	$8,000

Materials and supplies used by the Legal Department - $10,000	$10,000 × 10% of time spent by Legal Department employees on the research project	$1,000
Labor costs of Research Department employees and their direct supervisor - $600,000	$600,000 × 100% of time spent by Research Department employees on the research project	$600,000
Labor costs of Engineering Department employees - $200,000	$200,000 × 20% of time spent by Engineering Department employees on the research project	$40,000
Labor costs of Legal Department employees - $100,000	$100,000 × 10% of time spent by Legal Department employees on the research project	$10,000
Electricity for the facility - $200,000	Research Department $50,000 ($200,000 × 100,000/400,000 kilowatt-hours used for research project) + Engineering Department $2,000 ($200,000 × 20,000/400,000 kilowatt-hours used by Engineering Department × 20% of time spent by Engineering Department employees on the research project) + Legal Department $1,000 ($200,000 × 20,000/400,000 kilowatt-hours used by Legal Department × 10% of time spent by Legal Department employees on research project)	$53,000

Other utilities and overhead costs for the facility - $100,000	Research Department $10,000 ($100,000 × 1,000/10,000 square feet × 100% of time spent by Research Department on research project) + Engineering Department $2,000 ($100,000 × 1,000/10,000 square feet × 20% of time spent by Engineering Department on research project) + Legal Department $1,000 ($100,000 × 1,000/10,000 square feet × 10% of time spent by Legal Department on research project)	$13,000
Other miscellaneous overhead costs incurred by the Research Department - $50,000	$50,000 × 100% of time spent by Research Department employees on the research project	$50,000
Other miscellaneous overhead costs incurred by the Engineering Department - $50,000	$50,000 × 20% of time spent by Engineering Department employees on the research project	$10,000
Other miscellaneous overhead costs incurred by the Legal Department - $50,000	$50,000 × 10% of time spent by Legal Department employees on the research project	$5,000
Total SRE Expenditures		**$1,038,000**

.04 Consistency requirement. SRE expenditures must be treated consistently for purposes of all provisions under subtitle A of the Code (subtitle A). Thus, expenditures that are defined as SRE expenditures under section 4.02(2) of this notice must be treated as SRE expenditures for all purposes under subtitle A. Such expenditures may not be treated as ordinary and necessary expenses under § 162 or capitalized under § 195, § 263(a), § 263A, or § 471. The amortization deductions arising from such SRE

expenditures must also be allocated and apportioned consistent with the rules under §§ 1.861-8 and 1.861-17.

SECTION 5. SOFTWARE DEVELOPMENT

.01 Purpose. The Treasury Department and the IRS intend to propose rules in forthcoming proposed regulations consistent with the interim guidance provided in this section 5, which provides taxpayers with clarity in determining whether certain activities constitute software development for purposes of § 174(c)(3).

.02 Defined terms. For purposes of this notice:

(1) Computer software. The term computer software generally means any computer program or routine (that is, any sequence of code) that is designed to cause a computer to perform a desired function or set of functions, and the documentation required to describe and maintain that program or routine. The code may be stored on a computing device, affixed to a tangible medium (for example, a disk or DVD), or accessed remotely via a private computer network or the Internet, for example, via cloud computing. Computer software generally includes system software, programming software, application software, embedded software, and all forms and media in which the software is contained, whether written, magnetic, or otherwise. Computer software also generally includes computer programs of all classes, for example, operating systems, executive systems, software monitors, compilers and translators, assembly routines, and utility programs as well as application programs.

Computer software includes a computer program, a group of programs, and upgrades and enhancements (as defined in section 5.02(2) of this notice). Computer software also includes any incidental and ancillary rights that are necessary to effect the

acquisition of the title to, the ownership of, or the right to use the computer software, and that are used only in connection with that specific computer software. Computer software includes software developed for use by the taxpayer in its trade or business or for sale or licensing to others. Computer software does not include any data or information base described in § 1.197-2(b)(4) unless the database or item is in the public domain and is incidental to a computer program. For example, customer lists or client files are not included in computer software unless such items are in the public domain and incidental to a computer program. Additionally, computer software does not include any procedures that are external to the computer's operation.

(2) Upgrades and enhancements. The term upgrades and enhancements generally means modifications to existing computer software that result in additional functionality (enabling the software to perform tasks that it was previously incapable of performing), or materially increase speed or efficiency of the software.

.03 Activities that are treated as software development. Activities that are treated as software development for purposes of § 174 generally include but are not limited to:

(1) Planning the development of the computer software (or the upgrades and enhancements to such software), including identification and documentation of the software requirements;

(2) Designing the computer software (or the upgrades and enhancements to such software);

(3) Building a model of the computer software (or the upgrades and enhancements to such software);

(4) Writing source code and converting it to machine-readable code;

(5) Testing the computer software (or the upgrades and enhancements to such software) and making necessary modifications to address defects identified during testing, but only up until the point in time that:

(a) In the case of computer software developed for use by the taxpayer in its trade or business, the computer software is placed in service; and

(b) In the case of computer software developed for sale or licensing to others, technological feasibility has been established, product masters(s) have been produced, and the computer software is ready for sale or licensing to others; and

(6) In the case of computer software developed for sale or licensing to others (or the upgrades and enhancements to such software), production of the product master(s).

.04 Software development activities related to purchased computer software. In the case of upgrades and enhancements to purchased computer software, the principles set forth in section 5.03 of this notice apply. However, the purchase and installation of purchased computer software, including the configuration of pre-coded parameters to make such software compatible with the business and reengineering the business to make it compatible with the purchased software, and any planning, designing, modeling, testing, or deployment activities with respect to the purchase and installation of such software, are not activities that constitute software development for purposes of § 174.

.05 Activities that are not treated as software development. The following activities associated with software development projects are not treated as software development for purposes of § 174:

(1) Computer software developed by a taxpayer for use in its trade or business. In the case of computer software that is developed for use by the taxpayer in its trade or

business (or upgrades and enhancements to such software):

(a) Training employees and other stakeholders that will use the computer software;

(b) Maintenance activities after the computer software is placed in service that do not give rise to upgrades and enhancements (for example, corrective maintenance to debug, diagnose, and fix programming errors);

(c) Data conversion activities, except for activities to develop computer software that facilitate access to existing data or data conversion; and

(d) Installing the computer software and other activities relating to placing the computer software in service.

(2) Computer software developed for sale or licensing to others. In the case of computer software that is developed for sale or licensing to others (or upgrades and enhancements to such software), activities that occur after such software (or upgrades and enhancements to such software) is ready for sale or licensing to others, such as marketing and promotional activities, maintenance activities that do not give rise to upgrades and enhancements, distribution activities (for example, making the software available via remote access), and customer support activities.

SECTION 6. RESEARCH PERFORMED UNDER CONTRACT

.01 Purpose. The Treasury Department and the IRS intend to propose rules in forthcoming proposed regulations consistent with the interim guidance provided in this section 6, which provides taxpayers with clarity in determining whether costs paid or incurred for research performed under contract are SRE expenditures under § 174.

.02 Defined terms. For purposes of this section 6:

(1) Research provider. The term research provider means the party that contracts with a research recipient (as defined in section 6.02(2) of this notice) to:

(a) perform research services for the research recipient with respect to an SRE product, or

(b) develop an SRE product (as defined in section 6.02(4) of this notice) that the research recipient acquires from the research provider.

(2) Research recipient. The term research recipient means the party that contracts with the research provider to:

(a) perform research services for the research recipient with respect to an SRE product, or

(b) develop an SRE product that the research recipient acquires from the research provider.

(3) Financial risk. The term financial risk means the risk that the research provider may suffer a financial loss related to the failure of the research to produce the desired SRE product.

(4) SRE product. The term SRE product means any pilot model, process, formula, invention, technique, patent, computer software, or similar property (or a component thereof) that is subject to protection under applicable domestic or foreign law. For example, mere know-how gained by a research provider through the performance of research services for a research recipient that is not subject to protection under applicable domestic or foreign law does not give rise to an SRE product in the hands of the research provider.

.03 Treatment of costs paid or incurred by research recipient. 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).

.04 Treatment of costs paid or incurred by research provider. 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 (see section 4.03 of this notice) performed by the research provider under the contract are SRE expenditures. However, 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 a right to use any resulting SRE product in the 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), regardless of whether the research recipient is required to treat its costs as SRE expenditures under section 6.03 of this notice. For purposes of the preceding sentence, a research provider will not be treated as having a right to use the SRE product in the trade or business of the research provider or otherwise exploit the SRE product through sale, lease, or license 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.

.05 Example. The following example illustrates the rules set forth in section 6 of this notice.

(1) Facts. Company C engages Company D, a contractor located in the United

States, to develop an SRE product for use in Company C's trade or business. The activities undertaken by Company D are undertaken upon Company C's order, and Company D makes no performance guarantees with respect to the SRE product. Company C will pay Company D a fixed sum of $25,000 plus an amount equivalent to Company D's actual expenditures. Company D does not have any right to use or otherwise exploit any resulting SRE product. In 2023, Company D incurs $125,000 of expenditures to successfully develop the product in the United States, and Company C pays to Company D $150,000 pursuant to the terms of the contract.

(2) Analysis. Under section 6.04 of this notice, Company D may not treat the $125,000 of expenditures it incurs to develop the SRE product on behalf of Company C as SRE expenditures under § 174 because (i) Company D does not bear financial risk, and (ii) Company D does not have any right to use or otherwise exploit any resulting SRE product. Under section 6.03 of this notice, the $150,000 paid by Company C is an amount paid to another party for research or experimentation undertaken on Company C's behalf under § 1.174-2(a)(10) and (b)(3) and is thus an SRE expenditure under section 4.02(2) of this notice. The applicable § 174 amortization period is 5 years (60 months) because the research is performed by Company D in the United States. Company C's location is not relevant for determination of the applicable § 174 amortization period.

SECTION 7. DISPOSITION, RETIREMENT, OR ABANDONMENT OF PROPERTY

.01 Purpose. The Treasury Department and the IRS intend to propose rules in forthcoming proposed regulations consistent with the interim guidance provided in this section 7, which provides taxpayers with clarity in determining the treatment of

unamortized SRE expenditures if property with respect to which such expenditures are paid or incurred is disposed of, retired, or abandoned in certain transactions during the applicable § 174 amortization period.

.02 In general. Except as provided in section 7.04 of this notice, if any property with respect to which SRE expenditures are paid or incurred is disposed of, retired, or abandoned during the applicable § 174 amortization period, no recovery is allowed with respect to the unamortized SRE expenditures on account of such disposition, retirement, or abandonment, and the taxpayer that disposed of, retired, or abandoned such property continues to amortize such expenditures under § 174 over the remainder of the applicable § 174 amortization period. For purposes of this section 7, the term unamortized SRE expenditures means the amount of any SRE expenditures paid or incurred by the corporation (or its predecessor), less the amount of any amortization deductions previously allowed to the corporation (or its predecessor) under § 174.

.03 Transactions occurring before the midpoint of the taxable year. An amortization deduction is allowed under § 174 for SRE expenditures even if such expenditures relate to property that is disposed of, retired, or abandoned prior to the midpoint of the taxable year in which such expenditures are paid or incurred. Accordingly, such expenditures are subject to the rules in sections 7.02 and 7.04 of this notice.

.04 Transaction in which corporation ceases to exist.

(1) Transaction described in § 381(a). If a corporation ceases to exist for Federal income tax purposes in a transaction or series of transactions described in § 381(a), the acquiring corporation will continue to amortize the distributor or transferor corporation’s unamortized SRE expenditures over the remainder of the distributor or transferor

corporation's applicable § 174 amortization period beginning with the month of transfer.

(2) Transaction not described in § 381(a).

(a) In general. Except as provided in section 7.04(2)(b), if a corporation ceases to exist for Federal income tax purposes in a transaction or series of transactions to which § 381(a) does not apply, the corporation is allowed a deduction equal to the unamortized SRE expenditures in its final taxable year.

(b) Anti-abuse exception. Section 7.04(2)(a) of this notice does not apply if a principal purpose of the transaction(s) described in section 7.04(2)(a) of this notice is to claim a deduction for the unamortized SRE expenditures.

.05 Examples. The following examples illustrate the rules set forth in section 7 of this notice.

(1) Sale of property with respect to which SRE expenditures were incurred.

(a) Facts. Company X, an accrual method, calendar-year taxpayer, incurs $100,000 in SRE expenditures in 2023 for research performed in the United States. On September 30, 2025, Company X sells the property with respect to which such expenditures were incurred to Company Y and recognizes gain under § 1001.

(b) Analysis. In 2023, Company X amortizes $10,000 (10% × $100,000). See section 3.05 of this notice. In 2024, Company X amortizes $20,000 (20% × $100,000). In 2025 through 2028, Company X ratably amortizes the remaining $70,000 ($100,000 – $10,000 – $20,000) notwithstanding Company X's disposition of the assets with respect to which Company X's SRE expenditures were incurred. Company Y does not amortize any portion of the SRE expenditures originally paid or incurred by Company X. Company X does not factor its unamortized SRE expenditures into the computation of

gain or loss under § 1001. See section 7.02 of this notice.

	2023	**2024**	**2025**	**2026**	**2027**	**2028**
Company X amortization %	10%	20%	20%	20%	20%	10%
Company X Dollar amount	$10,000	$20,000	$20,000	$20,000	$20,000	$10,000

(c) Applicable asset acquisition. The results would be the same as in section 7.05(1)(b) of this notice if the sale of property with respect to which the SRE expenditures were incurred were part of an applicable asset acquisition within the meaning of § 1060(c).

(d) Section 351 exchange. The results would be the same as in section 7.05(1)(b) of this notice if X transferred the property with respect to which the SRE expenditures were incurred in an exchange described in § 351.

(2) Section 381 transaction.

(a) Facts. The facts are the same as in section 7.05(1)(a) of this notice, except that, on October 16, 2025, Company X is acquired by Company Z, an accrual method, calendar-year taxpayer, in a transaction described in § 381(a).

(b) Analysis. In 2023, Company X amortizes $10,000 (10% × $100,000). See section 3.05 of this notice. In 2024, Company X amortizes $20,000 (20% × $100,000). In 2025, Company X amortizes $15,000 ((9 months/12 months) × 20% × $100,000), and Company Z amortizes $5,000 ((3 months/12 months) × 20% × $100,000). See sections 3.06(1), 7.02, and 7.04(1) of this notice. In 2026 through 2028, Company Z ratably amortizes the remaining $50,000 ($100,000 – $10,000 – $20,000 – $15,000 – $5,000).

	2023	**2024**	**2025**	**2026**	**2027**	**2028**
Company X amortization %	10%	20%	15%	0%	0%	0%
Company Z amortization %	0%	0%	5%	20%	20%	10%
Company X Dollar amount	$10,000	$20,000	$15,000			
Company Z Dollar amount			$5,000	$20,000	$20,000	$10,000

SECTION 8. LONG-TERM CONTRACTS UNDER § 460

.01 Purpose. The Treasury Department and the IRS are providing this interim guidance to provide taxpayers with information about a proposed revision to the regulations under § 460 in forthcoming proposed regulations regarding how to apply the percentage-of-completion method (PCM) to account for income from long-term contracts when allocable contract costs include SRE expenditures.

.02 Background. Section 460(a) generally requires use of the PCM to account for taxable income from a long-term contract. Section 1.460-4(b)(2)(i) provides that under the PCM, the portion of the contract price a taxpayer must report in a tax year corresponds to the ratio of incurred allocable contract costs to total estimated allocable contract costs. This ratio represents the portion of a contract considered completed for purposes of the PCM. Under the PCM, a taxpayer generally deducts allocable contract costs as they are incurred. As provided by § 1.460-4(b)(2)(iv), an increase in the percentage of the contract price to be reported is matched by deduction of the incurred

costs that cause the increase. Under the current § 460 regulations in § 1.460-5(b)(2)(vi), allocable contract costs include research or experimental expenses, other than independent research and development expenses. Thus, when these expenses are incurred, they increase the portion of a contract considered completed and the percentage of the contract price required to be reported. The current § 460 regulations were drafted when a taxpayer could deduct currently research or experimental expenses under former § 174. Section 174(a), as amended by the TCJA, requires that SRE expenditures be charged to capital account and deducted over the applicable § 174 amortization period. As a result, the current § 460 regulations provide that incurred research or experimental expenses increase the percentage of the contract price required to be reported, although § 174(a) prevents a corresponding current deduction of incurred SRE expenditures. The resulting mismatch of contract price and contract costs is inconsistent with the contemplated operation of the PCM.

.03 Treatment of SRE expenditures under § 460. The Treasury Department and the IRS anticipate issuing proposed regulations that would amend the existing § 460 regulations, including § 1.460-5(b)(2)(vi), to provide that the costs allocable to a long-term contract accounted for using the PCM include amortization of SRE expenditures under § 174(a)(2)(B), rather than the capitalized amount of such expenditures, and that such amortization is treated as incurred for purposes of determining the percentage of contract completion as deducted. The amendments would not apply to expenditures previously capitalized under § 59(e)(2)(B) or under former § 174(b), or to independent research and development expenditures, as defined in § 460(c)(5), which are not allocable contract costs. Research or experimental expenditures that are not

independent research and development expenditures, however, would remain subject to allocation under § 460(c)(1) regardless of whether they are SRE expenditures.

SECTION 9. COST SHARING REGULATIONS AT § 1.482-7

.01 Purpose. The Treasury Department and the IRS are providing this interim guidance to provide taxpayers with information about a proposed revision to § 1.482-7(j)(3)(i) in forthcoming proposed regulations.

.02 Background. Section 1.482-7(j)(3)(i) addresses cost sharing transaction payments (CST Payments) between controlled participants in a cost sharing arrangement (CSA) that are made to ensure that each controlled participant's share of intangible development costs (IDCs) is in proportion to its share of reasonably anticipated benefits from exploitation of the developed intangibles (RAB share). Section 1.482-7(j)(3)(i) generally provides that CST Payments reduce deductible IDCs borne by the controlled participant to which the CST Payments are owed. Any amount of CST Payment in excess of such deductible IDCs is treated as in consideration for the use of land and tangible property furnished for purposes of the CSA by the controlled participant to which the CST Payment is owed. CST Payments generally are considered the payor's costs of developing intangibles at the location where such development is conducted. See also § 1.482-7(j)(3)(iii), Example 1.

.03 Anticipated revisions to § 1.482-7(j)(3)(i).

(1) The Treasury Department and the IRS anticipate issuing proposed regulations that would replace the second through fourth sentences of § 1.482-7(j)(3)(i) with rules providing that CST Payments owed to a controlled participant reduce:

(a) The amount of the category of IDCs borne directly by that participant that are

required to be charged to capital account, and

(b) The amount of the category of IDCs borne directly by that participant that are not described in section 9.03(1)(a) of this notice and that are deductible.

(2) CST Payments not in excess of the payor's RAB share of the total amount of the IDCs in both categories described in section 9.03(1)(a) and (b) of this notice reduce the amount of each such category of IDCs in the same proportion that the total amount of the IDCs in each category bears to the total amount of IDCs in both categories. CST Payments in excess of the payor's RAB share of the total amount of IDCs in both categories described in section 9.03(1)(a) and (b) of this notice will be treated as income.

.04 Examples. The examples provided below illustrate the anticipated revisions to § 1.482-7(j)(3)(i).

(1) Example 1.

(a) Facts. U.S. Parent (USP) and its wholly owned Foreign Subsidiary (FS) form a CSA to develop a miniature widget, the Small R. Based on RAB shares, USP agrees to bear 40% and FS agrees to bear 60% of the IDCs incurred during the term of the agreement. USP incurs $100,000 of IDCs to perform research in the United States annually and FS incurs $100,000 of IDCs to perform research in country X annually. USP's IDCs are required under U.S. Federal income tax rules to be charged to capital account and amortized ratably over the 5-year applicable § 174 amortization period beginning with the midpoint of the taxable year in which such expenditures are paid or incurred, and FS's IDCs incurred in country X are required under U.S. Federal income tax rules to be charged to capital account and amortized ratably over the 15-year

applicable § 174 amortization period beginning with the midpoint of the taxable year in which such expenditures are paid or incurred.

(b) Analysis. Of the total IDCs of $200,000, USP's share is $80,000 ($200,000 × 40%) and FS's share is $120,000 ($200,000 × 60%) so that FS must make a payment to USP of $20,000 ($120,000 – $100,000). The CST Payment reduces USP's IDCs in the United States that are required to be charged to capital account by $20,000. Accordingly, USP is required to charge $80,000 to capital account, all of which is required to be amortized over 5 years, while FS is required to charge $120,000 to capital account, $100,000 of which is required to be amortized over 15 years, and $20,000 of which is required to be amortized over 5 years.

(2) Example 2.

(a) Facts. The facts are the same as in Example 1, except that the $100,000 of IDCs borne by USP consist of (1) $5,000 of IDCs incurred by USP in the United States that are required to be charged to capital account and amortized ratably over the 5-year applicable § 174 amortization period beginning with the midpoint of the taxable year in which such expenditures are paid or incurred, (2) $5,000 of deductible IDCs, and (3) $90,000 of arm's length rental charge, as described in § 1.482-7(d)(1)(iii), for the use of USP's facility in the United States.

(b) Analysis. As in Example 1, of the total IDCs of $200,000, USP's share is $80,000 and FS's share is $120,000, so that FS must make a payment to USP of $20,000. The $20,000 CST Payment from FS to USP will first be treated as reducing the $5,000 of IDCs that are required to be charged to capital account and the $5,000 of deductible IDCs pro rata to the extent of FS's RAB share of such IDCs. Because the

IDCs required to be charged to capital account make up 50% of the combined amount of IDCs chargeable to capital account and the deductible IDCs directly borne by USP (i.e., $5,000 = 50% × $10,000), and because FS's RAB share of the total amount of IDCs in both categories is $6,000 (i.e., 60% × $10,000), $3,000 of the $20,000 CST Payment reduces USP's IDCs chargeable to capital account, $3,000 of the CST Payment reduces USP's deductible IDCs, and the remaining $14,000 ($20,000 – $6,000) of the CST Payment is treated as income.

(3) Example 3.

(a) Facts. The facts are the same as in Example 1, except that the $100,000 of IDCs borne by USP consist of (1) $15,000 of IDCs incurred by USP in the United States that are required to be charged to capital account and amortized ratably over the 5-year applicable § 174 amortization period beginning with the midpoint of the taxable year in which such expenditures are paid or incurred, (2) $45,000 of deductible IDCs, and (3) $40,000 of arm's length rental charge, as described in § 1.482-7(d)(1)(iii), for the use of USP's facility in the United States.

(b) Analysis. As in Example 1, of the total IDCs of $200,000, USP's share is $80,000 and FS's share is $120,000, so that FS must make a payment to USP of $20,000. The $20,000 CST Payment from FS to USP will first be treated as reducing the $15,000 of IDCs that are required to be charged to capital account and the $45,000 of deductible IDCs pro rata to the extent of FS's RAB share of such IDCs. Because the IDCs required to be charged to capital account make up 25% (that is, $15,000 / ($15,000 + $45,000)) of the combined amount of IDCs chargeable to capital account and deductible IDCs directly borne by USP, and because the deductible IDCs make up

75% (that is, $45,000 / ($15,000 + $45,000)) of the combined amount of IDCs chargeable to capital account and deductible IDCs directly borne by USP, 25% of the $20,000 CST Payment, or $5,000, reduces USP's IDCs chargeable to capital account, and 75%, or $15,000, reduces USP's deductible IDCs. Because all $20,000 of the CST Payment is applied against deductible IDCs directly borne by USP and IDCs incurred by USP that are chargeable to capital account, there is no amount of the CST Payment that is treated as income.

SECTION 10. APPLICABILITY DATES

.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 this notice, including for expenditures paid or incurred in taxable years beginning after December 31, 2021, provided the taxpayer relies on all the rules in sections 3 through 9 of this notice and applies them in a consistent manner. However, taxpayers may not rely on the rules in section 7 of this notice for SRE expenditures paid or incurred with respect to property that is contributed to, distributed from, or transferred from a partnership.

.02 Additional procedural guidance. The Treasury Department and IRS intend to issue guidance in the Internal Revenue Bulletin (see § 601.601(d) of the Procedural Rules) to provide procedures for taxpayers to obtain automatic consent to change methods of accounting to comply with this notice. Until the issuance of

such procedural guidance, taxpayers may rely on section 7.02 of Rev. Proc. 2023-24 to change their methods of accounting under § 174 to comply with this notice. The Treasury Department and IRS anticipate issuing updated procedures that will address situations in which taxpayers have, prior to the issuance of this notice, changed methods of accounting to comply with § 174 as amended by the TCJA but whose treatment of SRE expenditures is not entirely consistent with this notice. Unless specifically authorized by the Commissioner of Internal Revenue or by statute, a taxpayer may not request, or otherwise make, a retroactive change in method of accounting by filing an amended return. See Rev. Rul. 90-38, 1990-1 C.B. 57; Rev. Rul. 2023-8, 2023-18 I.R.B. 801.

SECTION 11. REQUEST FOR COMMENTS

.01 Comments regarding guidance provided in this notice. The Treasury Department and the IRS request comments on issues arising from the interim guidance set forth in this notice. In addition to general comments regarding the provisions of this notice, the Treasury Department and the IRS request comments to address the following issues:

(1) Scope of § 174 (section 4 of this notice).

(a) Whether additional guidance is needed regarding identifying expenditures allocable to SRE activities and allocating such expenditures to SRE activities.

(b) Whether simplified methods or safe harbors should be provided for identifying expenditures allocable to SRE activities and allocating such expenditures to SRE activities. If so, what methods or safe harbors should be provided? Are special methods needed for government research contracts?

(2) Software development (sections 4 and 5 of this notice).

(a) The definition of computer software is based on section 2 of Rev. Proc. 2000-50 and § 1.197-2(c)(4)(iv). Is there a more appropriate definition under the Financial Accounting Standards Board Accounting Standards Codifications (ASCs) or an appropriate industry standard that should be used instead? If so, what ASC or industry standard definition should be used? Additionally, to what extent should ASC guidance or an appropriate industry standard be used to determine activities that are software development activities, and costs that are software development costs, for purposes of § 174?

(b) What examples of costs that are, or are not, software development costs would be helpful to include in the forthcoming proposed regulations?

(c) Are special rules and examples needed to determine what activities related to developing a website would be software development?

(3) Research performed under contract (section 6 of this notice).

(a) Should the rules for determining whether a party to a research contract has SRE expenditures under § 174 be similar to the funded research rules under § 41(d)(4)(H)?

(b) Are special rules needed for service or manufacturing production contracts with the government, including § 460 long-term contracts?

(c) Are there other factors that should be considered in determining whether a party to a research contract has SRE expenditures?

(d) Are special rules or safe harbors needed to determine if research performed under a contract is foreign research (for example, where a research recipient pays the research provider for research that is performed by the research provider both inside

and outside the U.S.)?

(e) Are special rules needed for contracts with related foreign research providers and recipients?

(4) Disposition, retirement, or abandonment of property (section 7 of this notice). What, if any, changes to the rules in section 7 of this notice are appropriate to address potential abuses?

(5) Long-term contracts under § 460 (section 8 of this notice). In the case of SRE expenditures allocable to long-term contracts accounted for under the PCM set forth in § 460, do estimated total allocable contract costs include all SRE expenditures that directly benefit or are incurred by reason of the performance of the long-term contract or, alternatively, only that portion of the SRE expenditures expected to be amortized during the term of the contract? Under the first alternative, a taxpayer would be required to report any remaining portion of the contract price not previously reported by the tax year following the tax year in which the contract is completed, notwithstanding that some portion of the SRE expenditures remain unamortized. See § 460(b)(1).

.02 Comments regarding rules not included in this notice. The Treasury Department and the IRS continue to study issues that are not addressed in this notice, including but not limited to whether the general requirements governing record retention under § 1.6001-1 are adequate for purposes of substantiating expenditures under § 174, whether the definition of “pilot model” under § 1.174-2(a)(4) should be amended, and whether and how § 59(e) applies to § 174 expenditures. In addition to requests for comments on these issues, the Treasury Department and the IRS request comments on the following specific issues not addressed by this notice:

(1) Under what circumstances should unamortized SRE expenditures continue to be amortized or accelerated with respect to property that is contributed to, distributed from, or transferred from a partnership?

(2) Under what circumstances should unamortized SRE expenditures continue to be amortized or accelerated with respect to property of a partnership that is a party to a merger, consolidation, division, or liquidation, or that otherwise terminates under § 708 and the regulations thereunder? Is there potential for abuse as a result of allowing a deduction for unamortized SRE expenditures in the final year of a partnership that liquidates or otherwise terminates? If so, what rules are appropriate to address such abuse?

(3) Should special rules apply to start-up companies or small taxpayers? If so, how should § 174 be applied in such cases?

(4) Sections 280C(c)(1)(B) and 56(b)(2)(A) each refer to an "amount allowable as a deduction" for qualified research expenses or basic research expenses (in the case of § 280C(c)(1)(B)), and § 174(a) (in the case of § 56(b)(2)(A)). On the one hand, § 174(a)(1) (as amended by the TCJA) does not allow a deduction for qualified research expenses or basic research expenses because such expenses are required to be charged to capital account. On the other hand, § 174(a)(2) allows an amortization deduction with respect to the capitalized amount of such expenses. Should the "amount allowable as a deduction" references in §§ 280C(c)(1)(B) and 56(b)(2)(A) be interpreted to refer to the amortization deduction allowed under § 174(a)(2) or to $0, which is the deduction allowed for the qualified research expenses or basis research expenses under § 174(a)(1)? The Treasury Department and IRS request comments on this

interpretation and how to resolve any potential issues that might arise by applying the same interpretation to both §§ 280C(c)(1)(B) and 56(b)(2)(A).

.03 Procedures for submitting comments.

(1) Deadline. Written comments should be submitted by November 24, 2023. Consideration will be given, however, to any written comment submitted after November 24, 2023, if such consideration will not delay the issuance of the forthcoming proposed regulations.

(2) Form and manner. The subject line for the comments should include a reference to Notice 2023-63. All commenters are strongly encouraged to submit comments electronically. However, comments may be submitted in one of two ways:

(a) Electronically via the Federal eRulemaking Portal at www.regulations.gov (type IRS-2023-0040 in the search field on the regulations.gov homepage to find this notice and submit comments); or

(b) By mail to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2023-63), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044.

(3) Publication of comments. The Treasury Department and the IRS will publish for public availability any comment submitted electronically or on paper to its public docket on www.regulations.gov.

SECTION 12. EFFECT ON OTHER DOCUMENTS

As a result of the TCJA amendments to § 174 and the rules in sections 3 through 5 of this notice, section 5 of Rev. Proc. 2000-50 is obsolete.

SECTION 13. 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). For further information regarding corporate matters in section 7 of this notice, please contact Austin Diamond-Jones of the Office of Associate Chief Counsel (Corporate) at (202) 317-5085 (not a toll-free number). For further information regarding section 9 of this notice, please contact Annette Ofori of the Office of Associate Chief Counsel (International) at (202) 317-4910 (not a toll-free number).