May 23, 2024

Mr. Peter Blessing
Associate Chief Counsel (International)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20220

Re: Notice(s) 2023-63 and 2024-12

Dear Mr. Blessing:

The Alliance for Competitive Taxation ("ACT") is a coalition of leading American companies from a wide range of industries that supports a globally competitive corporate tax system.

Attached are ACT's comments on Notice 2023-63 and Notice 2024-12. We appreciate your consideration of these comments. ACT representatives welcome future discussion of these comments with your staff.

Yours sincerely,

Alliance for Competitive Taxation

cc: William M. Paul, Principal Deputy Chief Counsel, Internal Revenue Service
Scott Levine, Acting Deputy Assistant Secretary (International Tax Affairs), U.S. Department of the Treasury
Scott Vance, Associate Chief Counsel, Income Tax & Accounting, Internal Revenue Service

ALLIANCE FOR COMPETITIVE TAXATION COMMENTS ON NOTICEs 2023-63 AND 2024-12

I. INTRODUCTION

Notice 2023-63,[1] modified and clarified by Notice 2024-12,[2] provides guidance with respect to the treatment of "specified research or experimental expenditures" ("SRE" expenditures) under section 174 of the Internal Revenue Code (the "Code"), as modified by Public Law 115-97 (the "TCJA"). In particular, Notice 2023-63 provides guidance regarding when research-related costs should be treated as SRE expenditures, which are required to be capitalized and amortized, and Notice 2024-12 provides additional clarifying guidance, particularly with respect to costs incurred pursuant to certain contract research arrangements.

ACT believes that the Notices provide guidance that generally will be helpful to taxpayers to limit the circumstances in which both the principal and contract researcher may be required to capitalize under section 174 their respective costs incurred under the contract. We are concerned, however, that, absent further clarification by Treasury and the IRS, the approach taken by the Notices will have unintended consequences that adversely affect taxpayers. The term "research or experimental expenditures," as used in section 174 prior to its amendment by the TCJA,[3] is referred to in multiple sections of the Code. As discussed further below, the limitations in the Notices with respect to the definition of SRE expenditures, if applied to these other Code provisions, may inappropriately restrict their application, notwithstanding that there is no indication in text or legislative history of the TCJA that Congress intended such limitations.

II. DISCUSSION

Section 174(a), as amended by the TCJA, requires taxpayers to charge SRE expenditures to a capital account and amortize them over five years (15 years for expenditures attributable to research performed outside the United States). Section 174(b) defines SRE expenditures, for purposes of section 174, with respect to a taxable year, as 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.

Prior to the amendments enacted by the TCJA, former section 174(a) provided that taxpayers were allowed to treat research or experimental expenditures that are paid or incurred with their trade or business as a deduction rather than chargeable to capital account.[4] Accordingly, under prior

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1 Notice 2023-63, 2023-39 I.R.B. 919.

2 Notice 2024-12, 2024-5 I.R.B. 616.

3 The TCJA introduced and defined the term "specified research or experimental expenditures" in section 174(b). Prior to amendment, section 174 used the term "research or experimental expenditures", which was not defined in the statutory text.

4 As described in the preamble to the 2013 regulations, section 174 was enacted as a part of the Internal Revenue Code of 1954 to eliminate uncertainty in the tax accounting treatment of research and experimental expenditures and to encourage taxpayers to carry on research and experimentation. 78 Fed. Reg. 54796 (Sep. 6, 2013).

law, taxpayers were generally permitted to deduct currently the amount of research or experimentation expenditures paid or incurred in connection with a trade or business. The Code does not provide a definition of the term "research or experimental expenditures," but Treas. Reg. § 1.174-2 does provide a definition that was promulgated in 1957 following the enactment of section 174 in the Internal Revenue Code of 1954.[5] Since its promulgation, this definition has been referred to in various parts of the Code.

With the issuance of Notice 2023-63, Treasury and the IRS announced their intention to issue proposed regulations addressing the statutory changes made to section 174 by the TCJA. Notice 2023-63 includes proposed rules on the capitalization and amortization of SRE expenditures (i.e., the term introduced and defined in the TCJA revisions to section 174), the treatment of SRE expenditures under section 460, and the application of section 482 to cost sharing arrangements involving SRE expenditures. On December 22, 2023, Treasury and the IRS issued Notice 2024-12 modifying and clarifying the interim guidance set forth in Notice 2023-63.

Specifically, Section 4.02 of Notice 2023-63 provides that SRE expenditures are 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. While this general definition is consistent with the current regulatory definition of "research or experimental expenditures," Notice 2023-63 introduces further requirements for research or experimental expenditures to qualify as SRE expenditures under section 174 in certain cases. Particularly, Section 6.04 of Notice 2023-63 provides that costs or expenses paid or incurred by a contract research provider that are incident to SRE activities of such provider are SRE expenditures of the contract research provider only if the provider has either (i) financial risk, which is generally the risk of financial loss with respect to the failure of the research to produce the desired SRE product; or (ii) the right to use any resulting SRE product in its trade or business or through sale, lease, or license of that product to customers. This is commonly referred to as the "rights or risks requirement."[6] Notice 2024-12 clarifies this rights or risks requirement and provides 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" 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.[7] Notice 2023-63, amplified by Notice 2024-12, proposes that SRE expenditures be treated consistently for purposes of all provisions under subtitle A of the Internal Revenue Code.[8]

We understand that the inclusion of the rights or risks requirement in the definition of SRE expenditures aims to prevent double capitalization by both the principal and contract researcher of the same economic expense under section 174(a), as amended by the TCJA. For example, under this definition, it would be clear that in a case where a research provider affiliate provides contract research services to a research recipient affiliate that owns the rights to a SRE product, the

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5 T.D. 6255, 1957-2 C.B. 180.

6 Under Notice 2023-63, Section 6.02, the term "SRE product" is defined as 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.

7 Notice 2024-12, Section 2.04.

8 Notice 2023-63, Section 4.04; Notice 2024-12, Section 2.03.

research provider affiliate would not be required to capitalize under section 174 its related expenses because such expenses would not qualify as SRE expenditures. ACT supports and commends Treasury's and the IRS's efforts to eliminate such ambiguity and provide a clear rule that would prevent the requirement for double capitalization, as such an outcome was almost certainly not contemplated by Congress when it revised section 174 to require amortization and capitalization of SRE expenditures.

We are concerned, however, that incorporating this "rights or risk requirement" in the definition of research or experimental expenditures for purposes of other sections of the Code will inappropriately limit the application of these other Code sections in a manner that is inconsistent with Congress's intent in revising section 174 itself. The Code, in multiple sections, includes a reference to the definition of "research or experimental expenditures" provided in section 174 and provides different treatment depending on whether such definition is met or not. The proposed definition in Notice 2023-63, as clarified and modified by Notice 2024-12, is that of "SRE expenditures," which, as noted, is also the (new) defined term in section 174(b), as amended by the TCJA. ACT believes it is appropriate to limit the capitalization and amortization provisions of section 174, as revised, to SRE expenditures, as defined in section 174(b) and the Notices, while continuing to provide that the long-standing definition of "research or experimental expenditures" under Treas. Reg. § 1.174-2 continues to apply for purposes of the various Code provisions that refer to "research or experimental expenditures" and cross-reference section 174.[9]

As discussed further below, this recommendation is based on the fact that the other provisions that use the term "research or experimental expenditures" are addressing distinct policy goals generally unrelated to the capitalization requirements introduced by Congress in the TCJA. Rather, these other provisions that refer to section 174 simply utilize a long-standing term of art to describe certain expenditures for the purpose of the application of the provision at issue.

For example, section 864(g) provides special rules regarding the allocation of "qualified research and experimental expenditures," which are defined as "amounts which are research and experimental expenditures within the meaning of section 174."[10] Section 864(g) was enacted to codify the regulations regarding the allocation of research and experimentation expenses for purposes of determining the source of taxable income for determining the foreign tax credit limitation under section 904.[11] Accordingly, section 864(g) serves a purpose that is entirely distinct from the tax accounting considerations of section 174, and there is no indication that the statutory revisions to section 174 in the TCJA were intended to alter the application of section 864(g).

Similarly, section 59(e) provides taxpayers an election to deduct any "qualified expenditure" over a 10-year period. The term "qualified expenditure" encompasses *inter alia* any amount that would

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9 For example, among such potentially implicated Code sections, we note the following: section 59(e), section 168(e)(3)(B)(v) (referring to "research and experimentation," as defined in section 168(i)(11)), section 170(e)(4)(B)(v), section 469(c)(5), section 864(g)(2), section 993(d)(2)(C), section 1202(e)(2)(B), and section 1298(e)(1).

10 Section 864(g)(2).

11 H.R. Rep. 101-247 (Sep. 20, 1989).

have been allowable as a deduction under section 174(a).[12] As revised by the TCJA, section 174(a) has eliminated the deduction mechanism for SRE expenditures as such expenses are required to be capitalized. However, despite the modification to section 174(a), section 59(e) was not repealed by the TCJA. In this context, taxpayers need guidance regarding the application of the 10-year capitalization under section 59(e) with respect to "research or experimental expenditures" that are not required to be capitalized by section 174(a). Notably, the fact that section 59(e)(2)(B) was retained by the TCJA while repealing the alternative minimum tax for corporations indicates that Congress intended the provision to have ongoing application, despite the repeal of the corporate AMT and the revisions to section 174 that require capitalization and amortization of SRE expenditures. Accordingly, any expenses that are not subject to the capitalization requirement under section 174(a), but qualify as "research or experimental expenses" within the meaning of the pre-existing definition of that term ought to continue to be within the scope of "qualified expenditure" for purposes of section 59(e).

Notably, section 174(b) explicitly states that the definition of "SRE expenditures" applies only for purposes of section 174, indicating that Congress did not intend this definition to apply outside of the scope of section 174.[13] There is nothing in the legislative history of section 174 that suggests the presence of any Congressional intent contrary to the plain reading of the unambiguous statutory language. In addition, we note that when Congress intended to change the section 174 reference in a Code section to align it with the amended section 174, it explicitly did so. Section 41 is a notable example in this regard. Section 41 provides a research credit for "qualified research expenses," which heavily relies on the determination as to whether expenditures may be treated as SRE expenditures under section 174.[14] Section 41 was amended by the TCJA to incorporate the term "SRE expenditures" to replace the reference to "expenses under section 174"[15] This indicates that, in introducing the term "SRE expenditures" in section 174, Congress did not intend to alter the application of the Code sections that continue to refer to the term "research or experimental expenditures," as defined in section 174.[16]

"Research or experimental expenditures" is defined under a set of regulations that predate the TCJA by 60 years, and, since its promulgation, this definition has been relied upon by Congress to describe certain expenses in applying various Code provisions that were not amended by the TCJA. Further, as discussed above, there is no indication that Congress intended to alter the application of the policies effectuated through those other Code provisions, which are unrelated to the capitalization requirement that Congress added for SRE expenditures in the TCJA. Accordingly, ACT believes it is consistent with a plain reading of the relevant provisions and Congressional intent to conclude that the term "SRE expenditures," should be considered distinct

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12 Section 59(e)(2)(B).

13 Section 174(b) reads: "**For purposes of this section**, the term "specified research or experimental expenditures" means, with respect to any taxable year, research or experimental expenditures which are paid or incurred by the taxpayer during such taxable year in connection with the taxpayer's trade or business." [Emphasis added.]

14 Section 41(d)(1)(A).

15 P.L. 115-97, Sec. 13206(d)(1).

16 Notice 2023-63 states that the Notice is not intended to change the rules for determining eligibility for or computation of the research credit under section 41 but does not provide guidance on how such outcome would be reached.

from the term "research or experimental expenditures," as established under the former section 174.

III. CONCLUSION

ACT commends Treasury's and the IRS's efforts in Notices 2023-63 and 2024-12 to provide guidance to taxpayers and address the amendments made to section 174 by the TCJA. ACT respectfully recommends that Treasury and the IRS clarify that the long-established definition of "research or experimental expenditures" as incorporated in other areas of the Code by reference to section 174 remains unimplicated by the adoption of the definition of SRE expenditures in the proposed regulations.

ACT representatives would welcome the opportunity to discuss these matters with you at your convenience.