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The 'One Big Beautiful Bill Act' Permits Immediate Deduction of Domestic R&E Expenditures, in Some Cases Retroactively

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On July 4, the "One Big Beautiful Bill Act" (OBBBA) was signed into law, which includes provisions restoring immediate deduction of domestic research and experimentation (R&E) expenditures in tax years beginning after December 31, 2024, and permitting the acceleration of unamortized expenditures that were capitalized under prior legislation. For a discussion of the changes to the deductibility of domestic R&E expenditures in the version of the bill originally passed by the US House of Representatives, see this June 4 Cooley client alert, and for a discussion of the changes made by the Senate Finance Committee, see this June 26 Cooley client alert.

Historically, Section 174 of the Internal Revenue Code (IRC) permitted immediate deduction of all R&E expenditures. However, the Tax Cuts and Jobs Act of 2017 (TCJA) had required taxpayers to capitalize R&E expenditures and amortize them over five years for R&E performed within the United States, or 15 years for R&E performed outside the United States, for tax years beginning on or after January 1, 2022.

Under the OBBBA, new Section 174A permits taxpayers to immediately deduct R&E expenditures incurred in connection with the taxpayer's trade or business for work conducted within the United States or its possessions in taxable years beginning after December 31, 2024, permanently eliminating the capitalization requirement for these expenditures. Deductions for domestic R&E expenditures under Section 174A are reduced by the amount of any tax credit allowed under Section 41(a) for increasing research activities. The OBBBA does not change the treatment of R&E performed outside the United States, which must continue to be capitalized and amortized over 15 years under the TCJA.

As an alternative to immediate deduction, Section 174A would allow taxpayers to elect to capitalize and amortize domestic R&E expenditures over a period of not less than 60 months as may be selected by the taxpayer (beginning with the month in which the taxpayer first realizes benefits from such expenditures), or elect under Section 59(e) to capitalize and amortize R&E expenditures ratably over a 10-year period, beginning in the tax year in which such expenditures were made. Elections made pursuant to Section 174A apply to all subsequent taxable years and can be changed only with the approval of the Secretary of the Treasury.

Additionally, under the OBBBA, IRC Section 174(d) is amended to prevent the use of remaining tax basis associated with capitalized foreign R&E expenditures (as either a deduction or an offset to amount realized), requiring continued amortization even after the property developed through such expenditures is disposed of, retired or abandoned.

Under transition rules, certain small businesses are permitted to elect to immediately deduct domestic R&E expenditures retroactively to taxable years beginning after December 31, 2021 (when the capitalization requirement under the TCJA first came into effect). In order to make such election, a business generally must not have average annual gross receipts exceeding $31 million over the three tax years before its first tax year beginning after December 31, 2024. Taxpayers would be required to file amended tax returns for each taxable year affected by such election. Such election must be made within one year of the enactment of the OBBBA.

In addition, all taxpayers that have capitalized domestic R&E expenditures incurred after December 31, 2021, and before January 1, 2025, are permitted to elect to accelerate the remaining amortization deductions for such expenditures over a one- or two-year period starting in the first taxable year beginning after December 31, 2024.

If you have questions about how these changes may impact your company, we strongly suggest contacting a member of the Cooley tax team, your accountant or other tax advisor.

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