INTERNAL REVENUE SERVICE
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CC:DOM:P&SI:7--PLR-120619-98

MARCH 25, 1999

re:

Legend:

X:

a:

date 1:

date 2:

Dear :

We received your letter dated, , , in which you request permission to currently deduct all research and experimental (R&E) expenditures under § 174(a) of the Internal Revenue Code. This letter responds to that request.

The represented facts are as follows: X currently treats all R&E expenditures as deferred expenses under § 174(b). X requests that the change in the treatment of R&E expenditures apply to all research or experimental expenditures paid or incurred by X after date 1. At the beginning of the taxable year for which X is requesting the change the unamortized R&E expenditures were a. X is requesting the change, because X would prefer to implement the current expense method under § 174(a).

Section 174(a)(1) provides that a taxpayer may treat R&E expenditures paid or incurred during the taxable year in connection with the taxpayer's trade or business as expenses that are not chargeable to a capital account. The expenditures so treated are allowed as a deduction.

Section 174(a)(2)(A) further provides that the taxpayer may, without the consent of the Secretary, adopt the method provided in § 174(a) for his first taxable year--(i) which begins after December 31, 1953, and ends after August 16, 1954, and (ii) for which expenditures described in § 174(a)(1) are paid or incurred.

Section 174(a)(2)(B) also provides that a taxpayer may, with the consent of the Secretary, adopt at any time the method provided in § 174(a).

Section 174(b)(1) provides that, at the election of the taxpayer, made in accordance with regulations prescribed by the Secretary, research or experimental expenditures that are--(A) paid or incurred by the taxpayer in connection with his trade or business, (B) not treated as expenses under § 174(a), and (C) chargeable to capital account but not chargeable to property of a character which is subject to the allowance under § 167 (relating to allowance for depreciation, etc.) or § 611 (relating to allowance for depletion), with certain exceptions, may be treated as deferred expenses. In computing taxable income, such deferred expenses shall be allowed as a deduction ratably over such 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). Such deferred expenses are expenditures properly chargeable to capital account for purposes of § 1016(a)(1) (relating to adjustments to basis of property).

Section 174(b)(2) provides that the election provided by § 174(b)(1) may be made for any taxable year beginning after December 31, 1953, but only if made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The method so elected, and the period selected by the taxpayer, shall be adhered to in computing taxable income for the taxable year for which the election is made and for all subsequent taxable years unless, with the approval of the Secretary, a change to a different method (or to a different period) is authorized with respect to part or all of such expenditures. The election shall not apply to any expenditure paid or incurred during any taxable year before the taxable year for which the taxpayer makes the election.

Treas. Reg. § 1.174-3(b)(1) provides that the consent of the Commissioner is not required if the taxpayer adopts the method for the first such taxable year in which he pays or incurs research or experimental expenditures. If the taxpayer fails to adopt the method for the first taxable year in which he incurs such expenditures, he cannot do so in subsequent taxable years unless he obtains the consent of the Commissioner under § 174(a)(2)(B) and § 1.174-3(b)(2). See, however, § 1.174-3(b)(4), relating to extensions of time.

If the taxpayer has adopted a method of accounting under § 174, the taxpayer may adopt a different method of accounting only with the Commissioner's consent. Requests to change from a capitalization method of accounting for R&E expenses to a current deduction method under § 174 are made by submitting a private letter ruling request in accordance with § 1.174-4(b)(2).

Treas. Reg. § 1.174-4(b)(2) provides that the application for permission to change to a different method of treating research or experimental expenditures or to a different period of amortization for deferred expenses shall be in writing and shall be addressed to the Commissioner of Internal Revenue, Attention: T:R, Washington 25, D.C. The application shall include the name and address of the taxpayer, shall be signed by the taxpayer (or his duly authorized representative), and shall be filed not later than the end of the first taxable year in which the different amortization period is to be used (unless § 1.174-4(b)(3), relating to extensions of time, is applicable). The application shall set forth the following information with regard to the research or experimental expenditures which are being treated under § 174(b) as deferred expenses: (i) Total amount of research or experimental expenditures attributable to each project; (ii) Amortization period applicable to each project; and (iii) Unamortized expenditures attributable to each project at the beginning of the taxable year in which the application is filed.

In addition, § 1.174-4(b)(2) provides that the application shall set forth the length of the new period or periods proposed, the new method of treatment proposed, the reason for the proposed change, and such information as will identify the project or projects to which the expenditures affected by the change relate. If permission is granted to make the change, the taxpayer shall attach a copy of the letter granting the permission to his income tax return for the first taxable year in which the different method or period is to be effective.

The change in treatment of R&E expenditures will apply only to the R&E expenditures paid or incurred by X on or after the first day of the year of change in accordance with § 1.174-4(a)(5) of the Income Tax Regulations. As of the first day of the year of change, the total amount of unamortized R&E expenditures was a. This amount shall continue to be amortized over the remaining months in the amortization period.

Based solely on the facts and representations made in X's submission, and provided that X's expenditures otherwise qualify as R&E expenditures under § 174, we grant X permission to change from the deferred treatment of R&E expenditures under § 174(b) to the current expense method under § 174(a) for all R&E expenditures paid or incurred after date 1. The current expense

method will apply to all R&E expenditures paid or incurred by Taxpayer after date 1, to the extent that such expenditures qualify under the provisions of § 1.174-2, provided:

1) that X keeps its books and records for the year of change (provided they are not closed for that year on the date it receives this letter) and for later taxable years on the method of accounting granted in this letter. For purposes of this condition, any reconciliation entries that are necessary to compute taxable income must be maintained as part of X's permanent books and records;

2) that X uses the method granted in this letter for the year of change and all later tax years unless X secures permission to change to another recognized method;

(3) that X continues to deduct the unamortized balance of research and experimental expenditures incurred before date 2 according to the provisions of § 174(b); and

(4) that X attaches a copy of this letter to its income tax return for the year of change as evidence of its authority for making the change.

In addition, the determination as to whether X's expenditures are R&E expenditures within the meaning of § 174, is within the purview of the district director upon examination of X's return.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the above-described facts under any other provision of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

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