



TAX STRATEGIST
CROSS-BORDER ISSUES
SECOND QUARTER CONSIDERATIONS

June 22, 2022

Agenda for Today



Introductions



Latest Global Developments



Navigating the Complexities of Section 174 - From an International Perspective



BEPS 2.0 Updates



Closing

With You Today



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Introduction & Latest Global Developments



Emerging Mega-Trends



Navigating the Complexities of Section 174 - From an International Perspective



Overview of Rule Changes to Section 174

	Pre-2022	2022 and After
R&E Expenditures	<ol style="list-style-type: none">1) Immediately deduct under section 174(a)2) Capitalize and amortize over at least 60 mo under section 174(b)3) Capitalize and amortize over 10 years under section 59(e)	Capitalize and amortize over 5 years or 15 years (if foreign)
Software Development Costs under Rev. Proc. 2000-50	<ol style="list-style-type: none">1) Expense2) Capitalize and amortize over at least 60 mo3) Capitalize and amortize over 36 mo	Capitalize and amortize over 5 or 15 years (if foreign)

Effective Date of Change & Legislative Update

- ▶ As enacted under TCJA, the new rule would apply to R&D costs incurred or paid for taxable years beginning after December 31, 2021
- ▶ House version of Build Back Better Act proposed to delay the effective date until taxable years beginning after December 31, 2025
- ▶ Recent discussions regarding reconciliation bill still show bipartisan support for repealing/delaying the rule
- ▶ Tax extenders bill as a last resort?



Example of Section 174 Amortization Calculation

- ▶ Taxpayer incurs \$5 million of R&D expenditures in 2022
- ▶ Amortization begins with the midpoint of the taxable year for first year
- ▶ Year 1 Amortization = $(\$5,000,000 / 5 \text{ Years}) \times (6 \text{ months} / 12 \text{ months}) = \$500,000$

Prior to TCJA Rule	Under TCJA Rule
\$5,000,000 immediate expense	\$500,000 amortization exp (10% of total costs incurred)

Definition of Sec. 174 Costs

- ▶ All costs incidental to the development or improvement of a product
- ▶ Activities intended to discover information that would eliminate uncertainty
- ▶ Examples of potential section 174 costs include the following:
 - Salaries of research staff
 - Supplies consumed during research activities
 - Rent, utilities and depreciation related to facilities used for research
 - Attorneys' fees related to applying for patents

Overlap with R&D Tax Credit

Section 174 Expenses	R&D Credit-Eligible Expenses
Direct Wages	Direct Wages
Supplies	Supplies
Contract Research	Contract Research
Overhead	
Depreciation	
Patent Fees	
Research Outside of US	

Upcoming Guidance

- ▶ IRS/Treasury currently working on both procedural and substantive guidance related to section 174
 - Procedural guidance to be released first
 - Timing unknown
 - Government officials have indicated that the change to switch from deducting to capitalizing section 174 costs will be automatic
- ▶ How should taxpayers treat contract research arrangements? Is it possible for both parties in a contract research arrangement to have section 174 costs?



ITS Considerations

- ▶ FDII
- ▶ GILTI
- ▶ High-Tax Exclusion
- ▶ Sec. 861 Allocations
- ▶ BEAT





Cost Sharing/Contract Research Arrangements

Questions arise as to how to characterize certain expenses incurred in cost sharing/contract research arrangements

- ▶ Under current guidance, a taxpayer that pays another party to perform research on its behalf treats the amounts paid as section 174 costs
- ▶ Rules are silent as to how other party should treat the costs it incurs

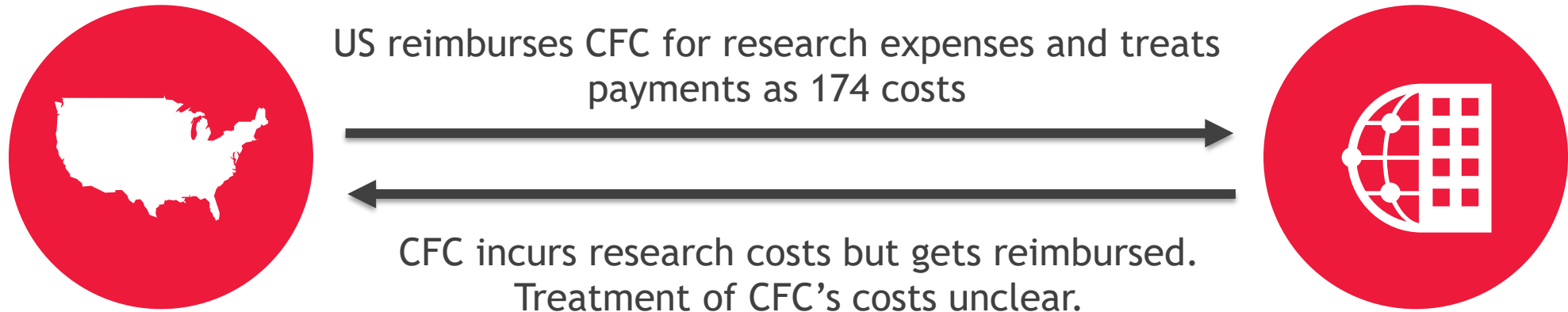
Example of Traditional Cost Sharing Arrangement

US Entity Performs R&D for the Benefit of the Global Group



Example of Funded Research Arrangement

- ▶ CFC that performs research on behalf of US related party
- ▶ Only US benefits from research performed by CFC





Basic Elements of Sec. 174 Calculation

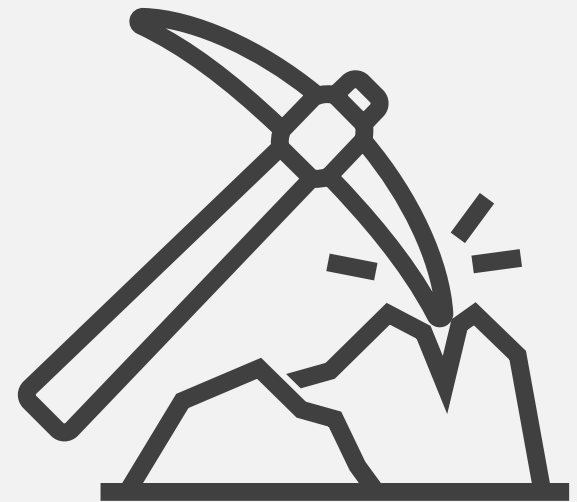
- ▶ Capture US and Foreign based activities
- ▶ Correct amortization periods based on jurisdiction of where research is performed
- ▶ Software development costs
- ▶ Patent costs
- ▶ Overhead allocation
- ▶ Book-to-tax adjustments that impact R&D expenses
- ▶ Alignment with position taken on R&D credit study



Lingering Questions

- ▶ Will section 174 apply to all types of software development costs?
- ▶ How much overhead and other indirect costs should be allocated to section 174 activities?
- ▶ How does the new provision impact section 280C?
- ▶ How should taxpayers in contract research arrangements treat their costs?

BEPS 2.0 Update





OECD BEPS 2.0

Latest developments

PILLAR ONE

- ▶ Implementation pushed back to 2024
- ▶ Expected G20 agreement November 2022
- ▶ Model Rules December 2022?

PILLAR TWO

- ▶ EU update
- ▶ Developments in other jurisdictions
- ▶ Impact of delay of Pillar One



OECD BEPS 2.0

US Developments

- ▶ GILTI - CFC vs IIR
- ▶ R&D Tax Credits
- ▶ Impact on FTC Regs

Closing



Questions?



Join the Next Webinar

BDO Tax Strategist: Cross-Border Issues - Third Quarter Considerations

- ▶ September 21, 2022 - 12pm - 1pm ET
- ▶ Register at bdo.com/events

