



**CAIN ELLSWORTH
& COMPANY, LLP**

Beyond the Numbers...



R&E expense amortization
got you down?



Significant changes to how research and experimentation expenses are treated under Section 174 of the Internal Revenue Code are now in effect thanks to the Tax Cuts and Jobs Act of 2017. Before 2022, taxpayers could deduct the full cost of R&E expenditures in the year they were incurred. However, these costs must now be amortized over at least five years for domestic and 15 years for foreign expenditures.

For example, if a business has \$1 million in domestic R&E expense for a calendar year, it must now amortize that \$1 million over five years instead of taking full deduction in one year. Making matters worse, R&E expenditures must be amortized from the midpoint of the year. So the company with \$1 million of R&E expense can only deduct \$100,000 in the first year instead of the \$200,000 you'd expect.

This is an unwelcome change for companies that invest heavily in research and experimentation. To help offset the changes in the deduction, here are three opportunities to increase your deductions and decrease your tax liability.

Section 179 Depreciation

Section 179 allows taxpayers to deduct the full cost of purchasing or leasing eligible new or used assets up to certain limits. To qualify for the Section 179 deduction, the asset must be used for business purposes at least 50% of the time and placed in service during the tax year for which the deduction is being claimed. The taxpayer can deduct up to \$1.08 million of expenses for assets placed into service in 2022. If the taxpayer purchased more than \$2.7 million of eligible assets in 2022, then the amount the taxpayer can deduct is reduced dollar-for-dollar for expenditures over \$2.7 million. It's important to note that there are certain restrictions on the type of property eligible for the deduction, and the deduction can only be used to offset net income and can't be used to create a net operating loss.



Bonus Depreciation

Bonus depreciation is a tax provision set by the Tax Cuts and Jobs Act that allows businesses to fully deduct the cost of certain qualifying property in the year it is placed in service rather than having to depreciate the cost over several years.

100% first-year bonus depreciation is available for qualified business assets acquired and placed into service after September 27, 2017, and before January 1, 2023. This generally applies to depreciable business assets with a recovery period of 20 years or less and certain other property. Machinery, equipment, computers, appliances, and furniture generally qualify.

Additionally, certain Qualified Improvement Property qualifies for 100% Bonus Depreciation thanks to the CARES Act.

Unfortunately, the bonus depreciation deduction begins to phase out in 2023, decreasing by 20 percentage points each year until it reaches zero in 2027. So the 100% first-year bonus depreciation for the tax year 2022 is now 80% for 2023.

MACRS / Cost Segregation Study

Companies are able to depreciate certain assets based on the modified accelerated cost recovery system. Depending on the classification of an asset, it may have a depreciable life of anywhere from 3 to 39 years, or it may be eligible for Section 179 or bonus depreciation. For taxpayers wanting to reduce their tax liability, it's important to ensure all assets are properly classified to accelerate depreciation and reduce taxable income.

While IRS Publication 946 provides guidance on depreciating assets using the modified accelerated cost recovery system, the rules are complex and lengthy. For this reason, companies with fixed assets often rely on our experts to perform an analysis of fixed assets for proper classification and depreciation.



If your assets include purchased, constructed, or renovated real estate, you should consider a cost segregation study. Real estate properties typically include the existing building structure, exterior components located on or connected to the property, and internal components such as HVAC and plumbing.

Residential buildings are depreciated over 27.5 years, while commercial buildings are depreciated over 39 years. However, certain components of a property have shorter depreciation schedules of 5, 7, or 15 years. Cost segregation studies identify the various components of a property and classify assets as personal property or land improvements to shorten their depreciation time for taxation purposes.

It is not a requirement for a property to be newly constructed to reap the benefits of a cost segregation study. Cost segregation studies performed on properties that were previously placed in service and have filed tax returns in years past are considered look-back studies. Look-back studies can be advantageous for some taxpayers because they can claim what is often referred to as catch-up deductions. Catch-up deductions are taken in a single year and are equal to the difference of what was depreciated compared to what could have been depreciated had a cost segregation study been performed.



Final Thoughts

While the R&E expense amortization may have reduced your deductions, utilizing Section 179 depreciation, bonus depreciation, proper asset classification, and a cost segregation study may help increase your deductions.

While this document provides an overview of certain strategies to increase deductions, it is not a substitute for speaking with one of our expert advisors.

If you'd like to learn more about maximizing your deductions and minimizing your tax liability, contact our office. We're happy to discuss your unique situation.



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