



Current Federal Tax Developments

September 11, 2023

Kaplan Financial Education

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This Week We Look At:

IRS make last minute change to K-2/K-3
FAQ for 2022 returns

Preliminary guidance for §174 changes
made in TCJA that took effect in 2022
issued by the IRS

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<https://www.currentfederaltaxdevelopments.com>



IRS Publishes Last Minute FAQ on K-2/K-3 Preparation



- Schedules K-2 and K-3 Frequently Asked Questions (Forms 1065, 1120S, and 8865) Question 30, September 5, 2023
 - A new question 30 was added to the FAQ for preparing Schedules K-2 and K-3 addressing negative entries in Part II, Section 1 (Gross Income)
 - Such entries are rejected when electronically filing the return
 - Note that the IRS does not concede that this reporting is acceptable

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<https://www.currentfederaltaxdevelopments.com>



<https://www.irs.gov/businesses/schedules-k-2-and-k-3-frequently-asked-questions-forms-1065-1120s-and-8865>

IRS Publishes Last Minute FAQ on K-2/K-3 Preparation

30. For the 2022 tax year, a pass-through entity receives information (for example, a Schedule K-3 from a lower-tier pass-through entity) that certain gross income amounts to be reported on the Schedules K-2 and K-3 are negative. However, the current schema for electronic filing of the Schedules K-2 and K-3 does not permit negative values for certain line items in Part II, Section 1 of Schedules K-2 and K-3. How should these negative amounts be reported on Schedules K-2 and K-3 to the IRS and to the partners or members? (added September 5, 2023)

A pass-through entity electronically filing the Schedules K-2 and K-3 for the 2022 tax year should enter zero on the line items in Schedules K-2 and K-3, Part II, Section 1 for which the schema does not permit negative values. A pass-through entity must attach a General Dependency (XML) schema to the Schedule K-2 identifying the line items and the negative values for which the pass-through entity reported zero on Part II, Section 1. Additionally, a pass-through entity should attach a list of the impacted line items and the negative numbers, partner by partner. A pass-through entity should report to its partners or members any changes to the amounts reported on the original Schedules K-3 issued to the partners or members. The IRS has not opined on whether it is legally appropriate to use negative values.

<https://www.irs.gov/businesses/schedules-k-2-and-k-3-frequently-asked-questions-forms-1065-1120s-and-8865>



IRS Finally Issues Interim Guidance on TCJA Changes to IRC §174 That Took Effect for 2022 Tax Years



Photo by [Louis Reed](#) on [Unsplash](#)

- Notice 2023-63, September 8, 2023
 - IRC §174 was changed in the Tax Cuts & Jobs Act in 2017 to require amortization of
 - Research & experimental expenditures
 - Software development costs
 - Amortization over
 - 5 years for domestic expenditures
 - 15 years for foreign expenditures
 - Effective for tax years beginning after December 31, 2021

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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IRS Finally Issues Interim Guidance on TCJA Changes to IRC §174 That Took Effect for 2022 Tax Years



Photo by [Louis Reed](#) on [Unsplash](#)

- Notice 2023-63, September 8, 2023
 - Expectation was that this provision would never take effect
 - Was, frankly, expected to be a “budget gimmick” much like the ACA “Cadillac tax”
 - Like the “Cadillac tax” effective date was delayed and both parties wanted the provision repealed
 - But this time the repeal failed to happen, so the law went into effect

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expensitures>

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IRS Finally Issues Interim Guidance on TCJA Changes to IRC §174 That Took Effect for 2022 Tax Years



Photo by [Louis Reed](#) on [Unsplash](#)

- Notice 2023-63, September 8, 2023
 - Scope of the guidance
 - Does apply to years beginning before January 1, 2022
 - But is expected to apply for §41 credit for increasing research activities to the extent it defines research & experimental expenditures

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Key TCJA provisions
 - Section 13206(a) of the TCJA - amortization and cannot be taken into account due to dispositions and adds software development
 - Section 13206(b) of the TCJA - change of accounting method with cut-off treatment (Rev. Proc. 2023-11 contains procedure to obtain required consent)

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expensiditures>

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- Notice 2023-63, September 8, 2023
 - Capitalization & Amortization provisions
 - Foreign research
 - Means any research conducted outside the United States, the Commonwealth of Puerto Rico, or any U.S. territory or other possession of the United States
 - Look to where SRE activities are performed

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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IRS Finally Issues Interim Guidance on TCJA Changes to IRC §174 That Took Effect for 2022 Tax Years



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- Notice 2023-63, September 8, 2023
 - Capitalization & Amortization provisions
 - Midpoint
 - Generally first day of seventh month of tax year
 - For short years, midpoint is different for months with even or odd number of months

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Terms Used in §174
 - Specified research and experimental (SRE) expenditures
 - Research or experimental expenditures
 - satisfy the requirements under § 1.174-2 to be research or experimental expenditures, or are paid or incurred in connection with the development of any computer software regardless of whether such expenditures are research or experimental expenditures

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Terms Used in §174
 - Reg. §1.174-2 provides research and experimental includes “all such costs incident to the development or improvement of a product”
 - Expenditures represent research and development costs in the experimental or laboratory sense if they are for activities intended to discover information that would eliminate uncertainty

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Terms Used in §174
 - SRE Activities
 - Software development activities
 - Research or experimental activities described in § 1.174-2

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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IRS Finally Issues Interim Guidance on TCJA Changes to IRC §174 That Took Effect for 2022 Tax Years



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- Notice 2023-63, September 8, 2023
 - Identification and Allocation of SRE Expenditures
 - Non-exhaustive list of costs that can be SRE provided
 - Labor costs
 - Materials and supplies costs
 - Cost recovery allowances
 - Patent costs

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Identification and Allocation of SRE Expenditures
 - Non-exhaustive list of costs that can be SRE provided
 - Certain operation and management costs
 - Travel costs
 - Also have a list of costs that will not be SRE
 - Reasonable allocation of costs

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Identification and Allocation of SRE Expenditures
 - Consistency requirement - must continue to treat and allocation in the same manner
 - Software Development Expenditures
 - Defined terms
 - Computer software
 - Upgrades and enhancements

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Software Development Expenditures
 - Activities treated as software development
 - Purchased software
 - Purchase and installation of such software is not development
 - But upgrades and enhancements will contain such software development expenditures

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Software Development Expenditures
 - Activities not treated as software developments
 - Limited items related to software developed for trade & business
 - Training
 - Maintenance
 - After placed in service
 - Not upgrade or enhancement

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Software Development Expenditures
 - Activities not treated as software developments
 - Limited items related to software developed for trade & business
 - Data conversion activities, except for activities to develop computer software that facilitate access to existing data or data conversion; and

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Software Development Expenditures
 - Activities not treated as software developments
 - Limited items related to software developed for trade & business
 - Installing the computer software and other activities relating to placing the computer software in service

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Software Development Expenditures
 - Activities not treated as software developments
 - Limited items related to software developed for others
 - Expenses incurred after such software is ready for use (other than upgrades and enhancements)

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Software Development Expenditures
 - Activities not treated as software developments
 - Limited items related to software developed for others
 - Marketing and promotional activities,
 - Maintenance activities that do not give rise to upgrades and enhancements

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Software Development Expenditures
 - Activities not treated as software developments
 - Limited items related to software developed for others
 - Distribution activities (for example, making the software available via remote access), and
 - Customer support activities

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Research Performed Under Contract
 - Research provider
 - Perform research services for the research recipient with respect to an SRE product, or
 - Develop an SRE product that the research recipient acquires from the research provider.

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Research Performed Under Contract
 - Research recipient
 - Contracts with research provider to
 - Perform research services for the research recipient with respect to an SRE product, or
 - Develop an SRE product that the research recipient acquires from the research provider.

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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IRS Finally Issues Interim Guidance on TCJA Changes to IRC §174 That Took Effect for 2022 Tax Years



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- Notice 2023-63, September 8, 2023
 - Research Performed Under Contract
 - Financial risk
 - SRE product - any pilot model, process, formula, invention, technique, patent, computer software, or similar property that is subject to protection under applicable domestic or foreign law.

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Research Performed Under Contract
 - Treatment by research recipient
 - Governed by Reg. §§1.174-2(a)(10) and (b)(3)
 - Generally can be covered by §174
 - But not if acquire a product subject to depreciation that is subject to specific requirements before payment is made

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expensiditures>

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- Notice 2023-63, September 8, 2023
 - Research Performed Under Contract
 - Treatment by research provider
 - If bears financial risk then will be incident to SRE activities
 - Even if no financial, if retain rights to SRE product then again are costs incident to SRE activities

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expensiditures>

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- Notice 2023-63, September 8, 2023

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- Notice 2023-63, September 8, 2023
 - Disposition, retirement or abandonment of property
 - Generally cannot write off balance by claiming related property is worthless or otherwise disposed of
 - Special rule if corporation ceases to exist
 - If transaction covered by §381(a), then successor continues to amortize the costs

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Disposition, retirement or abandonment of property
 - Generally cannot write off balance by claiming related property is worthless or otherwise disposed of
 - Special rule if corporation ceases to exist
 - If not covered by §381(a)
 - Generally can write off but
 - Not if violate anti-abuse rule

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expensitures>

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- Notice 2023-63, September 8, 2023
 - Additional special rules
 - Long-term contracts - PCM will include only amortization of costs under §174(a)
 - Cost sharing arrangements under Reg. §1.482-7 - will revise regulations to require costs to be allocated in accordance with expected benefits

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expensiditures>

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- Notice 2023-63, September 8, 2023
 - Applicability Dates
 - Regulations expect to apply to years ending after September 8, 2023
 - Generally can rely on these rules except for rules in section 7 of the notice for SRE expenditures paid or incurred with respect to property that is contributed to, distributed from, or transferred from a partnership

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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- Notice 2023-63, September 8, 2023
 - Applicability Dates
 - Change of accounting method
 - IRS expects to issue revised guidance but
 - Can continue to use existing Rev. Proc. until updated guidance is issued

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- Notice 2023-63, September 8, 2023
 - The future
 - Congress could still retroactively repeal the provision or just do so prospectively
 - Proposed regulations may not appear for a long time - remember the promised proposed regulations for PTE taxes found in Notice 2020-75

<https://www.currentfederaltaxdevelopments.com/blog/2023/9/9/irs-releases-interim-guidance-for-tcja-requirement-to-amortize-174-research-and-experimental-expenditures>

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