

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 41, 446, 481; 1.446-1, 1.481-1, 1.481-4)

Rev. Proc. 97-50

SECTION 1. PURPOSE

.01 This revenue procedure provides guidelines to be used in connection with the examination of federal income tax returns involving the costs paid or incurred by a taxpayer in its trade or business to convert or replace computer software to recognize dates beginning in the year 2000.

.02 This revenue procedure also provides procedures for a taxpayer to obtain automatic consent to change to a method of accounting described in this revenue procedure.

SECTION 2. BACKGROUND

Many computer systems use two digits rather than four digits to represent the year in a date field (for example, “97” to represent 1997). A two-digit year field, however, may be inadequate to represent years after 1999. For data involving the year 2000, for example, computer systems may not recognize “00” as a year, or may treat that year as 1900 instead of

2000. Thus, many computer systems may fail to operate, or may operate improperly, if the software is not converted or replaced to recognize four-digit years (*i.e.*, made “year 2000 compliant”). In order to ensure that their computer systems are year 2000 compliant, taxpayers may pay or incur costs to manually convert their existing software, to develop new software to replace their existing software, to purchase or lease new software to replace their existing software, or to develop or purchase software tools to assist them in converting their existing software to be year 2000 compliant (“year 2000 costs”).

SECTION 3. TREATMENT OF YEAR 2000 COSTS

Rev. Proc. 69-21, 1969-2 C.B. 303, provides guidelines to be used in connection with the examination of federal income tax returns involving the costs paid or incurred to develop, purchase, or lease computer software. Year 2000 costs fall within the purview of Rev. Proc. 69-21. Accordingly, the Internal Revenue Service will not disturb a taxpayer’s treatment of its year 2000 costs if the taxpayer treats these costs in accordance with section 3 of Rev. Proc. 69-21 (in the case of developed software, including converted software), section 4 of Rev. Proc. 69-21 (in the case of purchased software), or section 5 of Rev. Proc. 69-21 (in the case of leased software).

SECTION 4. RESEARCH CREDIT

Section 41 of the Internal Revenue Code provides a credit against tax for increasing research activities. To be eligible for the research credit, expenditures must be for activities satisfying the requirements of § 41 including the definition of “qualified research” in § 41(d). Except in extraordinary circumstances, year 2000 costs will not satisfy the definition of “qualified research” in § 41(d). For example, year 2000 costs generally do not involve research undertaken for the purpose of discovering information that is technological in nature where substantially all of the research activities constitute elements of a process of experimentation. Thus, a taxpayer that pays or incurs year 2000 costs may not claim the research credit except in those extraordinary circumstances in which those costs satisfy the definition of “qualified re-

search” in § 41(d) and otherwise meet all the requirements of § 41.

SECTION 5. APPLICATION

Any change in a taxpayer’s treatment of year 2000 costs to conform with section 3 of this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. A taxpayer wanting to change its method of accounting for year 2000 costs to conform with section 3 of this revenue procedure must follow the automatic change in accounting method provisions of Rev. Proc. 97-37, 1997-33 I.R.B. 18.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 69-21 is amplified. Rev. Proc. 97-37 is amplified to include this change in the Appendix.

DRAFTING INFORMATION

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