Tax Insights
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Services

Updated automatic consent procedures simplify method changes for R&E expenditures and residential construction contracts

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In brief

What happened?

In Rev. Proc 2026-32, the IRS has updated automatic consent procedures for accounting method changes for provisions affected by the 2025 One Big Beautiful Bill Act (OBBBA) under Sections 174 and 174A for research or experimental (R&E) expenditures and under Section 460(e) for residential construction contracts. The changes are generally effective for Forms 3115 filed after September 4, 2026.

Why is it important?

Rev. Proc. 2026-32 streamlines the automatic method change procedures for Section 174A domestic and Section 174 foreign R&E expenditures paid or incurred in tax years beginning on or after January 1, 2025; Section 174 R&E expenditures paid or incurred before 2025 that were subject to capitalization under pre-OBBBA law; and changes made by the OBBBA permitting the use of the completed contract method for residential construction contracts entered into in tax years beginning after July 4, 2025.

Actions to consider

Taxpayers should evaluate the need to change their accounting methods for R&E expenditures or residential construction contracts using the updated automatic procedures under Rev. Proc. 2025-23, as modified by Rev. Proc. 2026-32. Importantly, prompt action may be required for taxpayers with pending non-automatic Form 3115 filings or in-process method changes, due to key deadlines in October and November 2026.

In detail

R&E expenditures under Sections 174/174A

For tax years beginning after December 31, 2021, Section 174 required taxpayers to charge R&E expenditures to a capital account, with amortization deductions allowed ratably over a five-year period for domestic research or a 15-year period for foreign research, beginning with the midpoint of the tax year. These mandatory capitalization rules applied to expenditures paid or incurred in tax years beginning after December 31, 2021, and before January 1, 2025 (referred to as “TCJA Section 174 costs”).

For amounts paid or incurred in tax years beginning after December 31, 2024, changes made by the OBBBA to the treatment of R&E expenditures included the following:

- New Section 174A, which allows an immediate deduction for domestic R&E expenditures, including software development costs, paid or incurred during the tax year, as well as an election to capitalize and amortize domestic R&E over not less than 60 months, beginning with the month in which the taxpayer first realizes benefits.

- Amendments to Section 174, which maintains the 15-year amortization requirement for foreign R&E expenditures.

A change to comply with the OBBBA’s amendments to Section 174A are a change in method of accounting implemented on a cut-off basis, so previously capitalized TCJA Section 174 costs generally must continue to be amortized over the remaining amortization period. However, the OBBBA also permits taxpayers to make an election to accelerate the deduction of domestic TCJA Section 174 costs over a one- or two-tax year period beginning with the taxpayer’s first tax year after December 31, 2024.

Rev. Proc. 2025-28 provided procedures for elections regarding domestic R&E expenditures and modified the list of automatic changes set forth in Rev. Proc. 2025-23 for changes related to (1) TCJA Section 174 costs, (2) domestic R&E expenditures under Section 174A, and (3) foreign R&E expenditures under Section 174. See our Tax Insight, IRS provides a clear path on new options for domestic R&E expenditures, for more information.

Section 481(a) adjustment for prior recovery method changes

Under Rev. Proc. 2025-23, as modified by Rev. Proc. 2025-28, taxpayers that did not properly capitalize and amortize domestic TCJA Section 174 costs paid or incurred in tax years beginning after December 31, 2021, and before January 1, 2025, as required by TCJA Section 174, were permitted to correct their method of accounting using automatic consent procedures for a year of change beginning in 2023 or 2024. Rev. Proc. 2026-32 extends this window to any tax year beginning before January 1, 2028.

Consistent with the options provided by the OBBBA, taxpayers may accelerate the recovery of the remaining unamortized amount of domestic TCJA Section 174 costs using the recovery of unamortized amount method (recovery method) of Rev. Proc. 2025-23, as modified by Rev. Proc. 2025-28, by either (1) amortizing the remaining unamortized amount in full in the first tax year beginning after December 31, 2024, or (2) amortizing the remaining unamortized amount ratably over the two-tax year period beginning with the first tax year beginning after December 31, 2024. Rev. Proc. 2026-32 modifies this method change for TCJA Section 174 costs to coordinate the Section 481(a) adjustment with the recovery method as follows:

- If a taxpayer changed to the recovery method for a prior tax year, then the Section 481(a) adjustment for TCJA Section 174 costs must reflect application of the taxpayer's recovery method. For example, assume a calendar-year taxpayer files a method change in 2026 to change its method of accounting of improperly deducting certain TCJA Section 174 costs. Further, assume that the taxpayer elected to fully recover unamortized TCJA Section 174 costs in 2025 pursuant to the recovery method. The net Section 481(a) adjustment resulting from the 2026 change is $0.
- For taxpayers that have used or are concurrently adopting the recovery method, the Section 481(a) adjustment period is adjusted as follows:
  - **Concurrent changes in 2025:** If both the recovery method change and the TCJA Section 174 cost change are made for a 2025 tax year, the Section 481(a) adjustment period for any net positive adjustment matches the amortization period elected under the recovery method—either fully in the first year or ratably over two years.

    Observation: The Section 481(a) adjustment period is not impacted if the recovery method is not elected.
  - **Prior recovery method change with subsequent change made for TCJA Section 174 costs:** Taxpayers wanting to make a change to the recovery method are required to make the change in their first tax year beginning after December 31, 2024. If a taxpayer makes a TCJA Section 174 cost change in a tax year subsequent to its first tax year beginning after December 31, 2024 (e.g., 2026) and the taxpayer previously changed to the recovery method, any net positive Section 481(a) adjustment is spread over the remaining amortization period under the recovery method.
  - **Negative adjustment option:** If the modified Section 481(a) adjustment is negative, the taxpayer may instead choose to implement the change on a cut-off basis, consistent with the guidance provided in Rev. Proc. 2025-28.

Observation: The new coordination rules add some complexity for taxpayers that are making or have already made a recovery method election for domestic TCJA Section 174 costs. Because a change to the recovery method was available only for the first tax year beginning after December 31, 2024, taxpayers that did not make an election in 2025 would need to continue amortizing these costs over the remaining amortization period and recognize the net Section 481(a) adjustment over four years. For example, assume a calendar-year taxpayer that improperly deducted $120 of R&E costs in 2024, did not elect the recovery method in 2025, and files a method change in 2026 to capitalize the costs that were improperly deducted. If the R&E costs had been properly capitalized in 2024, then the taxpayer would have amortized $36 of the $120 improperly deducted R&E costs, leaving $84 of unamortized costs as of the beginning of 2026 and would compute the amortization and net Section 481(a) adjustment as follows:

	2026	2027	2028	2029	Total
TCJA Section 174 amortization	($24)	($24)	($24)	($12)	($84)
Section 481(a) adjustment	$21	$21	$21	$21	$84
Net amortization deduction	($3)	($3)	($3)	$9	0

Waivers of eligibility rules and other relief

Rev. Proc. 2026-32 expands the availability of the automatic consent procedures in Rev. Proc. 2025-23 for method changes for R&E expenditures under Sections 174 and 174A as follows.

- **Waiver of certain eligibility rules:** Rev. Proc. 2026-32 waives certain eligibility rules so that taxpayers either in their final year of a trade or business or that have recently changed their methods under Sections 174 and 174A for the same item during any of the five prior tax years may use the automatic consent procedures for any tax year beginning before January 1, 2028. Without these waivers, Rev. Proc. 2015-13 would have precluded these taxpayers from filing an automatic method change request for tax years beginning after December 31, 2024.
- **Changes from an impermissible method:** Rev. Proc. 2026-32 permits the use of automatic procedures to change from an impermissible method of accounting for TCJA Section 174 costs and foreign R&E costs even though the impermissible method of accounting was used only for one tax year.
- **Open-ended availability of foreign R&E automatic change:** Rev. Proc. 2026-32 also removes the limitation that previously restricted automatic method changes for foreign R&E expenditures to comply with the OBBBA amendments to Section 174 to tax years beginning before January 1, 2026. As revised, automatic procedures now can be used for foreign R&E expenditures for tax years beginning after December 31, 2024, without a sunset.

Observation: These waivers are particularly significant for taxpayers that previously changed their methods for R&E expenditures.

Conversion of pending non-automatic filings

Rev. Proc. 2026-32 provides a helpful transition rule for taxpayers who previously filed a Form 3115 under the non-automatic change procedures of Rev. Proc. 2015-13. If, before September 21, 2026, a taxpayer properly filed a Form 3115 under non-automatic change procedures and that Form 3115 is pending with the IRS National Office on September 21, 2026, then the taxpayer may choose to convert the filing to the automatic change procedures. To do so, the taxpayer must notify the National Office contact person for the pending Form 3115 before the later of October 21, 2026, or the issuance of a letter ruling granting or denying consent, and resubmit a Form 3115 that conforms to the automatic change procedures, with a copy of the National Office acknowledgment letter attached, by the earlier of 30 days after the acknowledgment letter or the duplicate copy filing deadline. According to Rev. Proc. 2026-32, the user fee paid with the nonautomatic method change will be returned, and the original non-automatic filing will be disregarded for purposes of the prior five-year change rules.

Observation: The conversion option allows taxpayers to avoid the user fee associated with a non-automatic method change and eliminates the uncertainty associated with a request for a letter ruling. Because the window to act is narrow, it is important for taxpayers with pending non-automatic filings that choose to convert a method change to notify the National Office contact person before the later of October 21, 2026, or issuance of a letter ruling on the pending request.

Limited audit protection

Rev. Proc. 2026-32 does not change the limited audit protection rules established for R&E expenditure method changes under Rev. Proc. 2025-28. Under these rules, audit protection generally is not available to taxpayers that are changing (1) their domestic TCJA Section 174 costs for expenditures paid or incurred in tax years beginning on or before December 31, 2021; (2) to a Section 174A method for expenditures paid or incurred in tax years beginning before January 1, 2025; or (3) their method for foreign R&E expenditures for pre-2022 expenditures or, for OBBBA-related changes, for expenditures paid or incurred in tax years beginning before December 31, 2024.

Observation: Taxpayers that change their methods under the expanded automatic procedures of Rev. Proc. 2026-32 should consider the scope of audit protection available, particularly where pre-change years remain open to examination.

Residential construction contracts under Section 460(e)

As revised by the OBBBA, more taxpayers now are eligible to use the completed contract method (CCM) under Section 460 to account for income from residential construction contracts entered into in tax years beginning after July 4, 2025. The OBBBA expands the availability of the CCM by permitting all residential construction contracts to qualify for the exception to the percentage of completion method (PCM), regardless of the number of dwelling units contained in the building. Under the amended rules, any business engaged in residential construction generally is eligible to utilize the CCM to account for income from long-term contracts.

Rev. Proc. 2026-32 now provides the automatic change procedures for residential construction contracts by modifying Section 19 of Rev. Proc. 2025-23. The procedures allow a taxpayer to change from the PCM or the PCCM (a modified version of the PCM) to an exempt contract method, or to begin capitalizing costs under Section 263A, for contracts entered into in tax years beginning after July 4, 2025. The change is made on a cut-off basis (i.e., no Section 481(a) adjustment is required or permitted), meaning only contracts entered into on or after the first day of the year of change are subject to the new method. Under Rev. Proc. 2026-32, a taxpayer that filed a return on or before September 21, 2026, for a tax year beginning after July 4, 2025, and properly applied the new methods on that return is deemed to have complied with the automatic change procedures.

Observation: Although Section 263A generally does not apply to long-term contracts, a special rule requires companies using the CCM for construction contracts to capitalize costs to the property constructed under the contract pursuant to Section 263A unless (1) the taxpayer is a small business and (2) the contract is completed within a three-year period (two years for home construction contracts) beginning on the contract's commencement date.

Effective date and transition rules

Rev. Proc. 2026-32 is generally effective for Forms 3115 filed after September 4, 2026. A transition rule allows taxpayers that properly file a duplicate copy of Form 3115 on or before November 15, 2026, under the prior rules to choose either to (1) implement the change under the prior rules, or (2) implement the change under the modified rules of Rev. Proc. 2026-32.

Observation: The transition rule gives taxpayers who are in the process of filing method changes a choice between the old and new frameworks, avoiding any disruption from the mid-year effective date. Taxpayers with upcoming filing deadlines should evaluate which set of rules produces the more favorable result.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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