



Prototypes and Depreciable Property: An Attempted Distinction

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Tax Notes

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The proposed section 174 regulations represent a significant step forward in the treatment of prototype-related expenditures. They clarify that a fully functional product or process can constitute a pilot model and that the subsequent sale or use of a prototype does not override the section 174 eligibility of the costs incurred to develop and fabricate the prototype. However, the proposed amendments do not resolve all questions concerning the treatment of prototype costs. Enduring issues include determining when experimentation ends and production begins, the scope of the pilot model when a component or components are modified, and the treatment of first-in-class sales. Moeller, Sadler, and Norton suggest a way in which these questions can be addressed based on the principles that underlie the proposed regulations.