1156 15th St NW
Suite 502
Washington, DC 20005
www.sbtc.org

Small Business Technology Council

March 2023

The Honorable Jason Smith
Chairman
US House Ways & Means Committee
Washington, DC 20515

The Honorable Richard Neal
Ranking Member
US House Ways & Means Committee
Washington, DC 20515

The Honorable Ron Wyden
Chairman
US Senate Committee on Finance
Washington, DC 20510

The Honorable Mike Crapo
Ranking Member
US Senate Committee on Finance
Washington, DC 20510

Dear Chairman Smith, Chairman Wyden, Ranking Member Neal, and Ranking Member Crapo,

The Small Business Technology Council (SBTC) would like to raise an urgent issue facing America's high-tech small business community this year. Changes made to section 174 of the Internal Revenue Code by the 2017 Tax Cuts and Jobs Act that went into effect in 2022 will potentially have a devastating effect on America's Small Business innovation ecosystem, and disincentivize many small businesses from performing R&D work. The changes will require businesses to amortize R&D expenses over a five-year period, rather than allowing them to be deducted in the year they were incurred.

The effect of these changes is that beginning in 2022, the cost of performing R&D will be much higher, and will result in a larger tax burden for many high-tech companies. This will have a chilling effect on American R&D in general, but it will particularly harm and disincentivize R&D-focused small businesses like those participating in the SBIR and STTR programs. These companies often have a much higher percentage of their expenses going to R&D work, and many newer, smaller companies simply don't have the cash in hand to amortize potentially hundreds of thousands of dollars over five years. Many of the firms hardest hit are early-stage high-growth companies that are not yet making a profit. The move to five-year amortization will further push these companies into negative territory in the near-term, limiting their ability to attract investment and obtain loans. For entities such as sole proprietorships, partnerships, and sub-s corporations, this tax obligation flows through directly to the individual owners.

For example, a typical SBIR Phase I grant is $250,000 and must be performed in one year, while a typical SBIR Phase II contract is up to $1.7 million and is performed in two years. This money must be spent on R&D and other related work, and isn't budgeted to pay tax expenses. While previously firms could deduct the entire amount immediately, they can now only deduct 10% of the total in the first year, and must pay taxes on the remainder as if it were income. While firms will eventually be able to amortize the money over 5 years, many brand-new startups and early stage firms simply don't have cash reserves or alternative revenue to pay the tens of thousands of dollars in taxes required in year 1 or 2, and could face bankruptcy. *See Addendum for SBIR Amortization Case Study.*

Unless Congress acts swiftly to restore the Sec. 174 deduction, SBTC worries that the long-term effects to America's innovation economy could be devastating. Fewer small businesses and startups will want to incur the cost of R&D work, leaving it primarily to larger, established businesses who have the cash reserves and profits to amortize their taxes. Many small businesses will simply opt out of innovation programs like SBIR/STTR, resulting in less innovation and a reduction in STEM jobs.

Considering the devastating effect these changes will have on high-tech small businesses, we the undersigned small businesses and organizations urge Congress to quickly restore the Sec. 174 deduction to ensure that American small business can continue to contribute to America's innovation ecosystem. At the least, we ask you to consider an exception that would allow SBIR/STTR award funds to deduct their expenses on a Federal R&D contract in the year they occur. Without such action, the US would lose out on some of the most innovative and cutting-edge technology being produced in the world.

Thank you for your consideration,

Jere W. Glover
Executive Director
Small Business Technology Council

Addendum: Sec. 174 SBIR R&D Amortization Case Study

While amortization is said to be over 5 years, it is actually over 6 years because of the way the rules work. It starts from the midpoint of Year 1 and end at the midpoint of Year 6.

Example of a small firm amortizing R&D work from an SBIR award:

Contract Value (Year 1)	$110,000
Fee/Profit	$10,000
Total Expenses: (Year 1)	$100,000
Year 1 Amortization Expense:	$10,000 [Amortized over 5 years starting at midpoint of first year]
Year 2 Amortization Expense:	$20,000
Year 3 Amortization Expense:	$20,000
Year 4 Amortization Expense:	$20,000
Year 5 Amortization Expense:	$20,000
Year 6 Amortization Expense:	$10,000
Total Amortization:	$100,000
Year 1 Revenue:	$110,000
Year 1 Allowable Expenses:	$10,000
Year 1 Reported Income	$100,000
Year 1 Actual Income	$10,000
Year 1 21% Corporate Tax	$21,000 (on $100k)
Year 1 Net Cash Flow	($11,000) = $10,000 - $21,000
Year 1 21% Corporate Tax (Prior Law)	$2,100 (on $10,000)
Year 1 Excess Taxes paid:	$18,900
Year 2 Reported Income:	($20,000)
Year 3 Reported Income:	($20,000)
Year 4 Reported Income:	($20,000)
Year 5 Reported Income:	($20,000)
Year 6 Reported Income:	($10,000)

In the first year, the company will have a negative cash flow due to taxes for that one job.

Over the next 5 years, the company can slowly recover excess taxes paid, but only if there is some excess net revenue to offset the losses and reduce taxes.

Larger more established firms with diverse revenue streams can offset these taxes, but newer startup firms often can't, and will either exit the SBIR program or face a tax deficit.