



Nov 22, 2023

Robert Schmidt
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RE: Notice 2023-63 Amortization of Specified Research or Experimental Expenditures under Section 174

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The Small Business Technology Council (SBTC) is the nation's largest association of small, technology-based companies in diverse fields. SBTC is a council of the National Small Business Association (www.NSBA.biz), the nation's first small-business advocacy organization. NSBA is a staunchly nonpartisan organization with 65,000 members in every state and every industry in the US. SBTC advocates on behalf of the thousands of firms who participate in the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs.

While every company that performs R&D work is potentially impacted by the change to Sec. 174 that was included in the 2017 Tax Cuts and Jobs Act (TCJA), high-tech R&D focused small businesses, like those that participate in the SBIR and STTR programs are much more severely impacted. These companies tend to allocate a much greater percentage of their expenses to R&D work than large high-tech firms, and many of these companies simply don't have the cash in hand to amortize potentially hundreds of thousands of dollars over several years. Awards under the SBIR program require companies to use roughly 90% of the award funds on R&D work, and since these firms are often working on pre-commercial products, they would have little to no other source of income.

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.

Any change to how R&D expenses are treated could have an outsize effect on high-tech small businesses, the most innovative sector in the American economy. With this in mind, SBTC believes that the proposed IRS guidance on Sec. 174 designated "Notice 2023-63" is incorrect, overly prescriptive, and not only changes how Sec. 174 works, but also in effect Sec. 162 in a way that we do not believe Congress intended. We believe that the IRS should revise its guidance in a way that conforms to how Sec. 162 has historically been used.



Since even before Section 174 of the Internal Revenue Code was enacted in 1954, companies that could show that their R&D expenses were a “necessary and ordinary” part of their business could deduct those expenses under Sec. 162. When Sec. 174 was passed, it made no change to Sec. 162, but simply added an R&D deduction for companies even if their R&D expenses weren’t “necessary and ordinary”. For nearly 70 years, firms whose R&D work was necessary and ordinary part of their business practice had a choice: to use either Sec. 174 or Sec. 162 to deduct their R&D expenses. Many of SBTC’s membership have told us that they have always used Sec. 162 to deduct their R&D expenses, some have used Sec. 162 for decades.

The TCJA made several changes to Sec. 174 which eliminated the immediate deduction for research or experimental expenditures, but made no modifications to Sec. 162. Previously, Sec. 174 allowed an option to expense or amortize these expenditures, and the new language eliminated that option. SBTC believes the new Sec. 174 language should not be interpreted to disallow treatment under other sections of the code that were previously elected. The changes should only apply to the treatment under Sec. 174, and not under other sections of the code. There will be some companies that will be required to use Sec. 174, but companies that previously had the option to use Sec. 162 should still be able to utilize that section.

SBTC urges the IRS to revise its guidance to make this point clear, and to clarify the distinction between research as part of a company’s established business practice, and independent research and development (IR&D). A company that performs contracted research, like that under the SBIR program, should continue to be allowed to use Sec. 162, as it is part of the company’s “necessary and ordinary” function, while IR&D would necessarily be covered by Sec. 174. SBTC believes this distinction is in line with Congressional intent, as Congress did not modify Sec. 162, and any R&D expenses incurred that could have been expensed under that section before the TCJA should still be eligible for it now.