



Restore the Sec. 174 R&D Tax Deduction

Congress Must Reverse Changes to Sec. 174 To Prevent American Innovation From Falling Behind

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- ❖ 2017 Changes to Internal Revenue Code Sec. 174 Requiring firms to amortize R&D expenses instead of deducting them disincentivizes R&D work and makes it prohibitively expensive for many small and start-up companies
- ❖ While all firms are affected, high-tech small businesses in particular will be hit hard due to the fact that many, if not most, simply do not have cash on hand to pay the very large tax increases that will occur due to this change.
- ❖ At a time when US continues to lose ground in its global technological advantage to China and other countries, Congress should not be making R&D work more expensive.
- ❖ Firms that participate in SBIR/STTR are disproportionately affected since nearly 100% of SBIR funds must be used for R&D. Many of these firms are start-ups with little to no outside revenue, and simply can't afford to pay the tax increase.

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.

Unless Congress acts swiftly to restore the Sec. 174 deduction, SBTC is concerned 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.

SBTC urges Congress to restore the Sec. 174 R&D deduction ensure that American small business can continue to contribute to America's innovation ecosystem.