# RSM Sect 174 Comment Letter 3-8-23

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The Honorable Charles Schumer
Senate Majority Leader
United States Senate
S-221 U.S. Capitol
Washington, D.C. 20515

The Honorable Kevin McCarthy
Speaker of the House
U.S. House of Representatives
H-204 U.S. Capitol
Washington, D.C. 20515

The Honorable Mitch McConnell
Senate Minority Leader
United States Senate
S-230 U.S. Capitol
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The Honorable Hakeem Jeffries
House Minority Leader
U.S. House of Representatives
H-232 U.S. Capitol
Washington, D.C. 20515

The Honorable Ron Wyden
Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Mike Crapo
Ranking Member
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Jason Smith
Chairman
House Committee on Ways and Means
1139 Longworth House Office Building
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

**Re: Capitalization of research and experimentation expenditures under section 174**

Dear Leader Schumer, Speaker McCarthy, Minority Leader McConnell, Minority Leader Jeffries, Chairman Wyden, Ranking Member Crapo, Chairman Smith and Ranking Member Neal:

For those recently elected (or re-elected) and seated as members of Congress and committees, congratulations and we hope for a productive and meaningful 118th Congress.

Let's get right to the point. The undersigned organizations join the many thousands of U.S. businesses now facing anti-competitive, onerous new requirements for the capitalization of research and experimentation costs under section 174 of the Internal Revenue Code. This shift from immediate expensing of these costs is harmful to businesses of all sizes and is contrary to the United States mission of supporting and encouraging domestic research activities.

In addition to the sheer breadth of U.S. companies now being disincentivized to innovate and invest in R&D, complying with the new law is proving to be both time consuming and complex, while also requiring an unanticipated focus on other areas of the tax code as well. As a result, a substantial number of companies are being forced to consider layoffs and relocating their research and development activities to more favorable tax jurisdictions around the world.

The brevity of the provision belies its complexity and scope. For many, defining what constitutes research and experimentation is a "you'll know it when you see it" test and companies now fear that their judgment in determining an immediately deductible business expense versus a capitalizable research cost will be the subject of IRS inquiry and enforcement in the years to come.

Also, while the Tax Cuts and Jobs Act (TCJA) simplified accounting methods for many small businesses, there is no small or middle market business exception to this required capitalization. Now even the tiniest companies are forced to undergo an examination of their business activities to determine whether any activity is being conducted in a research or laboratory sense, whether any experimentation is happening in a product development cycle, or if activities to upgrade technology constitute software development.

While the largest of companies will have polices and software in place to track research and development cost centers, the majority of small and middle market companies do not have the accounting personnel or resources to determine cost centers and allocate costs across departments in a highly specific manner. In addition, small and middle market companies have the least ease of access to raising capital and increasing their tax burden at a time when other costs are already high creates additional worry.

**Unexpected Complexities and Unintended Consequences Harming Taxpayers**

Furthermore, the lack of conforming amendments in other areas of the tax code that rely upon section 174 create additional hardships for taxpayers, both corporations and individuals. Take, for example, a company that is required to recognize revenue under a percentage of completion method. It appears that the entirety of the research costs incurred during a taxable year must be allocated to a contract and that allocation advances the recognition of revenue forward. However, the actual deduction of those costs is deferred as a result of the new law, leaving a company in this position with a significant mismatch in the timing of revenue versus the timing of the expense. Congress recognized this mismatch in other circumstances, specifically section 460(c)(6) of the tax code which provides a special rule for accelerated depreciation and allocation of that cost to a contract. Here, no such consideration is given which compounds the cash tax impact of required capitalization.

A second example is a favorite subject of many – the alternative minimum tax. While eliminated for corporations as part of TCJA, it remains for individuals and the tentacles of required capitalization reach here. Under the AMT, an individual is to adjust the amount of research costs incurred as an individual activity or passed through by an investment in a flow through entity. The adjustment requires an individual to take the amount of research costs described in section 174 and capitalize those amounts and amortize ratably over a 10-year period. The costs described in previous section 174 were research costs eligible for an immediate deduction so the adjustment slowed down immediate expensing. Taxpayers are now uncertain how to apply this provision. One interpretation may require taxpayers to capitalize the current year amortization deduction and deduct that amortization over a period of 10 years, leading to a nonsensical recovery period of 15 years for domestic research spend under the AMT. A different reading of the AMT provision would take the total research costs incurred in one year and amortize those costs over 10 years. That leads to foreign research costs being amortized over 10 years under the AMT, which does not appear to be a result aligned with Congressional intentions.

While near-term prospects for major tax legislation to emerge in the current political environment are unlikely, we know that overwhelming, bipartisan support exists for Congress to reverse course and restore prior law under section 174. Now that we are seeing that the negative impacts of inaction are actually far worse than expected, our hope is that Congress can find the political will necessary to quickly address these unintended realities we know are so detrimental to our nation's prosperity.

Advancing widely-agreed upon items, such as a common-sense return to expensing, shows the American people that divided government can work together and align its tax code to encourage companies to conduct their research here, employ people here, and increase our nation’s overall competitive advantage.

We appreciate your consideration of our request and welcome any questions or additional feedback you may wish to share.

Sincerely,

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cc: The Honorable Representative Ron Estes
The Honorable Representative John Larson