

September 7, 2023

The Honorable Ron Wyden, Chairman
U.S. Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Jason Smith, Chairman
U.S. House Committee on Ways & Means
1139 Longworth House Office Building
Washington, DC 20515

The Honorable Mike Crapo, Ranking Member
U.S. Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Richard Neal, Ranking Member
U.S. House Committee on Ways & Means
1102 Longworth House Office Building
Washington, DC 20515

RE: Request to Defer IRC Section 174 Amortization Requirement of the Research and Experimental Expenditures Provision

Dear Chairmen Wyden and Smith, and Ranking Members Crapo and Neal:

The Texas Society of Certified Public Accountants (TXCPA) is a nonprofit, voluntary professional organization representing more than 28,000 members. One of the expressed goals of the TXCPA is to speak on behalf of its members when such action is in the best interest of its constituency and serves the cause of the CPAs of Texas, as well as the public interest. TXCPA has established a Federal Tax Policy Committee to represent those interests on federal tax issues. The committee has been authorized by the TXCPA Leadership Council to submit comments on such matters of interest to the committee membership. The views expressed herein have not been approved by the Leadership Council or Board of Directors and, therefore, should not be construed as representing the view or policies of the TXCPA.

We write to express our concerns regarding certain revisions made to Section 174 of the Internal Revenue Code (IRC) in 2017 and to request, at a minimum, deferral of the implementation date. The *Tax Cuts and Jobs Act (TCJA)* enacted in 2017 requires that, for tax years starting after Dec. 31, 2021, amounts defined as specified research and experimental (R&E) expenditures, including any software development costs, be capitalized and amortized ratably over a five-year period rather than immediately expensed.¹ For expenditures attributable to research conducted outside of the U.S., the period over which these costs may be amortized is extended to 15 years.² We believe these changes are detrimental to taxpayers and tax practitioners, not only because they require ordinary and necessary business expenses that are currently incurred to be capitalized and amortized, but also because they leave many unanswered questions, thereby creating ambiguity and uncertainty.

IRC Section 174 R&E Expenditures Amortization Deferral

We support the American Institute of CPAs (AICPA) letter to you dated Feb. 14, 2023,³ urging Congress to immediately defer the IRC Section 174 amortization requirement of the R&E expenditures provision. We believe that revised Section 174 inherently increases the cost and complexity of accounting for R&E expenditures partly because Congress and the Department of the Treasury have left taxpayers and tax professionals without guidance

¹ IRC Section 174(a).

² IRC Section 174(a)(2)(B).

³ AICPA Letter to Chairmen Wyden and Smith, and Ranking Members Crapo and Neal, Request for Legislation Extending Expired Tax Provisions, Feb. 14, 2023; <https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/aicpa-letter-to-congress-extenders-2.14-submit.pdf>.



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on the types of costs required to be capitalized and amortized pursuant to the modified Section 174. For instance, Section 174 provides no definition for software development, which leaves many unanswered questions, such as: (i) whether capitalization is required for general overhead costs; (ii) to what extent wages for software developers should be capitalized; and (iii) whether ownership of the software product impacts the requirement to capitalize—this is a particularly glaring issue given that software development often involves multiple levels of contractors that may have varying proprietary rights in portions of their contract labor. Logically, capitalization should only be required for the ultimate owners of the software. Guidance is needed on these issues and many more.

For these reasons, we believe Congress should retroactively extend the effective date of amended IRC Section 174 R&E to amounts paid or incurred for tax years beginning after Dec. 31, 2025. This retroactive deferral would simplify tax compliance and help avoid the confusion related to identifying costs that should be capitalized versus expensed by allowing time for further guidance to be issued before the implementation date.

We acknowledge and appreciate that Congress has released several bills recently to help resolve these issues. In April 2023, there were bills introduced in both the House (H.R. 2763, *American Innovation and R&D Competitiveness Act of 2023*) and Senate (S. 866, *American Innovation and Jobs Act*). Both bills have cosponsors that cross party lines and show strong bipartisan support. Both versions of the bill contain provisions that would both permanently reinstate the deductibility of Section 174 expenses and thereby negate the need for the Internal Revenue Service (IRS) to issue additional guidance. Separately, in June 2023, the House Ways and Means Committee approved H.R. 3938, *Build It in America Act*, which would defer the capitalization and amortization requirement until tax years beginning after Dec. 31, 2025. Taxpayers and tax professionals have been expecting Congress to further address Section 174 given the bipartisan support for reverting to the prior version of Section 174. Unfortunately, we remain disappointed this has not occurred yet.

While our organization consists of accountants, many of our members work in technological industries and other industries fostering innovation and development or have a myriad of clients in these industries. We therefore offer the following additional observations. The layoffs of software developers rose precipitously in 2022 and 2023 as the cost of innovation increased and companies lost faith in the ability of Congress to revert to the prior version of Section 174.⁴ This view is acknowledged in the House Ways and Means Committee press release issued June 13, 2023, regarding H.R. 3938, which notes that the current capitalization and amortization requirement has led to workforce reductions and threatens the status of the U.S. as a global innovation leader. From an accounting perspective, this is easily understood: If a company with software development can only deduct 10% of its ordinary and necessary business expenses for software developer wages in the year those expenses are paid, then it follows that such a company may reduce its staff to offset corresponding increases in income taxes.

In addition, many software developers are employed by small businesses (e.g., early-stage start-ups) that have limited revenue streams during the development of software. This change results in increased costs for these small software developers at a time when capital must be raised from a finite and dwindling pool of investors. It therefore begs the question: How many investors will be willing to invest in software development companies that are being hamstrung by onerous tax laws that create income tax liabilities in businesses running economic losses?

⁴ TECHNICAL.LY, *Are small software companies at risk of ruin this tax season? Understanding Section 174*, Mar. 29, 2023; <https://technical.ly/civic-news/section-174-small-software-companies-taxes-explainer/>.

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These are just a few illustrations of the detrimental impacts that the current version of Section 174 may have on industries that are at the cutting edge of innovation and essential to the economic growth of the U.S. Overall, this seems like a major public policy shift given that the U.S. has always been a bastion of innovation and invention. Ironically, the one industry that stands to benefit from these new rules is the consulting industry, as the ranks of specialized consulting firms will no doubt swell to provide R&E studies. We seriously doubt this was the intention of Congress.

In conclusion, Congress should retroactively extend the effective date of amended IRC Section 174 R&E to amounts paid or incurred for tax years beginning after Dec. 31, 2025. This will promote accounting simplicity by allowing Section 174 expenditures, such as wages, to be accounted for as other ordinary and necessary business expenses until then. Requiring capitalization will significantly increase the administrative burden on taxpayers and the IRS by unnecessarily creating ambiguity and uncertainty.

We urge Congress to address the deductibility of Section 174 R&E expenditures as soon as possible.

Sincerely,



David E. Colmenero, J.D., LL.M., CPA
Chair, Federal Tax Policy Committee
Texas Society of Certified Public Accountants

cc: Members, U.S. Senate Finance Committee
Members, U.S. House Ways & Means Committee
Texas Members of U.S. Congress