November 27, 2023

Dear Members of the North Carolina Congressional Delegation,

It is with great urgency and sincerity that I write to each of you to advocate for the deferment of the Internal Revenue Code section 174's amortization requirement concerning R&E expenditures. Failure to act would result in a "tax on innovation" that would stifle entrepreneurship and growth across the state.

Originally enacted in 1954 as part of the Internal Revenue Code, Section 174 was created to eliminate uncertainty in tax accounting treatment of research and experimentation (R&E) expenditures, and to encourage R&E as a way to stimulate innovation. In the decades since the enactment of Section 174, businesses have deducted certain R&E expenses immediately to reduce their taxable income, which has helped increase their competitiveness and drive toward greater technological advancement and commercialization.

Under a new provision of the 2017 Tax Cuts and Jobs Act, however, costs associated with R&E activities must now be amortized over time—five years for R&E costs within domestic borders, and 15 for R&E costs incurred overseas. The change means that businesses cannot deduct these critical expenses, resulting in the businesses having higher reported income and therefore higher tax costs. Simply put, this "Research and Experimentation" tax policy change is a "tax on innovation."

The recent changes to Section 174 are already beginning to take effect; there have been numerous media reports that this tax-code change is negatively impacting businesses of all sizes. The National Association of Manufacturers estimates that 50,000 manufacturing jobs, many in large companies, will be lost due to Section 174. This is also a devastating blow to Small Business Innovation Research/Small Business Technology Transfer (SBIR/STTR) recipients, which could owe taxes on up to 90 percent of their SBIR/STTR award. Small businesses are not allowed to use any of the grant funds (often their only source of funds in their early years) to cover the tax expenses. This is creating an insurmountable financial strain and bankruptcy for many innovators. In 2022 alone, 114 North Carolina companies brought $126 million to the state for R&E activities from the federal SBIR/STTR program. The One North Carolina Small Business Program – which catalyzes and leverages SBIR/STTR funded companies in the state – couldn't even absorb the negative financial impact that Section 174 will bring to these companies.

This matter requires your immediate attention before the end of the 2023 calendar year. Innovation is an accelerator that creates new industries, keeps existing ones globally competitive, advances national security, and drives future economic growth and well-being. And there is no greater immediate threat to our most innovative businesses than the Section 174 requirement to amortize R&E costs. I strongly urge you to defer the Internal Revenue Code section 174's amortization requirement concerning R&E expenditures.

Sincerely,

Machelle Baker Sanders

Machelle Baker Sanders
Secretary, NC Department of Commerce

State of North Carolina | Department of Commerce
301 North Wilmington Street | 4301 Mail Service Center | Raleigh, NC 27699-4301
919 814 4600 T