SECTION 174:

Full Expensing of Research and Development

INNOVATOR Alliance
EMPOWERING INNOVATION THROUGH STRATEGIC TAX POLICY

THE ISSUE:

For nearly 70 years, American businesses have been permitted to deduct 100 percent of R&D expenses from taxable income in the year those expenses were incurred. This favorable tax treatment promoted innovation by incentivizing critical investments in research and technological advancement. Those investments led to countless scientific breakthroughs, powered economic growth, and produced significant commercial and military advantages for the United States.

In 2022, that treatment changed. Rather than deduct R&D investment expenses immediately, companies are required to capitalize those costs and amortize them over 5 years for domestic research or 15 years for foreign research. This change increases federal tax liabilities for these companies investing in the future, including on federal grants awarded through Small Business Innovation Research and Small Business Technology Transfer programs. These entrepreneurs and growth-stage companies now face difficult choices to pay the new tax obligation, such as entering into tax repayment plans, borrowing against homes, incurring credit card debt, dipping into retirement or savings accounts, implementing hiring freezes, suspending projects, and laying off valuable staff.

IMPACT ON INNOVATION:

The change in tax treatment disproportionately impacts the innovation community because it invests heavily in developing, testing, and improving new products and services. Higher tax liabilities for R&D investments can devastate fragile, early-stage companies that earn little income in their formative years. Indeed, for many startups across the country, the requirement to amortize R&D investments can be fatal. This has enormous economic consequence: Startups and growth-stage companies are disproportionately responsible for the innovations that drive productivity growth and economic growth, and account for virtually all net new job creation.

Job Loss and Economic Strain: Small- and medium-sized businesses are forced to implement hiring freezes, halt critical projects, or worse, lay off significant portions of their workforce to manage the additional tax liability. In October 2024, the Wall Street Journal published a story detailing how some businesses have laid off 35%-40% of their workforce due to the need to amortize research expenses.

Declining R&D Investment: Since the amortization requirement took effect in 2022, R&D spending has sharply declined. While R&D spending grew at an average annual rate of 6.6% in the five years prior to the amortization requirement, it expanded less than 1% in the 12 months ending in March 2024.

Losing Ground in Global Innvoation: The U.S. is one of only two developed countries that require R&D amortization instead of allowing for an immediate deduction. Our strategic competitors know this and are taking advantage of it. In fact, 17 countries provide a deduction that is more than 100% of eligible R&D expenses. China, for example, has permanently expanded its deduction for R&D expenses, allowing a first-year deduction 20 times greater than the first-year deduction for the same investment in the United States. In other words, a manufacturing company in China that spends $100 on R&D can deduct $200 in its first year.

REQUESTED ACTION

We respectfully urge Congress to restore 100% immediate expensing for research and development (R&D) costs, which will boost investments in innovation and give an edge to U.S. competitiveness.