

June 6, 2023

Chairman Jason Smith
House Committee on Ways and Means

Ranking Member Richard Neal
House Committee on Ways and Means

Chairman Ron Wyden
Senate Committee on Finance

Ranking Member Mike Crapo
Senate Committee on Finance

Chairman Roger Williams
House Committee on Small Business

Ranking Member Nydia Velázquez
House Committee on Small Business

Chairman Ben Cardin
Senate Committee on Small Business and
Entrepreneurship

Ranking Member Joni Ernst
Senate Committee on Small Business and
Entrepreneurship

Dear Chairmen Smith, Wyden, Williams, and Cardin and Ranking Members Neal, Crapo, Velázquez, and Ernst,

We represent founders, innovators, and support organizations throughout the U.S.' vibrant startup ecosystem. While our companies reflect diverse industries, we have in common a commitment to undertaking research and development activities in support of our startups and the broader innovation economy. As such, we write to you to encourage you to take action to mitigate the effects of Research and Experimentation (R&E) capitalization and amortization as mandated by the 2017 Tax Cuts and Jobs Act on the startup ecosystem by implementing a return to immediate expensing.

Our nation's startups are scrappy companies, often operating on lean budgets with minimal staff, particularly in their initial stages. Even for startups that have reached seed stage, they typically have limited capital—roughly \$55,000 a month—to operate.¹ These limited funds must cover a lot—from office space, to salaries, to insurance, to research and development, and more. Research, development, and experimentation costs can quickly eat away at a growing startup's budget, but immediate expensing for R&E expenditures helps to offset these costs, allowing startups to propel the U.S. as a leader in global innovation.

Unfortunately, the ability of a startup to invest heavily in research, development, and experimentation is at risk. This work is expensive, and immediate expensing allowed many startups to offset the cost, particularly as startups may have high research, development, and experimentation costs relative to the size of their companies. But under the newly implemented section 174 capitalization, startups will no longer be able to immediately expense qualifying costs and will instead be forced to amortize the costs over five years (15 years for international expenses), causing a significant hit to startups' cash flow. For startups that continue to engage in R&D, they will be forced to dedicate more of their limited funds to tax payments, eschewing

¹ Engine, *The State of the Startup Ecosystem*, <https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/60819983b7f8be1a2a99972d/1619106194054/The+State+of+the+Startup+Ecosystem.pdf>.

other critical areas for startup success, like hiring. For many startups, research, development, and experimentation will simply become unaffordable, requiring founders to limit expenditures in order to pay operating costs like rent, legal services, and salaries. The end result is slowed innovation and stunted startup growth.

Many industries, like software development, have already seen a hit from the change. As it stands, the U.S. remains now one of the only countries without immediate expensing for R&E expenditures.² As tax season rolled around, many companies expected Congress to have already implemented a return to immediate expensing, as policymakers had indicated they supported a fix. Instead, these companies were met with significant tax bills and uncertainty as to whether or not they will be able to survive the year.³ And for startups that are generating revenue but are pouring that revenue back into research, development, and experimentation, the shift to amortization could be catastrophic,⁴ especially as not all expenses falling under section 174 are clearly eligible for the R&D tax credit.⁵

While many believe only large companies avail themselves of tax benefits that support research, development, and experimentation, many small companies throughout the U.S. startup ecosystem rely on these provisions. Policymakers in both chambers, from both sides of the aisle support a fix. The startup community does not have the time to wait for a fix. We urge your committees to act quickly to investigate this issue and advance a legislative solution that includes a return to immediate expensing, to ensure the startup ecosystem can continue to innovate and prosper, supported by research and development efforts.

Sincerely,

² Vanessa Cruze, *Unprofitable Startups May Owe 2022 Taxes* (Nov. 18, 2022), <https://www.cpapracticeadvisor.com/2022/11/18/unprofitable-startups-may-owe-2022-taxes/73373/>.

³ Eric Rosenbaum, *Software Firms Across U.S. Facing Massive Tax Bills that Threaten Tech Startup World Survival* (April 18, 2023), <https://www.cnbc.com/2023/04/18/software-firms-face-huge-tax-bills-that-threaten-tech-startup-survival.html>.

⁴ Cruze, *supra* note 2.

⁵ Josh Zagorsky, *How the New 174 Capitalization Rules Punish Innovation* (April 21, 2023) <https://blog.taxcredit.ai/en/blog/section-174-capitalization-changes-punish-innovation>.

Abstract
Sacramento, CA

Concert Archives
Vancouver, WA

IncentiLock LLC
Chesterfield, MO

Actionfigure
Washington, DC

Cormig LLC
Portland, OR

Infiltron Software Suite
Warner Robins, GA

Baru Inc.
Cleveland, OH

Denver Angels
Denver, CO

InnovateEDU
New York, NY

Big Propeller, LLC
Miami, FL

Ecobot
Asheville, NC

Institute for Energy and
Sustainability, Inc.
Worcester, MA

BIPOC Adoptees LLC
Portland, OR

Engine
Washington, DC

Intersectional Group
Portland, OR

Brave Founders
Portland, OR

Epistimis LLC
Poulsbo, WA

KCRise Fund
Kansas City, MO

Bryght Labs Inc
Kansas City, MO

Float
New York, NY

M1PR, Inc.
Roswell, GA

Carefully, LLC
Brooklyn, NY

Formspree
San Antonio, TX

Make Startups, Inc.
Atlanta, GA

CodeHS
Chicago, IL

FreeFuse Inc.
Los Angeles, CA

MENTOR\$CHIP, INC.
Portland, OR

Cofounders Capital
Venture Partners
Cary, NC

Hacom LLC
Santa Ana, CA

MITO Material Solutions
Indianapolis, IN

Colorado Startups
Denver, CO

Hangar
New York, NY

Moved
Jacksonville, FL

hobbyDB
Boulder, CO

Narmi Jacksonville, FL	QBOID INC San Jose, CA	Toast Wear Inc. Portland, OR
NetBeez, Inc. Pittsburgh, PA	Raydiant Oxixmetry, Inc San Ramon, CA	Tostie Productions, LLC San Diego, CA
Nucleic Sensing Systems Saint Paul, MN	RevUp Capital San Ramon, CA	Ultrasonic Technology Solutions Knoxville, TN
OculoTherapy Memphis, TN	Scintillation Nanotechnologies, Inc. Tucson, AZ	UnaliWear, Inc. Austin, TX
Onfleet, Inc. San Francisco, CA	Signals Provo, UT	Venntive, LLC Warwick, NY
Oppti Westminster, CA	SmolTech LLC Rochdale, MA	Via New York, NY
People Clerk Miami, FL	Social Impact Capital New York, NY	Voatz Boston, MA
PILOT Inc. New York, NY	Tampa Bay Wave Tampa, FL	VODIUM Nashville, TN
Planship Seattle, WA	The Alliance for Longevity Initiatives Arlington, VA	Wearable Tech Ventures Baltimore, MD
PolyGone Systems, Inc Princeton, NJ	TheraTec, Inc Horace, ND	Zagaran, Inc. Boston, MA
Privacy Vaults Online, Inc. Dumfries, VA		Zylinium Research LLC Atlanta, GA

cc: Members of the House Ways and Means Committee, Senate Finance Committee, House Small Business Committee, and Senate Committee on Small Business and Entrepreneurship