R&D Amortization

Center Forward Basics
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Overview

U.S. companies spend billions of dollars each year on innovative research and development (R&D) and for the last 70 years, they have been able to deduct these R&D costs in full each year. This changed when the 2017 Tax Cuts and Jobs Act (TCJA) included a requirement for businesses to deduct R&D expenditures over five years (known as "amortization"). Starting in tax year 2022, this change no longer allows businesses to deduct such expenses in the tax year they occur. This has led to a significant change in companies' ability to dedicate revenue to R&D innovation.

This basic will provide an overview of what R&D amortization is, how it affects U.S. innovation and global competition, and the legislative outlook on the issue.

R&D Amortization Background

From 1954 to 2021, businesses have been permitted to deduct R&D expenditures in the same tax year under 26 U.S. Code § 174. The 2017 TCJA amended Section 174 to include a clause to require businesses to amortize deducting R&D expenses over a five-year period for domestic R&D and a fifteen-year period for foreign R&D for tax years beginning on or after January 1, 2022. This provision was added to the 2017 TCJA as an offset to meet Senate reconciliation requirements.

Center Forward Basics

Center Forward brings together members of Congress, not-for profits, academic experts, trade associations, corporations and unions to find common ground. Our mission: to give centrist allies the information they need to craft common sense solutions, and provide those allies the support they need to turn those ideas into results.

In order to meet our challenges we need to put aside the partisan bickering that has gridlocked Washington and come together to find common sense solutions.

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How R&D Amortization Affects U.S. Companies

The implementation of R&D amortization has already had a significant impact on U.S. companies. Because companies make estimated tax payments throughout the year based on their anticipated tax liability, many innovative companies have already been seeing a significant effect on their cash flow and ability to invest in R&D as a result of the requirement to amortize R&D expenses, even though they have not yet filed their returns for 2022.

Additionally, due to ongoing fluctuations in the economy, such as rising interest rates, high inflation, and the cooling economy overall, the deductions as spread over the amortization time period may not ultimately have the same value as continuing the longstanding policy of allowing R&D expenses to be deducted in the year they are incurred. The impact is considerable given the scale of R&D investments by U.S. companies. In 2020, U.S. companies currently spent around $532 billion on R&D, before the R&D amortization policy took effect.[1] R&D amortization would reduce that total by $4.1 billion a year for five years and $10.1 billion annually for the subsequent five years.[2]

Because the R&D amortization policy took effect in tax year 2022, companies have been factoring in estimated tax payments that incorporate this change over the last year, which has had an immediate impact on their cash flow. If Congress were to reverse the policy, companies would see refunds, but would likely take several months.

[1] NCSES: R&D InfoBrief
[2] Ernst & Young: Impact of Amortization on R&D

It has been reported that implementing R&D amortization will lead to a loss of more than 20,000 R&D jobs in the first five years of this policy, totaling nearly 60,000 over the following five years.[3] The loss of these R&D jobs would affect various sectors of the U.S. economy, including the pharmaceutical, biotech, software and internet, electronics, and automotive industries. Requiring the amortization of R&D expenses will not only lead to a reduction in these high earning jobs, but will also lead to reduced spending on future innovation and R&D. To give a sense of the effect of the future reduced R&D spending, for every $1 billion in R&D spending, 17,000 jobs are supported in the U.S.[4]

R&D amortization policy also affects U.S. global competitiveness. With the implementation of R&D amortization, the U.S. is now the only developed country that requires an amortization of R&D expenditures. In comparison, countries including China, the U.K., and Greece currently provide a super deduction for R&D expenses for up to an extra 100 percent of eligible R&D expenses in addition to the actual R&D expenses incurred. This means that U.S. companies' foreign competitors can receive approximately 20 times the tax benefit received by U.S. companies for doing the same research.

The impact of the change to amortization is not limited to large profitable companies. Many R&D-intensive companies on the cusp of profitability have not yet had a tax liability partially as a result of their Section 174 deduction. As amortization spreads this deduction over several years, certain small-to-medium size companies may find themselves facing an unexpected tax liability for the first time in 2022.

Legislative Outlook

There are several bills in Congress that support restoring the current year deduction for R&D expenditures that have significant bipartisan and bicameral support. H.R. 1304, the American Innovation and R&D Competitiveness Act, was introduced in February 2021 by Rep. John Larson (D-CT) and currently has 113 bipartisan cosponsors (61 Republicans, 52 Democrats). The Senate bill S. 749, introduced by Senators Maggie Hassan (D-NH) and Todd Young (R-IN), currently has 35 bipartisan cosponsors (18 Republicans, 17 Democrats).

In 2021, Congress attempted to implement a four-year delay of the R&D amortization provision through 2026 as part of the House-passed version of the Build Back Better Act (BBBA). The provision was ultimately not included in the Inflation Reduction Act (IRA) that passed in August 2022. In the current lame duck session, Congress is debating whether to include an R&D amortization fix in the year-end omnibus spending package that will contain tax, health care, and additional pending policy provisions.

Links to Other Resources

- Bloomberg Tax: The R&D Tax Break and Bipartisan Support for Its Restoration
- DLA Piper: 2022 post-election legislative and policy update: Implications of the midterms for the lame duck session and the next Congress
- Ernst & Young: Impact of the Amortization of Certain R&D Expenditures on R&D Spending in the United States
- H.R. 1304: American Innovation and R&D Competitiveness Act of 2021
- National Center for Science and Engineering Statistics: Businesses Spent Over a Half Trillion Dollars for R&D Performance in the United States During 2020, a 9.1% Increase Over 2019
- S. 749: American Innovation and Jobs Act

[3] Ernst & Young: Impact of Amortization on R&D
[4] Ernst & Young: Impact of Amortization on R&D

- Wall Street Journal: [U.S. CFOs Ask Congress to Repeal Change to R&D Tax Rules]