



September 15, 2023

The Honorable Kevin McCarthy
Speaker
U.S. House of Representatives
Washington, DC 20515

The Honorable Chuck Schumer
Majority Leader
U.S. Senate
Washington, DC 20510

The Honorable Hakeem Jeffries
Minority Leader
U.S. House of Representatives
Washington, DC 20515

The Honorable Mitch McConnell
Republican Leader
U.S. Senate
Washington, DC 20510

Dear Speaker McCarthy, Leader Jeffries, Leader Schumer, and Leader McConnell:

The National Defense Industrial Association (NDIA) is the nation's oldest and largest defense industry association. NDIA's membership is comprised of nearly 1,800 corporate and over 65,000 individual members. A majority of those members are small businesses, critical to driving innovation for our warfighters.

The National Small Business Association (NSBA) has been serving the nation's small businesses for over 85 years. NSBA's membership is comprised of more than 65,000 members representing every industry and all 50 states. Together this membership represents the 70 million owners and employees that make up American small businesses.

On behalf of NDIA and NSBA, we urge you to provide immediate relief to the requirement to amortize qualified research and development (R&D) expenses under section 174 of the Internal Revenue Code in the next available legislative vehicle.

Small businesses like ours drive innovation broadly in the U.S. economy and specifically in the U.S. defense industrial base (DIB). Companies with fewer than 250 employees accounted for 10% of the total private sector R&D performed in the United States in 2020.¹ Small businesses play an even larger role in the U.S. DIB. As the most recent Department of Defense (DoD) Small Business Strategy notes in Fiscal Year 2021 “small businesses made up 73 percent of all companies that did business with DoD and 77 percent of the research and development (R&D) companies that did business with DoD [emphasis added].”²

For small businesses, every dollar counts. Unfortunately, we have come under increasing pressure over the last three years. The residual effects of the pandemic—including supply chain and workforce shortages—as well as historically high inflation and interest rates have combined to increase liquidity risk to small businesses. Despite all these challenges, American small businesses continue to provide the critical goods and services that support our warfighters and intelligence professionals as well as our close allies and partners like Ukraine and Taiwan.

In 2023, we encountered another cash flow challenge—the R&D amortization requirement. While the policy discussions regarding R&D amortization have been active over the past few years, small

¹ See National Center for Science and Engineering Statistics, National Science Foundation, InfoBrief, NSF 22-343, October 4, 2022, <https://nces.nsf.gov/pubs/nsf22343>.

² U.S. Department of Defense, “Small Business Strategy,” (January 2023) 5, available at <https://media.defense.gov/2023/Jan/26/2003150429/-1/-1/0/SMALL-BUSINESS-STRATEGY.PDF>

businesses have now seen the evidence of the impact to their cash flow challenges in the 2022 tax return filings.³ Rather than receiving the full deduction for qualified R&D expenses in the year incurred, we must amortize that deduction over five years and are only allowed ten percent of our expenses in the year we incurred them. We will receive a drastically smaller tax benefit than in previous years. Losing ninety percent of our R&D deduction creates a dramatically higher tax bill that no small business anticipated. This year's tax bill substantially reduces the cash we have available to maintain a highly qualified and specialized workforce while also investing in our businesses, including accelerating our R&D efforts.

The R&D amortization requirement is a brake on our ability to innovate or even remain in the defense industrial base. Meanwhile, countries like China are using tax policy as an accelerator. China provides a "super deduction" (200 percent) of qualified R&D expenses to innovative manufacturers of all sizes—including those in its defense industrial base. Of note, 17 countries, including 10 OECD countries, provide for immediate recovery of more than 100 percent of eligible R&D expenses.⁴

Cash flow is the lifeblood of small businesses like ours. High interest rates, tightening credit requirements, and the fact interest costs on government contracts are not reimbursable make borrowing cash from banks extremely difficult, particularly in the current economic environment. The U.S. R&D amortization policy must be fixed now, or our nation risks further attrition of small businesses in the U.S. defense industrial base.⁵ Unlike the effects of the pandemic, high inflation and tightening credit markets, this problem is one of our own doing. Congress can easily fix this problem through legislation. Restoring immediate R&D expensing and providing relief to small defense businesses is not just an economic competitiveness issue with countries like China but a national security competitiveness imperative.

We appreciate your attention to this important matter and stand ready to work with you and your staffs on addressing this harmful tax policy.

Yours Respectfully,



ML Mackey
Chair, NDIA Small Business Division
CEO, Beacon Interactive Systems



Todd McCracken
President and CEO, NSBA

cc: The Honorable Jason Smith, Chairman, House Ways and Means Committee;
The Honorable Richie Neal, Ranking Member, House Ways and Means Committee;
The Honorable Ron Wyden, Chairman, Senate Finance Committee;
The Honorable Mike Crapo, Ranking Member, Senate Finance Committee;
The Honorable Mike Rogers, Chairman, House Armed Services Committee;
The Honorable Adam Smith, Ranking Member, House Armed Services Committee;
The Honorable Jack Reed, Chairman, Senate Armed Services Committee;
The Honorable Roger Wicker, Ranking Member, Senate Armed Services Committee.

³ Most small businesses are so-called "pass through" entities, where the income from the business and income from the individual owner(s) are combined for federal income tax filing purposes.

⁴ OECD, Tax Incentives for R&D and Innovation, <https://stip.oecd.org/innotax/>.

⁵ See "Small Business Strategy" *supra* note 2. ("Although the Department has achieved its small business prime contracting goal for the past eight years, the number of small business[sic] participating in the defense industrial base has declined by over 40 percent in the past decade.")