



## Accelerated Recovery for High Technology Assets under Section 197

### Issue

By imposing outdated depreciation schedules and prolonged recovery periods on purchased intangible assets, the Internal Revenue Code fails to reflect the accelerated obsolescence and shorter life cycles of high technology intangible assets.

### Background

Section 197 of the Internal Revenue Code, enacted in 1993, requires that all purchased intangible assets, including goodwill, patented technology and other forms of intellectual property, be amortized over 15 years. Section 197 greatly reduced the controversy caused by the prior treatment of goodwill as nondeductible — but at a high price. Acquired high technology assets, formerly amortized over periods of only several years, now must be amortized over 15 years.

Section 197 has a significant inadvertent negative impact on efforts of U.S. companies to acquire, develop and commercialize technology. Scientific innovation obsolesces acquired high technology assets so quickly, prompting most companies to amortize technology acquisitions very rapidly under Generally Accepted Accounting Principals (“GAAP”). For Federal income tax purposes, however, section 197 stretches out tax amortization to 15 years, well beyond the economic life of the technology, raising the after-tax cost of acquiring technology by an estimated 12 percent or more. For high technology companies, this cost is not offset by the ability to amortize goodwill because goodwill rarely exists in high technology acquisitions.

There have been prior legislative efforts to exclude certain high technology intangible property from a 15-year amortization period under section 197. Specifically, such legislation would have provided that the term “section 197 intangible” generally would not include (1) certain high technology property acquired from a person that regularly licenses, rents or sells high technology based products in the ordinary course of business to customers, provided that the acquired property was not licensed or purchased in a transaction related to the acquisition of a trade or business (or a substantial portion thereof), or (2) certain high technology intangibles acquired in connection with the acquisition of a “high technology trade or business.”

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### Policy Considerations

Section 197 imposes an unintended 12 percent tax on companies purchasing technology (including technology constituting a trade or business). Section 197 also has the following effects:

- Section 197 significantly raises the cost of acquiring technology that companies have neither the expertise, the time nor the capital to re-invent, making it more difficult for U.S. companies to acquire technologies which will reduce their product's time-to-market.
- This increased cost of acquiring technology disproportionately impedes the ability of small and mid-size companies to compete. These companies typically have a relatively narrow expertise in-house, and must shop for other important technology assets on the outside.
- Section 197 retards U.S. efforts to develop many critical technologies as diverse as semiconductor manufacturing, superconductivity, optoelectronics, advanced video display, space and satellite, software, and biotechnology. Companies facing funding difficulties enter alliances and cooperative research efforts and collaborate by acquiring or licensing technology.
- Only companies holding acquired technology in the U.S. are impacted by the costs from a 15-year amortization imposed by section 197. Japanese and European companies may acquire and bring home U.S. technologies and will deduct the cost of the acquired assets over five years or less. Because, acquiring emerging U.S. (or foreign) high technology is more expensive for U.S. companies than for their foreign competitors, section 197 encourages the migration of U.S. technology to foreign companies. Importing products spawned by the departed technology fosters a negative U.S. trade balance.

Tax simplification is important, but should not come at the expense of U.S. companies' ability to commercialize new technology. The key drivers of economic growth in the Information Age are knowledge and intellectual property. Intangible assets are the lifeblood of a knowledge-based economy. Throwing all acquired intangible assets into one 15-year classification, irrespective of their economic lives and irrespective of whether such acquisitions involve goodwill or other hard-to-value intangible assets, imposes and perpetuates a painful unintended tax on high technology intellectual property and also precipitates a negative U.S. trade balance.

### Recommendation

The SVTDG recommends that Congress pursue in the 108th Congress, consistent with prior legislative efforts, an exception of certain high technology property or high technology trades or businesses from the prolonged recovery period under section 197.