March 31, 2005

The Honorable Eric Solomon
Acting Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Room 3104
Washington, DC 20220

The Honorable Donald L. Korb
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Room 3026
Washington, DC 20224

Re: <u>Treatment of Computer Software for Purposes of Section 199</u>

Dear Messrs. Solomon and Korb:

I write to offer the views of the Technology Network (TechNet) on Notice 2005-14, issued by the Treasury Department and Internal Revenue Service on January 19, 2005 to provide interim guidance under Section 199 of the American Jobs Creation Act. In particular, I write to express TechNet's concern about the restrictive approach that the guidance takes with respect to the software eligible for the incentives contained in Section 199. We believe that domestically produced software should be eligible for the Section 199 deduction regardless of the manner in which that software is provided to the customer. Specifically, we believe that the Section 199 deduction should apply to domestically produced software made available to the end user via the Internet and other technologies that do not involve transferring a physical copy of software.

The Technology Network (TechNet) is the national network of chief executive officers and senior executives of the nation's leading companies in the fields of information technology, biotechnology, venture capital, investment banking and law. Based in Silicon Valley, TechNet has offices in Seattle, Austin, Boston, and Orange County, California. TechNet's top priority is to promote public policies that encourage innovation and technological advances. TechNet's members were extremely supportive of the American Jobs Creation Act's provisions to encourage domestic production and economic growth.

As we understand it, Notice 2005-14 would allow the deduction under Section 199 only where a copy of software is physically transferred or downloaded to the end user. We further understand that Notice 2005-14 interprets the deduction for domestic production activities of Section 199 to exclude fees received from customers for the use of software programs via remote access such as over the Internet.

This unduly restrictive approach ignores technological advances in the software industry in which companies are increasingly making software available to the customer via the Internet, known as "on-demand computing". Instead, the guidance in effect favors traditional modes of software delivery, i.e. the physical transfer of software copies through shipping or downloading to end users. In this way, Notice 2005-14 creates a disincentive to innovative advances in software delivery to the customer.

The trend toward on-demand computing is an important technological advance that has gained momentum in recent years. On-demand computing is an increasingly common approach in a range of software applications including customer relations management, human resource management, expense reporting and reimbursement, supply chain management and other financial applications. Many software industry experts expect that on-demand computing and other innovative means of making software available to the end user will increasingly become preferred methods of distributing and utilizing software.

This trend toward innovative distribution of software is a driver of broadband demand, supporting a key policy priority of TechNet and of U.S. policymakers including the Bush Administration and many Congressional leaders. TechNet has called for a 100-megabit per second broadband connection to 100 million homes and small businesses by 2010. We strongly support Internet applications that will drive broadband demand, for the benefit of citizens and the economy.

We are concerned that under the approach laid out in Notice 2005-14 the customer stands to lose efficiencies and cost-effectiveness that result from on-demand computing and other emerging or future software distribution methods that do not depend on a "transfer" of software copies to the customer. The benefits of software accessed and utilized through these innovative distribution methods include lower costs, greater simplicity and enhanced reliability.

The software industry is highly competitive and the distinction under Notice 2005-14 will have the unwelcome effect of favoring one segment of the software industry. This is a particular concern because the companies that are pioneering and developing on-demand software and other advanced distribution methods are generally smaller, newer, innovative companies. These companies will be put at a significant competitive disadvantage through denial of the Section 199 deduction.

We do not believe that it was the intention of the Congressional authors of the legislation to exclude from the deduction software based merely on the means by which it is delivered or distributed to the customer. Rather, we believe that the Congressional debate and legislative language did not intend to favor one method of software delivery, particularly when the software at issue has virtually the same functionality and is as much the result of domestic production as software eligible for the Section 199 deduction.

We believe the deduction provided under Section 199 of the American Jobs Creation Act was intended to create an incentive for domestic production of software, regardless of the means of delivery to the customer. We respectfully urge you to clarify the interim guidance under Section 199 to include domestically produced software regardless of its means of delivery or distribution to the end user.

Sincerely,

Rick White
President and CEO
TechNet