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Outsourcing After Section 174A: Eleven Months to Relearn It

Offshore, nearshore, and the expertise you cannot rent

Part 10 of 10 in *The Money Language Series*. Each piece stands on its own. The others: Part 1 · Part 2 · Part 3 · Part 4 · Part 5 · Part 6 · Part 7 · Part 8 · Part 9.

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For twenty years the offshore conversation was a rate-card conversation. A developer in one market costs so much, in another market less, and the argument was about whether the quality gap and the coordination overhead (the part nobody line-items) ate the difference.

In July 2025 a new variable entered, and most technology leaders I talk to have yet to fold it into the model. The US tax code now treats domestic and foreign software development completely differently, and the gap is wide enough to move decisions that used to be easy.

What changed

The Tax Cuts and Jobs Act had, from 2022, forced companies to capitalize and amortize research and experimental costs rather than deduct them: five years for domestic work, fifteen for foreign. Software development was swept in explicitly. That was brutal for software companies, especially ones with no profit to shelter, and it produced tax bills bearing no relationship to the cash a business generated.

The One Big Beautiful Bill Act, signed 4 July 2025, created Section 174A and restored immediate expensing of domestic research and experimental costs for tax years beginning after 31 December 2024. Permanently, with no sunset attached.

Foreign costs kept the old treatment. Foreign research and experimentation — software development included — is still capitalized and amortized across fifteen years.

	DOMESTIC DEVELOPMENT	FOREIGN DEVELOPMENT
Deduction timing	Immediate, in the year incurred	Amortized across 15 years
Legal basis	Section 174A	Section 174, unchanged by the Act
Cash flow effect	The full benefit now	Roughly a fifteenth a year, straight-line
Permanence	Permanent	Permanent
Optional alternative	May elect to capitalize over 60 months or more	No election available

Transition provisions covered the 2022 to 2024 capitalized balances, including a retroactive amendment window for smaller businesses that has now closed, and an election for larger businesses to pull the remaining balance into 2025 or split it across 2025 and 2026. Review those with a tax advisor rather than with an article.

What the gap is worth

Work it through. Take $1,000,000 of engineering cost at a 21 percent federal rate, setting state tax and credits aside for clarity.

	DOMESTIC	FOREIGN
Deduction in year one	$1,000,000	About $33,000, on the half-year convention
Tax benefit in year one	About $210,000	About $7,000
Remaining benefit	None pending	Spread across 15 years
Present value at a 10 percent discount	About $210,000	About $110,000

On a million dollars of spend, the domestic version delivers roughly $100,000 more in present-value terms; the year-one cash difference is around $200,000. Call it a 10 percent adjustment against the spend, which is a number small enough to ignore in one comparison and large enough to reverse another, depending entirely on how wide the rate gap was before anybody opened the tax code.

Against a 60 percent offshore rate advantage, 10 percent barely registers. Against a nearshore advantage of 25 or 30 percent, it takes a real bite. And in a comparison between a US contractor and a nearshore team, it can close a third of the gap before anybody has said the word quality.

One caveat governs all of that arithmetic: this is a cash-timing and present-value effect rather than a rate change. Over fifteen years the same dollar gets deducted either way. A company carrying forward losses cares much less; a profitable and cash-constrained company cares a great deal. Which one are you? Run it on your own numbers.

A second-order effect sits alongside it. Qualified research expenses feed the Section 41 research credit, which is a dollar-for-dollar credit against tax owed rather than a deduction, and qualified small businesses can apply a portion against payroll taxes even in a loss year. How Section 174A expensing interacts with that credit, including the Section 280C election, is genuinely complicated and worth modelling properly (an approximation here is where the money quietly goes).

The rest of the model

Tax is an input now. It is still a long way from the deciding one.

FACTOR	LOCAL	NEARSHORE	OFFSHORE
Hourly rate	Highest	Moderate	Lowest
Tax treatment	Immediate deduction	15-year amortization	15-year amortization
Timezone overlap	Full	4 to 8 hours	0 to 3 hours
Coordination overhead	Lowest	Low to moderate	High
Iteration speed on ambiguity	Fast	Moderate	Slow
Domain knowledge	Stays in-house	Depends on the contract	Often stays with the vendor
Attrition exposure	Yours	The vendor's, and yours in effect	Frequently high
IP clarity	Simplest	Contract-dependent	Contract-dependent, and jurisdiction matters
Best suited to	Ambiguous, strategic, architectural work	Product delivery needing real collaboration	Well-specified, bounded, stable scope

The variable that dominates in practice is specification cost. Offshore delivery works where the work can be specified clearly (and specified once, which is the harder half), and the further a task sits from a clear specification, the more of the rate saving disappears into clarification cycles. With an eight-hour gap, one clarification cycle costs a day.

That is why the same vendor can deliver brilliantly on one engagement and badly on the next with the same people on it. The work was different, and only one of the two engagements could be written down.

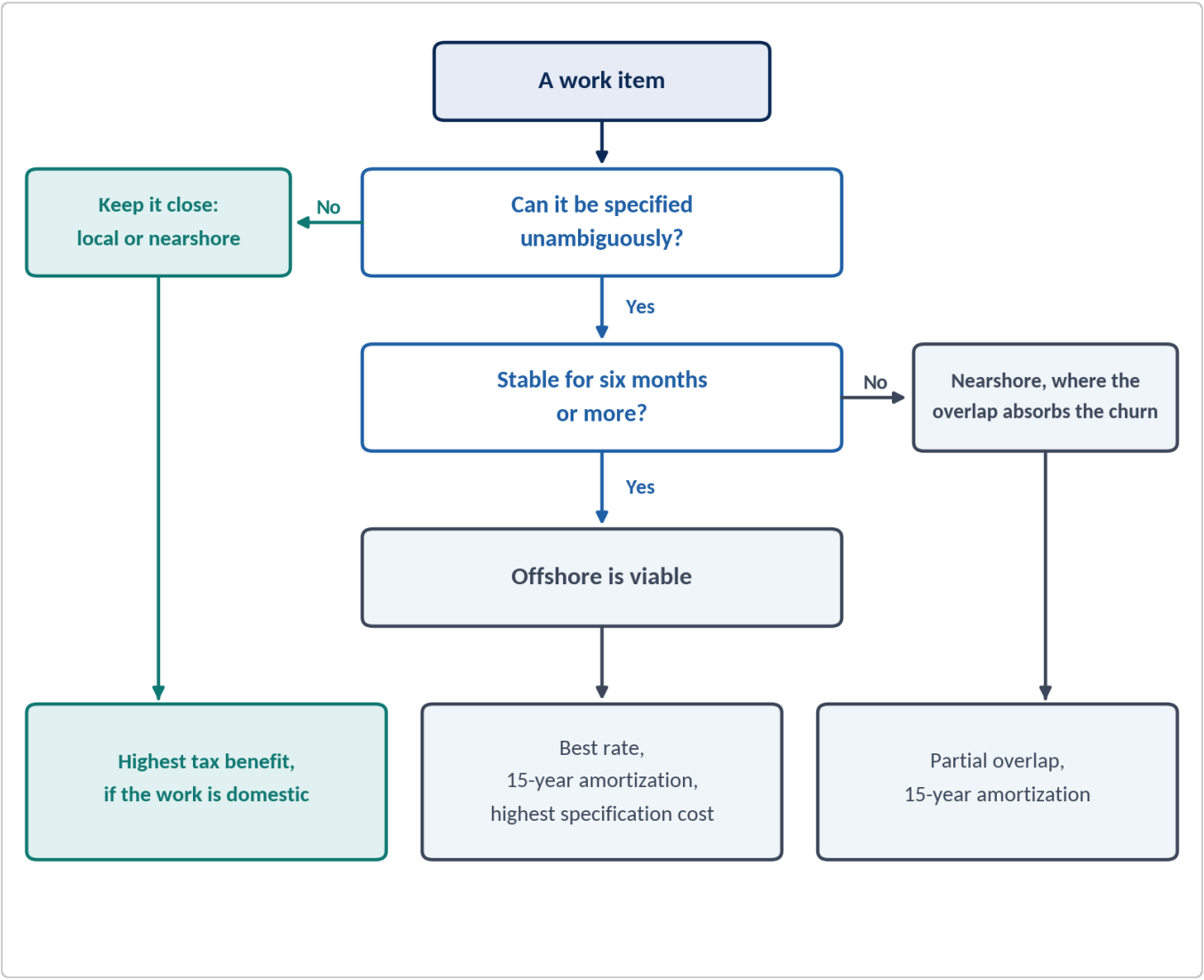


Figure 1. Two gates decide the placement, and neither of them is about rate. The tax treatment appears only in the outcomes, which is where it belongs: it adjusts a decision the specification has already made.

What you cannot outsource

Five things stay inside. I have watched organizations discover each of them the hard way, and the discovery always arrives later than the decision that caused it, usually at the moment the vendor relationship ends and somebody goes looking for the person who understands the thing.

Architecture and technical strategy come first. Decisions that constrain a company for five years belong to people whose careers are attached to the consequences.

Domain knowledge comes second, and it is the one that hurts. Why does the billing system carry that exception for accounts opened before 2019? Knowledge like that accumulates through exposure, and it leaves with a vendor when the contract ends, unless somebody internal was deliberately kept alongside it.

Production ownership is third. Operations can be outsourced. Accountability to your customers for an outage cannot, and somebody internal owns the pager conversation with the board.

Security posture is fourth. It stays reviewable and auditable, and it stays yours, whoever wrote the code.

Vendor management is fifth, and it is the one that catches people out. Managing a delivery partner is a real job needing real technical judgment, so a company that outsources because it lacks engineering capacity discovers it needed engineering capacity to run the outsourcing.

A company I know outsourced an entire product line to a capable offshore partner and kept no internal engineer on it. Delivery was fine for two years. Then the relationship ended; nobody inside the company could explain how a core reconciliation process worked. Rebuilding that understanding took eleven months — eleven months of senior engineers reading code that nobody had written down — and cost more than four years of the savings. The contract was fine, the IP assignment was fine, and the knowledge was never in the contract to begin with.

Contract terms worth getting right

TERM	WHY IT MATTERS
IP assignment	A present assignment of all work product, enforceable in the vendor's jurisdiction as well as yours
Background IP	What the vendor brings and keeps, so their reusable framework does not become a dependency you cannot license
Named key personnel	With notice on substitution, or your best people rotate off quietly
Documentation as a deliverable	Acceptance-gated, rather than promised for the end
Knowledge transfer and exit assistance	Priced in the contract and triggered on termination for any reason
Source control and environments	In your accounts, under your identity provider
Data residency and access	Who sees what, from where, under which law
Subcontracting	Disclosed and approved, rather than discovered

Exit assistance is the term people skip. Negotiating it at signature costs nothing, because nobody is thinking about leaving; negotiating it during a termination costs whatever they ask for.

How AI cuts both ways

This one is genuinely unsettled, and pretending otherwise would be dishonest.

The case that AI weakens offshore arbitrage runs like this. If AI compresses the cost of routine implementation, the work best suited to offshore delivery is exactly the work being automated, and what remains is ambiguous, architectural and context-

heavy, which is the work you keep close. On that reading the offshore proposition erodes from underneath.

The case that AI strengthens it runs the other way. AI raises the floor: it narrows quality gaps and it helps with language and documentation, so a smaller distributed team covers more ground. A vendor adopting it aggressively delivers more per engineer at the same rate.

Both are happening, to different tiers of work, which is why the two cases can each be argued convincingly by people looking at the same market and describing different halves of it. The commodity tier of offshore delivery is under real pressure. That much is clear. The senior tier, meaning skilled engineers in lower-cost markets working as an extension of your team, is holding and may be strengthening. So: if your offshore relationship is priced on a volume of hands, examine it, and if it is priced on capability, it is probably fine.

Restructuring a sourcing strategy on that reasoning would be premature. Part 9's evidence says productivity claims deserve measurement before they justify a structural decision, and that applies to a vendor's claims at least as much as to your own team's.

What I actually do

1. Model after tax rather than off the rate card, with real numbers and the company's real tax position, usually with the tax advisor in the room.
2. Sort the work by specification cost first, then apply a location decision to each tier rather than to the portfolio.
3. Keep an internal owner on everything outsourced: one person who can explain how it works. That is the cheapest insurance available anywhere in this article.
4. Insist on our source control and our cloud accounts, under our identity provider, every time and in every contract.
5. Price exit assistance at signature, while it is free.
6. Prefer nearshore for product work that needs real collaboration, and reserve offshore for bounded and stable scope.

7. Fund vendor management as an actual role with an actual name on it. It stops being a real job the moment it becomes an extra duty on a busy engineering manager.
8. Re-run the model every year. The tax law changed in 2025 and it can change again, the rates move, and so does whatever AI has just made cheap.

Glossary

TERM	DEFINITION
Amortization, in tax	Deducting a cost in equal parts across a prescribed number of years
Background IP	Pre-existing vendor intellectual property used in your deliverable
Key personnel clause	A contract term restricting substitution of named individuals
Managed delivery	A vendor owning outcomes for a scope of work
Nearshore	Delivery from a nearby country with substantial timezone overlap
Offshore	Delivery from a distant country with limited overlap
One Big Beautiful Bill Act	The federal tax act enacted 4 July 2025
Present value	What a future benefit is worth today, discounted
Research and experimental expenditure	A tax category that includes software development
Section 174 and Section 174A	The tax code sections governing research and experimental expenditure
Section 280C election	A choice affecting how the research credit and the deduction interact
Section 41 research credit	A dollar-for-dollar credit against tax owed, separate from the deduction
Staff augmentation	Contracted individuals working inside your teams

References

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- RSM US, "The OBBBA restores favorable tax treatment of domestic R&D expenses"
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- Anchin, "OBBBA, The Research Credit, and Section 174"
- Holthouse Carlin & Van Trigt, "OBBBA Restores Immediate Expensing for Domestic R&E Costs"
- Bennett Thrasher, guidance on the 2025 research deduction elections
- IRS Revenue Procedure 2025-28, on elections, transition rules and small business provisions
- DORA, 2025 State of AI-assisted Software Development, on AI and delivery effects

Best next read

This closes the series. A reader who came in partway through should start at Part 1, CapEx, OpEx, and EBITDA: The Same Dollar, Two Different Stories, which frames the whole argument, or at Part 2 if the vocabulary is new.

A reader about to make a decision usually gets the most from three of them: Part 3 on what becomes an asset, Part 5 on where the workload lives, and Part 7 on what the company is actually committed to.

The full series

PART	TITLE
1	CapEx, OpEx, and EBITDA: The Same Dollar, Two Different Stories
2	Reading the Financials: The Primer for Everyone Who Never Had To Care
3	Capitalize or Expense: Your Jira Board Is Now Audit Evidence
4	Depreciation and Useful Life: The Chip Outlives Its Economics
5	Placement Economics: The Right Answer, Applied Everywhere
6	Lift-and-Shift or Re-Architect: The Two That Modernized Later
7	Vendor Economics: The Email in November
8	AI Spend: Three Budgets Pretending to Be One
9	AI and Headcount: Somebody on the Board Did the Arithmetic
10	Outsourcing After Section 174A: Eleven Months to Relearn It, which is this one

This series is an introduction for technology leaders. It is accounting, tax and commercial context rather than accounting, tax or legal advice. Tax elections carry deadlines and contract terms are jurisdiction-specific. Model it with your CFO, your tax advisor and your counsel before you commit.

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// ABOUT THE AUTHOR

Jason Newell leads organizations and people in technology, and is a researcher, deep technologist and builder — from a CRAY to agentic AI. He founded MAX Research Collective to build AI for regulated industries that runs where its owner has control, with healthcare as its strongest focus. About Jason → Connect on LinkedIn →

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