

R&D CREDIT COALITION
COMMENTS FOR THE SENATE FINANCE COMMITTEE
ON THE
COST RECOVERY AND ACCOUNTING TAX REFORM DISCUSSION DRAFT
JANUARY 17, 2014

Introduction

The R&D Credit Coalition is a group of trade and professional associations along with small, medium and large companies that collectively represent millions of American workers engaged in U.S.-based research throughout major sectors of the U.S. economy, including aerospace, agriculture, biotechnology, chemicals, electronics, energy, information technology, manufacturing, medical technology, pharmaceuticals, software and telecommunications.

Although the R&D Credit Coalition is diverse, the member companies which the coalition represents share a major characteristic: they collectively spend billions of dollars annually on research and development, which provides high-wage and highly-skilled jobs in the United States. The high U.S. corporate income tax rate and the temporary nature of the U.S. R&D tax credit, compared to the lower corporate income tax rates and more stable, robust, and often permanent research incentives in most other developed countries, are key factors that companies consider in determining where they are going to create and maintain R&D jobs.

On November 21, 2013, Senate Finance Chairman Max Baucus released a staff discussion draft that proposed to amend section 174 and require taxpayers to amortize R&D expenditures over a 5 year period rather than allow the costs to be deducted in the year incurred. In announcing this draft proposal, the Committee noted that it is considering “expanding and making the permanent the research and development credit” and the Committee requested comments on these proposals.

Under current law, a taxpayer can deduct the cost of research expenses in the year incurred. In addition, until December 31, 2013, the tax code provided a R&D tax credit for up to 20% (14% under the Alternative Simplified Credit) of qualified research costs. However, if the taxpayer elects to utilize the R&D tax credit, the taxpayer’s deduction is reduced by the amount of any R&D tax credit.

The Coalition believes that the U.S. should provide a robust and permanent R&D tax credit as well as continue with the current law practice of allowing R&D costs to be deducted in the year incurred. For example, the Coalition has strongly supported bipartisan legislation to make the R&D tax credit permanent and increase to 20% the Alternative Simplified Credit.

With increased global competition, we need to ensure that the U.S. is the best place for companies to do business and conduct research. There are many other countries that offer *both* lower corporate tax rates and more attractive R&D incentives¹. If the U.S. is to retain and attract global R&D activities

¹ Deloitte, “Global Survey of R&D Tax Incentives,” March 2013.

across all sectors of the economy, there is a growing need for the certainty provided by a tax code that is favorable to R&D investment. Retaining current year expensing and providing a permanent and strengthened R&D tax credit would enhance the attractiveness of the U.S. compared to other nations to invest, stimulate job creation, and grow the economy to keep the U.S. competitive in the global race for investment dollars.

Discussion

There is significant global competition for R&D jobs. Companies have an array of choices on where to locate such jobs and where to invest research dollars—here in the U.S. or abroad. It is clear that investments in research and innovation have positive spillover effects in the economy.

For example, the R&D tax credit has a significant impact on private R&D spending and the creation of research jobs. A recent study by the Center for American Progress concludes that, “the credit is effective in the sense that each dollar of foregone tax revenue causes businesses to invest at least an additional dollar in R&D.”² In addition, according to a recent study by Ernst & Young, “In total, the overall policy – the existing credit plus strengthening the alternative simplified credit – is estimated to increase annual private research spending by \$15 billion in the short-term and \$33 billion in the long-term.”³ Moreover, it is important to note that the R&D tax credit is a *jobs* credit—70 percent of credit dollars are used to pay the salaries of high skilled R&D workers in the U.S. The EY study also stated that, “the credit and its enhancement is estimated to increase research-related employment by 140,000 in the short term and 300,000 in the long-term.”⁴

The U.S. must maintain a globally competitive tax system that supports high-skilled, high-paying jobs, here in the U.S. The R&D tax credit, originally enacted in 1981, was designed to be an important incentive in spurring private sector investment in innovative research by companies of all sizes and in a variety of industries. The enactment of this incentive helped establish the U.S. as a world leader in cutting-edge research that created high-paying jobs here in the U.S. During the 1980s, the U.S. was the leader among OECD countries in providing the best R&D incentives for companies. However, in recent years, many other countries have instituted more generous and often permanent R&D incentives. As a result, according to an OECD study, the U.S. was ranked 24th in research incentives among industrialized countries⁵.

Several OECD countries have enacted a variety of tax incentives to attract research activities, including tax credits that can be as high as 40% of research expenses, super deductions that can be as high as 200% of research expenses, as well as other incentives to encourage research spending. A recent National Science Board report concluded that the United States’ lead in science and technology is “rapidly shrinking” as R&D jobs and overall R&D spending continue to increase faster outside the

²Center for American Progress, “The Corporate R&D Tax Credit and U.S. Innovation and Competitiveness,” by Laura Tyson and Greg Linden, January 2012, p.2.

³Ernst & Young, “The R&D Credit: An effective policy for promoting research spending,” September 2011, p. i.

⁴Ernst & Young, “The R&D Credit: An effective policy for promoting research spending,” September 2011, p.11.

⁵OECD, “Science, Technology and Industry Scorecard,” December 2009, p. 79.

U.S. than here at home. The report shows that “between 1999 and 2009...the U.S. share of global research and development (R&D) dropped from 38 percent to 31 percent, whereas it grew from 24 percent to 35 percent in the Asia region during the same time.”⁶

In enacting section 174 “Congress was pursuing two related objectives One was to encourage firms to invest more in R&D than they otherwise would. The second objective was to eliminate or lessen the difficulties, delays, and uncertainties encountered by businesses seeking to write off their research expenditures”⁷

Expensing R&D expenditures reflects the tax and accounting realities inherent in bringing a new product to market. With R&D, amounts are expended to create an asset with a future benefit. In most other instances this would result in the capitalization and recovery through amortization of such costs. The inherent issue with expenses incurred in research and development is whether an asset of any value is being (or will be) created. At the time the amounts are expended, such a determination is often impossible. Further, research and development costs usually are incurred with the goal of creating a new or improved product, service, process or technique, but more often than not, the efforts do not result in success. As such, U.S. GAAP does not require the capitalization and amortization of R&D costs.

Proposals to further limit the ability of companies to deduct the costs of U.S. based research activities will act as a disincentive to research investment, particularly for small firms with limited cash flow, and combined with the failure to permanently extend and strengthen the R&D tax credit will put current jobs at risk of moving abroad, and jeopardize the expenditure of R&D funds in the U.S. It is clear that R&D activities will continue; the question is where those R&D jobs will be located.

Given that the number of OECD countries offering some incentive for research has grown dramatically in recent years as countries attempt to become leaders in research, the U.S. tax system must evolve in order to provide globally competitive R&D incentives that can be counted on by businesses. As noted above, many other countries offer *both* lower corporate tax rates and more attractive R&D incentives⁸. Accordingly, the U.S. should not engage in an “either/or” debate with respect to lower marginal rates and boosting U.S. job creation through R&D incentives when looking at options to reform the corporate tax code. To remain competitive in the global economy, the U.S. can and should provide an effective and permanent incentive for R&D even if the corporate tax rate is reduced.

In contrast to the incentives offered by a number of other countries, the temporary nature of the U.S. R&D tax credit makes it a less powerful incentive in terms of a company’s R&D budget and decisions about where to locate new R&D activities. The certainty of a strengthened, permanent credit and the continued option to deduct research expenses currently rather than amortize those costs over several years, is critical to maintaining U.S. leadership in advanced research and encouraging companies to continue to spend R&D funds here in the U.S.

⁶ National Science Foundation press release, “New Report Outlines Trends in U.S. Global Competitiveness in Science and Technology,” January 17, 2011.

⁷ Senate Budget Committee, *Tax Expenditures, Compendium of Background Material on Individual Provisions*, 2012, p. 90 (The Compendium).

⁸ Deloitte, “Global Survey of R&D Tax Incentives,” March 2013.

Conclusion

R&D incentives, such as the tax credit and the expensing of research costs, are designed to ensure that companies from varied industries, including manufacturers and services businesses, conduct their research activities in the United States and create well-paying, highly skilled jobs. The original purpose of the tax credit still holds true today, although increasing global competition is making it more difficult. It is vitally important that U.S. policy makers support proposals that enhance the attractiveness of the U.S. as a place to invest in research activities. A strengthened and permanent research and development tax credit that is seamlessly extended as soon as possible and the continued ability to deduct research expenses are critical to competitiveness, innovation and U.S. jobs. In the global economy many companies have a choice as to where they are going to do their research—and with many other countries offering *both* lower corporate income tax rates and more robust R&D incentives, the U.S. tax system must provide globally competitive R&D incentives that can be counted on by businesses. The R&D Credit Coalition looks forward to assisting members of the Committee and their staffs in gaining a more detailed understanding of the competitive pressures faced by companies as well as of the research and development tax credit and its impact on U.S. jobs. We also look forward to working together to advance legislation to extend, strengthen and make permanent the R&D tax credit.

Links to Studies:

Center for American Progress, “The Corporate R&D Tax Credit and U.S. Innovation and Competitiveness”

http://www.americanprogress.org/issues/2012/01/corporate_r_and_d.html

Ernst & Young, “The R&D Credit: An effective policy for promoting research spending”

http://www.investinamericasfuture.org/PDFs/EY_R&D_Credit_Report_2011_09_16.pdf

Deloitte, “Global Survey of R&D Tax Incentives,”

<http://www.investinamericasfuture.org/PDFs/Global%20RD%20Survey%20Final%20-%202011.pdf>

National Science Foundation press release, “New Report Outlines Trends in U.S. Global Competitiveness in Science and Technology”

http://www.nsf.gov/nsb/news/news_summ.jsp?cntn_id=122859&org=NSB&from=news

OECD, Ministerial Report on the OECD Innovation Strategy, May 2010

<http://www.oecd.org/dataoecd/51/28/45326349.pdf>

OECD, “Science, Technology and Industry Scorecard,” December 2009

http://www.oecd.org/document/21/0,3746,en_2649_33703_48714517_1_1_1_1,00.html

U.S. Department of the Treasury, “*Investing in U.S. Competitiveness: The benefits of Enhancing the Research and Experimentation (R&E) Tax Credit*” <http://www.investinamericasfuture.org/PDFs/TreasuryRDReportMarch25.PDF>

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