

## **Federal Research and Development Tax Credit**

### *Synopsis:*

The information technology sector of the US economy has for a long time contributed a great deal to the growth of the US economy. In fact, products based on intellectual property, such as IT hardware via patents, and software via copyright and patents, actually comprise 40% of the growth of the economy.

One significant reason for this continued growth is the investment in, and ultimately the results of, research and development spending. Because of the importance of continued domestic research and development we strongly support efforts to extend the R&D tax credit for the longest term possible, including permanency, while making sure that all those who are investing in research and development have an equal opportunity to leverage the benefits of the credit.

### *The background and history:*

The R&D tax credit provides businesses with a tax credit for certain R&D related expenditures. The credit spurs innovation and economic growth by promoting private sector investment in R&D. While society clearly benefits from innovation, companies engaged in R&D face high risks, and often times fail to reap the full rewards of their investments. In fact, experts believe that up to 80% of R&D projects end in economic failure.

First enacted in 1981, the credit provides companies with a credit for incremental R&D expenditures made in the United States. Extensions of the credit have resulted in gaps in coverage, and not always were they retroactively filled. This “on again - off again” nature of the credit deprives business decision-makers of confidence that the credit will still be on the books in the out years, thus hindering investment in long-term projects. A permanent credit allows companies to rely on its availability in formulating their long-term corporate R&D programs.

### *The benefit:*

Information technology is a research-intensive industry. Products can move from concepts to markets in 18 months or less. Given this rapid pace of change—and the technology breakthroughs made possible by ever increasing processor power—competitive advantage is defined by a company’s ability to predict market directions and to innovate to meet those market demands. Research determines the extent to which IT companies will be innovators or imitators. The R&D credit reduces the cost of capital, thereby mitigating the risks of R&D investment and allowing companies to “push the envelope” in their technology development. A more aggressive approach to research yields more bountiful returns to company investors, customers, employees and the U.S. economy as a whole. Studies show that every one-dollar reduction in the after-tax cost of R&D creates one additional dollar of new spending in the short term and two dollars in the long term.

A global economy means that capital can flow to countries that offer the most favorable terms for its investment. Nothing assures that R&D programs will remain in the U.S. On the contrary, with highly skilled and under-utilized IT workers located offshore, foreign governments are seeking to entice U.S. companies to perform their R&D overseas. Tax credits are an important incentive in their strategy. Most all member nations of the Organization for Economic Cooperation and Development offer such credits. In the past Canada has even openly advertised its generous R&D credit in U.S. newspapers. The R&D tax credit is critical to the U.S. competitive posture in world markets.

Congress must continue to encourage private sector R&D particularly in light of the substantial tax and other financial incentives offered by many of our major foreign trade competitors. Because it is targeted almost exclusively at wages and salaries paid to employees engaged in direct U.S.-based R&D, the credit promotes the creation of new, high-skilled jobs, here in this country for the very direct benefit of the public.