

Overview

In 1981, Congress enacted the research and development (R&D) tax credit (also known as the “research and experimentation tax credit”) to encourage private sector investment in R&D that would lead to technological innovation. The credit has never been made permanent and has instead been extended 15 times on a short-term basis. The last extension of the credit expired at the end of 2013, and Congress is currently debating whether and how to extend the credit again.

Why was the R&D tax credit created?

The R&D credit was first enacted to stem a decline in private R&D investment that began in the 1960s. According to a Congressional Research Service [history](#) of the credit, “more than a few analysts thought the decline was a primary cause of both a slowdown in U.S. productivity growth and an unexpected loss of competitiveness by a variety of U.S. industries in the 1970s.”

Many economists believe that in the absence of a subsidy, companies would underinvest in research and development. As a Treasury Department [report](#) put it, “[B]usinesses may not be able to capture the full benefits of their research spending because the knowledge it produces may be used by other businesses. As a result, the private sector may not make some investments in research that would benefit society as a whole.” The R&D credit is intended to make up for that gap.

How does the R&D tax credit work?

While there are actually four separate components of the R&D tax credit, the two most commonly claimed are the “regular” research credit and the “alternative simplified” credit. Both credits give companies a tax break equal to a percentage of that company’s spending on “qualified research expenses” – 20 percent in the case of the regular credit and 14 percent in the case of the alternative simplified credit. In some cases, because of the formulas involved, start-up firms can get a bigger break under the alternative simplified credit.

“Qualified research expenses” generally include wages and salaries, as well as the cost of equipment and supplies. Roughly 70 percent of the federal spending on the credit goes toward subsidizing wages for workers engaged in R&D, many of whom are highly skilled. The rate of the credit today is lower than when it was first enacted – in 1981, the regular R&D credit rate was 25 percent.

Do other countries offer similar R&D tax incentives?

Yes. Many nations – from major competitors such as the United Kingdom, China, Germany and South Korea, to smaller economies such as Slovenia and Turkey – offer private companies tax incentives for making investments in R&D. Many of these countries are also more generous than the United States. [France](#), for example, offers a credit equal to 30 percent of “eligible” R&D expenses.

Key Facts

- The research and development (R&D) tax credit, first enacted in 1981, has been extended 15 times and expired at the end of 2013.
- In 2010, businesses claimed approximately \$8.5 billion in tax credits to support their R&D activities.
- According to the U.S. Treasury Department, approximately 70 percent of the cost of the credit goes toward labor costs, much of it in high-wage jobs.
- President Obama’s budget calls for expanding and making permanent the R&D credit, a proposal which has bipartisan support.

Essential Links

- Congressional Research Service, [Research Tax Credit: Current Law, Legislation in the 113th Congress, and Policy Issues \(RL31181\)](#)
- U.S. Department of the Treasury, [Investing in U.S. Competitiveness: The Benefits of Enhancing the Research and Experimentation Tax Credit](#)
- National Science Foundation, [Science and Engineering Indicators 2014](#)

According to the Information Technology and Innovation Foundation ([ITIF](#)), America currently [ranks](#) 27th in the world in the generosity of its R&D incentives.

Is the R&D tax credit effective?

The best way to determine if the R&D credit is effective is to look at the amount of additional research incentivized by the credit versus its cost. By that measure, the credit works.

Several studies have shown that the R&D credit results in a dollar for dollar increase in the amount of research investment by companies. Some economists believe that companies would invest even more if the credit were permanent. The continuing short-term extensions of the credit mean that companies may be reluctant to invest in longer-term projects if they can't count on the credit.

President Obama, as well as bipartisan groups of members in Congress, have offered a variety of proposals for expanding the credit and making it permanent. President Obama's proposal, for example, would increase the rate of the alternative simplified credit from 14 percent to 17 percent and encourage more companies to use the simplified credit. An Administration [analysis](#) of the proposal argues that these enhancements would support nearly 1 million research workers and leverage nearly \$100 billion in private-sector investment over the next 10 years.

Why are R&D investments important?

Research shows that R&D investment can be vital to innovation. One [analysis](#) by the National Science Foundation found that companies investing in R&D were also more likely to innovate. R&D investments are particularly important to America's manufacturing sector. According to the [National Association of Manufacturers](#), U.S. manufacturers account for two-thirds of private-sector R&D. Supporting R&D would therefore support the resurgence of U.S. manufacturing.

Why hasn't the R&D tax credit been extended again or made permanent?

The principal issue is cost. According to the [White House](#), one recent proposal to expand and make permanent the R&D tax credit ([HR 4438](#)) would add \$156 billion to the federal deficit over ten years, if there are no offsets. While there is broad bipartisan support for the R&D credit and for its expansion, there's far less agreement on how the credit should be paid for. Absent that agreement, the future of the credit is uncertain.

More Links

- EY, [Worldwide R&D Incentives Reference Guide, 2013-2014](#)
- Deloitte, [2013 Global Survey of R&D Tax Incentives](#)
- [R&D Credit Coalition](#)

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