

Align Efforts to Increase Investment in Basic and Applied Research Through Changes to the Tax Code

NACIE Recommendation, April 2015

1. RECOMMENDATION

The U.S. Department of Commerce (DOC) should (1) direct BEA to develop an economic analysis of proposals to provide stronger tax incentives for collaborative R&D and to provide a temporarily decreased repatriation tax rate tied to R&D spending and (2) work to align Federal stakeholders to support and advocate for legislation that implements these proposals.

2. CHALLENGES

Increasingly, U.S. firms are cutting back on basic and applied research, both in-house and extramural (e.g., at universities). In part this is because of increased competitive pressures, particularly from nations like China. This is a problem because basic and applied in-house research is critical for long-term competitiveness and innovation as well as firm top line and bottom line growth. And extramural collaborative research (e.g. research funded by businesses but performed at a university, federal lab, or industry consortium) allows firms to rapidly import new, innovative ideas without having to reinvent the wheel.

Yet the federal R&D tax credit not only does not incentivize research collaborations—it penalizes them. Moreover, the corporate tax code does not let firms bring back foreign source income without paying the full tax rate on it (minus any foreign tax credit taken).

3. SOLUTIONS

a. Overview

Making two changes to the U.S. tax system could revitalize R&D by enabling not only more innovation but also more tech-based entrepreneurship and more demand for STEM workers.

b. Reform the Federal R&D Tax Credit

First, we need to reform the federal R&D credit. Only 65 percent of expenditures on commercially-oriented R&D that a business provides to universities are eligible for the credit. The R&D tax credit defines basic research as “any original investigation for the advancement of scientific knowledge *not having a specific commercial objective.*” 26 U.S.C. §41(e)(7)(a) (emphasis added). By narrowing the definition of basic research, the credit provides less incentive for business to invest in university-based research. Congress should eliminate the language excluding commercially-aimed research and allow 100 percent of expenditures on research made at universities to qualify as research expenditures under the regular and Alternative Simplified credits. This would immediately signal that research collaborations, such as between universities and industry, are a priority.

In addition, a provision of the credit also provides a more generous credit for collaborative R&D if it is focused on energy R&D. *See* 26 U.S.C. §41(a)(3); *see also* §41(b)(3)(D)(i)(III). In this credit, 20 percent of research expenditures can be taken as a credit. *See* §41(a)(3), §41(b)(3)(D)(i). Congress could delete the word “energy” from the current code that refers to the 20 percent credit for collaborative R&D. This would allow any collaborative R&D funding to qualify for the more generous credit.

c. Incentivize the Repatriation of Foreign-Held Earnings Spent on U.S.-Based R&D

At the same time, U.S. corporations have roughly \$2 trillion in foreign earnings parked overseas that they are unlikely to bring home because doing so would subject them to high taxes. The idea would be to let companies repatriate funds, provided they spent at least half of these funds on research, either intramural or extramural, or extramural commercialization initiatives. These repatriated profits would be subject to a tax of 5 percent. But in exchange for taking advantage of this opportunity, companies would have to use half of the money to increase their funding of research over the next five years compared to the average levels of the previous three years.

d. The Path Forward

i. Identifying and Aligning Executive Branch Efforts

The two proposed changes should be analyzed by BEA. Obtaining BEA's a thorough analysis of the impacts of the proposed changes, along with its support, will provide the data and rationale around which other stakeholders can align.

With respect to amending the R&D Tax Credit, the President's 2016 Budget "would create a single formula with an 18 percent credit rate, which would make it more attractive and simplify tax filing for businesses. In addition, the Budget makes the R&[D] credit permanent to provide certainty and increase effectiveness."¹ More details of the proposal can be found in the FY2016 Greenbook.²

While OSTP and Treasury's proposal is somewhat in line with the first reform set forth herein, *supra*. §3(b), the alignment of DOC's, OSTP's, and Treasury's positions—supported by BEA's analysis—on *both* proposed reforms, *supra*. §3(b),(c), would help display unified Executive Branch support for these two reforms.

DOC should also work to identify any other Executive Branch stakeholders.

ii. Identifying and Engaging Legislative Stakeholders

With respect to specific legislators, [Congressman Scott Peters \(D-CA\)](#) has proposed legislation extending the energy credit to include life sciences³, and [Congressman John Delany \(D-MD\)](#) has proposed letting companies bring back profits at a low tax rate if invested in infrastructure⁴. Furthermore, DOC should engage the [Joint Economic Committee \(JEC\)](#), the U.S. Senate [Committee on Commerce, Science, & Transportation](#), and the U.S. House of Representatives [Committee on Energy and Commerce](#).

¹ Office of Science and Technology Policy, *Middle Class Economics: Investing in American Innovation* at 4, available at https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/fact_sheets/investing-in-american-innovation.pdf (last visited Apr. 13, 2015).

² Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* at 49-50 (Feb. 2015), available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf> (last visited Apr. 13, 2015).

³ Igniting American Research Act, H.R. 3757, 113th Cong. (2013).

⁴ Infrastructure and Global Tax Competitiveness Act of 2014, H.R. 5857, 113th Cong. (2014); Infrastructure 2.0 Act, H.R. 625, 114th Cong. (2015); see also Partnership to Build America Act of 2013, H.R. 2084, 113th Cong. §3 (2013); Partnership to Build America Act of 2015, H.R. 413, 114th Cong. §3 (2015).

4. OUTPUTS AND OUTCOMES

Legislation that provides stronger tax incentives for collaborative R&D and that provides a temporarily decreased repatriation tax rate tied to R&D spending by encouraging more corporate R&D spending and by incentivizing collaboration and connectivity among industry, academia, and the Federal laboratories.

Outputs of these efforts should include

1. a BEA-led analysis of the benefits of legislation to provide stronger tax incentives for collaborative R&D and to provide a temporarily decreased repatriation tax rate tied to R&D spending;
2. alignment of OSTP's, DOC's, and Treasury's support of this legislation; and
3. increased efforts in support of this legislation.

Ideal intermediate outcomes of the program would include

1. a change in legislation that provides stronger tax incentives for collaborative R&D; and
2. a change in legislation that provides a decreased repatriation tax rate tied to R&D spending.

Finally, long-term outcomes should include

1. more and stronger partnerships among companies (large and small), U.S. research universities, and Federal laboratories;
2. increased corporate R&D;
3. increases in STEM graduates; and
4. increases in high-tech startups.