INTERNATIONAL BUSINESS TIMES

Push to make R&D credit permanent

By Gerald Helguero | December 14, 2010

As Congress considers a broad tax deal proposed by President Barack Obama and Republicans, high tech and manufacturing businesses are particularly favorable to a provision that would extend research and development tax credits.

R&D incentives have been given a stamp of approval by the President, who emphasized last week the importance of innovation to the competitiveness of American businesses. Innovation is one of the long term keys to creating new jobs and growing the economy, he said.

His comments on American competitiveness came as part of a broader agenda that also includes making a commitment to investment in education and the nation's infrastructure, areas where he may face opposition.

With the debate over the size of the federal budget set to take place next year, the President has argued that the U.S. must not forsake those areas despite the current fiscal challenges the nation faces.

Investments in education and infrastructure, he said, were going to be "the seeds of economic growth in the 21st century."

"Where they are planted, the most jobs and businesses will take root," he said.

The business community, especially high tech companies and manufacturers, are not only in favor of a short term extension for R&D credit, but advocates also see a place for a permanent extension, although that is not a part of the tax deal currently being considered by Congress.

Currently, the United States is the world's leader in spending for R&D, according to government estimates.

While global R&D spending was $330 billion worldwide in 2009, the U.S. had 71 percent of all spending at $234 billion, according to a report by the National Science Foundation and the Census Bureau. Of that, $49 billion was spent by foreign companies in the U.S.

In September, President Obama proposed making R&D tax credits permanent, instead of a renewable credit that may depend on the make-up of Congress. He also cited efforts by former Presidents Bill Clinton and George W. Bush to do so.

Tax breaks for R&D, while seen by the President and businesses as having long term benefits, can also have an immediate impact.

Rep. Chris Lee, R-NY, who has been advocating over the past year to make the credit permanent, cited a 2008 Ernst & Young study noting that roughly 70 percent of the tax credit's benefits are used to pay salaries.

The proposals differ slightly. While the President proposes closing "tax loopholes that incentivize investment in overseas jobs," Lee's idea would give a "bonus tax credit to companies who manufacture most of their products in the United States."

Lee's bonus proposal would be based on a sliding scale, where a greater percentage of R&D spending in the U.S. would provide greater tax breaks starting with a 2 percent bonus at 50 percent of spending, up to a 10 percent bonus for spending greater than 90 percent, according to a spokesman for Lee.

The temporary R&D Tax Credit expired last December, although it does not have to be reinstated until the end of 2010.

If renewed in the latest package of tax measures worked out between the President and Republicans, it would be the 14th extension for the credit since it originally became law in 1981. It has lapsed several times during that period.

"This credit has proven very effective at encouraging technical advancements and sustaining economic growth in the industry," the General Aviation Manufacturers Association said on Monday.

Business Roundtable Executive Director Larry Burton said his group - an association of U.S. chief executives - applauded the inclusion of the tax credit, among others provisions, in the recent tax deal.

"These provisions include long-standing features of the tax code that businesses rely on when they undertake hiring and investment decisions," he said.

Restoring the provisions "lifts an uncertainty for businesses," he added.

President Obama noted in a recent speech that President Lee Myung-bak of South Korea told him that his country was putting aside 5 percent of its gross domestic product in research and development, with 3 percent of that going to clean energy.

The same day Obama made that speech last week, he set a goal of investing 3 percent of U.S. GDP into R&D.

"That has to be a priority," he said.

Global competition for R&D money is growing. While the U.S. had the world's most generous R&D credit when it was first enacted, today, 16 other nations have a more generous tax break, according to an index developed by economists Donlad McFetridge and Jacek Warda, according to Pamela Villarreal of the National Center for Policy Analysis.

She notes that while the U.S. has only a 7 percent tax credit for each dollar spent, other countries, such as Spain, Mexico and Canada provide tax credits of 44 percent, 37 percent and 17 percent, respectively.

"In the long run, the tax credit increases GDP by as much as $2.96 for each dollar of tax revenue lost, but a stop-and-go policy is less beneficial," she told R&D magazine.

The effect is just under two dollars generated for every dollar of tax benefit, according to Technet, a bipartisan political network of CEOs that promotes the growth of technology industries and the economy.

"Without the R&D credit, many companies across the country might not choose to make potentially risky R&D investments because the return on those investments would be insufficient and the projects require long-term planning as they represent multi-year funding commitments," the network says.

Congressman Lee says that Congress's failure to act on making the tax credit permanent places the U.S. at a "grave competitive disadvantage."

The U.S. finished "dead last" in R&D tax competitiveness among eight leading Western economies, he said, citing a study by accounting firm Mazars.

Competitors have 10 and 20 year proposals for R&D tax credits, Lee said.

"We plan year to year, election to election," he said.

With a permanent R&D tax credit in place, Lee argued, U.S. companies will be encouraged to make long-term plans.