



THE WAY TO WHAT'S NEXT

UTILIZING THE TAX CODE TO INCENTIVIZE INNOVATION

A pro-growth tax code is vital for innovation to flourish. Crucial research and development (R&D) activities support American jobs while bolstering our economic competitiveness and national defense. This year, Congress has the opportunity to correct a harmful provision in the tax code that penalizes American innovators from doing this important work.

Background:

Since January 2022, American innovators have no longer been able to immediately write off the full value of their R&D expenses. This harmful tax change makes the U.S. only one of two developed countries with this policy, making the U.S. an unattractive place to conduct R&D activities.

R&D Impacts Workforce

With less private investment in R&D, our workforce will fall behind in the high-tech skills and expertise to maintain our competitive edge. Moreover, wages and salaries comprise approximately 75 percent of R&D spending.¹ The private sector accounts for more than 75 percent of total R&D spending² with small businesses alone accounting for about 15 percent of all private sector R&D investments.³ Direct R&D jobs are high-paying jobs with an average wage of more than \$140,000.⁴ The 2022 R&D tax change continues to have a dragging effect on the U.S. economy, with expected losses of over 260,000 U.S. jobs and \$82 billion in GDP in 2023.⁵ Some small and medium-sized businesses have already laid off up to 40 percent of their workforce due to the need to amortize expenses.⁶

R&D Impacts Economic Competitiveness

American companies have always played a leading role in advancing the technology we need to maintain our competitive edge, notably in the aerospace and defense industry. Since this policy was implemented, investment in private sector R&D investment has steadily slowed; the final two quarters of 2023 showed. Growth in real private investment in R&D has slowed steadily since this policy went into place. In fact, in 2023, the United States saw the slowest annual growth in R&D investment since 2012, and private R&D investment actually declined in the second half of the year.⁷ While U.S. R&D investments stagnate, other countries continue to surge public investment and incentivize private investment in R&D.

R&D Impacts National Security

Between 2000 and 2019, China's share of global R&D rose nearly 488 percent, from 4.9 percent to 23.9 percent.⁸ At the same time, China extended its super deduction for R&D expenses for manufacturing companies to an extra 100 percent of eligible R&D expenses in addition to actual expenses incurred. That means for every \$100 spent on innovation, Chinese companies can deduct \$200, 10 times more than American companies. According to the National Science and Technology Council, "ensuring national security and resilience is critical for the United States, especially as other nations dramatically increase their R&D expenditures," and sustained R&D investments "are essential to ensure that the United States remains able to secure and protect the American people in the face of this increased competition."⁹ Any reduction in R&D spending as a result of this tax change would make this task more difficult.

Recommendation:

The Senate must take up bipartisan legislation, *The Tax Relief for American Families and Workers Act*, led by Senator Ron Wyden (D-OR) and Representative Jason Smith (R-MO). This legislation passed the House 357 to 70 on January 31, 2024, and includes a temporary retroactive fix to R&D expensing. Doing so will prevent the further loss of jobs and spur the innovation needed to ensure America's future competitiveness. Delaying action risks the permanent loss of R&D spending as budgets are trimmed and projects are shelved. We must avoid this self-inflicted injury.

¹ Internal Revenue Service, Statistics of Income, *Corporation Income Tax Returns Line Item Estimates 2019*, Publication 5108, Rev. 6-2022, Form 6765, <https://www.irs.gov/pub/irs-pdf/p5108.pdf>.

² National Center for Science and Engineering Statistics, National Science Foundation, *National Patterns of R&D Resources: 2020-21 Data Update*, NSF 23-321, January 4, 2023, <https://ncses.nsf.gov/pubs/nsf23321>.

³ National Center for Science and Engineering Statistics, National Science Foundation, *InfoBrief*, NSF 22-343, October 4, 2022, <https://ncses.nsf.gov/pubs/nsf22343>.

⁴ <https://investinamericafuture.org/ey-impact-of-the-amortization-of-certain-rd-expenditures-on-rd-spending-in-the-united-states/>

⁵ <https://www.nam.org/new-data-taxing-rd-will-cost-us-more-than-260000-jobs-next-year-if-congress-doesnt-act-19948/>

⁶ A Tax Rule Change Is Threatening the Survival of Some Businesses - WSJ

⁷ <https://taxfoundation.org/blog/us-china-competition-technology-rd-tax-treatment/>

⁸ <https://crsreports.congress.gov/product/pdf/R/R45403>

⁹ Subcommittee on Research and Development Infrastructure, Committee on Science and Technology Enterprise of the National Science and Technology Council, *National Strategic Overview for Research and Development Infrastructure*, October 2021, p. 23.