



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:

Beginning in 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 will result in a loss of over 260,000 U.S. jobs and \$82 billion in GDP in 2023 alone if the harmful change is not reversed.⁵

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. Real private investment in R&D declined at an annual rate of 1.1 percent in the third quarter and 0.6 percent in the fourth quarter of 2022 – the first consecutive quarterly decline in private sector R&D investment in more than seven years.⁶

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.⁷ 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."⁸ Any reduction in R&D spending as a result of this tax change would make this task more difficult.

Recommendation:

Congress must immediately pass bipartisan, bicameral legislation (S. 866 and H.R. 2673) led by Senators Maggie Hassan (D-NH) and Todd Young (R-IN) and Representatives Ron Estes (R-KS) and John Larson (D-CT) to address this issue. Doing so will prevent the loss of jobs and the innovation necessary 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://investinamericasfuture.org/ey-impact-of-the-amortization-of-certain-rd-expenditures-on-rd-spending-in-the-united-states/>

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

⁶ U.S. Bureau of Economic Analysis, "Table 5.3.1. Percent Change From Preceding Period in Real Private Fixed Investment by Type".

⁷ <https://crsreports.congress.gov/product/pdf/R/R45403>

⁸ 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.