



Permanent Extension of the Section 41 R&D Tax Credit

Issue

Since its original enactment in 1981, the research and development ("R&D") tax credit has been temporarily extended ten times. It is currently scheduled to expire on June 30, 2004. To be most effective, the R&D tax credit needs to be made permanent.

Background

The R&D tax credit (under section 41 of the Internal Revenue Code) provides for a credit equal to 20 percent of the amount by which a company's "qualified research expenditures" for a taxable year exceeds its base amount for that year.

In November 1999, almost five months after its previous expiration, Congress approved a five-year retroactive extension of the R&D tax credit, from June 30, 1999 to June 30, 2004. Included in this extension was a 1-percent increase in the rates for the alternative incremental research credit ("AIRC"), which benefits many companies who no longer qualify for the traditional research credit.

On January 29, 2003, several House Ways and Means Committee Members introduced a bill (H.R. 463) that, among other things, would make the R&D tax credit permanent. In addition, the Bush Administration FY 2004 budget proposals, released February 3, 2003, includes a provision to make the research credit permanent.

Policy Considerations

The R&D tax credit is a significant factor in the U.S.'s economic prosperity and international competitiveness. A large part of U.S. economic growth and productivity increases over the past 20 years are due, in large part, to the business investment incentives provided by the credit. However, the lack of permanency of the R&D tax credit limits its effectiveness. The temporary nature of the credit is unattractive to business leaders seeking long-term certainty with respect to capital investments. Moreover, the unreliability of the credit's availability exacerbates the already substantial uncertainty surrounding the expected returns to prospective R&D projects.

The R&D tax credit counters a primary disincentive to private sector research and experimentation — the financial disadvantage incurred by a firm that conducts research, with the result of seeing their competitors gain access to the new technology without actually undergoing the research process themselves. The R&D tax credit in effect reimburses those industries whose research benefits the entire economy, and enables the government to encourage private sector development of a strong research base on which to build future economic stability.

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Recommendation

The SVTDG supports legislation (H.R. 463) to permanently extend the R&D tax credit and slightly increase the AIRC rates. The SVTDG recommends that a permanent R&D tax credit, and other elective measures, be enacted in the 108th Congress.