

April 15, 2013

Manufacturing Tax Reform Working Group  
Attn: Representatives Gerlach, Sanchez and Roskam  
U.S House of Representatives  
Washington, D.C. 20515

Dear Representatives Gerlach, Sanchez and Roskam:

The Research & Development Alternative Simplified Credit (ASC) Coalition - whose members cover the full spectrum of U.S. manufacturers including those in the aerospace, automotive, construction, farming, defense, pharmaceutical, computer chip, software, and other high-technology industries – writes to encourage that any tax reform legislation include a robust and permanent incentive for research and development conducted in the United States.

### **The R&D Tax Credit Creates and Supports U.S. Manufacturing Jobs**

The purpose of the R&D tax credit is to encourage investment in U.S.-based research and to promote high-paying jobs here in the United States. The R&D credit has done both – particularly in the manufacturing sector.

- 43% of all companies claiming the R&D tax credit are manufacturers. More striking, manufactures claim 70% of all the R&D tax credits. (2008 IRS data.)
- Between 70% and 80% of the R&D tax credit is directly attributable to the salaries of U.S. workers performing research in the United States.
- According to the National Science Foundation, average wages in the science and technology occupations are 1.8 times (or nearly 80% higher) than the average wages for all occupations.
- Several studies including the recent study by the Center for American Progress concludes that, “the credit is effective in the sense that each dollar of foregone tax revenue causes businesses to invest at least an additional dollar in R&D.”

### **United States Pioneered the First R&D Tax Credit**

In 1981, the United States became the first country to provide an R&D incentive through the tax code. The enactment of this incentive helped establish the United States as a leader in cutting-edge research, spurred robust R&D investment in the United States and helped drive economic growth through the 1980s and 1990s. Congress designed the R&D credit to be an important incentive in spurring private sector investment in innovative research by companies of all sizes and in a variety of industries. Unfortunately, the United States is no longer the innovator when it

comes to R&D incentives. Once FIRST, today the United States ranks just 27<sup>th</sup> out of 42 countries that provide R&D tax incentives. (The Information Technology & Innovation Foundation – July 1012.)

### **The United States Needs an Enhanced and Permanent R&D Credit to be Competitive**

In the global economy, companies have a choice as to where they invest in research and development. With most countries offering both lower tax rates and more robust R&D incentives, the United States needs to provide competitive tax rates and globally competitive R&D incentives that can be counted on (i.e. permanent) or risk losing valuable U.S. research investment and the associated U.S. jobs. U.S. companies don't need to travel across the globe for lower rates and more robust R&D incentives – our neighbors Canada and Mexico offer both.

### **The ASC Should be Increased and Made Permanent**

One thing that President and many House and Senate Republicans and Democrats have all agreed on is that the Alternative Simplified R&D tax credit (ASC) should be increased and made permanent.

- The President's Budgets all call for a permanent ASC increased from 14 percent to 17 percent.
- *The American Research and Competitiveness Act of 2011* (H.R. 942) introduced by Representatives Brady and Larson with 106 co-sponsors called for a permanent ASC increased from 14 percent to 20 percent.
- *The Greater Research Opportunities with Tax Help Act of 2011* (S. 1577) introduced by Senators Baucus and Hatch with 19 co-sponsors called for a permanent ASC increased from 14 percent to 20 percent.

Under current law, there are two R&D tax credits – the “traditional” R&D credit and the ASC. The “traditional” R&D credit is tied to a business' research expenditures and gross receipts in the 1984 through 1988 time-period. The ASC is tied to a business' research expenditures over the more-timely most recent three year time-period.

Congress enacted the ASC in 2006 to respond to the fact that a significant number of businesses (despite investing large amounts on research and development) were getting little or no benefit from the “traditional” credit. Today, at a 14 percent rate, the ASC is the R&D credit utilized by the vast majority of businesses. Virtually all businesses investing in research and development would utilize the ASC over the “traditional” credit if the ASC was increased from 14 percent to 20 percent.

More importantly, increasing and making permanent the ASC would significantly increase U.S. job growth and the U.S. GDP. According to the 2010 Information Technology & Information

Foundation Study, increasing the ASC from 14 percent to 20 percent would add 162,000 U.S. jobs in the high-tech sector alone and increase GDP by \$66 billion annually.

Bottom line is that in order to attract and to maintain research and development in the United States, we need a competitive tax code that offers both a lower tax rate and a strong permanent R&D incentive. Our businesses desperately want to keep and to expand their U.S. research and development in the United States but they cannot ignore the significantly lower tax rates and strong R&D incentives that are being pushed on them by other countries on almost a daily basis.

### **Simplify Administration of the R&D Tax Credit**

As discussed in great detail in the GAO's November 2009 Report - The Research Tax Credit's Design and Administration Can Be Improved, the overall effectiveness of the R&D tax credit is currently reduced by the significant administrative compliance burden.

One way to address this issue is to provide more clear and concise definitions and examples of what activities qualify for the R&D tax credit. Reducing the subjectivity as to what qualifies as a "new" or "improved" product would enable taxpayers to better comply with and to avoid expensive controversies with the IRS.

One particular area of concern is the IRS disallowing certain qualified research expenditures on the basis that they are performed after the beginning of commercial production. As noted in the GAO Report, "[practitioners] objected to Treasury deeming certain activities, such as preproduction planning, tooling, trial production runs, and debugging flaw, to occur after commencement of production when they often actually occur before the manufacturing process is ready for commercial use." Providing better definitions and examples in this area would both reduce controversies and make the credit more effective.

We thank the Committee and the Manufacturing Working Group for the opportunity to provide input on the importance of a robust U.S. R&D tax incentive. As you work through the tax reform process, please do not hesitate to contact us.