EXECUTIVE SUMMARY

The goal of this analysis is to determine how the United State’s research and development (R&D) incentives compare to those in other countries. The US spends more than any country on governmental and total R&D expenditures. However, the US is only ninth globally in R&D intensity, defined as the ratio of R&D expenditures to GDP.

In comparing how tax incentives contribute to the amount of tax a firm pays on a representative R&D investment, across a sample of countries, the US had the highest net tax due but a relatively high tax savings.

Additionally, Marginal Effective Tax Rates (METRs) were calculated for the sample countries. METRs represent the amount of tax arising from a profit maximizing firm’s decision to invest in a marginal unit of capital, given competition in the capital market and provisions for depreciation, deductions, credits, and tax rates. METRs provide a more comprehensive measure of the value of the incentive within the individual countries’ tax systems.

Across a variety of scenarios, the US had the highest METRs. Three factors contribute to its high METRs. First, the US corporate tax rate is relatively high at 35 percent. Second, the US’s Research and Experimental (R&E) tax credit reduces the amount of R&D a taxpayer may expense. Third, the high METRs reflect Congress’ intent to reward only incremental expenditures.

Recommendations for improving the effectiveness of US R&D incentives include:

1. Maintain the R&E Tax Credit because it can be made easier to administer and less expensive than a deduction.

2. Make the credit refundable. This will expand the credit by providing an incentive for start-ups and enterprises without taxable income.

3. Simplify the base formula to increase the number of companies eligible for the maximum credit.

4. Improve the administration of the credit to decrease legal costs and uncertainty associated with the credit.