What is It?

- The federal Research and Development Tax Credit ("R&D tax credit") is a business tax credit for qualified research expenses that can be deducted from overall corporate income taxes.

- Qualified research expenses include: certain labor and wage costs for performing research activities "in-house;" certain supplies used in conducting research; and a percentage of costs associated with "contract research expenses." The credit only applies to research performed in the United States.

- The traditional R&D tax credit provides a 20 percent credit for qualified research expenses that exceed the taxpayer’s base amount (determined by reference to the taxpayer’s research expenses during the mid 1980s and the taxpayer’s recent gross receipts). In lieu of the traditional credit, taxpayers may elect to claim the Alternative Simplified Credit (ASC). The ASC provides a 14 percent credit for qualified research in excess of 50 percent of a company’s prior three-year average qualified research expenses.

- Under certain circumstances, businesses can also claim a credit if they fund qualified research at another organization such as a university or other research organizations. In such instances, a business can claim only 65 percent or 75 percent (as compared to 100 percent for in-house R&D expenditures) of qualifying expenditures toward the tax credit. The 75 percent rate applies only to qualified research organizations (such as universities or research consortiums), which are tax-exempt entities organized primarily to conduct scientific research and which are not private foundations.

Background

- The R&D tax credit is designed to encourage companies to make new discoveries and advancements and to partner with entities, such as universities, and other organizations to conduct research and development activities. Because the tax credit can only be taken for R&D activities performed in the U.S., it helps fuel our nation’s competitiveness and economic and national security by encouraging greater R&D investment and fostering the creation and retention of domestic high-skilled jobs.

- Originally enacted in 1981, the R&D tax credit is not a permanent part of the Internal Revenue Code, but has been allowed to expire on a number of occasions since. However, it has been renewed each time, sometimes retroactively. It was renewed for the 15th time since 1981 as part of the American Taxpayer Relief Tax Act of 2012 and which included a one-year retroactive and one-year prospective extension of the R&D tax credit. The R&D tax credit expired on December 31, 2013.
The R&D Tax Credit and Universities

- Current law allows companies to claim the R&D tax credit for research and development activities conducted at universities or other qualifying organizations, including research consortiums which may include universities.

- Universities benefit indirectly from the R&D tax credit. The tax credit encourages industry to take on new research and development challenges that are important to industry but also well-suited to academic research.

- When companies contract with universities to conduct R&D, faculty and graduate students benefit from receiving complex academic and practical research problems and the financial support to study them. The R&D tax credit, in turn, promotes greater collaboration between industry and universities. This in turn leads to R&D-based employment opportunities for students and graduates.

- The R&D tax credit also fosters start-up companies, many of which are a result of new technologies developed at universities as a result of industry-funded research.

Potential Reforms

- The current R&D credit could be improved by providing greater incentives for companies to partner with universities for R&D. This would include increasing the tax credit for R&D activities conducted at universities and other research entities so that it equals the benefit provided for “in-house” research. In addition, making the R&D tax credit permanent would significantly improve its effectiveness, since industry could reliably plan for R&D expenditures and their tax implications. This is particularly important for research that takes several years.

Additional Information
