

RESEARCH AND EXPERIMENTATION TAX CREDIT CURRENT LEGISLATIVE STATUS

The R&D tax credit was originally enacted in 1981 and has been extended 11 times. Corporate taxpayers receive a 20 percent tax credit for qualified R&D expenditures in excess of a calculated base amount. There is also an alternative incremental research credit (AIRC) in current law. The AIRC computation combines a three-tiered fixed-base percentage with a reduced three-tiered credit percentage. The R&D credit is available only for research and development expenditures incurred in the United States. The primary categories of qualified R&D expenditures are wages paid to employees performing qualified research activities, a portion of the amount paid to outside contractors for the performance of qualified research, and the expenditures for supplies used in the conduct of qualified research.

A one-year extension of a strengthened R&D credit was included as part of the Senate-passed Tax Relief Act of 2005, and the House-passed Tax Relief Extension Act of 2005, but final conference action was not completed before the credit expired on December 31, 2005. As a result, it is imperative that the credit be extended without any lapse and that legislation incorporate the important changes in current law that already have passed in the House and in the Senate.

The Tax Relief Act of 2005 (S. 2020) and the Tax Relief Extension Act of 2005 (H.R. 4297) would:

- **Extend the R & D Credit through December 31, 2006:** As noted above, the credit was first enacted in 1981 and has been extended 11 times, with a one-year gap in the late 1990's. It is a proven, effective incentive for companies to increase their research and development activities in the United States. However, because the credit has been extended only for short durations, companies are unable to factor the full benefits of the R & D credit into their research budgets because of its continuing short-term nature. **The conference agreement must extend the credit without any lapse.**
- **Increase the AIRC rates to those originally proposed:** The rates originally proposed for the AIRC were scaled back at the time of enactment in 1996. As originally proposed, the AIRC rates ranged from 3 percent to 5 percent, depending on the levels of qualified R & D spending relative to a base amount. The House and Senate tax reconciliation bills would increase the AIRC rates to the rates originally proposed (3 percent, 4 percent, and 5 percent). **The conference agreement must retain this increase in AIRC rates.**
- **Provide a new Alternative Simplified Credit:** The House and Senate tax reconciliation bills would allow taxpayers to elect a new alternative simplified credit equal to 12 percent of qualified research expenses for the taxable year in excess of 50 percent of the average qualified research expenses for the 3 prior taxable years. Although the current statutory incentive is effective for many companies, this new simplified credit will provide an incentive to companies that spend significant amounts on R&D in the United States but get little or no benefit from the current credit due, for example, to changing business models. **The conference agreement must retain this new alternative simplified credit formula.**