

Innovation Tax: the TCJA and Section 174 in three slides



Executive Summary

*For nearly 70 years, the US tax code recognized the importance of R&D by allowing businesses to fully deduct their R&D expenses in the same year they were incurred. Starting in 2022, the tax code has required businesses to amortize (or deduct over a period of years) their R&D expenses, **resulting in a loss of:***

- **American R&D: \$10.1B per year**
- **American jobs: 169,400 per year**
- **American income: \$14.4B per year**

America ranked near the bottom of the OECD for R&D tax incentives before this change, all while China and other global competitors are creating super-deductions (200% in China's case) to spur their own defense, tech, healthcare and other innovation economies.

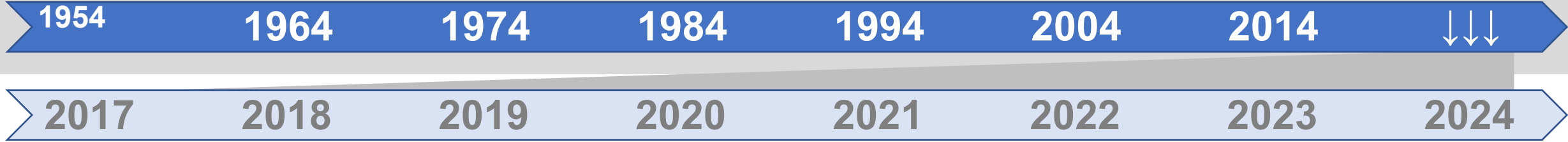
*Bipartisan, bicameral bills are drafted. We simply need – we all need – **Congress to act.***

Businesses allowed to immediately deduct qualifying R&D expenditures (1954)

Modern-day R&D Tax Credit created to reward American businesses for keeping technical jobs within the country and driving innovation within their industry (1981)

Protecting Americans from Tax Hikes Act (PATH Act) officially made the R&D Tax Credit a “permanent addition to the U.S. tax code” (2015)

R&D Tax Credit expired eight times and extended fifteen times due to its strategic and economic importance



The Tax Cuts and Jobs Act (TCJA) of 2017 required that beginning in tax year 2022, R&D conducted in the United States be amortized over 5 years and other R&D be amortized over 15 years.

*Multiple **bipartisan, bicameral** bills introduced to fix the TCJA, most recently S.866 - American Innovation and Jobs Act and H.R.2673 - American Innovation and R&D Competitiveness Act of 2023. Other priorities and politics as usual prevent their adoption.*

Senator Schumer once again hitches S.866 to partisan priorities while the House is dysfunctional.

Election Year = little hope for legislation



R&D tax incentives were invented and proven by the US, but we've been overtaken... and left in the dust.

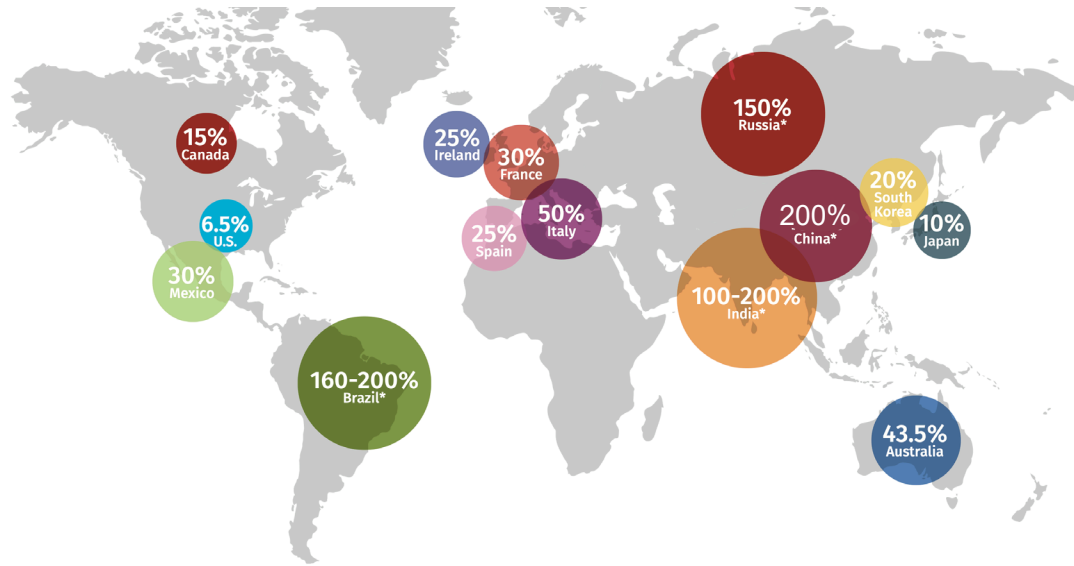
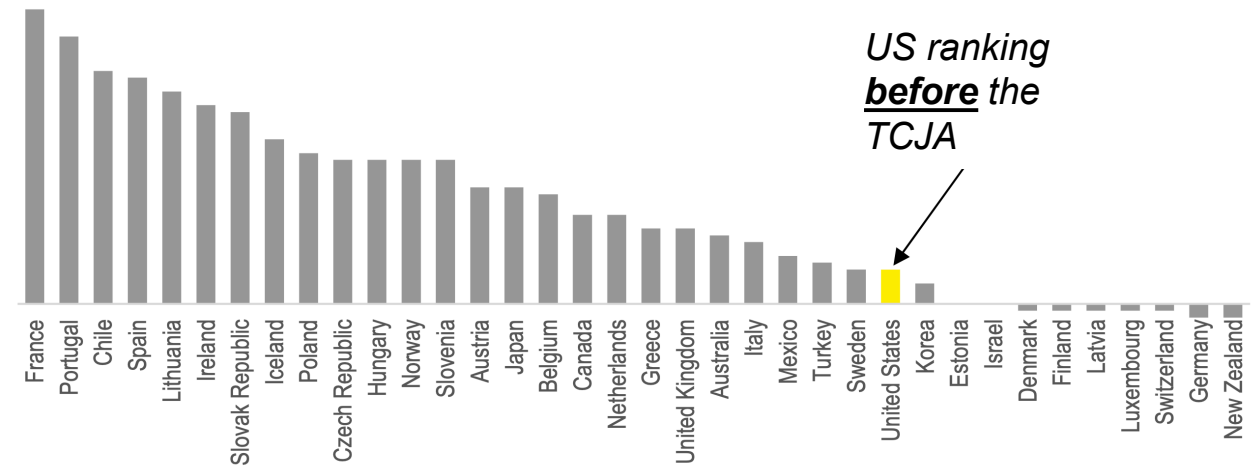


Figure E. Research & Development Incentive Deduction and/or Credit Activity Value Percentages by Country
[claim restrictions vary by country]

Figure 1. Ranking of R&D tax incentives among OECD countries, 2018



Note: This is the US ranking for the implied tax subsidy rate on R&D expenditures for large profitable companies. The implied tax subsidy rate is defined as one minus the B-index. The B-index is the before-tax return needed for a company to break even on a marginal investment. See OECD, R&D Tax Incentive Database, November 2018.
Source: OECD, R&D Tax Incentive Database, November 2018.

The U.S. is now one of two developed countries requiring the amortization of R&D expenses. While America's tax code makes R&D more costly, **China recently expanded and made permanent** a super deduction for R&D expenses, allowing companies to deduct 200% of R&D expenses. In fact, 17 countries, including 10 OECD countries, provide for the recovery of more than 100% of eligible R&D expenses.

The amortization requirement poses a serious threat to our national security. As the National Science and Technology Council has noted, R&D investments "are essential to ensure that the U.S. remains able to secure and protect the American people in the face" of other countries' increasing support for R&D."

Sources: Alliant, Ernst & Young, National Defense Industrial Association, National Small Business Association



Impacts include the loss of millions of high-paying jobs, tens of billions in income, and thousands of our most innovative companies

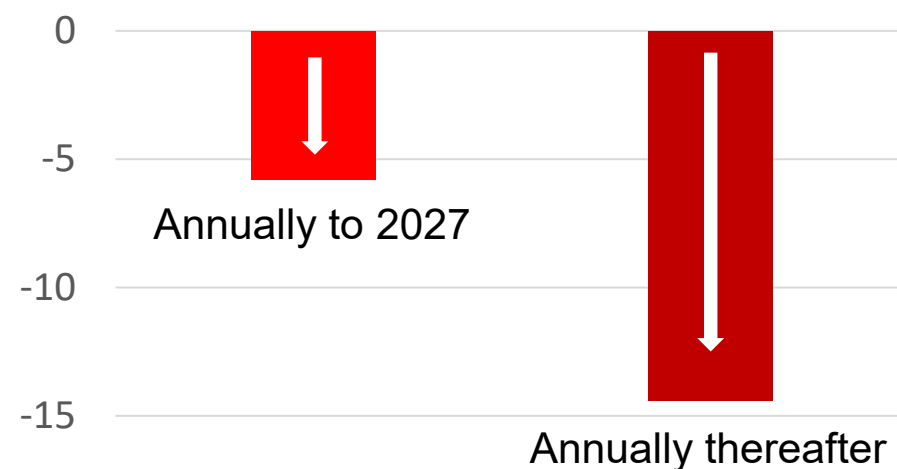
Table B-2. Annual decline over the second five years and beyond in R&D spending, R&D-related wages, and R&D-related employment, by state
Number of jobs; millions of dollars

	R&D spending	Wages	Employment
United States	\$10,131	\$8,217	58,608
Alabama	28	23	163
Alaska	1	1	5
Arizona	154	125	891
Arkansas	11	9	64
California	3,434	2,785	19,864
Colorado	115	93	685
Connecticut	198	161	1,146
Delaware	47	39	275
District of Columbia	7	6	43
Florida	144	117	834
Georgia	139	113	802
Hawaii	4	3	21
Idaho	45	37	263
Illinois	384	311	2,220
Indiana	162	131	937
Iowa	72	59	418
Kansas	48	39	276
Kentucky	24	20	141
Louisiana	7	6	43
Maine	8	7	49
Maryland	108	88	626
Massachusetts	587	476	3,396
Michigan	567	460	3,278
Minnesota	214	174	1,240
Mississippi	6	5	37
Missouri	113	91	651
Montana	4	3	23
Nebraska	16	13	92
Nevada	13	11	77
New Hampshire	25	20	144
New Jersey	419	340	2,423
New Mexico	10	9	61
New York	437	354	2,527
North Carolina	235	190	1,357
North Dakota	8	6	45
Ohio	207	168	1,196
Oklahoma	21	17	121
Oregon	205	166	1,186
Pennsylvania	362	294	2,096
Rhode Island	27	22	154
South Carolina	37	30	215
South Dakota	4	4	25
Tennessee	45	36	260
Texas	484	393	2,801
Utah	93	76	540
Vermont	7	6	43
Virginia	73	59	421
Washington	617	500	3,569
West Virginia	5	4	29
Wisconsin	142	116	824
Wyoming	5	4	31

Annual Change in Employment (Jobs)



Annual Change in Labor Income (\$B)



*Annual loss in new defense technologies, life-saving drugs, myriad other innovations and global competitiveness: **unknown***

*Less than \$0.05 million.
Note: Estimates are distributed to the states (plus the District of Columbia) based on the National Science Foundation's 2016 funds spent for business R&D performed in the United States paid for by the company. These data were the most recent National Science Foundation data at the time of the analysis. Figures may not sum due to rounding.
Source: EY analysis.