

# International R&D Tax Incentives

The following is a summary of R&D tax incentives offered by select competitor-nations that help explain why foreign-based R&D spending has grown faster than U.S.-based R&D spending. By way of comparison, the United States provides a maximum 10% incremental credit (a nominal rate of 20%) for R&D spending. The average company that is able to claim the traditional credit only realizes a credit rate of 6%, while companies claiming the AIRC realize a credit rate of about 2%. Further, the United States requires that the deduction for R&D expenses be reduced by the amount of any R&D credit, which drives the effective rate even lower.

In 2003, U.S. majority-owned affiliates invested \$22.3 billion in R&D in foreign countries, up from \$15.0 billion invested in 1998 – a 49% jump.<sup>1</sup> By comparison, spending on R&D in the United States by U.S. parent companies rose more slowly (by 23%) over this period, from \$114.2 billion to \$140.1 billion.

Country	R&D Tax Incentive	Comment
<b>Australia</b>	<ul style="list-style-type: none"> <li>Allows a 125% deduction for R&amp;D expenses</li> <li>Plus a 175% deduction for R&amp;D expenditures exceeding a base amount of prior-year spending.</li> </ul>	The 125% deduction is the equivalent of a flat 7.5% R&D tax credit. In discussing its R&D-friendly environment, the Australian government's website (investaustralia.com) concludes, " <b>It's little surprise then, that many companies from around the world are choosing to locate their R&amp;D facilities in Australia.</b> " The government also points out that "50% of the most innovative companies in Australia are foreign-based."
<b>Canada</b>	<ul style="list-style-type: none"> <li>Offers a permanent 20% flat (i.e., first-dollar) R&amp;D tax credit.</li> <li>Also, many provincial governments offer various incentives (e.g., refundable credits) for R&amp;D activities conducted in their provinces.</li> </ul>	In 2003, U.S. subsidiaries spent <b>\$2.5 billion on R&amp;D in Canada</b> , which has mounted an aggressive marketing campaign, including television and print advertisements, to lure more U.S. companies to locate R&D operations north of the border. Ontario print ad discusses " <b>R&amp;D tax credits, among the most generous in the industrialized world</b> " and "a cost structure which KPMG confirms as lower than the U.S. and Europe"; the ad concludes, "you'll see why R&D in Ontario is clearly worth investigating."
<b>China</b>	<ul style="list-style-type: none"> <li>Offers foreign investment enterprises a 150% deduction for R&amp;D expenditures, provided that R&amp;D spending has increased by 10% from the prior year.</li> </ul>	The 10% incremental-increase threshold should not be difficult to meet for U.S.-owned companies growing start-up operations in China. China's Ningbo Economic & Technical Development Zone ("NETD") invites <b>global companies to "enjoy a number of preferential taxation policies,"</b> as well as other benefits.
<b>France</b>	<ul style="list-style-type: none"> <li>Allows a 50% R&amp;D credit, includes a 10% flat credit and a 40% credit for R&amp;D expenditures in excess of average R&amp;D spending over the two previous years.</li> </ul>	France recently expanded the scope of eligible R&D expenses that serve as a basis for the computation of the credit. Beginning in 2006, taxpayers can take into account twice the actual amount of salaries paid during 12 months for the first employment of certain newly-graduated searchers; and can claim up to Euro 10M (up from Euro 8M) in research sub-contracting payments made to certain qualifying entities. In 2003, U.S. subsidiaries spent <b>\$1.8 billion on R&amp;D in France</b> . "This is the first time in our industry that Americans are coming to Europe to join the R&D of Europeans," Pasquale Pastore, President and CEO of STMicroelectronics, in <i>The New France. Where the Smart Money Goes</i> .
<b>India</b>	<ul style="list-style-type: none"> <li>Companies carrying on scientific research and development are</li> </ul>	"More than 100 global companies ... have established R&D centers in India in the past 5 years, and more are coming. ... As I see it from my perch in India's

<sup>1</sup> "Survey of Current Business," Bureau of Economic Analysis, Department of Commerce.

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	<p>entitled to a 100% deduction of profits for 10 years.</p> <ul style="list-style-type: none"> <li>Automobile industry also is entitled to a 150% deduction for expenditures on in-house R&amp;D facilities.</li> </ul>	<p>science and technology leadership, <b>if India plays its cards right, it can become by 2020 the world's number-one knowledge production center,</b>" Raghunath Mashelkar, Director General, Council for Scientific &amp; Industrial Research, India, in <i>Science Magazine</i>.</p>
<b>Ireland</b>	<ul style="list-style-type: none"> <li>Offers a 20% R&amp;D tax credit, plus a full deduction, as well as a low generally applicable 12.5% corporate income tax rate.</li> <li>Capital expenditures may also qualify for a separate flat credit.</li> </ul>	<p>According to IDA Ireland, the government agency with responsibility for the promotion of direct investment by foreign companies into Ireland, <b>"Many leading global companies have found Ireland to be an excellent location for knowledge-based activities.</b> ... Nearly half of all IDA supported companies now have some expenditure on R&amp;D and 7,300 people are engaged in this activity."</p>
<b>Japan</b>	<ul style="list-style-type: none"> <li>Offers a flat 10% R&amp;D tax credit (a 15% flat credit is provided for small companies), in addition to other incentives.</li> </ul>	<p>In 2003, U.S. subsidiaries spent <b>\$1.7 billion on R&amp;D in Japan.</b> Junichiro Mimaki, an official from Japan's Ministry of Economy, Trade, and Industry, said in an August 26 interview with the Bureau of National Affairs that <b>R&amp;D and IT tax relief has created 400,000 jobs and boosted gross domestic product by 6.1 trillion yen (\$55 billion) over three years.</b></p>
<b>Korea</b>	<ul style="list-style-type: none"> <li>Tax holidays, up to 7 years, are provided for high-technology businesses.</li> <li>In addition, a variety of tax credits are provided for R&amp;D-type expenditures.</li> </ul>	<p><b>Korea is moving aggressively to attract foreign R&amp;D investment,</b> promoting not only tax incentives but also other benefits for foreign companies locating R&amp;D in the Incheon Free Economic Zone ("IFEZ").</p>
<b>Singapore</b>	<ul style="list-style-type: none"> <li>"R&amp;D and Intellectual Property Management Hub Scheme" offers U.S. companies a 5-year tax holiday for foreign income earned with respect to Singapore-based R&amp;D.</li> </ul>	<p>According to Singapore's Economic Development Board website, <b>"Singapore does not just welcome business ideas; it actively seeks and nurtures them.</b> We play host to any shape and size of enterprise and innovation – startups with little more than the germ of an idea; global corporations with large R&amp;D teams and complex production operations."</p>
<b>United Kingdom</b>	<ul style="list-style-type: none"> <li>Allows a 125% deduction for R&amp;D expenses, plus a 175% deduction for R&amp;D expenditures exceeding a base amount of prior-year R&amp;D spending.</li> </ul>	<p>The UK leads the world in attracting R&amp;D investment by U.S. affiliates – U.S. subsidiaries spent more than <b>\$4 billion on UK-based R&amp;D</b> in 2003. The 125% deduction alone is the equivalent of a flat 7.5% R&amp;D tax credit.</p>
<b>United States</b>	<ul style="list-style-type: none"> <li>Allows a maximum 10% incremental credit (a nominal 20% credit) for qualified R&amp;D expenditures in excess of a calculated base amount.</li> <li>An Alternative Incremental Research Credit formula is also available. The AIRC computation combines a three-tiered fixed-base percentage with a reduced three-tiered credit percentage.</li> <li>The business deduction for R&amp;D expenses must be reduced by the amount of any R&amp;D credit.</li> </ul>	<p><b>The U.S. R&amp;D credit expired on December 31, 2005.</b> Congress currently is considering legislation (H.R. 4297) that would reinstate a strengthened R&amp;D credit for up to 2 years. The strengthened credit includes a new Alternative Simplified Credit ("ASC") intended to provide an incentive for U.S.-based R&amp;D to more R&amp;D-intensive companies Under the ASC calculation, a company would be eligible for a credit of 12% of R&amp;D expenditures that exceed 50% of average R&amp;D expenditures over the prior three years.</p>