



Highlights of [GAO-10-136](#), a report to Committee on Finance, U.S. Senate

## TAX POLICY

# The Research Tax Credit's Design and Administration Can be Improved

### Why GAO Did This Study

The tax credit for qualified research expenses provides significant subsidies to encourage business investment in research intended to foster innovation and promote long-term economic growth. Generally the credit provides a subsidy for research spending in excess of a base amount but concerns have been raised about its design and administrability.

GAO was asked to describe the credit's use, determine whether it could be redesigned to improve the incentive to do new research, and assess whether recordkeeping and other compliance costs could be reduced. GAO analyzed alternative credit designs using a panel of corporate tax returns and assessed administrability by interviewing IRS and taxpayer representatives.

### What GAO Recommends

Congress should consider eliminating the regular credit option and adding a minimum base to the alternative simplified credit. GAO recommends that the Secretary of the Treasury clarify the definition of qualified research expenses and organize a working group to develop standards for documentation. Treasury agreed with our recommendation and plans to provide additional guidance in the next few months.

[View GAO-10-136](#) or [key components](#). For more information, contact James White at (202) 512-9110 or [whitej@gao.gov](mailto:whitej@gao.gov).

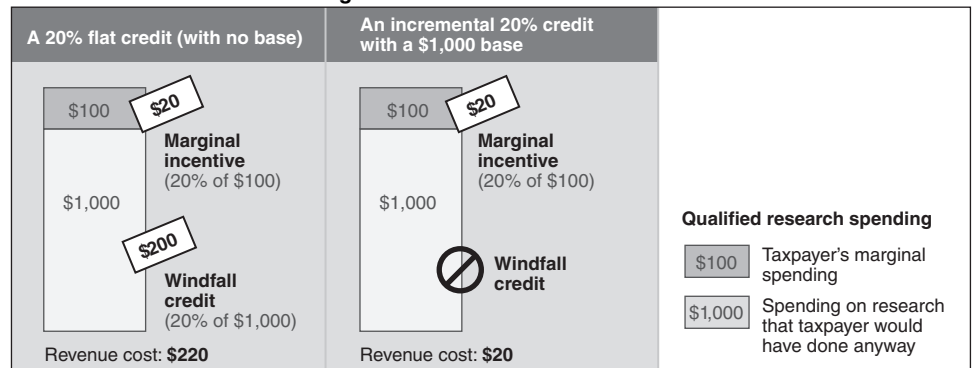
### What GAO Found

Large corporations have dominated the use of the research credit, with 549 corporations with receipts of \$1 billion or more claiming over half of the \$6 billion of net credit in 2005 (the latest year available). In 2005, the credit reduced the after-tax price of additional qualified research by an estimated 6.4 to 7.3 percent. This percentage measures the incentive intended to stimulate additional research.

The incentive to do new research (the marginal incentive) provided by the credit could be improved. Based on analysis of historical data and simulations using the corporate panel, GAO identified significant disparities in the incentives provided to different taxpayers with some taxpayers receiving no credit and others eligible for credits up to 13 percent of their incremental spending. Further, a substantial portion of credit dollars is a windfall for taxpayers, earned for spending they would have done anyway, instead of being used to support potentially beneficial new research. An important cause of this problem is that the base for the regular version of the credit is determined by research spending dating back to the 1980s. Taxpayers now have an "alternative simplified credit" option, but it provides larger windfalls to some taxpayers and lower incentives for new research. Problems with the credit's design could be reduced by eliminating the regular credit and modifying the base of the alternative simplified credit to reduce windfalls.

Credit claims have been contentious, with disputes between IRS and taxpayers over what qualifies as research expenses and how to document expenses. Insufficient guidance has led to disputes over the definitions of internal use software, depreciable property, indirect supervision, and the start of commercial production. Also disputed is the documentation needed to support a claim, especially in cases affected by changes in the law years after expenses were recorded. Such disputes leave taxpayers uncertain about the amount of credit to be received, reducing the incentive.

**An Illustration of How Base Design Affects Windfall Credits**



Source: GAO.