R&D Tax Credit Expansion Act (S.2207)

Senators Maggie Hassan and Thom Tillis

Section-by-Section

Section 1: Expanding Refundable Research Credit for New and Small Businesses

Refundable tax credits are vital for new and small businesses that are not yet profitable enough to have income tax liability. However, startups have limited access to the R&D tax credit because of restrictions on its refundability. Currently, the refundable R&D tax credit is capped at $250,000 and cannot exceed a business' Social Security payroll taxes, which are 6.2% of wages. Further, a small business is only eligible for the refundable R&D credit if its gross receipts are less than $5 million.

This section:

- Doubles the refundable R&D tax credit by increasing the refund cap from $250,000 to $500,000 and indexing the cap to inflation. The current credit cap reduces the international competitiveness of startups in the U.S. Canada has a fully refundable R&D tax credit with a $1 million cap, and Germany's new R&D tax credit is capped at $565,000 (€500,000).

- Expands the refundability of the R&D credit to cover *all* payroll taxes paid by businesses, which amount to 8.25% of payroll, including Social Security (6.2% of wages), Medicare (1.45% of wages), and unemployment payroll taxes (typically 0.6% of wages).

- Extends the refundable R&D credit to more small businesses by increasing the eligibility cap to $10 million in receipts from $5 million in receipts, which is lower than other small businesses thresholds. For example, in accounting method changes from the 2017 tax law, the small business threshold was raised from $5 million to $25 million in receipts.

Section 2: Targeting the Alternative Simplified R&D Credit to Innovative Startups

Startups commonly choose to take the "alternative simplified" R&D tax credit instead of the traditional R&D tax credit. However, while the traditional credit covers 20% of a business' current-year R&D spending that is above the greater of its historical average or half its current-year R&D spending, the alternative simplified credit only covers 14% of current-year R&D spending that is above half of its previous three-year average.

Further, while the refundable R&D credit is available to startups through the first five years of profitability, the design of the alternative simplified R&D credit limits incentives for startups in these first years of business. Currently, a startup that does not have R&D spending in each of the previous three years must take a 6% alternative simplified credit against current-year R&D, with no option to take the 14% alternative simplified credit for increases in R&D spending. This limits the incentive provided by the R&D credit to new startups that are quickly scaling up research budgets.

This section:

- Equalizes the alternative simplified R&D credit favored by startups with the traditional credit by increasing the alternative credit rate from 14% to 20% for new and small businesses that are eligible for the refundable credit.

- Expands the alternative simplified R&D credit for new startups and provides greater flexibility in the first five years of business. In the first year it claims the R&D credit, a new startup can take the full expanded 20% alternative simplified credit against current-year R&D spending. Then, through the first five years of profitability, a new startup without R&D spending in each of the previous three years can choose either:

  (1) a 10% credit against current-year R&D, or

  (2) the full expanded 20% credit for R&D spending that is above half of its previous three-year average, not counting any years without R&D spending.