

Tax Plan Would Have Mixed Impact on R&D

It would retain the R&D tax credit but remove some provisions that help draw venture capital into high-technology enterprises

In another time, Washington lobbyists for industrial research would declare war on a plan that junked the investment tax credit and stretched out depreciation schedules. But research and development companies are being careful not to protest too loudly President Reagan's sweeping proposals for overhauling the tax codes for fear of inviting something worse from Congress.

Overall, high-technology companies and firms involved in other forms of high-risk R&D have fared well relative to other sectors of industry. Some research and development companies that have been commercializing new technologies through tax shelters will be hurt. But research and development tax credits would survive, although in more limited form.

"We have been put into a situation where we are ecstatic at losing some of our tax benefits," says Kenneth C. O. Hagerty, vice president of government operations for the American Electronics Association (AEA). The Treasury Department plan issued in November by then-Secretary Donald T. Regan, he notes, would have hurt research firms more.

Whatever emerges from Congress, it is sure to be a mix of tax reform plans, plus concessions to special interests. Reagan's plan, however, will serve as an outline for the debate.

Corporate financial officers are still sifting through the 461-page proposal to assess their situations. But initial worse-case findings indicate that the near-term damage to the R&D sector would be slight. Although the 10 percent investment tax credit and accelerated depreciation would be done away with under the Reagan plan, the loss could be offset by proposals to:

- Lower corporate tax rates from 46 to 33 percent.
- Index depreciation schedules for inflation.
- Cut personal capital gains tax rates from 20 to 17.5 percent. (Corporate rates stay at 28 percent.)
- Adjust capital gains charges for inflation.
- Deduct 10 percent of dividends paid to shareholders.

For many fledgling research enterprises in the biotechnology and electron-

ics fields, for example, the plan to lower income taxes has little value because they operate at a loss. And one attractive tool for moving science from the lab to the marketplace—industrial revenue bonds—could no longer be used to underwrite pilot plants.

Still, the long-run effect of Reagan's proposals appears positive for established R&D companies, as well as new ventures, analysts say. Research costs incurred by small-scale entrepreneurs in garage laboratories would be recognized by the Treasury as real expenses. Pres-

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ently, they are not. Computer software designers also would benefit from a similar change.

"We are enthusiastic about the tax plan," says Charlotte LeGates, spokeswoman of the Computer and Business Equipment Manufacturers Association (CBEMA), which represents major companies such as IBM, Texas Instruments, Sperry, Digital, and Control Data. Many of these companies, LeGates notes, are highly taxed—paying on average 40 percent more than other companies. A lower corporate tax rate will help them, she notes. CBEMA officials say they do not expect their members' R&D efforts, or those of their customers, to be curtailed by the loss of the investment tax credit. "It is not a discretionary product for most of our customers," LeGates says. "They have simply got to buy it."

AEA's Hagerty agrees that the "application of electronics to improve productivity is pervasive throughout our economy." But the representative of 2500 electronics manufacturers—mostly smaller companies with less than 250 workers—wonders about the plan's effect on basic industry. The loss of the investment credit, he says, "is a significant hit" for the U.S. manufacturing sector.

Equally punishing is the proposed elimination of the accelerated cost recovery system. It has allowed for rapid depreciation of R&D equipment, machinery and other apparatus in 3 to 5

years. The Administration proposes to replace this with a less generous system. Comments Hagerty, "It is impossible for the high-tech sector to flourish in an environment of impoverished customers."

Emerging industries that rely on 11 to 40 percent energy tax credits to advance solar hot-water systems, photovoltaic grids and windmill farms will suffer. The Administration plans to kill the credits that manufacturers often need to compete economically with conventional energy sources.

Scott Sklar, legislative director for the Solar Energy Industries Association, says half of the domestic hot-water collector manufacturers will be forced under. Similarly, two-thirds of U.S. windmill manufacturers could fail. Also, domestic alcohol fuel production, which gets a 60 cent per gallon exemption from federal excise taxes, could be threatened after 1992 when the subsidy expires.

Venture capital will not dry up under the Reagan plan. But J. Leslie Glick, chairman of Genex, a Rockville, Maryland-based biotechnology firm is less confident about the outlook for venture capital. "The strongest factor that has affected real venture capital," he notes, "has been the fact that long-term capital gains taxes were lower than rates on ordinary income." The plan to cut maximum personal tax rates from 50 to 35 percent, says Glick, may make high-risk investment less attractive.

Limited partnership financing of products such as drugs, computers, software, and so forth would remain largely intact. "I think they [the Administration] have seen the value of them and have chosen to leave it pretty much alone," says Robert W. Pangia, director of technology finance for Kidder, Peabody & Co., Inc.

The months ahead, however, may prove that nothing is sacred—including research and development. Congress is concerned about the plan's effect on total revenue. Thus, there will be pressure to push up personal and corporate income tax rate caps and/or brackets. In addition, there will be intense pressure by manufacturers and other threatened groups to shift some of the pain to less affected sectors.—MARK CRAWFORD