When countries cut taxes for new ideas, capital investments rise

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Countries that offer tax breaks for corporate innovation realize greater economic growth than those with no such policies, according to a study from The University of Texas at Austin.

Researching seven countries from 1999 to 2017, the study's authors found that tax cuts for income resulting from intellectual property—such as patents, copyrights and trademarks—lead to greater capital investment and increased average pay for employees.

Published in *The Accounting Review*, the study was co-authored by Lisa De Simone, associate professor of accounting at the McCombs School of Business, and offers valuable insight for U.S. policymakers—who some argue have fallen short of enacting provisions that truly reward innovation.

"We showed the tangible results of tax cuts for intellectual property," said De Simone, who researches how tax policy influences where companies decide to put their offices, factories and people. "This is important information for policymakers as they consider changes to tax regulations."

Countries cutting taxes for intellectual property activity saw 2.6% higher levels of capital expenditures, including assets such as factories and machinery, compared with similar countries offering no tax incentive. But a significant rate cut—60% or more—was needed to show results.

Although the study found no bump in hiring or overall compensation from these policies, it did find increased average pay for employees, probably including higher-skilled research and development workers. Workers earned at least 46,844 euros more, equal to $49,525.

The study is good news for the 21 countries worldwide that—as of 2022—had adopted an "innovation box" policy, named for the box added to corporate tax returns that indicates income derived from innovation.

But the U.S. attempt at an innovation box—in the Tax Cuts and Jobs Act of 2017—is flawed, said De Simone, who researches how tax policies influence where companies decide to put their offices, factories and people.

"It is sort of like giving a reduced tax rate on innovative income that's being earned from overseas," said De Simone. "The idea was to try to increase investment in the U.S., but there's a problem with the way that policy was passed. It actually includes incentives to reduce investment in the U.S., based on the way the benefit is calculated.

"If it is changed to a true innovation box comparable to the ones we study in this paper, it could increase investment in the U.S.," said De Simone.

More information: Shannon Chen et al, The Effect of Innovation Box Regimes on Investment and Employment Activity, *The Accounting Review* (2023). DOI: 10.2308/TAR-2019-0338

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