CONNECT

Public Policy

An Innovation Agenda for the 112th Congress

For too long Congress has approached innovation policy in a fragmented and uncoordinated way. The result is that other countries are beginning to erode America's standing as the global innovation leader. In fact, the National Academy of Sciences recently warned Congress that other countries have copied America's innovation playbook and are aggressively implementing pro-growth policies at a rapid pace.

As the 112th Congress begins its transition, it has the opportunity to refocus its attention on consensus-building, job-creating policies that can accelerate innovation. To assist Congress in this endeavor, CONNECT submits a multi-faceted Innovation Agenda.

<u>Incentivize the investment of foreign profits into emerging technology research and commercialization:</u>

U.S. companies are sitting on hundreds of billions of dollars in foreign profits that are subject to a 35% tax rate if they are returned and put to use in the U.S. This high tax rate acts as a deterrent to bringing that capital back to the U.S. and expanding research and development which creates jobs.

Congress should incentivize the investment of those foreign profits back to the U.S. in a way that will infuse capital into early-stage innovation and emerging technologies which have especially struggled in the sputtering economy. Congress can draw money into the "valley of death" for these innovations by cutting the tax rate to 0% for foreign profits returning to the U.S. to fund external research and development through sponsored, purchased or collaborative R&D, funding proof of concept centers, or venture investments. Additionally, the 0% tax rate would be available for foreign profits directed to plant, equipment and infrastructure or to create/expand U.S. manufacturing, including investments in start-up manufacturing, contract manufacturing, or regional manufacturing clusters.

Such an infusion of capital would jumpstart the struggling economy without deficit spending, while also propelling technology commercialization efforts in the U.S.

Strengthen, simplify and make permanent the Research and Development Tax Credit while adding an Innovation Tax Credit:

There is broad agreement that the R&D tax credit should be simplified to broaden its usage. A strengthened and simplified credit should be made permanent. The evidence shows the credit leads to new jobs and technologies and helps the U.S. keep pace with global competitors. The permanent credit should be enhanced with a targeted credit to external research and development.

Congress should make the Alternative Simplified Credit permanent at 14% but for those companies that claim the permanent ASC, they should also be allowed to claim an Innovation Tax Credit of an additional 14%. The 14% Innovation Tax Credit could be claimed for R&D directed to fund external research and development through sponsored, purchased or collaborative R&D, funding proof of concept centers, or early stage venture investments.

The result would be that America's larger innovation leaders would be able to plan their R&D efforts with certainty and predictability for the long term while simultaneously infusing new capital into smaller and emerging innovators, their start-up companies, and their research lab partners.

Reform business accounting requirements that create unnecessary burdens to start-up innovation and require federal agencies to rescind innovation-hindering regulations:

Recently, small businesses have faced an increasing onslaught of regulatory impacts that create additional barriers to success in an already challenging market. In fact, the Small Business Administration's Office of Advocacy recently released a study finding that federal regulations cost small business 36% more than larger businesses.

President Obama has recognized the burden unnecessary federal regulations have on business, particularly small business, and issued an Executive Order requiring federal agencies to develop a plan to regularly review regulations to determine if they are detrimental to new business growth. Congressional committees should solicit input from the innovation community as to which regulations should be reviewed and slated for modification or repeal and then transmit those comments to the Administration.

While such reviews are ongoing in Congress, Congress should promptly focus on removing two particular small-business growth barriers to unshackle start-up businesses. First, Congress should eliminate the counterproductive Form 1099 reporting requirements which will add crushing paperwork burdens on a start-up's already limited resources. Additionally, Congress should review the Financial Accounting Standard 167 (FAS 167) and explore how to alleviate the consolidation burden for business activities of a related entity that are focused on early-stage venture investment, sponsored or collaborative R&D, capital expenditures, or manufacturing expansion.

Congress should also explore requiring all federal agencies to publish Innovation Impact Statements before the rules are finalized. The vast majority of states have laws that require state agencies to include a small business impact statement when they promulgate rules. Yet the federal government promulgates regulations on a daily basis without a requirement to analyze and explain how or whether federal regulations will impact innovation.

Congress should require all federal regulatory rulemaking procedures to include "Innovation Impact Statements" that would explain to the public 1) what impact the regulation will have on innovation, 2) what data and processes were used to reach the agency's conclusion on how innovation will be impacted, 3) the particular impact on emerging technologies in the industry or related industries, 4) the cost to start-up and high-growth businesses in the industry or related industries, and 5) the trends in the public comments related to the regulation's impact on innovation and start-up/high-growth business.

<u>Refashion the Small Business Administration and related federal agencies to increase their focus on the ingredients that spark innovation start-up companies:</u>

For years the SBA has been the destination for small businesses trying to survive in the American economy. As the economy changes to a new economy driven by innovation start-up companies and technological advancements, the SBA should expand its focus to embrace the new face of small business.

Congress should direct the SBA and other agencies involved in the Small Business Innovation Research/Small Business Tech Transfer programs to no longer exclude Angel and venture backed applicants that would otherwise qualify for grant programs.

The SBA should also consider how to value intellectual property as an asset for start-up business applicants that might not have other traditional assets. The SBIR/STTR programs should allow grant funding to be expended on protecting intellectual property including acquiring patents, copyrights and trademarks.

Additionally, the SBA should explore how to encourage applications from pre-venture investment companies also known as Product Definition Companies. These PDCs could be a subset of the successful Small Business Investment Company program and could receive federal limited partner matching funds which would be refunded to the Treasury upon exit.

Congress should also extend for a longer term or make permanent several provisions in the recently enacted Small Business Jobs Act and tax extenders legislation which are particularly helpful to innovation start-ups but which expire in 2011 including: provisions allowing for no capital gains tax for investments made in small businesses that are held for five years or more (coupled with a low general capital gains tax rate to encourage capital investment); increased thresholds for expensing capital investments and bonus depreciation; and the five year carryback of general business credits with AMT offset.

Create incentives for domestic manufacturing that work for new economies:

The old way of manufacturing, where manufacturing plants were tooled for a single use, is likely less efficient for the new innovation ecosystem because tech start-ups are unable to bear the debt burden of financing a manufacturing facility on their own. A more helpful model might be one where regional manufacturing facilities provide manufacturing outputs for multiple companies. Such a system has worked in other countries.

Congress should explore creating pilot projects to develop the model or grant states and multi-state regions regulatory waivers to allow for novel incentive and financing options. Creative public policy solutions will allow the American manufacturing base to return and again be a supporting pillar of American innovation.

Create Visas for STEM educated Ph.D.s and start-up entrepreneurs:

In addition to increasing the H-1B Visa cap, Congress should act on two pieces of legislation that will quickly impact the innovation economy by addressing critical workforce shortage issues while new efforts are undertaken to educate and retrain America's workforce.

It is no secret that American education has fallen behind and is in the process of retooling its focus to increase the number of American-born students earning degrees in Science, Technology, Engineering, and Mathematics fields. Additionally, local and state governments are exploring ways to find resources to retrain their workforces for the new economy. The federal government should loosen regulations and funding restrictions that limit municipal and state governments from creating incentives to improve STEM education and coordinate workforce training.

However, the effort to improve education and retrain America's workforce will take years before American innovation reaps the benefits of retooling efforts. Until then, the 112th Congress should pass the STAPLE Act (H.R. 1791 in the 111th Congress.) The STAPLE Act simply creates a new class of workforce visas for high-skilled, foreign-born Ph.D.s to stay and work in the U.S. in the STEM field of which they graduated. This new class of visa would not count against any existing visa cap.

Additionally, Congress should pass the Start-Up Visa Act (S. 3029/H.R. 4259 in the 111th Congress) which creates a new class of visas that will encourage foreign-born entrepreneurs to start companies in the U.S. with American-backed investors.

<u>Ensure Healthcare Reform regulatory implementation does not hinder innovations in fields like biotech, medical devices, genomics, pharmaceuticals, and wireless health</u>:

Although the Congressional debate on healthcare reform included a focus on decreasing costs administratively, little debate focused on healthcare innovation and the new frontier of healthcare diagnosis and delivery that can not only improve health outcomes but also reduce cost. As Congress continues to look at healthcare reform and monitors developing regulations, Congress should direct its focus to incubating the thriving but fragile innovation ecosystem in the medical world.

One place to start would be to repeal the new $20 billion tax on medical devices in the Healthcare Reform Act by passing the Medical Device Tax Repeal Act (H.R. 5616 in the 111th Congress.) The repeal will give certainty to investors looking at medical device start-up companies while also ensuring cutting edge devices are not stunted by an unnecessary tax.

Congress should conduct oversight on the approval processes at the Food and Drug Administration that have gotten slower and more expensive since Congress last visited the issue. Congress should also explore how to include the input and perspective of patient advocates early in the approval process.

<u>Create a federal Angel tax credit and prohibit the SEC from raising Angel investor standards</u>:

A majority of states have already enacted some form of Angel tax credits and are experiencing positive results. The 112th Congress should further spur Angel activity by creating a 25% federal Angel tax credit to augment credits states offer. However, the pool of Americans that qualify for the credit could be sharply reduced if the Securities and Exchange Commission (SEC) increases the standards to qualify as an Angel investor. In order to compliment the new federal Angel tax credit and increase the opportunity for start-up businesses to secure Angel capital, Congress should promptly repeal the provision in the recently passed Financial Reform Bill that gives greater power to the SEC to reduce the pool of Angel investors. Additionally, Congress should reclaim jurisdiction on setting Angel investor standards.

Allow full funding of the Patent and Trademark Office and prevent Congress from future fee diversion:

For the first time in several years, the 111th Congress diverted patent applicant user fees from the U.S. Patent and Trademark Office (PTO) to the tune of $53 million. That $53 million adds to a cumulative $750 million in diverted patent applicant and patent maintenance user fees Congress has diverted over the last two decades. This Congressionally-diverted revenue comes at a time when the patent application backlog is over one million and pendency for patent approval is nearly three years or more depending on the technology. The backlog and waiting time represents a barrier to market entry for a host of new products, new companies and new jobs that Congress is preventing from taking shape as companies wait for their patents. It is well accepted that a solid patent portfolio is the key to attracting investment capital to help a start-up tech company grow.

The 112th Congress should immediately appropriate to the Patent and Trademark Office the full $53 million that was diverted by the 111th Congress and pass legislation that will restrict Congress' ability to divert funds from the Patent and Trademark Office in future years. Congress should explore further what revenue streams are available to refund to the PTO the $750 million in previously diverted fees which will result in hundreds of thousands of new patents pulling the economy forward.

Keep the Internet free from innovation-hindering regulation while allowing for spectrum incentive auctions:

Congress should carefully scrutinize the recent regulations passed by the Federal Communications Commission related to managing the networks that keep the Internet open and accessible to ensure that the regulations promote innovation and investment into the next generation of communication technology. Congress should ensure it is hearing from start-up innovators to understand their critical innovation perspective.

Additionally, Congress should explore how best to allocate spectrum to market competition including spectrum incentive auctions which will help address impending spectrum shortage problems while also bringing new revenue into the U.S. Treasury.

Conclusion:

Some may question the cost of this Innovation Agenda as “scoring” in a way that adds to the nation’s sizable deficit and debt. Yet, Americans know that the motivation to play by the rules is tainted when the rules don’t appear to be fair or understandable. Thus, Congress should review the Budget Act of 1974 and consider how to properly account for the positive tax revenue benefits and related economic impact multipliers that these proposals will generate. A more robust fiscal impact analysis will reveal that this package of innovation proposals is quite affordable.

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CONNECT is a nonprofit organization that is dedicated to creating and sustaining the growth of innovative technology and related businesses. Since 1985, CONNECT has assisted in the formation and development of over 2,000 companies and is widely regarded as one the world’s most successful regional programs linking inventors and entrepreneurs with the resources they need for success.

CONNECT focuses on research institution support, business creation and development, entrepreneurial learning, access to capital, protection of intellectual property, public policy advocacy, awards, recognition and networking. More than 40 countries and regions have adopted the CONNECT model, including New York City, the U.K, Sweden, Norway, Denmark, Australia and India.

CONNECT is the recipient of the 2010 Innovation in Economic Development Award in the “Innovation in Regional Innovation Clusters” category presented by the U.S. Department of Commerce’s Economic Development Administration.

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