Abstract

With growing academic and policy interest in R&D tax incentives, the question about their effectiveness has become ever more relevant. In the absence of an exogenous policy reform, the simultaneous determination of companies' tax positions and their R&D spending causes an identification problem in evaluating tax incentives. To overcome this problem, we exploit a UK policy reform and use the population of corporation tax records that provide precise information on the amount of firm-level R&D expenditure. Using difference-in-differences and other panel regression approaches, we find a positive and significant impact of tax incentives on R&D spending, and an implied user cost elasticity estimate of around -2.3. This translates to more than a pound in additional private R&D for each pound foregone in corporation tax revenue.