UNITED STATES MANUFACTURING COUNCIL

October 15, 2014

The Honorable Penny Pritzker
Secretary of Commerce
U.S. Department of Commerce
Washington, DC 2020

Dear Madam Secretary:

The Manufacturing Council (Council) has taken the lead in identifying recommendations for tax policies that have great significance to small- and medium-sized enterprises (SMEs). As we conducted countless interviews and research on this topic, we decided to place an additional focus on companies organized as "pass through" entities (LLCs of S-corporations) within the manufacturing sector. The Council believes that manufacturing SMEs could realize greater growth and increased employment if their effective tax burden were lessened and stability in tax policy was implemented.

The vast majority of SMEs in the United States operate as pass through entities - approximately 81 percent of all manufacturers are structured in this manner according to a 2011 Ernst and Young Report. Increases in tax rates as a result of expiring or reduced tax mitigating policies has the undesirable effect of less capital available to these entities. With less capital available, SMEs are unable to invest in growing their enterprises or adding new employees to their payrolls. Currently, LLCs and S-corporations have an effective tax rate of 30 percent or higher, giving this group the highest tax burden globally.

Additionally, capital-intensive businesses, especially SMEs in manufacturing, need tax policies that are stable, consistent, and straightforward. Tax policy also affects small businesses' ability to borrow, particularly pass-through entities because lenders look more closely at cash flow and potential tax liability.

The Council recommends that Congress and the Administration make permanent and enhance several current tax policies. Currently, these policies require continual re-authorization by Congress. As a result, companies experience the unpredictability as to whether or not they will be able to take advantage of these tax options while planning their futures. Manufacturers, especially SMEs, need permanence and stability in the tax code to plan effectively and leverage these policies.

The Council believes strongly that SMEs could grow faster and hire more employees if the following policies are made permanent and enhanced: the Research and Experimentation (R&E) Tax Credit, Section 179 Depreciation Deduction, and Section 199 Deductions.

R&E Tax Credit

The R&E Tax Credit was introduced in 1981 as an incentive to encourage innovation among U.S. manufacturers. As noted in our letter of January 14, 2014, since its introduction, this R&E tax credit has been extended 14 times and expired 8 times. The Council supports the Administration's proposal to expand, simplify, and make permanent the R&E Tax Credit. We ask however that the Administration's proposal be further enhanced in two ways. First, that instead of increasing the credit from 14 percent to 17 percent, that it be the increased from 14 percent to 20 percent. Second, as during the Small Business Jobs Act of 2010 (which has since expired), SMEs should be allowed to apply general business credits, including the R&E Tax Credit, to be used against (or as a preference) in Alternative Minimum Tax (AMT) calculations. Today, R&E Tax Credits cannot be used to offset the AMT as they can for regular taxes. Since most pass through SMEs are subject to AMT, any R&E Tax Credit available to them provides no current tax benefit or research and development incentive. This year the Senate Finance Committee passed a bill that would allow the R&E Tax Credits to offset AMT (as they did in 2010). Should this legislation be fully enacted, it would be of great benefit to SMEs and would provide a more immediate reward for engaging in research and development activities.

An alternative to changing the AMT provision would be to allow manufacturing companies to take a credit against annual payroll taxes with their unused R&E Tax Credits. Legislation with this provision has been introduced by Senator Warner and could offer an alternative mechanism for SMEs to access the advantages of R&E Tax Credits from which they are currently exempt because of the AMT. This credit has been a proven incentive for spurring private sector investment in research and experimentation which pays enormous dividends by fueling innovation and new product development as well as creating domestic high-paying research and development jobs.

Section 179 Depreciation Deduction

The Section 179 Depreciation Deduction (Deduction) has been one of small businesses' most valuable tax planning tools. The Council understands the Administration's 2015 Fiscal Year budget proposes to permanently extend Section 179 Depreciation Deductions at $500,000. This is a vast improvement over the current situation in which the Deduction reverted to a $25,000 limit at the beginning of this year.

We would ask that the Administration and Congress make permanent the Section 179 Depreciation Deduction at an increased level of $1 million, which has been suggested in the President's Framework for Business Tax Reform. Making the Deduction permanent would promote business investment and economic growth by reducing the uncertainty created by having a temporary tax law that needs to be reauthorized periodically. Small businesses have taken advantage of this provision in the past, saving tax money that they then have invested in hiring more employees and supporting further growth.

We would also ask that the previous 50 percent Bonus Depreciation and the $2 million phase-out be reinstated and remain part of the new Section 179 Depreciation Deduction tax policy. We would also recommend that Congress and the Administration consider a provision to adjust levels for inflation each year and make these changes retroactive for all of 2014.

This Section 179 Depreciation Deducation is a tremendous incentive for businesses to invest in new equipment. For an SME this Deduction often makes the difference as to whether or not they can afford to make needed capital expenditures in order to grow.

Section 199 Deduction

The Section 199 Deduction represents valuable tax mitigation for businesses that perform their manufacturing activities in the United States (which is the case for the majority of SMEs). Currently the benefit is a 9 percent tax deduction on income derived from domestic "qualified production activities." If the Administration and Congress cannot adopt new tax policy that results in a reduction of the top statutory rate of income taxes, the Council would ask that the domestic production deduction under Section 199 be made permanent at a rate of 11 percent.

As noted in the Council's letter of January 14, 2014, the Section 199 Deduction is a unique policy that encourages manufactures to invest in the U.S. economy. The Section 199 Deduction is allowed for both the regular tax and the AMT for individuals allowed to partners (LLCs) and the owners of S-corporations.

The Section 199 Deduction equals a percentage of the net income from eligible activities; however, the amount of the deduction is limited to 50 percent of wages paid to employees (reported on Form W-2) and attributable to domestic production. The Council's recommendation is that this limitation be removed and that 100 percent of wages attributed to domestic production qualify in the calculation of the deduction.

Simplification of this tax legislation is very important so as not to disadvantage SMEs. The complicated nature of the Section 199 Deduction puts an undue burden on SMEs for whom legislation such as this is designed to benefit.

The Council believes that by making these changes to the Section 199 Deduction, domestic manufacturing will be incentivized and companies will be enabled to expand their workforce.

In summary, many believe that SME manufacturers are the engines of our economy. Reducing the effective tax burden, providing stability in tax policy, and simplifying the tax code allows manufacturers, particularly SMEs, to re-invest in their businesses and create new jobs. Your support of these tax policy recommendations is a way to provide real support and benefit to small and medium private and pass-through manufacturing businesses in our country. In return, these SMEs will have the ability to grow their businesses, create jobs for our manufacturing sector, and produce sustainable and meaningful economic growth for our country.

The Manufacturing Council thanks you for your considerations and your willingness to support a tax system that encourages investment in manufacturing, supports economic growth, and enables small-and medium-sized businesses to continue generating the majority of new manufacturing jobs.

Sincerely,

Mark Chandler
Chair, Tax Policy and Export Growth Subcommittee

Steve Braig
Vice-Chair, Tax Policy and Export Growth Subcommittee

Mike Laszkiewicz
Chair, Manufacturing Council

Mary Isbister
Vice-Chair, Manufacturing Council