



UNITED STATES MANUFACTURING COUNCIL

May 18, 2016

The Honorable Penny Pritzker
Secretary of Commerce
U.S. Department of Commerce
Washington, D.C. 20230

Dear Madam Secretary:

The United States has the highest corporate tax rates in the industrialized world, which impedes economic growth, inhibits manufacturers from being able to obtain reasonable returns from their capital investments, and reduces U.S. manufacturing competitiveness. Comprehensive tax reform is essential to increasing productivity and output for U.S. manufacturing and encouraging economic growth. The urgent need for tax reform was highlighted by past Manufacturing Councils and the White House's Advanced Manufacturing Partnership report in 2012¹, as well as by the National Association of Manufacturers in its 2015 report on the need for a more competitive corporate tax system.²

It is the Council's opinion that the current U.S. corporate tax system, including the treatment of the numerous manufacturing companies organized as C Corporations, S Corporations, and limited liability corporations, places American companies and domestic producers at a significant competitive disadvantage. Our tax system is out of alignment with the more competitive, export-driven tax systems of our global trading partners. A more competitive U.S. tax system would encourage greater investment and innovation in the U.S. manufacturing sector and would help to boost manufacturer jobs and wages.

The Council acknowledges that the issues involved in comprehensive tax reform are complex, that there are many diverse opinions on the subject, and that tax reform is politically difficult. However, the Council believes it is critical to overcome these obstacles and achieve real tax reform. Consider, for example, that smaller businesses have provided some of the fastest employment and output growth for the United States, yet receive some of the worst tax treatment under the current code. We hope to highlight how critical tax reform is and what is at stake for the U.S. economy.

According to BLS and Census data, 98 percent of America's manufacturing firms are small. More than one in three Americans who work in the manufacturing sector are employed by a business which employs fewer than 500.³ In addition, most large manufacturing companies in the United States rely on small and medium-sized manufacturers as essential suppliers. Oftentimes, tax issues affect manufacturers of different sizes in different ways. For this reason, we provide a summary below of recommendations to ensure that smaller businesses' needs are appropriately addressed along with the needs of larger businesses.

The Council agrees and re-affirms the last Council's recommendations that focus on manufacturing tax reform. We recommend and commit to work with the Commerce Department and the Administration to:

¹ Report to the President, "*Capturing a Domestic Competitive Advantage in Advanced Manufacturing*," July 2012, https://www.whitehouse.gov/sites/default/files/microsites/ostp/amp_final_report_annex_4_policy_july_update.pdf

² The National Association of Manufacturers, "*The United States Needs a More Competitive Corporate Tax System*," 2015, <http://www.nam.org/Data-and-Reports/Reports/MAP1---Tax-Competitiveness.pdf>

³ <https://www.sba.gov/blogs/small-manufacturers-driving-job-creation-economic-growth>

- 1) **Move to a competitive system for taxing multinational firms.** The current U.S. system of taxing U.S. corporations on their worldwide income is in sharp contrast to the territorial tax systems of other countries. The U.S. system was developed at a time when the United States was the primary source of capital investment and dominated world manufacturing. However, the United States faces increasing global competition for investment. The current worldwide tax system places U.S. companies at a disadvantage and distorts capital allocation by treating income earned and retained outside the U.S. differently than income earned or reinvested within the United States. Our recommendation to move to a hybrid tax system, with base erosion protections, is supported by numerous institutions and commentators, including among them the White House, the U.S. Treasury Department, the Senate Finance Committee, and the House Ways and Means Committee.
- 2) **Reduce nominal top tax rates applicable to all manufacturing income to a more globally competitive level, effective rate of less than 25 percent.** The current U.S. nominal corporate tax rates are the highest in the developed world, higher than any other OECD member state. The OECD non-U.S. average rate is 25 percent, and is forecast to fall to 24.2 percent this year based on already enacted reductions, compared to the U.S. 35 percent nominal rate. The Council acknowledges the need to accommodate certain concerns and craft a balanced approach in reducing the tax rate, including ensuring that a reduced corporate rate does not cause an unmanageable revenue loss.
- 3) **Maintain effectiveness of and expand (or add) programs such as IC-DISC that benefit small and medium sized manufacturing companies.** The IC-DISC program provides important export tax incentives to small and medium companies. By offsetting risk and improving competitiveness with export tax credits, the IC-DISC program assists U.S. manufacturers in reaching global markets. Being able to compete effectively for export opportunities allows small to medium-sized U.S. manufacturers to provide more jobs and make additional investments, growing the core of American manufacturing.
- 4) **Retain the domestic production deduction under Section 199 which provides a tax benefit when goods are manufactured in the United States.** Given the manufacturing multiplier effect on job creation, as documented in numerous studies, strengthening the domestic production deduction under section 199 is a policy that encourages manufacturers to invest in the U.S. economy. Additionally, it is important to simplify the required computations in order to avoid disadvantaging Subchapter S and LLC businesses, many of which are small businesses. Subchapter S and LLC businesses, both large and small, report taxes on the owner's or member's personal income taxes and the calculations used to capture the section 199 deduction are excessively complicated in relation to the owner's/member's compensation as well as certain other below-the-line expenses. Often times, this makes it too onerous for the many small businesses organized as S Corps and LLCs to take advantage of the Section 199 tax credit. The National Association of Manufacturers (NAM) estimates direct manufacturing employment at 11.8 million and indirect employment at 6.8 million. This means a typical manufacturing facility that employs 100 people actually supports 158 jobs.
- 5) **Maintain interest expense deduction.** Throughout its history, the federal tax code has permitted businesses to deduct interest in computing taxable income. Like rent, wages, supplies, and other such expenses, interest is an ordinary cost of doing business. Limiting the ability of companies to deduct interest expense would increase the effective cost of borrowing and make it more difficult for companies to finance expansions and new equipment in the United States.

In addition to these five specific recommendations, the Council also feels strongly that elected and appointed decision makers could benefit from greater familiarity and a deeper understanding of the effect of taxation on the vitality and growth of U.S. manufacturers and job creation. Better information, provided by an honest broker, could lead to improved public policy decisions. Accordingly, the Council recommends that the U.S. Department of Commerce undertake to provide or commission two studies to provide future guidance to policy makers:

- a) **A comprehensive study of the total tax burden imposed on manufacturing in the United States. The study should include all types of taxes such as income, sales, property, use, etc., and should look at all levels of government: federal, state and local. Ideally the study will included a segmented look across large and small**

manufacturers. We all agree that a vibrant and responsive manufacturing sector is crucial to U.S. economic well being and middle class employment opportunities. Understanding the impact and effect of tax policy as it is applied to manufacturing is critical to maintaining the economic health and competitiveness of this sector. In addition, by offering a segmented look at the total tax burden across various sized manufacturing businesses with various corporate structures, decision makers will have a powerful tool to evaluate tax burdens and policy decisions that can help attract and grow manufacturers of all sizes.

Unlike most of our trading partners who only develop tax policy at the national level, U.S. manufacturing companies are subject to uncoordinated taxation by three discreet levels of government: federal, state and local. These three layers of taxation all combine to have a material effect on U.S. manufacturing competitiveness. Many of the state and local taxes that affect manufacturers are “legacy” tax regimes that might have made sense when the U.S. dominated manufacturing globally with little international competition. We are not questioning the right of states and localities to tax manufacturing activity, nor are we arguing that the U.S. Department of Commerce should question state and local taxing rights; we are suggesting that for elected officials at all levels to make good policy decisions they need complete, credible, accurate, and trustworthy data on what is the total tax burden on manufacturers and manufactured products.

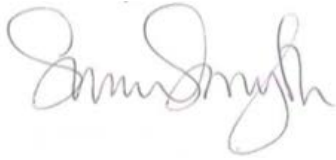
The U.S. Department of Commerce is uniquely positioned as a trusted, credible source to provide meaningful data to decision makers from U.S. trade representatives to Congressional leaders to state officials all the way down to local mayors on the total tax burden that is imposed on manufacturers and manufactured goods by their various tax policies. As officials consider trade policy, or tax policy, or employer mandates, they should be guided by quality information on the costs currently imposed on U.S. manufacturing.

Therefore, we recommend the U.S. Department of Commerce undertake or hire a qualified university partner to undertake a study to calculate by state or preferably by MSA (Metropolitan Statistical Area), the total tax burden being borne by U.S. manufacturers of various sizes in that state or MSA.

- b) ***A similarly comprehensive study of the total imputed tax burden on American exports and a comparison with the tax burden on imported product highlighting the competitive advantages of various global tax systems.*** The expansion of Value Added Tax (VAT) or Border Adjustable Tax (BAT) tax schemes among nearly all of our global trading partners combined with the policy of many of those partners to refund VAT/BAT taxes on exported products puts U.S. manufactured products at a significant disadvantage in world markets. Many trading partners appear to be moving to more consumption-based taxes vs. income-based taxes, and when they are refunded at export while levied on import, it provides a significant boost to exports as well as to domestic producers who enjoy reduced income tax burdens. An authoritative study comparing the impact of these different taxing regimes could provide important guidance to elected and appointed leadership and provide important information to guide future trade negotiations.

Madam Secretary, we are deeply appreciative of your commitment to work together with the manufacturing industry to help create a tax system that encourages U.S. based jobs, investment in manufacturing assets and intellectual property, and strengthens our ability to export and compete on the global playing field. We believe U.S. manufacturing is the golden goose that will continue to provide immense wealth creation and unparalleled upward mobility now and for future American generations. Comprehensive tax reform is critical to the U.S. manufacturing industry, and it remains an issue of great importance and urgency to our national economy deserving of sustained attention and calls for action.

Respectfully submitted,



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