



James C. Greenwood
President & CEO

March 20, 2013

The Honorable Jim Gerlach
Chair
Manufacturing Tax Reform Working Group
Committee on Ways & Means
United States House of Representatives
Washington, DC 20515

The Honorable Linda Sanchez
Vice Chair
Manufacturing Tax Reform Working Group
Committee on Ways & Means
United States House of Representatives
Washington, DC 20515

Dear Congressman Gerlach and Congresswoman Sanchez,

On behalf of the Biotechnology Industry Organization (BIO) and its more than 1,100 members, I am writing in strong support of Congressional efforts to reform the tax code, lower the corporate tax rate, and make the U.S. tax system more competitive given our global challenges.

As the Manufacturing Working Group considers reforms, it is imperative that policymakers recognize the importance of biotechnology and innovation to America's long term economic growth. It is vital that biotech companies at all stages of development are supported as they conduct vital R&D, from established commercial leaders facing a burdensome worldwide tax system to innovative pre-revenue businesses.

America currently leads the world in biotechnology, and BIO member companies are supporting high-quality jobs in all 50 states while also leading the search for groundbreaking medicines, renewable fuels, and other innovative technologies. Nationwide, biotech companies employ 1.61 million Americans and support an additional 3.4 million jobs. Innovative discoveries in biotech labs across the country have the potential to improve the quality of life for millions of Americans.

Multinational biotech innovators often face a competitive disadvantage due to the high U.S. corporate tax rate and America's burdensome worldwide tax system. BIO supports lowering the corporate rate and moving the U.S. to a territorial tax system in order to speed the delivery of innovative technologies to patients and consumers and stimulate job creation here in America.

However, the majority of companies in the biotech industry are pre-revenue small businesses. Tax reform that is defined only by a broader tax base and a lower tax rate will not do enough to spur innovative, early-stage research in these emerging companies. These research-intensive biotechs are at the front end of a development timeline that will take over ten years and cost them more than \$1 billion. Virtually all of this process will take place before a company has product revenue, so lowering tax rates and broadening the tax base will not help small biotech companies in the near term. Tax reform should recognize the unique nature of pre-revenue companies that are not yet taxpayers, but aspire to be. As the Manufacturing Working Group considers reforms to the tax code, it is vital that it address proposals to protect and promote small business innovation.

The tax code can support biotech research by providing incentives for other companies, individuals, and funds to invest in small businesses. The \$1 billion biotech development process is funded almost entirely by private investors, so any incentives to spur capital



Attachment I: Promoting Innovation Through Tax Reform

BIO supports a U.S. tax code that recognizes innovation as a crucial part of the 21st century American economy. By itself, a lower corporate tax rate will not support growth and innovation in America's biotech companies, most of which are pre-revenue. Comprehensive tax reform should go further than "broadening the base and lowering the rate." Instead, policymakers should specifically promote innovative research-intensive businesses through incentives for other companies, individuals, and funds to invest in small companies and support their research.

Section 469 R&D Partnership Structures

Background: In the 1980s, the growth of the biotech industry was fueled in part by the ability of growing companies to use R&D Limited Partnerships, in which individual investors would finance R&D projects and then utilize the operating losses and tax credits generated during the research process. These structures gave investors a tax incentive to support biotech research, which is entirely dependent on outside investors but often too risky or expensive to attract sufficient investment capital. The enactment of the passive activity loss (PAL) rules in 1986 prevented investors from using a biotech's losses to offset their other income, thus removing the incentive to support vital research.

Proposal: BIO supports a limited exception from the PAL rules for R&D-focused pass-thru entities. Under the High Technology Small Business Research Incentives Act, small companies would be able to enter into a joint venture with an R&D project's investors. The losses and credits generated by the project would then flow through to the company and investors, who would be able to use the tax assets to offset other income. Relaxing the PAL rules to allow investors to enjoy a more immediate return on their investment, despite the long and risky timeline usually associated with groundbreaking research, would incentivize them to invest at an earlier stage, when the capital is most needed.

Section 382 Net Operating Loss (NOL) Reform

Background: Biotechnology companies have a long, capital-intensive development period, meaning that they often undergo a decade of research and development without any product revenue prior to commercialization. During this time period, companies generate significant losses, which can be used to offset future gains if the company becomes profitable. However, Section 382 restricts the usage of NOLs by companies which have undergone an "ownership change." The law was enacted to prevent NOL trafficking, but small biotech companies are caught in its scope – their reliance on outside financing and deals triggers the ownership change restrictions and their NOLs are rendered useless.

Proposal: BIO supports reform of Section 382 to exempt NOLs generated by qualifying research and development conducted by a small business from Section 382. This change would allow small companies the freedom to raise capital for innovative research without fear of losing their valuable NOLs. Additionally, the ability of a small business to maintain its NOLs makes it more attractive to investors and purchasers looking to take its research to the next level.

Section 1202 Capital Gains Reform

Background: Section 1202 allows investors to exclude from taxation 100% of their gain from the sale of a qualified small business (QSB) stock if they hold the stock for five years. This provision was designed to promote investment in growing businesses, but its overly restrictive size requirements prohibit innovative biotech companies from accessing valuable



investment capital. Currently, QSBs must have gross assets below \$50 million. The high costs of biotech research, coupled with valuable intellectual property (IP) and successive rounds of venture financing, often push growing biotechs over the \$50 million gross assets limit and out of the QSB definition.

Proposal: BIO supports changing the QSB definition to include companies with gross assets up to \$150 million, with that cap indexed to inflation. BIO also supports excluding the value of a company's IP when calculating its gross assets. These changes would allow more growing innovators to attract investors to fund their vital research. Providing incentives to invest in biotech research will increase the innovation capital available to research-intensive businesses and speed the development of groundbreaking medicines.