

March 19, 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,

As representatives of small businesses that devote significant assets to innovative research and development (R&D), we support 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 Congress considers reforms, it is imperative that policymakers recognize the importance of both large and small business innovation to America's long term economic growth. America currently leads the world in groundbreaking R&D, and small companies are also at the forefront of the effort. Small businesses are also the creators of most new jobs.

Companies leading the research-based economy are supporting high-quality jobs in all 50 states while also leading the search for the next scientific breakthroughs or revolutionary technologies. Many of these companies are small businesses which devote their time and assets to important R&D, pushing the boundaries of science and technology during a long and difficult development process.

Comprehensive tax reform that fosters innovation by growing companies could spur investment and support the growth of an R&D-intensive, modern American economy. Many emerging research-centric businesses do not generate revenue, and therefore do not have tax liabilities at the early stages of their development. Lowering tax rates and broadening the tax base will not help these companies in the near term. Considering the long term significance of innovative small businesses to the economy, we believe that tax reform should address this segment of the economy.

Comprehensive tax reform has the potential to inspire job growth in key R&D sectors and reverse recent trends that have seen research and manufacturing employment leave the U.S. In order to create domestic jobs and ensure that the U.S. maintains its global leadership, tax reform must go further than broadening the base and lowering the rate. Innovation by pre-revenue companies must be promoted if the U.S. is going to lead the way in the global economy. As the Manufacturing Working Group considers reforms to the tax code, it is vital that it address proposals to protect and promote pre-revenue small business innovation.

Attached please find our proposals to reform the passive activity loss rules under Section 469, treatment of net operating losses under Section 382, and small business capital gains tax rates under Section 1202. We believe these targeted reforms will spur capital formation for small businesses and support vital pre-revenue innovation.

We look forward to working with you as Congress undertakes this important effort.

Sincerely,

AdvaMed

Biotechnology Industry Organization

Center for Innovative Technology

Commercial Spaceflight Federation

CONNECT

Electricity Storage Association

NanoBusiness Commercialization Association

National Council for Advanced Manufacturing

Neurotechnology Industry Organization

Water Innovations Alliance

██████████ ████████████████████
██
██

The **Advanced Medical Technology Association (AdvaMed)** is a trade association that leads the effort to advance medical technology in order to achieve healthier lives and healthier economies around the world and acts as the common voice for companies producing medical devices, diagnostic products and health information systems. AdvaMed advocates on a global basis for the highest ethical standards, timely patient access to safe and effective products, and economic policies that reward value creation.

The **Biotechnology Industry Organization (BIO)** is the world's largest biotechnology trade association. BIO provides advocacy, business development, and communications services for more than 1,100 members worldwide. BIO's mission is to be the champion of biotechnology and the advocate for its member organizations – both large and small.

The **Center for Innovative Technology (CIT)** creates technology-based economic development strategies to accelerate innovation, imagination and the next generation of technology and technology companies. Created in 1985, CIT, a non-profit corporation, plugs gaps at the earliest stages of the Innovation Continuum – commercialization and seed funding – as it helps entrepreneurs launch and grow high-growth technology companies and create high-paying jobs for the future. To facilitate national innovation leadership and accelerate the rate of technology adoption, CIT creates partnerships between innovative technology start-up companies and advanced technology consumers. Lastly, CIT builds the infrastructure for new innovation economies with expert broadband strategies.

The **Commercial Spaceflight Federation (CSF)** is the industry association of leading businesses and organizations working to make commercial human spaceflight a reality. The mission of the Commercial Spaceflight Federation is to promote the development of commercial human spaceflight, pursue ever higher levels of safety, and share best practices and expertise throughout the industry.

CONNECT is a program that catalyzes the creation of innovative technology and life sciences products by linking inventors and entrepreneurs with the resources they need for success. Since 1985, CONNECT has assisted in the formation and development of more than 3,000 companies. CONNECT focuses its efforts on accelerating the commercialization of new technology and life sciences products.

The **Electricity Storage Association (ESA)** is the world's premier energy storage trade organization. Our members include utilities, technology developers and manufacturers, national laboratories, system designers and academia using the ESA as the leading forum to promote a better understanding of the benefits of storage in the electricity grid. Long considered the leading technical resource on storage related issues, ESA members actively engage in numerous activities to promote the development and commercialization of competitive and reliable energy storage systems.

The **NanoBusiness Commercialization Association (NanoBCA)** is a trade organization dedicated to promoting the commercialization of nanotechnology and helping companies bring affordable, life-improving nanotech products to the market.

The **National Council for Advanced Manufacturing (NACFAM)** is an industry-led, policy research organization, working collaboratively with industry, education, government, and trade/professional associations since 1989 to accelerate the development of advanced technologies and related workforce skills.

The **Neurotechnology Industry Organization (NIO)** is the first and only trade group that lobbies on behalf of neuroscience-focused companies, brain research institutes, and patient advocacy groups across the spectrum of neurological disease, psychiatric illnesses, and nervous system injuries.

The **Water Innovations Alliance (WIA)** is the public policy voice of the world's water researchers, technologists, and innovators. The Alliance's role is to advocate policies that promote the aggressive development of water technologies and innovations across all sectors and users of water by creating new market opportunities, increasing funding, strengthening research and development programs, removing regulatory and market barriers and improving education, communication, and outreach efforts.

Attachment I: Promoting Innovation Through Tax Reform

The Coalition of Small Business Innovators (CSBI) 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 small businesses, many 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: Prior to 1986 tax reform, many growing companies attracted investors by using 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 high tech 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 company's losses to offset their other income, thus removing the incentive to support vital research.

Proposal: CSBI 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: Innovative companies often have a long, capital-intensive development period, meaning that they can 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 high tech 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: CSBI 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 companies from accessing valuable investment capital. Currently, QSBs must have gross assets below \$50 million. The high costs of research, coupled with valuable intellectual property and successive rounds of venture financing, often push growing innovators over the \$50 million gross assets limit and out of the QSB definition.

Proposal: CSBI supports changing the QSB definition to include companies with gross assets up to \$150 million, with that cap indexed to inflation. CSBI 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 high tech research will increase the innovation capital available to research-intensive businesses and speed the development of groundbreaking technologies.