

Manufacturing Tax Reform Working Group: Questions on Tax Reform

U.S. House Committee on Ways and Means

Q: From the perspective of your industry/company, which provisions in the current Tax Code do you consider the most important to manufacturers?

A: Accelerated depreciation, research credit, domestic manufacturing deduction, LIFO.

Q: Of these tax provisions, in the context of comprehensive tax reform, which of these would you be willing to give up in return for a lower tax rate?

A: We would be willing to give up accelerated depreciation and LIFO; however, depreciation should not be slowed to such an extent that the cost of a productive asset may not be recovered within the asset's reasonable useful life. Ford conducts very substantial research and high-wage manufacturing activities in the U.S. However, if the rate were lowered very substantially, we would be willing to give up the research credit and domestic manufacturing deduction as well. Ford is unwilling to give up deductibility of research expenses. Capitalization and amortization of research expenses would result in negative cash flow and an unworkable business model for a manufacturer like Ford that continually incurs R&D expense in response to changing regulatory requirements and opportunities for technological advancement .

Q: Are the tax incentives available to US manufacturers similar to the tax incentives available to your international competitors? If not, please provide examples.

A: Yes, most countries provide incentives for manufacturing activity including R&D and capital investment. The recent trend—especially as to R&D—has been for other countries to enhance their offered incentives, either by enacting new incentives or changing the structure of prior incentives to make them more effective. For example, the UK recently changed from a super deduction for research expenses to a refundable research credit. A refundable credit is particularly attractive for a manufacturer like Ford that endures business cycles that affect year-to-year profitability. Ford's history has been that it engages in the desired activity, earns the research credit, and then carries the credit forward for years until it can finally be used to reduce tax payments; this makes it a less effective incentive.

Q: In general, what impediments are there in the US Tax Code that makes it difficult for American manufacturers to compete in a global market place?

A: Restrictions on tax incentives like the domestic manufacturing deduction, research credit and accelerated depreciation diminish their effectiveness as incentives. For instance, the domestic manufacturing deduction is not available during any year in which an NOL is generated or to which an NOL is carried from a prior year. As a result, the manufacturing deduction does not provide any benefit to companies that are conducting all the necessary activities, but in the down part of a business cycle or

early years of recovery. Research credits are not permitted to reduce Alternative Minimum Tax and may only reduce a portion of regular tax. As a result, they often do not generate cash benefit for years and years, seriously diminishing their incentive effect. Likewise, accelerated depreciation provides no cash benefit during a downturn in a business cycle and thus provides no incentive effect.

Q: Are companies at a competitive disadvantage due to the fact that the US currently has the highest statutory corporate rate of all OECD countries?

A: For their U.S. operations, U.S. corporations may be at a competitive disadvantage as compared to foreign-based competitors to the extent they may be unable to take advantage of debt and transfer pricing structures available to foreign corporations. For their foreign operations, U.S. corporations may be at a disadvantage compared to foreign competitors to the extent U.S. corporations' foreign earnings may be subject to the higher U.S. tax rate. However, the main consequence of a high rate is that the U.S. is at a competitive disadvantage in attracting investment from both U.S. and foreign-based corporations. Lowering the corporate tax rate is the most simple, effective and efficient way to relieve the tax burden on U.S. companies.

Q: Would eliminating the tax expenditures listed in #1 and replacing such expenditures with a meaningful reduction in the statutory corporate tax rate help manufacturers to better compete domestically and internationally? What about for pass-through entities and smaller manufacturers if the individual marginal rate is reduced?

A: Ford views a lower rate as preferable to certain provisions affecting the timing of income like accelerated depreciation and LIFO. Provisions affecting timing have an incentive effect only to the extent a taxpayer is currently profitable. Also, certain provisions, like bonus depreciation, tend to be made effective for years for which it is already too late for a large corporation to expand investment. Eliminating provisions that permanently affect tax like the research credit and domestic manufacturing deduction would help manufacturers compete only to the extent the rate reduction significantly exceeds the benefit of the provision.

Q: Should any of the manufacturing tax provisions be modified to ease the administrative burden of compliance such as R&D? If so, how should such provisions be modified?

A: Yes, the research credit should be modified to equal a straight percentage of qualified expenditures, *i.e.*, the concepts of a base period and incrementality should be eliminated. Also, the percentage of tax liability and minimum tax limitations on use of research credits should be eliminated. The domestic manufacturing deduction should be available without regard to net operating losses.

Q: Can you discuss how your company relies on or takes advantage of certain cost recovery provisions in the tax code, such as accelerated depreciation? How do these recovery methods help manufacturers [manage] cash flows? Do you think there are areas in the rules governing depreciation that should be evaluated or modified in tax reform?

A: Depreciation affects only the timing of income and Ford's reliance on accelerated methods depends almost entirely on where we are in the business cycle. Ford will forego accelerated depreciation during years for which it has losses or NOL/credit carryovers. Accordingly, accelerated depreciation is not always a tool that incentivizes investment. The very periods during which incremental investment decisions are most difficult (economic downturns) tend to be the very periods during which incremental investment produces no cash flow benefit. Generous carryback provisions can sometimes produce positive cash flow benefit, but even this is not assured in the case of a prolonged downturn. It is, however, important that the cost of an investment is permitted to be recovered within the investment's likely useful life.

Q: How can the Tax Code better encourage manufacturers to innovate and develop new products here in the US?

Many of our global competitors utilize patent boxes or "innovation boxes" which essentially provide tax benefits for the commercialization of successful R&D. Do you believe implementing such a structure in the US would help manufacturers compete globally?

A: Ford believes the research credit with its focus on qualified activities is an effective incentive to innovate and develop new products in the U.S. Congress could simplify and enhance the research credit to even better encourage U.S. innovation and development activities. A patent box-type regime may serve as a useful incentive to encourage U.S. ownership of intellectual property. Such a regime may be particularly successful if it were coupled with an anti-tax base erosion provision that served as a disincentive for corporations to own intellectual property in tax haven countries.