TAX REFORM AND THE U.S. MANUFACTURING SECTOR

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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TAX REFORM AND THE U.S. MANUFACTURING SECTOR

THURSDAY, JULY 19, 2012

U.S. House of Representatives,
Committee on Ways and Means,
Washington, DC.

The committee met, pursuant to call, at 9:43 a.m., in room 1100, Longworth House Office Building, the Honorable Dave Camp [Chairman of the Committee] presiding.

HEARING ADVISORY

Camp Announces Hearing on Tax Reform and the U.S. Manufacturing Sector

Thursday, July 19, 2012

Congressman Dave Camp (R–MI), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on business tax issues currently facing U.S. manufacturing companies, and will examine how comprehensive tax reform could improve the ability of manufacturers to contribute to job creation and economic growth, including U.S.-based public and closely held companies as well as foreign-owned U.S. manufacturers. **The hearing will take place on Thursday, July 19, 2012, in Room 1100 of the Longworth House Office Building, beginning at 9:30 A.M.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing. A list of invited witnesses will follow.

BACKGROUND:

The United States has the highest corporate income tax rate in the developed world at 39.2 percent (federal and state combined)—compared to the OECD average of approximately 25 percent—and recent economic research indicates that much of the corporate tax is borne by workers in the form of lower wages and fewer jobs. In addition, U.S. manufacturers that operate internationally are subject to tax on their worldwide earnings, while their competitors in foreign markets often are based in countries with a territorial system that does not tax foreign earnings, putting U.S. manufacturers at a competitive disadvantage.

Furthermore, a substantial portion of manufacturing activity by U.S. companies is conducted through pass-through entities, and income earned by these entities is taxed at the individual income tax rates. Consequently, uncertainty surrounding the individual rate structure after 2012 poses significant challenges to business planning and job creation in the manufacturing sector, especially for smaller manufacturers further down the supply chain.

In announcing this hearing, Chairman Camp said, **"U.S. manufacturing has long been a cornerstone of our economy, and it continues to provide high-paying jobs for American workers while supplying global consumers with high-quality products. As with the rest of our economy, however, the strength of U.S. manufacturing is being undermined by our current tax system, which is too complex, too costly, and too time-consuming to comply with. As we examine the implications of comprehensive tax reform for specific industries, I will be interested in hearing from U.S. manufacturers about how tax reform can make the United States a more attractive place for the industry to hire and invest."**

FOCUS OF THE HEARING:

This hearing will examine how the current tax system affects U.S. manufacturers, including U.S.-based public and closely held companies as well as foreign-owned U.S. manufacturers, and how comprehensive tax reform might affect their ability to expand and create jobs.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "Hearings." Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Thursday, August 2, 2012**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–3625 or (202) 225–2610.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://www.waysandmeans.house.gov/*.

Chairman CAMP. Good morning, thank you for joining us for another in a series of hearings examining how comprehensive tax reform can help stir economic growth. Today's hearing is an opportunity to look more closely at the manufacturing industry. Specifically, we will examine how the current tax system affects U.S. manufacturers, including U.S.-based public companies, small and closely-held manufacturers, and foreign-owned U.S. manufacturers. We will also explore how comprehensive tax reform might affect manufacturers' ability to expand and create jobs.

The importance of the manufacturing sector to the U.S. economy has been well-established. In 2011, manufacturing accounted for 12.2 percent of the country's gross domestic product, and approximately $1.27 trillion in exported goods according to the Commerce Department's of Bureau of Economic Research. With a long and treasured history in America, manufacturing touches every aspect of our lives. From the food we eat, to the cars we drive, to the clothes we wear, the impact of manufacturing is felt each and every day.

Supporting about one in six private sector jobs, the manufacturing industry is a cornerstone of our economy that provides high-paying and high-quality jobs to approximately 12 million people according to June's Labor Department data. Manufacturing is closely connected with research and innovation which improves our lives and our standard of living.

Whether small, medium, or large, whether publicly traded or closely held, manufacturing companies contribute to the American economy every day. Nowhere is that more evident than in my home State of Michigan, the heart of the auto industry and the engine of the industrial Midwest. Manufacturers have been hit particularly hard in this country.

Since the President took office, we have lost over one-half million American manufacturing jobs. According to the Department of Labor, the precise number is 590,000. So as we examine the effect of our current Tax Code as well as the implications of comprehensive tax reform, the importance of understanding how tax reform can make America a more attractive place for the industry to hire and invest can't be overstated.

A recent op ed offered by the National Association of Manufacturers sums up the challenges posed by today's Tax Code, stating manufacturers have added 13 percent of the net new jobs gained since the end of 2009. And we have made larger than normal contributions to gross domestic product. But there is a black cloud looming with much uncertainty ahead. The op ed goes on to describe the impact that those looming tax increases will have on manufacturers, both for individual and corporate taxpayers. Citing a recent survey, 64 percent of manufacturers describe the tax and regulatory environment as their top concern.

The concern expressed by the manufacturing community is well founded, and it is a concern shared by many on this committee and in the Congress. We are all familiar with the statistics. The United States has the highest corporate tax rate in the world at 39.2 percent if you combine Federal and State. The high corporate rate in our outdated worldwide system of taxation do little to attract the investment and hiring we need to help get America back to work.

Similarly, as the NAM-authored op ed reminds us, businesses paying at the individual rate are also affected by today's broken Tax Code; not to mention its December 31st expiration date.

If the tax relief originally enacted in 2001 and 2003 expires, then 2/3s of manufacturers that operate as pass-through entities and pay taxes at the individual rate, will face even higher tax bills. The bottom line is that today's Tax Code isn't working. It is not working for the manufacturers that are organized as pass-through entities because it is too complex, too costly, and too expensive to comply with. It isn't working for manufacturers who operate internationally because it is outdated, and leaves America uncompetitive in the global marketplace.

Most of all, it is not working because it is not helping families struggling in a weak economy get back to work. It is time America's Tax Code puts the America economy first. We know that what doesn't work and now it is time for a comprehensive tax reform plan that will work. Since this Congress convened in January of 2011, the Ways and Means Committee has had more than 20 hearings focused on the steps Congress might take to transform our broken Tax Code into a pro-growth Code that will provide employers the certainty, the flexibility and freedom they need to invest and hire. At the request of the Ways and Means Committee, the last two House-passed budgets have outlined a framework for comprehensive tax reform that lowers rates for individuals and corporate taxpayers, repeals the AMT for 31 million households and transitions America to a more competitive territorial system of taxation, which even the Obama administration pointed to as a "hopeful area of consensus."

The framework is a good start, but more must be done. Today we will hear directly from stakeholders in the manufacturing community as they share their ideas for what Congress can do to help and what we ought to avoid that might hurt.

Your voices are critical to this discussion and after all, it is not enough simply to write a plan that reads well in Washington. It has to be a plan that works in the real world, the world where you run your businesses. Thank you for taking the time to be here today and I look forward to your testimony. I will now yield to Ranking Member Levin for his opening statement.

Mr. LEVIN. Thank you, and welcome to each and every one of you. Thank you for coming.

During the 2000s, we experienced a crisis in manufacturing employment. During the 8 years of the Bush administration, we lost 4.5 million manufacturing jobs. Now, since the recovery has taken hold, the manufacturing sector has added about a half a million jobs. We have seen that gain in manufacturing employment over the last 2 years. And now we hear talk about a resurgence of American manufacturing in part because of the policies of this President.

The President took the difficult but vital step of providing assistance to the domestic auto industry. If he hadn't done that, it would have devastated the manufacturing sector well beyond the Big Three, and even beyond their suppliers.

The Recovery Act Included key provisions like the 48C credit to encourage investment in advanced energy manufacturing. The tax agreement at the end of 2010 included 100 percent bonus depreciation for capital investments. But more needs to be done, clearly. We are still below where we were at the end of the Clinton administration by about 5 million manufacturing jobs. Ways and Means Democrats, we here have introduced a no-excuses agenda of items like bonus depreciation, the Wind Credit, R&D, 48C, Build America Jobs, and a provision to reduce the incentive to ship jobs overseas that this committee should act on immediately to promote job creation, especially in the manufacturing sector.

This committee should act on these provisions as soon as possible. Today we are considering how manufacturing fits into tax reform. Tax reform must fit into support for manufacturing. Eliminating every corporate tax expenditure including the domestic manufacturing deduction, R&D, and accelerated depreciation, would not pay for reducing the corporate rate to 25 percent, and could work against further support for manufacturing.

The President and Democrats in Congress view, in terms of tax reform, the larger goal as one of economic growth and job creation.

Just setting a rate and not saying how you will get there doesn't really tell you whether you are achieving those goals or not.

We think manufacturing should be at the heart of our goals for tax reform. Manufacturing still provides millions of middle-class jobs, conduct more than 2/3 of private R&D, accounts for 60 percent of exports, and has vital positive spillover effects in the broader economy.

Secretary Geithner said this very well before this committee in February. He said, and I quote, "I would say we would look at any proposal through that simple test which is relative to what you face today, are we making it more likely that the next factory by a U.S. company or a foreign company will be built here?"

Republicans often say that they don't want to pick winners and losers. It is not picking winners or losers, it is picking what side you are on. Being on the side of those who want to build things in America is not picking winners and losers, but winners for the American public.

That is why we think tax reform needs to mean a great deal for manufacturing sector. That is a major purpose of the hearing today, and we look forward to hearing our witnesses' thoughts on how we achieve that goal. Thank you.

Chairman CAMP. Thank you, Mr. Levin.

And we are pleased to welcome our excellent panel of experts who have extensive experience running both large and small manufacturers. I believe that their experience and insight will be helpful as we focus on tax reform as it relates to their industry. First, I would like to welcome and introduce Ms. Diane Dossin. Ms. Dossin is the chief tax officer and a long-time employee of Ford Motor Company. Ms. Dossin, thank you for being here today.

To introduce our second witness I yield to the gentleman from Minnesota, Mr. Paulsen.

Mr. PAULSEN. Thank you, Mr. Chairman, it is my privilege to welcome also Mr. Skip Gjersdal, from 3M who is the vice president of Tax and Real Estate who we will hear from in just a little bit. Skip has worked in the tax department actually at 3M for over 12 years. He has a strong background in tax, and also has worked previously at Cargill, which is also based in Minnesota. He brings a strong wealth of knowledge from a manufacturing perspective on tax policy, and the impacts that U.S. companies have in competing in the global marketplace. He was born and raised in my district in the third district in Minnesota, and I am proud to welcome him here. He has been a good advisor to me from a corporate tax standpoint as well, Mr. Chairman.

Chairman CAMP. Well, thank you very much, Mr. Paulsen. And now to introduce our witness from New York, I will yield to Mr. Reed.

Mr. REED. Thank you, Mr. Chairman. It is my pleasure, and I am pleased to introduce Susan Ford, the vice president of Tax at Corning Incorporated. As you know, Corning Incorporated is headquartered my district in Corning, New York. This company has been around for 161 years. It is the world's leading manufacturer of high technology glass, and glass ceramic components. It was founded by Amory Houghton the great-great grandfather of former Congressman Amo Houghton who, as you know, was a member of the committee for many years and a good friend to many of us here on this panel.

Corning is proud to have invented a number of technologies with significant impact on the world, including optical fiber, ceramic substrates for catalytic converters, and is the world's largest produce of glass for LCD–TVs and a lot of our phones and other materials have that material on them.

So I am proud to be here. I am proud to introduce Ms. Ford, and I look forward to her testimony, and I welcome her and yield back the balance of my time.

Chairman CAMP. Well, thank you, Mr. Reed. Our fourth witness, Ralph Hardt, the President of Jagemann Stamping Company in Manitowoc, Wisconsin. Aside from his work at Jagemann, Mr. Hardt brings a wealth of experience from managing several other small manufacturing businesses.

And fifth, we will hear from in Kim Beck, the President and CEO of Automatic Feed Company in Toledo, Ohio. Mr. Beck had so much good information to share with us that last night after his flight from Toledo to Washington was canceled, he hopped in his car and made what I imagine must have been close to an 8-hour drive to Washington, D.C. So Mr. Beck, thank you for your commitment and fortitude in making the effort to be with us here today.

Our sixth witness will be Mr. Hugh Spinks. Mr. Spinks is the vice president of Tax for Air Liquide USA, located in Houston, Texas. Additionally, Mr. Spinks is on the tax committee of the American Chemistry Council and serves on the board of directors to the Organization for International Investment.

And finally, we will hear from Miss Heather Boushey. Ms. Boushey is a senior economist at the Center for American Progress here in Washington, D.C.

Thank you all again for your time today. The committee has received each of your written statements. They will be made part of the formal hearing record. Each of you will being recognized for 5 minutes for your oral remarks and Ms. Dossin, we will begin with you. You are recognized for 5 minutes. Thank you.

STATEMENT OF DIANE DOSSIN, CHIEF TAX OFFICER, FORD MOTOR COMPANY

Ms. DOSSIN. Thank you. Good morning, Chairman Camp, Ranking Member Levin, and Members of the Committee. I am the Chief Tax Officer of Ford Motor Company, a manufacturer of cars and trucks, headquartered in Dearborn, Michigan. We employ over 66,000 at 25 manufacturing facilities and other office buildings. And we thank you for holding this hearing on tax reform in the manufacturing sector, which you all understand is the most important sector in the American economy.

Ford has manufactured cars and trucks for over 100 years, but not that long ago, we were fighting for survival. And we stood up in that moment and developed a plan to aggressively restructure the company. We rationalized our brands. We leveraged our global strengths to build high-quality products more efficiently. We revised labor contracts. We funded post-retirement healthcare. We funded pensions. We restructured the dealer network. And to fund all of that, we took out what everyone described as the largest home-improvement loan that was secured by all of the assets of Ford, including the trademark blue oval. And over the last couple of years, we have repaid over $20 billion of that debt, and the blue oval belongs to us again.

And we did all of that against the backdrop of the severe economic conditions at the time, and we did it outside of bankruptcy.

In short, we have restructured every element of the business that we could, and we have returned to profitability in the U.S., but our tax expense does remain internationally uncompetitive. We are grateful that Republicans and Democrats have recognized that the U.S. corporate tax rate is simply too high. Chairman Camp's discussion draft and the President's framework for business tax reform both suggest much lower rates.

We are very hopeful that the time for reforming America's uncompetitive corporate Tax Code has arrived, and we believe that lowering the corporate tax rate is the single most important and efficient and simple way to relieve the burden on U.S. companies.

Ford understands that in the current fiscal climate, it is likely impossible to achieve a lower rate without broadening the base. We also understand that base-broadening comes with costs that must be weighed against the value of the lower rate. As an American manufacturer, Ford is interested in several tax provisions of broad applicability that do encourage important U.S. investment. First, the research credit. Many other countries have both a low rate, and incentives for research. The U.S. should not put itself at a competitive disadvantage by heading too far in the opposite direction.

Second, depreciation, reasonable cost recovery periods at least consistent with expected economic wear or obsolescence are critical to support continued U.S. capital investment, and third, the domestic manufacturing deduction, which recognize the special advantages manufacturing activity provides to the U.S. economy.

We are hopeful that a lower rate and a reformed U.S. corporate Tax Code will be a net positive for American manufacturers to permit us to continue strong U.S. investment.

Ford does operate globally, and builds vehicles where its customers live. We earn a large part of our income in the U.S. Abroad, Ford generally operates in relatively high tax countries, and we do not have substantial foreign earnings that have been taxed at very low foreign rates, and that only come back to the U.S. at a very high U.S. tax cost.

And for that reason, Ford does not have a particular position on how the U.S. taxes foreign earnings. Whatever the method, Ford believes it is appropriate for corporate tax reform to provide some minimum level of U.S. tax when corporations shift income to tax-savings countries.

We see value in all three anti-base erosion options included in Chairman Camp's proposal, and that lawmakers need not necessarily choose a single approach to combat tax-base erosion. The transition to a reformed code is also important to Ford. In particular, we are interested in how transition rules will apply to foreign earnings and profits deficits, to foreign tax credit carryovers, to foreign taxes that have been paid but not yet claimed on tax returns, and to overall domestic losses.

In summary, for over a century, the United States has been Ford's home, and its most important market. Ford wants to remain profitable in the U.S., and to pay income tax at a reasonable rate, similar to the rates now levied by other countries. The stakes for corporate tax reform are high, and the consequences of failure are serious. We know it won't be easy, and appreciate all the more your willingness to tackle this important task. We at Ford stand ready to help you in any way we can. On behalf of Ford, thank you for the opportunity to testify, and I look forward to answering your questions.

Chairman CAMP. Thank you very much, Ms. Dossin.

[The prepared statement of Ms. Dossin follows:]

Testimony of
Diane Dossin
Chief Tax Officer
Ford Motor Company

Before the Committee on Ways and Means
U.S. House of Representatives

July 19, 2012

Hearing on Tax Reform and the
U.S. Manufacturing Sector

Good morning Chairman Camp, Ranking Member Levin, and members of the Committee. My name is Diane Dossin. I am the Chief Tax Officer of Ford Motor Company, a manufacturer of cars and trucks headquartered in Dearborn, Michigan. Thank you for holding a hearing on the topic of corporate tax reform and its potential impact on manufacturing—one of the most important sectors of the American economy.

Manufacturing remains a key driver of the U.S. economy. Manufacturers provide high quality jobs and continue to innovate, invest, and grow in the United States. Compared to other sectors of the economy, manufacturing has a higher rate of growth in productivity, supports more economic activity per dollar of production, and is more engaged in global trade and export growth.[1] If the United States is to continue to be the world's economic leader, it must remain a leader in manufacturing.

Ford has manufactured cars and trucks in this country for over 100 years and employs more than 66,000 Americans at 25 U.S. manufacturing plants, as well as research labs, design centers, and other facilities. Ford's global annual revenues exceed $135 billion. Every year in the U.S., Ford spends more than $30 billion on raw materials and components that go into vehicles, $1.5 billion on capital equipment to produce vehicles, and another $3 billion on research and development to develop next-generation products and technology. Ford is a driver of the U.S. economy in every sense of the word.

But in the middle of the last decade, Ford's role as an American manufacturing and economic leader was threatened. We were unprofitable and hemorrhaging cash—our very future was in doubt. Ford stepped up in that moment.

We committed to a plan that aggressively restructured the business to operate profitably, matched capacity to meet true demand, and accelerated the development of vehicles that exceeded our customers' expectations for quality, fuel efficiency, safety, and smart technology.

We rationalized our brands to bring a laser focus to Ford and Lincoln.

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[1] The Manufacturing Institute, *The Facts About Manufacturing*, 8th Edition; Dep't of Commerce, *The Competitiveness and Innovation Capacity of the United States* (2012); President's Council of Advisors on Science and Technology, *Ensuring American Leadership in Advanced Manufacturing* (2011)

We leveraged our global assets, innovation, technology, and scale to deliver world-class products efficiently for every market.

Working with our UAW partners, we revised labor contracts, funded retiree health care, and made discretionary contributions to pension plans to help close the competitive gap. As a result, Ford is now making small cars profitably in the United States.

Working with our dealer partners, we restructured the dealer network to enhance the sales and service experience for our customers.

We funded our transformational plan by taking on an immense loan secured by all of our assets, including the trademark Blue Oval. We continued to strengthen our balance sheet, and between the end of 2009 and 2011, we repaid more than $20 billion of that debt. Today we are back to an investment grade credit rating and have full rights to all of our collateral.

We did all of this against the backdrop of the severe economic conditions of late 2008 and 2009 and outside of bankruptcy.

Ford is now profitable, especially in the United States. Our 2011 operating earnings were more than $8.5 billion. We are now recording tax expense on our earnings at a rate near the U.S. statutory rate of 35%. From a cash standpoint, for the next few years, Ford will continue to offset its U.S. taxable income with losses sustained and tax credits earned in the last decade. However, the day is fast approaching when Ford will make substantial cash payments to meet its corporate income tax obligations in the United States—at the world's highest statutory rate. This tax burden will directly reduce the cash that is available to support investment in new product and job creation in the U.S. and to compete with foreign-based manufacturers who conduct key functions in their home countries (with the benefit of lower tax rates).

In short, we have restructured every element of the business that we can, but our tax expense remains internationally uncompetitive. To continue to compete on the world stage, we need a lower corporate tax rate at home that is much closer to those of other developed nations. And to achieve that, we need your help.

Corporate Income Tax Rate Reduction

It is well chronicled that the U.S. now has the highest corporate income tax rate in the developed world. We are grateful that Republican and Democratic leadership—both here in Congress and in the Administration—have recognized that the U.S. corporate tax rate is too high. We are especially pleased at the level of engagement of both Chairman Camp and Ranking Member Levin, as well as many other members of the Committee. Chairman Camp's Discussion Draft and The President's Framework for Business Tax Reform have suggested tax rates of 25% and 28%, respectively. We are hopeful that the time for reducing and reforming America's uncompetitive corporate tax code has arrived.

In pursuit of that objective, Ford has joined the RATE Coalition, a group of 28 companies and organizations supporting 30 million American jobs and dedicated to advancing the cause of a lower corporate tax rate. Lowering the corporate tax rate is the most efficient and simplest way to relieve the outsized tax burden on U.S. companies – and particularly on manufacturing companies with hard assets and operations in this country. A lower rate will also decrease the incentive to move U.S. jobs and investment abroad and will increase the incentive to move foreign investment and jobs into the U.S.

Corporate Tax Base Broadening Considerations

Ford understands that, in the current fiscal climate, achieving a lower corporate income tax rate is probably only possible if the tax base is broadened. We also understand that base broadening does not come without attendant costs—costs that must be weighed against the relative value of a lower rate. In considering base broadening alternatives, Ford urges consideration of the full impact of the ultimate tax reform package on the U.S. economy. The final product should have a net positive effect on the goals of increased competitiveness, economic growth, and job creation in manufacturing here at home.

The automotive industry is a key component of the overall U.S. manufacturing sector. It is supported by a large and lengthy supply chain and is a large consumer of goods and services from many other economic sectors including raw materials, construction, machinery, computers, and health care. In an April 2010 study, the Center for Automotive Research estimated that each automaker job supports nine other jobs in the supply chain, automobile dealer network, and broader economy and that the U.S. auto industry collectively supports nearly 8 million U.S. jobs. Automakers alone pay $200 billion of annual wages for jobs that are among the best in their communities.

Therefore, it is not surprising that Ford, as an American manufacturer, employer, and innovator, benefits from several provisions in today's tax code that were enacted in support of this sector of the U.S. economy:

> **Research Credit**. The four pillars of Ford's brand strategy are Quality, Green, Safe, and Smart—four vehicle characteristics that are highly valued by today's customers and supportive of national policies around fuel economy, sustainability, and safety. To advance in these core areas, Ford continually innovates, at a cost of more than $3 billion per year in the U.S. The U.S. tax credit for research and experimentation supports locating technologically innovative activities in this country. Many other countries have incentives for research and experimentation activities in addition to their lower statutory rates. The U.S. should not put itself at a competitive disadvantage in this critical area by heading too far in the opposite direction.
>
> **Depreciation.** Investment recovery provisions are important to Ford because of the continuous need to invest in plant machinery, equipment, and tooling. Ford expects to add over $6 billion in capital investment in the U.S. through 2015—investment that will have considerable spillover benefits. Reasonable cost recovery periods, at least consistent with expected economic wear or obsolescence, are critical to support these investments.
>
> **Domestic Manufacturing Deduction.** Congress recognized the special advantages manufacturing provides to the U.S. economy when in 2004 it enacted the Internal Revenue Code §199 domestic production activities deduction. In the years since 2004, the relative importance of manufacturing to the U.S. economy has only increased. Because of cumulative losses, Ford has benefitted minimally from §199 to date, but our forward-looking business plans assume that our U.S. operations will receive substantial benefits going forward.

We are hopeful that a lower rate in a reformed U.S. corporate tax code could be a net positive for an American manufacturer like Ford to permit continued strong investment in this country.

Prevention of Tax Base Erosion

Ford operates globally and builds vehicles where its customers live. The U.S. is Ford's most important market and, in recent years, Ford has earned a large part of its income in the U.S. Outside the U.S., Ford generally operates in relatively high tax countries. Ford does not have substantial foreign earnings and cash that have been taxed at very low foreign tax rates and that, therefore, could only be repatriated to the U.S. at a high U.S. tax cost.

We know there has been a lot of debate about the best way to tax foreign earnings so that the U.S. remains competitive in the global economy. Ford does not have a particular position on the exact design and believes that any of several variations of worldwide, territorial or formulary apportionment systems could be workable. We see most countries' systems as hybrids. Systems generally understood to be worldwide often have territorial elements, like deferral mechanisms, while many of those considered to be territorial have worldwide elements, like subpart F-type provisions. We note that the reforms being discussed in Washington today are effectively hybrids.

Ford believes it is appropriate for corporate tax reform to provide for some minimum level of U.S. tax when corporations shift income to tax haven countries. This would be particularly true if the U.S. were to adopt a more territorial system. Option B of Chairman Camp's Discussion Draft would seem to provide a workable model for a minimum level of U.S. tax, under which the U.S. would currently tax income earned by a controlled foreign corporation if such income is subject to an effective foreign tax rate of less than 10% – although using a threshold rate as low as 10 percent could be unnecessarily generous. We note that Option B may be more fair and effective if it included a sliding scale for U.S. inclusion similar to that employed in Option A of the Chairman's Discussion Draft. Global competitiveness concerns that could arise because only U.S.-based multinational corporations would be subject to Option B might be alleviated by a lower U.S. statutory rate and by the likelihood that other nations would follow the U.S. lead and enact similar provisions of their own.

Option C would seem to provide an effective incentive to develop and own intangible assets in the U.S. Accordingly, Option C could help address global competitiveness concerns regarding U.S. research and development. Lawmakers need not necessarily choose a single approach to combat tax base erosion. Provisions could be used in various combinations to achieve desired goals.

Transition Considerations

The issue of how we transition to a reformed tax code is important to Ford. In particular, we are interested in how the transition rules will apply to foreign earnings and profits deficits, foreign tax credit carryovers, foreign taxes paid but not yet claimed on U.S. tax returns, and overall domestic losses.

Conclusion

Ford was born in America. For over a century, the United States has been Ford's home and its most important market. Ford wants to remain very profitable in the U.S. and to pay income tax at a fair and reasonable tax rate similar to the rates now levied by many other developed nations.

The stakes for corporate tax reform are very high and the consequences of failure are serious. We know it will not be easy and appreciate all the more your willingness to tackle such an important undertaking. We at Ford stand ready to help you in your work in any way we can.

On behalf of Ford, I thank you for the opportunity to testify before you today and look forward to answering your questions.

Chairman CAMP. Mr. Gjersdal, you are recognized for 5 minutes.

STATEMENT OF HENRY W. GJERSDAL, JR., VICE PRESIDENT OF TAX AND REAL ESTATE, 3M

Mr. GJERSDAL. Good morning, Chairman Camp, Ranking Member Levin and Members of the Committee.

Chairman CAMP. You need to push the button on the microphone.

Mr. GJERSDAL. Good morning, Chairman Camp, Ranking Member Levin, and Members of the Committee. My name is Skip

Gjersdal and I am the vice president of Tax and Real Estate at 3M Company. I thank the committee today for the opportunity to address the important issue of tax reform. As you know, the U.S. corporate tax rate is the highest tax rate of any country in the world. In some cases, the high U.S. tax rate is mitigated by tax credits and deductions. These credits and deductions, however, often fail to adequately encourage the behavior they are intended to incentivize, and create competitive imbalances between U.S. companies. In addition, the Internal Revenue Code has not kept up with the rapidly changing international business environment.

Virtually, every developed country has responded to these changes by adopting tax systems that provide their domestic corporations the tools to compete in the global marketplace. Also, part of this new global reality is that nearly 50 percent of the world's public companies, and frankly many of our competitors, are now based outside the U.S. in Western Europe. They start with the competitive advantage in the marketplace because of the lower tax rates they enjoy.

3M submits that the U.S. could take a few key steps to address these competitive imbalances while simultaneously creating greater simplicity and predictability for its domestic corporations. First and foremost, we recommend that the corporate tax rate be reduced. We support the chairman's proposal to reduce the rate to 25 percent, a rate which is more in line with other developed countries that view a lower corporate tax rate as a competitive advantage.

We recognize that a large reduction of the corporate tax rate would require substantial offsets from existing deductions and credits. For example, 3M utilizes the Section 199 manufacturer's deduction, accelerated and bonus depreciation, and the R&D credit.

The manufacturer's deduction, provides a significant benefit to our company, since 3M has half of its manufacturing base in the United States. However, lowering the rate to 25 percent would offset the benefit of this deduction, and would also eliminate the complex and time-consuming record requirements required by the Section 199.

3M would also support the repeal of accelerated and bonus depreciation to partially pay for a significantly lower tax rate. While depreciation provisions provide a significant benefit to the company, these rules merely change the timing deductions and result in an upfront cash flow benefit. Importantly, they do not impact the tax rate reported by the company in its financial statements.

Finally, 3M would also forego the current R&D credit for a significantly lower rate. As one of the most innovating companies in the world, 3M believes that intellectual property development must remain a cornerstone of American business. 3M spends over $1.6 billion a year on R&D. However, today's R&D credit provides insufficient incentives to encourage R&D investment in the U.S. because it is based on incremental spending on a limited portion of R&D expenditures. And of course, its temporary nature limits its effectiveness. If Congress wishes to continue to encourage R&D here in the United States, there are numerous ways to substantially improve the incentives for research development and the ownership of intellectual property.

For example, a so-called patent box could provide a low rate of tax on income generated from intellectual property developed and owned in the United States. This would not only encourage investment in IP, but it would also encourage its retention in the U.S.

Lastly, 3M applauds the chairman's inclusion of a territoriality system in his proposal. We agree with the 95 percent exemption system rather than the alternative systems that would create unnecessary complexity. The territorial system would bring the U.S. in line with most developed countries, including the U.K., Canada, Germany and Japan. In addition, such a change would facilitate a partial or full repeal of many international tax rules, which are amongst the most complex and controversial rules in the Code. Replacing those rules with the territorial system would greatly enhance simplification and transparency.

Again, we thank the committee for inviting 3M to speak today. We support its efforts to achieve comprehensive reform with a substantially lower rate and territoriality, field a simpler and more transparent Code, and to help American companies compete in a global economy.

Chairman CAMP. Well, thank you, Mr. Gjersdal.

[The prepared statement of Gjersdal follows:]

Committee on Ways and Means
Hearing on "Tax Reform and the U.S. Manufacturing Sector"
July 19, 2012
Written Statement of Henry W. Gjersdal
Vice President of Tax

3M Company ("3M") appreciates the opportunity to testify before the Committee on Ways and Means on "Tax Reform and the U.S. Manufacturing Sector."

3M is a large U.S.-based employer and manufacturer established over a century ago in Minnesota. Today, 3M is one of the largest and most diversified manufacturing companies in the world. We are a global company conducting the majority of our manufacturing and research activities in the United States. 3M thanks the Committee for its leadership on the critical issue of tax reform and for considering our perspective in this important debate.

Our comments are written to share the practical impact of corporate tax reform on 3M. 3M respectfully urges the Committee to continue making the global competitiveness of American businesses and workers a key objective of reform. From 3M's perspective, this means a significant reduction to the corporate tax rate and the adoption of a territorial system. 3M generally supports the approach outlined in the Ways and Means October 2011 discussion draft on a Participation Exemption (Territorial) System. We recognize that to reform the system in this way, all current incentives, credits and deductions must be reviewed.

3M looks forward to working with the Committee on achieving meaningful and comprehensive tax reform.

Background on 3M

3M, formerly known as Minnesota Mining and Manufacturing, is an American company currently headquartered in St Paul, Minnesota. The company, created in 1902 by a small group of entrepreneurs, initially began as a small sandpaper product manufacturer. Today, 3M is one of the largest and most diversified manufacturing companies in the world. 3M is home to such well-known brands as Scotch, Scotch-Brite, Post-it®, Nexcare®, Filtrete®, Command®, and Thinsulate® and is composed of six business sectors: Consumer and Office; Display and Graphics; Electro and Communications; Health Care; Industrial and Transportation; and Safety, Security and Protection Services.

Ahead of their peers, 3M's founders insisted on a robust investment in R&D. Looking back, it is this early and consistent commitment to R&D that has been the main component of 3M's success. Today, 3M maintains 40 different technology platforms. These diverse platforms allow 3M scientists to share and combine technologies from one business to another, creating unique, innovative solutions for its customers. The financial commitment to R&D equated to $1.6 billion of R&D spending in 2011 and over $7 billion during the past five years, and produced high quality jobs for 3900 researchers in the United States (and 7000 total worldwide).

The results are equally impressive with 571 U.S. patents awarded in 2011 alone, and over 40,000 global patents and patent applications. Over 32% of 2011 sales came from products developed in the last 5 years.

3M's worldwide sales in 2011 were nearly $30 billion. 3M is one of the 30 companies on the Dow Jones Average and is a component of the Standard & Poor's 500 Index. Owned by millions of shareholders directly and indirectly through mutual funds, 3M has consistently delivered positive results to its owners. It has paid dividends to its shareholders every quarter since 1916. 3M paid dividends of $1.6 billion in 2011 and a total of $8.2 billion over the past five years. Most remarkably, for the last 50 consecutive years, annual dividends have consistently increased.

This success is attributable to the people of 3M. Generations of imaginative and industrious employees in all of its business sectors throughout the world have built 3M into a successful global company.

3M: Competing in A Highly Competitive Global Economy

3M is a U.S. company that manufactures and sells its products throughout the world. Headquartered in St. Paul, Minnesota, 3M has operations in 28 U.S. states, where approximately half of 3M's worldwide manufacturing operations are located. Internationally, 3M has historically had a large manufacturing presence in Western Europe, Canada and Japan. 3M employs approximately 33,000 in the United States. In addition, 3M conducts over 60% of its worldwide R&D activities in the United States. The U.S. market currently accounts for approximately one-third of 3M's global business.

While its U.S. presence is strong, 3M is increasingly a global company. 3M operates in more than 70 countries and sells products into more than 200 countries. In 2011, approximately two-thirds of 3M's sales were outside the United States, a percentage that is projected to rise in future years. In the current global economy, where international markets are growing faster than U.S. markets, being able to compete successfully in the global marketplace is critical to 3M.

Global market competition has made "localization" critically important for the company's future success. If 3M is going to successfully compete against its foreign competitors, it must invest in new facilities in those foreign markets to be closer to its non-U.S. customers. 3M must hire international employees with an in-depth understanding of their markets. 3M's success has depended on our ability to tap into the talent of a richly diverse global employee base to share ideas and innovate. Local knowledge and execution, supported by 3M technologies, products, and brands, is an overarching strength and competitive advantage. It enables 3M to provide international customers with leading-edge products, strong marketing support and responsive service, thereby achieving borderless customer success.

This business-driven need for further localization, as well as the need to simplify 3M's historically complex supply chains, has led 3M to adopt a regional sourcing initiative. 3M pursues more customer-focused supply chains with an increased localization target – meaning that more of our products sold in a region will be produced in the same region as that of the customer. This shift to greater localization is not tax-driven, but rather results from competitive pressures to better serve the needs of our global customers.

Reforming the Current U.S. Business Tax System

Tax reform is essential to ensure long-term competitiveness of American businesses and workers. As the Committee knows, the US corporate tax rate is the highest tax rate of any major country. In some cases, the high US tax rate is mitigated by tax credits and deductions. These credits and deductions, however, often fail to adequately encourage the behavior they were designed to incentivize and often create competitive imbalances between US companies.

In addition, the Internal Revenue Code has not kept up with the rapidly changing international business environment. Virtually every developed country has responded to these changes by adopting tax systems that provide their domestic corporations the tools to compete in the global marketplace. Also, part of this new global reality is that nearly 50% of the world's largest public companies - and many of our competitors - are now based outside of U.S. and Western Europe. They can start with a competitive advantage in the marketplace because of the lower tax rates they enjoy.

3M submits that the U.S. could take a few key steps to address these competitive imbalances while simultaneously creating greater simplicity and predictability for its domestic corporations.

Significantly Lower the Corporate Income Tax Rate. First and foremost, we recommend the corporate tax rate be reduced. We support the Chairman's proposal to reduce the rate to 25%; a rate which is more in line with other developed countries that view a lower corporate tax rate as a competitive advantage. From 3M's perspective, the current high corporate tax rate has two adverse effects on domestic investment: it reduces the after-tax return on domestic investments and creates significant inefficiencies in the deployment of the Company's capital and the management of its balance sheet.

Since 3M maintains the majority of its manufacturing and R&D activities in the United States, our effective tax rate is one of the highest among our competitors. For 2012, 3M is anticipating a worldwide effective tax rate of 29.5%. In 2011, 3M's worldwide tax expense was over $1.6 billion. In an increasingly global marketplace, 3M's high effective tax rate is a competitive disadvantage. .

In addition, the high U.S. tax rate imposes an undue cost barrier to repatriating foreign earnings under the current international tax system. American businesses should be encouraged to successfully compete in foreign markets and repatriate foreign earnings back to the United States. A significantly reduced corporate tax rate would eliminate significant inefficiencies in the deployment of the Company's capital and the management of its balance sheet. We recognize that a large reduction in the corporate tax rate would require substantial offsets from existing deductions and credits. For example, 3M utilizes the Section 199 manufacturer's deduction, accelerated and bonus depreciation, and the R&D tax credit.

The manufacturer's deduction provides a significant benefit to our company since 3M has a majority of its manufacturing base in the US. However, lowering the tax rate to 25% would offset the benefit of this deduction and would also eliminate the complex and time consuming record keeping requirements.

3M would also support the repeal of accelerated and bonus depreciation to partially pay for a significantly lower tax rate. While the depreciation provisions provide a significant benefit to the company, these rules merely change the timing of deductions and result in an upfront cash flow benefit. Importantly, they do not impact the tax rate reported by the Company in its financial statements. Timing benefits like accelerated and bonus depreciation do not impact earnings per share.

In addition, 3M would also forego the current R&D credit for a significantly lower rate. As one of the most innovative companies in the world, 3M believes that intellectual property development must remain a cornerstone of American business for their success. 3M spends over $1.6 billion a year on R&D. However, today's R&D credit provides insufficient incentives to encourage R&D investment because it is based on incremental spending on a limited portion of R&D expenditures. And, its temporary nature limits its effectiveness.

If Congress is unable to secure a significant rate reduction or wishes to continue to incentivize R&D here in the U.S. in a reform package, there are numerous ways to substantially improve the incentives for research, development and ownership of intellectual property. For example, a so-called "patent box" could provide a low tax rate on income generated from intellectual property developed and owned in the US. This would not only encourage investment in research and development, but it would also encourage its retention in the U.S. and address concerns regarding the migration of IP offshore. Other countries, such as the Netherlands, Spain and Belgium, have adopted provisions that permit a deduction or exclusion for a portion of royalties received for the use of IP created by the licensor.

Territorial System. The worldwide base of the current international tax system adversely impacts the competitiveness of American businesses which operate overseas for business reasons, like 3M, relative to competitors that are based in jurisdictions that exempt foreign income. It is important for 3M to be able to manage debt and reinvest capital on a regional basis. A territorial system would allow the movement of capital across country borders without triggering a US tax consequence, giving American companies the ability to deploy capital efficiently in competing for growth opportunities abroad.

3M applauds the Chairman's inclusion of a territoriality system in his proposal. We agree with a 95% exemption system rather than alternative systems that would create unnecessary complexity. This approach accomplishes the policy objectives of exempting foreign earnings and limiting deductibility of related U.S. based expenses in a far less complicated manner than other proposals. A territorial system would bring the US into line with most developed countries, including the UK, Canada, Germany and Japan. In addition, such a change would fully or partially repeal of many international tax rules, which are among the most complex and controversial rules in the Code. Replacing those rules with a territorial system would greatly enhance simplification and transparency.

We agree with the Committee that anti- abuse rules are necessary to prevent the erosion of the U.S. tax base. Regarding transition rules for pre-enactment foreign earnings, 3M, like many companies, has substantial foreign earnings permanently reinvested in active businesses outside of the U.S. The up-front tax impact on accumulated earnings that can never be repatriated to the U.S. need to be considered, along with the complexity involved in determining the accumulated undistributed earnings for companies that date back over 50 years. In addition, 3M suggests this tax should not be imposed on accumulated earnings that are invested in assets used in active businesses since theses earnings will never be repatriated

Summary of 3M Tax Reform Recommendations

We thank the Committee for the opportunity to share our perspective as an American employer interested in preserving and enhancing the global competitiveness of American businesses and workers.

As a U.S. based multinational company that is contending with many foreign-based competitors every day around the globe, it is critical to reduce the U.S. corporate tax rate and adopt a territorial system to help make us more competitive.

We sincerely appreciate the significant work you and the Committee have and are doing to craft a U.S. tax code that levels the playing field for U.S. based companies and encourages more investment, manufacturing and jobs in the U.S.

3M stands prepared to work with you in any way we can to support you on this critical public policy matter.

Chairman CAMP. Ms. Ford, you are recognized for 5 minutes.

STATEMENT OF SUSAN L. FORD, VICE PRESIDENT OF TAX, CORNING INC.

Ms. FORD. Good morning, Chairman Camp, Ranking Member Levin and Members of the Committee. My name is Susan Ford and I am the vice president of Tax for Corning Incorporated. We are a glass technology and research company located in Upstate New York. Mr. Reed gave a great background for Corning, so I won't cover most of that, but I do want to hit a couple of points to give us context for our discussion.

Corning does have approximately $7.8 billion in sales as of 2011, and we have 29,000 employees worldwide, of which more than half of that payroll is located in the United States. Corning takes a tremendous amount of pride in its heritage as one of America's oldest and most innovative companies, the company that has been said to recreate itself. Corning spends about 10 percent of our global revenues in R&D, about 98 percent of which is conducted within the United States, and mostly in Upstate New York. We have manufacturing in 11 of the 26 States in which we operate in this country.

Corning is also a global company, however, approximately 79 percent of our sales are to foreign customers. Corning operates in many industries where the customers and competitors are predominantly or entirely located outside of the United States. To survive and prosper, Corning must operate there as well. I will give you an example in our display business. Display is our largest segment at Corning and it is segment that makes the LCD glass in the televisions. The glass that we actually make is formed in sheets that are about the size of a king-size bed and about the width of four times the human hair. So you can imagine that shipping that kind of glass, nothing good happens when you ship it thousands of miles.

For that reason, we often located our manufacturing facilities in the same, obviously on the same—frequently, excuse me, on the same piece of land as our customers. Because foreign markets are a larger proportion of the global consumer demand, we must be able to grow both not just domestically, but internationally. This is true for Corning and many other U.S. manufacturers working to compete in an intense global market. We need tax policy that is competitive while continuing to incentivize innovation and job creation in the United States. The current Tax Codes, manufacturing and R&D incentives, tax rates, and worldwide system taxation are complex and simply no longer globally competitive in our view.

I will give you a brief example for Corning. Our U.S. effective tax rate in 2011 was approximately 36, 37 percent. And our foreign rate was approximately 17 percent. This was principally due to the fact that some of the foreign jurisdictions in which we operate provided significant incentives for capital investment. Again, these are business decisions that were made to be close to our customers because our product is difficult to ship, but additionally, it receives some incentives that allowed us to earn income at some lower foreign rates, particularly in Asia. It is very common in Asia. For this reason we are very heartened by the growing consensus among U.S. policymakers in general for the need to reform the U.S. Tax Code.

Some of the points, I will make are a bit repetitive to the prior two witnesses, but I think they are important enough to have another mention. Two principal points. I think the lower rate is very key. The lower rate will allow for a couple of things. One is its universal applicability, right. It will help domestic manufacturers. It will help companies that export from the U.S. It will help companies who are competing with foreign importers, for example. And secondarily, I think that the lower the rate can go, the less likely companies are incented to move income offshore.

The second part of Mr. Camp's proposal that I think is a principle that improves competitiveness is the territorial system. This is particularly important to multinationals like Corning who are based in the U.S., have significant employment in the U.S., but must compete with foreign companies abroad in their home countries.

We believe the territorial system—the nonterritorial system currently is a disadvantage to U.S. companies because it costs more for us to repatriate trade income, versus our competitors.

We do acknowledge that moving to a territorial system presents some transition challenges and we acknowledge Mr. Camp's proposal of a foreign earnings inclusion as an appropriate response to that. We appreciate the reduced rate on those earnings because companies like Corning often have earnings abroad that are in capital and in buildings and infrastructure that can't be returned. This presents a particular hardship for companies like Corning when tax is on all of the income but the cash cannot be returned to pay those taxes.

I think as a final point, it is important to note that base erosion principles, I agree with Ford in the sense there are three of them there and a balance can be used. We do believe that option C encourages companies to keep their innovation here in the United States, and their IP here in the United States because it does tax that income at a lower rate. It allows us to be more competitive with other companies, again, who have these intangibles offshore, and pay lower rates on their royalty income.

As patent laws around the world become more sophisticated and the enforceability improves, historic benefits of having U.S. technology ownership just no longer serve as sufficient compensation for a higher U.S. tax burden on the related income.

In summary, we do believe tax reform is a necessary action for the competitiveness and economic health of the United States and the manufacturers in it. For U.S. headquartered companies competing at home or abroad, the current system is cumbersome and inefficient. Many developed nations have modified their policies to facilitate competition and encourage domestic investment. The United States should not allow its trading partners to gain an advantage through tax policy modernization. Moving to a competitive territorial system with a competitive tax rate will result in benefits both to the United States and its manufacturers. Thank you, very much for the opportunity to participate today.

Chairman CAMP. Thank you, Ms. Ford.

[The prepared statement of Ms. Ford follows:]

Testimony of Susan Ford
Vice President
Corning Incorporated

Written Testimony for the U.S. House Committee on Ways and Means
Hearing on Tax Reform
Thursday July 19, 2012

Good morning Chairman Camp, Ranking Member Levin, and Members of the Committee. My name is Susan Ford and I am the Vice President of Tax for Corning Incorporated, a glass technology and manufacturing company located in the upstate town of Corning, New York. Thank you for the opportunity to speak to you today. I am pleased to provide Corning's views on tax reform.

Corning Background

Corning Incorporated is a 161 year old company with its world headquarters in Corning, New York. The company was founded by Amory Houghton, the great-great grandfather of former Congressman Amo Houghton, who was a member of this committee for many years. Corning's stock is publicly traded on the New York Stock exchange and its market cap is approximately $19 Billion. Sales in 2011 were approximately $7.8 Billion and we have about 29,000 employees worldwide with over half of our payroll in the United States. Corning takes a tremendous amount of pride in its heritage as one of America's oldest and most innovative companies. Corning spends about 10% of our global revenues on R&D, and its principal R&D center is in upstate New York. Corning has the world's most advanced optical fiber manufacturing plants in Wilmington and Concord, North Carolina, a specialty glass manufacturing facility in Harrodsburg, Kentucky, and a state of the art automotive and diesel emissions control product manufacturing facilities in a small town in upstate New York, neighboring our headquarters in Corning. Corning operates in 25 other states, including several states represented by Ways and Means Members - California, Kentucky, Massachusetts, New Jersey, Pennsylvania, Tennessee, and Texas. We have manufacturing in 11 of the 26 states in which we have a presence.

Over the last 161 years Corning has delivered innovation that has significantly impacted the way the world communicates, conducts medical research, protects the environment, prepares its food, and is entertained. Corning made the glass envelopes for Thomas Edison's light bulbs, as well as railroad lanterns which could withstand intense heat and cold. In the 1950s, Corning developed CorningWare and Pyrex, which most of you probably still have in your kitchens. Corning was also the world's leading manufacturer of cathode ray television tubes for decades. In the 1970s, Corning invented optical fiber and ceramic honeycomb substrates enabling the catalytic converter. Today, Corning continues to manufacture and sell optical fiber, cable and hardware and equipment for the telecommunications industry, as well as the ceramic substrates for automobile and heavy duty diesel catalytic converters. Additionally we are currently the world's leader in the production of liquid crystal display glass used in LCD televisions and computer screens. Your mobile phone likely features a damage resistant Corning display glass called

Gorilla Glass. And Corning has a growing family of life sciences products used in pharmaceutical and biotechnology research. Corning has been fortunate to receive the President's Medal of Technology four times. Almost all of these technologies were developed and remain owned by Corning Incorporated in the United States.

Corning is also a global company. Approximately 79% of our sales are to foreign customers. Corning operates in industries where customers and competitors are predominantly located outside of the United States. To survive and prosper, Corning must operate there as well. As an example, China is currently the largest growth country in the world. They are the number one optical fiber consumer in the world, the number one auto maker in the world, and becoming the world's largest consumer of LCD televisions.

A closer look at our Display Technologies segment underscores the importance of Corning's global, and particularly our Asian, presence. In the case of Corning's Display business, we sell our specialized LCD glass substrates to manufacturers of active-matrix LCD panels. There are no panel makers located in the United States. They are located in Taiwan, Japan, Korea, and more recently, China. Our LCD glass is formed in large sheets—sheets larger than what might cover a king size bed at a thickness of approximately four times that of a human hair. You can imagine that little good can happen to this glass if it is shipped thousands of miles. In many instances, our melting plants are located plant-side to our customers to avoid this. In the instances where we must ship this glass internationally, the packaging process is itself patented.

Because foreign markets are the larger proportion of the global consumer demand, we must be able to grow not just domestically, but internationally. This is true for Corning and many other U.S. manufacturers working to compete in an intense global market. We need tax policy that is competitive while continuing to incentivize innovation and job creation in the United States. The current tax code's manufacturing and R&D incentives, tax rates, and worldwide system of taxation are complex and no longer globally competitive.

Impact of Current U.S. Tax Policy, Growing Consensus of Need for Reform

American manufacturers are at a distinct disadvantage to competitors headquartered in other countries. Specifically, foreign manufacturers uniformly face a lower corporate tax rate than U.S. manufacturers, and virtually all operate under territorial systems which encourage investment both abroad and at home. In addition, many foreign manufacturers enjoy more robust R&D incentives than do American companies, and a growing number enjoy other innovation incentives, like "patent boxes." Together, these factors can give foreign manufacturers a significant edge over their American counterparts. This situation is not new, but has become exacerbated in recent years as foreign governments have increasingly turned to tax law to help their companies compete internationally.

As an example, in 2011, Corning's U.S. effective tax rate ("ETR"), including state taxes, was approximately 36% and our average foreign ETR was 17%.[1] In 2012, while both rates are

[1] This ignores one-time special items and considers only consolidated affiliates. Note that this is a non-U.S. GAAP measure and is exclusive of equity earnings (e.g. the earnings of companies that we don't control and are included in our U.S. GAAP measure after tax but treated as pre-tax income in our ETR calculation for U.S. GAAP purposes).

increasing, the disparity between our U.S. and foreign rates grows because of the expiration of the U.S. R&D credit and the look-through exception to Subpart F. Corning's example shows how differences in tax laws and incentives between other countries and the United States can result in U.S. companies having fewer after-tax dollars to invest than our foreign competitors.

We therefore are very heartened by a growing consensus among U.S. policymakers on the need to reform the U.S. tax code. Key Members of the House and Senate, as well as the Obama Administration, have all publicly stated the importance of tax reform to the American economy and competitiveness. Starting last year, the Ways and Means and Senate Finance Committees have held hearings exploring this topic and are continuing to do so, as evidenced by our meeting today. In October 2011, Chairman Camp released his discussion draft on corporate tax reform, which we believe spurred the conversation forward dramatically. Last month, Chairman Baucus provided an outline of his thoughts in a major speech on tax reform, noting that other countries have lowered corporate rates and shifted to territorial systems in order to become more competitive. And the Obama Administration also has recognized that our current tax system is uncompetitive, distorts business decision making and slows economic growth. Having such broad bipartisan agreement on the existence of the fundamental problem is in itself a significant development, and we are therefore very optimistic on the prospects for meaningful tax reform.

Because Chairman Camp's 2011 discussion draft is the most detailed legislative proposal on the table, most of my comments are made with it in mind. Chairman Camp's proposal would provide a top corporate rate of 25%; a 95% deduction for the foreign-source portion of dividends received from controlled foreign corporations ("CFCs"); no additional allocation of U.S. incurred expenses such as interest expense to foreign exempt earnings; a deduction for 95% of gain on disposition of stock in certain active CFCs (with no deduction for losses on such transactions); imposition of a 5.25% tax rate, subject to an election to spread the tax over as long as eight years, on pre-effective date foreign earnings; and provisions for the prevention of base erosion.

We believe Chairman Camp's discussion draft contains several provisions that could increase U.S. competitiveness. A substantial reduction in the statutory tax rate is critical. A statutory rate nearing the average rate of our major trading partners would make significant progress toward leveling the competitive landscape and would be more effective than many current incentives in supporting that purpose. The most obvious appeal of a significant tax rate reduction is that it would help all U.S. companies - U.S-based multinationals, U.S. exporters and U.S. companies which operate strictly domestically. However, the chosen rate has to make an impact. A token reduction coupled with a broadening of the tax base would have limited positive effect and could actually hurt U.S. competitiveness. A significant rate cut accompanied by a review of existing, often inefficient, tax benefits is in order.

Mr. Camp's proposal for a territorial tax system could do as much as a rate reduction to foster U.S. competitiveness. Most of the world's tax systems are territorial, excluding from tax the majority of their taxpayer's foreign earned income - including foreign dividends. The current U.S. system of worldwide taxation is expensive to administer, dissuades multinational companies from headquartering in the U.S., and discourages U.S. companies from repatriating foreign earnings. Moving to a competitive territorial system will address all of these issues. Corning appreciates the Camp proposal's flat taxation of five percent of foreign earnings in place of an allocated expense disallowance. This approach is predominate in territorial systems and provides simplicity, thus furthering parity with global systems and reducing the cost of taxpayer compliance and government enforcement.

Moving to a territorial system does present transition challenges, such as how income earned abroad prior to the adoption of the territorial system should be treated after adoption. Some policy makers advocate "bringing everything current" by taxing all pre-adoption foreign earnings immediately. We believe that Mr. Camp's proposal to reduce the rate on such "deemed" repatriation via an eighty-five percent dividends received deduction begins to address the potential hardship that could result from an immediate and potentially large U.S. taxable inclusion that might face companies like Corning who must manufacture abroad. However, the trade-off for the lower rate is that ***all*** foreign earnings would be deemed repatriated without a reduction for losses in separate entities or for earnings that are not represented by cash (i.e. those invested abroad in hard assets and therefore cannot be repatriated). This can be a comparatively harsh result for a capital intensive company like Corning that must put its manufacturing facilities in the same country as its customers. Further study may be warranted to consider the appropriate use of foreign losses, the treatment of trapped earnings, the use of U.S. net operating losses and foreign tax credit carryovers, and the terms for payment of the resulting tax.

Chairman Camp's proposal also includes possible "base erosion" protections. As a starting point, it is important to recognize that the greater the reduction in the U.S. corporate tax rate, the less companies will be compelled to migrate income producing activity or assets. We appreciate, however, the need to carefully consider the possibility that any new system could be abused and to discuss possible protections against abusive erosion of the U.S. tax base. Of the three preventive measures proposed by Mr. Camp, Option C appears to best alleviate the competitive pressure that compels many U.S. technology companies to move research activities and intellectual property offshore. As patent laws around the world become more sophisticated and their enforceability improves, the historic benefits of U.S. technology ownership no longer serve as sufficient compensation for a higher U.S. tax burden on the related income. Mr. Camp's Option C, which levies a fifteen percent tax on foreign income generated by U.S.-owned intangibles, will help U.S. companies with U.S.-created and owned intellectual property to compete with those that create and own such property abroad. In this area too, any broadening of the tax base accompanying a tax rate reduction on foreign earned income from intellectual property must be measured for total effect. We are aware of concerns raised by software makers and others regarding the potential negative impact Option C could have on their business models. Corning looks forward to working with all interested parties to ensure that any such provision supports the competitiveness of all U.S.-based companies.

Another aspect of tax reform that must be considered relates to provisions intended to incentivize the creation of technology in the United States. We believe such provisions should be broadened and made more efficient in order to make them more effective in improving the competitiveness of U.S. technology and manufacturing companies.

It is hard to disagree with incentivizing the conduct of American research and development, but a comparison of the U.S. R&D credit to those that exist in some other countries shows that the

U.S. incentive is complex and uncompetitive. As an example, consider Corning's recent experience with the U.S. R&D credit compared to the French R&D incentive. Ninety-five percent of Corning's R&D expenditures fund activities conducted in the United States. Much of the balance of our R&D occurs in France. Last year Corning's U.S. R&D credit as a percentage of its total U.S. R&D expenditure was approximately 1.2%. By contrast, in France it was approximately 30%. Further, calculation of the U.S. R&D credit is so complex that it often requires the hiring of a consulting firm with sophisticated software. If the R&D credit is to be effective, it must undergo significant reform.

Another tax benefit offered to U.S. manufacturers is the Domestic Manufacturing Deduction. This incentive does reduce the tax impact of the high regular tax rate in the United States, but is also extremely complex and is not available to manufacturers that have suffered U.S. operating losses. We would expect that many smaller manufacturers also would have difficulty obtaining a benefit from it due to its complexity and/or operating losses attributable to the most recent recession. Like the R&D credit, the Domestic Manufacturing Deduction could benefit from reform in order to become a more effective investment incentive.

Summary

In summary, we believe tax reform is a necessary action for the competitiveness and economic health of the United States. For U.S.-headquartered companies competing at home or abroad, the current system is cumbersome and inefficient. Many developed nations have modified their tax policies to facilitate competition and encourage domestic investment. The United States should not allow its major trading partners to gain an advantage through tax policy modernization. Moving to a competitive territorial system with a competitive tax rate will result in benefits both to the United States and its manufacturers.

Thank you again for the opportunity to participate today. Corning commends the Committee for its work on tax reform to date and urges it to continue the effort. We stand ready to work with you to reform the tax code in a manner that is positive for American companies and the American economy.

5

Chairman CAMP. Mr. Hardt, you are recognized for 5 minutes.

STATEMENT OF RALPH E. HARDT, PRESIDENT, JAGEMANN STAMPING COMPANY

Mr. HARDT. Good morning, Chairman Camp, Ranking Member Levin, and all committee members. Thank you for the opportunity to testify before you today on an issue that impacts manufacturers of all sizes, especially small businesses like ours.

I am Ralph Hardt, President of Jagemann Stamping based in Manitowoc, Wisconsin. Chairman Camp got it pretty close in your introduction, thank you.

Chairman CAMP. All right.

Mr. HARDT. It is a family-owned business, with 300 employees, where we manufacture precision metal parts and export 22 percent of our products over 15 different countries. We have a subsidiary in Nashville, Tennessee with 33 personnel as well. I am also chairman and owner of another small manufacturing company in South Carolina, with 31 employees in precision grinding and finishing. My involvement with these three small businesses located in very different parts of the country, gives me an excellent understanding of how to compete globally and grow investments in our equipment and our employees. We are also members of the Precision Metal Forming Association, and National Tooling Machines Association, which together have about 3,000 companies averaging 50 employees per business. Most are family owned and about 2/3s of these companies are structured as Subchapter S corps with some more pass-throughs. How our businesses are organized and the way we pay taxes has the single greatest impact on our companies, and how much we can reinvest in our businesses.

For example, one of our members, a New England based manufacturer with roughly 200 employees will see a 6 percent effective tax rate increase this year compared to 2011, assuming no congressional action will take place, and could jump as much as 15 percent.

With so much uncertainty over upcoming tax increases and changes, small companies and small manufacturers like us are becoming very conservative right now, are frozen in place and possibly not making significant investment in our business. This is a very important point. The uncertainty in a Tax Code and what the future holds keeps many manufacturers from investing as much as they should or could to grow their business, purchase new equipment, and hire new employees.

In fact, even the Federal Reserve chairman when testifying recently before Congress, said, “The global and other uncertainties are slowing the demand for capital investment.” This is simply the wrong thing needed for our country right now.

In order for manufacturing to succeed in this country, we need stability and transparency in our Tax Code. In our industry, we often have to investment millions of dollars annually into new equipment, research and training for our employees to remain globally competitive. We therefore fully support expanded bonus depreciation, Section 179, domestic production activity deductions as tools manufacturers use to create jobs and compete globally.

For example, our precision grinding company in South Carolina with barely 30 employees just bought a new machine for $270,000, that require three additional new employees to operate; a 10 percent increase in our workforce.

What many policymakers in Washington do not understand, is unlike larger corporations, small manufacturers like us are required to provide a personal guarantee for most loans when purchasing capital equipment, or expanding our facilities. I just recently signed a personal guarantee for the new $270,000 grinder I just mentioned. This means as a small business owner, I have to put even my family’s home on the line and take significant risk if I want to grow my business and compete globally.

In Wisconsin, our investment over the years come up to 147,000 per employee and we spent over half a million in research and development. There is a lot of noise in Washington right now about only raising taxes on wealthy to pay for government programs and hopefully balance our federal budget. However, small businesses, we may report 250,000 or more in profit, but few manufacturers actually take those profits home. They will overwhelmingly reinvest it in the business and our employees manufacturing in America. Based upon an industry survey, most small manufacturing business owners pay a combined tax rate of 36 percent, distribute 18 percent; however, reinvestment between 46 and 50 percent back into the business.

Tax increases also result in reduced cash flow potential, further limiting access to capital which is already difficult enough for small business lenders to secure. Lenders and other investors in a new business look at the tax implications as closely as we do whether deciding, or not, to funding manufacturing investments.

We, again, need a reformed tax structure in this country, which encouraging Americans to start, and I emphasize this is important, to be compelled to start or expand any manufacturing businesses here and hire new employees here in the U.S. Comprehensive tax reform to us means fixing the problem for both traditional C corps and S corp pass-throughs at the same time; the vast majority which are family-owned.

With over 70 percent of all U.S. manufacturers structured as pass-throughs, companies like ours contributing the overwhelming economic activity in the sector which accounts for a substantial portion of our GDP.

However, small manufacturers are ready to step up to the plate on tax reform, and will forego some tax credits and deductions if it means a lower effective rate for all manufacturers in solving our Nation's budget crisis. However, we cannot afford to fix the problems on the backs of family-owned businesses and only address larger corporations or multinationals without remembering that again, 70 percent of us in manufacturing are structured this way.

I strongly urge politicians to move beyond labels, rich versus poor, employer versus employee. No manufacturing company can succeed without strongly investing in their employees and equipment. Tax reform needs to happen for everyone.

On behalf of Jagemann Stamping, Jagemann Precision Plastics, Labtech Industries, and all of our employee associates, I thank you very much for the opportunity to testify before you today, and I look forward to answering any questions you may have.

Chairman CAMP. Thank you very much, Mr. Hardt.

[The prepared statement of Mr. Hardt follows:]

Written Testimony of
Ralph Hardt
President
Jagemann Stamping Company
Manitowoc, WI

Before the
House Committee on Ways and Means

Hearing on
Tax Reform and the U.S. Manufacturing Sector

July 19, 2012

Chairman Camp, Ranking Member Levin, members of the Committee, thank you for the opportunity to testify before you today on this important issue that impacts manufacturers of all sizes, especially small businesses like ours. My name is Ralph Hardt. I am the President of Jagemann Stamping Company based in Manitowoc, Wisconsin, a fourth generation family-owned business with three hundred employees where we manufacture precision metal parts for defense, solar energy, industrial machinery, and automotive customers and export 22 percent of our products to over 15 different countries around the world. We also have a subsidiary in Nashville with 33 employees where we do precision insert molding. I am also Chairman of another small manufacturing company in South Carolina with 31 employees where we do precision grinding and finishing for industrial, medical and other industries. In all of these operations we provide full health care and other benefits to our employees, whom we consider as members of our extended family. My involvement with these three small businesses, located in very different parts of the country manufacturing highly technical parts, gives me an excellent understanding of how to compete globally and grow our investments in equipment and our employees.

I am also a member of the Precision Metalforming Association and National Tooling and Machining Association, which together have about 3,000 member companies averaging about 50 employees per business, most of which are family-owned or closely held like ours. About two-thirds of these companies are structured as Subchapter S corps or similar passthroughs. How our businesses are organized and the way we pay taxes has the single greatest impact on our companies and how much we reinvest in the business.

For the record, I have attached the formal comments these two associations submitted to the Ways and Means Subcommittee on Select Revenue regarding their June 8, 2012 Tax Extenders hearing. In addition, for the record, to further demonstrate the impact of tax reform on small manufacturing businesses, I have attached as Exhibit 1 a tax template created by accounting firm Plante & Moran in partnership with the two associations. The sample template was completed by a New England based manufacturing business with roughly 200 employees and demonstrates the impact on that particular manufacturer should Congress eliminate certain tax deductions and credits or increase certain rates. In this New England manufacturer example and based on their current claims and deductions, this 200-employee company will see a 6% Effective Tax Rate Increase in

2013 compared to 2011 law assuming no Congressional action and will jump 15% under a worst case 39.6% scenario with no deductions permitted. Some smaller companies have shown a 15% increase in 2013, and a 7% increase under 39.6% with no deductions.

The manufacturing businesses I manage in Wisconsin and Tennessee are both structured as S-Corporations where the individual owners pay the taxes, whether at a 35 percent rate or possibly in the future up to 39.6 percent. However, the small manufacturing business in South Carolina is still structured as a traditional C-Corporation, subject to double taxation. While the company was initially incorporated in this way when we bought it, we fully planned on changing its structure to an S-Corporation. However, given the uncertainty over upcoming tax increases and potential changes, we are frozen in place.

This is an important point – the uncertainty in the tax code and what the future holds keeps many manufacturers from investing as much as they should or could to grow their business, purchase new equipment and hire more employees. In order for manufacturing to succeed in this country we need two things – stability and transparency in our tax code. Particularly in an industry like ours, we often have to invest millions of dollars into new equipment and training for our employees to remain globally competitive. We fully support expanded bonus depreciation, Section 179 expensing, and the Section 199 Domestic Production Activity Deduction as tools manufacturers use to create jobs and compete globally. For example, our precision grinding company in South Carolina with barely 30 employees just bought a new machine for $270,000 that will require 3 additional new employees to operate. As any business owner knows, you typically purchase large capital equipment in one of two ways – out of your profits or through borrowing – which is increasingly more difficult for a small manufacturer like us to secure.

What many policymakers in Washington do not understand is unlike larger corporations, small manufacturers like us are required to provide a personal guarantee for most loans when purchasing capital equipment or expanding our facilities. I just recently signed a personal guarantee for the new $270,000 grinder I just mentioned. This means as a small business owner, I have to put my family's home on the line, and take significant risks if I want to grow my business and compete globally. For example, in Wisconsin, we have made significant progress manufacturing critical high precision metal components and exporting them around the world. However, that took millions of dollars in investments over the past several years, done so even in a poor economy at a greater investment rate than our total profits. In fact, the total investment in our Wisconsin facility over the years comes out to $147,000 per employee. In addition, this year we plan on spending approximately $500,000 in Research and Development. We found out early on that we cannot compete globally or even survive domestically if we do not continuously invest in equipment and our people. This is why tax reform is so important to manufacturing companies across the country – to free up capital for investing in people and equipment and to hopefully provide more certainty to aid in our decisions.

More than 70 percent of manufacturers are structured as S-Corporations or other passthroughs paying taxes at the individual rate, which is poised to jump to 39.6 percent. There is a lot of noise in Washington right now about only raising taxes on the "wealthy" to pay for social programs and hopefully balance our federal budget. However, as a small business, we may report $250,000 or more in profit but few manufacturers take those profits home – they are overwhelmingly reinvested in the business and our employees manufacturing in America. This means that the less resources we have due to paying more taxes ties our hands and does not allow us to buy new million dollar machines that need new employees to run.

The majority of manufacturers like us leave most of the money in the business, directly reinvesting in our employees, facilities and equipment. Due to our current U.S. tax code, we are taxed on income we do not take out of the company but leave in the business to reinvest. This means we have fewer resources to put towards hiring, training and buying new machines. Based on an industry survey among small manufacturers, most small manufacturing business owners pay 36 percent in taxes, distribute 18 percent to owners and reinvest 46 percent in the business. And that is conservative. In sum, when more money goes towards federal, state and local taxes, less is reinvested in our employees, equipment and manufacturing plants.

If statutory rates increase by nearly 5 percent as scheduled, business owners have to take it out of the pie somewhere, either from the owners' families, or from the reinvestment in the employees and company, usually both. Tax increases result in reduced cash flow in the business, causing a major unintended ripple effect, limiting access to capital which is already difficult enough for a small business to secure.

Another unintended consequence of our current tax code is the way it discourages manufacturers from starting their own business. When an entrepreneur sits down with their lender or venture capitalist they must factor in whether a temporary tax incentive will still be there for them in six months or whether they will have enough capitalization in the startup to cover upcoming tax increases. Lenders, venture capitalists and other investors in a new business look at the tax implications as closely as we do when deciding whether or not to fund a new manufacturing plant in the U.S. We need a reformed tax structure in this country which encourages Americans to start their own manufacturing business and hire new employees.

Banking and other lending requirements have toughened, forcing most owners to leave retained earnings in the business for the sole purpose of meeting collateral requirements. Profits left in the business are still subject to taxation even before distribution to the owner creating a current system which penalizes and taxes business owners who leave money in the business for reinvestment, resulting in reduced ability to secure loans. Therefore, increased tax liability means less money in the business, which will restrict the ability of a small business to access timely and sufficient credit to purchase machines, expand their facilities and hire new employees.

Since I became President of Jagemann Stamping in Wisconsin, we have grown our exports by over 30 percent – this means we face global competition not only here in the U.S. but when marketing overseas. This is where tax deductions and credits come in as the only tool we have to reduce our effective tax rate unless Washington can finally act on comprehensive tax reform.

Comprehensive tax reform means fixing the problem for both traditional C-Corporations and S-Corporation passthroughs at the same time, the vast majority of which are family-owned. With over 70 percent of all manufacturers structured as passthroughs, companies like ours in Wisconsin and Tennessee contribute the overwhelming share of economic activity in this sector which accounts for 12 percent of our nation's GDP. We simply cannot afford to sacrifice 70 percent of our nation's manufacturers in the name of tax reform – we need a comprehensive solution that incorporates all businesses, especially small manufacturers like ours.

Small manufacturers are ready to step up to the plate on tax reform and possibly forego some tax credits and deductions if it means a lower effective tax rate for all manufacturers and solving our nation's budget crisis. However, we cannot afford to fix our nation's problems on the backs of family-owned small businesses and only address larger corporatious or multinationals that are predominately C-Corporations.

I remember working my way through school at Arby's and at a local lumber yard, experiences that shaped my perspective as an employer. Most of the business owners today I know got their start when they were just a teenager, sweeping the shop floor of their parent's manufacturing plant. Now, they are the owners and hope to someday pass along their family business to their children. This is part of the main reason so many manufacturers are structured as passthroughs – they want their children to inherit the family business and grow. When asked by policymakers in Washington why S-Corporations simply do not convert to becoming a traditional C-Corporation the answer is clear – when an owner passes a company down to the next generation there is a much greater tax liability in a C-Corporation and the costs associated with the conversion are astronomical, especially for a small business.

I strongly urge politicians to move beyond labels – rich vs. poor or employer vs. employee. No manufacturing company can succeed without investing in their employees and equipment and we cannot do that without sufficient capital in the business and a solid ability to borrow. Tax reform needs to happen for everyone, whether a C-Corporation, an S-Corporation, or an individual regardless of income. Small manufacturers like ours have to compete not only globally but also against much larger manufacturers. This is why we reinvest every cent we can back into the business. But every penny we pay to the government in taxes is less that we have available to purchase a million dollar machine or hire the five employees we need to make our new parts and jumpstart the American economy.

Thank you for the opportunity to testify before you today and I look forward to answering any questions you have.

ONE VOICE
PMA
OH 44131

June 22, 2012

The Honorable Pat Tiberi
Chairman
House Subcommittee on Select Revenue Measures
1101 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Tiberi:

On behalf of One Voice, the joint effort between the National Tooling and Machining Association (NTMA) and the Precision Metalforming Association (PMA) based in Ohio, and our nearly 3,000 nationwide metalworking member companies, thank you for your leadership and continued efforts to address tax reform. Please accept these comments in response to your request for input following your hearing on the Framework for Evaluating Certain Expiring Tax Provisions on June 8, 2012 ("tax extenders hearing"). These comments focus on expiring provisions included in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 and related expiring tax law.

While we will formally comment on comprehensive tax reform at a later point, at this time we will focus specifically on the tax credits and deductions that our member companies report using to help them create jobs and remain globally competitive. Our member companies are primarily family-owned small and medium-sized middle market manufacturers with fewer than 50 employees who supply tooling, parts and other components for manufacturing machinery or goods serving the automotive, defense, aerospace, medical, agriculture, electrical and energy, among other industries. A recent survey of our members showed that roughly 60 percent are structured as Sole Proprietorships and other "pass-through" entities, such as S Corps and LLCs which account for 72 percent of all small businesses in the U.S. and 80 percent of all manufacturers.

Manufacturers, including small businesses, utilize tax credits and deductions to relieve their tax burden, lower their effective tax rate, and improve global competitiveness. If tax reform involves eliminating credits and exemptions, Washington must lower tax rates for all manufacturers, whether C Corporations, S Corporations, Partnerships or any other pass-through entities.

Our members utilize numerous tax provisions not discussed here, many of which are applicable more broadly to corporations and business owners. Survey results are based on responses in January 2012 from 131 One Voice manufacturing company executives.

Other tax provisions important to One Voice members included in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("TRUIRJCA") and related expiring tax law but not discussed in detail here include:

- Overall limitation on itemized deductions and the personal exemption phase-out
- Reduced rate on dividends and capital gains
- AMT relief
- Energy efficient appliance credit
- Deduction of State and local sales taxes
- Above-the-line deduction for qualified tuition and related expenses (employees benefit)
- Refundability of unused AMT credits
- Employer wage credit for employees who are active duty members of the uniformed services
- Enhanced charitable deduction for corporate contributions of computer inventory for educational purposes
- Expensing of environmental remediation costs
- Basis adjustment to stock of S corps making charitable contributions of property
- Temporary exclusion of 100 percent of gain on certain small business stock

These comments focus on the following tax deductions, credits and provisions as examples and is not a comprehensive list and is not limited to those included in TRUIRJCA.

- R&D Tax Credit
- Section 199 Domestic Production Activity Deduction
- Bonus Depreciation, 100% Expensing, and Section 179 Increased Expensing
- Last-in-First-Out (LIFO)
- Interest Charge Domestic International Sales Corporation (IC-DISC)
- Estate Tax

R&D Tax Credit (R&D)

As it is in many other industries, the R&D Tax Credit is an important component of innovation for small and medium-sized manufacturers. Fifty-three percent of One Voice members who responded reported using the R&D Tax Credit. This figure is down somewhat over previous years as some members cite increased audits by state and federal officials over the use of the R&D Tax Credit. This has dissuaded some small manufacturers who lack necessary resources from taking advantage of the credit in order to avoid costly audits. As one manufacturer reported, "paying $20,000 in accounting and legal fees to support a $40,000 R&D credit simply isn't worth it." R&D is an important tool which incentivizes manufacturers to conduct domestic innovation activities and is a high priority for One Voice manufacturers. Further, the ability to claim R&D credits against AMT liability as an offset is an important tool for manufacturers.

Section 199 Domestic Production Activity Deduction (Section 199)

The Section 199 deduction is one of the few provisions within the tax code that truly focuses on manufacturing in America. While not as well known by smaller manufacturers as other credits, nearly half of One Voice members report claiming the Section 199 Deduction. A renewed and focused deduction is critical for helping manufacturers level the global playing field. For manufacturing companies that used the Section 199 Deduction, they reported a 3.15 percent effective tax rate reduction (based on a 35 percent rate). When the majority of privately held manufacturers report they invest most of their earnings back into the company, paying a 3 percent lower effective tax rate frees up resources to invest in equipment and hiring workers. For those who use it, this deduction is among the most effective in improving global competitiveness, especially when the U.S. now has the highest corporate tax rate in the developed world.

Bonus Depreciation, 100% Expensing, and Section 179 Increased Expensing

Members of One Voice are heavy investors in capital equipment with machines that they purchase regularly costing over $1 million. While 99 percent of One Voice members are classified as small business and most of those make "small parts," they use sophisticated machines which are costly investments. Purchasing new capital equipment is a major undertaking for a small business who must hire additional workers to operate the machines. In the survey, 88 percent of One Voice members report using the Section 179 Expensing provision for capital equipment of which 78 percent claimed Bonus (Accelerated) Depreciation. These numbers reinforce how critical purchasing equipment is to this industry.

A majority of members reported maxing out their Section 179 before turning to Bonus Depreciation. However, most of the equipment purchased by One Voice members exceeds the Section 179 limits on expensing which is why so many turn to Bonus Depreciation. While these businesses meet the Small Business Administration's intent with Section 179, a 10-person machine shop will purchase a $750,000 machine when expanding operations and often factors in tax incentives when deciding whether or not to make such a significant investment. Extending and increasing the allowable limit for capital expensing is critical for One Voice members and this industry. One Voice members describe Bonus Depreciation as the provision that has the greatest influence over their activities -- such as whether or not (and/or when) to purchase capital equipment costing $1 million which often requires hiring more employees.

Last-in-First-Out (LIFO)

Nearly one-third of One Voice members reported using LIFO as an inventory accounting method. However, respondents in particular industries report more usage than others. For example, LIFO is used more frequently by automotive suppliers but it also depends on the state of the particular industry our members supply. For those who utilize LIFO, it makes a significant impact. A business with roughly 300 employees supplying the automotive and defense industries reported having more than $750,000 in LIFO exposure.

Interest Charge Domestic International Sales Corporation (IC-DISC)

As manufacturers increasingly look to increase export sales, they are exploring various opportunities and incentives to address foreign markets. While only 11 percent of One Voice members report claiming IC-DISC, 58 percent of respondents report exporting parts and products abroad, a significant increase over previous years. As the economy improves and small manufacturers learn more about exporting opportunities, we expect the number of manufacturers who utilize IC-DISC to increase. For those companies who have long thrived on exports, IC-DISC remains a critical component of their strategy to make their costs more globally competitive when selling their parts and tooling overseas.

Estate Tax

The vast majority of One Voice members are structured as family-owned small businesses. Many companies are now controlled by the third and fourth generations and often employ generations of families on the shop floor from the grandchildren to grandparents. Family-owned businesses are facing a crossroads, as many of the baby boomer's parents who founded the companies are passing away while the current owners are planning for their own retirements in the next ten years and are considering their estate planning now. The Estate Tax restricts the ability of family-owned businesses to pass along the company to the next generation of manufacturers putting the employees' futures in jeopardy and risking a business simply closing its doors rather than take out a loan to pay the taxes. One Voice members strongly believe Congress should repeal the Estate Tax entirely. However, recognizing the political and fiscal realities, we urge the Committee not to exceed the exemption level and rates currently in place in 2012 (i.e. $5 million exemption indexed to inflation, 35% tax rate, with spousal transfer and stepped-up basis).

Regardless of the outcome of comprehensive tax reform, manufacturers need stability and transparency in the tax code. A business cannot effectively plan for the future when it is unclear whether Congress will extend a provision before it expires, or gamble that the R&D will be made retroactive. Business owners make decisions for the next year beginning the previous summer and in many cases earlier. Tax credits and deductions can only succeed if manufacturers can trust they will still exist six months from now. The prime example is Bonus Depreciation. A small manufacturer cannot make a decision on whether to purchase a $1 million machine without knowing if they can depreciate the cost of the equipment. A tax credit or deduction, such as Bonus Depreciation in this example, can mean the difference between investing in that equipment and hiring workers or not taking on the new business.

To further demonstrate the impact of tax reform on small manufacturing businesses, we have attached as Exhibit 1 a tax template created by accounting firm Plante & Moran in partnership with One Voice. The sample template was completed by a New England based manufacturing business with roughly 200 employees and demonstrates the impact on that particular manufacturer should Congress eliminate certain tax deductions and credits or increase certain rates. In this New England manufacturer example and based on their current claims and deductions, this 200-employee company will see a 6% Effective Tax Rate Increase in 2013 compared to 2011 law assuming no Congressional action and will jump 15% under a worst case 39.6% scenario with no deductions permitted. Some smaller companies have shown a 15% increase in 2013, and a 7% increase under 39.6% with no deductions.

To strengthen the competitiveness of small and medium-sized manufacturers, we need to simplify and stabilize the tax code and implement policies that encourage investment and eliminate tax disadvantages. The current tax structure is a myriad of high rates, temporary credits, loopholes, and outdated policies that slow growth and competitiveness. In order to compete globally under the current U.S. tax structure, domestic manufacturers must use as many tax incentives as possible to lower their burden, expand their businesses and hire more employees.

Manufacturing businesses employ nearly 12 million Americans, represent more than 10 percent of our entire economy, and are a vital part of America's future economic and national security. Comprehensive tax reform is the single most important stimulus Washington could provide businesses manufacturing in America.

Thank you for your consideration and your leadership on behalf of the metalworking industry.

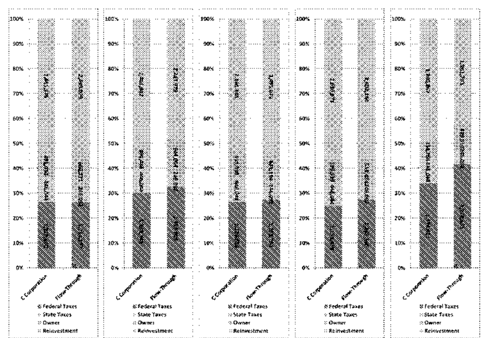
Sincerely,

William E. Gaskin
PMA President

Dave Tilstone
NTMA President

Annual Tax Liability on Manufacturing Entity & Owner - Summary
New England Company

	Current Law - 2011 C Corporation	Current Law - 2011 Flow-Through	Current Law - 2013 C Corporation	Current Law - 2013 Flow-Through	35% - Base Case C Corporation	35% - Base Case Flow-Through	25% Case C Corporation	25% Case Flow-Through	39.6% - Worst Case C Corporation	39.6% - Worst Case Flow-Through
Significant Inputs & Assumptions										
Adjusted Taxable Income	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597
Owner Wages/Bonuses	257,275	257,275	257,275	257,275	257,275	257,275	257,275	257,275	257,275	257,275
Distributions Paid	328,410	328,410	328,410	328,410	328,410	328,410	328,410	328,410	328,410	328,410
IC-DISC Commission	-	-	-	-	-	-	-	-	-	-
Owner's Itemized Deductions (except SALT)	300,000	300,000	300,000	300,000	300,000	300,000	300,000	300,000	300,000	300,000
Is LIFO repealed?	NO	NO	NO	NO	NO	NO	YES	YES	YES	YES
Domestic Producers Deduction (DPAD) Repealed?	NO	NO	NO	NO	NO	NO	YES	YES	YES	YES
Research Credit Repealed?	NO	NO	YES	YES	NO	NO	YES	YES	YES	YES
IC-DISC Benefits Repealed?	NO	NO	NO	NO	NO	NO	YES	YES	YES	YES
Itemized Deduction Phase-out Reinstated	NO	NO	YES	YES	YES	YES	YES	YES	YES	YES
Itemized Deductions Subject to a Tax Rate Limitation	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
Itemized Deductions Repealed?	NO	NO	NO	NO	NO	NO	YES	YES	YES	YES
Consider Depreciation Expense in Calculation?	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
Depreciable Property Placed In-Service	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879
Bonus Depreciation %	100.00%	100.00%	0.00%	0.00%	50.00%	50.00%	50.00%	50.00%	50.00%	50.00%
Maximum §179 Deduction	500,000	500,000	25,000	25,000	500,000	500,000	500,000	500,000	500,000	500,000
Minimum §179 Phase-out Limitation	2,000,000	2,000,000	200,000	200,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Maximum Corporate Income Marginal Rate	34.00%	34.00%	34.00%	34.00%	34.00%	34.00%	25.00%	25.00%	34.00%	34.00%
Maximum Individual Ordinary Income Marginal Rate	35.00%	35.00%	39.60%	39.60%	35.00%	35.00%	25.00%	25.00%	39.60%	39.60%
Federal Individual Dividend Preferential Rate	15.00%	15.00%	39.60%	39.60%	15.00%	15.00%	25.00%	25.00%	39.60%	39.60%
Federal Individual Capital Gain Preferential Rate	15.00%	15.00%	20.00%	20.00%	15.00%	15.00%	20.00%	20.00%	20.00%	20.00%
Unearned Income Medicare Surcharge	0.00%	0.00%	3.80%	3.80%	0.00%	0.00%	3.80%	3.80%	3.80%	3.80%
State & Local Income Tax - Entity Level	9.50%	0.00%	9.50%	0.00%	9.50%	0.00%	9.50%	0.00%	9.50%	0.00%
State & Local Income Tax - Owner Level	5.30%	5.30%	5.30%	5.30%	5.30%	5.30%	5.30%	5.30%	5.30%	5.30%
Millionaires Tax	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	3.00%	3.00%	3.00%	3.00%
Millionaires Tax Threshold	-	-	-	-	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Summary & Statistics										
Cash Used to Pay Federal Taxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Cash Used to Pay State Taxes	446,044	246,692	446,044	246,692	446,044	246,692	446,044	246,692	446,044	246,692
Cash Retained by Owner	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Cash Reinvested in Business	2,465,345	2,495,079	2,401,842	2,247,979	2,465,345	2,495,079	2,046,877	2,602,144	[illegible]	[illegible]
Total Cash Income	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080
% of Cash Used to Pay Federal Taxes	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
% of Cash Used to Pay State Taxes	9.62%	5.31%	9.62%	5.31%	9.62%	5.31%	9.62%	5.31%	9.62%	5.31%
% of Cash Retained by Owner	[illegible]	[illegible]	8.62%	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	7.22%	[illegible]
% of Cash Reinvested	53.18%	53.82%	51.81%	48.49%	53.18%	53.82%	56.67%	56.13%	49.20%	42.32%
Effective Tax Rate on Cash Income	36.14%	31.50%	39.58%	37.62%	36.14%	32.57%	34.50%	32.67%	43.58%	46.91%
Effective Tax Rate Change Compared to 2011 Law			3.43%	6.12%	0.00%	1.07%	-1.64%	1.17%	7.44%	15.41%
Effective Tax Rate Differential of Entity Structure	4.65%	-4.65%	1.96%	-1.96%	3.58%	-3.58%	1.83%	-1.83%	-3.33%	3.33%



Chairman CAMP. Mr. Beck, you are recognized for 5 minutes.

STATEMENT OF KIM BECK, PRESIDENT AND CEO, AUTOMATIC FEED COMPANY, ON BEHALF OF THE ASSOCIATION FOR MANUFACTURING TECHNOLOGY

Mr. BECK. Thank you, Chairman Camp, and Mr. Levin, and Members of the Committee for holding this hearing today and giving me an opportunity to participate. I am here representing small manufacturers, even smaller than Mr. Hardt's here, on behalf of AMT, The Association For Manufacturing Technology, a trade association made up of 600 manufacturers across the United States, most of them with sales of less than $10 million.

I am here to convey to you the toll the great recession has had on this Nation's small business, particularly small manufacturers like Automatic Feed Company, and I want to tell you that small business owners have great concerns about the words and actions coming out of the Federal Government. This year marks 63 years of continuous operation of Automatic Feed Company in Napoleon, Ohio. We were devastated by the recession. We almost didn't survive. In just 12 months, our revenues dropped by 90 percent. Our sales went from $30 million down to $4 million. Prior to the recession, we had 110 employees. They were highly-skilled engineers, welders, machinists, and machine assemblers. 48 of them were skilled union employees. Over the next 2 years, our workforce dwindled to 25. Wages were cut an average of 40% while the top management took 60 percent pay cuts that still haven't been restored.

I have spent the last 4 years trying to save our company. We survived only because we made the necessary sacrifices, and we had very little debt. The banks were under such scrutiny that they were not lending, especially to small manufacturers tied to the automobile industry.

Today, small manufacturers are angry that after they made such great sacrifices, they are now being asked once again to finance a government that is too large, too inefficient and fiscally irresponsible. The rhetoric out of Washington against small businesses is getting louder every day. Why would the government punish small manufacturers with higher taxes and other imposed cost burdens when we are the ones creating jobs? It is illogical and unfair. Often it seems as though the largest impediment to our growth is our U.S. Government. Higher taxes, more regulations, increased health care, and energy costs, outdated policies, and a complicated broken Tax Code all contribute to a significant competitive disadvantage American manufacturers face when compared to foreign counterparts.

In 1975 when I came into this business as a young man out of college, U.S. manufacturing and machine tools were number one in the world. Today, we are number seven behind China, Japan, Germany, Italy, Korea, and Taiwan. Automatic Feed Company has no U.S. competition. Our competition comes from companies that are 100 times larger than we are. They are German, Korean, Japanese, Spanish, and Chinese. For us to consistently outpace our competition, we need to have a lower cost structure. Part of that lower cost structure has to be lower regulations, lower taxes, and support that helps us compete worldwide.

One of the biggest obstacles is our own Tax Code. Today, the United States now has the highest corporate tax rate in the industrialized world. It significantly contributes to an unlevel playing field for American manufacturers. Bad tax policy is not only anticompetitive, but it also leads to less tax receipts collected by the Federal Government. Bad tax policy outsources jobs.

The President proposed letting the Bush tax cuts expire for those making over $250,000 a year. When are our elected leaders going to realize that a tax increase on those who report higher incomes is a direct tax increase on manufacturers like me. Partnerships, LLCs, sole proprietorships, and Subchapter S corporations are a significant share of those that are considered "wealthy" under this tax law, because we file individual income taxes. When in actuality, none of us bring $1 million into our own homes each year. We take that money that we make and we reinvest it into salaries for our people, for R&D, and for modernizing our plants and facilities.

The 3 or 4 percent tax increase means a lot to small manufacturers that were starved of profits during the last recession. Today, we could use that money for reinvestment and help rebuild this economy.

One hundred percent bonus depreciation, increased Section 179, expensing levels, and the R&D tax credit should be extended now. The R&D tax credit has helped us in developing a new product line that we have been working on for 5 years. We haven't made a cent on it yet. It hasn't hit the market, but without the credit, we would not even have tried. In the long term, we need to tackle tax reform across the board. We need to increase the cash flow to our companies through investment, and also free up more days of operation for covering our processes.

And also, we need to keep our current estate tax rates. I want to thank you for this opportunity and I urge you to take the action necessary to help strengthen small businesses and small manufacturers.

Chairman CAMP. Thank you, Mr. Beck.

[The prepared statement of Mr. Beck follows:]

automatic FEED COMPANY

AMT THE ASSOCIATION FOR MANUFACTURING TECHNOLOGY

TESTIMONY OF
KIM W. BECK, PRESIDENT & CEO
AUTOMATIC FEED COMPANY
ON BEHALF OF
AMT – THE ASSOCIATION FOR
MANUFACTURING TECHNOLOGY
Before the
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS & MEANS
JULY 19, 2012

"Tax Issues Facing U.S. Manufacturers"

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INTRODUCTION

Mr. Chairman and members of the Committee, thank you for holding this hearing today and for giving me the opportunity to participate.

My name is Kim Beck, President and CEO of Automatic Feed Co. in Napoleon, Ohio. I am also a member and former Chairman of AMT-The Association For Manufacturing Technology – a trade association representing nearly 600 U.S.-based companies that produce and sell machine tools and other technologies essential to the manufacturing process. While AMT's membership includes large companies such as ExxonMobil, 70 percent have less than $30 million in revenue and half have revenue of under $15 million.

I am here today because I want Congress to understand the significant impact these tax policy discussions have on small manufacturing companies like mine. Business owners have great apprehension about the actions coming out of the federal government. Even though business is much better, the best industry analysts predict a slowdown in manufacturing technology order activity in the last part of this year due in large part to uncertainty about what's happening in Washington. Our sales people are already concerned, seeing quote activity beginning to drop off. The prospect of tax increases and the outlook for real long-term tax reform figure prominently in the anxiety.

COMPANY OVERVIEW

This year marks 63 years of continuous operation of Automatic Feed in Napoleon. In 1952, when our building on Canal Street was purchased, it measured just over 2,000 sq. ft. Today, we boast a 150,000 sq. ft., state-of-the-art facility. Since our humble beginnings, we have been designing and manufacturing coil pressing equipment for the auto industry. Over the years, we have received various awards and honors from automobile companies like Honda, Toyota, Nissan, Chrysler and General Motors.

The Great Recession hit us hard. In just 12 months, we went from a $30 million company to a $4 million company, and by 2009, our facility was mostly dark with no orders. We had to consolidate to a small portion of the plant to save on utility bills. Over the years, we offered stable employment for, at times, up to 175 people. In 2007, just prior to the recession, we employed **110** workers, almost all of which were highly skilled engineers, welders, machinists and machine assemblers – including 48 skilled union employees. Two years later, our workforce was down to just **twenty-five**.

Today, we are clawing back to about where we were before the recession, because we made difficult sacrifices to remain viable – something our government could learn from us. During the financial meltdown, the average wages of the 25 remaining employees were reduced by 40%, with top management taking 60% pay cuts that today still have not been fully restored. It is a horrible situation when you go to bed every night and pray that those most loyal employees don't lose their homes to foreclosure because of pay cuts.

To survive, we increased our efforts to diversify away from autos. Now, we are developing new products for other industries, but it is increasingly difficult trying to remake a 60+-year-old company with the federal government seemingly working against us in every way. Each night on the news we hear of rumblings in this town that will negatively impact our business. Uncertainty abounds. Businesses fear another recession is just around the corner. Every time a new law or resolution is approved, it affects business decision-making.

STATUS OF THE MANUFACTURING TECHNOLOGY INDUSTRY

Although the U.S. manufacturing technology industry is relatively small in terms of numbers, what it contributes has an enormous impact on America's ability to manufacture – and to manufacture competitively. Our companies provide the means by which all products are manufactured. We provide the innovative solutions that ensure those products are world-class. Without our manufacturing technology companies, no other American manufacturing would be possible in the United States. This country would be left to rely on foreign manufacturing technology to make parts and finished products – be they cars, wind turbines, medical devices or even defense systems.

In 1975 when I came into this business as a young man out of college, America was the world leader in building machine tools – the foundation of almost every manufactured product and critical to our defense industrial base. In 2012, we stand a distant 7th behind China, Japan, Germany, Italy, Korea, and Taiwan.

Even so, the outlook for manufacturing technology is positive considering the lackluster recovery and persistent unemployment. AMT reports that May orders were up 14.5% from April and up 19.0% from May 2011. Overall, 2012 is up 12.1% compared with 2011. This latest data indicates sound health. While the latest Purchasing Managers Index saw a slight contraction, overall indications are that manufacturing will continue to lead the general economic recovery.

Our market is expected to realize a 10-15% growth in orders for 2012 over 2011. This is phenomenal when taken in perspective. In 2010, the industry realized a 91% gain in 2010 over 2009 and another 66% gain last year over 2010 – finally overtaking 2007 levels, our last peak year before the recession. We've made up a lot of lost ground in two years, but it will be difficult to sustain that upward trajectory without some decisive action out of Washington.

TAX CODE ADVERSELY AFFECTS SMALL MANUFACTURERS

It seems as though the largest obstacles to continued growth are created by the U.S. government. High taxes, burdensome regulations, increasing healthcare and energy costs, outdated policies and complicated, broken processes all contribute to the significant competitive disadvantage American manufacturers face when compared to our foreign counterparts.

Your first reaction might be to ask "What law can we enact? What program can we create? What tax incentive can we pass to reverse this trend?" I am here to tell you little will make any difference unless we take action to make the United States a better place to do business. The cost of running a company in this country is becoming prohibitive.

My company's competition is foreign-based. Every competitor is at least 100 times bigger than us. They are German, Korean, Japanese, Spanish and Chinese. For Automatic Feed to be competitive, we must have a cost structure similar to our competitors. For us to consistently outpace our competition, we need to have a lower cost structure. U.S. manufacturers cannot be successful against foreign competitors that have little or no regulatory costs, lower taxes, and export subsidies without appropriate action from our government to level the playing field.

A major obstacle is our own tax system. It significantly adds to our competitive disadvantage in the global marketplace. The United States now has the highest corporate tax rate in the industrialized world. In addition, unlike most industrialized nations, it has a worldwide system of taxation. These factors make it less attractive for companies (foreign and domestic) to invest and manufacture in the United States and more attractive for companies to invest and manufacture overseas.

Bad tax policy is not only anticompetitive; it also leads to less tax receipts collected by the federal government. For example, in 2007, my employees paid $1 million in payroll taxes. Automatic Feed paid another $1 million in income taxes. Two years later, with only 25 employees and drastically reduced revenue, tax receipts from my company decreased substantially. Those remaining 25 employees, in an attempt to save the company, accepted pay reductions that not only represented a significant decline in income, but in tax revenue as well. Obviously, our laid off workers didn't pay taxes either.

SHORT-TERM – EXTEND ALL BUSH TAX CUTS

Now that business is stronger, small manufacturers need to reinvest their income into developing new products and conquering new markets. New products mean innovation and job creation. Tax increases simply leave less for investment and jobs. The last thing Congress should do right now is raise taxes on small manufacturers just as we are rebounding after a devastating recession, especially to finance more government spending. President Obama and some in Congress propose to do exactly that by calling for the expiration of the Bush tax cuts on incomes over $250,000 a year. The federal government must recognize that a tax increase on those who report income in the top brackets is a direct tax increase on manufacturers like me. Partnerships, LLC's, Sole Proprietorships and Subchapter S corporations are a significant share of those who are considered "wealthy" under current tax law, because they file individual income taxes.

Economists estimate that letting the cuts expire for upper earners would generate $850 billion over 10 years. That's $85 billion a year in revenue, a sizeable sum by most metrics; but it amounts to less than seven percent of our projected 2012 deficit of $1.17 trillion. A 3-4% tax increase, on the other hand, means a lot to the small manufacturers that have been starved of profits during the recession. They are eager to reinvest their income directly back into their businesses and continue to drive the economy forward. Successful small businesses that are investing and creating jobs – essentially leading the recovery – would bear the brunt of the burden.

EXTEND 100% BONUS DEPRECIATION/INCREASED SEC. 179 EXPENSING

American manufacturers are never going to compete successfully with low-cost foreign producers on the basis of low wage rates or lower worker benefits. We can only compete on the basis of our higher productivity and quality – making things faster, cheaper, and better. That's where newer and more productive equipment comes in. Companies emerging from the recession are eager for the latest manufacturing technology, and they come from all sectors of the economy – healthcare, automotive, defense, energy and aerospace. If manufacturing is to continue to strengthen U.S. economic growth and competitiveness, these companies must be able to expand their investments in state-of-the-art machinery and manufacturing processes.

In today's emerging markets, rapid innovation is what determines who gains market share. However, the anemic recovery and nagging uncertainty about the future have made many companies cautious about investing and hiring. Bonus depreciation and increased Section 179 expensing can be deciding factors for businesses considering equipment upgrades or company expansions. These two incentives most assuredly contributed to the impressive growth in manufacturing technology orders in 2011. Reducing these incentives for 2012 and beyond effectively increased the cost of job-producing capital investment at the worst time – just as the economy is showing signs of life. This is the wrong time to thwart the investment and modernization that is directly related to innovation and job creation in the United States. Now is when 100% bonus depreciation and enhanced Sec. 179 small business expensing can have a significant impact on 2012 investment decisions.

EXTEND THE RESEARCH & DEVELOPMENT (R&D) TAX CREDIT

Since the R&D tax credit was first enacted in 1981, it has been extended more than a dozen times, sometimes retroactively. This obviously negates its effectiveness as an incentive to expand research. Most recently, the credit was allowed to expire just as companies were in a better position to take advantage of it. There's no question R&D leads to new technologies and innovation – key drivers of productivity, economic growth and job creation – and that the R&D tax credit spurs greater R&D. We used the credit during the recession to keep our company going, developing a new product at a critical time. Without the credit, we may not have made the investment.

LONG-TERM TAX REFORM IS CRITICAL

Fear of the unknown is a considerable impediment to growth, especially in a lackluster economy. Until Congress takes significant action to fix the tax code and rein in spending, businesses will continue to play it safe with investment and hiring decisions. Piecemeal fixes and temporary extensions of incentives important to American businesses only add to our competitive disadvantage.

Congress must find the political courage and determination to tackle real tax reform to give businesses the confidence they need to invest and hire. It must be simple and balanced. I commend Chairman Camp's leadership in offering a tax draft for consideration which lowers corporate rates and moves the U.S. to a territorial system of taxation. I urge this Committee to remain mindful of the small manufacturers that don't file under the corporate code. Both individual and corporate rates must come down to a level which allows us to compete with other nations. Otherwise, manufacturing goes overseas and with it goes innovation and jobs. Simplification and balance are key to bringing down compliance and filing costs.

It is important that attention be given to the small manufacturers in my industry that are cash-based businesses, which depend on working capital for orders that can take many months or longer to complete. Uncertainty surrounding the timeliness of paid receivables and a need for a steady cash flow for day-to-day operations and investments creates challenges for these critical supply chain manufacturers. Often, we are squeezed between our customers that require terms that don't pay in full until after delivery (or, in many times, after the equipment produces its first parts) and our lenders who are increasingly hesitant to fund Work-in-Process, making it impossible to take orders. So the orders go to our foreign competitors. Some companies have turned to self-financing to avoid banks altogether, but this takes resources away from R&D, business development and job creation. Tax preferences, such as 100% expensing, net operating loss caryover and a permanent R&D tax credit, are essential to helping alleviate the negative impact of uneven cash flow on day-to-day operations.

For our customers, a permanent R&D tax credit and 100% expensing mean increased investment in research and state-of-the-art facilities and processes. Current depreciation schedules are sorely out of sync with the rapid pace of manufacturing technology. Allowing companies to recover the cost of their capital investments sooner will encourage modernization of plants and processes.

Our tax code must do more to support small business growth rather than hinder it. According to the Small Business Administration, small businesses represent more than 99% percent of all employer firms, employ half of all private sector employees and generated 65 percent of net new jobs over the past 17 years. Yet they get little support from the federal government and repeatedly bear the brunt of tax provisions targeted for other groups. The estate tax is a prime example.

My most valuable investment is the company itself. Automatic Feed has been in my family for 63 years. Many of our nation's best companies are small, family-owned businesses that want the opportunity to keep the business in the family from generation to generation and to continue to provide good, high-paying manufacturing jobs in the community. However, families are often forced to sell their businesses to pay estate taxes. Absent total repeal, Congress should extend the current estate tax rates. Estate taxation is one of the most arcane and complicated parts of the federal tax code and must be part of comprehensive reform.

I recognize that the original intent of the estate tax was to prevent massive wealth from building up among a small number of families. But that intent has long been outwitted by an ever-complicated tax code that allows very wealthy individuals a number of options for shielding their "wealth" from this federal tax, including corporate structures and foundations. As a result, a tax originally aimed at the super rich is hitting small American businesses on the chin – and ensuring that families that don't have the resources to shelter their "wealth" are the ones who bear the burden of this tax. Stop gap measures usually have this result. The Alternative Minimum Tax is another example.

In any discussion of tax reform, fiscal restraint must be part of the equation. The real problem is not a lack of revenue but out-of-control spending. Consider that in 2000 (the last time the U.S. ran a budget surplus), the federal government spent $1.8 trillion and collected $2.0 trillion in revenue. Fast forward to 2012 when spending is projected to reach $3.4 trillion and tax receipts to total $2.4 trillion. Government spending nearly doubled over a 12-year period. If I had operated my business the way our elected leaders run our federal government, I would not be sitting here before you today.

CONCLUSION

I commend Congress' efforts to tackle these significant issues. We cannot put people back to work and get this economy moving again if high taxes and other costs of doing business continue to sap manufacturers' ability to compete. What American small manufacturers need right now is tax relief and tax certainty.

Perhaps more important than what we need is what we don't need. We don't need higher taxes on top of increasing health care costs and regulatory requirements that are increasingly burdensome. We don't need temporary fixes, and we most assuredly don't need additional spending paid for on the backs of small manufacturers.

I hope you understand the importance of what you have heard here today and take the bold action necessary to rein in federal spending and enact simplified, balanced tax reform to create a better business environment for America's small manufacturers. That is the only path to sustainable economic growth and world-class competitiveness.

Thank you. I would be pleased to respond to your questions.

Chairman CAMP. Mr. Spinks, you are recognized for 5 minutes.

STATEMENT OF HUGH SPINKS, VICE PRESIDENT OF TAX, AIR LIQUIDE USA, INC.

Mr. SPINKS. Mr. Chairman, and Members of the Committee, I appreciate the opportunity to testify today on the issue of corporate tax reform to produce a more simple, predictable, and competitive tax environment in the U.S.

My name is Hugh Spinks and I appear today on behalf of Air Liquide USA, one of the Nation's leading industrial and medical gas companies. Air Liquide is the world leader in industrial medical gases. We operate in 80 countries around the world, employing over 46,000 world citizens. Headquartered in Houston, Texas, Air Liquide USA, has over 5,000 American employees, in more than 200 locations throughout the country, and actually a physical presence in all 50 States. For decades, Air Liquide has offered industrial and medical gases and related services to the Nation's largest industries, including manufacturing, electronic, and health care. Air Liquide is focused on technological innovation to help make our Nation's manufacturing and industrial sectors more efficient, environmentally friendly, and productive.

The industrial gases business is an essential and thriving cornerstone of American manufacturing and technology, reaching into every conceivable sector of the economy. Air Liquide, is committed to significant growth and domestic expansion, and in fact, has doubled its investment in the United States during the last 5 years.

This investment has created new jobs, and access to critical products and technologies in communities throughout the Nation; from Texas to North Dakota, from California, to Delaware.

We see the future for U.S. manufacturing as bright, and rich with opportunities, but we are also pragmatists in the distribution of our resources. In deciding where Air Liquide will make its investments, we examine all of the potential costs, including taxes. With such a large and capital-intensive operation, we oftentimes have more potential projects than capital on a worldwide basis, forcing difficult decisions about where to allocate scarce resources. Corporate tax reform should be designed in a manner that encourages global companies like Air Liquide to make increased capital investment in the United States.

This requires, among other things, a level-playing field, one that is not punitive or discriminatory based upon where a company is headquartered.

Over the last couple of decades, many countries have significantly lowered their corporate tax rates to attract new business investment and create jobs. For example, U.S. competitors in such diverse geographies as Canada, the United Kingdom, and recently Japan, have significantly lowered corporate tax rates and passed legislation to simplify their taxation of business.

With Japan's 2012 corporate rate cut, the Federal plus State income tax rate of about 39 percent in the U.S. is the highest in the OECD. This puts the U.S. in a position of trying to compete for new investment projects with countries whose corporate tax rates are often 7 to 10 percentage points lower.

In spite of the many advantages that the U.S. offers as a premier location to do business, trying to achieve an equivalent after-tax return on investment under these circumstances is challenging. With a lower corporate tax rate of 25 percent as suggested by Chairman Camp, the U.S. would be better able to compete for new projects.

As an internationally headquartered company, Air Liquide is part of the dynamic business community of global companies that play a critical role in the health of the U.S. economy, particularly in the manufacturing sector. The U.S. subsidiaries of global companies employ over 5 million American workers directly nationwide, including 2 million in the manufacturing industry. These companies produce 21 percent of total U.S. exports, conduct 14 percent of domestic research and development spending, and account for 17 percent of U.S. corporate income tax payments.

I applaud the committee's recognition of the important link between tax reform and inbound business investment. To conclude, we support comprehensive tax reform, and we understand there will be trade-offs in the pursuit of a lower rate as well as greater certainty and simplicity in the Tax Code. I thank the committee for inviting me to testify, and I will be pleased to answer any questions that you have.

Chairman CAMP. Well, thank you, Mr. Spinks.

[The prepared statement of Mr. Spinks follows:]

AIR LIQUIDE

Statement of Hugh Spinks
Vice President, Tax
Air Liquide USA LLC
On the Issue of Corporate Tax Reform in the United States
U.S. House Ways & Means Committee
U.S. House
July 19, 2012

Mr. Chairman and Members of the Committee, I appreciate the opportunity to testify today on the issue of corporate tax reform here in the United States. My name is Hugh Spinks and I appear today on behalf of Air Liquide, one of the Nation's leading industrial and medical gas companies. Headquartered in Houston, Texas, Air Liquide has over 5,000 U.S. employees in more than 200 locations throughout the country. For decades, Air Liquide has offered industrial and medical gases and related services to the Nation's largest industries including manufacturing, electronics and healthcare. Air Liquide is focused on technological innovation to help make our Nation's manufacturing and industrial sectors more efficient, environmentally friendly and productive. In 2007, Air Liquide established its Delaware Research and Technology Center which houses more than 100 scientists and engineers specifically devoted to developing innovative applications for gas products in sectors such as electronics, healthcare, energy and food.

The industrial gases business is an essential and thriving cornerstone of American manufacturing and technology, reaching into every conceivable sector of the economy. Air Liquide is committed to significant growth and domestic expansion, and in fact has doubled its investment in the United States during the last five years. This investment has created new jobs and access to critical products and technologies in communities throughout the nation from Texas to North Dakota and California to Delaware. Air Liquide is the world leader in industrial and medical gases and we operate in over 80 countries, employing over 46,000 world citizens.

We see the future for U.S. manufacturing as bright and rich with opportunities, but we are also pragmatists in our distribution of resources. In deciding where Air Liquide will make its investments, we examine all of the potential costs, including taxes. With such a large, capital intensive operation, we oftentimes have more potential projects than capital on a worldwide basis, forcing objective decisions about where the best return on investment exists. Air Liquide evaluates these competing potential projects in different geographies on an after-tax basis, as do many companies.

Over the last couple of decades, many developed and developing economy countries have significantly lowered their statutory corporate tax rates to attract new business investment and create jobs. U.S. competitors in such diverse geographies as Canada, the United Kingdom and recently Japan have recently enacted significantly lower corporate tax rates and legislation to simplify their taxation of business. With Japan's 2012 corporate rate cut, the federal + state income tax rate of about 39% in the U.S. is the highest in the OECD. This puts the U.S. in a position of trying to compete for new investment projects with countries whose corporate tax rates are often 7 to 10 percentage points lower, or even less in many developing economy countries. In spite of the many advantages the U.S. offers as a premier location to do business, trying to achieve an equivalent after-tax return on investment is challenging with a corporate rate far in excess of competing countries. With a lower corporate tax rate of 25%, as suggested by Chairman Camp, the U.S. would be better able to compete for new projects.

As an internationally – headquartered company, Air Liquide is part of the dynamic business community of global companies that play a critical role in the health of the U.S. economy—particularly in the manufacturing sector. The U.S. subsidiaries of global companies employ over five million American workers nationwide, including two million in the manufacturing industry. These companies produce 21 percent of total U.S. exports, conduct 14 percent of domestic research and development spending, and account for 17 percent of U.S. corporate income tax payments. I applaud the Committee's recognition of the important link between tax reform and inbound business investment.

Air Liquide, being a capital intensive manufacturing company, has been able to utilize existing tax preferences in its business. We understand that there is a need for fiscal prudence in any corporate tax reform legislation and that base-broadeners may be required to reach a workable solution. Taking these realities into account, we strongly believe that substantially reducing the U.S. corporate tax rate will significantly improve America's competitiveness, increase investment and create new jobs.

For these reasons, Air Liquide supports all efforts by this Congress to undertake sensible tax reforms that protect the productivity and competitiveness of the Nation's manufacturing and industrial sectors and make America an attractive location for new growth and investment

Once again, Air Liquide appreciates the Committee's attention to this important issue and commends your dedication to preserving America's place as a leading home for manufacturing and commercial investment. I thank the Committee for inviting me to testify, and I would be pleased to answer any questions you may have.

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Chairman CAMP. Ms. Boushey, you are recognized for 5 minutes.

STATEMENT OF HEATHER BOUSHEY, PH.D., SENIOR ECONOMIST, CENTER FOR AMERICAN PROGRESS

Ms. BOUSHEY. Thank you, Chairman Camp, and Ranking Member Levin and Members of the Committee for inviting me here to testify on the effects of tax policy on the U.S. manufacturing sector. My name is Heather Boushey, I am a Senior Economist at the Center for American Progress Action Fund.

I want to make two points in my remarks this morning, which I expand upon in my written testimony, which I have submitted for the record. First, manufacturing is not only a key part of our economy, but moving forward, it will remain critical to our Nation's economic vitality. Economic research is increasingly showing that manufacturing is critical to our future. A strong manufacturing industry supports solid middle-class jobs, it enables our Nation to be a leader in technology and innovation, and can help us address our trade deficit.

Second, there are a variety of ways that policymakers can support manufacturing, of which reforming the corporate Tax Code, is one piece of the puzzle. The research is clear, that any set of policies aimed at supporting U.S. manufacturing should include investments in education and training, infrastructure, basic and applied research and development, and improvements to basic data collection. In terms of tax policy to support manufacturing, I recommend that this Congress focus on a few key items.

First, pass comprehensive business tax reform that both eliminates loopholes and inefficient business tax expenditures without disadvantaging domestic manufacturing. Currently, loopholes allow companies to avoid paying U.S. taxes by artificially shifting their profits offshore. Closing these loopholes, by adopting strong provisions to prevent base erosion that will promote job growth in the United States and ensure businesses are both competitive and fairly taxed.

Along these lines, we need to introduce a minimum tax on foreign earnings to prevent production from going to tax savings overseas, as the President has proposed. This would also ease the Tax Code's current bias towards foreign as opposed to domestic investment, and to level the playing field among competing businesses.

We also need to find a fiscally responsible way to make the research and experimentation tax credit permanent in other to boost and attract domestic private investment in R&D. Studies have shown that the R&D tax credit stimulates as much research and development investment as a direct subsidy, and that the social returns on R&D are greater than returns for private investors who finance R&D.

I want to stress that the level of taxation is only one piece of the puzzle and the statutory corporate rate is only one aspect of the corporate Tax Code and how it affects businesses as we have heard already this morning.

But I also urge you to keep in mind the reason that we tax. Tax revenues fund public goods that U.S. manufacturing and global corporations that manufacture in the United States benefit from and which otherwise would not exist.

For that reason, when considering levels of taxation, it is equally important to weigh the benefits of the public goods and services made possible with taxpayer dollars. When it comes to creating good manufacturing jobs in the United States, government spending plays a critical role in setting the stage for economic growth. To promote manufacturing and innovation in the United States, or at least to not disadvantage it relative to other industries, we recommend improving infrastructure so that U.S. goods can be more easily transported and marketed at home and abroad. This should include addressing our aging and overwhelmed electrical grid as we have all learned about here in the District of Columbia over the past few weeks; implementing the Obama administration's proposal to start an $8 billion community-college-to-career fund to encourage collaboration and partnerships between community colleges and businesses in training our future workforce.

Two million workers would learn skills vital to working in burgeoning industries like advanced manufacturing and health care. A highly skilled workforce would also give the U.S. and its regional economies further advantages over its global competitors.

In addition, we should increase government investment in advanced manufacturing and establish a national network for manufacturing innovation. Having a strong manufacturing industry in the United States should be at the top of our national economic agenda. We will not be a global leader for long without a vibrant and innovative manufacturing base.

The industrial commons matters for innovation and the extent to which we allow manufacturing processes to continue to go overseas, we only make it that much harder to regain our place as a global leader.

Moreover, as more of our energy future will rely on high-tech manufacturing, our economic competitiveness, and in fact, our future trade deficits will be even more closely aligned with our ability to be an innovator and producer of manufacturing goods, especially in the energy sector.

I want to thank you for inviting me here to testify and I would be happy to take any questions.

[The prepared statement of Ms. Boushey follows:]

Center for American Progress Action Fund

Testimony before the U.S. House of Representatives Committee on Ways and Means
on Tax Reform and the U.S. Manufacturing Sector

Heather Boushey,
Senior Economist, Center for American Progress Action Fund
July 19, 2012

Thank you Chairman Camp and Ranking Member Levin for inviting me here today to testify on the effects of tax policy on the U.S. manufacturing sector. My name is Heather Boushey and I'm a Senior Economist at the Center for American Progress Action Fund.

The U.S. manufacturing sector is and will remain vital to our nation's economic prosperity. The rise of American industry made the United States the wealthiest and strongest nation on earth, provided the foundation for a strong middle class, and fueled critical breakthroughs in innovation and technology that transformed our lives and produced previously unimaginable achievements, from the invention of Henry Ford's assembly line to the landing of a man on the moon.

I want to make a two key points in my testimony today:

First, manufacturing is not only a key part of our economy, but moving forward it will remain critical to our nation's economic vitality. A strong manufacturing industry supports solid, middle-class jobs; enables our nation to be a leader in technology and innovation; and can help us address our trade deficit. Economic research is showing that manufacturing is critical to our economic future.[1]

Second, there are a variety of ways that policymakers can support manufacturing, of which reforming the corporate tax code is one piece of the puzzle. Manufacturers make their investment decisions based on a variety of factors, not only the level of taxation. The research is clear that any set of policies aimed at supporting U.S. manufacturing should include investments in education and training, infrastructure, basic and applied research and development, and improvements to basic data collection.

To support manufacturing, I recommend that this Congress focus on a few key items:

- Pass comprehensive business tax reform that both eliminates loopholes and inefficient business tax expenditures without disadvantaging domestic manufacturing.[2] Currently, loopholes allow companies to avoid paying U.S. taxes by artificially shifting their profits offshore. Closing these loopholes by adopting strong provisions to prevent base erosion and will promote job growth in the United States and insure businesses are both competitive and fairly taxed.

- Find a fiscally responsible way to make the research and experimentation, or R&E, tax credit permanent in order to boost and attract domestic investment in research and development, or R&D, from the private sector. Studies have shown that the R&E tax credit stimulates as much research and development investment as a direct subsidy and that the social returns on R&D are greater than returns for private investors who finance R&D.[3] The Obama tax proposal finances the credit exclusively through business tax reform.[4]

- Introduce a minimum tax on foreign earnings to prevent production from going to tax havens overseas.[5] This would also ease the tax code's current bias towards foreign, as opposed to domestic, investment and level the playing field among competing businesses.

I want to stress, however, that the level of taxation is only one piece of the puzzle and the statutory corporate tax rate is only one aspect of the corporate tax code and how it affects businesses. Supporting manufacturing requires a deeper policy commitment and while I will focus my time in my remarks specifically on tax policy, given the jurisdiction of this committee, there are also a variety of other ways that we can promote manufacturing and innovation in the United States—or least not disadvantage it relative to other industries—including:

- Improve infrastructure so that U.S. goods can be more easily transported and marketed at home and abroad. This will also make the U.S. more appealing to businesses and globally competitive.[6]

- Implement the Obama administration's proposal to start an $8 billion "Community College to Career Fund" to encourage collaboration and partnerships between community colleges and businesses in training our future workforce. Two million workers would learn skills vital to working in burgeoning industries like advanced manufacturing and heath care. A highly skilled workforce would also give the U.S. and its regional economies further advantages over its global competitors.[7]

- Increase government investment in advanced manufacturing by 19 percent, to $2.2 billion in fiscal year 2013, as outlined by the current administration.[8] Manufacturing workers receive better pay and benefits, while the manufacturing sector is the driving force behind innovation in our economy. Additional investments in this area will benefit workers, improve our standard of living, and strengthen our economy.[9]

- Follow through on President Obama's plan to establish a National Network for Manufacturing Innovation. This network, comprised of up to 15 new manufacturing institutes, would facilitate and promote collaboration between companies and research universities, all with the aim of increasing and scaling up manufacturing production.[10]

Having a strong manufacturing industry in the United States should be at the top of our national economic agenda. Without a vibrant and innovative manufacturing base, we will not be a global leader for long. Moreover, as more of our energy future will rely on high-tech manufacturing, our economic competitiveness will be even more closely aligned with our ability to be an innovator and producer of manufactured goods.

Further, this is an urgent national issue and one of those cases where success begets success. Economists have begun to study and show that the "industrial commons" matters for innovation and the extent to which we allow manufacturing processes to continue to go overseas, we only make it that much harder to regain our place as a global leader.[11] As my colleagues Michael Ettlinger and Kate Gordon have put it, "the cross-fertilization and engagement of a community of experts in industry, academia, and government is vital to our nation's economic competitiveness."[12]

Manufacturing is not only a key part of our economy, but moving forward it will remain critical to our nation's economic vitality

The U.S. manufacturing sector is still a force internationally and an important part of our economy, despite employment losses and the relative rise in manufacturing in other countries over the past few decades.[13] Last year, manufacturing contributed over $1.8 trillion to U.S. gross domestic product, or about 12 percent of the economy.[14] Two years ago, manufacturing accounted for 60 percent of all U.S. exports.[15] In 2008, the United States ranked first in the world in manufacturing value added, and it was the third largest exporter of manufactured goods to the world, behind only China and Germany and ahead of Japan and France.[16] Between 1979 and 2010 manufacturing output per hour of labor in the United States increased by an average of 4 percent annually, and the United States has one of the world's most productive workforces.[17] Moreover, in 2009 there were 11.8 million direct jobs in manufacturing and 6.8 million additional jobs in related sectors.[18] Put another way, one in six U.S. private-sector jobs is directly linked to manufacturing.[19]

Yet the industry suffered declines in the 2000s. The U.S. share of worldwide manufacturing value added dropped from 26 percent in 1998 to less than 20 percent in 2007, and we have gone from being a net exporter of manufactured goods in the 1960s to a net importer.[20] Manufacturing as a share of U.S. GDP has declined from more than 15 percent in 1998 to 11 percent in 2009.[21] And jobs in U.S. manufacturing declined from 17.6 million in January 1998 to 11.5 million in January 2010.[22] And although the manufacturing sector has gained jobs in every month since then, for a total of 504,000 jobs as of June 2012, its share of total employment is down from 16.8 percent in 1998 to 10.8 percent today.[23]

These trends matter because the United States needs a strong manufacturing sector. Manufacturing provides good, middle-class jobs; propels U.S. leadership in technology and innovation, which is critical to our economic growth and vitality; and is important to balancing the trade deficit, as well as important for our nation's long-term national security.

The manufacturing sector has historically been a source of solid, middle-class jobs and it continues to be so today. The average manufacturing worker earns a weekly wage that is 8.4 percent higher than non-manufacturing workers, taking into account worker and job characteristics that influence wages, including unionization.[24] Economist Susan Helper and her colleagues conclude that the economic evidence points to the fact that "the main reason why manufacturing wages and benefits are higher than those outside of manufacturing is that manufacturers need to pay higher wages to ensure that their workers are appropriately skilled and motivated."[25]

U.S.-based manufacturing underpins a broad range of jobs in other industries, including higher-skill service jobs such as accountants, bankers, and lawyers, as well as a broad range of other jobs such as basic research and technology development, product and process engineering and design, operations and maintenance, transportation, testing, and lab work.[26] Compared to jobs in other economic sectors, manufacturing jobs have the highest "multiplier effect," that is, the largest effect on the overall economy for each job created, relative to jobs in other industries. To put this in perspective, each job in motor vehicle manufacturing creates 8.6 indirect jobs, each job in computer manufacturing creates 5.6 indirect jobs, and each job in steel product manufacturing creates 10.3 indirect jobs.[27]

Manufacturing is also important because it fuels the United States' leadership in technology and innovation, which are critical to maintain for our future economic competitiveness.[28] Manufacturing firms are more likely to innovate than firms in other industries: Research from the National Science Foundation finds that 22 percent of manufacturing companies are active innovators compared to only 8 percent of nonmanufacturing companies.[29] This number is even higher for specific sectors within manufacturing. For example, in computer and electronic products manufacturing, 45 percent of companies are product innovators and 33 percent are process innovators.[30] Manufacturing firms also perform the vast majority of private research and development: Despite comprising just 12 percent of the nation's GDP in 2007, manufacturing companies contributed 70 percent of private research and development spending.[31]

In addition to what manufacturers spend on innovation, there is increasingly strong empirical evidence showing a tight link between innovation and manufacturing production. Economic research now shows that the United States will not likely be able to keep the highly skilled technical jobs if the production jobs go overseas. Harvard Business School professors Gary Pisano and Willy Shih have written about the decline of the "industrial commons" in the United States: the collective R&D, engineering, and manufacturing capabilities that mutually reinforce each other to sustain innovation.[32] For many types of manufacturing, geographic proximity is key to having a strong "commons," and they point to evidence showing that there are few high-tech industries where the feedback loop from the manufacturing process is not a factor in developing new products.[33] As they put it, "product and process innovation are intertwined."

Pisano and Shih point to the example of rechargeable batteries as a product where innovation followed manufacturing. Rechargeable battery manufacturing left the United States many years ago, leading to the migration of the batteries commons to Asia. Now new technology (batteries for hybrid and electric vehicles) are being designed in Asia where the commons are located. I'd draw your attention to a January *New York Times* article on China's increasing investment in research and development, which asked, "Our global competitiveness is based on being the origin of the newest, best ideas. How will we fare if those ideas originate somewhere else?"[34]

Finally, manufacturing matters because it is an important part of our trade deficit, which in turn has implications for our macroeconomy. The United States has had a trade deficit in almost every year since 1971 and the size of those deficits has grown over time. The trade deficit was at

$727 billion in 2011, having never topped $300 billion prior to 2000.[35] Running a trade deficit over many years can have the effect of slowing economic growth, increasing unemployment, and risking economic instability. And, eventually, the U.S. will need to grow to pay back the debt we have incurred. The U.S. trade balance in high tech began to decline in 2000 and became negative in 2002.[36]

The trade deficit can come down in a variety of ways, but it is hard to see significant progress without manufacturing playing an important role. Brookings Institution economists Susan Helper and Howard Wial with researcher Timothy Krueger calculated that the United States could eliminate its trade deficit by 2019 through service exports alone only if service exports grew at an annual rate of 13.5 percent, compared to their annual growth rate from 2001to 2010 of 7.9 percent.[37] According to their analysis, it would be easier to balance the trade deficit by with manufacturing exports alone, as manufacturing exports would need to grow at an annual rate of 9.3 percent, compared to their 2001-2010 annual growth rate of 6 percent.[38]

There are a variety of ways that policymakers can support manufacturing, of which reforming the corporate tax code is one piece of the puzzle

The goal of this Congress should be to support U.S. manufacturing in ways that generates U.S. jobs and helps to locate the United States as an innovation leader. While taxation may be part of this agenda, it is far from the only part. For too long we have allowed this one aspect of how to grow our economy and support U.S. manufacturing to overshadow all others. Yet, the research is clear that any set of policies aimed at supporting U.S. manufacturing should include investments in education and training, infrastructure, basic and applied research and development, and improvements to basic data collection. Further, as economist Susan Helper and her colleagues have noted, the focus should include encouraging workers, employers, and unions, and government to share the responsibility for improving the manufacturing base.[39]

I want to stress that the level of taxation is only one piece of the puzzle and the statutory corporate tax rate is only one aspect of the corporate tax code and how it affects businesses. I urge you to keep in mind the *reason* we tax. Tax revenues fund public goods that U.S. corporations and global corporations that do business in the United States benefit from and which otherwise would not exist. For that reason, when considering levels of taxation, it is equally important to weigh the benefits of the public goods and services made possible with taxpayer dollars. When it comes to creating good manufacturing jobs in the United States, I will argue that government spending plays a critical role in setting the stage for economic growth.

First, investments in education and worker training are critical to ensuring that manufacturers can find skilled workers to make their products. In a recent survey conducted by Accenture, 61 percent of companies indicated that they are considering more closely matching supply location with demand location, which means products for the U.S. market are increasingly likely to be made in the United States.[40] However, these same companies also expressed that they are concerned about the availability of a skilled workforce in the United States.[41] Another survey by Deloitte documents a growing skills gap in manufacturing.[42] Of companies surveyed, 67 percent reported a moderate to severe shortage in qualified workers overall and 83 percent reported a moderate to serious shortage of skilled production workers; the majority expect this gap to worsen over time.[43] While companies can and should do more to train workers, it also makes sense for the country to boost investments in workforce training and education.[44] Instead, the House approved a budget that would actually cut investments in education and training by 48 percent per capita over 2010 levels.[45]

Second, there is broad bipartisan consensus that a strong national infrastructure network is crucial to the success of the manufacturing sector and overall economic growth. Without an adequate infrastructure system, manufacturers face longer delivery times, more money wasted on gasoline as delivery trucks get stuck in traffic, rising energy costs, and more frequent power outages. But U.S. infrastructure has been woefully underfunded in recent years, to the great detriment of our manufacturing competiveness. The Center for American Progress has written extensively about the need to repair our aging roads, bridges, water, and other key public assets.[46] About one-in-four bridges in the country is structurally deficient or functionally obsolete.[47] Inadequate freight rail means that our highways are clogged with both trucks and passenger vehicles, making transporting goods inefficient and costly.[48] Our strained electrical grid contributes to an increasing frequency of debilitating blackouts.[49] The repercussions of this failing infrastructure system to U.S. competitiveness are severe: according to the World Economic Forum's *Global Competitiveness Report*, the United States now ranks 24th on key global indicators for infrastructure quality among 142 nations, down from 8th in 2006.[50]

In order to revitalize our infrastructure and enhance our global manufacturing competitiveness, the Center for American Progress has recommended a set of critical reforms, starting with increasing the nation's infrastructure investment by $129 billion a year over the next 10 years.[51] Doing so will bring our crumbling infrastructure system up to par, helping to improve manufacturing productivity and ensure that manufacturers have the transportation network to efficiently bring their goods to market.[52] Instead, this House has opted to pass a budget that would cut transportation infrastructure investments per capita by 28 percent over 2010 levels.

Third, funding adequate investments in research and development is necessary to promote U.S. manufacturing jobs.[53] The relationship between basic research and development, commercialization, and the manufacturing sector is critical: the microwave, the photovoltaic cell, and the Internet, just three of a host of inventions, all came out of Department of Defense investments in basic research and development, without which they may have taken years or decades longer to be invented and commercialized.[54] Yet federal research budgets have diminished in recent decades relative to GDP growth.[55] Investments in science and technology research provide a critical basis for manufacturing innovation, but the House has instead voted for a budget that would reduce research and development spending per capita by 24 percent over 2010 levels.[56]

Finally, improving federal data collection and competitiveness coordination is important to supporting U.S. manufacturing.[57] One of the biggest barriers to the United States developing a more robust set of policies to support manufacturing is that policymakers do not have a clear idea of what this country already produces and there is little coordination between the many government agencies and programs that focus on basic competitiveness.[58] For example, under the current systems of measurement, "it is not now possible to know how many jobs in the Detroit region are actually tied to the manufacturing industry."[59] We should reform our insufficient statistical system to assess the competitiveness of key traded industries,[60] to adequately measure intermediate outcomes that influence competitiveness,[61] to improve the analysis of factors that influence competitiveness,[62] and to improve evaluation of competitiveness programs.[63] Congress should also grant President Barack Obama the authority to reorganize the government to streamline federal competitiveness efforts by consolidating the following six agencies into one department: U.S. Department of Commerce's core business and trade functions, the Small Business Administration, the Office of the U.S. Trade Representative, the Export-Import Bank, the Overseas Private Investment Corporation, and the U.S. Trade and Development Agency.[64] Taking these steps is an inexpensive way to ensure that we are guided by the best, most accurate information when making manufacturing policies.

Creating a climate for the United States to be globally competitive requires that we make investments toward this goal. It is through this lens that we need to evaluate tax policy. As we think through how to construct a tax system that encourages manufacturing and other economic activity, we must balance the need for revenues to fund public goods that otherwise would not exist, alongside the distortions that taxes create. If our tax code cannot be reformed to raise additional revenue, the resulting deficits will drive debt-to-GDP ratios to unsustainable levels under any realistic spending scenario, with negative repercussions for the U.S. economy over the long term.

The fact is that we need to increase our revenues. Our current tax code is inadequate to fund our national needs without accumulating more debt and the problem is not one of accelerated spending, but rather of declining revenues. In the 1950s corporate taxes contributed about 30 percent of federal revenues, but have steadily declined and now average only about 10 percent of federal revenues.[65] With the diminishing corporate tax the United States has relied more heavily on other taxes, in particular payroll taxes on wages, which have risen from about 12 percent of federal revenues during the 1950s to about 40 percent of revenues today.[66] The increasing share of business activity being conducted via "pass-through" entities, including S corporations and LLCs is partly responsible for the decline in corporate tax revenues. But also responsible is the fact that corporations are paying lower effective tax rates on their profits than they did in the recent past.

The good news is that there is room for revenue-positive tax reform, including revenue-positive reform of the corporate tax code. The corporate tax is the third largest federal revenue source, behind individual income and payroll taxes. While the statutory corporate tax rate is 35 percent, the second highest in the OECD, the better measure of the actual tax paid by corporations is their effective rates.[67] Recent studies have found that the effective rates of large U.S. corporations are in line with or actually lower than their foreign counterparts.[68] In fact, corporate taxes represent a smaller portion of GDP in the United States than in other OECD economies.[69]

In thinking through any reform, however, we need to bear in mind a number of key issues specific to manufacturing and whether the goal of a 26 percent rate for all industries is achievable. The Joint Committee on Taxation has said that eliminating nearly all major tax expenditures to lower the corporate rate in a revenue neutral way would allow us to get the rate to 28 percent, but not to 25 percent and if we are to increase revenue, this should be carefully targeted.

The mantra of "lower the rate, broaden the base in a revenue-neutral way" may in fact do the most harm to domestic manufacturing. Repealing tax expenditures and lowering the rate would increase, not decrease taxes on manufacturing firms. Writing for *Daily Tax Report*, Gerald Prante, Robert Carroll, and Tom Neubig found that:

> ...the biggest winners from using repeal of business tax expenditures to lower business tax rates to approximately 28 percent would be the retail and wholesale trade, information, transportation, finance and insurance, and services industries. Rate reduction would more than offset the loss of benefits from their tax expenditures.[70]

Congress should consider carefully whether this kind of reduction serves our national economic goals. First, it is not clear that that we should continue to privilege finance over other industries and retail and wholesale trade are, by their nature, geographically constrained. In a fiscal environment where we are already facing large and growing budget deficits, we need to make sure that our tax policy both brings in sufficient revenue and focuses on supporting our manufacturing base.
Prante, Carroll, and Neubig go on to note that while

> ... eliminating all business tax expenditures would disproportionately hit the manufacturing industry, especially those manufacturers with multinational operations. ... Within manufacturing, durable goods manufacturers, especially those with a multinational presence, would be the biggest losers, requiring a far greater reduction in the corporate tax rate to break even.[71]

This is consistent with analysis by economist Martin Sullivan in his analysis of lowering the rate in a revenue-neutral way, which found that this approach will be detrimental to domestic manufacturing. His analysis concluded that the biggest winners would be securities (net reduction of 12.3 percent), insurance (-11.9 percent), credit intermediation (-10.2 percent), and retail trade and bank holding companies (-10.1 percent each), while metal, minerals, and machinery manufacturing would see its net taxes rise by 7.3 percent and computers an electronics would see net overall taxes rise by 33.0 percent.[72]

Second, tax reform should put an end to any bias toward foreign over domestic investment. The Government Accountability Office has found that the effective tax rate that U.S. corporations pay on their foreign profits is 16.2 percent, about two-thirds of the tax rate on their domestic profits, which they estimate to be 25.2 percent.[73] Tax reform must level the playing field, not further tilt it against investment in the United States.

An initial, critical step to correcting this bias is to stop the drain of profits into offsbore tax havens. Moving to a territorial tax system, especially without adequate safeguards, would make the problems worse. The discussion draft circulated by Chairman Camp admirably acknowledges the need for anti-tax haven rules. In seeking ways to pay for a corporate tax rate cut, the committee should be wary that many tax expenditures benefit domestic investment and eliminating them to pay for a corporate rate cut could actually make investment in the United

States less attractive from a tax perspective. That's why the best way to broaden the tax base is to crack down on offshore loopholes.

Third, tax reform should reflect our national economic priorities and support long-term U.S. competitiveness. In this regard we are long overdue for a review of the growing number of special tax breaks, or "tax expenditures." The tax code contains permanent tax breaks to subsidize oil and gas, even though with oil hovers above $100 per barrel, there is no clear economic need for subsidies, while the tax breaks for alternative energy—which would not only help our nation lead the world in addressing the warming planet, but also support U.S. manufacturing in cutting-edge technologies—are merely temporary. This should be reversed.

There are real opportunity costs to tax expenditures and those that serve no policy purpose, like those for hedge funds and private equity fund managers (carried interest), should also be eliminated. Tax breaks that have a worthy public purpose and solid economic rationale, such as the domestic production deduction (section 199), should be reviewed to make sure they are well targeted and serving their purpose in a cost-efficient way. The president has proposed targeting that deduction more narrowly at manufacturing and advanced manufacturing, where there are the most spillover benefits.

The research credit also has a strong policy rationale.[74] Congress should find a way to pay for a permanent or at least long-term extension rather than renewing it every year, sometimes retroactively.

Maintaining current revenue levels will only lead to continued deficits and more debt, while sacrificing the kinds of investments needed to meet basic needs and support manufacturing and economic competitiveness more generally. If our tax code cannot be reformed to raise additional revenue, the resulting deficits will drive debt-to-GDP ratios to unsustainable levels, with long-term negative repercussions for the U.S. economy. As Treasury Secretary Geithner said in a *Bloomberg* interview recently:

> One thing we can do is change our tax system so we're creating more powerful incentives for companies to invest here, because, again, we want the stuff that the world needs, stuff Americans are uniquely good at, to be produced in the United States by American companies and by foreign companies.[75]

Given the important place of domestic manufacturing in our economy, this seems like the right goal.

Endnotes

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[60] For example, "the Department of Labor should request, and Congress should approve, funds for BLS to create an input price index to more accurately measure manufacturing productivity." Ibid.
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Chairman CAMP. Well, thank you, Ms. Boushey. Thank you all for your testimony. I do have a question for Ms. Dossin, Mr. Gjersdal, and Ms. Ford.

Several witnesses at the table as manufacturers have testified that lowering the statutory rate is so critical to America's ability to compete, that it is worth giving up substantial deductions and credits. And some have also talked about the importance of encouraging domestic innovation, moving to a territorial system with anti-abuse rules.

Now, would a 25 percent rate, a territorial system with reasonable safeguards to prevent shifting to low tax havens and adequate incentives to conduct R&D, and locate intellectual property in the U.S. be attractive enough to you, that even as manufacturers who benefit from numerous deductions and credits, you would be willing to put all of your tax preferences on the table? And why don't I start with Ms. Dossin.

Ms. DOSSIN. Sure. I think the very fact that you have called this hearing means that you recognize those provisions do have power in the economy, and I don't think it is time quite yet to choose which ones stay, and which ones go, but I am here to say that when that time does come, they will be all on the table, and we will want to be at that table helping choose what helps the U.S. economy go forward.

And for Ford's business to go forward in the U.S., I will say again, we think the low rate is the single-most important thing, and beyond that, we would look for more stability, simplicity, so that whatever is in there is something that I can communicate to management to help decision-making and hopefully that would support decision-making that keeps investment in this country.

Chairman CAMP. All right, thank you. Mr. Gjersdal.

Mr. GJERSDAL. We would certainly be willing to put every preference on the line. There is no question that a lower tax rate not only would be evening the playing field for all companies here in the U.S., the other thing it would do is, it would really simplify things and create transparency. Right now, the Tax Code simply is not believable, and that is not only to the public at large, that is to the executives at 3M. I find it almost impossible to explain the Tax Code to them these days. They don't believe me it is so complicated. So frankly going to a lower rate——

Chairman CAMP. I am familiar with that problem.

Mr. GJERSDAL. It is a very difficult proposition. But frankly, putting all of the preferences on the line for a lower tax rate is definitely the way to go.

Chairman CAMP. All right. Thank you, Ms. Ford.

Ms. FORD. I would echo the comments made. I think everything should be considered, particularly when you start to get towards the 25 percent rate. It does make us more competitive. I think the overriding concern, of course, is that rates can have a very easy tendency to creep back up. So I think it is really important that we think through the other provisions that we remove is they are incentivizing particular behaviors, and then avoid a subsequent kind of rate creep up over time.

Chairman CAMP. Thank you. I have a question for Mr. Hardt and Mr. Beck. Earlier this week Ernst & Young released a report that analyzed what would happen if we would adopt the administration's proposal to let taxes on small businesses go up at the end of the year. Roughly, it is the $200,000 for individuals, $250,000 for couples. And among other conclusions, the report finds if that were enacted, that it would destroy over 700,000 jobs and that wages would fall by 2 percent. Now, I would just ask both of our small manufacturers, how would this proposal affect your businesses specifically?

Mr. HARDT. Thank you for the question. As I mentioned earlier, approximately 70 percent of the manufacturers in the United States are structured as S corps, or pass-through entities. And there is only so much of the pie. You have taxes to pay out of the pie, reinvestment in your business, which is by far the overwhelming portion where our profits goes. I just mentioned that yesterday we were installing a $270,000 grinder, which is in excess of the $250,000 you just mentioned, which comes out of profits of the business. And of course, to repay borrowings to our banks. And again, they are wanting more profits in the business as well to justify borrowings these days. Borrowing money has been a little tougher the last couple years.

So to me, it would directly impact investment, if you switch up the pie, shall we say, and it would be negative for us. The real issue we have today is uncertainty. I need to mention that again, that we are making decisions, borrowing money, personally guaranteeing loans, hiring people, and the uncertainty with that proposal also is very concerning to us.

Chairman CAMP. All right. Mr. Beck.

Mr. BECK. I agree with Mr. Hardt. When you take a look at a company like ours, basically my brother and I own the company. If the company makes $1 million, that means as a subchapter S company, I pay—would pay the taxes on half of that, $500,000, and my brother would pay the other half. The money comes from the company, but we are not taking that as revenue into our own pockets. That money that we make has to be reinvested in the business.

If you take 3 or 4 percent more intakes, we have already gone through a great recession. We have been starved for profits. We are hoping to make some profits this year. We would like to hold onto whatever we can, and not have to give it back as taxes. We need to reinvest in training our people, because now we have had to hire back a lot of people. We haven't put investment back in our company because we haven't been able to. We would like to do what Mr. Hardt is doing and upgrade our machinery. And 3 or 4 percent to a small company like ours I think has a lot more impact than the revenue that you are going to be generating for the Federal Government.

Chairman CAMP. All right. Thank you. Mr. Levin is recognized for 5 minutes.

Mr. LEVIN.Well, I think if we can, we should resist using this hearing to have an overall discussion of the very basic disagreement as to the high income tax cuts. I am not sure of the situation for the two of you, but Joint Tax has told us that only 3 percent of small businesses have income over $250,000 a year. So the Ernst & Young report is deeply flawed in terms of its methodology, assuming that none of the tax cut, the end of the tax cut for high income would go for deficit reduction. It has other deep flaws. But if we spend our time today arguing over this, I think it will be a mistake.

I thought the focus was the importance of manufacturing. And what has happened in these last years is there has been a resurgence in understanding of the importance of manufacturing in this country. The language became that we were in a post-industrial era. And it turns out, as shown by what has happened in the last couple of years, that manufacturing remains a very key part of our economy. And it has helped to lead us back from the pit, and helped to create jobs. And the difference of opinion about that was crystallized in our reaction to whether we would let a couple of the domestic auto companies go under and not be able to come back.

So I would hope we could have a focus today on the importance of manufacturing, and how our Tax Code relates to it, and how we approach tax reform, keeping in mind the importance of manufacturing. And I think this panel illustrates the challenge for us to do that. And to simply say let's have a goal or a policy of reducing to a certain level, without taking into account what would be the impact on manufacturing, I think is misguided.

There are differences of opinion among all of you as to what would be the impact of the focus only on the rate, without determining its impact on manufacturing. And I understand that difference of opinion. Your companies are in different positions. To say that everything should be on the table, that is, I think, okay, provided you keep in mind the objective of what you look at when everything is on the table. And I think the testimony, if I might say so, on manufacturing by the two of you illustrates that. And so Mr. Hardt, without discussing larger issues of taxation and upper income taxation, I think it is revealing when you say on page—our pages I guess aren't numbered—but you do refer to it, and I think it was important. You said we fully support expanded bonus depreciation, Section 179 expensing, and Section 199, domestic production activity deduction as tools manufacturers use to create jobs and compete globally.

And I think it is important to remember that, because if you eliminate those, you don't get down to 25 percent eliminate everything. And the question becomes, what happens to these incentives for manufacturing? Should we have them? And then Mr. Beck, you say I think very compellingly on page three, "Bonus depreciation and increased 179 expensing can be deciding factors for businesses considering equipment upgrades or company expansions. These two incentives most assuredly contributed to the impressive growth in manufacturing technology orders in 2011."

And then you go on to say, "There is no question," on page 4, "R&D leads to new technologies and innovation." And you conclude on page 4, "Without the credit, we may not have made the investment." So I think that illustrates how we need to approach this, not with a simple mantra, but with a question, is manufacturing and the Tax Code supporting that an important criterion in terms of tax reform? And I think the answer clearly has to be yes, it is a major priority.

Chairman CAMP. Thank you. Time has expired. Mr. Johnson is recognized for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman. Mr. Hardt, you know, it is a testimony to the great entrepreneurial spirit that has helped make this country as great as it is. It is too bad the President and others are attacking this spirit. I am sure you heard by now President Obama say, "If you got a business, you didn't build that. Somebody else made that happen." Mr. Hardt, did somebody else build your business?

Mr. HARDT. It was a team effort with myself, my partner, and a lot of our employees, but we took the risk, that is a fact, and continue to.

Mr. JOHNSON. And government didn't build your business either, did it?

Mr. HARDT. Government can assist. Government can assist with certain incentives to help invest in what we do, to make sure we are globally competitive. But we took the majority of the risk, that is a fact.

Mr. JOHNSON. You bet. Mr. Hardt, with respect to tax reform, would you be willing to put all the various deductions and credits on the table for a top rate of 25 percent?

Mr. HARDT. It is a little bit difficult for me to answer that, to be honest with you. The reason I say that is I do believe that in small manufacturers like ourselves, cash flow is a key priority to what we do. And that some of the incentives to recognize investing in the U.S., to spending capital, to taking risks, for encouraging people to get into the business, such as e, mentioned, the depreciation deductions, are beneficial. However, saying such, looking at the total effective tax rate, and looking at lowering the total effective tax rate to allow us to put more into our business is very critical, and would be very welcome. And I am sure both of us, two small guys here, would do that.

Mr. JOHNSON. That is close. So tell me, what key three points would you like to leave with us when it comes to tax reform?

Mr. HARDT. First of all, that manufacturing is very important to our economy. And we do need to look at manufacturers, both large and small, C Corps and pass-throughs, as being very vital to our economy. And I need to support my brethren to my right here, the larger companies, because they are my customers, and so they need to remain competitive too. And we need to make sure that we make all manufacturers competitive.

Secondly, I encourage us to continue to look to incentivizing people to get into business, to start businesses, to build businesses that are vibrant to the backbone of the country and to feel confident that they can take the risk, and they know with some certainty what is going to happen if they take the risk. I need to mention again, uncertainty is very difficult when running a small business or a family business. So those are really my two key points that I need to leave you with.

Mr. JOHNSON. Thank you. Mr. Gjersdal, as you may know, earlier this year the administration released its framework for business tax reform, which calls for a minimum tax on foreign earnings. What are your thoughts about that proposal?

Mr. GJERSDAL. Well, that is a difficult question to answer because, first of all, we don't know what that rate might be. Secondly, we don't know how the foreign tax credit mechanism may work with it. At a high level, though, it concerns me. First of all, it just suggests to me that this will increase complexity, not decrease complexity. And furthermore, I don't see it really helping us compete in the global marketplace. I still believe territoriality is a much better answer.

Mr. JOHNSON. So you more or less think that we need to have a less complex system?

Mr. GJERSDAL. Simplicity, simplicity, simplicity.

Mr. JOHNSON. Okay. And such a proposal that we are hearing could cost jobs in America, could it not?

Mr. GJERSDAL. Pardon me?

Mr. JOHNSON. If we try to stick with a high rate of overseas.

Mr. GJERSDAL. Absolutely. Absolutely.

Mr. JOHNSON. Thank you for your testimony. Thank you, Mr. Chairman.

Chairman CAMP. Thank you. Mr. Nunes is recognized.

Mr. NUNES. I have no questions at this time.

Chairman CAMP. All right. Mr. Tiberi is recognized.

Mr. TIBERI. Thank you, Mr. Chairman. To the two manufacturers, the pass-throughs, Mr. Hardt and Mr. Beck, I don't remember which one of you in your written testimony talked about buying a piece of machinery over $250,000. But the question is to both of you.

Mr. HARDT. $270,139 to be exact.

Mr. TIBERI. Okay. My question to both of you is, I can't imagine how frustrating it is in Napoleon—I am from Ohio, where you are from—to hear the President or others talk about the fact that you are obligated, you should pay more because of how much money you make. And I think your testimony is so very good to try to help educate policymakers and the rest of America that if you make $250,000, I think you mentioned that, as a business owner who is a pass-through entity, or an owner of a business, talk a little bit more to us today, both of you, real quick, what that means in terms of reinvesting in your business. Out of that $250,000, you have to buy machinery, you have to employ more employees. There are training costs. So it is not like you are pocketing it and saving money to go buy an island in Hawaii.

Mr. BECK. As a pass-through, such as a subchapter S or a sole proprietorship and you have $250,000 of income from your company, you pay the taxes through your own personal tax forms. And it appears to most people that it would be your salary. But it is not your salary.

Mr. TIBERI. Can you say that again?

Mr. BECK. It is not your salary. It is what your company made, which means that out of that $250,000,a large portion goes to taxes. You may take a salary of $50,000, $60,000, $100,000, I don't know what people take. A Small businessowner might take a $50,000 annual salary. The other $200,000 (less taxes) would be reinvested. What is not paid in taxes would be reinvested in their businesses.

Mr. TIBERI. So if the rate is 35 today and it goes to almost 41, the top rate tomorrow, 6 percent, that is pretty significant.

Mr. BECK. I want you to know, 2 weeks ago I met with my joint venture partner in Germany, and I asked him if he wanted to invest in a company in the United States. So we compared corporate rates. And he said, "Your corporate rates are too high." He said, "The most I will invest with you is maybe 20 percent," when I was hoping to have him coming in and doing a 50 percent investment into a venture together. That is Germany.

Mr. TIBERI. Mr. Hardt, anything to add to that?

Mr. HARDT. Yeah, I agree. The majority of the profits that we make are reinvested into the business. And that is not just us, the surveys show it. So there is only so much of the pie to go around. Secondly, we need to leave a lot of our profits and our cash flows in the business today to keep our banking brethren happier, because it is tougher to borrow money today without a profitable business.

Mr. TIBERI. So if the rates are increased, that is less that is reinvested?

Mr. HARDT. Less that is reinvested, and it is less that can be potentially borrowed as well, because the banks aren't as happy with our cash flows.

Mr. TIBERI. Thank you. To the three on the far left, all three of you American, large companies, do business overseas. I will start with Ms. Dossin, if you could all answer this question. You are competing, when you are selling a Ford in Italy, you are competing with German companies, you are competing with Korean companies, you are competing with Italian companies, and you as well. So the three of you, how difficult is it today to compete when their rates are lower and we have a worldwide system? And how does it benefit us as Americans when you are expanding in Europe or expanding in Asia? How does that benefit America? Does it benefit the corporate headquarters? Do you have more employees at the corporate headquarters? Can you just comment on that rather than this thought of shipping jobs overseas, which is a mantra of some?

Ms. DOSSIN. Well, that is a little bit of a complex question, because, of course, wherever you compete, in Italy let's say, in Italy your profits in Italy are subject to the same tax whether you are BMW or Ford. It is where the more movable profit is, right? It is where the entrepreneurial profit is. It is where maybe the profit from intellectual property resides.

Mr. TIBERI. But if you repatriate your profits from Italy back to the United States, versus if the German company repatriates it back to Germany, there is a disadvantage for you.

Ms. DOSSIN. It tends not to be our issue. That repatriation issue tends not to be our issue. But I would say, it is correct that where the residual profit resides, for us it is headquarters, for us it is the U.S., and that is the pain that other companies headquartered elsewhere do not suffer, I will say, on that type of profit, on their entrepreneurial profit.

Chairman CAMP. Just quickly, time has expired. Other two, just answer very quickly.

Mr. GJERSDAL. Just a very quick example. Let's assume we make \$100, our competitor that is overseas makes \$100. We pay a tax rate of 35, they pay a tax rate of 24. We have \$65 left, they have \$76. It is just not a matter of making extra money, they now can reduce their prices by \$10, \$11 and beat us in the marketplace and hurt competition.

In terms of jobs, yes, jobs can be created. Fifty percent of our manufacturing is in the U.S. A healthy company will promote HQ jobs. And most of our core R&D is here in the U.S., so, of course, expansion of R&D would create jobs in the U.S.

Chairman CAMP. All right. Thank you. Very quickly, if you could.

Ms. FORD. I would just echo briefly that I think the job situation is not a zero sum game, it is not U.S. jobs versus foreign jobs. It is if you have to have foreign locations and increase your foreign jobs, your U.S. jobs will increase as well. We found that in both our R&D center, our IT world, and our corporate headquarters as well.

Chairman CAMP. All right. Thank you. Mr. Rangel is recognized.

Mr. RANGEL. Thank you, Mr. Chairman. And thank you all for sharing your views with us. My questions are basic. I want to thank you once again. Territorial taxes. How does it affect, or how does it create jobs or any benefits to the United States? If U.S. businesses decide to go overseas and pay no taxes to the United States, but whatever the tax rates in a foreign country, how does America benefit? Ms. Dossin?

Ms. DOSSIN. Well, we are not particularly a proponent of one system or another. But if it was pure territorial, with no anti-base erosion provisions, that could be a worry. I think that is where the anti-base erosion——

Mr. RANGEL. Is anyone supporting a pure territorial tax? How can America get some taxation out of business people that were trained and enjoyed the benefit of being American and not pay any taxes at all? Paying the taxes to the foreign government at their lower rates? Anybody here support any type of territorial tax? Come on. All of you said you supported it. I just want to know how does our country benefit by your support for it?

Mr. GJERSDAL. We support a territorial tax system primarily because it helps us compete with our international partners.

Mr. RANGEL. How does it help the United States of America? It helps your stockholders. Is that it?

Mr. GJERSDAL. No, it just doesn't help our stockholders.

Mr. RANGEL. How does it help the United States of America that you can effectively compete with——

Mr. GJERSDAL. Well, 50 percent of our manufacturing base is in the U.S. So if we can compete on an international scale with our international competitors, it will help our manufacturing base.

Mr. RANGEL. So you are saying that the profits you make overseas by not paying U.S. taxes helps the base back here, where you hope that you will be paying a lower corporate tax?

Mr. GJERSDAL. It certainly will help the base back here both in terms of our manufacturing——

Mr. RANGEL. But if you have no base back here?

Mr. GJERSDAL. We would never be at that point.

Mr. RANGEL. Strike that. Suppose we create that you don't have to have a base here to have a U.S. business abroad. And so I would think under that hypothetical, we won't benefit at all, no jobs, no taxes, you are just a foreign company with a U.S. base with no jobs. That is possible too. We have to do a lot of work on this territorial thing. And the chairman is an advocate, so I think you do better explain it than they do. Not at this time.

Chairman CAMP. We do have base erosion provisions in the draft.

Mr. RANGEL. Okay. Okay. Let's get to the corporate tax. You tell me what the one impediment it is for us not to reform the tax system where liberals, conservatives, Republicans, and Democrats and others all agree that it is loaded with provisions that should be eliminated, that there is no problem in reducing the tax and paying for it by broadening the base. And yet when all of you get together at the country clubs and the cocktail parties you know what it is that stops this Congress, Republicans and Democrats alike, from not taking up this sensible reform that has us as the highest corporate tax provisions in the entire world.

Now, you don't—I don't need all of you, because I am convinced that there is one thing that all of you have agreed upon that stops this from doing the right thing, economically and politically. Now, what is it that you believe it is?

Okay. The chairman says maybe my question isn't that clear. But if everyone agrees that this is good for the country, the corporations, the stockholders of America generally, the creation of jobs that allow you to be more effective, why aren't we doing it? Is it a question that everyone wants to protect their interests? I mean, is anyone here that believes that when we clean it up that we should get rid of research and development? No.

If we were talking about depreciation benefits, you want that. I just wonder whether it is a question that corporates want lower rates, eliminate the loopholes, but don't bother their loopholes. And so we can't get you guys to agree. As Ms. Dossin said, everything is on the table, and when we get there, we will tell you what we insist on and what we will, you know, but I—if it is such a good deal for America and the Congress, and you guys pay so much for lobbyists, what reason do you hear that we have not moved on it? Not this administration, not past administrations. And we are not going to do it because of what? Why don't you think we do it? You all are smart Americans, business people. Ms. Dossin, please.

Ms. DOSSIN. For myself, I will say——

Chairman CAMP. If you could answer quickly, because time has expired.

Ms. DOSSIN. I am a chief tax officer. You know, that is my job. I would say that a reason is it is just darn hard. Before I came here, I kind of reread the story of the 1986 Act. Really, really hard. And you can only do it——

Mr. RANGEL. I was here. What is the hard part of it?

Ms. DOSSIN. It is the hard part. And we are ready, we are here because we are ready, the chairman is ready.

Mr. RANGEL. We are here to do hard work. You are here to make us do hard work. What part of the job is so hard that you can't figure out why we refuse to do what we were sent here do?

Ms. DOSSIN. Well, I think the time is right and hopefully——

Mr. RANGEL. The time has been right since 1986.

Chairman CAMP. All right. Thank you. Time has expired. Mr. Davis is recognized for 5 minutes.

Mr. DAVIS. Thank you. I would point out that companies like Procter & Gamble, headquartered in my district, or across the river from my district have almost 50 percent of their employees are directly related to international business. So territorial taxation makes a lot of sense. And you know, I know there are a lot of undertones for manufacturers. I grew up around manufacturing, blue collar background, worked in manufacturing, run with manufacturing small business owners now. And you know, the only club that my friends belong to is Sam's. And I think that is an important thing to point out. And I understand this issue, the S corp issue, the pass-through issues.

I would like to bring some context on these issues of tax reform, particularly for the small manufacturers that make up the backbone of the supply chain feeding into the parts into my Ford F–250 I have been driving for 15 years. And thanks for the Ford Tough. I appreciate that.

Mr. Beck, in your testimony you took particular time discussing the importance of expensing, of depreciation, and the R&D tax credit. You and Mr. Hardt are both small business owners. It is the core of what I look at as a person with a lot of experience in manufacturing. You describe these provisions as especially important to cash-based manufacturers who face particular challenges in managing their accounts receivable and their working capital.

You guys live on accounts receivable and on that weekly cash flow, making sure that that cycle is compressed. Would you please provide the committee, starting with Mr. Beck, some examples, very specific examples of how the AR cycles and the working capital needs of small manufacturers affect your businesses, and how these tax provisions help smooth out that cash flow roller coaster?

Mr. BECK. Well, from a standpoint of a machinery builder, we have to have enough cash to float, with certain customers, $3, $4, $5, $6, and $7 million projects. Now, that is not the same as somebody that is making parts and components for an automobile company. The only way that we can possibly do that is to have profits, and to retain those profits and retain the cash in our company. And if you use some of the vehicles that you have talked about, like accelerated depreciation, you show more expense for that particular year. But what that really does for you, it does allow you to write off equipment faster, which means you have a less of a tax burden from that standpoint, which means you are not paying as much in taxes and you have more cash in your company.

Mr. DAVIS. Let me take that to the next level. I think that generally we spoke before the hearing for a couple of minutes when we met, but we agreed that a reduction in the tax rate and a transition, particularly for the international businesses, to a territorial system would be very helpful, in a variety of ways. And they are important reforms. But do those reforms alleviate, say, the lowering of the rate, the territorial piece, does that alleviate the need for maintaining some sort of cost recovery positions in tax reform for you as a manufacturer?

Mr. BECK. Boy, I am not a tax expert.

Mr. DAVIS. Let me put it this way: What I am hearing you say is that depreciation expensing and R&D as part of this process are very important to you.

Mr. BECK. Well, it is very important to us because you can recoup quicker the costs that you put out there to help develop something or to buy a piece of equipment, which allows you to expense it faster, which causes you to have less revenue in those years that you are doing that, which means that you are paying less in taxes. So you are able to hold on to your cash longer. And if you have gone through a situation like we have gone through, and banks won't even talk to you because of the requirements that they were under, you know, we had to hold onto every single penny. So basically, it sounds very simplistic, but it is the revenues coming in, it is the expenses going out. Taxes is part of your expenses.

Mr. DAVIS. Not at all. I mean I had clients in the 1990s, when the Clinton tax increases, when those rates went up so significantly, literally couldn't hire employees to do additional work because of the tax hit on them as S corporations, closely held. Would you like to comment briefly, Mr. Hardt?

Mr. HARDT. I mean the timing of cash flows is critical to a small business. When you are trying to grow your business, you have cash being tied up in receivables, money is owed from your customers. And of course, usually in a manufacturing business, you have to buy equipment as well. And of course, the banks want to see positive cash flow to lend you the money, and you have to make payroll during that whole period, including hiring new employees, planning for training dollars. We have great apprenticeship programs at all of our divisions that we fund internally.

So the timing of cash flows is key. So retaining cash into the business, investing cash into the business, you know, expense deductions for depreciation to help maximize that cash flow during investment time periods is very important to us, extremely important.

Mr. DAVIS. Great. Thank you. I yield back, Mr. Chairman.

Chairman CAMP. Thank you. Mr. Buchanan is recognized.

Mr. BUCHANAN. Thank you, Mr. Chairman, for holding this important hearing. Also, I would like to thank our witnesses today. According to Enterprise Florida, which is our economic development arm in Florida, there are 17,000 manufacturers in Florida. They employ over 300,000 folks out of Florida. These skilled personnel represent about 5 percent of the State workforce in the State.

In my district, Atlantic Mold and Machine opened about 5 years ago. It is a family-run businesses that specializes in high-precision plastics and metal molds. And again, I grew up, I was chairman of the Florida Chamber, and I was in business for 35 years, employed a lot of folks.

I want to get back to Mr. Hardt and Mr. Beck. I got to tell you, I did a hearing where we had small business people in there about 2, 3 years ago, and I just for one reason or another started the hearing out with having people raise their hand in terms of that had challenges with their banks, either got their line of credits reduced or whatever. I thought it would be about 20 percent. About 95 percent of the people in the room raised their hand where they had challenges.

It gets back, my point I want to try to make here, when we talk about employment, or people, they talk about 3 percent of businesses I heard a gentleman say, the bottom line, there might be 3 percent of small businesses as they measure at 500 employees or less, but the reality of it is, is what is that percentage in terms of revenues and in terms of jobs? I know a lot of middle market companies that are considered small companies, but they might employ 300 employees or 400 employees.

So from a tax standpoint, what do you think would be the simplest—what would be best in terms of helping your businesses moving forward in terms of based on where the Tax Code is at today? I mean, my sense what I hear is people want a simpler, fairer, flatter tax. The Tax Code is 73,000 pages. What would your thought be, based on where we are at today, would be the most helpful, Mr. Beck, to your business?

Mr. BECK. Well, when I was filing my taxes on a paper basis, and now it is electronic, I think I had a stack that I brought home from the accountant that was about that high. Now, you can imagine the intricacy and the amount of work that goes in to create those tax returns. To tell you exactly what the percentage ought to be, I think that needs to be worked out not by us, but by the committee, because you are looking at the revenues that the government needs.

However, a flatter tax, a simpler tax, one that doesn't change with the wind, one that is set helps businesses plan accordingly for the long term. You know, we have to be able to plan for the long term. We have to be able to look out 2, 3, 4, 5, 6 years. You know, when I developed this product, I got the R&D tax credit. It is now 5 years into it, and we haven't made a penny off of it yet. We are hoping in this next year that we can bring it to market. So we have to look out. And small businesses are in it for the long term. They are not in it month- to-month. Small businesses are not looking at the quarterly or the monthly return, they are looking at the long-term viability of their company. So we need a very stable Tax Code. And we need one that competes internationally.

Mr. BUCHANAN. Mr. Hardt, I know we have touched on it quite a bit, but I think it is important for people to understand, as both of you know, that if you make 750, you don't take home 750. And if you make 750 in a company, you end up paying a third out to taxes, you might take out 100 each or whatever you need to live in terms of your own, and the balance stays in, the banks require it. Do you want to expand on that anything more? I know you touched on it a couple times. But I don't know that it can be touched on enough, because a lot of jobs are created through these pass-through entities. And when you put a floor in at 250 and you have got 100 employees and the banks are requiring more and you are paying out a third of what you make to taxes, you know, that is not a great thing in terms of where we are at in terms of our country.

Mr. HARDT. I will simplify it and put it into numbers. In Wisconsin this year, our capital budget is about $2.3 million. We have already hired five new apprentices in the spring, we hope to hire five new apprentices this year, and we have some open positions for engineers, et cetera, as we grow our business. Our profit projection for this year is about $2.4 million. So 2.4 million is going to go through personal tax returns as a pass-through entity, $2.3 million is going back into the business. I can't simplify it any further. You cannot look at this as just money going into our pockets, going into our clubs, whatever we say here. The overwhelming majority of small business profits goes back into the business. It is our livelihood, it is the future for hopefully our families and children. And again, I also support simplification, however, because we need to plan. We need to plan how to transition our businesses to the next generation, how to plan to grow our businesses. So simplification and transparency are very important.

Mr. BECK. It is uncanny, my numbers are almost exactly as his. Almost exactly. And my salary isn't even $100,000.

Mr. BUCHANAN. Thanks, gentlemen. I yield back.

Chairman CAMP. Thank you. Mr. McDermott is recognized.

Mr. MCDERMOTT. Thank you, Mr. Chairman. Ms. Dossin, you said it is complicated. And I would like to enter into the record an article from the National Journal called Guns and Stethoscopes.

Chairman CAMP. Without objection.

[The article follows: The Honorable Jim McDermott]

Guns vs. Stethoscopes

When it comes to the sequester, all eyes are on defense. But health spending is certain to take a hit, and some groups are fighting back.

By Meghan McCarthy

July 17, 2012 | 9:30 p.m.

When most politicians talk about the looming sequestration cuts threatening American lives, they aren't referring to health care cuts.

The buzz around the sequester, which will cut $54.7 billion each from defense and nondefense programs, has focused on the impact that the budget-slashing will have on the military. Former Vice President Dick Cheney marched up to Hill on Tuesday to drum up support for avoiding defense cuts at all costs.

But when it comes to the health care cuts, loud defenders from either side of the aisle are not to be found. Karl Moeller, the executive director of the Campaign for Public Health Foundation, knows that all too well. Moeller points to past budget cuts over the past few years as examples of what is to come if the Centers for Disease Control and Prevention and other public-health programs see an 8.4 percent drop in their budgets from sequestration.

Take for example, an April letter from the CDC to the Florida Department of Health, warning of the worst tuberculosis outbreaks the agency had seen in 20 years, "both in terms of size and rapid growth."

The letter arrived a few days after Republican Gov. Rick Scott of Florida signed a budget bill that slashed funding for the state's public-health agency and ordered a state hospital that specialized in treating tuberculosis to close.

Now, three months later, tuberculosis has claimed 13 lives in the state and infected 99 people, according to the Palm Beach Post. CDC personnel have been sent to Florida to assist in containing the outbreak, and the agency is reviewing a request from the state for supplemental federal funds to "address programmatic gaps."

Moeller has been cataloguing outbreaks like Florida's on his foundation's blog; 18 states also have seen record levels of whooping cough this year.

"The thing about public health is that these outbreaks happen in stages," Moeller said in an interview. "These stories are just starting to come out, now that CDC has been pushed back to 2001 funding levels already. Throw in another $500 million in cuts [from the sequester], and you are going to see more of these stories."

But Moeller believes that tales of spreading infection, which often hits homeless or low-income people first, still won't be enough to get his group's message across to Congress. To do that, the Campaign for Public Health Foundation is relying on the one thing on top of voters' minds: jobs and the economy.

Moeller's group hopes to take 30 business executives on a tour of the CDC to get them interested in what the agency is up to.

"If you see more sick people not showing up for work ... let's go tour the CDC to learn about what they're doing that impacts business, the health of your workforce," Moeller said.

His isn't the only group lobbying on how cuts in health funding will negatively impact the economy. United for Medical Research is an umbrella organization representing businesses, patient-advocacy groups, and research institutions that lobbies for increased funding for the National Institutes of Health.

UMR President Carrie Wolinetz says the group is trying to "sound the drumbeat" on the effects that sequester cuts will have. The Department of Health and Human Services recently estimated that the sequester could eliminate 2,300 NIH grants, about 5 percent of the total grants that the institute awards. UMR did its own study and estimates that 33,704 jobs could be lost if NIH funding gets trimmed under the sequester.

"They are hearing a lot from the folks on the defense side; we are trying to increase the volume on nondefense side," Wolinetz said in an interview.
To up that volume, Wolinetz said the group recently flew CEOs to Washington to meet with congressional leadership and appropriators.

"They talked about how the uncertainty of the looming sequester was causing a tremendous number of problems for our industry partners to plan effectively," Wolinetz said. "They need to have a feeling about what the situation will be in terms of their own strategic planning."

The House Labor, Health and Human Services, and Education Appropriations Subcommittee is slated on Wednesday to mark up its fiscal 2013 bill, which would make even deeper cuts to health agencies. While the bill isn't likely to make it to the House floor, it lays out a negotiating marker for House Republicans to take to the Senate when both chambers are ready to negotiate federal funding. Their message, so far, is loud and clear: Sequester or not, health programs are getting cut.

This article appears in the July 18, 2012, edition of National Journal Daily.

Mr. MCDERMOTT. In 1992, I had a memorable discussion with a manufacturer. He was the H.R. person from a major automobile company. And he said, you know, our costs, number one is steel, and number two is health care costs. And taxes is way down there somewhere. He said, I could look across the river into Windsor and see automobiles made for $2,000 less than they are made in the United States because of health care costs. He said, our second biggest expenditure, Blue Cross Blue Shield of Michigan. So the President has been trying to deal with making manufacturing more competitive. And one of the things he did was come out with the Accountable Care Act. Now, I would like to ask all the six of you who have companies, how many of you provide employees with health insurance?

Ms. DOSSIN. Ford does.

Mr. GJERSDAL. 3M does.

Mr. MCDERMOTT. You can just put your hands up. All six of you do, right? How many of you support the effort at the Accountable Care Act to shift and make sure that everybody is in and try and get ahold of costs and get the free riders out of the system? How many of you supported it? Did Ford?

Ms. DOSSIN. I am not sure of the question, and I am not a health care expert, but I think that Ford does not have to adjust much of anything in reaction to that Act——

Mr. MCDERMOTT. Okay.

Ms. DOSSIN.—because of what we already do.

Mr. GJERSDAL. I am the vice president of tax. I am really not a specialist in health care. So I really cannot comment on that. If there is anything that I can do after the hearing to get you an answer, I would be happy to.

Mr. MCDERMOTT. Okay. Let me get to the guys who are buying it for themselves, the two in the middle.

Mr. BECK. All I can say to you is our that health care rep came in the other day and said he has seen the largest increases ever for health care for companies of our size. So if you ask me if I support that, I have to say no.

Mr. MCDERMOTT. And that is different from last year? Last year you didn't have an increase?

Mr. BECK. We have increases all the time. But he said the increases are substantially higher coming.

Mr. MCDERMOTT. And you?

Mr. HARDT. Our plan increase for 2013 is over 12 percent. We spend over $12,000 for family and over $8,000 for single right now. There are certain provisions, in reading the voluminous Act, that we can support, but overall I think a simplification is what we really support.

Mr. MCDERMOTT. So what I hear you saying, all of you, is you in the corporate sector want to keep control of your own health care costs to your employees. You want to do it. You don't want any help from us. Is that right? That is not a cost item you worry about. I guess if you are going to hide behind the silo of being a tax person, I don't know how to deal with you, because it is so simplistic to come in here and talk about taxes as being the only issue that affects a company's profitability.

The big issues are not taxes, they are these other personnel costs and material costs that when you buy something, you buy a machine that is $250,000, I don't know where that ranks in terms of the costs in your company in terms of the health care costs. What is your health care bill in comparison to that?

Mr. HARDT. Our health care bill is rather substantive. It is a big part of what we do. I just mentioned the numbers per family and per individual.

Mr. MCDERMOTT. What percentage is it of your expenses every year?

Mr. HARDT. Approximately 10 percent.

Mr. MCDERMOTT. How about next? Mr. Beck?

Mr. BECK. I don't know the number off the top of my head.

Mr. MCDERMOTT. You don't know how much you spend on health care? You really don't?

Mr. BECK. No, I don't.

Mr. MCDERMOTT. Wow.

Mr. BECK. But it is a substantial amount. And I would guess it is probably about 10 percent.

Mr. MCDERMOTT. And how much are your taxes? What percent of your expenses go into taxes?

Mr. BECK. It depends on whether we are losing money or making money.

Mr. MCDERMOTT. So it could be nothing. But you still got to pay that 10 percent in health care?

Mr. BECK. Yeah. You have to pay that health care part. But you know, oftentimes when the health care has gone up, we have had to shift some of that cost back into the individual because we couldn't cover it as a company.

Mr. MCDERMOTT. When I listened to you, I thought it is very interesting you would get involved with a guy from Germany. Germany has had a national health plan since 1883. And he comes over and he looks at your business and says to himself, why should I buy into this crazy health care system they have in the United States, which has no control? They are spending 12 percent of GDP on health care costs, we are spending 17, and you don't have any control whatsoever. The rep comes in and says here is what it is going to cost you next year. So what I have a hard time understanding is how taxes gets all the attention, when nobody wants to talk about what happens in health care. It is like——

Chairman CAMP. Time has expired.

Mr. MCDERMOTT. It is not because of taxes we have got problems in productivity.

Chairman CAMP. Quick answer, please.

Mr. BECK. I prepared today for taxes, I didn't prepare today to talk about health care. I am sorry.

Chairman CAMP. All right. Thank you. Mr. Smith is recognized for 5 minutes.

Mr. SMITH. Thank you, Mr. Chairman. And thank you to our witnesses today. I am wondering a little bit about temporary tax policies that we know abound, and certainly emphasis on the temporary nature. We have to renew them oftentimes on an annual basis. I was wondering if any one of the businesses could reflect a little bit how you plan for that, whether it is a business plan from the beginning, or how you plan for that for the future, on the temporary nature of so many of these tax provisions.

Mr. GJERSDAL. Well, the problem is, you really can't plan for it. Take the R&D credit, which is really the classic. We assume that eventually it will be renewed. It may or it may not be. But the fundamental question becomes with that kind of uncertainty, how could it ever go into a business person's decision in making a decision? That is the fundamental problem. I can plan for it in my tax rate, but I can't recommend to a businessman to take it into account in making a business decision.

Mr. SMITH. And so then the cost of compliance, I mean that is slightly different, but certainly needs to be considered as well given the complexity. Do you ever put an actual number to the cost of compliance?

Mr. GJERSDAL. Well, we are fortunate we are a cap audit taxpayer. And so we have reached agreements with the IRS as to how to compute the credit, how to compute the manufacturers' deduction. So our cost of compliance in those areas has gone down substantially. But before that, it was a very, very expensive proposition both at the time of computing it, and then also at the time when you had to discuss it with the IRS, and needless to say, have a controversy.

Mr. SMITH. Okay. Anyone else? Can you elaborate then on that process with the IRS that you went through?

Mr. GJERSDAL. The cap audit process? It is a program that was established I think it was about 7 or 8 years ago. Basically, what it allows you to do is have a much more open relationship as a large corporation with the IRS. Through this process, we are current now on our audit. We are basically closed through 2010. Our requirement is to be much more transparent. We have to disclose all our transactions during the year as they occur. The IRS, on the other hand, their view is to get the audits done. So they don't bring up all these frivolous issues that they used to bring up. They bring up key issues.

It is not like we don't have controversies. We still do have controversies. But when you think about it, 5 years ago we had issues going back 10 years. That creates a lot of business uncertainty. Today, our 2010 audit is done. Think of the business certainty that creates.

So I really applaud the IRS in this effort. This has been a wonderful process we have been involved in. The other companies we know of that are involved in it also think it is a very good process.

Mr. SMITH. Mr. Hardt, could you reflect on the temporary tax provisions and the cost of compliance?

Mr. HARDT. I think the uncertainty again weighs on a small business's mind more than anything else. You pick up the paper in the morning, you hear what is going on in Europe, you are not sure what your tax bill is going to be at the end of the year. We both of us in particular, and all of us, lived through the great recession a couple years ago and how we had to struggle to get through that. The uncertainty of the current Code causes you to be cautious. It causes you to maybe not make that investment you would like to make to see if you can make it pay off, but it causes you to be cautious. That is the biggest thing I can comment on.

Mr. SMITH. Mr. Beck.

Mr. BECK. I think it is basically the same thing as what Mr. Hardt said. I mean, I really can't elaborate on it much more other than if it is simplified and more stable, then we can plan further out. And as far as the R&D tax credit, we had never taken an R&D tax credit until we started the R&D this particular machine. A small company doesn't have ideas like this every day. Maybe in a larger company it might be used more often. But it did certainly play into our final decision whether or not the R&D tax credit would help us alleviate some of the risk going forward. So I have to admit that in this particular case, it made sense for us. But overall, just knowing what the taxes are, and knowing they will be stable over a longer period of time certainly is helpful to small businesses.

Mr. SMITH. Okay. Thank you. I yield back.

Chairman CAMP. Thank you. Mr. Lewis is recognized.

Mr. LEWIS. Thank you very much, Mr. Chairman. Let me take this opportunity to thank all of the witnesses for being here. Dr. Boushey, I grew up in Alabama, where we once had booming manufacturing industries. Most of the south did back then. But manufacturers are gone, the jobs are gone, and left behind hundreds and thousands of families who have struggled and continue to struggle to find their place in America's middle class.

Can you repeat for the members of this committee why keeping manufacturing here in the United States is good policy for local community and families? And I want you to feel free to speak from your heart.

Ms. BOUSHEY. Thank you, Congressman. Thank you. This has been just a very interesting hearing. There is a couple things on that. I mean, certainly manufacturing has traditionally provided solid middle class jobs. And there is some new research by an economist Susan Helper from the Brookings Institution and her colleagues that shows that manufacturing workers are paid about 8 percent more even once you account for all of the characteristics of jobs and those workers. So even once you account for the fact that these are union workers, these workers are paid more than other nonmanufacturing workers. And the research has shown, and of course, I am not a business expert like all of you, but the research has shown this is because those workers also have specific skills.

Which gets to the second reason why manufacturing is vitally important to our economy, which is one of the key sources of innovation. There is a lot of emerging economics research that is showing, and you from Corning talked about this, I think very eloquently in your testimony and here today, that there is what economists call either industrial commons or other reasons why having different kinds of manufacturing together, both suppliers and the companies that they are working with, in one place creates innovation and vitality. And if our country wants to remain a leader in the world in terms of technology and innovation moving forward, making sure that we support that manufacturing base so that when you talked about the glass being very thin, needing to be near where the TV screens or whatever is being made, that is being done in Asia or wherever for a reason. We want those kinds of synergies to be happening here in the United States.

So it is not just having one, you know, kind of manufacturing, but having that variety is very, very important and vital, and important if we want to remain a leader in terms of technology in the next century. And then finally, manufacturing plays a vitally important role in our macro economy. I mean, over the course of the recovery, manufacturing has been a leader in terms of job gains. It has been very good. That has been very encouraging to hear. But it is also vitally important for our trade deficit. Over the long term, this is something we are going to need to address. And if we don't start bringing manufacturing back into this country as one of the easiest ways we can address our trade deficit, and if we don't, we are going to have to continue to borrow from abroad, and eventually we will have to pay that back.

If we don't deal with this, we will be looking at a lower standard of living in the decades to come. And I would add that energy is a key component of this. You know, as we both deal with rising energy costs in terms of oil that we are importing, and we are all looking for new ways to produce energy, green technologies, the extent to which we can do those here will be good for our trade deficit 10, 20, 30 years down the road.

And then one just note, Congressman Smith, on your question on things about uncertainty, there is a lot of uncertainty right now about the extension of a number of the tax credits and provisions for manufacturing in the green sector, including the production tax credit and the advanced energy manufacturing tax credit, which are causing a lot of uncertainty for particularly those manufacturers.

Mr. LEWIS. Dr. Boushey, one member of the panel, responding to our colleague Mr. Johnson, said that you made it on your own, that you developed your own business. Don't we all live on this little piece of real estate we call America? And what about the roads, the bridges? Or what about the transit system? What about the clean water, the sewer system? Could you respond?

Ms. BOUSHEY. Well, I am glad you asked that question because this is of profound importance. I was reading The New York Times this morning, and there was an article on the cover of the paper about Stockton, California, which is about to go into bankruptcy. And talking about how they don't have any police, murders have doubled, that there is this devastation in this American city, a lot of which is because they don't have tax revenues. And we have just lived here through in the District of Columbia this massive power failure, hundreds of thousands of people without power for over a week because of a set of storms. These are our Nation's infrastructure. And if we don't have safe streets, if we don't have electricity that you can count on, if you don't have roads and bridges and all the things, and importantly a public school system that can compete with the rest of the world, we will not be able to remain an economic powerhouse.

If we do not educate the next generation that can create the kind of workforce that all of these companies benefit from, we will not be able to do that. So while any innovator, and of course, small business owners, they take an enormous amount of risk, an enormous responsibility for moving their investment forward, but they do so because they can hire workers that had been educated in their community and because they can build on the infrastructure that is there. These are two pieces of puzzle, and we need to think of them always simultaneously.

Mr. LEWIS. Thank you, Dr. Boushey. Thank you, Mr. Chairman.

Chairman CAMP. Thank you. Ms. Jenkins is recognized for 5 minutes.

Ms. JENKINS. Thank you, Mr. Chairman. Good hearing. Thank you all for being here. Mr. Hardt and Mr. Beck, in your testimony, you both raised the issue of the impact of the estate tax and the effect it has on family-owned businesses. Mr. Hardt, in your testimony, you made the point that the primary reason for structuring a business as an S corp is the hope that someday you can pass along that business to your children.

Family-owned businesses, from farming and ranching families to family-owned manufacturing companies such as yours deserve an opportunity to pass that business from generation to generation, and preserving these good paying jobs in our communities. I believe families shouldn't be forced to sell their farm or their business to pay estate tax. So I am a strong supporter of a full repeal of the estate tax. But I was wondering if you could each comment or tell me personally how the estate tax has affected your business and your decision-making, and what recommendations might you have for Members of the Committee on how we could treat the estate tax and any tax reform proposal.

Mr. BECK. Well, because of changes in the estate tax it would be more advantageous to plan when you die. But I can't plan on when I am going out. And so an estate tax needs to be set so that a businessowner can have something to plan around. Because ultimately you get to the point where you can't plan for how much cash you would have to generate to keep the business in your family.

I think that is the biggest fear that a lot of family-owned companies have. How do you pay that estate tax burden? Do you start saving for that tax burden a the expense everything else you are trying to do—while you are trying to buy machinery, you are trying do R&D and you are trying run your business? How do you finance it if you come to the point where you have a huge tax burden to try to keep the business into your family?

Let me tell you from the standpoint of a family-owned business, (I am not saying that large companies don't treat their people well, because they do treat them well) there certainly is a closeness that we have in our company. It is important to us that our people are successful. When our people took 40 percent pay cuts because we were trying to survive, I was worried about those people, that they couldn't pay their mortgages on their homes and that they were going to lose their homes. They stuck by us through that whole thing. And I truly believe that family-owned businesses have a real closeness to their employees, and really want to try to help their employees. And when often times you have to sell your business, it gets sold to a bigger company. Then when business gets bad, they just close them up or they consolidate them down.

And that is what happens if you can't keep the business in your family. So I think estate tax planning is very critical for keeping these family businesses for long term and for protecting employees and small enterprising companies. I also want to say is when it comes to infrastructure, I paid a lot of taxes for infrastructure. I think I paid my fair share. And I do believe we all as companies pay our fair share in infrastructure. We are part of the infrastructure of this country because we pay taxes to support it. I got a little off topic.

Ms. JENKINS. No, I totally agree. Mr. Hardt.

Mr. HARDT. I want to follow up on the infrastructure thing too, I mean, after coming through the great recession, I am glad to pay taxes. Those weren't fun years.

Anyway, the issue of estate planning is very important, and again, I am going to put the tone on as a manufacturer. A manufacturer has to put a lot of capital back into the business. So a lot of us are faced with estate taxes, whether uncertain, or certain, with the decision if we can't put enough money back into the business because we have the huge estate tax liability to pay for, then it results in almost an inevitable sale, and we have many second and third generation workers working within our business, just as we have four family generations.

So from a manufacturing standpoint when you have to invest so much capital back into your business, an uncertain estate tax, or the ability to plan for such, does result in a sale too often a time, and usually it is not good for the business.

Mr. BECK. No.

Ms. JENKINS. Thank you. Mr. Chairman, I yield back.

Chairman CAMP. Thank you very much. Mr. Thompson is recognized.

Mr. THOMPSON. Thank you, Mr. Chairman, and thank you to all of the witnesses who are here today. I appreciate your coming in, and appreciate what you do, and what your companies do, and all of your employees. It is very important to our economy, and very important to our country, and I don't think I speak for myself when I say that I want to do all that I can to help make sure that business in America is successful.

It is important to the entire country, and to our future, and I think tax reform is a very, very big part of that, but I do want to say that tax reform has got to be smart. It has got to be smart, and it has got to do a couple of other things. It has got to keep jobs in America, and it has got to bring jobs back to America. It needs to be revenue neutral, and as one of the witnesses said, it needs to pay the freight. It needs to pay the bills on everything that our country does.

I think that Mr. Lewis was very specific on those issues, and the sewer systems, the highways, et cetera. And I don't think we can just pick a number out of the air to say that is what the corporate rate should be, and that 25 percent number has become the kind of number of the week, or the month. And I was very interested in when all of you who own and run businesses talked about what should be on the table to get to 25 percent.

This is the second hearing similar to this that we have had. The last one, I don't remember all of the witnesses, but I know Caterpillar was here, a couple of the big corporations, and they were all very specific. They said almost to a person, take all of the other tax expenditures away. Just get us down to a number. And that was about the 25 percent number, I think.

I understand that from the people that advise us, that you can't get to revenue neutral at 25 percent, even if you get rid of all of the tax expenditures. It gets you down to about 28 percent. So if you do that, you can't just put it on the table. You have got to pay for it. If you don't pay for it, we are in a bigger soup than when we started. And I think, Mr. Beck, you talked about that.

You talked specifically about how you were able to pull through this recession because you had very little debt, and that you were fiscally responsible. And I think that is an important takeaway for us, because we have to be fiscally responsible as well. And "fiscally responsible" means that we pick up the tab, or at least part of the tab for education, because you can't educate your own workers. We pay for a Navy that keeps the shipping lanes open, that allow you to move your product overseas; a Coast Guard that responds to emergencies on the water; the medical professionals that Mr. McDermott talked about; the infrastructure that is so critically important to your companies.

Secretary Geithner was in before this committee, and told us that the infrastructure problems we have is a hidden tax on the very people that are before us today testifying. And I think we all, we all know that, and that is not—that is not helping your business either.

I also want to mention that the American jobs stuff is critically important. And it is not all going overseas. As a, matter of fact, we are seeing a change in that. A lot of it is coming back. I visited with a person just last week in my district who has seen his business grow by about, I think, 18 percent per year. And he has got—he is a supplier to one company. He makes stuff for snowmobiles and ATVs, and his growth is because they are not making their components in China anymore, because they have huge costs for quality control. They have to send somebody over there to make sure that it is done correctly, and they—the cost of shipping stuff back and forth is extremely expensive.

They are better off making it, Factory Pipe in Ukiah, California. And I think it is a prime example of the sort of thing that we need to figure out how to make that more prosperous so that you and your colleagues can continue to grow jobs overseas.

But I think we need to be honest and fair about it. We can't just pick numbers out of the air. We need to do it in a way that balances the books, and is able to pay for the things that allow all of you to run the companies that you run so well today.

So I hope we can get to that, and I hope we can have a good discussion on that. Mr. Chairman, thank you.

Chairman CAMP. Thank you. Mr. Marchant is recognized.

Mr. MARCHANT. Thank you, Mr. Chairman. I represent a district that basically surrounds the DFW Airport. So I have a very small geographical district. So when you land at DFW Airport and you begin to drive through my district, you see the corporate headquarters of not Ford, but companies like Exxon, and Fluor, and these multinational, and you begin to get the impression that this is the main driver, business driver in my district. But the truth is, it is the small manufacturing companies that have gravitated there near the airport, near the multinational companies that are there basically to serve the needs of, to supply these larger companies.

When you begin to talk about taxing incomes over $250,000 at a higher rate, you are not talking about really taxing the large multinational companies. You are talking about talking about taxing those small manufacturing companies who rely totally on retained earnings to fund their equipment purchases, your grinder, to fund new jobs being created, the three positions that will operate that grinder, and you are talking about the physical expansion of their plant facilities.

All of these companies use their retained earnings to do that. If you raise the tax on those retained earnings an additional 5 or 6 percent, the direct result of that will, there will be 5 or 6 percent less money put into facilities, equipment, and new job creation.

So it has a very detrimental effect on it. And it is really to the advantage of the big companies who rely very heavily now on just-in-time inventory, rely on the efficiency of the smaller manufacturing and the smaller and mid-sized companies that are out there that are providing all of this.

So I believe if you begin to target, what I would call the job creators in any kind of a tax reform, or any kind of a tax extension, that you will eventually end up driving costs higher at the large company level. Now, that is my comment.

My question to all of the companies here is, since an increasing number of targeted business tax expenditures are enacted on a temporary basis, is there a greater value in a permanent tax rate reduction than these temporary benefits that must be renewed by Congress every year or so? And I will start with Ms. Dossin.

Ms. DOSSIN. I think that is undeniable. It would be far better to have a stable system that would inform good decision-making. That is what we would hope for.

Mr. MARCHANT. Thank you.

Mr. GJERSDAL. Just one word, absolutely.

Ms. FORD. I would agree. I think the temporary provisions are particularly painful. Corning, in particular, benefits from the look-through as well as the R&D credits, and having those bounce temporarily is very troublesome.

Mr. HARDT. Again, uncertainty, I think I have used the word about ten times so far. It makes it very difficult to plan when you have all of the things on your mind as a small business. I believe that a stable, longer-term environment is what we all need. I would also, however, state that I also agree that if there is anything that can be retained or implemented to encourage investment in our country, to encouraging people to get into manufacturing, stay in manufacturing, that should be considered.

Mr. BECK. I just think a stable tax is the best tax. I probably would lean more a little bit the other way. If you had a lower tax, and you had to give up some of these other things, at least we know the playing field that we are playing on. Faster depreciation and R&D tax credits certainly are important incentives for manufacturers, and we certainly appreciate those incentives. But at what cost? I think stability to me is still the most important thing.

Mr. SPINKS. In a capital-intensive business like ours where it takes typically 2 to 3 years to build a plant, understanding what the tax result will be when the plant is finally placed in service 2 or 3 years down the road, and the predictability of that is a huge, huge advantage and a game changer, I think.

Ms. BOUSHEY. I would like you to point you to a couple of citations in my testimony about what lowering the rate in a revenue-neutral way would do to a variety of industries. So that would lead to the elimination of many of these deductions, and there is some work by an economist named Martin Sullivan who showed that if you reduce the rate in a revenue-neutral way, this would be most detrimental overall to domestic manufacturing in his analysis, and that the biggest winners would be securities who would see a net reduction of 12.3 percent, insurance, credit intermediation and retail trade and bank holdings, so reducing the rate overall, but eliminating these deductions would primarily go to finance and retail, while overall, it would mean a net in aggregate increase for manufacturing, and in particular, computers and electronics would see the largest increase in their taxes under that proposal. So I do think that there is—it seems to be that there are some concerns.

Chairman CAMP. Thank you, Mr. Blumenauer is recognized.

Mr. BLUMENAUER. Thank you, Mr. Chairman. I would hope, just a question to Mr. Beck and Mr. Spinks at some point, not now, but if I could just get a one-page explanation about the reinvestment in the business. You were talking about the uptick in the tax rate would be a disincentive for you to invest in the business, and my understanding is that in many instances, the reinvestment is a deductible expense.

And so if you could just explain on one page at some point, we don't have time to go into it now, and I am probably not smart enough to understand it, if you could explain to me whether or not these are deductible expenses and how that works for your enterprise.

I am sorry, my friend, Mr. Davis, is not here because he talked about the negative consequences of employment when the Clinton tax increases were put in effect.

Because if memory serves, the 8 years of the Clinton administration, there was something like 22 million jobs created, versus less than a tenth of that during the 8 years of the Bush administration with two rounds of tax reductions. But I appreciate the range of discussions that are here, because I think there is no question, but what as a result of hearings we have had, and conversations we all have, that the tax system is broken. And the focus on manufacturing is important because as I look at the manufacturers that I represent, they are some who manufacture in the United States. They are some of the few people who actually pay that statutory rate.

As you know, that top statutory rate is not what most businesses pay. The average is much less than that. But it is manufacturing in the United States that gets hammered. And so your helping us focus on that, and think about how we protect that and move forward, I think is very, very important.

I appreciate what my colleague, Mr. Thompson, talked about in terms of how we go forward and how we are balanced. Because despite all of the rhetoric, we are collecting less in tax as a percentage of our Gross National Product, than any time since Truman was President. So tax collections are down in the aggregate. We have a growing and aging population. Something has got to give. We want to help manufacturing. We have a system that is not particularly rational, but it seems to me we need to be able to look at the big picture.

I was intrigued the reference to Germany. Germany has a total corporate hit of somewhere in the neighborhood of 49 percent when you look at all of the business costs in. When you look at the amount of money that governments collect from business, the United States is 27.3 of total revenue that come from business.

The average of the OECD is 36.2 percent. So these collect more from business and they have almost without exception, much higher personal income tax rates. So if we are going to undertake a change and pay our bills and not much less deal with what has been referenced this infrastructure deficit, we have got to figure out how to get about this.

One of the differences is all of these countries we are competing with have a value-added tax along with the territorial system. So they make up the gap by having a substantial revenue flow. And again, there isn't time, and I don't want to trap anybody, but I would hope that if any of you have some thoughts about how a value-added tax would fit into long-term, we would welcome that.

If you have got super policy people, or you just have some random thoughts, I spend a lot of time on airplanes going back and forth every week to Oregon. So in addition to reading your testimony, I would really love if you have some thoughts about how a value-added tax might fit into this. Thank you, Mr. Chairman.

Chairman CAMP. Thank you. Mr. Reed is recognized.

Mr. REED. Thank you, Mr. Chairman. Ms. Ford, if we could spend a little time together here. I wanted to explore a little bit more in detail your comments that you offered on the transition rules, because one thing that I have come to the conclusion, and I am glad to be at this conclusion, is that it is not a question of if we are going to do comprehensive tax reform; it is a question of when. So in order to prepare for that, I would like to have a little bit more of your comments and detail on the issues dealing with transition and transition rules and what are the pros and cons that you could offer us? What issue will be you focusing on?

Ms. FORD. Certainly, I think there are pros and cons to the general concept that in order to go to a territorial system, we have treat the cumulative foreign earnings that are have existed to date in a certain way. I think the current proposal that Chairman Camp has put forward is that all of the earnings that have accumulated abroad would be taxed immediately prior to the transition, and that they would be taxed at a reduced rate.

I think, obviously, the pros there are for companies trying to compete is that the reduction in rate helps reduce the overall liability. I think the concerns are that all of the cumulative earnings are not necessarily in the form of cash, and so to some extent there is a disparity between the actual money we could bring home under that, and the amount that we would be taxed on.

So I think that is a major concern. And then some of the things that can help address that concern are the permission to use carryover losses and foreign tax credits that have accrued over time to reduce that cash liability, and I think allowing it to be paid over time is helpful. And maybe some indication or agreement to limit the amount that is subject to tax to the extent that there is a very huge disparity between the cash available, and the actual earnings.

Mr. REED. So as a small business owner, that was always something that was so important to me, is that cash is king.

Ms. FORD. Cash.

Mr. REED. And if those bills are due, you have to have the resources to pay for it. So I appreciate that. And then on option C, you mentioned it as part of the base erosion protection issues. Can you also gets a little bit more in detail what the pros and cons of pursuing that option would be?

Ms. FORD. I think one of the common themes that applies to any tax reform is that the devil is always in the details. I don't think there is anyone on the panel that will disagree with me there. I think the biggest concern with respect to option C is how broad that base becomes. The reduction in the tax rate on income from intangibles is of course very helpful. It is competitive compared to some—compared to some of what our competitors enjoy, but I think the biggest concern is, is how will that base be defined? To the extent that there is foreign source income or foreign source intangible income in foreign locations, the challenge is how much of that would be brought into and be subject to this tax. I think that is the greatest concern.

Mr. REED. I appreciate that. And Mr. Gjersdal, do you have any comments on option C, again, in particular, the pros and cons of what is being proposed and can you over some insight from 3M's perspective?

Mr. GJERSDAL. Well, 3M historically has had 100 percent of its IP here in the U.S. The only IP that is actually offshore is the IP that we might have acquired in acquisition, and it is simply too expensive to move back here.

So any type of option that would go after some of the abuses that do exist with IP offshore, you know, I think would be welcomed; welcomed by me. At the same time, I think we do need a kind of a carrot-and-stick approach, and that is that the carrot approach is why would we not do more to encourage research and development here in the U.S., and IP ownership here in the U.S. We spend a $1.6 billion each year on R&D. Our R&D credit is $20 million. Obviously, that is not going to change a whole lot of minds in terms of where we investment.

But if we did something like the patent box which is becoming quite common in Europe as a carrot, you might see a fundamental change in the way IP is developed and owned by U.S. companies.

Mr. REED. And why is that so important to keep that IP here in America?

Mr. GJERSDAL. Well, I mean certainly, the patent protection, and I am not a patent lawyer so I can't address it in detail, but certainly the patent protection, having the IP here. The fact that where the IP is also going to encourage where it is developed. For 3M, our fundamental innovation is in the U.S., is in St. Paul. Thirty-two percent of our products that we are selling this year have been developed in the last 5 years. We want to keep that innovation here in the U.S. We do have labs offshore. That is a necessity of our business also, but we want to keep the base innovation here.

Mr. REED. And with that base innovation, I would assume the jobs that are associated with it, like in Corning, my hometown of Corning, those are typically your research scientists, your engineers, and others; is that correct?

Mr. GJERSDAL. Correct, and then obviously, a successful company adds to the headquarters staff. Fifty percent of our manufacturing is here. And to be perfectly honest, if you look at some of the really innovative stuff that we have, for instance, we have revolutionized the abrasive industry over the last 5 years. That technology is not going anywhere. We are going to keep it here. We are going to make it here. That is simply not technology we are going to readily put offshore. Other technologies, however, that are older and less IP protected, certainly, manufacturing ends up offshore, because we are a short cycle supplier. Our customers are demanding that we be close to them, very much like the Corning example.

Mr. REED. And I appreciate that. I know my time has expired and with that IP being here, I always keep the hope out that manufacturing would then blossom next to the IP center here in America. With that, Mr. Chairman, I yield back.

Chairman CAMP. Thank you, Mr. Kind is recognized.

Mr. KIND. Thank you, Mr. Chairman. I, too, want to thank our panelists for your testimony here today. It is helpful and we have been hearing countless hearings throughout the year on what comprehensive tax reform should entail. So getting this feedback, I think, is very beneficial. But unless or until, and I have made this point in previous hearings, unless we start putting something in draft, putting something on paper, we are all dealing in a 30,000-foot theoretical level, because we all know that at the end of the day, and the chairman knows this and every member of the committee knows this, once you put something on paper, you are immediately going to be creating winners and losers, no matter what we do. It is just going to make reform very, very difficult.

And that is why we are going to be asking you to do some pretty hard calculations, and those of who you are representatives of the manufacturing sector of this country, of what you are willing to live with, and what you are willing to give up for the sake of a shared goal of trying to lower rates, broaden the base, and simplify, simplify, and simplify.

Now, we are getting contradictory messages from some of you witnesses here today, where you are telling is, not all of you, and Mr. Gjersdal, we had a nice conversation about this, and 3M is—you were clear with me yesterday, and you were clear in your testimony today that you are willing to give up a lot of the expenditures that you currently take for the sake of a lower rate and I appreciate that. But you can't have both, and we are hearing from some of you that you like lower rates, but you would also like to keep R&D. You like to keep depreciation. You like to keep 199.

And that is the concern that I have. Because the goal of trying to get to 25 percent, the Congressional Budget Office already told us that in order to try to get there, we have to take away every tax expenditure that exists on the C side. And even then, the best we can do is get to 28. So if the goal is really to get to 25, then somehow you are going to have supplant that lost revenue and dip into the pass-through side. So Mr. Hardt, Mr. Beck, that is when your ears perk up, as they should in a hurry. Because I don't think you are going to be willing to pay more as a pass-through entity for the sake of C corps getting a lower 25 percent rate if we are going to do this in a deficit-neutral fashion.

And yet, most of the expenditures that are talked about being eliminated are the ones that directly benefit manufacturing. And Dr. Boushey, I want to ask your opinion in a second of what the impact would be on the manufacturing sector of our economy if we do take away R&D, if we do take away depreciation, we do take away 199 for the sake of lowering the rates and broadening the base, because I happen to believe that a country as great as ours, we have to have the ability to make things, and to produce things, and to invent things, and create things, and grow things, but we are no longer going to be a super power in this world.

And therefore, I think there would be more interest on this committee of what type of changes we have to make in the Tax Code that would benefit companies such as yours that make things, and invent things, and create things here in the United States of America.

That is why earlier this year I introduced legislation called the Promoting American Manufacturing Act, which calls for reducing the manufacturing rate from 35 to 20, for those that make things, for those manufacturers of our country. And we are not going to be able to do that for every industry, for every sector of our economy. But what is being pitted right now against each other are basically your manufacturers and your technology sector, versus everyone else, from the retailers, the wholesalers, financial corporations, the service sectors, who are paying a high rate right now, but they are not getting these deductions. They would love to have a lower rate. But in order to get there you are going to be taking away a lot of the expenditures that directly benefit manufacturers in the process.

And we need help in trying to figure this out, and you guys are going to have to make those hard calculations of what you are willing to live with for the sake of lower rates, what you are willing to give up. But maybe Dr. Boushey, I ask you first, and then Mr. Hardt, I want to go back to you to get your perspective on this, too. But what do you think will be the impact on domestic manufacturing if we take those expenditures off that directly benefit manufacturing in the high-tech sector today just for the sake of lowering rates for everyone?

Ms. BOUSHEY. Well, from where I sit looking at the big picture as an economist, it seems like that would be bad for U.S. manufacturing, and we already have an industry that certainly has been in trouble, that has been—we have seen a decline in many ways in manufacturing employment, and as a shared GDP, and I think it should be a national goal to make sure that manufacturing remains a vital part of our economy and grow it.

And so these kinds of tax expenditures that seem very important to manufacturing should not be done at the expense of lowering of the rate, when a lowering of the rate, at least according to all of the analysis, if you did that in a revenue-neutral way, would disproportionately benefit other industries like finance, and insurance, and retail, which while are, of course, certainly important, don't have the pivotal place that manufacturing plays, both in terms of job creation, but also as a key sector for innovation.

Mr. KIND. Dr. Boushey, not to sound too crass in my analysis and listen, I don't hold myself out as an expert, but if you take a look at the manufacturing and tech sector, these jobs are highly mobile. You guys can go anywhere around the globe, where it makes sense for you to do it. But you look at the other sectors, retailers, wholesalers, financial, the service sectors, they are less mobile. I mean, where are they going to go? They have to stay here in the United States, provide jobs here, because this is where the customer base is.

Chairman CAMP. Your time is expired, so if you could just be brief.

Ms. BOUSHEY. Okay, not only are they less mobile, but they don't create the same kind of innovation effects that are so critical for us remaining the sort of the economic powerhouse that we have been.

Chairman CAMP. Thank you. And I would just say, Mr. Kind, the tax expenditure report that you mentioned is incomplete. It does not include all of the tax expenditures and it is not necessary to get rid of every tax expenditure in order to get to 25.

So Mr. Brady is recognized for 5 minutes.

Mr. BRADY. Mr. Chairman, thank you for hosting this hearing. We are hearing from iconic American companies, and to top it off, we have a company headquartered in Texas. So it doesn't get any better than this panel.

Clearly, if America wants to have the strongest economy in the world for the next 100 years, we have to get our Tax Code right. Today, despite what you see on the campaign trail, there aren't incentives in the Tax Code to send jobs overseas. The Tax Code itself is the problem, making it harder to locate jobs, especially manufacturing jobs here in merge.

The Ways and Means Committee led by Chairman Camp last fall laid out a draft proposal to make us competitive again, both lowering the rate, moving to a territorial system to make sure that we are not out of sync with the rest of America, allowing companies both to compete overseas and to bring those profits back to invest in America.

The President has, in a less specific way, outlined two general approaches. He, too, wants to lower the rate which I commend. But he keeps in place, or at least the White House keeps in place the territorial system, the outdated system we have today. In fact, even removes some of the provisions that would create double taxation risks for companies. Looking at those two approaches, the draft that has been laid out by this committee, and from the White House, I want to start with our business witnesses.

From a competitive standpoint, both competing around the world in the competition you face here in America, do you have a preference on which concept, which direction allows you to compete best going forward?

Ms. DOSSIN. My written testimony, and I think my oral today, said Ford does not have a particular position. We think a variety of different approaches could work.

Mr. BRADY. So may I ask, so a territorial, you would be—you have no problem leaving the territorial system in place, the worldwide system in place?

Ms. DOSSIN. Well, I mean, we have been working with that for some years. To us, the low U.S. tax rate is the single-most powerful thing, and because of our profile, because of where we historically have operated near our customers, our profile does not suggest to us a leaning strongly one way or the other. But if it is territorial, anti-based erosion provisions are really important.

Mr. BRADY. Okay.

Mr. GJERSDAL. We clearly support the chairman's proposal, at least the outline of the chairman's proposal. As far as the lower rate is concerned with the base broadening, we create a more even playing field here in the United States, and make the U.S. more competitive internationally. Territoriality is really a separate issue. It will enable us to compete with our foreign competitors, so both are really important. One does not go without the other. But clearly, the chairman's proposal would be our preference.

Mr. BRADY. Thank you.

Ms. FORD. I think our preference would also be to shift more towards a territorial system, because so many of our competitors and customers are located internationally and those companies have territorial systems that leaves it as an unfair advantage. We do spend some time when we look at expenses in the U.S., funding our R&D, funding our corporate headquarters. We do spend a lot of time analyzing, is it actually cheaper to borrow in the U.S. to fund those activities instead of bring money home that we already own. So I think it is a significant issue for companies like Corning and territorial would be more competitive.

Mr. BRADY. Great, thank you. Mr. Hardt.

Mr. HARDT. Well, the territorial doesn't really impact us, being a domestic manufacturer. One point to Mr. Kind, there is an exhibit in my testimony on a tax template, how the tax changes would specifically impact pass-through manufacturers, so that is in my testimony for the review.

Again, I have to state that the ability in the Tax Code and we are a capital-intensive business, and that is what we have to remember here. We are a capital-intensive business, so we need profits to reinvest in our businesses; we need profits to leave in our businesses in order to borrow money. So an overall effective tax rate will clearly allow us to do that. However, I continue to encourage the fact that since we are a capital investment business, if there is anything that can be retained to assist with those incentives, it is for the best of all us.

Mr. BRADY. And can I make a point there? I think this is a healthy discussion, one we have wanted to have for a long time. The reason we have held almost 20 hearings on this issue, having a discussion about the lowest rate possible, or pro-growth Tax Code, the cost of capital and the impact, this is all part of getting to, I think, the best Tax Code we can create for our companies. So thanks for that.

Mr. HARDT. Well, working with manufacturing capital investment isn't just about us. I mean, I have 120 suppliers to me. We have service businesses in our community that respond to our capital——

Mr. BRADY. Got it. Can I hear real quick from Mr. Beck and Mr. Spinks?

Chairman CAMP. Real quick, because your time is expired.

Mr. BECK. Being territorial doesn't affect us either, but going back to accelerated depreciation, when you talked about that, I have been in this business and running it for 35 years. I bought machinery where we didn't have accelerated depreciation, and I have bought machinery where we have had it. When you have it, it is certainly may be an incentive intended to make a decision that you may not make ordinarily because you have that advantage. It certainly can help when the economy isn't good.

Mr. BRADY. Good.

Mr. BECK. But I have lived under both.

Mr. BRADY. Thanks, Mr. Beck, I have run out of time. Mr. Spinks.

Chairman CAMP. Mr. Neal is recognized.

Mr. BRADY. Thank you.

Mr. NEAL. Thank you, Mr. Chairman. I appreciate Mr. Brady's emphasis on the lowest possible corporate tax rate. Mr. Gjersdal, would you comment on the idea, if you had the option of a 27 percent rate, or giving up R&D, which one would it be?

Mr. GJERSDAL. For the R&D credit versus 27 percent?

Mr. NEAL. Yeah.

Mr. GJERSDAL. 27 percent.

Mr. NEAL. 27 percent. We would be assured that you would never have anybody come back for looking for the R&D afterwards?

Mr. GJERSDAL. Well, I mean, right now, it is such a small number that it really doesn't affect our decision-making process right now.

Mr. NEAL. It is a big issue in Massachusetts, to be very frank, as you might expect.

Mr. GJERSDAL. And obviously, every corporation is in a different position.

Mr. NEAL. And we have had these conversations back and forth. I appreciate the testimony. It is really very, very helpful. The problem is, that at this stage of the question and answer period, every question either has been asked or exhausted. So what is the—after the issue of taxation, what for manufacturers is the next big issue? Any member of the panel.

Mr. GJERSDAL. Well, if I could, I have noticed today that there is violent agreement to do something, and that is really encouraging. The problem is, is what we do has to recognize that we are now in a global economy, and a global economy—and a globe that is becoming smaller and smaller every day. We can't look at the past as to how we might do manufacturing. We have to look at the future as to how we might do manufacturing and where can the U.S. succeed. Everyone wants the U.S. to succeed. There is no doubt about that. But you have to go overseas and see what is going on in other places to see how much we have to learn how to compete in this economy.

Mr. NEAL. And the other panelists, what other considerations would you have just besides the issue of taxes?

Mr. HARDT. Definitely a skilled workforce is very important to us. It takes skilled and talented employees to innovate.

Mr. NEAL. Are we falling down on that front?

Mr. HARDT. To be very honest, we usually have to take young apprentices and send them to community colleges for basic skills in mathematics and everything else just to get them into our apprenticeship programs. We are falling down a little bit on the basics.

Mr. NEAL. Okay, the other panelists?

Mr. SPINKS. To be honest, I think as an internationally headquartered company, we still see the United States as probably the premier place in the world to do business. But when we compare the tax rates that we see in other industrialized countries to the United States, there is a serious disadvantage here.

Mr. NEAL. Okay, Ms. Boushey.

Ms. BOUSHEY. I would like to direct your attention, there was an article yesterday in The Wall Street Journal that talks about a number of firms that are insourcing, in-shoring back to the United States, and they cite a number of examples for why they are doing it. Some of it has to do with patent protection, some of it has to do with education, and a skilled workforce, but there is a long list of things that is not just about taxes that is very—I will get this to you.

Mr. NEAL. I saw the article and you gave me the run-up. Any of the panelists, are you considering bringing jobs back right now for those of who you have international interests?

Ms. FORD. I think as a general rule, our view is if we grow internationally, we grow domestically as well. And I think since the recession, I believe we added about 1,500 jobs in China, because many of our businesses sell to Chinese markets and we added 2,000 in the U.S. So but I don't think it is a zero sum game. I think we continue to add in both.

Mr. NEAL. Fair enough, Mr. Hardt.

Mr. HARDT. We have added jobs back, and again, exports are a big part of our business, 22 percent overseas. So you know, international and globalization is part of what we have to deal with every day.

Mr. NEAL. Okay, Mr. Gjersdal.

Mr. GJERSDAL. Well, as a short-cycle material supplier, if our customers come back to the U.S., we will be coming back to the U.S.

Mr. NEAL. Any immediate plans to?

Mr. GJERSDAL. We are not seeing that great of an increase in U.S. manufacturing at this point in terms of our customers, but as I say, when they do come back, I mean, we will be right next to them.

Mr. NEAL. Great. Ms. Dossin.

Ms. DOSSIN. We locate where our customers are. So I will just channel Alan Mulally and say profitable growth for all is what we want for all parts of the world. So U.S. included.

Mr. NEAL. Okay, just a last comment, Mr. Chairman. One of the frequent concerns that I hear from the manufactures where I live, it really is the issue of skills. I hear it all of the time. And the fact that they are subsidizing additional education, remedial education, and then on to the community college, which is a very important part of the economic discussion in America. But it is a frequent topic of discussion now. And again, particularly with the high-end manufacturers.

Chairman CAMP. I couldn't agree more. I mean, it is an issue and obviously, that is something that the workforce committee and Chairman Kline are trying to address. And this committee's general focus is tax policies and tax issues, but understanding there are a variety of issues that affect our ability of our businesses to compete, and grow, and create jobs. But at this time, I recognize Mr. Schock.

Mr. SCHOCK. Thank you, Mr. Chairman. I am specifically interested in the several small business owners that are represented on the panel here today. Are you guys aware of the President's comment this past week about business owners? And if so, I am just curious your perspective.

Mr. BECK. Yes, I am. And it is interesting. I talked to a number of small business owners, and they weren't, needless to say, very happy. They said, "I am sure glad you are going to speak to the

House Ways and Means Committee because you won't use any uncivil swear words in front of them, but we would because of the feelings that the small business people have back in our communities about those types of words," about what President Obama had said. And I said to myself, you know, these people are really upset.

Mr. SCHOCK. Anyone else wish to comment? I am just curious because I will tell you, as an entrepreneur before I came to Congress, maybe I was foolish to think that it was my hard work that helped me be successful, and the businesses that I had worked in that I thought I was building, but I know some of you are a little bit older than I am and perhaps been in business longer than I was. And I thought maybe I would like to get your perspective, because I found them very spellbinding when I read them first, and then saw them, that as we talk about jobs, we talk about a President with a record of unemployment for the longest period of consistency in my lifetime, and we are all throwing up our hands here in Washington, D.C. wondering why people won't hire.

And the Commander-in-Chief, the leader of the free world, says things like, if you built a business, if you have a successful business, you didn't build it. Somebody else did. Somebody else made that happen.

Mr. BECK. Every one of us wants to see our business grow. Every one of us wants to be profitable. Every one of us when we are profitable, we pay taxes. When we pay taxes, we pay for the infrastructure. We are part of the infrastructure of this country.

Mr. SCHOCK. I just thought that you had a perspective on who made you guys successful if it wasn't, in fact, you and your——

Mr. BECK. I think my colleague over here already said it. We, along with our team, and those people that work with us each day, made our company successful. We never asked for a penny from anybody. And we have paid our fair share in taxes.

When I went from 110 people down to 25, I couldn't ask for a government bailout. There were no loans that were going to keep my doors open. We had to figure it out ourselves. And our people took great sacrifice in salaries and worked really hard to help pull the company back out of the hole. We are now seeing some real strength in our company as we have come back from it. But to—but we would never have received any help from any place. We would have just gone away. We are only 110 people. We would have just gone away.

Mr. SCHOCK. Well, as one elected official, I want to say thank you, because I believe you guys are the ones who create jobs. And I believe that you are successful as businesses because of your work ethic, your ability to take risk, your willingness to put in the time, talent, and energy necessary to be able to do so. So know that there are some of us on Capitol Hill who recognize why small businesses and entrepreneurs are successful.

With that, I want to ask some specifics on tax reform as it relates to manufacturers. I am curious if anybody up here represented small or large, currently utilizes LIFO in their accounting practices. Ms. Dossin, could you maybe please speak to this, because I know we have had scores of businesses small and large come to my office, and we have had testimony here from big companies, small companies, and most of them say what you have said, which is get rid of the credits, get rid of the deductions.

I know Caterpillar, which is in my hometown said, look, we will give up R&D even though we use it. Get us down to 25 percent, and we will give it all up. LIFO seems to be one that, because of its retroactivity in terms of the tax collection, it is not moving forward, that has the potential to really put some businesses out of business.

And I am just curious to what degree it would affect you if LIFO was repealed moving forward, but also the retroactivity in terms of the liability it would mean for you? Have you guys looked at that?

Ms. DOSSIN. We have, but you will notice it was not part of my testimony because it wouldn't have been effective for me to come here and say I want to lower rate and A, B, C, D, E, F, G, right? So I didn't list it as one. It will be painful to lose it, but I think the degree of pain is not what you hear from some others.

Mr. SCHOCK. Would you agree that it is important for us to try and, when eliminating deductions, accounting practices, whatever you want to call them, that we do it moving proactively, and that we limit what is retroactive? In other words, I would assume if we tried to get back all of the depreciation retroactively that the bonus depreciation has awarded over the last couple of years, there might be some screaming and gnashing of teeth if we tried to do that. LIFO seems to me to be a similar mechanism where going forward is one discussion, proactive, but retroactivity seems a lot more harmful.

Ms. DOSSIN. Well, once——

Chairman CAMP. Your time is expired, so if you could just answer as fast as you can.

Ms. DOSSIN. I will just say, once you have the bones of an idea of a tax package, transition rules are going to be really important, and you won't want to cause harm in the transition.

Mr. SCHOCK. Thank you.

Chairman CAMP. Thank you. Mr. Pascrell.

Mr. PASCRELL. Yes, Mr. Chairman, we are now 19 months into this Congress. We have yet to see comprehensive jobs agenda, let alone a comprehensive manufacturing plan.

We have already established, I think, reestablished today that while we complain about regulations and taxes, they apparently were not the cause of what happened beginning in 2006 to the manufacturing sector going back 20 years. What concerns me is that from January of 2000 to January 2010, we lost—the United States of America lost 5.5 million manufacturing jobs. In my home State of New Jersey, we lost 11 percent of our manufacturing base.

A recent study by Alan Blinder and Alan Krueger, who is the chairman of the President's Council of Economic Advisors has shown 1/4 of American jobs—this is what really concerns me—are potentially offshoreable, with 80 percent or over 600,000 of these jobs in manufacturing.

That is almost 150,000 manufacturing jobs in New Jersey, 300,000 in Michigan, over half a million in Texas, and 365,000 in Ohio. The light of our economic recovery is powered by domestic production. You are right. Over the past 2 years, the manufacturing sector has added 400,000 jobs. Who would have thought 2 years ago that this would be the lead factor in getting the economy started and starting to get the economy back on its feet.

The first period of sustained growth since the 1990s, we need to enact policies to keep up the momentum, and that is why the gentleman and ladies are here today. The recently released non-partisan Congressional Budget Office report entitled “Fiscal Policy Options for Increasing Economic Growth and Employment in 2012 and 2013” has made it clear that what we can be doing is reducing cost of adding employees and investing.

Those are two things that are available to us if we have the urge to do that. Yet, we have great legislation to do just that; we have been unable to move it, including bipartisan legislation with 100 percent expensing for capital expenditures.

To me, that is a no-brainer. I think it is a no-brainer to all of you. Today the Senate will block action on legislation that I have introduced, the Bring Jobs Home Act aimed and lowering the cost for companies looking to in-source jobs back to America.

Ms. Boushey, I even had to battle some of my own party about my belief that manufacturing provides a substantial economic impact. Can you elaborate on how it helps drive our economy in your eyes?

Ms. BOUSHEY. Well, it drives it in a number of ways. I mean, looking immediately at the short-term certainly manufacturing as a sector has one of the biggest multipliers of other industries, so when you create a job in manufacturing, you create many more other jobs in other sectors than you do if you create a retail or a service-sector job. So certainly, in the short-term, the fact that the recovery has been led by gains in manufacturing has certainly been something that has been optimistic, that certainly we could gain on.

But second, I think that one of the key ways that manufacturing is vital for our economy, is because it is—manufacturing is where innovation happens. And so if we want to be the kind of economy that creates the next great inventions, we need to be the kind of economy that supports the kinds of sectors in our economy that employee engineers, that employee the innovators of the future, and manufacturing certainly does that.

So it has both the big multiplier effect, it has the innovation effect. And I would just add that it is also critically important for our macro economy.

Mr. PASCRELL. So we made a big mistake in listening to corporate America 30 years ago, in moving towards a service economy while we have lost millions and millions of manufacturing jobs, and really reviving the old Jefferson-Hamilton debate that we did not have to have a multifaceted economy. And Jefferson, the great hero of America, told us, let’s keep on our path, and agriculture will see to the conclusion. Hamilton was correct.

Can you compare how the 20 percent tax credit for insourcing in the Bring Jobs Home Act would help employment in the United States as opposed to proposals to exempt overseas profits from U.S. taxes?

Ms. BOUSHEY. That is a long question.

Chairman CAMP. And if you could respond in writing because time is expired, the committee would appreciate that.

Mr. PASCRELL. Can she give a short answer, Mr. Chairman?

Chairman CAMP. If you can give a few-second answer.

Mr. PASCRELL. Thank you.

Ms. BOUSHEY. Certainly, I think would it be better to encourage firms to relocate to the United States than to stop taxing their ventures overseas. But I will——

Chairman CAMP. You can elaborate in writing to the committee. Thank you, Mr. Berg is recognized.

Mr. BERG. Thank you, Mr. Chairman. I really appreciate you being here. I am from North Dakota, and North Dakota a long time, our manufacturing has been a core passion of mine. You know, I come out here and our challenge as a country is, quite frankly, we need more revenue. And manufacturing, we always used to use the term "primary sector."

Manufacturing creates new wealth in America. And I mean, that is a core fundamental of our economy, and it has worked for a long time. I look at a lot of the rhetoric out here and, you know, 95 percent of our consumers live outside the United States.

What we should be doing is not focused on, worried about foreign competition as much as we should say, how can our manufacturers be that competitor in all of these foreign markets? And very clearly, as you have talked today, we have heard about that.

One question, Mr. Hardt, I mean, obviously you don't have a lot of foreign—my understanding is you don't do much business outside of the United States.

Mr. HARDT. We export to 15 different countries, about 22 percent of our sales.

Mr. BERG. So it is big.

Mr. HARDT. A big part of our business.

Mr. BERG. My question really was, you know, even if there are companies that aren't exporting out of our country they are still facing that foreign competition from their customers, they are making different choices. Let me just—I had a thought the other day, and we heard it today. And the thought is, your profit, you have got a partner that is taking 1/3 of your net profit. That partner is the Federal Government. They are not putting $1 of capital in, but kind of, they are your partner. And what we are here sitting here today, this is like a different board of directors for that silent partner.

I am just frustrated because the Federal Government should be doing everything it can do to help you increase your revenue, increase your profits. And I am sitting here thinking, it can't be for American manufacturing, at the same time, increase the cost on that manufacturing and increase the uncertainty on that manufacturing. You know, and that is kind of what we have heard over and over again.

My question really gets down to, we are talking about a flatter, fairer tax, and we heard some comments that that is bad for manufacturing. I guess my question here is, if we go with a flat tax, flat or fair tax, 25 and 10 percent like we have talked, got rid of some of the exemptions, not all of the exemptions, there are some key ones we talked about, research, et cetera, but it was a net dollar equal, would your company do better in that environment? Would they make more money, which obviously, the great comment about making $1.4 million and investing $1.3 back in capital.

So I would just like to ask the manufacturers here, if it was a flat tax or a flatter tax from what we have got, would that generate more revenue for your company?

Ms. DOSSIN. I will give you a quick answer, but I might have to think about that one a little bit, because I suspect what it would do is allow business decisions to be made on the basis of business factors more than tax factors. And we hope that is good everywhere we operate. So I think it is directionally correct.

Mr. GJERSDAL. Devil is in the details, but rough math would tell me we would do a lot better.

Ms. FORD. Similarly, we would also do better because our competitors are more international and their tax costs are much lower.

Mr. HARDT. A stable longer-term system would help us with better business decisions.

Mr. BECK. And it would be the same for us. You normally make a decision based upon the business first, and then the tax second.

Mr. SPINKS. I completely agree that a more competitive rate versus the other countries in the world would achieve, go a long way towards the real goal which is to increase investment in the United States.

Mr. BERG. Again, Ms. Boushey, you mentioned that report that said the exact opposite, and we are hearing from manufacturers, and I couldn't agree with you more. So anyway, this along with some stability in your regulatory environment, I think would help American manufacturers be more competitive, and would bring more manufacturing jobs in America. So thank you for being here today.

Chairman CAMP. Well, thank you. Mr. Crowley is recognized.

Mr. CROWLEY. I thank the chairman. I am going to go right to questioning. Ms. Dossin, would you agree that the U.S. manufacturing industry, and more specifically, the U.S. auto industry, is in far better shape than it was on January 19, 2009?

Ms. DOSSIN. I guess so, yes.

Mr. CROWLEY. You would agree with that. I would agree as well. I think that the deal that was worked out by Ford's CEO, Alan Mulally, as well as with President Obama, and working with Democrats here in the House on a rescue package for the U.S. auto industry, and it worked, and literally saved millions of jobs, and created new jobs in our economy.

Would you, Ms. Dossin—Ford received a Federal loan guarantee from the Department of Energy through the advanced technology vehicles manufacturing loan program in the amount of $5.9 billion. The goal of the loan was to provide capital to the U.S. auto industry for the purpose of funding projects that help vehicles that are manufactured in the United States. Did this program benefit Ford and saved jobs here in the United States?

Ms. DOSSIN. In my testimony, I talked about all of the things Ford did to restructure itself. And that included, you know, completely overhauling a great deal of the business, and once we did that and reached a point of financial viability, we were in a position to go look for funding to accelerate the plan. And when we do that we will go to the lowest cost source of funding. And we did go to the government for those——

Mr. CROWLEY. So you would agree that that particular loan program——

Ms. DOSSIN.—for the loans, and it did support jobs in many facilities. Probably——

Mr. CROWLEY. Ms. Dossin, my time is very limited, so that specific loan program was beneficial to your company, was it not?

Ms. DOSSIN. It was.

Mr. CROWLEY. Okay, so you would agree that these loan programs are generally beneficial to job creation, would you not?

Ms. DOSSIN. They were a good low-cost source of borrowing at the time.

Mr. CROWLEY. Thank you. Mr. Beck, if President Obama did not create a rescue package for the U.S. auto industry, a package championed and crafted with the support of Ford CEO Alan Mulally, where would your business be today?

Mr. BECK. Well, I think Ford would have probably survived.

Mr. CROWLEY. Where would your business be today?

Mr. BECK. Very good.

Mr. CROWLEY. You would be good if GE—I am sorry, if Chrysler and GM had gone under?

Mr. BECK. Right now, most of my work is with Ford.

Mr. CROWLEY. So you think that overall—do you think that Ford would have survived had the others gone down?

Mr. BECK. I think Ford would have survived.

Mr. CROWLEY. I think many economists would disagree, including Mr. Mulally——

Mr. BECK. I just gave you my opinion.

Mr. CROWLEY. And I am going to—it is my time, so I am going to take it back, and I am going to say that many economists would disagree with your position, and would suggest that the entire industry would have collapsed and therefore, your business, had we taken the Romney approach of let Detroit go bankrupt, I think your business would have gone the way of the Studebaker.

Finally, I just want to follow up on what my colleagues Mr. Johnson and Mr. Schock were talking about before in terms of interpreting what President Obama's comments on how no one is an island, and America is a society. And so that behind every successful small business is another hand to help them get there.

I would like to think that I didn't get to Congress on my own; that the fact that my parents saw to it that I had the right kind of education, helped along the way, that people helped get me elected, helped me get here as well. So people are ridiculing him because they are parsing the words, distorting his words, but I think the President was right.

Mr. Hardt, do you think that we as a Nation, that we owe a debt of gratitude to our veterans? Do you think that you would be where you are today without the work and sacrifice of our veterans and the men and women who died to protect the interests of this country?

Mr. HARDT. That is clearly an important part of our society.

Mr. CROWLEY. You would agree, would you not? An important part of our society, people dying to maintain our way of life is an important part of society?

Mr. HARDT. Correct.

Mr. CROWLEY. That is the level of enthusiasm you give to that?

Mr. HARDT. I am not here to have political labels.

Mr. CROWLEY. Again, I am surprised by the lack of fervency there.

Do you think that we owe a debt to those individuals? Do you think that your company could have survived had America not survived, had those soldiers failed in their attempt to maintain our way of life, our capitalist way of life?

Mr. HARDT. No way we could have survived.

Mr. CROWLEY. I am glad that you agree that your business would not have survived had those sacrifices not been made.

Chairman CAMP. Mr. Crowley, I have to say that this line of questioning is really not on topic.

Mr. CROWLEY. Mr. Chairman, it is on topic.

Chairman CAMP. You have a few seconds. Why don't you conclude.

Mr. CROWLEY. With all due respect, Mr. Schock raised this point and I am clarifying the point Mr. Schock raised.

Chairman CAMP. Complete your questioning.

Mr. CROWLEY. I will. Thank you, Mr. Chairman. None of us would be here, none of us without the patriotism and dedication, and sacrifices of our veterans. So I urge all of my colleagues to stop questioning the patriotism and dedication of our military, our veterans, and stop playing politics with the President's remarks.

Chairman CAMP. The gentleman's time has expired.

Mr. CROWLEY. No man or woman is an island.

Chairman CAMP. The gentleman's time has expired. Ms. Black is recognized.

Mr. CROWLEY. Thank you, Mr. Chairman.

Mr. PASCRELL. You can hit the gavel all you want.

Mrs. BLACK. Thank you, Mr. Chairman, and I want to thank the panel for being here today. It is a very good conversation on topic about our tax reform and the necessity for that, and I want to thank you all of you, both the large companies and also the smaller companies. Having been a business owner who started a business, I can say that I know those challenges that we have. But I want to turn our attention to one area that has not really been explored fully, is to look at why foreign companies invest in the United States.

And we know that nearly 40 percent of all of those foreign direct investments by global companies into the United States are connected to manufacturing, which statistics show, directly translate into about 2 million jobs, which is pretty important.

Mr. Spinks, probably this question is best for you. How does the United States tax system affect those choices that are made by those foreign-based manufacturers when they evaluate whether to invest in the United States or to go to another country?

Mr. SPINKS. Thanks. As I said in my testimony, we do look. We are in many, many countries around the world. We evaluate our projects on an after-tax cash basis. And when we look at the other industrialized nations, particularly in the OECD, what we are seeing now is a U.S. tax rate that is the highest in the world. So what it means is that the mathematics of getting to an after-tax return on investment, it is very, very difficult when you have got corporate rate differences of 7 to 10 percentage points.

In the particular case of Air Liquide over the last 5 years, even with the global recession, we basically doubled down on the U.S. economy. We have doubled our investment in the United States in the last 5 years. We would like to continue to do that. And we think that a system that is more predictable, more simple, and with a more competitive tax rate will allow us as well as a lot of other global companies to do exactly that.

Mrs. BLACK. Thank you. I want to now just talk about the fact that we need to have all of this. We need to have the global investment into our country, the smaller businesses, and then also the larger corporate businesses that do worldwide work as well.

And Ms. Ford, I want to turn to you, because you noted that the major of the Corning's employees are located right here in the United States, but 80 percent of those sales are to customers located abroad and that Corning also has extensive foreign operations.

How do you, or how, excuse me, how do your worldwide operations affect your U.S. operations in employment, such as areas of R&D, and headquarter jobs?

Ms. FORD. Thank you for the question. Because we conduct probably 99 percent of our research and development here in the United States, and we are a technology manufacturer, we send our engineers all over the world to our plants where we are located close to our customers, and there is a very strong exchange there. So when—at the location they need a certain development piece and they need something done, much of that comes back to the U.S., and we add R&D jobs to support it.

And certainly our corporate headquarters is here in the U.S., as well as our IP is maintained here in the U.S., and so we have our fill of lawyers and accountants, and corporate folks, and they are also all located in the U.S. So, you know, I have stated previously that it is not, you know, it is not a zero sum game. It is not U.S. jobs versus foreign jobs. As our foreign markets grow and we are able to continue to compete there, we add U.S. jobs as well.

Mrs. BLACK. I think the importance here is to say that it takes all of this to make a vibrant economy. It is not one. It is not just the small businesses. It is not just the large businesses. It is not the investments that come from foreign entities, but it is the combination of, and I really appreciate you all being here today and sharing what it is from your individual perspective that would be good for moving the United States forward in our taxing area to be able to continue to have and grow a more vibrant economy. So I thank you all so much, because I think this dialogue is so good as we move forward.

I think the time, and several of you mentioned this, that you believe that the time is here. I believe the time is here. Obviously, the chairman believes the time is here, and I want to commend him for putting a draft out of the territorial so that you all will have the input, and it is with us all working together as partners that are going to bring us to the conclusion of doing good tax reform that will continue to move this country forward to be the strongest economic country in the world.

So thank you so much, and thank you, Mr. Chairman, for this very interesting hearing.

Chairman CAMP. Well, thank you. And this concludes our hearing. I want to thank all of our witnesses for taking time away from your usual responsibilities to come here and give us the benefit of your expertise.

And let me just say that we have been trying to conduct over the last 20 hearings an open process where we actually hear from those who are in industries, and in this case, manufacturing, academics, experts, economists, so that we can make the best decision as we try to move the issue forward of fundamental and comprehensive tax reform, because the fact is, our economy is not recovering as quickly as we would like it to be.

We still have unemployment that is far too high, and I believe that if we can move the issue of comprehensive tax reform, we will see a pro-growth tax policy that is adopted by this country that helps us do better here in the United States, and also that we can help those companies who are U.S.-based doing business around the world.

As you have all so articulately stated, we are in a global economy and we need to make sure that we compete in that way. So I just want to, again, thank you for being here on a very long day, giving the opportunity for members to get the benefit of your experience and advice. And with that, this hearing is now adjourned.

[Whereupon, at 12:40 p.m., the committee was adjourned.]

[Submissions for the Record follow:]

3M

Committee on Ways and Means
Hearing on "Tax Reform and the U.S. Manufacturing Sector"
July 19, 2012
Written Statement of Henry W. Gjersdal
Vice President of Tax

3M Company ("3M") appreciates the opportunity to testify before the Committee on Ways and Means on "Tax Reform and the U.S. Manufacturing Sector."

3M is a large U.S.-based employer and manufacturer established over a century ago in Minnesota. Today, 3M is one of the largest and most diversified manufacturing companies in the world. We are a global company conducting the majority of our manufacturing and research activities in the United States. 3M thanks the Committee for its leadership on the critical issue of tax reform and for considering our perspective in this important debate.

Our comments are written to share the practical impact of corporate tax reform on 3M. 3M respectfully urges the Committee to continue making the global competitiveness of American businesses and workers a key objective of reform. From 3M's perspective, this means a significant reduction to the corporate tax rate and the adoption of a territorial system. 3M generally supports the approach outlined in the Ways and Means October 2011 discussion draft on a Participation Exemption (Territorial) System. We recognize that to reform the system in this way, all current incentives, credits and deductions must be reviewed.

3M looks forward to working with the Committee on achieving meaningful and comprehensive tax reform.

Background on 3M

3M, formerly known as Minnesota Mining and Manufacturing, is an American company currently headquartered in St Paul, Minnesota. The company, created in 1902 by a small group of entrepreneurs, initially began as a small sandpaper product manufacturer. Today, 3M is one of the largest and most diversified manufacturing companies in the world. 3M is home to such well-known brands as Scotch, Scotch-Brite, Post-it®, Nexcare®, Filtrete®, Command®, and Thinsulate® and is composed of six business sectors: Consumer and Office; Display and Graphics; Electro and Communications; Health Care; Industrial and Transportation; and Safety, Security and Protection Services.

Ahead of their peers, 3M's founders insisted on a robust investment in R&D. Looking back, it is this early and consistent commitment to R&D that has been the main component of 3M's success. Today, 3M maintains 40 different technology platforms. These diverse platforms allow 3M scientists to share and combine technologies from one business to another, creating unique, innovative solutions for its customers. The financial commitment to R&D equated to $1.6 billion of R&D spending in 2011 and over $7 billion during the past five years, and produced high quality jobs for 3900 researchers in the United States (and 7000 total worldwide).

The results are equally impressive with 571 U.S. patents awarded in 2011 alone, and over 40,000 global patents and patent applications. Over 32% of 2011 sales came from products developed in the last 5 years.

3M's worldwide sales in 2011 were nearly $30 billion. 3M is one of the 30 companies on the Dow Jones Average and is a component of the Standard & Poor's 500 Index. Owned by millions of shareholders directly and indirectly through mutual funds, 3M has consistently delivered positive results to its owners. It has paid dividends to its shareholders every quarter since 1916. 3M paid dividends of $1.6 billion in 2011 and a total of $8.2 billion over the past five years. Most remarkably, for the last 50 consecutive years, annual dividends have consistently increased.

This success is attributable to the people of 3M. Generations of imaginative and industrious employees in all of its business sectors throughout the world have built 3M into a successful global company.

3M: Competing in A Highly Competitive Global Economy

3M is a U.S. company that manufactures and sells its products throughout the world. Headquartered in St. Paul, Minnesota, 3M has operations in 28 U.S. states, where approximately half of 3M's worldwide manufacturing operations are located. Internationally, 3M has historically had a large manufacturing presence in Western Europe, Canada and Japan. 3M employs approximately 33,000 in the United States. In addition, 3M conducts over 60% of its worldwide R&D activities in the United States. The U.S. market currently accounts for approximately one-third of 3M's global business.

While its U.S. presence is strong, 3M is increasingly a global company. 3M operates in more than 70 countries and sells products into more than 200 countries. In 2011, approximately two-thirds of 3M's sales were outside the United States, a percentage that is projected to rise in future years. In the current global economy, where international markets are growing faster than U.S. markets, being able to compete successfully in the global marketplace is critical to 3M.

Global market competition has made "localization" critically important for the company's future success. If 3M is going to successfully compete against its foreign competitors, it must invest in new facilities in those foreign markets to be closer to its non-U.S. customers. 3M must hire international employees with an in-depth understanding of their markets. 3M's success has depended on our ability to tap into the talent of a richly diverse global employee base to share ideas and innovate. Local knowledge and execution, supported by 3M technologies, products, and brands, is an overarching strength and competitive advantage. It enables 3M to provide international customers with leading-edge products, strong marketing support and responsive service, thereby achieving borderless customer success.

This business-driven need for further localization, as well as the need to simplify 3M's historically complex supply chains, has led 3M to adopt a regional sourcing initiative. 3M pursues more customer-focused supply chains with an increased localization target – meaning that more of our products sold in a region will be produced in the same region as that of the customer. This shift to greater localization is not tax-driven, but rather results from competitive pressures to better serve the needs of our global customers.

Reforming the Current U.S. Business Tax System

Tax reform is essential to ensure long-term competitiveness of American businesses and workers. As the Committee knows, the US corporate tax rate is the highest tax rate of any major country. In some cases, the high US tax rate is mitigated by tax credits and deductions. These credits and deductions, however, often fail to adequately encourage the behavior they were designed to incentivize and often create competitive imbalances between US companies.

In addition, the Internal Revenue Code has not kept up with the rapidly changing international business environment. Virtually every developed country has responded to these changes by adopting tax systems that provide their domestic corporations the tools to compete in the global marketplace. Also, part of this new global reality is that nearly 50% of the world's largest public companies - and many of our competitors - are now based outside of U.S. and Western Europe. They can start with a competitive advantage in the marketplace because of the lower tax rates they enjoy.

3M submits that the U.S. could take a few key steps to address these competitive imbalances while simultaneously creating greater simplicity and predictability for its domestic corporations.

Significantly Lower the Corporate Income Tax Rate. First and foremost, we recommend the corporate tax rate be reduced. We support the Chairman's proposal to reduce the rate to 25%; a rate which is more in line with other developed countries that view a lower corporate tax rate as a competitive advantage. From 3M's perspective, the current high corporate tax rate has two adverse effects on domestic investment: it reduces the after-tax return on domestic investments and creates significant inefficiencies in the deployment of the Company's capital and the management of its balance sheet.

Since 3M maintains the majority of its manufacturing and R&D activities in the United States, our effective tax rate is one of the highest among our competitors. For 2012, 3M is anticipating a worldwide effective tax rate of 29.5%. In 2011, 3M's worldwide tax expense was over $1.6 billion. In an increasingly global marketplace, 3M's high effective tax rate is a competitive disadvantage. .

In addition, the high U.S. tax rate imposes an undue cost barrier to repatriating foreign earnings under the current international tax system. American businesses should be encouraged to successfully compete in foreign markets and repatriate foreign earnings back to the United States. A significantly reduced corporate tax rate would eliminate significant inefficiencies in the deployment of the Company's capital and the management of its balance sheet. We recognize that a large reduction in the corporate tax rate would require substantial offsets from existing deductions and credits. For example, 3M utilizes the Section 199 manufacturer's deduction, accelerated and bonus depreciation, and the R&D tax credit.

The manufacturer's deduction provides a significant benefit to our company since 3M has a majority of its manufacturing base in the US. However, lowering the tax rate to 25% would offset the benefit of this deduction and would also eliminate the complex and time consuming record keeping requirements.

3M would also support the repeal of accelerated and bonus depreciation to partially pay for a significantly lower tax rate. While the depreciation provisions provide a significant benefit to the company, these rules merely change the timing of deductions and result in an upfront cash flow benefit. Importantly, they do not impact the tax rate reported by the Company in its financial statements. Timing benefits like accelerated and bonus depreciation do not impact earnings per share.

In addition, 3M would also forego the current R&D credit for a significantly lower rate. As one of the most innovative companies in the world, 3M believes that intellectual property development must remain a cornerstone of American business for their success. 3M spends over $1.6 billion a year on R&D. However, today's R&D credit provides insufficient incentives to encourage R&D investment because it is based on incremental spending on a limited portion of R&D expenditures. And, its temporary nature limits its effectiveness.

If Congress is unable to secure a significant rate reduction or wishes to continue to incentivize R&D here in the U.S. in a reform package, there are numerous ways to substantially improve the incentives for research, development and ownership of intellectual property. For example, a so-called "patent box" could provide a low tax rate on income generated from intellectual property developed and owned in the US. This would not only encourage investment in research and development, but it would also encourage its retention in the U.S. and address concerns regarding the migration of IP offshore. Other countries, such as the Netherlands, Spain and Belgium, have adopted provisions that permit a deduction or exclusion for a portion of royalties received for the use of IP created by the licensor.

Territorial System. The worldwide base of the current international tax system adversely impacts the competitiveness of American businesses which operate overseas for business reasons, like 3M, relative to competitors that are based in jurisdictions that exempt foreign income. It is important for 3M to be able to manage debt and reinvest capital on a regional basis. A territorial system would allow the movement of capital across country borders without triggering a US tax consequence, giving American companies the ability to deploy capital efficiently in competing for growth opportunities abroad.

3M applauds the Chairman's inclusion of a territoriality system in his proposal. We agree with a 95% exemption system rather than alternative systems that would create unnecessary complexity. This approach accomplishes the policy objectives of exempting foreign earnings and limiting deductibility of related U.S. based expenses in a far less complicated manner than other proposals. A territorial system would bring the US into line with most developed countries, including the UK, Canada, Germany and Japan. In addition, such a change would fully or partially repeal of many international tax rules, which are among the most complex and controversial rules in the Code. Replacing those rules with a territorial system would greatly enhance simplification and transparency.

We agree with the Committee that anti- abuse rules are necessary to prevent the erosion of the U.S. tax base. Regarding transition rules for pre-enactment foreign earnings, 3M, like many companies, has substantial foreign earnings permanently reinvested in active businesses outside of the U.S. The up-front tax impact on accumulated earnings that can never be repatriated to the U.S. need to be considered, along with the complexity involved in determining the accumulated undistributed earnings for companies that date back over 50 years. In addition, 3M suggests this tax should not be imposed on accumulated earnings that are invested in assets used in active businesses since theses earnings will never be repatriated

Summary of 3M Tax Reform Recommendations

We thank the Committee for the opportunity to share our perspective as an American employer interested in preserving and enhancing the global competitiveness of American businesses and workers.

As a U.S. based multinational company that is contending with many foreign-based competitors every day around the globe, it is critical to reduce the U.S. corporate tax rate and adopt a territorial system to help make us more competitive.

We sincerely appreciate the significant work you and the Committee have and are doing to craft a U.S. tax code that levels the playing field for U.S. based companies and encourages more investment, manufacturing and jobs in the U.S.

3M stands prepared to work with you in any way we can to support you on this critical public policy matter.

American Council for Capital Formation

Tax Reform, U.S. Investment and Job Growth: Does Cash Flow Matter?
By
Margo Thorning, Ph.D.
Senior Vice President and Chief Economist
American Council for Capital Formation

Testimony submitted for the record for the hearing on
"Manufacturing and Tax Reform"
Committee on Ways and Means
U.S. House of Representatives

July 19, 2012

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Cash Flow, U.S. Investment and Jobs: New academic research provides evidence of the strong link between investment and cash flow; a dollar of current and prior-year cash flow is associated with $0.32 of additional investment for firms that are least likely to face difficulty in raising money in capital markets and with $0.63 of new investment for firms likely to face constraints. These results have implications for U.S. investment and job growth since ACCF research shows that each $1 billion in new investment is associated with an additional 23,300 jobs.

Accelerated Depreciation, the Cost of Capital, U.S. Investment and Jobs: If accelerated and bonus depreciation for equipment is repealed and replaced with economic depreciation which is generally longer than the current Modified Accelerated Cost Recovery System (MACRS), the cost of capital for new equipment will rise and investment is likely to decline. The benefit of MACRS and bonus depreciation is its positive impact on cash flow, which occurs immediately as the investment is put in place. If, as seems likely, higher hurdle rates were to cause U. S. investment in equipment (which averaged $1.1 trillion in 2011) to decline, there would be a significant negative impact on employment.

Role of Oil and gas Industry in U.S. Economic Growth: In the last 4 years, the U.S. oil and gas sector has been one of the few bright spots in terms of investment and job growth. Maintaining a viable, growing domestic energy industry can help strengthen U.S. economic recovery. In addition, other U.S. industries such as steel, chemical and plastics production have benefited from the energy boom, especially from reduced prices for natural gas.

Tax Reform and U.S. Energy Investment: Several tax reform proposals put forward in the last several years eliminate accelerated and bonus depreciation, LIFO and other deductions applicable to capital intensive industries, including oil and gas, while lowering the corporate income tax rate. As a new report by the Progressive Policy Institute notes, strong domestic investment by U.S. oil and gas companies in 2011 was due in part to outlays that would be classified as intangible drilling costs and geological and geophysical expenses. If IDCs had to be depreciated rather than deducted or, in the case of G&G, amortized over longer periods, it is likely that less investment would have occurred in the oil and gas industry and fewer new jobs would have been created in the U.S.

Conclusions: As policymakers contemplate fundamental tax reform, they need to weigh carefully the possible consequences of eliminating accelerated depreciation and other provisions which affect the cash flow from new investments and slow the payback period in order reduce the corporate income tax rate. It may be well to consider "paying for" corporate and business income tax rate reductions with cuts to entitlements for upper income individuals (as suggested in the Bowles/Simpson tax reform plan) rather than eliminating proven investment provisions such as accelerated depreciation that enhance growth and further, consider even more powerful approaches to tax reform such as a consumed income tax where all investment is expensed.

Tax Reform, U.S. Investment and Job Growth: Does Cash Flow Matter?

By
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Senior Vice President and Chief Economist
American Council for Capital Formation

Testimony submitted for the record for the hearing on
"Manufacturing and Tax Reform"
Committee on Ways and Means
U.S. House of Representatives

July 19, 2012 **

Introduction

Chairman Camp, Ranking Member Levin, and members of the Committee, my name is Margo Thorning, senior vice president and chief economist, American Council for Capital Formation (ACCF),* Washington, D.C. I am pleased to submit this testimony for the hearing record to discuss how tax reform, including reducing the corporate income tax and eliminating provisions in the current tax code which reduce the cost of capital for new investment may impact key sectors of the U.S. economy including manufacturing and the energy sector.

The American Council for Capital Formation represents a broad cross-section of the American business community, including the manufacturing and financial sectors, Fortune 500 companies and smaller firms, investors, and associations from all sectors of the economy. Our distinguished board of directors includes cabinet members of prior Democratic and Republican administrations, former members of Congress, prominent business leaders, and public finance and environmental policy experts. The ACCF is celebrating over 30 years of leadership in advocating tax, regulatory, environmental, and trade policies to increase U.S. economic growth and environmental quality.

Background

Some in the business community support giving up current tax code provisions such as accelerated depreciation, Section 199 and other provisions that reduce the cost of capital for new investment in exchange for a reduction in the corporate income tax rate. For example, testimony

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**Founded in 1973,* the *American Council for Capital Formation is a nonprofit, nonpartisan organization advocating tax, energy, regulatory and environmental policies that facilitate saving, investment, economic growth and job creation. For more information about the Council or for copies of this testimony, please contact the ACCF, 1750 K Street, N.W., Suite 400, Washington, D.C. 20006-2302; telephone: 202.293.5811; fax: 202.785.8165; e-mail: info@accf.org; website: www.accf.org*

** Submitted for the record for the Committee on Ways and Means hearing held on July 19, 2012 by Henry W. Gjersda of 3M at the July 19 hearing supports repealing accelerated and bonus depreciation and Section 199 (the deduction established in 2004 to help U.S. manufacturers) in exchange for a substantial reduction in the corporate income tax rate.[1] Other witnesses, including Diane Dossin of Ford Motor Company and Ralph Hardt of Jagemann Stamping Company, support reducing the tax rate on business income but want to retain accelerated depreciation and other provisions used by capital intensive companies.[2] Another witness, Heather Boushey of Center for American Progress Action Fund recommends eliminating cost recovery provisions used by domestic energy producers to help pay for corporate tax rate reduction, although she also clearly suggests that tax reform should not disadvantage manufacturers and in fact that tax policy should focus on "supporting our manufacturing base". [3]

Given the weakness of the U.S. GDP growth, the unemployment rate remaining above 8 % and real non-residential investment still 6.5% below the 4th quarter of 2007, policymakers need to be sure that tax reform proposals will help, rather than hinder, new investment and economic growth. Therefore, as policymakers contemplate tax reform it seems appropriate to carefully consider how various approaches may impact overall U.S. investment. For example, the National Commission on Fiscal Responsibility and Reform (Bowles/Simpson) calls for broadening the tax base by eliminating virtually all tax deductions and credits used by both corporations and individuals, including those which reduce the cost of new investment in order to pay for reducing corporate and individual income tax rates.

A key question is how reducing cash flow to capital intensive industries by eliminating provisions such as accelerated depreciation and Section 199 and other provisions will impact U.S. investment and economic growth. Another important question is how eliminating provisions used by the U.S. energy sector such as lengthening the period for amortizing geological and geophysical expenses and deducting intangible drilling costs will impact the cost of capital and new investment in the oil and gas industry. In the last 4 years, the U.S. oil and gas sector has been one of the few bright spots in terms of investment and job growth so maintaining a viable, growing domestic energy industry can help strengthen U.S. economic recovery. In addition, other U.S. industries such as steel, chemical and plastics production have benefited from the energy boom, especially from reduced prices for natural gas.[4] Thus, increasing the cost of finding and developing domestic oil and natural gas will reduce investment and could also lead to more imported oil.

How Important is Cash Flow to Investment?

Over the past three decades, economics and finance experts have examined the question of whether financial variables such as cash flow and cash stocks have a significant effect on

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[1] see http://waysandmeans.house.gov/UploadedFiles/Gjersdal_Testimony.pdf

[2] http://waysandmeans.house.gov/UploadedFiles/Ford_Testimony.pdf and http://waysandmeans.house.gov/UploadedFiles/Hardt_Testimony.pdf

[3] see testimony by Heather Boushey of the Center for American Progress Action Fund at http://waysandmeans.house.gov/UploadedFiles/Boushey_Testimony.pdf

[4] http://articles.businessinsider.com/2012-03-19/markets/31208642_1_natural-gas-prices-steel-industry and http://online.wsj.com/article/SB10001424052702304331204577352161288275978.html and http://www.nytimes.com/2012/04/25/business/energy-environment/ohio-steel-mills-expand-to-meet-demand-in-energy-and-auto-industries.html and http://www.economist.com/node/21558591

investment. Some studies conclude that cash flow is mainly relevant for situations in which capital market imperfections exist and access to external debt and equity is costly.

Numerous other economic analyses and surveys have concluded that financial factors are important in determining investment levels. For example, a new analysis by Dartmouth College professors Jonathan Lewellen and Katharina Lewellen (L&L) provides evidence of the strong link between investment and cash flow.[5] Using an improved measure of cash flow and data from Compustat for 1800 firms per year from 1971-2009, L&L's results show that a dollar of current and prior-year cash flow is associated with $0.32 of additional investment for firms that are least likely to face difficulty in raising money in capital markets. For firms likely to face capital market constraints, each additional dollar of cash flow is associated with $0.63 of new investment. L&L's results have significant implications for U.S. investment and job growth because historical data show that each $1 billion dollars of new investment is associated with an additional 23,300 additional jobs in the U.S. (see Figure 1).

Additional support for the important role of cash flow in stimulating investment is found in a new report by the Joint Committee on Taxation.[6] The new report "Background and Present Law Relating to Manufacturing Activities Within the United States" concludes that:

> "However, for the most part, the economic literature on tax policy and investment does lean toward the conclusion that changes in taxes do have a noticeable impact on investment. A well-known survey of the literature, for example, concluded that investment was highly responsive to changes in the cost of capital.[270] One study looking at the period from 1953 to 1988, during which time accelerated depreciation and investment tax credit provisions were both enacted and repealed, found that tax policy had a strong effect on the level of investment, especially for machinery and equipment.[271] The authors also provided evidence that suggests firms with lower net cash flows, which may be more liquidity-constrained, are more responsive to changes in the cost of capital.[272] If this is true, then firms with less access to capital markets are particularly sensitive to changes in tax incentives for investment. Moreover, insofar as tax changes affect both net cash flows and the user cost of capital, some economists have found that the cash-flow effect is stronger.[273] Recent research on the bonus depreciation provisions enacted in 2002 and 2003 found a noticeable impact of tax incentives on investment in capital goods.[274]"

Previous economic analyses also support the idea that cash flow is an important determinant of investment. For example, a 1998 empirical analysis by Professors Gilchrist and Himmelberg concludes that for the average firm in their sample, cash flow and cash stocks raise the overall response of investment to an expansionary shock by 25% relative to a baseline case where financial frictions (capital market imperfections) are zero.[7] They note that "Consistent with

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[5] http://mba.tuck.dartmouth.edu/pages/faculty/jon.lewellen/docs/Investment%20and%20cashflow.pdf
Jonathan Lewellen and Katharina Lewellen, "Investment and Cash Flow: New Evidence", January 2012, working paper.

[6] https://www.jct.gov/publications.html?func=startdown&id=4473, page 87.

[7] Simon Gilchrist and Charles Himmelberg, "Investment, Fundamentals and Finance", NBER Working Paper 6652, see http://www.nber.org/tmp/22969-w6652.pdf

theory, small firms and firms without bond ratings show the strongest response to financial factors.... Because bond-rated firms account for 50% of aggregate manufacturing investment, our results suggest that the overall amplification of manufacturing investment {from cash flow and cash stocks} is somewhat less than 25%."

Similarly, a recent analysis of large number of Swedish firms during the 1989-2005 periods concludes that cash flow has a significant impact on investment and the effect is particularly strong for constrained firms, especially during recessions.[8]

To summarize, mounting recent evidence suggests a strong correlation between available cash flow and new investment, both for firms which are constrained in terms of access to capital markets and those which are unconstrained.

Accelerated Depreciation, the Cost of Capital, U.S. Investment and Job Growth

If accelerated depreciation for equipment is repealed and replaced with economic depreciation which is generally longer than the current Modified Accelerated Cost Recovery System (MACRS), the cost of capital for new equipment will rise and investment is likely to decline, relative to the baseline forecast. The benefit of MACRS is its positive impact on cash flow, which occurs immediately as the investment is put in place. As noted above, there is a direct correlation between available cash flow and new investment and thus retaining or enhancing MACRS (e.g. by retaining bonus depreciation) will increase new investment, while reducing cash flow by eliminating MACRS can be expected to reduce new capital investment.

Further, in an increasingly uncertain world in which markets, demand and production costs can shift almost overnight, the rapid payback from MACRS depreciation substantially reduces the risk premium for investment in equipment. For long-term investments which take many years to plan and complete, the impact of MACRS on hurdle rates and cash flow may be particularly important as profit expectations may have changed significantly by the time the project comes on line. While a lower corporate income tax rate would also make investment attractive, if MACRS and other provisions that increase the cash flow from investment are repealed, it seems likely that the slower payback period will raise the hurdle rates and slow the productivity enhancing investment in new equipment.

If higher hurdle rates were to cause U. S. investment in equipment (which averaged $1.1 trillion in 2011) to decline, there would be a significant negative impact on employment since each $1 billion in investment is associated with 23,300 new jobs. In addition, reducing corporate income tax rates benefits "old capital" and provides a windfall to previous investments. Thus, to the extent that the rate reduction is "paid for" by repealing accelerated cost recovery provisions, new investment will be slowed, exactly the opposite result that policymakers would want to achieve.

[8] Ola Melander, "The Effect of Cash Flow on Investment: An Empirical Test of the Balance Sheet Channel", see http://www.riksbank.se/upload/dokument_riksbank/kat_publicerat/workingpapers/2009/wp228.pdf

- **Has Bonus Depreciation Helped to Stimulate the U.S. Economy?**

Since the 4th quarter of 2007, which marks the beginning of the recession, through the 2nd quarter of 2012, real U.S. equipment investment has increased by 2.4%, from $1.1 trillion to $1.2 trillion. Given the weakness of growth in GDP and consumer demand during this period (real GDP growth has averaged only 0.24% and real personal consumption expenditures increased by a total of only 2.4% during the past 4 years), it seems likely that accelerated and bonus deprecation have played a major role in sustaining investment in equipment. In fact, if bonus depreciation were made permanent, and thus could be incorporated into the planning for all future projects, we would expect to see an even greater boost to domestic investment. Thus, tax policies such as repeal of MACRS, Section 199 and bonus depreciation would reduce the cash flow from new investment and could have negative consequences for growth in investment, GDP and employment.

U.S. Economic Recovery, Tax Reform and Investment by the U.S. Energy Industry

- **The Role of the Energy Industry in U.S. Economic Recovery**

For the last several years, personal income and job growth in major energy producing states such as Texas, Oklahoma, Montana, Wyoming, North and South Dakota has been much greater than in other states (see Figure 2). In addition, a new analysis by the Progressive Policy Institute, "*Investment Heroes: Who's Betting on America's Future*" notes that in 2011, four of the top ten non-financial companies investing in the U.S. were oil and gas companies (see Table 1)[9]. These four companies, Exxon Mobil, Occidental Petroleum, ConocoPhillips and Chevron, invested a total of $28.3 billion domestically in 2011. As noted above, historically each $1 billion increase in investment is associated with an additional 22,300 jobs in the U.S. Thus, the $28.3 billion of investment by the four oil and gas companies may have produced over 600,000 new jobs in 2011.

The PPI report notes that most of the U.S. capital expenditures by energy companies consisted of production and exploration costs, which includes building out oil and natural gas pipelines and exploratory costs for new drilling sites. The report concludes "Despite any environmental concerns, the fact remains that such large amounts of domestic investment by these individual companies have the ability to prop up local area economies while meeting the realities of increased power demand."[10]

- **Tax Reform and U.S. Energy Investment**

As mentioned above, several of the tax reform proposals put forward in the last several years, including the National Commission on Fiscal Responsibility and Reform (Bowles/Simpson) eliminate accelerated depreciation, bonus depreciation, last in-first out (LIFO) accounting and other deductions used by both capital intensive and other industries while lowering the corporate

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9 http://progressivepolicy.org/wp-content/uploads/2012/07/07.2012-Mandel_Carew_Investment-Heroes_Whos-Betting-on-Americas-Future.pdf

10 Ibid, p.5.

income tax rate.[11] The President's Framework for Business Tax Reform, released in 2012, would eliminate or curtail many current law tax provisions which reduce the cost of capital for new investment such as accelerated depreciation, deduction for interest expense, LIFO as well as provisions applicable to the oil and gas industry.[12] For example, the President's plan calls for eliminating expensing for intangible drilling costs (IDCs), requiring such costs to be depreciated over time. When companies drill for oil or gas, they incur IDCs which are largely the labor costs of locating and drilling wells. IDCs are costs that cannot be recovered as they have no salvage value (in contrast to the drill pipe and casing itself, which is a "tangible asset" and is subject to depreciation). It is noteworthy that all other natural resource industries (e.g., minerals and coal production) have almost precisely the same rules as apply to oil and gas and other industries such as software development and pharmaceuticals are able to expense research and development costs. In addition, the President's FY 2013 budget also calls for increasing the amortization period for geological and geophysical costs (G&G). G&G expenses include the costs incurred for geologists, seismic surveys, and the drilling of core holes; like IDCs, they have no salvage value.[13] Further, the President's FY 2013 budget would repeal Section 199 for only oil and gas companies, leaving it in place for all other companies that manufacture, produce, extract or grow items in the U.S. {Section 199 (c)}.

Given the importance of cash flow to investment spending, policymakers need to weigh carefully the impact of repealing current law provisions that reduce the cost of capital for new investment. As the new report by the Progressive Policy Institute notes, the strong domestic investment by U.S. oil and gas companies in 2011 was due in part to outlays that would be classified as intangible drilling costs and G&G. If IDCS had to be depreciated rather than deducted or, in the case of G&G, amortized over longer periods, it is likely that less investment would have occurred in the oil and gas industry and fewer new jobs would have been created in the U.S.

Tax Reform to Promote Saving and Investment and Job Growth

Over the years, many economic analyses have estimated that if the U.S. switched to a consumed income tax in which all investment was expensed, investment and economic growth would be enhanced. In an attempt to understand how such a system would have impacted the U.S. economy had it been in place in the 1991-2004 periods, Dr. Allen Sinai, president and chief global economist of Decision Economics, used his large scale macroeconomic model to simulate the impact of a consumed income tax compared to the federal tax code in effect in 2001. The simulation modeled a system in which all saving is tax exempt, all new investment is written off in the first year, and interest expense for business and individuals is not tax deductible. The consumed income tax simulation shows strong increases in GDP, investment, employment, and federal tax receipts compared to the baseline forecast. If the consumed income tax system had been in place starting in 1991, GDP would have been 5.2 percent higher, consumption and investment would have been greater, and employment higher by over 140,000 jobs per year by 2001 (see Table 2). In addition, federal tax receipts would have been $428.5 billion larger in 2001 compared to the baseline forecast.

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[11] http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf

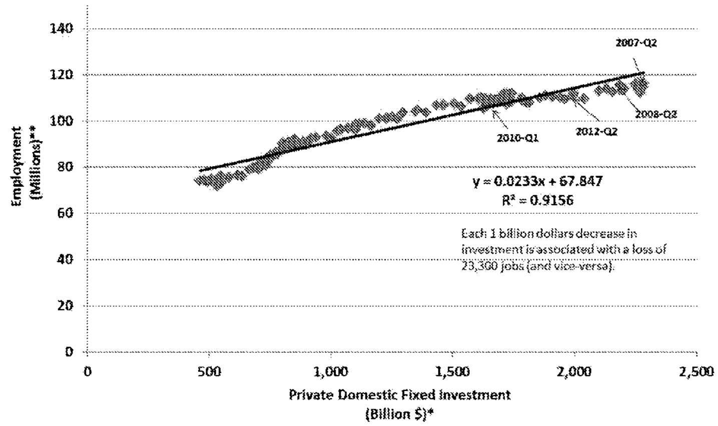
[12] http://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-02-22-2012.pdf

[13] http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2013.pdf

Conclusions

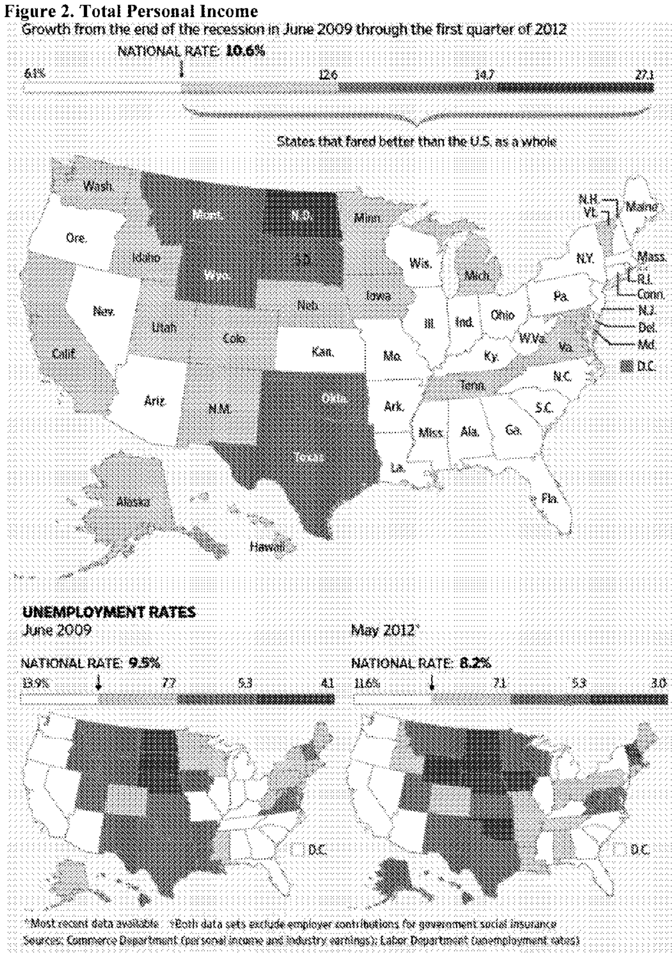
As policymakers contemplate fundamental tax reform, they need to weigh carefully the possible consequences of eliminating accelerated depreciation and other provisions which affect the cash flow from new investments and slow the payback period in order reduce the corporate income tax rate. It would be particularly ironic if the choices made in tax reform actually harmed versus increased economic growth. Further, as many practitioners will remember, the cut in the corporate rate to 34% in 1986 only survived five years, so there is no guarantee that a future rate cut will endure. It may be well to consider "paying for" corporate and business income tax rate reductions with cuts to entitlements for upper income individuals (as suggested in the Bowles/Simpson tax reform plan) rather than eliminating proven investment provisions such as accelerated depreciation that enhance growth. If we are to embark on the enormously complex and difficult task of comprehensive tax reform, it is important to maximize the economic benefits from that exercise. Thus we also recommend considering even more powerful approaches to tax reform such as a consumed income tax where all investment is expensed.

Figure 1. Total Private Employment and Private Domestic Fixed Investment 1980-Q1 to 2012-Q2



* Seasonally adjusted at annual rates, date source Bureau of Economic Analysis.
** End of quarters, data source Bureau of Labor Statistics
Prepared by American Council for Capital Formation, July 27, 2012.

Figure 2. Total Personal Income



Source: "Which States Have Best Income Growth," The Wall Street Journal, July 16, 2012, http://blogs.wsj.com/economics/2012/07/16/which-states-have-best-income-growth/

Table 1. Investment Heroes: Top 25 Nonfinancial Companies by U.S. Capital Expenditure*

Rank	Company	U.S. Capital Expenditures ($bns)
1	AT&T**	**20.1**
2	Verizon Communications**	**16.2**
3	Exxon Mobil	**11.7**
4	Wal-Mart	**8.2**
5	Intel	**7.4**
6	Occidental Petroleum	**6.2**
7	ConocoPhillips	**5.6**
8	Comcast**	**5.3**
9	Chevron	**4.8**
10	Southern Company**	**4.5**
11	Hess	**4.4**
12	Exelon**	**4.0**
13	Ford Motor	**3.9**
14	General Electric	**3.7**
15	Enterprise Product Partners**	**3.6**
16	Sprint Nextel**	**3.1**
17	Walt Disney	**3.0**
18	FedEx	**2.9**
19	Time Warner Cable**	**2.9**
20	General Motors	**2.8**
21	Target	**2.5**
22	IBM	**2.5**
23	Chrysler Group	**2.5**
24	Google	**2.2**
25	Apple	**2.0**
Total		**136.2**

*Universe includes nonfinancial Fortune 150 companies from 2011; financial reporting from FY11
**Reported to have U.S. operations only; may include a small amount of non-U.S. investment

Source: Company financial reports & filings for FY2011 and PPI estimates. Total includes capital expenditures in plants, property, and equipment, and investment in exploration for energy companies. Totals do not include R&D.

Table 2 Economic Impact on the United States of Switching to a Consumption Tax in 1991

Expensing business investment, removal of the business and personal interest deduction, and tax exemption of savings

	Average 1991–1995	Average 1996–2000	Average 2001–2004
Real GDP—level (billions of 96$)			
Base	7,085.8	8,499.6	10,113.1
Simulation of consumption tax	7,203.2	8,890.0	10,637.7
(Difference in level)	117.5	390.5	524.6
(Percent change in level)	1.7%	4.6%	5.2%
Business capital spending, total (billions of 96$)			
Base	684.2	1,092.0	1,599.6
Simulation of consumption tax	824.9	1,495.6	2,168.8
(Difference in level)	140.7	403.5	569.2
(Percent change in level)	20.6%	37.0%	35.6%
Consumption (billions of 96$)			
Base	4,761.7	5,717.2	6,746.3
Simulation of consumption tax	4,773.3	5,843.4	7,021.5
(Difference in level)	11.6	126.1	275.3
(Percent change in level)	0.2	2.2	4.1
S&P 500 Price Index			
Base	449.1	1081.9	1803.2
Simulation of consumption tax	557.4	1370.5	2123.4
Difference	108.4	288.6	320.2
(Percent difference in level)	24.1%	26.7%	17.8%
Employment (millions of persons)			
Total payrolls, base	111.8	125.8	138.5
Total payrolls, simulation of consumption tax	111.8	129.3	140.9
(Difference in level)	0.0	3.6	2.4
Productivity (annual percent change)			
Nonfarm business, base	1.5	2.7	2.3
Nonfarm business, simulation of consumption tax	2.6	2.8	2.8
Difference	1.1	0.1	0.5
Total federal tax receipts			
Base	6,210.5	8,853.2	9,179.3
Simulation of consumption tax	5,745.5	8,821.0	9,607.7
(Difference in level)	-465.0	-32.2	428.5

Source: See Margo Thorning, "U.S. Capital Formation: How the U.S. Tax Code Discourages Investment", http://www.ipi.org/ipi_issues/detail/us-capital-formation-how-the-us-tax-code-discourages-investment using data from Allen Sinai, "Macroeconometric Model Simulation With the Sinai-Boston Model of the U.S. Economy," unpublished study, 2001.

Advanced Medical Technology Association

Testimony of Stephen J. Ubl
President and CEO
Advanced Medical Technology Association (AdvaMed)
Tax Reform and the Manufacturing Sector: Hearing before the House Ways and Means Committee
July 19, 2012

Thank you for the opportunity to submit testimony on behalf of AdvaMed and the medical technology industry. And thank you for holding a hearing on this important topic.

I would particularly like to thank Chairman Camp for his leadership on the issue of tax reform. Tax reform is critical if America is to compete successfully in this globalized economy, and your leadership, Mr. Chairman, has been instrumental on elevating tax reform to the top of the national priority list.

AdvaMed is the world's leading trade association representing manufacturers of medical devices and diagnostics. With a membership consisting of over 1,600 of the world's leading medical technology innovators, AdvaMed member companies produce the medical devices and diagnostic products that are transforming health care through earlier disease detection, less invasive procedures and more effective treatments. AdvaMed members range from the largest to the smallest medical technology innovators and companies, and over 70% of our members are small companies with sales of less than $30 million per year. Our members manufacture approximately 90% of the medical technology sold in the United States and half of that sold worldwide. America is the acknowledged world leader in this knowledge-based, high-value added industry.

Let me make three points at the outset.

The medical technology industry has been a significant contributor to employment and economic growth. Our future potential is great, but that future is threatened by competition from other countries.

The current corporate tax system is a ball and chain dragging down our ability to compete in the world and American markets. Reform is essential.

As far as our industry is concerned, job one for tax reform is repeal of the anti-competitive, job-destroying medical device excise tax scheduled to go into effect January first.

The medical technology industry and its contribution to the U.S. economy

The medical technology industry is an American success story. Our industry directly employs more than 400,000 workers nationwide. Typically, for every worker our industry directly employs, another four workers are employed by businesses supplying components and services to our industry and our employees, so that the total numbers generated by our industry exceed two million.

The jobs our industry provides are good jobs—the kinds of jobs that allow employees to live the American dream. Industry pay levels are 38 percent higher than average pay for all U.S. employment and 22 percent higher than other manufacturing employment. While the number of manufacturing jobs was plummeting across the larger economy, even before the recent economic downturn, employment in our industry was expanding. Between 2005 and 2007, medical technology employment grew 20.4%, adding 73,000 jobs. During the recession, between 2007 and 2008, MedTech employment dropped 1.1 percent, compared to 4.4% for manufacturing as a whole.

Medical technology is also one of the few manufacturing industries that has maintained a favorable balance of trade, with $36 billion in total exports in 2010.

The future opportunities for our industry to grow and to contribute good jobs to the American economy are great. Markets for medical technology will expand dramatically as populations age in countries around the globe. In the U.S. alone, the elderly population will increase by 32 million over the next two decades—a jump of 80%. Worldwide, the elderly population will reach 1.2 billion by 2025—and growth of the elderly in that year will be 3.5 times as fast as the population as a whole.

The exponential growth in middle-class populations in countries like China, India and Brazil demanding world class medical care is another extraordinary opportunity. China's middle class alone is projected to exceed the entire U.S. population by 2015, and India's middle class could reach 600 million by 2025.

Finally, in this century of the life sciences, technological advances fueled by fundamental advances in knowledge of human biology and continued progress in computing, communications, materials science, physics and engineering can be expected to drive creation of new and better medical technology products. The potential for economic gains is as great as those attributable to the advances in the physical sciences in the previous century that fueled the development of the airplane, the computer, and the cell phone.

The Competitive Challenge and the Role of America's Corporate Tax Structure

While the medical technology industry in America is still the clear world leader, its competitive position is slipping, and its leadership is increasingly challenged by other countries adopting targeted policies to support home-grown competitors and attract multinational companies. While the future prospects for the industry are bright, it is increasingly questionable whether that future will be made in America.

A survey of medical technology companies found that most expected to grow employment both inside and outside the U.S., but growth was expected to be much faster in both percentage and absolute terms abroad. A recent study by PricewaterhouseCoopers (PwC) found that the U.S. still leads on five key dimensions of medical technology innovation, but our lead is slipping on every dimension. As they state, "The innovation ecosystem for medical device technology, long centered in the United States, is moving offshore." While the U.S. has maintained a favorable balance of trade, the surplus of exports over imports has been narrowing both in absolute terms and relative to the size of the export-import sector. In 1998, imports and exports together totaled $24.6 billion and the trade surplus was $6.6 billion—more than one-quarter of total trade. By 2010, total trade had almost tripled—to $70 billion, but the trade surplus had shrunk by more than two-thirds—to $2 billion, and the surplus was only 3% of total trade.

America's corporate tax structure is a key factor contributing to the decline of the competitiveness of the American medical technology industry. It was designed for a world in which America was economically unchallenged—not for a one of globalized flows of investment, knowledge and production. It was conceived in a world in which our major competitors had not adapted their tax systems to compete for the high value-added industries that are key to international competition. And while the corporate tax structure is riddled with special preferences tailored to the desires of various economic interests, it lacks the kind of strategic policies necessary to support a truly competitive and healthy economy in a globalized world system.

AdvaMed's Recommendations

There are a number of aspects of the U.S. corporate tax code that make it more difficult for America to retain its world leadership in medical technology and other high value-added manufacturing industries and are a powerful deterrent to expanding employment in the United States rather than abroad.

Mr. Chairman, you have pointed to the fact that corporate taxes in America are the highest in the world—far higher than most of our major trading partners. In effect, the tax system provides a powerful incentive for both U.S. based and foreign-based companies to locate manufacturing research and other activities abroad, whether the goods produced will ultimately be consumed in the United States or in international markets. In this increasingly competitive world, we can no longer afford to handicap products invented and made in America with this kind of dysfunctional corporate tax structure.

The most important tax policy issue facing the medical technology industry today is the imminent imposition, effective January 1, of the medical device excise tax included in the Affordable Care Act. This tax singles out this industry and adds a heavy burden to companies that are already weighed down by the underlying anticompetitive general corporate tax structure. Several studies have projected job losses in the tens of thousands as the result of this tax. Companies are already laying off employees, deferring new hires or cutting back on research and development in anticipation of the tax. Mr. Chairman, to preserve this industry as the world leader and as an engine of economic growth, the most important single step Congress can take is to repeal this tax. For us, this is job one of tax reform. I thank the Committee and the whole House for recently passing bipartisan legislation to accomplish this goal, and I urge the Senate to follow your lead.

Beyond the device tax, there a number of fundamental reforms that would go a long way to improving the competitive position of the medical technology industry in America. First, we support the emerging consensus that the United States needs a corporate tax structure that is simpler and provides lower rates.

Second, for manufacturing industries generally and for knowledge-based, high value added manufacturing industries like ours in particular, the tax structure needs to create a level playing field with competitor nations. Simply lowering the overall rate—while very helpful—would not by itself create anything approaching parity. In the tax reform principles we have adopted, we have presented a number of suggestions as to how to make the tax structure for our industry more competitive, including an "innovation box," and a more generous and rational research and development tax credit. The President's proposal for a special lower rate for advanced manufacturing also deserves serious consideration.

A key element of international competitiveness is to adopt a territorial tax system, as have virtually all of our competitor nations. It makes no sense that America should stand alone in rejecting this approach. I commend you, Mr. Chairman, for your leadership on this issue.

Finally, for our industry to thrive—and I think this is true of many other highly innovative, knowledge-based industries—a continual flow of venture capital into small, start-up firms is essential. In our industry, many of the new breakthrough products driving the markets of the future are created by these firms. They are highly dependent on venture capital investment, but venture capital investment has been slowing down in recent years—particularly for the early-stage, highest risk investments that are the seed corn of our future competitiveness.

For a long time, America's venture capital community was unique in the world and a powerful asset supporting American technological leadership. Today, that has changed. Other countries are developing large pools of venture capital. Indeed, China now has the second largest pool of venture capital in the world, and American venture capital now makes investments worldwide, not just in the United States. Accordingly, we think it is important that reform of the tax code provide additional incentives for investment in innovative, high risk start-up firms in industries like ours.

I thank the Committee for the opportunity to submit these comments for the record. I have attached an AdvaMed white paper that discusses these issues in depth and lays out our principles for tax reform.

AdvaMed's Tax Reform Principles
February 7, 2012

Overview

There is broad bipartisan agreement that comprehensive corporate tax reform is essential to improve America's competitiveness and rebuild our nation's economic future. AdvaMed has developed a set of broad principles for tax reform that, if adopted, will make a significant contribution to maintaining our nation's world leadership in the medical technology industry. In this century of the life sciences, medical technology has an exceptionally bright future as a source of jobs and sustained economic growth. The open question, however, is whether this future will continue to be made in America.

While the principles described in this report were designed by AdvaMed based on the needs of the medical technology industry, we believe they are broadly applicable to all knowledge-based manufacturing industries—a key part of the high value added tradable sector which is essential to America's future as a prosperous country where wages are high and prosperity is broadly shared.[i] Tax policy is certainly not the only factor driving American competitiveness—but it is a key factor.[ii] Because tax reform is maturing as public issue and because we believe that medical technology has an important perspective to add—not only for our industry but more broadly—we feel it is important to participate fully in the tax reform discussions to come. The principles described in this paper provide a broad conceptual base for the active role we expect to play.

The Economic Potential of Medical Technology

The medical technology industry is comprised of companies developing and manufacturing medical devices and diagnostics. These products are diverse, running the gamut from tongue depressors to the most complicated molecular diagnostic tests and cardiac implants. They are an essential part of modern medical practice, and development of new medical technology has been one of the main engines of medical progress.

Small firms are a key part of the medical technology industry. A 2007 study by the U.S. International Trade Commission (USITC) found a total of 7,000 medical technology firms in the U.S.[iii] The U.S. Department of Commerce estimated that 62% of medical technology firms had fewer than 20 employees and only 2% had more than 500.[iv] Even large companies in the medical technology space tend to be smaller than large companies in many other sectors. There are only four pure device and diagnostic companies in the Fortune 500 and none in the Fortune 100. These small firms, often venture capital funded, are particularly critical to the future of U.S. scientific and technology leadership, because they are the source of a disproportionate number of the breakthrough technologies that drive medical practice and industry growth.[v]

Whether created by large or small firms, medical technologies are characterized by a very rapid innovation cycle. The typical medical device is replaced by an improved version every 18-24 months.

To fuel innovation, the medical device industry is highly research intensive. U.S. medical technology firms spend over twice the U.S. average on R&D. High technology medical device companies devote upwards of 20% of revenue to R&D.[vi]

In part because of this rapid innovation cycle, the medical technology industry is highly competitive. A study of medical device prices from 1989 to 2009 found that they increased, on average, only one-fifth as fast as other medical prices and less than one-half as fast as the regular CPI. Because the highly competitive market kept prices low, medical devices and diagnostics accounted for a relatively constant 6% of national health expenditures throughout the 20-year period despite a flood of new products that profoundly changed medical practice.[vii]

The U.S. medical technology industry is a very dynamic part of the U.S. economy and a source of economic growth and good jobs. The future opportunities for growth are immense. The industry employs more than 420,000 people in the U.S. It generates an additional four jobs in suppliers, component manufacturers, and other companies providing services to the industry and its employees, for every direct job—for a total of more than two million jobs nationwide.[viii] The jobs the medical technology industry provides are good jobs. The average medical technology worker enjoys wages that are almost 40% higher than average pay for the economy as a whole and 22% higher even than the average for manufacturing wages.[ix]

While employment in other manufacturing industries has been declining, the medical technology industry has been expanding. Between 2005 and 2007, medical technology employment grew 20.4%, adding 73,000 jobs.[x] During the recession, between 2007 and 2008, MedTech employment dropped 1.1%, compared to 4.4% for manufacturing as a whole.[xi]

The medical technology industry is also a strong source of exports and is almost alone among manufacturing industries in consistently maintaining a favorable balance of trade. Exports in 2010 totaled $36 billion.[xii]

The future opportunities for industry growth are great. Worldwide markets for medical technology will expand dramatically as populations age in countries around the globe. In the U.S. alone, the elderly population will increase 32 million over the next two decades—a jump of 80%.[xiii] Worldwide, the elderly population will reach 1.2 billion by 2025—and growth of the elderly in that year will be 3.5 times as fast as the population as a whole.[xiv]

The exponential growth in middle-class populations in countries like China, India and Brazil demanding world class medical care is another extraordinary opportunity. China's middle class alone is projected to exceed the entire U.S. population by 2015, and India's middle class could reach 600 million by 2025.

Finally, in this century of the life sciences, technological advances fueled by fundamental advances in knowledge of human biology and continued progress in computing, communications, materials science, physics and engineering can be expected to fuel creation of new and better medical technology products. The potential for economic gains is as great as those attributable to the advances in the physical sciences in the previous century that fueled the development of the airplane, the computer, and the cell phone.[xv]

The Competitive Challenge and the Role of America's Corporate Tax Structure

While the medical technology industry in America is still the clear world leader, its competitive position is slipping and its leadership is increasingly challenged by other countries adopting targeted policies to grow home-grown competitors and attract multinational companies. A survey of medical technology companies found that most expected to grow employment both inside and outside the U.S., but growth was expected to be much faster in both percentage and absolute terms abroad.[xvi] A recent study by PricewaterhouseCoopers (PwC) found that the U.S. still leads on five key dimensions of medical technology innovation, but our lead is slipping on every dimension. As they state, "The innovation ecosystem for medical device technology, long centered in the United States, is moving offshore."[xvii] While the U.S. has maintained a favorable balance of trade, the surplus of exports over imports has been narrowing both in absolute terms and relative to the size of the export-import sector. In 1998, imports and exports together totaled $24.6 billion and the trade surplus was $6.6 billion—more than one-quarter of total trade. By 2010, total trade had almost tripled—to $70 billion, but the trade surplus had shrunk by more than two-thirds—to $2 billion, and the surplus was only 3% of total trade. [xviii]

America's corporate tax structure is a key factor contributing to the decline of the competitiveness of the American medical technology industry. It was designed for a world in which America was economically unchallenged—not for a one of globalized flows of investment, knowledge, and production. It was conceived in a world in which our major competitors had not adapted their tax systems to compete for the high value-added industries that are key to international competition. And while the corporate tax structure is riddled with special preferences tailored to the desires of various economic interests, it lacks the kind of strategic, targeted policies necessary to support a truly competitive and healthy economy in a globalized world system.

There are a number of aspects of the U.S. corporate tax code that make it more difficult for America to retain its world leadership in medical technology and other high value added manufacturing industries and are a powerful deterrent to expanding employment in the United States rather than abroad:

- General corporate tax rates are high and uncompetitive. The statutory tax rate for the U.S. is 56% higher than the non-U.S. OECD average. Indeed, the U.S. now has the second highest tax corporate tax rate among all OECD countries, exceeded only by Japan.[xix] For manufacturing industries in particular, there is a similar wide disparity in effective tax rates. For a typical small or medium sized manufacturing business, the effective tax rate in the U.S. is 25.9%, higher than 31 out of 34 Organization for Economic Cooperation and Development countries and 58% higher than the non-U.S. OECD average of 16.4%.[xx]

- The United States is an outlier among competitor nations in retaining tax system that taxes worldwide income of U.S. corporations rather than adopting a territorial tax system that taxes only income earned from domestic activities.[xxi] Under the U.S. system, income earned abroad by foreign subsidiaries is subject to taxation (offset by taxes paid to the foreign tax authority) but the taxes are deferred unless and until the income earned is brought back to the United States to be invested or paid out in dividends. This system provides a double blow to U.S. competitiveness. First, it encourages profits earned abroad to be invested abroad rather than in the U.S. Second, a U.S. based multinational firm that wants to invest in the U.S. sometimes is forced to borrow money to make the investment—potentially raising the cost of the investment—rather than using profits earned abroad to generate economic activity at home.

- The U.S. has failed to match competitor nations in positive tax incentives to attract knowledge-based, high value manufacturing industries like medical technology. These incentives have the effect of lowering the effective corporate tax rate abroad for such industries far below the (already more competitive) general tax rate.
    - R & D. The U.S. was the first country to establish an R&D tax credit, but 23 countries now offer a generous tax incentives for R & D than we do.[xxii] Our reliance on temporary extensions of the credit means that it does little to stimulate investment, since it cannot be relied on for planning purposes. The credit does not cover building R&D facilities or purchase of equipment for those facilities, even though the decision to locate an R&D facility in a particular country certainly stimulates further R&D investment to make use of the facility.
    - Innovation box. Nine countries, including China, have introduced or plan to introduce a tax benefit referred to as a "patent box" or "innovation box".[xxiii] Many more are considering establishing one. While the exact features of these programs vary, they essentially provide for a much lower corporate tax rate for activities based on intellectual property.

- Additional tailored incentives. In addition to general tax incentives, other countries provide targeted incentives for projects that offer jobs and economic growth, especially projects in high value-added industries. These incentives include waiving or reducing taxes on the project, providing direct subsidies in the form of below interest loans or grants, or making land and infrastructure available as needed. Emerging growth markets like China, India, and Brazil have been especially aggressive at offering special tax concessions or other incentives for individual projects or groups of projects.

- The medial device excise tax enacted in 2010 and scheduled to go into effect in 2013 puts a special and heavy competitive burden on the medical technology industry. This tax is estimated by the Joint Tax Committee to average approximately $3 billion per year. While the incidence of an excise tax is always difficult to estimate, the high level of price competitiveness in the industry suggests that much of the cost will be borne by manufacturers, and a number have already begun to streamline their operations in order to offset the expected tax burden. In many cases, the operational efficiencies are achieved by reducing the work force. The additional burden of the tax could raise the overall tax burden for this industry by one-third or more—to a level that would surely be one of the highest experienced by any American manufacturing sector and make the American tax rate even more uncompetitive with foreign nations.[xxiv]

- The problems small and start-up companies face in the medical device sector in attracting needed capital are especially acute right now. A recent survey by the National Venture Capital Association found that 40% of respondents had decreased their investment in medical devices over the last three years, while only 22% had increased their investment, and continued declines in investment were projected over the next three years. Perhaps most troubling for the future of the industry, is the decreases were disproportionately concentrated in early-stage start-up companies and that investors are increasingly moving the focus of investment to Europe and Asia.[xxv] Overall, the availability of venture capital in competitor countries is growing dramatically. China now represents the second-largest pool of venture capital, followed by Brazil.[xxvi]

Overall, the much higher effective rates paid by medical technology companies for activities located and taxed in the United States versus activities located and taxed abroad—are a major disincentive to industry job and economic growth in the United States. Data from AdvaMed member companies showed that the average effective tax rate on activities located in the United States was 35 percent compared to 14% for activities located and taxed abroad.[xxvii]

In a recent survey of member companies, respondents were asked "Based on your own company's experience, does a more favorable tax system or direct subsidies provided by foreign governments play a role in the decision to locate manufacturing activities abroad rather than in the U.S.? Sixty-three percent of the respondents identified these factors as playing a major role and 100% said it played a major role or some role.[xxviii]

AdvaMed's tax reform principles

In response to the need to maintain American leadership in medical technology, AdvaMed has developed a broad set of principles for corporate tax reform. As noted earlier in this paper, while these principles were developed specifically for our industry, we believe they are broadly applicable to knowledge-based manufacturing industries facing international completion.

Our principles state:

The goal of tax reform should be to support job creation, economic growth and competitiveness

To achieve that objective:

- Tax reform should provide a level playing field for medical device companies competing in world markets.
- Tax reform should encourage retention and expansion of jobs in the U.S. by providing tax incentives at comparable to or better than our major competitor nations.
- Tax reform should provide incentives for the investment in research and development, which is key to the growth of the knowledge-based, high value added industries on which America's economic future depends.
- Tax reform should encourage the availability of capital for small and start-up companies that play a vital role in inventing and developing innovative breakthrough products.

Implications of AdvaMed's tax reform principles

AdvaMed intends to engage fully in the tax reform debate and will be advocating both for specific proposals to support these principles and commenting on others that may arise affecting the industry. As a starting point, AdvaMed believes that the following policies should be part of tax reform:

- The medical device excise tax should be repealed. For the reasons noted above, the medical device tax is a serious drag on the industry and adds an additional heavy competitive disadvantage to an industry that is already struggling to retain world leadership.

- The United States should adopt a territorial tax system consistent with tax regime of virtually every other advanced economy. If this is not possible, the current system of deferral of taxes on foreign earnings should be retained. As discussed above, the lack of a territorial tax system inhibits investment and economic growth in the United States.

Absent a territorial system, eliminating or significantly curtailing deferral would raise the effective tax rate of international companies competing in world markets very significantly.

- The combined Federal and State corporate tax rate should be lowered to levels comparable to or lower than competitor nations.

- The R & D tax credit should be made permanent and provide research and development incentives comparable to or better than competitor nations. The U.S. needs to encourage research and development here in America, since R & D is so critical to industry leadership and growth.

- The U.S. should institute an "innovation box" regime that provides a substantially reduced corporate tax rate for profits derived from intellectual property developed in the U.S. or used in manufacturing products in the U.S. Since even a substantially lowered tax rate—to 26%, for example—would still leave a very large differential between the tax on economic activities conducted in the U.S. and those located abroad, targeted tax incentives are needed to create a level playing field for industries in the tradable sector—especially knowledge-based high value industries. If the U.S. is to create a future of economic growth and broad prosperity, it must be able to compete in these industries. An innovation box regime is one mechanism for leveling the playing field for the medical device industry and the much broader group of industries who fall in this category.

[i] Michael Spence and Sandrik Hlatshwayo, "the Evolving Structure of the American Economy and the Employment Challenge," Council on Foreign Relations, March, 20ll. For the special importance of manufacturing in driving economic growth, see *The Competitiveness and Innovative Capacity of the United States,* prepared by the U.S. Department of Commerce in consultation with the National Economic Council, January, 2012.

[ii] For AdvaMed's full agenda to maintain America's medical technology industry's preeminent world position, see the reports listed under "AdvaMed's Competitiveness Agenda," at www.advamed.org.

[iii] United States International Trade Commission, "Medical Devices and Equipment: Competitive Conditions Affecting U.S. Trade in Japan and Other Principal Foreign Markets," March, 2007.
http://www.usitc.gov/publications/332/pub3909.pdf
[iv] U.S. Department of Commerce, unpublished data, 2002.
[v] Michaela Platzer, *Patient Capital: How Venture Capital Investment Drives Revolutionary Medical Innovation, 2007.*
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[vi] USITC, "Medical Devices and Equipment: Competitive Conditions Affecting U.S. Trade in Japan and Other Principal Foreign Markets," March, 2007.
http://www.usitc.gov/publications/332/pub3909.pdf
[vii] Donahoe, Gerald and King, Guy. "Estimates of Medical Device Spending in the U.S." June, 2011. Available from www.advamed.org under the "Reports" section.
[viii] The Lewin Group, "State Economic Impact of the Medical Technology Industry," June 7, 2010 and February, 2007.
http://www.socalbio.org/studies/MTI_Lewin_2010.pdf
[ix] *Ibid.*
[x] *Ibid.*
[xi] *Ibid.*
[xii] ITC data web; The Manufacturing Institute, "The Facts about Modern Manufacturing," 2009, p. 18.
http://www.nist.gov/mep/upload/FINAL_NAM_REPORT_PAGES.pdf
[xiii] U.S. Adminstration on Aging, Department of Health and Human Services.
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[xiv] Population Division, Department of Economic and Social Affairs, "World Population Aging," 2002,
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[xv] See Dr Lawrence Summers, "America Must Not Surrender Its Lead in the Life Sciences," January 28, 2007.
http://www.commerce.gov/sites/default/files/documents/2011/july/competitivenessagendabackgrounder.pdf
[xvi] Internal AdvaMed survey of member companies.
[xvii] PricewaterhouseCoopers, "Medical Technology Innovation Scorecard: The Race for Global Leadership," January, 2011. And see, more generally, the AdvaMed competitiveness studies cited in footnote #2.
http://www.pwc.com/es_MX/mx/publicaciones/archivo/201106-medical_technology.pdf
[xviii] U.S. International Trade Commission Dataweb.
[xix] The U.S. rate is 39.2% compared to 24.3% for other OECD countries (figures include subnational corporate income taxes). OECD Tax Database and PWC Worldwide Tax Summaries, at http://www.pwc.com/gx/en/worldwide-tax-summaries/indes.jhtml. Japan recently passed legislation reducing its corporate tax rate. Implementation of the legislation was deferred because of the impact of the tsunami, but when it goes into effect, the U.S. rate will be the highest in the OECD
[xx] World Bank Group and PwC, "Paying Taxes 2011: the Global Picture," November 18, 2010.
http://doingbusiness.org/data/exploretopics/paying-taxes. The cited rates are for small manufacturers generally and are not necessarily reflective of the actual rates for medical technology companies, many of whom pay higher effective rates. The general point of very large, noncompetitive disparities between U.S. and foreign effective tax rates apply to all manufacturing industries.
[xxi] PwC analysis. Twenty-six out of 34 OECD countries have a territorial tax system.
http://www.pwc.com/en_US/us/washington-national-tax/assets/tax-policy-deficit-driven-world-tax-leg-outlook.pdf
[xxii] OECD Science, Technology and Industry Scoreboard, 2009.
http://www.oecd.org/dataoecd/63/32/48712591.pdf
[xxiii] Robert C. Atkinson and Scott Andes, "Patent Boxes: Innovation in Tax Policy and Tax Policy for Innovation," Information Technology and Innovation Foundation, October 2011.
http://www.itif.org/files/2011-patent-box.pdf
[xxiv] Unpublished data developed for AdvaMed.
[xxv] National Venture Capital Association, "MedIC vital signs report," October, 2011.
[xxvi] Pricewaterhouse Coopers, op. cit.

[xxvii] Effective tax rates included combined national and subnational corporate income taxes. For the U.S., the average effective Federal tax was 31.5% and the state and local tax was 3.6%. Data came from companies participating in AdvaMed's tax reform working group. While the data was not designed as a random company sample, the companies providing data were representative of multinational medical technology companies, including large, medium size, and small firms. Interestingly, tax rates on U.S. and OUS activities were similar for U.S. and foreign-domiciled companies.
[xxviii] Ibid.

American Fuel & Petrochemical Manufacturers

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August 2, 2012

The Honorable Dave Camp
Chairman
U.S. House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Sander Levin
Ranking Member
U.S. House Committee on Ways and Means
1106 Longworth House Office Building
Washington, D.C. 20515

RE: Committee Hearing on Tax Reform and the U.S. Manufacturing Sector

Dear Chairman Camp and Ranking Member Levin:

AFPM, the American Fuel & Petrochemical Manufacturers, respectfully submits this letter for the record regarding the U.S. House Ways and Means Committee's July 19th, 2012 hearing on "Tax Reform and the U.S. Manufacturing Sector."

AFPM is a trade association representing high-tech American manufacturers of virtually the entire U.S. supply of gasoline, diesel, jet fuel, other fuels and home heating oil, as well as the petrochemicals used as building blocks for thousands of products vital to everyday life. AFPM's members operate in a highly competitive international market, where fractions of a penny on a per gallon basis can mean the difference between a refinery continuing operations or shuttering its doors.

As the U.S. economy continues to struggle in its recovery, AFPM applauds the Committee's commitment to examining the tax code in order to explore reforms that will make U.S. business more competitive and promote new investment in America. Although U.S. refiners provide more than 95 percent of the fuel consumed in the United States, a blizzard of reduced demand, the high price of crude oil, increased regulatory costs, and government mandates have posed significant challenges for several refineries in the past few years, particularly those on the East Coast. Lowering the statutory tax rate would provide welcome relief to domestic refiners, but only if it resulted in a net decrease in their overall effective tax burden. In contrast, raising the tax burden on U.S. refiners would only exacerbate these challenges, further increasing the real cash costs of doing business in our own country and serving to make domestic industry less competitive. Thus, reducing the regulatory and effective tax burdens on U.S. refiners and petrochemical manufacturers, and all other domestic manufacturers, should be the goal—these changes will have a positive effect by helping to keep companies competitive and providing high-quality, high-paying jobs in the U.S.

As the Committee explores reforms to the tax code and, in particular, lowering the statutory rate, AFPM urges Committee members to tread cautiously when dealing with so-called "base broadeners" that result in higher taxes on domestic refiners and petrochemical manufacturers. In particular, AFPM would like to call to the Committee's attention the following tax code provisions, which are used by U.S. manufacturers in many industries:.

- **"Last-In, First-Out" (LIFO):** LIFO is a well-accepted accounting method used by American businesses and approved by the IRS since the 1930s. It is primarily used to determine book and taxable income for companies that anticipate inflation or rising prices over the course of their operations. For refiners, it is an effective way to better take into account replacement costs, particularly as the cost of crude oil increases. Repealing LIFO accounting for all taxpayers, and in particular the oil and gas industry, would amount to a multi-billion dollar tax penalty in retroactive tax hikes that would adjust inventory on hand as income. Refineries keep large inventories in order to maintain supplies and keep an even predictive flow of crude costs. Repealing LIFO would require companies to redirect cash or sell assets in order to cover the tax payment – potentially devastating businesses and American jobs. There is no justification to enact a retroactive tax on American businesses.

- **Section 199:** The American Jobs Creation Act of 2004 contains the "Section 199 Domestic Production Activities Deduction", often—but incorrectly—referred to as the "domestic manufacturing deduction." The Section 199 deduction applies broadly to income from property "manufactured, produced, grown, or extracted by the taxpayer" in the U.S., and further applies to qualified films, electricity, natural gas, or potable water produced in the U.S. and construction of real property in the U.S., including associated engineering or architectural services (see I.R.C. Section 199(c)). It provides needed tax relief for domestic production activities of all kinds—which support middle class jobs—including support to help stimulate manufacturing activity in the United States. Petroleum refining and the production of domestic oil and natural gas resources are one of many sectors eligible for this credit, which incentivizes the expansion of U.S. refining capacity, energy supplies, and infrastructure. The deduction is needed to keep American fuel and petrochemical manufacturers competitive in an increasingly tough global marketplace. Since 2010, the oil and gas industry has received a discriminatory smaller deduction (6 percent) than every other manufacturer or producer (9 percent), including Hollywood film producers. This discrimination should be eliminated in any tax reform.

- **Depreciation**: US taxpayers have been using the Modified Accelerated Cost Recovery System (MACRS) since the 1980s. This long-standing method of depreciation has a positive impact on cash flow, which is an important determinant in the level of investment in new tangible property. In an increasingly uncertain world in which market demand and production costs can shift quickly, the rapid cash payback from MACRS depreciation substantially reduces the risk premium and hurdle rate to make new investments attractive. Studies have shown that US depreciation rates are not more generous than our trading partners. Recent tax reform discussions have focused on the potential repeal of MACRS, and replacing it with a longer depreciation rate as a way to finance corporate tax rate reduction. Studies have shown that such a change will increase the cost of capital and the cost of new equipment—this change has been projected to reduce the amount of new investment in the US and US jobs.

- **Publicly Traded Partnerships:** Publicly traded partnerships (PTPs), sometimes referred to as master limited partnerships (MLPs), are an important component of our domestic refining and petrochemical operations. A significant amount of the natural gas, crude oil, and refined products (such as gasoline) manufactured and consumed daily in America is transported by the pipelines and stored in the facilities owned by these PTPs. During the upcoming consideration of tax reform initiatives, there will be an effort by some to tax these pass-through entities more like corporations. We believe such an outcome would be unfortunate for several reasons. First, the PTP structure, sanctioned by Congress in 1987 and relied upon by businesses as well as investors for over thirty years, has been extremely successful at encouraging investment in the domestic energy infrastructure. Second, this level of investment operates in the best interests of the sector by creating easier access to capital as well as inuring to the benefit of individual investors by providing a dependable source of income. The capital intensive nature of building and maintaining energy infrastructure projects that is somewhat ameliorated by the lower cost of equity capital associated with PTPs should not be discounted. We ask that the Committee retain the current treatment of PTPs within the Code.

AFPM appreciates your consideration of our views. Please contact Geoff Moody, AFPM's director of government relations, with any questions. He can be reached at gmoody@afpm.org or 202-552-8489.

Sincerely,

Charles T. Drevna
President

American Chemistry Council

AMERICAN CHEMISTRY COUNCIL

WRITTEN STATEMENT SUBMITTED FOR CONSIDERATION TO

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

HEARING ON "TAX REFORM AND THE U.S. MANUFACTURING SECTOR"

DATE OF HEARING: JULY 19, 2012

The American Chemistry Council (ACC) thanks the Committee for continuing to examine comprehensive tax reform, and specifically for the recent examination of tax reform and the U.S. manufacturing sector. Because of the importance to the U.S. economy of the manufacturing industry and the effect of tax rules on manufacturers, the subject is particularly significant to the Committee's consideration of a reformed business tax system.

Ultimately, our comments address whether the manufacturing sector grows or retrenches, the corresponding economic effects, and whether jobs will be created or lost.

ACC and its place in U.S. manufacturing:

ACC represents the leading companies engaged in the business of chemistry. ACC member companies apply the science of chemistry to create and manufacture innovative products that make people's lives better, healthier and safer. The business of chemistry is a $720 billion enterprise and a key element of the nation's economy. Nearly 27% of U.S. GDP is generated from industries that rely on chemistry, ranging from agriculture to oil and gas production, from semiconductors and electronics to textiles and vehicles, and from pharmaceuticals to residential and commercial energy efficiency products. Our industry directly employs over 780,000 Americans in high-paying, quality jobs and each of those jobs supports an additional 5.5 American jobs in other manufacturing industries, meaning that over 5 million Americans are working in the industries that rely on chemistry to drive economic growth, innovation, and American competitiveness. Importantly, our industry is one of the nation's largest exporting sectors, with over $171 billion in exports in 2010, or more than ten cents out of every export dollar. The US chemical industry is a leader in the amount of R&D performed, innovation delivered, and exports shipped, contributing enormously to the nation's economy. Further, given the recent surge in the development and availability of domestic natural gas, which is an important feedstock for the production of chemical products, the US chemical industry has reacted by announcing plans for billions of dollars of new US based investment. These investments will spur the US economy, increase employment and increase the US standard of living.

As a major US advanced manufacturing industry, we are keenly interested in how tax reform can, and will, affect our industry and manufacturers generally. To ensure the US regains its competitive edge, our tax code should be reformed to drive US investment, innovation and productivity to create US jobs. The focus of your July 19, 2012 hearing on manufacturing was timely, and the decisions you make can be critical to the health of the manufacturing sector in general, and to the American chemical industry in particular. In considering the outlook for tax reform, last November, the ACC Board adopted the following "Guiding Principles for Corporate Tax Reform."

- *Tax reform should produce a fair, simpler, and internationally competitive tax system that promotes economic growth and job creation in America.*
- *Tax reform should recognize and reflect the important role of American manufacturing and the jobs it creates.*
  - *Manufacturing is a capital intensive activity, and therefore, tax treatment of capital cost recovery is of key importance.*
  - *Advanced manufacturing techniques and products rely on research, and therefore, incentives for research and development expenses also should be supported.*
- *ACC supports adoption of a competitive territorial system for the taxation of income earned outside the United States.*
- *ACC supports a substantial income tax rate reduction to reflect rates comparable to Organization for Economic Development and Cooperation (OECD) averages.*
- *Tax reform must produce a "level playing field concept" such that American companies investing abroad can compete equally with foreign investors, and American and foreign companies investing in the United States are treated equally.*
- *Tax reform should be enacted comprehensively, not piecemeal, and should include transitional rules that allow taxpayers to adjust to a new tax regime without financial dislocation, contraction, or reduction in employment.*

Our comments below reflect these principles.

Proposals for business tax reform:

As our principles state, the ACC believes that business tax reform should produce a fair, simpler, and internationally competitive tax system that promotes economic growth and job creation in America. The measure of each decision and trade off made in the process of tax reform should be whether it advances these goals. We also support the adoption of a more internationally competitive and modernized system of taxing earnings outside the US.

We note that business tax reform is generally proposed within a framework of revenue neutrality, under which the reformed system of business income taxes would produce the same amount of tax revenue as the current system, but at a lower tax rate—requiring repeal of a broad range of so-called "tax expenditures." We respectfully suggest that the Committee take into account the impact on revenues that would result from a reformed system, more supportive of economic growth, in assessing whether such reforms would be revenue neutral. We fear that embarking on a complex and difficult tax reform process that simply achieves revenue neutrality on a "static basis" would be less effective in promoting economic growth since, by definition, it would create winners and losers in a zero sum game

We are also concerned that a base broadening effort to repeal a number of so-called tax expenditures could disproportionately and adversely affect US manufacturing. For example, accelerated depreciation is highly significant in encouraging and supporting investments and job creation by the manufacturing sector. Without careful balancing of the impact of changes in current law on the manufacturing sector, solid, middle class jobs could be impacted.

A poorly designed system could reduce the chemical industry's ability to compete in U.S. and global markets, could cause the industry to experience reduced growth or contraction, resulting in a corresponding reduction of the manufacturing workforce. Likewise, spill-over consequences would adversely affect suppliers and service-providers that depend upon manufacturing customers.

Our concerns arise from recent economic analyses of certain tax expenditures and the consequent effect of repeal of such provisions on economic growth.[1] Specifically, unless the statutory tax rate under a reformed business tax system is low enough to compensate industry for the loss of tax provisions for investment, reductions in capital investment and economic growth are likely to result.

Similarly, tax reform must also provide fair rules for the taxation of earnings outside the US. Finally, any comprehensive changes to the tax code must include transition rules in order to ensure that taxpayers have time to adjust to a new tax regime without economic contraction and consequent reduction in employment.

Rate reduction –

The US has the highest marginal corporate tax rate of any major industrial nation in the world. This high tax rate acts as an impediment to US investment and expansions for both US and foreign owned firms. The US needs to enact comprehensive tax reform that *significantly* reduces the tax rate. Doing so can provide powerful incentives for US investment, particularly when not neutralized by other changes that directionally increase the cost of capital. ACC realizes that coupled with the tax rate, a wide number of tax expenditures may be eliminated or reduced to fund the lower tax rate. But if the rate reduction is not sufficiently large and if the loss of tax expenditures disproportionately affects the manufacturing sector, the result may be less, not more, growth.

[1] See, e.g., Joint Committee on Taxation Report , "Background and Present Law Relating to Manufacturing Activities Within the United States", July 2012, p. 87.

Accelerated Cost Recovery --

The accelerated depreciation of capital assets, known as "accelerated cost recovery" or "ACR", has been allowable under the tax code for decades ACR is a central element in the business plans of most chemical manufacturers. It allows recovery of the cost of capital investment more quickly for tax purposes than under financial accounting rules that amortize asset value over asset life, but slower than under expensing or recent "bonus depreciation" rules.

ACR encourages new investment in manufacturing, by providing a cost-recovery rules that compensate companies in part for the risk of investing large amounts of capital in relatively low-profit enterprises. For the chemical industry, this typically means longer start-up periods for bringing new assets on line and longer pay-out times in order to achieve returns commensurate with the investment.

Because ACR is extremely significant to manufacturing, repeal would have an obvious, and disproportionate adverse effect on the industry. ACR *leverages* the value of capital investment in productive assets. Accordingly, greater investment means more growth and more U.S. jobs, all of which could be at risk if tax reform removed the provision.

We respectfully question whether "reform" and the progress the term implies, actually would occur if changes in the tax law meant a significant economic discouragement from making new capital investments, with less growth, and erosion of the national economic ballast that the manufacturing sector currently represents.

Incentives for research and development –

The chemical industry is among the largest creators and users of technology. Accordingly, the current federal tax incentives for research and development represent a key factors in retaining a domestic chemical industry that can compete with chemical manufacturers globally that typically enjoy more favorable home-country tax regimes. The tax reform debate should consider the continuing and important role of competitive incentives for creation of US technology, including expensing and an effective R&D credit, while addressing the mobile nature of capital and intellectual property. As a goal, the tax system should encourage investment in the US in R&D activities, the ownership of resulting intellectual property (IP) in the US and exploitation of the IP from the US.

A territorial system for taxation of foreign earnings –

ACC endorses adoption of a competitive territorial taxation system in replacement of the obsolete and overburdened world-wide system for taxation of foreign earnings from active business operations. The US is the only major industrial nation with a worldwide tax system. The incremental US tax imposed upon ACC member companies' foreign operations causes such companies to be less competitive than their foreign competitors. This is not just a matter of abstract theory since 95% of the world's population is outside the US. To serve this large and growing market, we encourage the Committee to continue to search for ways to promote exports of property manufactured in the US to meet these global needs. But in addition to serving such markets by exports, as explained below, ACC member companies must also expand overseas to grow and prosper. It is important to note that as these companies expand throughout the world, new high value jobs in the US in R&D, engineering and administration are created in the US.

Manufacture of chemical products is a global industry and highly competitive. Freight is a significant cost for ACC member companies: to compete effectively they cannot produce all products in the US, ship them across an ocean and truck them to a customer in the interior of a continent. We must be local to compete effectively and the current US tax code acts as an impediment to our competitiveness.

Finally, movement to a territorial taxation system would eliminate the current "lock out" effect of existing tax law and allow substantial amounts of cash to be repatriated to the US. This result, when coupled with pro-growth domestic tax changes, would drive additional capital investment and employment in the US.

LIFO–

Congress enacted the LIFO tax accounting method in 1939, concluding that for some taxpayers, LIFO is a more accurate means of calculating taxable income. A business cannot thrive and maintain operations, unless it generates enough after-tax cash flow to produce and purchase replacement goods at current—not historical prices. By matching current revenues against current inventory costs, LIFO can provide a better measure of the true economic performance of a business.

Without LIFO, a business could not deduct current prices from taxable income and its ability to produce or purchase new, replacement inventory and to maintain and grow investment would be impaired. Purely inflationary gains would be masked and taxed as "profit."

Like ACR, inventory accounting methods bave been designed to appropriately reflect taxable income and to serve as prime instruments for encouraging reinvestment of earnings. Far from a "loophole", LIFO is an essential element in the structure of a tax on business net income. Elimination of LIFO represents a tax increase to manufacturers, a significant cash cost, and would hinder growth.

Summary: "Level playing fields"

As reflected in the attached Guiding Principles for Corporate Tax Reform and as an overall principle to guide policymakers, ACC believes that US tax reform must provide for a "level playing field" where US companies investing abroad can compete equally with foreign investors, and where US subsidiaries of foreign investors which invest in the US and US parented companies are treated equally. Further, we believe that tax reform should not create winners and losers among industries or among types of businesses, but should attract investment and enhance job creation throughout U.S. business enterprises and foreign enterprises investing in the United States. In summary:

- The US should adopt US tax rules that will enable, rather than impede, US companies to compete on a level playing field with regard to their foreign business operations. ACC supports the adoption of a territorial system (which is comparable to those of our major trading partners) for the taxation of foreign business income, that would permit competitive treatment for US companies.
- US companies operating in the US—whether US owned or foreign owned-- should be subject to comparable rules, and thus taxed on a level playing field with regard to US business operations. ACC supports US tax rules which would provide parity between US-owned companies and foreign-owned companies.
- Changes that would place the burden of US tax reform on one or more particular industries would not result in a level playing field. For example, when looking at potential base broadeners, the manufacturing industry (including the chemical industry) should not be disproportionately impacted, unfairly so, vis-à-vis other industries. Otherwise, this would have a significant negative impact on US manufacturing, economic growth, new investment and jobs.

Biotechnology Industry Organization

Biotechnology Industry Organization

Written testimony of the

Biotechnology Industry Organization

Submitted to the United States House of Representatives Committee on Ways and Means

"Tax Reform and the U.S. Manufacturing Sector"

July 19, 2012

The Biotechnology Industry Organization (BIO) represents more than 1,100 innovative biotechnology companies, along with academic institutions, state biotechnology centers, and related organizations in all 50 states. Entrepreneurs across the biotech industry are conducting groundbreaking science and are deeply invested in solving the problems that our nation and world face. Biotech companies are searching for new medicines to treat devastating diseases, developing advanced biofuels and renewable chemicals to reduce our dependence on foreign oil, and improving agriculture to feed a growing world.

The biotechnology industry is a powerful economic growth engine, directly employing 1.61 million Americans with an average salary of $82,697 and supporting an additional 3.4 million jobs.[1] Biotech employees are scientific researchers, lab technicians, factory workers, and support staff in all 50 states.

In order to protect these jobs and support biotech research and development, Congress should promote innovation in tax reform. A simpler tax code, lower corporate rate, and competitive territorial tax system will allow the U.S. to lead the world in biotech development. The tax code should also support innovation through specific tax structures and incentives for pre-revenue, pre-tax R&D companies as they continue to create high-quality American jobs, stimulate long-term economic growth, and bolster America's competitiveness on an increasingly global stage.

International Competitiveness

As it currently stands, the U.S. corporate tax code impedes America's ability to innovate and to compete with other industrialized countries on the global stage. Since 1988, the average OECD corporate income tax rate (excluding the U.S.) has dropped 19 percentage points while the U.S. federal rate has increased by one point. In 2011, the average OECD corporate tax rate was 25.1%, nearly 15 percentage points lower than the U.S. combined rate of 39.2%. With Japan recently reducing its rate, the U.S. has become the industrialized nation with the highest statutory corporate tax rate. A burdensome and complicated tax code does little to promote life-changing innovation.

The United States is in danger of falling behind, in part because of a worldwide corporate tax system that stifles growth. America's competitors have largely moved to territorial tax systems, imposing domestic taxes only on income generated within their borders. Meanwhile, the U.S. continues to have a burdensome worldwide system out of step with the

[1] Battelle/BIO State Bioscience Industry Development 2012. Battelle Technology Partnership Practice, June 2012.

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rest of the world. Every other G-7 nation has moved to a territorial system, as have 26 of the 34 countries in the OECD. Both Japan and the United Kingdom recently made this change, recognizing the value of a competitive corporate tax structure.

With international competitors gaining ground in the biotech industry, the U.S. cannot afford the competitive imbalance faced by domestic firms forced to comply with worldwide taxation. Moving to a territorial system is a critical step towards creating a competitive tax code. Freeing up over one trillion dollars that is currently trapped overseas due to the inefficiencies of the tax code will boost economic growth and capital investment. Congress should bolster domestic innovation by instituting a territorial tax system that allows U.S. innovators to compete effectively and fairly.

Promoting Investments in Innovation and Life-Saving Research

In addition to a lower corporate rate and competitive territorial tax system, tax reform must go further than "broadening the base and lowering the rate." By appropriately incentivizing innovation through the tax code and eliminating barriers to international competitiveness, Congress has the opportunity to support and inspire breakthrough discoveries and bolster economic growth. BIO supports a U.S. tax code that recognizes innovation as a crucial part of the 21st century American economy.

For health-focused biotech companies, the tax code takes on increased import due to their unique life cycle and development timeline. It takes more than a decade and over $1 billion to develop a lifesaving biotechnology treatment. Further, of every 1,000 compounds discovered at the pre-clinical stage, only one will make it through the FDA approval process. The entire extended development period is undertaken in the context of tremendous risk and without the benefit of product revenue, so all operating capital must come from investors. These investor-backed companies depend on substantial private – not government – investment to provide the necessary funding for their capital-intensive research, development, and manufacturing. And yet, the current set of incentives for investors in the tax code do not do enough to stimulate biotech investment.

It is essential that investors in start-up businesses have a reason to invest early in a company's life cycle and hold that investment. Structures which allow them to utilize a small company's tax assets that it cannot currently use or expand their options for liquidity would provide incentives to invest. A reformed tax code should include incentives for investors in high-risk industries, including preferential capital gains treatment, pass through structures to utilize certain tax assets, and investment credits. Congress should provide important incentives and structures to stimulate an innovation-led economy.

Congress has also historically recognized the importance of innovation at the companies themselves. Provisions like the R&D Credit are examples of the tax code providing incentives for innovative job creators. However, because most biotechs are in a loss position, these provisions do not do enough to stimulate innovation. Small companies that are pre-revenue are unable to immediately utilize these incentives; instead, they are accumulated as deferred tax assets for use later to offset future profits. These deferred assets do not incentivize much-needed investments in pre-revenue companies because they do not provide immediate or short-term tax benefits to investors or to the companies themselves.

While a lower corporate rate will be helpful in the event that these companies become profitable, it will not stimulate investment in the near term. More should be done to support innovation by growing companies, including allowing them to either immediately utilize their deferred tax assets to attract investment or maintain their value during transactions. The unique nature of innovative companies with very long-term product cycles must be taken into account in tax reform, and the tax code should reflect the needs of these pre-revenue capital-intensive businesses.

Under the current tax system, companies are unable to use the tax code to attract investors, prevented from taking advantage of innovation and R&D incentives from a loss position, and hamstrung by a high corporate rate when they finally do become profitable. Congress should reform the tax code to make the corporate rate globally competitive while also providing important incentives for the development and manufacturing of innovative products.

Role of the Tax Code in Driving Investment in Manufacturing of Renewable Chemicals, Biobased Products, and Advanced Biofuels

BIO's Industrial and Environmental Section represents 85 leading companies in the production of advanced biofuels, renewable chemicals, biobased products, and other sustainable solutions to energy and environmental challenges. BIO member companies apply industrial biotechnologies to help resolve important challenges in synthesizing new products, whole cell systems and other biologic processes to improve the range of manufacturing and chemical processes. BIO members include the leaders in developing new crop technologies for food, feed, fiber, and fuel.

In the industrial and environmental biotechnology sector, tax policy is particularly important to emerging technologies that have not yet achieved commercial scale. This is especially true for emerging technologies that must compete with well-established incumbent technologies that have benefitted from longstanding support within the tax system. The growing portfolio of emerging technologies for the conversion of renewable biomass to advanced biofuels, renewable chemicals and biobased products is such an example.

By combining America's leading positions in agriculture and manufacturing innovation, industrial biotechnologies have outstanding potential to create jobs and economic growth, stimulate the U.S. bioeconomy, enhance America's energy security and improve the environment. Emerging technologies in renewable chemicals, biobased products, and advanced biofuels are ready for commercial deployment, but are in need of capital for first-of-a-kind biorefinery construction.

Commercialization of these technologies is especially challenging because the markets they seek to enter are dominated by mature fossil-based incumbents with a long history of federal government support. In the case of biofuels, Congress has recognized the important role of tax policy in overcoming market barriers. Tax incentives for first generation biofuels have played a key role in reducing the nation's dependence on imported petroleum, mitigating fuel price volatility and providing consumer choice at the pump. The next generation of cellulosic and other advanced biofuels offers even greater benefits. Congress has again recognized the societal benefits of these technologies in providing targeted tax incentives for cellulosic and other advanced biofuels even as first generation tax incentives have been phased out. But the first commercial cellulosic biorefineries are only just coming online this year. Comprehensive reform of tax policy must ensure that the tremendous progress in advanced biofuels commercialization is not thwarted by a heavy new tax burden.

In substituting domestic, renewable biomass feedstocks for traditional fossil-based chemical feedstocks, renewable chemicals and biobased products offer the same wealth of public benefits as advanced biofuels, with particularly strong potential for domestic job creation and revitalization of U.S. manufacturing. A recent report estimates that the global sustainable chemical industry will grow to $1 trillion, with the potential for 237,000 direct U.S. jobs and a trade surplus within the chemical sector.[2] The report finds that, through the development of the U.S. renewable chemicals and biobased products industries, the U.S. has the opportunity to reclaim significant U.S. manufacturing jobs that have been lost to other nations in recent decades.

But because most of these technologies have only just emerged, the tax code does not yet provide incentive for the domestic manufacture of these highly promising alternatives. Providing a tax credit for the production of renewable chemicals through the application of industrial biotechnology in the U.S. will promote investment in innovation and the development of a robust domestic renewable chemicals industry. In addition, extending and modifying the advanced energy projects credit to include renewable chemicals and biobased products will promote domestic manufacturing and create jobs. To realize the tremendous potential these technologies represent to revitalize U.S. manufacturing, comprehensive tax reform must foster private investment in this space.

Closing Remarks

The current tax code is complicated and expensive to administer and comply with. Further, temporary tax rules are always in danger of expiring and result in extreme uncertainty for businesses trying to plan for their growth. Companies planning their development pipelines and investors considering biotech investments need to know what they can expect as they move through the development process. Combined with a highest-in-the-world corporate tax rate and ineffective innovation incentives, the U.S. tax code does not do enough to stimulate biotech research and development.

The U.S. biotechnology industry remains committed to developing a healthier American economy, creating high-quality jobs in every state, and improving the lives of all Americans. Federal tax policy that recognizes the special demands placed on biotech companies and other highly innovative industries will speed the development of products to vastly improve the lives of Americans and people around the world. By recognizing the importance of innovation and the economic potential of the biotech industry, Congress can incentivize further development, create jobs, and improve America's economic health.

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[2] "Biobased Chemicals and Products: A New Driver of U.S. Economic Development and Green Jobs." http://www.bio.org/sites/default/files/20100310_biobased_chemicals.pdf

Center for Fiscal Equity

Comments for the Record

United States House of Representatives
Committee on Ways and Means

Tax Reform and the U.S. Manufacturing Sector

Thursday, July 19, 2012, 9:30 AM
1100 Longworth House Office Building

By Michael Bindner
Center for Fiscal Equity

Chairman Camp and Ranking Member Levin, thank you for the opportunity to address these topics, which were also submitted to the Senate Finance Committee in March. In our comments, we will address how our four part tax plan relates to these issues, specifically how investment expenses are paid for in a consumption tax environment, the impact of lower tax rates on productivity and jobs, how corporate ownership may be impacted under various scenarios for Personal Accounts in Social Security and the impact of tax reform on globalization.

As you know, the Center for Fiscal Equity has a four part proposal for long term tax and health care reform. The key elements are

- a Value Added Tax (VAT) that everyone pays, except exporters,
- a VAT-like Net Business Receipts Tax (NBRT) that is paid by employers and includes OASI employer contributions but, because it has offsets for providing health care, insured personal retirement accounts, education benefits and family support, does not show up on the receipt and is not avoidable at the border,
- an employee payroll tax to for Old Age and Survivors Insurance (OASI), and
- an income and inheritance surtax on high income individuals so that in the short term they are not paying less of a tax burden because they are more likely to save than spend – and thus avoid the VAT and indirect payment of the NBRT.

In a VAT and Net Business Receipts Tax environment, tax is paid to the suppliers of plant and equipment when services are invoiced. VAT is receipt visible, while NBRT, as a vehicle for deductions, is designed not to be (hence the need for a second tax). Those providers then pay taxes to the taxing authority based on those sales. How these assets are accounted for in the price of the product, however, is open for debate.

The credit against VAT and NBRT collections resulting from purchasing investment assets might be applied in the year the purchase is made or, if Congress so desires, the credit can be applied over the useful life of the asset. Extending the credit allows the taxpaying business to even out tax payments over time and will cause less disruption along the supply chain so that the entire price of the item is not a VAT credit at the next stage in the production process. How other nations deal with these questions is dealt with in the VAT literature and is beyond the scope of these comments. Should the Committee desire a more complete treatment of this issue, a separate hearing would be appropriate.

Separate rules could conceivably be adopted for VAT and NBRT, as VAT is collected on a transaction basis, similar to Sales Taxes, while NBRT can be calculated on a period basis, like Corporate Income Taxes. This is especially the case if NBRT collections are not "receipt visible" due to their purpose as a vehicle for claiming offsets for the Child Tax Credit, the health insurance exclusion and other tax expenditures.

As important as how capital expenditures are treated as a factor of production is how dividends and capital gains are taxed. Prior to 1981, tax rates at the highest income levels were confiscatory, especially between 1956 and 1965 when the tax rate was 91%. During this era, special tax benefits were necessary so that when combined with state taxes, the effective tax rate was not over 100% of income. Beginning in 1981, tax obligations for these forms of income declined in several steps, including the 1986 tax reform, the 1997 decrease in capital gains tax rates to the current permanent rate of 20% and the 2003 tax legislation which dropped these rates to 15%.

While technology exploded during this period, as we moved from the mainframe computer to Cloud Computing, robotic and the iPad, much of this explosion was incentivized by the ability of owners to keep an ever increasing percentage of the resulting productivity gains, as well as productivity gains from taking advantage of the expansion of free trade due to the North American Free Trade Agreement, other trade actions and the opening of China as a source of cheap assembly. If the gains from these investments were all kept by the government, they might not have been made. The downside of such gains, however, is the loss of manufacturing jobs, as well as a greater incentive to engage in union busting and the threat of union busting to keep wage increases low, essentially excluding the middle class from enjoying the benefit of these gains through wages, although some might realize them to the extent that they have accumulated either pension assets or participated in defined contribution plans.

Studies have shown that dividend payouts of these productivity gains are generally at the level of normal profit. Dividend levels have not substantially increased due to these gains. Instead, they have gone mainly to CEO bonuses and stock grants and options. While CEO leadership is, of course, important to the adoption of innovation and investment, it is not so great that this factor deserves the lion's share of reward.

It is rather unseemly that fiscal policy has had what amounts to a causal effect on what can be described as disastrous levels of inequality, leading most consumers to borrow to maintain their standard of living and partake in the rise of advanced consumer electronics that in another form has reduced their wages. This overleveraging has led us to the financial situation now plaguing this nation, which can best be described as a long term Depression, even though there are periods of recession and recovery within this era.

Tax reform can ameliorate these effects. Adoption of consumption taxes like a VAT and NBRT impact labor and capital equally. In Europe, this allows for the adoption of lower rates for capital gains taxes. While profit is theoretically taxed by the Corporate Income Tax, such taxation is uneven given the maze of special tax provisions favoring some industries and businesses over others, leaving profit untaxed in many cases, except as part of personal income taxation. Given the probability of evasion, lower rates are not justified. This Center opposed these rate cuts in 2003 and we continue to oppose them.

In the area of personal income taxation, the Center favors a single rate structure for dividend, capital gain, wage and inherited income (rather than inherited assets that are not yet liquidated – with the only exception being that proceeds from sales of these assets to a broad based Employee Stock Ownership would remain tax free). Tax rates could range from 4% on at the $100,000 a year level for joint filers or widows ($50,000 for individuals) to a top level of 28% - which is roughly the effective rate for the NBRT (to discourage income shifting). While fewer, less graduated rates are possible, most middle income taxpayers would not find them desirable. As tax tables will only have a single rate for each income level, the existence of multiple rates does not increase complexity for the taxpayer.

Another option to ameliorate the maldistribution of wealth is the adoption of Personal Retirement Accounts for Social Security, although doing so is like holding a lightning rod in a thunderstorm. We do agree with President Obama that such accounts should not be used for speculative investments or even for unaccountable index fund investments where fund managers ignore the interests of workers. Investing such accounts in insured employee-ownership of the workplace would have an entirely different outcome, especially if voting shares occurred on an occupational basis with union representation. The impact at the international level of such employee-ownership if extended to subsidiaries and the supply chain is also potentially profound, especially in regard to transfer pricing and the international growth of the union movement.

A major strength of Social Security is its income redistribution function. We suspect that much of the support for personal accounts is to subvert that function – so any proposal for such accounts must move redistribution to account accumulation by equalizing the employer contribution.

We propose directing personal account investments to employer voting stock, rather than an index funds or any fund managed by outside brokers. There are no Index Fund billionaires (except those who operate them). People become rich by owning and controlling their own companies. Additionally, keeping funds in-house is the cheapest option administratively. We expect it is even cheaper than the Social Security system – which operates at a much lower administrative cost than any defined contribution plan in existence.

Safety is, of course, a concern with personal accounts. Rather than diversifying through investment, however, we propose diversifying through insurance. A portion of the employer stock purchased would be traded to an insurance fund holding shares from all such employers. Additionally, any personal retirement accounts shifted from employee payroll taxes or from payroll taxes from non-corporate employers would go to this fund.

The insurance fund will serve as a safeguard against bad management. If a third of shares were held by the insurance fund than dissident employees holding 25.1% of the employee-held shares (16.7% of the total) could combine with the insurance fund held shares to fire management if the insurance fund agreed there was cause to do so. Such a fund would make sure no one loses money should their employer fail and would serve as a sword of Damocles' to keep management in line. This is in contrast to the Cato/ PCSSS approach, which would continue the trend of management accountable to no one. The other part of my proposal that does so is representative voting by occupation on corporate boards, with either professional or union personnel providing such representation.

The suggestions made here are much less complicated than the current mix of proposals to change bend points and make OASI more of a needs based program. If the personal account provisions are adopted, there is no need to address the question of the retirement age. Workers will retire when their dividend income is adequate to meet their retirement income needs, with or even without a separate Social Security program.

No other proposal for personal retirement accounts is appropriate. Personal accounts should not be used to develop a new income stream for investment advisors and stock traders. It should certainly not result in more "trust fund socialism" with management that is accountable to no cause but short term gain. Such management often ignores the long-term interests of American workers and leaves CEOs both over-paid and unaccountable to anyone hut themselves.

Progressives should not run away from proposals to enact personal accounts. If the proposals above are used as conditions for enactment, I suspect that they won't have to. The investment sector will run away from them instead and will mobilize their constituency against them. Let us hope that by then workers become invested in the possibilities of reform.

All of the changes proposed here work more effectively if started sooner. The sooner that the income cap on contributions is increased or eliminated, the higher the stock accumulation for individuals at the higher end of the age cohort to be covered by these changes -- although conceivably a firm could be allowed to opt out of FICA taxes altogether provided they made all former workers and retirees whole with the equity they would have otherwise received if they had started their careers under a reformed system. I suspect, though, that most will continue to pay contributions, with a slower phase in -- especially if a slower phase in leaves current management in place.

The international consequences of adopting personal retirement accounts which include employee-ownership are also interesting. As employees begin to own and control their workplace, they will find it in their best interests to include overseas subsidiaries and their supply chains in the same type of arrangement. They are also more likely to set transfer pricing so that all employees in an international enterprise receive the same standard of living from work, so that incentives to exploit other workers would be eliminated. This development would not only revive the labor movement, it would make it international in a way that trading agreements have not been able to accomplish. Recognition of this fact should make the possibility of personal accounts more attractive to progressives and the more populist members of the Tea Party, but not to the more corporatist members of either party.

International aspects are unavoidable in a discussion of tax reform. Indeed, one of the reasons for engaging in tax reform is to increase the competitiveness of American manufacturers. While VAT does not function as an explicit tariff, the lack of one while many of our trading partners have one essentially builds all of our tax costs into the cost of exported products, where competing nations exclude these costs at the border. The current regime violates the spirit, though likely not the letter, of constitutional provisions banning export taxes.

As the Committee is well aware, VAT is good for competiveness because it can be zero rated at the border for exports and collected fully for imports. Unlike a VAT, an NBRT would not be visible on receipts and should not be zero rated at the border – nor should it be applied to imports. While both collect from consumers, the unit of analysis for the NBRT should be the business rather than the transaction. As such, its application should be universal – covering both public companies who currently file business income taxes and private companies who currently file their business expenses on individual returns.

It is not appropriate for NBRT to be zero rated, as doing so would decrease the incentive to pass Child Tax Credit and Health Insurance tax benefits to employees. As importantly, the tax benefits and government services provided under this tax go to workers and their families. As such, overseas purchasers accrue benefits from these services and should therefore participate in their funding.

If the NBRT is enacted in this way, the United States should seek modification to our trade agreements to require that similar expenditures not be funded with taxes that are zero rated at the border. As foreign consumers benefit from subsidies for American families, American consumers benefit from services provided to overseas workers and their families. This benefit should be recognized in international tax and trade policy and American workers should not be penalized when other nations refuse to distribute the cost of benefits to foreign workers to the American consumers who receive the benefit of these services. If our trading partners do not match this initiative, some items of spending could be shifted from NBRT funding to VAT funding, so that we are not making unilateral concessions in this area.

The final question on capital investment is the repatriation of profit from overseas subsidiaries. Under a consumption tax regime, there would be no separate levy on profit. Value added taxes are already paid in the country where the product is sold and these taxes include both the contributions of labor and capital. For the purposes of businesses, profit should not be taxed again when repatriated, except to the extent that this profit results from value added in the United States. Use of VAT exemptions must not be allowed as a tax avoidance scheme. Products with parts that have been produced or developed in the United States, then sent elsewhere for assembly, must reacquire any obligation to pay that was shed at the border. Not providing for this contingency opens the door for a great deal of abuse.

The source nation of dividend income, meanwhile, must be irrelevant for purposes of collection of the proposed high income and inheritance surtax. The subject of this tax is not the income of the business, which has been shifted to the NBRT for individual filers, but the income of households for personal consumption and savings. The existence of this tax takes into account the decreased likelihood that this income will be spent and therefore taxed under NBRT and VAT regimes and to safeguard savings opportunities for the non-wealthy, who would otherwise be priced out of the market for investments by higher income individuals who, because they have greater opportunities to save, garner greater and greater shares of America's wealth. The proposed surtax is an attempt to level the playing field so that everyone can invest.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

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Committee on Ways and Means
Tax Reform and the U.S. Manufacturing Sector
Thursday, July 19, 2012, 9:30 AM
1100 Longworth House Office Building

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears:

This testimony is not submitted on behalf of any client, person or organization other than the Center itself, which is so far unfunded by any donations.

Ernest Christian

WRITTEN STATEMENT SUBMITTED FOR CONSIDERATION TO:
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

HEARING ON TAX REFORM AND THE U.S.
MANUFACTURING SECTOR

HEARING DATE: JULY 19, 2012

SUBMITTED BY:

ERNEST S. CHRISTIAN

— • —

ON HIS OWN BEHALF AS A FORMER
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WRITTEN STATEMENT SUBMITTED FOR CONSIDERATION TO COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES

HEARING ON TAX REFORM AND THE U.S. MANUFACTURING SECTOR

Hearing Date: July 19, 2012

Introduction

My name is Ernest S. Christian. I am pleased to submit on my own behalf this written statement about the dynamic role of lower tax rates and improved capital cost recovery allowances in economic growth -- with special emphasis today on manufacturing.

I am a former Treasury tax official and, in and out of government, have been a tax lawyer in Washington, DC since the early 1960s. At present, I am a co-chairman of the Center for Strategic Tax Reform (CSTR), a role that I share with several former members of this Committee. CSTR is a nonprofit §501(c)(6) organization that Dr. Murray Weidenbaum, former Chairman of the President's Council of Economic Advisors, and I formed over 20 years ago to promote pro-growth tax reform. The views expressed here are solely my own.

During the 1970s, I served as both the Deputy Assistant Secretary and Tax Legislative Counsel of the Treasury Department, where I designed and drafted the Asset Depreciation Range System (ADR) of depreciation enacted in 1971. That tax reform measure continued the essential acceleration of depreciation allowances that began in the Kennedy administration. During the Reagan administration, I assisted with further reforms, including lower tax rates and designing the present capital cost recovery system known as MACRS and its predecessor -- ACRS.

Overview

Changes in tax rates and capital cost recovery allowances both have profound effects -- for good or ill -- on manufacturing's key role in job creation. On the positive side, to maintain and expand manufacturing and manufacturing jobs, and for the overall health of the U.S. economy, the Congress should reduce the corporate tax rate and make permanent either 50 percent or 100 percent first-year expensing of business capital equipment. That should be followed with tax reforms that better enable businesses to export goods and compete directly in foreign markets.

On the negative side, the worst thing Congress could do is, with one hand, cut nominal or statutory tax rates, and with the other, reduce capital recovery allowances from their already inadequate levels. This would increase the effective tax rate for many manufacturers and others -- and would increase the "tax cost" of job-creating investment all across the U.S. economy. The tax code should not drive more manufacturers offshore.

Ever since the Kennedy administration in the 1960s, tax reformers who have focused on economic growth have sought not just to lower tax rates, but also to accelerate depreciation allowances so as to alleviate the long-standing tax bias against job-producing "capital-intensive" businesses. It would be a tragedy if, because of budget pressures outside the jurisdiction of this Committee, the Congress were to reverse the course of tax reform and start back down the road of making manufacturing in the U.S. even more tax-expensive and less productive.

I applaud this Committee's focus on the need to remove tax impediments to economic growth. And I agree especially with Chairman Camp's emphasis on the need both to lower the tax rate and to have a correct tax base to which that rate is applied. If the Congress were to go in the wrong direction on either of these elements of the tax code, we would end up with a system that further retards economic growth and the true cause of tax reform could be set back for decades.

My purpose is to assist in the Chairman's effort to keep tax reform on the right path toward producing highly positive economic results. This can be accomplished by making first-year expensing permanent and phasing in a major reduction in the corporate tax rate in a way that maximizes the bang-for-the-buck from these two components of fundamental tax reform.

Phase-In of Pro-Growth Tax Reform That Works

Alex Brill, a former Policy Director and Chief Economist of this Committee, recently suggested that 50 percent first-year expensing be made permanent and that a corporate rate cut be phased in. (See "A Pro-Growth, Progressive, and Practical Proposal to Cut Business Tax Rates," AEI Tax Policy Outlook No. 1, January 2012.)

Following up on that, I have worked with Gary Robbins, formerly a Treasury Department tax economist and now president of Fiscal Associates, to formulate a specific proposal and to quantify its revenue consequences (both static and dynamic) as well as its all-important growth effects.

Our proposal is permanent 50% first-year expensing for all businesses and a phased-in reduction of the corporate tax rate to 25%. The results are illustrated in Table I below.

Table I – One Percentage Point Per-Year Corporate Rate Cut plus 50% Expensing for All Businesses

Calendar Year	Corporate Rate Cut	Static Cost of Rate Cut ($)	($) Static Cost of 50% Expensing plus MACRS	Combined Static Cost ($)	Combined GDP Growth	Combined Dynamic Cost ($)
2013	34%	-9.2	-70.5	-78.5	0.3%	-68.9
2014	33%	-24.4	-66.8	-88.9	0.7%	-67.8
2015	32%	-37.9	-62.7	-97.4	1.0%	-61.9
2016	31%	-49.9	-48.0	-94.6	1.4%	-44.1
2017	30%	-66.4	-36.7	-99.9	1.7%	-35.4
2018	29%	-79.0	-27.8	-103.9	1.9%	-25.9
2019	28%	-90.9	-20.9	-109.3	2.1%	-17.5
2020	27%	-101.5	-16.5	-115.8	2.3%	-11.0
2021	26%	-116.2	-14.3	-128.2	2.5%	-10.4
2022	25%	-131.1	-12.5	-141.5	2.6%	-9.8
				-1,057.8		-352.7
					% Reflow	66.7%

Note: All dollar amounts are in billions of dollars. The column "Static Cost of Rate Cut" shows the cost of changing the corporate rate to the rate indicated in the "Corporate Rate Cut" column from 35 percent without 50% Expensing. The "Static Cost of 50% Expensing plus MACRS" shows the effect of 50% Expensing without a change in the corporate rate. The "Combined Static Cost" column is not equal to the sum of the two prior columns because it accounts for interactions between the parts of the plan. Additional GDP results in additional federal receipts. That is the difference between the combined static and dynamic cost of the plan. The "% Reflow" is the ratio of the additional receipts to the "Combined Static Cost."

Note: For this purpose, MACRS includes other cost recovery provisions that under present law remain in effect in 2013 and thereafter. So-called "bonus depreciation", a temporary provision which expires, is replaced by the more correctly denominated 50% expensing rule which works in essentially the same way except that it is a permanent part of the law.

Table I tells us many important things. The static "cost" of rate reduction builds up over time, but the static cost of 50% expensing declines rapidly and is nearly gone after 10 years. The combined annual static cost of these two reform components is on average about $100 billion per year -- essentially equal to the annual cut in spending beginning in 2013 that is required by the Budget Control Act of 2011. Those who are concerned about the potential negative impact of spending cuts on our fragile economy might welcome the significant tax cuts in 2013 – 2015 as shown by Table I.

Indeed, the most powerful part of the story is in the last two columns of Table I which illustrate the highly efficient, large bang-for-the-buck growth effects of combining rate reduction and expensing. The dynamic cost is only $353 billion over 10 years and the boost to GDP is a whopping 1.8% or, in dollar terms, roughly $3,599 billion -- thereby providing a 10-to-1 return ($3,599 divided by $353). Moreover, even the 10-year $1,057.8 billion static cost (for those who prefer old-fashioned accounting) is only 29% of the $3,599 billion of induced GDP growth -- thereby providing almost a 3.5-to-1 return.

Given the current fragile condition of the economy, fine-spun arguments about the distinction between dynamic and static scoring are largely irrelevant. Absent a powerful pro-growth tax cut, and sensible long-term reductions in spending, it is highly likely that we face a 4% economic decline starting in the first quarter of 2013 according to the Congressional Budget Office (CBO). Keep in mind that compared to where we would have been if GDP had returned to its historic trend of 3.2% per year growth, we are already $2 trillion in the hole (i.e., GDP is that amount smaller than it should be this year).

It is in this context that the pro-growth tax cut in Table I is almost "free" in the sense that if we don't do it, the economy and revenue will continue to muddle along at a subpar or worse rate. CBO's current-law forecast shows the result of accepting this low level of recovery and growth as the "new normal." By the end of the budget window, in 2022, GDP will be 16.5% below its 50-year trend level or $3.6 trillion too low, or a $12,000 loss for every man, woman and child, each and every year into the future.

The tax cut illustrated in Table I is especially powerful and needed not just because it reduces the corporate rate. Indeed, most of its strong boost to economic growth comes (a) from moving closer to the free-market neutrality of full expensing and farther away from the distortive, efficiency-reducing effects of the "winners and losers" class lives that underlie the MACRS system; and (b) because the 50% expensing rule applies to capital investments made by unincorporated businesses as well as in the case of corporations.

Although not discussed in detail here, we have analyzed and would also recommend a proposal that reduces tax rates for unincorporated businesses as well as corporations. When combined with first-year expensing for all businesses, that approach would produce an even more powerful boost to economic growth.

Important Perspectives on Tax Reform

Nominal vs. Real Tax Rates

Alan Viard, a Resident Scholar at the American Enterprise Institute, recently reiterated the perils of tax changes that reduce the nominal statutory rate, but ignore the effective rate of tax. (See "The Benefits and Limitations of Income Tax Reform," AEI Tax Policy Outlook No. 2, September 2011.) When the nominal rate is cut, but deductions are denied, and the tax base is therefore changed, the effective rate of tax may go up or down or remain the same.

Suffice it to say that if the corporate tax rate were to be cut and depreciation deductions for new purchases of capital equipment were reduced, the effective rate of tax (Note) for job-

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(Note) Here we are talking about the real (cash) effective rate, not the somewhat different "effective rate" often used as a financial accounting term.

creating companies that are purchasing a lot of new capital equipment would go up, but would go down for those that are not, and would remain about the same for those in the middle.

Chris Edwards at the Cato Institute has correctly pointed out that when Canada cut its corporate tax rate from 29 percent to 15 percent over the last decade, the reforms did not broaden the tax base in anti-growth ways such as by reducing depreciation allowances. In addition, recent research by Douglas Holtz-Eakin and Ike Brannon at the American Action Forum reveals that of 96 corporate rate cuts of one percentage point or more among OECD countries since the year 2000, only 25 were paid for with some other tax increase.

The "Economic Efficiency" Notion

The notion that lowering the business rate while cutting back depreciation to the vastly disparate "class lives" would introduce efficiency gains for the economy is wrong. It assumes that the existing class lives are accurate, closely matching the ever-changing, almost impossible to quantify decay rates for innumerable kinds of business assets across various industries. They aren't -- and here I speak from experience, having been at the Treasury Department in the period 1971-1975, where I was responsible for updating and rearranging the class lives, often using data that was even then out of date.

Despite the best efforts of many people in the 1970s, including those in the Treasury Department's then, but now disbanded, Office of Industrial Economics, the task proved to be impossible -- and still is. Therefore, the class lives in the old ADR system -- and as now carried forward into MACRS -- are at best only rough approximations and make arbitrary distinctions that have become more distortive with the passage of time. Consequently, if present capital cost recovery allowances were, for example, to be cut back to the class life system, disparities in depreciation rates would tend to be magnified and, instead of economic inefficiencies being reduced, they would be increased.

Neither MACRS nor Expensing Is a Loophole

There are loopholes in the Internal Revenue Code -- hundreds of them, in fact, but allowing a business to deduct when incurred (or soon thereafter through MACRS) the costs of the tools that it puts in the hands of its workers is not one of those loopholes. Allowing expensing is not a subsidy like allowing a business to deduct the cost of healthcare benefits that are not included in employees' income. The costs of a machine tool, a forklift, a rolling mill in a steel plant, the components of a refinery and so forth are in all cases just as much an expense of doing business as the wages of the employees who operate the equipment.

Expensing the cost of capital investments produces the correct measure of income when the goal is to avoid double taxing investment. Double taxation occurs under a depreciation regime because deductions are allowed only over a period of years -- and, as a result, the present value of the deductions is always less than the actual expense incurred. Thus, because only a partial deduction is allowed, the equipment is partially double taxed, with the severity of the penalty being proportionately greater the longer the so-called "class life" arbitrarily assigned to the item of capital equipment. As the Treasury Department recognized in its 1984 tax reform proposal ("Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President, November 1984"), if deductions for capital cost recovery are deferred and devalued, the face amount of deductions should be increased to start with in order to avoid double taxation. It is far simpler to allow first-year expensing.

When Economy Slows Congress Improves Capital Cost Recovery

Typically, when the economy slows, one of the first things almost every administration and Congress has done is to improve capital cost recovery by enacting an investment credit, a more accelerated cost recovery system, and/or allowing for partial or full expensing of the costs of the tools and equipment necessary for economic growth and job creation. It would be counterproductive and wrong for Congress in the current extraordinarily difficult economic circumstances to move in the opposite direction.

Tax Reform Requires Lower Rates and a Movement Toward Expensing

Since the 1960s, tax reform has been about lowering the tax rate and correcting the tax base to assure that there are no incorrect omissions from the tax base and that nothing is included in the tax base twice and double taxed. For a long time, the most obvious example of double taxation was the corporate income tax itself. Because the same dollar of earnings is taxed both to the corporation and its shareholders, tax reformers sought to integrate the two taxes. The effort partially succeeded in many foreign countries, but not here. In recent years, the two-layers-of-tax problem has been alleviated somewhat by the soon expiring lower tax on dividends and by increased use of "pass-through" entities. But the more damaging double taxation from the failure of the tax code to allow for first-year expensing continues. The problem should be fixed, not made worse.

It may be appropriate to "capitalize and depreciate" capital equipment costs for the purpose of financial accounting, but when done for the entirely different purpose of imposing a tax, the result is to discriminate against capital equipment, which is the most critical component of economic growth and job creation.

Since the 1970s (the renowned *Blueprints for Tax Reform*, for example) all the way up through Congressman Paul Ryan's current-day Roadmap, tax reform proposals have provided for the combination of lower rates and a movement toward expensing.

Here are a few examples: The National Commission on Economic Growth and Tax Reform in 1996 ("The Kemp Commission"); The President's Advisory Panel on Federal Tax Reform in 2005 (the "Breaux-Mack Commission"); and The USA Tax -- the ground-breaking, bipartisan proposal by then Senators Sam Nunn and Pete Domenici (USA Tax Act of 1995, as introduced in S. 722 on April 25, 1995) and subsequently fully explained in "USA Tax System -- Description and Explanation of the Unlimited Savings Allowance Income Tax System," *Tax Notes Special Supplement*, Mar. 10, 1995, pp. 1481-1575.

Summation and Conclusion

The intellectual and moral integrity of tax reform lies in its dedication to economic growth -- the real kind that arises from allowing the free market to function properly within a tax code that has low rates and an evenhanded, non-distortive tax code that is as close as possible to full first-year expensing.

It is improbable that the Congress will be able to achieve growth-oriented tax reform in a "revenue neutral" manner by closing loopholes. There simply aren't enough of them to go around -- and certainly neither expensing nor MACRS is a loophole.

The bottom line choice is either to cut spending enough to pay for all or part of the tax cut that is inherent in true tax reform -- or to bite the bullet and enact a net tax cut. Either one will boost economic growth substantially and make all Americans better off.

America is in an emergency situation that requires extraordinary measures. The question of whether and when the tax cut will "pay for itself", in terms of enhanced revenue to the federal government, is not the point. More jobs, economic growth and making more Americans better off is what the exercise of government is all about. The tax cut I am suggesting is one that jumpstarts economic activity in the short term and moves us when fully phased in to a far more efficient and growth-oriented tax code over the long term -- and that's an ideal tax reform.

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August 1, 2012

Re: Hearing on Tax Reform and the U.S. Manufacturing Sector

Dear Chairman Camp and Ranking Member Levin:

We are writing to thank you for holding this important hearing on Tax Reform and the U.S. Manufacturing Sector. In these challenging economic times, Congress should seize on every opportunity to facilitate U.S. manufacturing and to incentivize the purchase of U.S.-made goods. In this spirit, we would like to bring to your attention an initiative which would make U.S. manufactured goods more attractive to buyers overseas who are making finished goods and importing them back into the United States.

Chapter 98 of the U.S. Harmonized Tariff Schedule (USHTS) was created to avoid "double taxation" of U.S. goods since such goods are taxed already when they are produced in the United States. Chapter 98 allows for the value of the U.S. component to be subtracted from the dutiable value of a finished good which incorporates the U.S. component. Duties are still assessed on the foreign made good, but the U.S. component is exempted from the additional taxation. This system has been in place for nearly 50 years. It is WTO compliant. It encourages the use of more U.S. inputs on goods made abroad.

Unfortunately, while this benefit is available to many manufacturing sectors, it is narrowly limited with respect to textiles and apparel. Consequently, U.S. inputs such as cotton, as well as yarns and fabrics (with the limited exception of sewing thread and narrow elastic fabric), are not able to benefit from a Chapter 98 duty reduction. The implications of this are wide-reaching. Were Chapter 98 to be amended, we could expect benefits to flow into many sectors of the economy, and regions of the country, particularly to those not abundantly served by other manufacturing sectors.

Cotton is grown in 17 states in the U.S. including Alabama, Arkansas, Arizona, California, Florida, Georgia, Kansas, Louisiana, Mississippi, Missouri, New Mexico, North Carolina, Oklahoma, South Carolina, Tennessee, Texas and Virginia. U.S. cotton is in high

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demand internationally, acknowledged as the best grade and most environmentally sustainable. Most of the U.S. cotton is exported – only about 3.5 million bales out of a total of 17 million are consumed in the U.S. Further industrialization of cotton in the U.S. – spinning into cotton yarn – could reap significant rewards for these local economies: every additional pound of cotton industrialized into yarn contributes up to 40 cents in additional economic activity. If cotton yarns are included in Chapter 98 programs, we anticipate an additional yarn production consuming an additional 1.5 billion pounds of cotton, or approximately $6 billion per year in wages, power and insurance. One note about insurance, including domestic yarn producers in the Chapter 98 benefit will also lessen risk for cotton growers (and thereby insurance rates) who sell domestically; cotton growers face a higher risk of default when they sell to overseas yarn spinners.

In sum, the expansion of Chapter 98 to include all U.S.-made inputs would bring the following benefits to the U.S. economy and the manufacturing sector in particular:

- Encourage increased U.S. cotton production
- Encourage increased U.S. industrialization of cotton
- Encourage investment in new U.S. cotton yarn spinning plants
- Encourage use of U.S. origin cotton in making fabrics
- Encourage use of U.S. origin yarn and fabrics in making apparel overseas.
- Increase two-way trade through U.S. ports
- Reduce reliance of cotton exporter on GSM and other government programs (reducing the burden on taxpayers).

As mentioned above, the current system creates essentially a "double tax" on the U.S. producers of inputs that do not quality for Chapter 98 duty reductions.

We believe there is an existing, elegant, usable provision that Congress can amend that will provide immediate benefits to U.S. companies that does not entail an overhaul of the tax code. We urge you to consider adopting this proposal – to reform Chapter 98 of the HTSUS to stop the "double taxation" of U.S. components (yarns and fabrics) contained in goods finished abroad.

Sincerely,

Jerry Cook
Vice President
Government and Trade Relations

HbI

LIFO Coalition

Statement for the Record

HOUSE WAYS AND MEANS COMMITTEE

Hearing on Tax Reform and the U.S. Manufacturing Sector

July 19, 2012

Submitted July 18, 2012 by:

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The LIFO Coalition (the Coalition), which represents trade associations and businesses of every size and industry sector that employs the LIFO method, was organized in April 2006, when LIFO repeal was first proposed in the Senate as a revenue offset to fund unrelated policies. Since then, the Coalition has grown to include more than 120 members including trade associations representing a wide swath of American industry – including manufacturing, wholesale distribution and retailing – and companies of all sizes. The Coalition's mission is to preserve the option of companies to value their inventories pursuant to the LIFO method for federal income tax purposes. A list of the Coalition members is attached to this document, and can be found at http://www.savelifo.org/pdf/LIFOMemberList.pdf

The LIFO Coalition respectfully submits this Statement for the Record to the House Ways and Means Committee in connection with the hearing on "Tax Reform and the US Manufacturing Sector." The LIFO Coalition membership is not limited to the manufacturing sector, but the issue of LIFO repeal has been considered in a number of recent discussions of broad-based tax reform. The tax reform debate is therefore critically important to all of the industries represented by the Coalition, and we very much appreciate the opportunity to provide our views to your committee.

OVERVIEW OF LIFO

LIFO is an accounting method used by businesses with inventory to clearly determine both "book" income and tax liability and has been an accepted and established accounting method in the United States for 70 years. LIFO and FIFO (first-in, first-out) in fact achieve the same purpose: most closely matching cost of goods sold with cost of purchasing replacement inventory. LIFO is used extensively by both publicly-traded and privately-held companies, manufacturers, extractive industries, wholesaler-distributors, retailers, newspapers, automobile and equipment dealers, and a wide range of other businesses. According to two separate recent studies, one by Georgia Institute of Technology and the other by the American Institute of Certified Public Accountants, LIFO is used by between 36% and 40% of businesses in every industry sector that maintains inventories. It is widely used by small businesses and is particularly important to businesses which have thin capitalization, small profit margins, and/or particular sensitivity to rising materials costs. Many of these companies have been using LIFO for decades, creating many years of LIFO reserves.

The LIFO Coalition does not believe that repeal of the LIFO method should be a part of any tax reform proposal for two primary reasons: ***the LIFO method is not a tax expenditure, and repeal would be an unprecedented retroactive tax increase.*** The Coalition has previously prepared detailed analyses of these issues, both of which are attached as part of this submission, along with the Coalition's response to a letter from Jeffrey Zeints, Acting Director of OMB, to 22 members of the House of Representatives defending the Administration's call for repeal of the LIFO method.

Repeal of LIFO would have a devastating effect on many of the companies that use it, particularly small, privately-held companies. This point was made emphatically by the Small Business Administration's Office of Advocacy in their September 29, 2009 letter to the Tax Reform Subcommittee of the Presidential Economic Recovery Advisory Board (PERAB). In their letter, they wrote:

> The longer that the business uses LIFO, the larger its reserves will be relative to its inventory. If LIFO were no longer permitted, these reserves would be taxed at rates up to 35 percent, even though the reserves reflect nothing more than the impact of economic inflation on the value of the business' inventory over ten years. ***Ultimately, eliminating the ability to use LIFO would result in tax increases for small business that could ultimately force many small businesses to close.*** (Emphasis added.)

Ironically, proponents of repeal often base their call for repeal on the completely erroneous belief that the companies that use LIFO are large, publicly-traded corporations, primarily gas and oil companies. In fact, in testimony in February before the House Budget Committee, in response to a question from Mr. Yarmuth, OMB Deputy Director for Management Jeffrey Zients made that incorrect claim when he said: "On the LIFO, that disproportionately benefits oil and gas producers who have record profits."

LIFO is not a tax expenditure, is not used exclusively or even primarily by "big oil" or other large corporations but by hundreds of thousands of smaller companies, and its repeal would be a devastating retroactive tax increase that would force many small businesses into insolvency. This is surely not what tax reform is intended to accomplish.

THE COALITION'S PRINCIPAL ARGUMENTS

LIFO repeal would be an unprecedented retroactive tax increase:

The LIFO repeal proposal in the President's FY 2013 budget is estimated to generate about $74 billion. It is important to note, however, that most of the revenue generated by this proposal would come not from prospective repeal of the LIFO method but rather from the proposal's retroactive effect. LIFO users would be required to recalculate their income for all the years in which they used LIFO and "recapture" into taxable income their entire LIFO reserve – the total benefit that they received from the use of the LIFO method over the taxpayer's entire lifetime – often many decades. (For a detailed explanation of the LIFO reserve, please see attached LIFO Coalition papers on retroactivity and tax reform.)

Because the LIFO method has been authorized for more than 70 years, many companies have accumulated extraordinarily large reserves over time. In many cases these reserves are greater than the net worth of the company. The tax liability associated with taking those reserves into income, even over the 10-year period provided by the Administration's LIFO repeal proposal, would severely harm large numbers of businesses and would render many of them insolvent.

The LIFO Coalition is not aware of any other serious revenue raising proposal that has this type of retroactive effect. For example, no proposal for the elimination of accelerated depreciation or the research credit or the mortgage interest deduction includes a requirement that taxpayers pay back the taxes that they saved from the prior use of these methods. No proposal to increase tax rates on dividends and/or capital gains ever suggests that taxpayers pay back the benefits of reduced rates on those types of income for past years.

The income tax liability associated with recapturing the LIFO reserve into taxable income would severely harm most companies and potentially bankrupt many of them. It should be noted that the savings represented by a company's LIFO reserve is not sitting in a liquid investment awaiting the repayment; instead, the savings are reinvested annually in the company's inventory. In this sense, a company's LIFO reserve is different from a depreciation reserve that reflects tax savings which companies are expected to set aside in order to be available to replace plant and equipment that becomes obsolete. The tax saving from a company's LIFO reserve has already been spent because the saving is continually reinvested in replacement inventory.

Recapture of a company's LIFO reserve into taxable income ordinarily occurs only when a company experiences a permanent decline in the level of its inventories. In such circumstances, cash is freed up from the sale of inventory that is not replenished, so that repayment of the prior tax saving from the use of the LIFO inventory method at such time is both logical and appropriate.

In contrast, if a company must repay the tax saving from the prior use of the LIFO inventory method at a time when the company's inventory is not declining in real quantity terms, as would occur if LIFO were repealed retroactively as proposed, cash will not be readily available from the sale of inventory to pay the increased tax burden caused by the recapture of LIFO reserves. Even with a 10-year amortization period for the payment of the retroactive tax burden, a company would be faced with the choice of either shrinking its business or financing its inventory through additional borrowings, assuming that credit is available, or it would go out of business.

It should further be emphasized that if Congress properly rejects the imposition of an unprecedented retroactive tax increase for the reasons noted above, consideration of LIFO repeal in the context of comprehensive tax reform makes little sense – the amount of revenue generated in exchange for reduced rates would be a small percentage of the amounts that have typically been associated with LIFO repeal proposals. Any such amount would not come close to justifying the disruption and other adverse economic and policy consequences that would inevitably result from prospective repeal. For these reasons, therefore, the Congress should reject any tax reform proposal that includes either total (i.e., prospective and retroactive) repeal or prospective-only repeal of the LIFO method.

LIFO is an accepted inventory valuation method, not a tax expenditure:

It is the position of The LIFO Coalition that the LIFO inventory method is not a tax expenditure. It differs significantly from the other provisions now classified as tax expenditures in the Joint Committee on Taxation (JCT) staff's annual list of tax expenditures, should not be classified as a tax expenditure, and should not be eliminated from the Internal Revenue Code in exchange for a reduction in income tax rates as part a tax reform program.

According to a 2010 OMB publication, "A tax expenditure is an exception to baseline provisions of the tax structure that usually results in a reduction in the amount of tax owed. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, deciding whether provisions are exceptions, therefore, is a matter of judgment." OMB, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2010,* at 298 (2010).

The LIFO inventory method has been part of the Internal Revenue Code since 1939, but for more than 33 years following the enactment of the 1974 Budget Act, LIFO was not classified as a tax expenditure by JCT staff. It was not until a 2008 JCT reexamination of the criteria for defining tax expenditures that JCT staff began classifying the LIFO inventory method as a tax expenditure. The JCT reexamination was not prompted by any change in the 1974 Budget Act; the JCT staff simply invented a new class of tax expenditures labeled "Tax-Induced Structural Distortions" and included the LIFO inventory method in this new class of tax expenditures.

Tax-Induced Structural Distortions are structural elements of the Internal Revenue Code (not deviations from any clearly identifiable general tax rule and thus not Tax Subsidies) that materially affect economic decisions in a manner that imposes substantial economic efficiency costs.

The foregoing definition of a new category of tax expenditure bears no relationship to the definition of a tax expenditure contained in the 1974 Budget Act. The JCT staff makes no effort to reconcile its definition of tax expenditures with the 1974 Budget Act definition.

The Office of Management and Budget ("OMB") publishes its own list of tax expenditures, and has not classified the LIFO inventory method as a tax expenditure either prior to 2008 or subsequent thereto. See Office of Management and Budget, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2013.*

This inconsistency in classification between two branches of government is particularly significant considering that the OMB under the Obama Administration has proposed that Congress repeal the LIFO inventory method. Thus, even though the Obama Administration favors the repeal of the LIFO method, the Obama Administration does not classify the LIFO inventory method as a tax expenditure.

In fact, under any rational classification system, the LIFO method should not be classified as a tax expenditure. If the criteria for classifying provisions in the federal income tax law as tax expenditures are developed in an objective and logical way, the LIFO inventory method would surely be excluded from classification as a tax expenditure. Under any type of rational income tax system, a reasonable method for distinguishing between merchandise that is sold and merchandise that remains in ending inventory would be absolutely indispensible. Moreover, a system for assigning costs to merchandise that is sold and to the merchandise that remains in ending inventory would also be essential.

The main reason in support of the LIFO inventory method is that, if a company is to remain a going concern, the company must replenish or replace the inventory that it sells. If prices of merchandise are increasing and a company must pay an income tax based on the *historical* cost of the merchandise that is sold, but must pay for replacement merchandise at its higher *replacement* cost, the capital for such replenishment is eroded by the income tax that the company must pay on the inflationary increase in the cost of its inventory The LIFO method enables companies to finance the replacement of inventory that is sold by using the increased after-tax profit that results from employing the LIFO inventory method.

The LIFO method, as well as any other generally accepted method of inventory accounting, thus should be viewed as a rational response to the need for effective tax treatment of inventories. It should not be viewed as a tax expenditure, a "loophole," or any other aberration from the norm.

Repeal of the method thus has no place in a tax reform regime that is designed essentially to lower rates – and perhaps deficits – by repealing tax expenditures or loopholes. It is therefore distinguishable from the many base-broadening elements of recent tax reform proposals in this regard, as well as in the retroactivity uniquely associated with LIFO repeal and discussed earlier.

OTHER MAJOR CONSIDERATIONS

Repeal of the LIFO method is not an appropriate offset to reduced business tax rates:

The size of a company's LIFO reserve, particularly if the company has used the LIFO inventory method for an extended period of time, is likely to dwarf the future tax savings resulting from the reduction in tax rates contemplated by tax reform. If one multiplies the annual inflation rate over the past several decades on a compounded basis by the amount of a company's inventory each year, it is not difficult to see how a company's cumulative LIFO reserve might exceed the company's entire taxable income for a taxable year, if not the company's entire net worth. No realistic amount of rate reduction will significantly ameliorate the size of that additional tax burden.

Most companies using the LIFO inventory method are pass-through entities:

Given that tbere are approximately 30 million pass-through entities today and fewer than 2 million C corporations and that approximately 36% - 40% of the companies in all industries that maintain inventories use the LIFO method, it is not an exaggeration that hundreds of thousands of companies use the LIFO method. The overwhelming majority of those companies using LIFO are privately-held, and the overwhelming majority of them are not organized as C corporations, but as pass-through entities, and are therefore taxed under the individual rather than the corporate tax code.

Accordingly, the main premise of one type of tax reform that has been discussed, which is to broaden the tax base for corporations while lowering the rate of tax on corporations, would simply be inapplicable to many users of the LIFO inventory method . Repealing that method in exchange for a reduction in corporate tax rates which does not benefit a user of the LIFO inventory method would impose an enormous burden on small businesses not taxed as corporations and would undoubtedly lead to a significant number of business failures.

As noted above, The LIFO Coalition submits that even for corporate taxpayers, tax reform that entails a reduction in corporate tax rates in exchange for the repeal of the LIFO method and other provisions listed as tax expenditures by JCT staff, will not make corporations whole, given the size of the typical LIFO reserve relative to a company's net worth. For non-corporate businesses, repeal of the LIFO inventory method in exchange for rate reductions that benefit only corporate entities would be an unmitigated disaster in financial terms. It's hard to conceive of another tax provision the repeal of which would destroy more businesses and eliminate more jobs than repeal of the LIFO inventory method so constructed.

International financial reporting standards and U.S. competitiveness considerations:

Both of these issues are covered in depth in the attached coalition document, *Reasons Why The Lifo Method Should Not Be Repealed In The Context Of Business Tax Reform*, but both warrant a brief mention in this statement.

First, for the last several years the Securities and Exchange Commission (SEC) has been considering the adoption in the U.S. of the International Financial Reporting Standards (IFRS), which do not permit the use of LIFO. Companies may only use LIFO for federal income tax purposes if they use LIFO for financial reporting purposes (the "LIFO conformity rule"). Accordingly, if the use of IFRS were to be required for SEC registrants, those companies may be barred from continuing to use the LIFO inventory method for federal income tax purposes. Thus, the argument was made tbat the LIFO method may well be eliminated as a practical matter in the near future and Congress should take action before this happens in order to take credit for the revenue gain that would result from the repeal of the LIFO inventory method.

However, a move by the SEC to adopt IFRS is not imminent, as was made clear in the July 13, 2012 Staff Report on the subject released by the SEC. Further, it is equally clear from the Report that the Commission is unlikely to fully adopt IFRS even if they move in that direction; rather, they are more likely to incorporate IFRS into U.S. GAAP with FASB retaining an active role in the standard setting process. Under such an endorsement process, local deviations from IFRS, such as the use of LIFO, could be accommodated.

The Staff Report specifically notes that LIFO usage is one of several "fundamental differences" between IFRS and U.S. GAAP, concluding that "*In some cases, the resolution of these differences will be individually challenging (e.g., removal of, or any change to, LIFO), and any attempt by the SEC or others to resolve these differences in a time period even as long as five to seven years may prove to be difficult.*" See *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers Final Staff Report* at 14.

Second, repeal of LIFO, especially in the context of a tax reform initiative to increase the competitiveness of U.S. Corporations, simply makes no sense. Since only U.S. companies use LIFO, it is one of the very few provisions of U.S. tax law that gives companies that use it a competitive advantage against their foreign competitors. This is of great significance now with the U.S. corporate tax rate the highest among industrialized economies; and even if broad-based tax reform is enacted in the U.S. in the near term, it is highly unlikely that our business tax rate will be reduced to a rate lower than that of most of our competitors.

In light of the fact that the LIFO inventory method: (i) allows U.S.-based companies to better compete against foreign-based companies that are generally subject to lower effective tax rates, and (ii) is consistent with the United States' international trade obligations, it is essential that the LIFO inventory method be retained in the tax code, regardless of any tax reform effort.

CONCLUSION

LIFO is a 70-year-old, long-accepted inventory accounting method which, just like first-in, first-out (FIFO), allows a company to most closely match cost of goods sold with cost of purchasing replacement inventory to allow the company to stay in business. LIFO is neither a tax expenditure nor a tax preference under any rational definition of those terms. Repeal of the LIFO method would be an unprecedented retroactive tax increase that would cause economic harm, cost jobs, and put a significant number of companies out of business. The members of the LIFO Coalition strongly urge the members of the Ways and Means Committee not to consider repeal of the LIFO method in tax reform legislation.

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Alabama Grocers Association
American Apparel & Footwear Association
American Chemistry Council
American Forest & Paper Association
American Fuel and Petrochemical Manufacturers
American Gas Association
American International Automobile Dealers Association
American Petroleum Institute
American Road & Transportation Builders Association
American Supply Association
American Veterinary Distributors Association
American Watch Association
American Wholesale Marketers Association
Americans for Tax Reform
AMT-The Association for Manufacturing Technology
Associated Equipment Distributors
Association for High Technology Distribution
Association for Hose & Accessories Distribution
Association of Equipment Manufacturers
Automobile Dealers Association of Alabama
Automotive Aftermarket Industry Association
Brown Forman Corporation
Business Roundtable
Business Solutions Association
California Independent Grocers Association
Caterpillar Inc
Ceramic Tile Distributors Association
Connecticut Food Association
Copper & Brass Servicenter Association
Deep South Equipment Dealers Association
Deere & Company
East Central Ohio Food Dealers Association
Equipment Marketing & Distribution Association
Far West Equipment Dealers Association
Farm Equipment Manufacturers Association
Financial Executives International
Food Industry Alliance of New York State
Food Marketing Institute
Forging Industry Association
Gases and Welding Distributors Association
Greater Boston Chamber of Commerce
Healthcare Distribution Management Association
Heating, Airconditioning & Refrigeration Distributors International
Illinois Food Retailers Association
Independent Lubricant Manufacturers Association
Industrial Fasteners Institute
Industrial Supply Association
International Foodservice Distributors Association
International Franchise Association
International Sanitary Supply Association
International Sealing Distribution Association
International Wood Products Association
Iowa Grocers Industry Association
Iowa Nebraska Equipment Dealers Association
Jewelers of America
Kansas Food Dealers Association
Kentucky Association of Convenience Stores
Kentucky Grocers Association
Louisiana Retailers Association
Manitowoc Company Inc (The)
Maryland Retailers Association
MDU Resources Group
Metals Service Center Institute
Mid-America Equipment Retailers Association
Midwest Equipment Dealers Association
Minnesota Grocers Association
Minnesota-South Dakota Equipment Dealers Association

Missouri Grocers Association
Missouri Retailers Association
Montana Equipment Dealers Association
Moss Adams LLP
NAMM-The International Music Products Association
National Association of Chemical Distributors
National Association of Convenience Stores
National Association of Electrical Distributors
National Association of Manufacturers
National Association of Shell Marketers
National Association of Sign Supply Distributors
National Association of Sporting Goods Wholesalers
National Association of Wholesaler-Distributors
National Auto Dealers Association
National Beer Wholesalers Association
National Electrical Manufacturers Association
National Federation of Independent Business
National Grocers Association
National Lumber and Building Material Dealers Association
National Paper Trade Alliance
National Roofing Contractors Association
National RV Dealers Association
Nebraska Grocery Industry Association
New Hampshire Grocers Association
New Jersey Food Council
North American Equipment Dealers Association
North American Horticultural Supply Association
North American Wholesale Lumber Association
Ohio Grocers Association
Ohio-Michigan Equipment Dealers Association
Paperboard Packaging Council
Pet Industry Distributors Association
Petroleum Equipment Institute
Power Transmission Distributors Association
Printing Industries of America
Professional Beauty Association
Retail Grocers Association of Greater Kansas City
Retail Industry Leaders Association
Safety Equipment Distributors Association
SBE Council
Security Hardware Distributors Association
Society of Independent Gasoline Marketers of America
SouthEastern Equipment Dealers Association
Southern Equipment Dealers Association
SouthWestern Association
Souvenir Wholesale Distributors Association
SPI: The Plastics Industry Trade Association
State Chamber of Oklahoma
Textile Care Allied Trades Association
Tire Industry Association
U.S. Chamber of Commerce
Washington Food Industry Association
Wholesale Florist & Florist Supplier Association
Wine & Spirits Wholesalers of America
Wine Institute
Wisconsin Grocers Association, Inc.
Wood Machinery Manufacturers of America

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March 2011
(updated July 2012)

THE ADMINISTRATION'S LIFO REPEAL PROPOSAL: HISTORICALLY UNPRECEDENTED RETROACTIVITY

A Brief Background on LIFO.

LIFO is an accounting method used by businesses which maintain inventory to clearly determine both "book" income and tax liability and has been an accepted and established accounting method in the United States for 70 years. LIFO and FIFO (first-in, first-out) in fact achieve the same purpose: most closely matching cost of goods sold with cost of purchasing replacement inventory. LIFO is used extensively by both publicly-traded and privately-held companies, manufacturers, extractive industries, wholesaler-distributors, retailers, newspapers, automobile and equipment dealers, and a wide range of other businesses. According to two separate recent studies, one by Georgia Institute of Technology and the other by the American Institute of Certified Public Accountants, LIFO is used by between 36% and 40% of businesses in every industry sector that maintains inventories. It is widely used by small businesses and is particularly important to businesses which have thin capitalization, small profit margins, and/or particular sensitivity to rising materials costs. Many of these companies have been on LIFO for decades, creating many years of LIFO reserves.

The Repeal Proposals.

The Obama Administration has continued to call for LIFO repeal in its annual Budget submissions to Congress, including the Fiscal Year 2013 Budget. The Administration's proposal would not, however, simply prohibit the use of the method prospectively. Rather, it would require each LIFO taxpayer to take into income over a 10-year period the full amount of the taxpayer's LIFO "reserve," which, as will be discussed more fully below, is equivalent to the amount of all deductions of the taxpayer attributable to the LIFO method ever since that method was first adopted by the taxpayer. In effect, therefore, it would retroactively repeal all of those deductions – in some cases deductions taken by the taxpayer as many as 50, 60 or 70 years ago. The extent of this retroactive reach by the government appears to be unprecedented in the history of the Internal Revenue Code.

The FY 2013 proposal has been scored by the Joint Committee on Taxation as generating approximately $74 billion in revenue for the federal treasury over 10 years. What is often not understood, however, is that by far the most significant portion of that revenue would come from the retroactive feature of the proposal just described. The adoption of that feature would be analogous to a repeal of the tax code's bonus and other accelerated depreciation provisions not only for future acquisitions of depreciable property, but also for all previous acquisitions for which tax savings had been enjoyed by the taxpayer under the provisions – i.e., the taxpayer would be required to pay back all of those tax savings retroactively. It is hard to imagine the Congress adopting an accelerated depreciation repeal so configured.

The purpose of the discussion that follows is to attempt to describe the mechanism by which this retroactivity would come about under the LIFO proposal and how that retroactivity would result in excessively harsh – it is fair to say punitive – treatment of taxpayers during already challenging times.

The LIFO "reserve" – What is it?

The retroactive repeal of decades-old deductions referred to above would result from the proposal's requirement that a LIFO taxpayer's LIFO "reserve" must be "recaptured" under the terms of the proposal. An understanding of this result may be facilitated by an explanation of the concept of a LIFO "reserve." To begin, the value of the LIFO method to a tax paying company is that, in periods of rising prices such as those typically experienced since the LIFO method was included in the tax code more than 70 years ago, the method allows the company to assume that the inventory sold during any given year is the company's higher-priced inventory – the "last in" – rather than the company's lower-priced inventory – the "first in" – which the company would be required to assume had been sold during the year if the company were on the alternative FIFO method. The company therefore is typically permitted to take a higher deduction under LIFO during a given year for the cost of the goods sold by the company in that year than would be permissible under FIFO.[1] The "reserve" the company is required to establish – which is not an actual accumulation of company funds, but rather a figure the company is simply required to compute and record – represents the difference between these two deduction amounts. The company is required to add each year to the reserve the difference between the amount of its cost-of-goods-sold deduction under LIFO and the amount of the deduction that would have been allowed to the company under FIFO. At any given time, therefore, the company's LIFO reserve is the cumulative amount over the years of these "incremental deductions" permissible under LIFO but not under FIFO. [2]

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[1] A taxpayer's cost of goods sold as a technical matter is not actually a deduction from gross income but is rather an element of gross income that reduces the gross income amount before adjustments and deductions are applied to that amount. Treas. Reg. § 1.61-3. Since that cost operates in a manner similar to a deduction, however, and is often referred to in common parlance as a deduction, this paper will refer to it as such.

[2] It is worth repeating that there ***neither is nor ever was*** any cash in a company's LIFO reserve. The tax savings the company received were invested back into the company to purchase replacement inventory, thus contributing to economic growth and job creation. With no actual cash in the reserve, repeal of LIFO

<u>"Recapture" of the reserve – Why it amounts to unprecedented retroactivity.</u>

A significant feature of the reserve requirement is that it provides a mechanism for the "recapture" – or the taking into income – by the taxpayer of the amount of the reserve in certain defined circumstances. When the reserve is taken into income, this has the effect of undoing, or retroactively repealing, the deductions that were responsible for the build-up of the reserve. The deductions that are repealed are, as noted, the amount by which the deductions allowed the taxpayer under LIFO exceed those that would have been allowed under FIFO. Recapturing the reserve effectively puts the taxpayer in the same position as if the taxpayer had been on FIFO all along and had never had the tax benefits of LIFO accounting.

The tax code currently provides that a taxpayer's LIFO reserve will be totally recaptured only under certain conditions. Principal among these is when the company undergoes a complete liquidation of its assets, including its inventories. LIFO taxpayers have long been aware that the very significant consequences of recapture would be triggered by any such action by the company. Taxpayers have *not* operated on the assumption, however, that such consequences would be triggered by an act of law, and that all of the deductions associated with their use of the LIFO method over the life of the company would be retroactively repealed by such legislation. Yet the Administration's proposal to recapture existing LIFO reserves over a 10-year time frame would produce just such a repeal. The taxpayers would be treated as if they had been on FIFO all along and would be deprived retroactively of all the tax benefits they had received – sometimes over the course of many decades – from their use of LIFO accounting.

Moreover, they would be required to pay back those tax benefits at a time when they have generated no cash to enable them to do so. While a company's liquidation of its inventories and other assets under current law typically can be expected to produce substantial amounts of cash with which to pay the resulting LIFO recapture tax bill, the proposed repeal will generate no cash whatever. Affected taxpayers, accordingly, will be forced to borrow very large sums of money, if indeed they can obtain such financing at all. The impact of such a significant and retroactive tax increase on economic recovery and job creation cannot be overstated.

<u>Retroactivity would be extremely unfair and extremely harsh to affected companies.</u>

The proposal is unfair because it departs so dramatically from the taxpayer expectations just described. As noted, existing law has long provided that reserves will be recaptured only under certain conditions, and it is now proposed to require recapture even in the absence of those conditions. The harshness of the proposal results from the magnitude of the reserves involved.

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would require affected companies to find or borrow the funds to pay the recapture tax. With 36- 40 % of U.S companies using LIFO, the resulting huge demand for credit to pay recapture taxes would in many circumstances have a damaging impact on credit availability and interest rates. A seriously adverse macroeconomic impact could also be expected, since available credit resources would be tapped not to help create jobs and grow the economy, but to transfer funds in payment of retroactive taxes.

Because the LIFO method has been authorized for more than 70 years, many companies have accumulated extraordinarily large reserves over time. In many cases these reserves are greater than the net worth of the company. The tax liability associated with taking those reserves into income, even over a 10-year period, would severely harm large numbers of businesses and would render many of them insolvent. Enacting the legislation in the midst of the nation's current adverse economic circumstances no doubt would add to the disruption by creating a serious chilling effect on competitiveness and job creation at a fragile time.[3] While the Administration's proposal would not trigger recapture until 2014, the prospect of these very large tax liabilities for affected companies inevitably would reduce available credit and investment capital for these companies immediately upon enactment of the proposal.

Conclusion.

For the reasons discussed, the Administration's and other similarly configured proposals to repeal LIFO should be strongly opposed. This discussion has focused solely on the problems associated with the retroactive effect of the Administration's proposal, which is perhaps that proposal's most undesirable feature. The proposal should be rejected, however, for other reasons as well. LIFO is an accepted and longstanding accounting method that remains as conceptually sound as it was when it was first approved by the Congress. There would be no justification for repealing the method, especially in the current economic and employment circumstances, even if the repeal were prospective only. The fact that the proposed repeal involves a degree of retroactivity not seen elsewhere in the tax code, however, provides sufficient reason by itself to reject the proposal.

[3] For thinly capitalized closely-held companies, the requirement to recapture a company's LIFO reserve would probably exhaust all working capital and, notwithstanding a 10-year spread of the tax on recapture, would prevent bank borrowing and might force insolvency and shut down of the company, thereby eliminating jobs.

THE LIFO COALITION

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REASONS WHY THE LIFO METHOD SHOULD NOT BE REPEALED IN THE CONTEXT OF BUSINESS TAX REFORM

I. Background

The LIFO Coalition has previously provided its views on why the LIFO inventory method, presently contained in section 472 of the Internal Revenue Code, is a proper method of accounting and should not be repealed as part of any general deficit reduction effort. These views were provided in connection with proposals by members of the Senate Finance Committee to repeal the LIFO inventory method in 2006 and in response to proposals by the Obama Administration to repeal the LIFO inventory method as part of the Administration's budget proposals for Fiscal Years 2010-2013. The LIFO Coalition also provided its views on the propriety of the LIFO inventory method in the context of deliberations concerning possible tax reform by the President's Economic Recovery Advisory Board and the President's Deficit Reduction Commission.

Tax reform is increasingly part of the tax debate today: it was actively discussed during the deliberations of the "Super Committee" in 2011, a number of proposals are being drafted by Members of Congress, Congressional tax-writing committees are conducting hearings on various aspects of reform, and consideration of broad-based reform is certain to be a major issue facing the 113th Congress next year. In this context, the theme that has been discussed by the Obama Administration and some members of Congress is that business tax expenditures should be curtailed in exchange for a reduction in the business income tax rates in an effort to broaden the tax base and promote tax reform in a revenue neutral environment.

It is important to note that while the President and some in Congress were originally discussing reform only of corporate taxes, Subchapter S corporations and other pass-through business entities pay taxes at individual and not corporate rates. Reforming the corporate tax code while leaving individual rates unchanged would have dire consequences for the approximately 30 million Subchapter S corporations, as will be addressed later in this document.

Since the LIFO inventory method is characterized as a tax expenditure in the list of tax expenditures prepared annually by the staff of the Joint Committee on Taxation ("JCT staff"), the propriety of retaining the LIFO inventory method in the Internal Revenue Code could well be considered in the context of comprehensive tax reform. However, in contrast to prior consideration of this subject, in the present circumstances, the use of the LIFO inventory method is not being singled out for possible elimination, but instead, the possible repeal of the LIFO inventory method is being considered together with other tax provisions that are included in the JCT staff list of tax expenditures relating to businesses.

It is the position of the LIFO Coalition that the LIFO inventory method should not be classified as a tax expenditure and should not be eliminated from the Internal Revenue Code either as part of any deficit reduction effort or in exchange for a reduction in income tax rates as part of a revenue neutral tax reform program. While the LIFO Coalition takes no position on the desirability of tax reform generally, the Coalition submits that the elimination of the use of the LIFO inventory method for federal income tax purposes, whether or not in the context of a tax reform effort that entails broadening the business tax base in exchange for a reduction in tax rates, would be extremely -- in many cases irreversibly -- damaging to users of the LIFO inventory method and cause lasting damage to the economy and job creation in the United States.

The reasons for the LIFO Coalition's position are set forth below.

II. Summary of Reasons for Opposition to Repeal of the LIFO Inventory Method in the Context of Corporate Tax Reform

1. If tax expenditures are going to be the main category of provisions that will be considered as offsets for reductions in business tax rates in the context of tax reform, the system of classifying tax provisions as tax expenditures needs to be reviewed and drastically revised. The present criteria for including particular tax provisions in the annual list of tax expenditures reported by JCT staff are neither logical nor internally consistent.

2. Whatever criteria are ultimately adopted for classifying tax provisions in the Internal Revenue Code as tax expenditures, the LIFO inventory method should not be classified as a tax expenditure. The LIFO inventory method is not a tax expenditure; it differs significantly from the other provisions now classified as tax expenditures in the JCT staff's annual list of tax expenditures.

3. The overwhelming majority of the revenue that would result from the repeal of the LIFO inventory method comes from the recovery of income taxes that were deferred in taxable years prior to the effective date of any repeal of the LIFO inventory method. Accordingly, in contrast to other tax expenditures that might be eliminated with prospective effect, the repeal of the LIFO inventory method would single out users of the LIFO inventory method for a unique *retroactive* increase in taxes.

4. Future tax rate reductions would in no way compensate companies for the damaging effects to their capital base resulting from the recapture of LIFO reserves into taxable income as a result of repeal of the LIFO inventory method. In addition, the damage to companies' capital base would not be eliminated by the allowance of an amortization period to recapture deferred taxes resulting from the repeal of the LIFO inventory method.

5. A majority of the businesses using the LIFO inventory method are smaller companies organized in the form of pass-through entities, such as partnerships or S corporations. The real owners of these entities are taxed at individual tax rates. Accordingly, any reduction in corporate income tax rates that might accompany a repeal of the LIFO inventory method and other tax expenditures employed by both non-corporate and corporate taxpayers would not provide any offsetting relief for pass-through entities. Should this option be pursued, the consequences for the small business community would be more devastating than any other alternative yet proposed.

6. Once companies' LIFO reserves are fully recovered through amortization into taxable income by reason of the repeal of the LIFO inventory method, the ongoing annual revenue savings from the elimination of the LIFO inventory method would not be significant. Thus, in contrast to other provisions listed as tax expenditures by JCT staff, the repeal of the LIFO inventory method represents primarily a "one-shot" boost to federal revenues and would not pay for business tax rate reductions in taxable years outside the budget horizon.

7. Some commentators have mentioned that the LIFO inventory method may be repealed in the near future without Congressional action because of the forthcoming adoption of International Financial Reporting Standards ("IFRS") in the U.S. IFRS does not recognize the LIFO inventory method and taxpayers using the LIFO inventory method for federal income tax purposes must use that same method for financial reporting purposes, which would not be permissible if IFRS were adopted in the U.S. However, the SEC Staff Report on IFRS released in July, 2012 makes it clear that convergence will not occur in the near term, if at all, as the timetable for an SEC decision has been indefinitely postponed. The Staff Report also makes clear that if convergence were to occur, it would most likely occur in a way that does not result in the elimination of the LIFO method for financial reporting purposes, thus avoiding a conflict between IFRS and the LIFO conformity requirement in sections 472(c) and (e) of the Internal Revenue Code.

8. Repeal of the LIFO inventory method will harm U.S.-based companies and benefit their foreign competitors. Since, as noted above, U.S. accounting standards ("U.S. GAAP") permit the use of the LIFO inventory method, but international accounting standards ("IFRS") do not permit the use of the LIFO inventory method, at present only U.S.-based companies are able to use the LIFO inventory method. As a result, if the LIFO inventory method is repealed, this action would raise taxes on U.S. companies, but not their foreign competitors. A compelling reason in support of retaining the LIFO inventory method is that it is one of the few tax incentives that enhances the competitiveness of U.S.-based companies in the global marketplace without violating the United States' international trade obligations.

Each of these points is discussed in detail below.

III. Detailed Reasons for Opposing the Repeal of the LIFO Inventory Method

1. The Present System for Classifying Tax Expenditures by JCT is Not Logical, Uniform or Fair

Section 3(3) of the Congressional Budget and Impoundment Control Act of 1974 (the "1974 Budget Act") defines "tax expenditures" as:

> [T]hose revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability ...

Pub. L. No. 93-344, 93d Cong., 2d Sess., § 202(d) (1974).

The legislative history of the 1974 Budget Act further provides:

> The term 'tax expenditures' means those Federal revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from the taxpayer's gross income, or which provide a special credit, a preferential rate of tax, or a deferral of tax liability representing a deviation from the normal tax structure for individuals and corporations.

S. Rep. No. 93-688, 93d Cong., 2d Sess. *reported in* 1974 U.S.C. Congressional & Administrative News 3504, 3532 (1974).

However, nowhere in the statute or legislative history of the 1974 Budget Act is there any description of what constitutes the "normal structure" of a tax law. There is no uniform definition of a "normal" income tax, so that deviations from such norm may be identified as tax expenditures. What is a special deduction, credit or preference may vary from one country's tax laws to the next. Thus, there is no consensus as to what constitutes a tax expenditure.

This conclusion is confirmed by the following acknowledgement from a 2010 publication of the Office of Management and Budget:

> A tax expenditure is an exception to baseline provisions of the tax structure that usually results in a reduction in the amount of tax owed. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, deciding whether provisions are exceptions, therefore, is a matter of judgment.

OMB, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2010,* at 298 (2010).

The LIFO inventory method is a perfect example of the imprecise nature of the concept of tax expenditures. While the LIFO inventory method has been part of the Internal Revenue Code since 1939, for over 33 years following the enactment of the 1974 Budget Act, the LIFO inventory method was not classified as a tax expenditure by JCT staff.

However, in 2008, the JCT staff performed a reexamination of the criteria for defining tax expenditures and JCT staff issued a revision to its criteria. See staff of the Joint Committee on Taxation, *A Reconsideration of Tax Expenditure Analysis* (JCX-37-08) (May 12, 2008). As a result of this reconsideration, JCT staff began classifying the LIFO inventory method as a tax expenditure starting with the 2008 taxable year. Staff of the Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012*, 21 (Oct. 31, 2008).

The JCT staff's reexamination of the concept of tax expenditures in 2008 was not prompted by any change in the 1974 Budget Act. Instead, as part of this reexamination, the JCT staff on its own initiative simply invented a new class of tax expenditures that JCT staff labeled "Tax-Induced Structural Distortions." The JCT staff then included the LIFO inventory method in this new class of tax expenditures. The actions of JCT staff to include the LIFO inventory method in this new class of tax expenditures has had the effect of raising the profile of the LIFO inventory method and making it appear that this long-accepted method of inventory accounting that is permissible for GAAP is suddenly an exception from a "normal" income tax law.

The foregoing invention by JCT staff of a new category of tax expenditures and the inclusion of the LIFO inventory method in such category of tax expenditures is surprising for several reasons. First, the Office of Management and Budget (OMB) publishes its own list of tax expenditures and the estimated revenue effects resulting from the inclusion of such provisions in the income tax laws. However, the OMB has not classified the LIFO inventory method as a tax expenditure either prior to 2008 or subsequent thereto, even though the JCT staff now includes the LIFO inventory method in its list of tax expenditures. See Office of Management and Budget, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2013*. This inconsistency in classification between two branches of government is particularly significant considering that the OMB under the Obama Administration has proposed that Congress repeal the LIFO inventory method. Thus, even though the Obama Administration favors the repeal of the LIFO method, the Obama Administration does not classify the LIFO inventory method as a tax expenditure.

Second, in conducting its reexamination of tax expenditures, JCT staff was mindful of the criticism that would be attached to any effort to redefine tax expenditures in a way that was considered politically motivated. In this regard, JCT staff noted in its initial implementation of new criteria for defining tax expenditures:

> The concept of a normal tax baseline as the underpinning of tax expenditure analysis has evoked serious and continuous criticism, however, since its introduction in the late 1960s. Numerous tax academics and policy experts have rightly observed that the ideal "normal" tax system does not correspond to any generally accepted formal definition of net income. Instead, many observers view tax expenditure analysis, in the form envisioned by Stanley Surrey, as a thinly veiled agenda for a specific form of tax reform. Under this view, the normative tax system is not simply an analytical tool but is also an aspirational goal of the political process.
>
> Tax expenditure analysis cannot serve as an effective and neutral analytical tool if the premise of the analysis (the validity of the "normal" tax base) is not universally accepted. The "normal" tax is admittedly a commonsense extension (and cleansing) of current tax policies, and not a rigorous framework developed from first principles. As a result, the normal tax cannot be defended from criticism as a series of ultimately subjective or pragmatic choices, and its use as a baseline has diminished the utility of tax expenditure analysis.

Staff of the Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012*, 5 (Oct. 31, 2008).

Notwithstanding its own admonitions to the contrary, the JCT staff embarked on what can only be perceived as a politically-motivated endeavor to create a new category of tax expenditures that it labeled "Tax-Induced Structural Distortions." JCT staff defines "Tax-Induced Structural Distortions" as follows:

> Tax-Induced Structural Distortions are structural elements of the Internal Revenue Code (not deviations from any clearly identifiable general tax rule and thus not Tax Subsidies) that materially affect economic decisions in a manner that imposes substantial economic efficiency costs.

Id. at 7.

The foregoing definition of a new category of tax expenditure bears no relationship to the definition of a tax expenditure contained in the 1974 Budget Act. The JCT staff makes no effort to reconcile its definition of tax expenditures with the definition in the 1974 Budget Act. Any doubts as to JCT staff's motivations for adding this new category of tax expenditures are reinforced by JCT staff's decision to include the lower of cost or market inventory method in this new category of tax expenditures at the same time that added the LIFO inventory method to the list of tax expenditures.

The specific definition of "tax expenditures" in the 1974 Budget Act clearly requires that in order to be classified as a "tax expenditure," a tax provision must be reflected in a special provision in the tax statutes. However, the lower of cost or market inventory method has never been prescribed by statute. Thus, the inclusion of the lower of cost or market inventory valuation method in the JCT staff's list of tax expenditures is clearly inconsistent with the express terms of the 1974 Budget Act, which limits tax expenditures to provisions in a tax statute, not in income tax regulations.

The history of the lower of cost or market method is that the tax law in Code section 471, and its predecessors, dating back to 1918, simply contains a general authorization to the Secretary of Treasury to promulgate regulations stipulating which generally accepted inventory methods will be acceptable for federal income tax purposes. In 1918, the Treasury acted on this authorization to issue regulations accepting the use of the lower of cost or market method for federal income tax purposes. Moreover, apart from the fact that the lower of cost or market method is not a creature of statute, such method is part of the foundation of GAAP and has been an accepted method for federal income tax purposes for over 90 years. Such method was not classified as a tax expenditure by the JCT staff for over 33 years following the enactment of the 1974 Budget Act. However, in 2008, the lower of cost or market method suddenly appeared in JCT's annual list of tax expenditures.

JCT staff's analysis of tax expenditures is rife with such inconsistencies. While the lower of cost or market method, which is not even specifically authorized by statute, is classified by JCT staff as a tax expenditure, special *statutory* provisions such as the allowance of a reserve for inventory shrinkage in section 471(b) of the Code, the amortization of goodwill in section 197 of the Code and the amortization of business organizational expenses in section 248 of the Code are not classified as tax expenditures by JCT staff.

Moreover, if Congress had intended the definition of tax expenditures in the 1974 Budget Act to include methods of accounting that are authorized by regulation or other administrative action of the Treasury Department, rather than expressly by statute, then why hasn't JCT staff classified the progressive or rolling average inventory costing method permitted in Rev. Proc. 2008-43, 2008-2 C.B. 186, and the replacement cost method permitted in Rev. Proc. 2002-17, 2002-1 C.B. 676, and Rev. Proc. 2006-14, 2006-1 C.B. 350, as tax expenditures? Why isn't the retail inventory method authorized in Treas. Reg. § 1.471-8 classified as a tax expenditure? Why aren't all of the special inventory costing methods contained in the regulations under section 263A of the Code classified as tax expenditures?

The point of this exercise is not to cast aspersions on any of these other special methods of accounting for inventories, but rather to highlight the fact that a "normal" income tax law may accommodate a wide variation in accounting and inventory methods. What is special, or an exception from the norm, is an extremely vague standard. About the only conclusion one could draw from examining JCT staff's list of tax expenditures is that methods of accounting seem to be included in, or excluded from, the list of tax expenditures depending on the whim of JCT staff, rather than on the basis of a logical and consistent standard. In fact, an objective analysis of JCT staff's list of tax expenditures might lead an observer to conclude that whether a method of accounting is singled out for inclusion in JCT staff's list of tax expenditures depends more on whether the method is in or out of favor with JCT staff, rather than on the nature of the method itself.

In conclusion, if Congress is going to use JCT staff's list of tax expenditures as the starting point in looking for offsets to pay for a reduction in business tax rates, Congress needs to reevaluate the criteria being used by JCT staff to determine what provisions are and are not classified as tax expenditures.

2. Under Any Rational Classification System, the LIFO Method Should Not be Classified as a Tax Expenditure

If the criteria for classifying provisions in the federal income tax law as tax expenditures are developed in an objective and logical way, the LIFO inventory method would surely be excluded from classification as a tax expenditure. Under any type of rational income tax system, a reasonable method for distinguishing between merchandise that is sold and merchandise that remains in ending inventory would be absolutely indispensible. Moreover, a system for assigning costs to merchandise that is sold and to the merchandise that remains in ending inventory would also be essential.

One could argue that the "norm" for an income tax statute ought to be based on the specific identification and actual cost of the merchandise in ending inventory and the specific identification and actual cost of the merchandise that is sold, thus rendering any methods that deviate from such norm as tax expenditures. However, use of the specific identification method to identify merchandise in ending inventory or the tracking of the actual cost of merchandise in ending inventory are not possible in most cases. Most merchandise within a product category is homogenous in nature and tracking the actual cost of such merchandise is not feasible. Accordingly, any rational income tax system must permit the use of cost flow assumptions. Moreover, such cost flow assumptions need to be adaptable to accommodate the software systems commonly in use under modern computer technology.

There are presently in use for federal income tax purposes four different cost flow assumptions apart from the specific identification method: (1) the first-in, first-out method or "FIFO"; (2) the last-in, first-out method or "LIFO"; (3) the average cost method; and (4) the replacement cost method. Each of these methods reflects a reasonable, but significantly different, cost flow assumption. When prices of merchandise are rising, the LIFO method, followed by the replacement cost method, produces the largest cost of goods sold and the lowest amount of taxable income of the four methods. In contrast, when prices of merchandise are declining, the FIFO method, followed by the average cost method, produces the largest cost of goods sold and the lowest amount of taxable income of the four methods. When prices of merchandise are relatively stable, all four methods yield approximately the same result. Nevertheless, while all four cost flow assumptions are now permitted for tax purposes, only the LIFO inventory method is singled out for inclusion in JCT staff's list of tax expenditures. Moreover, for totally inexplicable reasons, the specific identification method for homogeneous merchandise is also listed as a tax expenditure, albeit with minimum revenue loss associated with such method.

In a 2010 study conducted by the Congressional Research Service (CRS) and published by the Senate Budget Committee, CRS offered several reasons for the inclusion of the LIFO inventory method in JCT staff's list of tax expenditures. See S. Rep. No. 111-58, TAX EXPENDITURES Compendium of Background Material on Individual Provisions, prepared by Congressional Research Service, 111[th] Cong., 2d Sess. 517-19 (Dec. 2010). In most respects, these reasons mirror those offered in JCT staff's initial classification of the LIFO inventory method as a tax expenditure in staff of the Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012*, 21 (Oct. 31, 2008).

First, CRS notes that while the specific identification method would be the norm for valuing inventory (while ignoring the fact that this method is listed as a tax expenditure), due to its impracticality in the case of homogeneous merchandise, CRS asserts that the FIFO inventory method should be considered the norm based on the expectation that companies would sell their oldest merchandise first. Second, CRS contends that all of the cost flow assumptions permit taxpayers to reduce their tax burden for the difference between the sales price and cost of the merchandise, but the FIFO inventory method comes closest to valuing inventory at its market value, whereas the LIFO inventory method permits inventory to be valued at a level below its market value. Finally, CRS asserts that the use of the LIFO inventory method facilitates tax planning opportunities that are not available to taxpayers using the FIFO inventory method. As examples, the CRS suggests that firms expecting a high tax liability may be able to purchase additional inventory at year end to increase costs and reduce taxable income, whereas firms expecting losses may reduce taxable income by shrinking inventory.

The reasons offered by the CRS are completely invalid and in some instances demonstrate a complete lack of understanding of how the inventory rules in general and the LIFO inventory method in particular operate. For example, the first reason that CRS offers to support the classification of the LIFO inventory method as a tax expenditure is that the method does not mirror the expected pattern of sales of merchandise by companies. However, in the case of homogeneous merchandise, there is no evidence that companies necessarily sell their oldest merchandise first. Moreover, the CRS' reasoning is internally inconsistent, as the CRS notes in its own study that "[a]llowing specific identification permits firms to select higher cost items and minimize taxable income."

The second reason that CRS offers as support for treating the LIFO inventory method as a tax expenditure is that the FIFO inventory method comes closest to valuing inventory at its fair market value, whereas the use of the LIFO inventory method permits companies to value their inventory at below its fair market value. However, no inventory system values inventory at its market value except for a "mark-to-market" system, such as is required by section 475 of the Code for securities dealers. Moreover, CRS cites nothing to support its unstated premise that valuing inventory at market value is a desirable goal that would be part of any normal income tax system. In fact, the "realization" concept, which is a cornerstone of the U.S. income tax system, is flatly inconsistent with the concept of valuing inventory at its market value. Moreover, one should not confuse offering prices for merchandise with its fair market value. The fact that a company offers its merchandise for sale at a particular price does not insure that a customer will actually buy the merchandise at that selling price or at any other price at which the merchandise is offered for sale. In fact, no one can say what is the fair market value of merchandise in inventory until someone actually buys the merchandise.

The final reason that the CRS offers for treating the LIFO inventory method as a tax expenditure confirms that the CRS does not understand how the LIFO inventory method operates. CRS suggests that companies expecting a high tax liability may purchase inventory at year end to lower their tax liability, whereas companies expecting losses can reduce their taxable income by shrinking inventory.

Taking CRS' first point, under any inventory system, the cost of purchases near year end that are included in ending inventory offset each other and have a neutral effect on taxable income except where the additional purchases are valued at less than their cost. However, under the LIFO inventory method, purchases of merchandise at the end of a taxable year are typically included in an increment in a taxpayer's LIFO inventory, which would be valued at the current-year cost of the purchased merchandise and thus would have no impact on taxable income. Alternatively, if decrement in LIFO inventory would otherwise be expected, taxpayers would not purchase additional inventory to *reduce* taxable income, as CRS claims. Moreover, the tax law is replete with provisions and court decisions that prevent taxpayers from engaging in tax-motivated purchases of LIFO inventory to manipulate their income. Thus, the CRS' concerns in this regard are totally misplaced.

The main reason in support of the LIFO inventory method is that if a company is to remain a going concern, the company must replenish or replace the inventory that it sells. If prices of merchandise are increasing and a company must pay an income tax based on the *historical* cost of the merchandise that is sold, but must pay for replacement merchandise at its higher *replacement* cost, the capital for such replenishment is eroded by the income tax that the company must pay on the inflationary increase in the cost of its inventory. Most merchants would not consider themselves enriched simply because they have the same quantity of inventory as in the previous year, but the inventory is now valued at a higher replacement cost. The LIFO method enables companies to finance the replacement of inventory that is sold by using the increased after-tax profit that results from employing the LIFO inventory method.

The CRS responds to this argument with two criticisms, neither of which is persuasive. First, the CRS argues that the LIFO inventory method defers or excludes *real* gains from income. However, the CRS fails to explain or justify its definition of *real* gains. The CRS illustrates its contention by focusing on the substantial increase in oil prices that occurred during the first half of 2008. In fact, most observers would regard the increase in oil prices that occurred during the first half of 2008 as a temporary aberration, in light of the sharp drop in oil prices that occurred thereafter. The LIFO method is designed to defer taxes on permanent increases in the replacement cost of merchandise that must be reinvested in a business in order for that business to remain a going concern. Moreover, the LIFO inventory method is an annual system that measures the change in the price of merchandise from one year end to the next year end. Temporary fluctuations in prices of merchandise within a year, such as the situation illustrated by CRS, have no real effect on companies' income tax liabilities when the LIFO inventory method is employed.

CRS' second argument against permitting the continued use of the LIFO inventory method is that the LIFO inventory method represents a form of indexation of inventories for inflation, a concept that CRS argues the federal income tax law does not permit for any other type of property. However, the CRS overlooks the role that the allowance of accelerated depreciation and MACRS depreciation periods play in the case of depreciable plant and equipment. While the allowance of accelerated depreciation and shorter MACRS depreciation periods may not represent indexation in form for capital equipment, these methods produce the same overall effect as indexation for capital investment. See Viard, "Why LIFO Repeal is not the Way to Go," TAX NOTES, 574 (Nov. 6, 2006).

Most merchandising companies' two largest investments that are necessary to remain a going concern are investment in plant and equipment and investment in inventory. Thus, it is appropriate to compare the tax treatment of these two investments. As Mr. Viard so eloquently explains in the above-cited article, the LIFO method of valuing inventories and the allowance of accelerated depreciation for plant and equipment may be viewed as equivalent tax treatment in substance, if not in form, of these two major asset classes.

In conclusion, the criticisms leveled at the LIFO inventory method by CRS in its recent study are not valid and should be rejected when considering the subject of tax reform.

3. The Repeal of the LIFO Inventory Method Would Represent a Unique Retroactive Tax Increase on Companies Using the LIFO Method

In marked contrast to the other provisions listed as tax expenditures in JCT staff's annual study, the repeal of the LIFO inventory method would have a retroactive effect on users that would be unique in the annals of tax reform. Since any legislation to eliminate tax expenditures, including the LIFO inventory method, that might be enacted as an offset to lower income tax rates would undoubtedly have a prospective effective date, one might question how this form of legislation could be retroactive in effect insofar as the legislation might apply to the repeal of the LIFO inventory method.

To answer this question requires a brief explanation of how the LIFO inventory method works. Each year that a company employs the LIFO inventory method for federal income tax purposes, the taxpayer starts out by valuing the portion of its ending inventory equal in quantity to the quantity of merchandise in its beginning inventory at the original cost of the merchandise in beginning inventory. To the extent the quantity of merchandise in the ending inventory exceeds the quantity of merchandise in the beginning inventory, that increase or increment in quantity of merchandise is valued at its current-year cost. Over time, the effect of this methodology is to value the ending inventory at the historical cost of the merchandise when additional quantities of merchandise were first added to the company's ending inventory.

In addition to valuing its ending inventory under the LIFO inventory method, as described in the preceding paragraph, a company using the LIFO inventory method must also maintain a parallel record of what its inventory value would be each year if the company had used the FIFO inventory method. The cumulative difference between the value of a company's inventory based on the LIFO inventory method and the FIFO inventory method is referred to as a company's "LIFO reserve." Thus, the LIFO reserve represents the cumulative reduction in a company's ending inventory (and hence taxable income) that resulted from the use of the LIFO inventory method instead of the FIFO inventory method.

However, the term "LIFO reserve" is misleading in the sense that it does not represent actual funds set aside by a company to pay back the tax deferral reflected in the company's LIFO reserve. Instead, the LIFO reserve is merely a memorandum account that tracks the cumulative difference between the value of the company's inventory using the LIFO and FIFO inventory methods.

In the past, all of the legislative proposals to repeal the LIFO inventory method have included as a key feature the requirement that a company repay all of its cumulative prior tax savings from the use of the LIFO inventory method by including the amount of its LIFO reserve in taxable income when the use of the LIFO method is discontinued. Under some tax reform proposals, relief is provided in the form of an amortization of the amount of the recapture of the company's LIFO reserve over a period of years, such as 10 years.

Thus, the effect of the repeal of the LIFO inventory method would not be limited to the future use of the LIFO inventory method, but companies would have to pay back all of the historical tax savings that they enjoyed from the use of the LIFO method over the entire history of the company. As noted above, the LIFO inventory method has been part of the federal income tax law since 1939, so that for some companies, the LIFO reserve was built up over a period of more than 70 years.

There is no other provision listed as a tax expenditure by JCT staff which, if repealed, would entail this type and degree of retroactivity. For example, if the use of accelerated depreciation and shorter MACRS depreciation periods were repealed to offset a reduction in business income tax rates, no one would suggest that taxpayers repay the tax savings that they enjoyed in all prior years by virtue of having claimed depreciation deductions on productive property for federal income tax purposes that exceeded straight line depreciation over the physical useful life of the productive property.

Moreover, it is unlikely that there is any other type of tax provision which could have the potential for this degree of retroactivity. The longest lived type of depreciable property has a MACRS depreciation period of 39.5 years, whereas most property is depreciated over a much shorter life. In theory, a company's LIFO reserve could have been built up over 70 years. In practice, the lion's share of companies adopted the LIFO inventory method in the early 1970s, meaning that for the typical company the LIFO reserve is at least 40 years old.

Based on inflation over this length of time, the typical company's LIFO inventory is valued at less than half of its FIFO value and its LIFO reserve could easily exceed the company's net worth. The income tax liability associated with recapturing this amount of LIFO reserve into taxable income would severely harm most companies and potentially bankrupt many of them. As noted above, the savings represented by a company's LIFO reserve is not sitting in a liquid investment awaiting the repayment; instead, the savings is reinvested annually in the company's inventory. In this sense, a company's LIFO reserve is different from a depreciation reserve that reflects tax savings which companies are expected to set aside in order to be available to replace plant and equipment that becomes obsolete. The tax saving from a company's LIFO reserve has already been spent because the saving is continually reinvested in replacement inventory.

These circumstances might cause an observer to wonder why anyone proposing the repeal of the LIFO inventory method would require the recapture of a company's LIFO reserve. The answer to that question is: "That's where the money is." The overwhelming share of the revenue raised by the repeal of the LIFO inventory method results from the recapture of companies' LIFO reserves. As an offset to reduced business tax rates, it's not worth repealing the LIFO inventory method if such repeal is not accompanied by a recapture of companies' LIFO reserves.

Therein lies the dilemma; the LIFO inventory method is the only tax expenditure listed by JCT staff that needs to be repealed retroactively in order to raise the type of money needed to finance a significant reduction in income tax rates. For that reason, tax reformers will not relinquish retroactivity as part of the proposed repeal of the LIFO inventory method, but for that same reason, tax reform should not include the repeal of the LIFO inventory method.

4. Neither a Reduction in Business Tax Rates, Nor Amortization of the Recapture of LIFO Reserves, Would Eliminate the Damaging Effect of Recapture of a Company's LIFO Reserve

The premise of proponents of the idea of repealing the LIFO inventory method as part of business tax reform is that the additional income triggered by the requirement to recapture a company's LIFO reserve would be offset by the reduction in future income tax rates and the amortization of the recapture of the LIFO reserve over a period of years. Both of these premises do not withstand analysis.

First, with respect to the offset for reduced business tax rates, as noted above, the size of a company's LIFO reserve, particularly if the company has used the LIFO inventory method for an extended period of time, is likely to dwarf the future tax savings resulting from the reduction in tax rates. If one multiplies the annual inflation rate over the past several decades on a compounded basis by the amount of a company's inventory each year, it is not difficult to see how a company's cumulative LIFO reserve might exceed the company's entire taxable income for a taxable year, if not the company's entire net worth. No realistic amount of rate reduction will significantly ameliorate the size of that additional tax burden. Thus, while the impact of the ongoing disallowance of the LIFO method on future years' taxable income might be offset by future tax rate reductions, the tax burden of recapture of a company's entire LIFO reserve on top of the loss in the annual benefit from the LIFO inventory method cannot possibly be offset by future annual tax rate reductions.

Second, the fact that a LIFO repeal proposal permits amortization of the amount of recapture of a company's LIFO reserve will not materially ease the tax burden that accompanies the recapture of a company's LIFO reserve. Apart from the size of the typical company's LIFO reserve, the main reason why amortization would not materially ease a company's tax burden is because of the way that the LIFO inventory method operates. Companies using the LIFO inventory method do not expect to recapture their LIFO reserve, except as a result of transactions that generate cash to pay the resulting recapture tax.

The LIFO inventory method is designed to indefinitely defer the tax on any inflationary gain in the value of inventories that remains reinvested in replacement merchandise. As noted in the preceding section, as long as actual deflation does not occur, if a company's ending inventory equals or exceeds its beginning inventory in real quantity terms, a company's LIFO reserve will either increase in amount or remain steady and, accordingly, will not be recaptured into taxable income.

Recapture of a company's LIFO reserve into taxable income ordinarily occurs only when a company experiences a permanent decline in the level of its inventories. In such circumstances, cash is freed up from the sale of inventory that is not replenished, so that repayment of the prior tax savings from the use of the LIFO inventory method at such time is both logical and appropriate.

In contrast, if a company must repay the tax savings from the prior use of the LIFO inventory method at a time when the company's inventory is not declining in real quantity terms, such as by reason of the repeal of the LIFO inventory method, cash will not be readily available from the sale of inventory to pay the increased tax burden caused by the recapture of LIFO reserves. In such circumstances, amortization over a period of years of the tax burden resulting from recapture of LIFO reserves is not a sufficient offset to enable a company to finance its increased tax burden because the tax savings from the prior use of the LIFO inventory method remain invested in the company's inventory in these circumstances. Thus, a company would be faced with the choice of either shrinking its business or financing its inventory through additional borrowings, assuming that credit is available.

Accordingly recapture of a company's LIFO reserve in a setting where inventories are not reduced is a recipe for disaster. Companies will be forced to either shrink in size or go out of business in order to pay the tax on the recapture of LIFO reserves. Business tax rate reductions and amortization of the LIFO reserve recapture amount will not eliminate the significant additional tax burden placed on companies by the repeal of the LIFO inventory method.

5. **Many Companies Using The LIFO Inventory Method Do Not Operate In Corporate Form And Would Not Benefit If Only Corporate Tax Rate Reductions Are Considered To Offset The Repeal of The LIFO Inventory Method And Other Tax Expenditures Employed By Both Non-Corporate And Corporate Taxpayers**

The use of the LIFO inventory method is not restricted to large, publicly-held corporations; the method is available to all taxpayers with inventories. See S. Rep. No. 648, 76th Cong., 1st Sess., 1939-2 C.B. 524, 528. Moreover, as the CRS notes in its study of tax expenditures, apart from its use in certain basic manufacturing industries such as petroleum, chemicals and metals, the LIFO inventory method is most prevalent in industries such as motor vehicles (i.e., dealers), food and beverage production and retailing, and general merchandise retailing. See S. Rep. No. 111-58, TAX EXPENDITURES Compendium of Background

Material on Individual Provisions, prepared by Congressional Research Service, 111th Cong., 2d Sess. 517, 518 (Dec. 2010).

In fact, as the membership of the LIFO Coalition underscores, LIFO is used by a far broader range of businesses and industries than CRS identified. (A copy of the membership list of the Coalition is appended to this document.) According to two separate recent studies, one by Georgia Institute of Technology and the other by the American Institute of Certified Public Accountants, LIFO is used by between 36% and 40% of businesses in every industry sector that maintains inventories. Clearly, repeal of LIFO would not be removal of a narrowly-used tax deduction or preference and would have wide-spread consequences. (You can access the GA Tech study here: http://www.savelifo.org/pdf-2011/GA%20Tech%20Study%20Consequences%20of%20the%20Elimination%20of%20LIFO.pdf.)

Many of the businesses operating in these industries, as well as other industries where the use of the LIFO inventory method is prevalent are relatively small businesses. The use of the LIFO inventory method by small businesses is manifested in the composition of the membership of The LIFO Coalition. The lion's share of the trade associations that make up the core of the membership of The LIFO Coalition represent small businesses that employ the LIFO inventory method.

Many, if not most, of these small businesses are organized in non-corporate form. For example, many of the businesses that employ the LIFO inventory method are organized as pass-through entities and are taxed either as S corporations or partnerships. Businesses organized as S corporations or partnerships are not taxed at the entity level at the rate of tax imposed on corporations. Instead, the individual owners of these businesses are taxed at individual tax rates.

Accordingly, the main premise of one type of tax reform that has been discussed, which is to broaden the tax base for corporations while lowering the rate of tax on corporations, would simply be inapplicable to many users of the LIFO inventory method . Repealing that method in exchange for a reduction in corporate tax rates which does not benefit a user of the LIFO inventory method would impose an enormous burden on small businesses not taxed as corporations and would undoubtedly lead to a significant number of business failures.

As noted above, The LIFO Coalition submits that even for corporate taxpayers, tax reform that entails a reduction in corporate tax rates in exchange for the repeal of the LIFO method and other provisions listed as tax expenditures by JCT staff, will not make corporations whole, given the size of the typical LIFO reserve relative to a company's net worth. For non-corporate businesses, repeal of the LIFO inventory method in exchange for rate reductions that benefit only corporate entities would be an unmitigated disaster in financial terms. It's hard to conceive of another tax provision the repeal of which would destroy more businesses and eliminate more jobs than the a repeal of the LIFO inventory method so constructed.

6. The Repeal of the LIFO Inventory Method Will Not Pay for Lower Business Tax Rates in the Long Term

As noted above, the vast majority of the revenue raised from the repeal of the LIFO inventory method comes from the recapture of companies' existing LIFO reserves. A much smaller portion of the revenue that would be raised from the repeal of the LIFO inventory method would come from the ongoing effects of the elimination of the LIFO inventory method.

This disparity in revenue sources derives from the fact that for companies that have used the LIFO inventory method for many years (which is the case for most companies using LIFO), the amount of the company's LIFO reserve is usually a significant multiple of the annual increase in the company's LIFO reserve. Thus, for example, assuming relatively uniform inflation rates over time of between three to five percent and relatively constant inventory levels over the period of usage of the LIFO inventory method, one would expect that the annual revenue gain from the repeal of the LIFO inventory method for a company that employed the LIFO inventory method for 40 years would be small fraction of the company's cumulative LIFO reserve.

In addition, the rate of inflation in the United States for the past few years has been relatively modest. In contrast, the inflation rate in the United States over the past forty years has greatly exceeded the recent rate of inflation. Accordingly, a company's cumulative LIFO reserve is likely to greatly exceed the result of multiplying the current inflation rate by the number of years that the LIFO method has been employed and multiplying that amount by the average cost of inventory at the company.

One additional reason why projected future savings from the repeal of the LIFO inventory method is comparatively modest is the fact that companies have been reducing the levels of inventory that they maintain by relying on computerized order and record keeping systems, such as just-in-time inventory systems, in order to minimize the capital tied up in inventory. Accordingly, future revenue projections do not take into account much growth in the levels of LIFO inventories.

The conclusion that consideration of all of these factors leads to is that once current LIFO reserves are fully included in taxable income through amortization over some period of time, ongoing revenue savings from the repeal of the LIFO inventory method will not be available in significant enough amounts to balance out the long-term costs of business tax rate reductions. This is in marked contrast to other tax expenditures listed by JCT staff which display consistent or increasing revenue gains resulting from their repeal. This point is masked in the Obama Administration's proposal to eliminate the LIFO inventory method because the projected revenue gains from the proposal are shown through only the budget time horizon of ten years.

Accordingly, the repeal of the LIFO inventory method would prove to be a highly temporary and unreliable source of significant revenue after the amortization of companies' LIFO reserves is completed.

7. The Likelihood of Convergence with IFRS Has Significantly Diminished and Should Not Affect or Influence Decisions about the Retention of the LIFO Inventory Method

One final reason that some have offered in support of repeal of the LIFO inventory method is that the Securities and Exchange Commission (SEC) is giving serious consideration to requiring SEC registrants to issue their financial statements in compliance with IFRS. Because it is based primarily on European accounting standards where the LIFO method is not widely used, IFRS does not permit the use of the LIFO inventory method in reporting net income for financial reporting purposes. However, section 472(c) and (e)(2) of the Internal Revenue Code require as a condition for companies to use the LIFO inventory method for federal income tax purposes that they use no method other than the LIFO method in reporting their net income for financial reporting purposes.

Accordingly, if the use of IFRS were to be required for SEC registrants, those companies might be barred from continuing to use the LIFO inventory method for federal income tax purposes. Thus, the argument was made that the LIFO method may well be eliminated as a practical matter in the near future and Congress should take action before this happens in order to take credit for the revenue gain that would result from the repeal of the LIFO inventory method.

However, this reasoning is flawed, was premature, and is rendered moot by the indefinite postponement of a decision by the SEC on the adoption of IFRS. On July 13, 2012, the SEC released its Staff Report on convergence, which makes no recommendation to the Commissioners on the adoption of IFRS in any form or time frame and contains the following introductory statement:

> The Commission believes it is important to make clear that publication of the Staff Report at this time does not imply—and should not be construed to imply—that the Commission has made any policy decision as to whether International Financial Reporting Standards should be incorporated into the financial reporting system for U.S. issuers, or how any such incorporation, if it were to occur, should be implemented.

Further, the Report references LIFO several times, describing it as one of the "fundamental differences" between U.S. GAAP and IFRS, concluding that "In some cases, the resolution of these differences will be individually challenging (e.g., removal of, or any change to, LIFO), and any attempt by the SEC or others to resolve these differences in a time period even as long as five to seven years may prove to be difficult." See *"Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers Final Staff Report" at 14.*

Even if the SEC were to eventually move to the adoption of the international accounting standards, it is increasingly unlikely that they will do so by fully moving from GAAP to IFRS as originally intended. Rather, an endorsement method of adoption is more likely, by which US GAAP will continue to used, FASB will retain an active role in devising and implementing accounting standards, and IFRS will be incorporated into GAAP. Under such an endorsement process, local deviations from IFRS, such as the use of LIFO, could be accommodated.

The SEC Staff Report referenced above makes this point very clearly:

> [T]he staff focused on other methods of potential incorporation, such as an endorsement mechanism or continued convergence of accounting standards issued by the Financial Accounting Standards Board ("FASB") and the IASB ... As noted in the 2010 Progress Report, very few jurisdictions provide for the use of standards issued by the IASB without measures to ensure the suitability of those standards. Rather, most jurisdictions generally rely on some mechanism to incorporate IFRS into their domestic reporting system. Mechanisms range from converging a jurisdiction's standards to IFRS without necessarily incorporating IFRS fully into its national framework, to various forms of endorsement approaches whereby IFRSs are incorporated into the national framework on a standard-by-standard basis, if the newly issued IFRS standard passes some prescribed threshold

In addition, wholly apart from the uncertain timing and scope of any decision concerning the possible adoption of IFRS in the U.S., any requirement that U.S. companies follow IFRS and discontinue using the LIFO inventory method in computing net income in the body of their financial statements would not automatically result in the termination of the use of the LIFO inventory method for federal income tax purposes. Under the Internal Revenue Code, the Treasury has broad discretion to permit the continued use of the LIFO inventory method in these circumstances. Accordingly, it does not necessarily follow that adoption of IFRS in the U.S. will result in the termination of the LIFO method for tax purposes.

In sum, the possibility of changes in the financial accounting world should not be allowed to influence any decision by the Congress on whether to repeal the LIFO inventory method for tax purposes. Any such decision should be based solely on the merits of LIFO repeal, rather than on any assessment of what actions an agency such as the SEC may take in the future. The SEC Staff Report demonstrates quite convincingly that actions of this sort basically defy prediction.

8. Repeal of the LIFO Inventory Method will Harm U.S.-Based Companies and Benefit their Foreign Competitors.

Under the U.S. worldwide system of taxation, U.S.-based companies face both a high U.S. statutory tax rate and remain subject to tax on their foreign earnings when repatriated to the United States. It is well established that these factors contribute to U.S.-based companies that operate worldwide bearing effective tax rates that are among the highest in the world. *See, e.g.,* Chen and Mintz, "New Estimates of Effective Corporate Tax Rates on Business Investment," Cato Institute (Feb. 1, 2011) reported in TAX NOTES TODAY, 2011 TNT 37-17 (Feb. 24, 2011). Chen and Mintz note that the effective U.S. tax rate on corporations was 34.6 percent in 2010, which was the highest rate in the Organization for Economic Cooperation and Development and the fifth highest rate among 83 countries in the world. Moreover, this study is not just based on statutory tax rates, but takes into account such tax provisions as accelerated depreciation and inventory allowances:

> This bulletin presents estimates of effective corporate tax rates on new capital investment for 83 countries. "Effective" tax rates take into account statutory rates plus tax-base items that affect taxes paid on new investment, such as depreciation deductions, inventory allowances, and interest deductions.

Id.

One can infer from the Chen and Mintz study that the detrimental impact of such high effective tax rates on the competitiveness of U.S.-based companies is mitigated to a limited degree by the LIFO inventory method. As noted above, only U.S. companies use the LIFO inventory method, which allows them to better compete against foreign-based companies who are generally subject to lower effective tax rates, but cannot use the LIFO inventory method under international accounting standards.

As the Congress and the Administration consider how to revise the tax code to encourage the competitiveness of U.S.-based companies, the United States must be mindful that any export subsidies it considers must be consistent with the United States' international trade obligations, particularly those imposed by the World Trade Organization (WTO). Indeed, a number of prior export subsidies, such as the foreign sales corporation and extraterritorial income regimes, have been found to violate these obligations and were required to be repealed. The LIFO inventory method, by contrast, has not been subject to challenge by the WTO and, therefore, remains a permissible means to encourage U.S.-based companies to manufacture and export domestic products in the global marketplace.

In light of the fact that the LIFO inventory method: (i) allows U.S.-based companies to better compete against foreign-based companies that are generally subject to lower effective tax rates, and (ii) is consistent with the United States' international trade obligations, it is essential that the LIFO inventory method be retained in the tax code, regardless of any tax reform effort. Moreover, as the Chen and Mintz study confirms, repeal of the LIFO inventory method, along with other tax expenditures, in exchange for lower business statutory tax rates, will still leave corporations with an effective tax rate that is among the highest in the world.

IV. Conclusion

In the final analysis, repeal of the LIFO inventory method, in the context of business tax reform that involves base broadening in exchange for lower statutory tax rates, will not accomplish the goal of lowering the *effective* tax rate on businesses. Repeal of the LIFO inventory method will not enhance the competitiveness of U.S. businesses in the worldwide marketplace and, in fact, will damage the capital position of businesses in many industries that rely on the LIFO inventory method to finance their replacement of inventory in an inflationary environment. Finally, even if individual tax rates are reduced for businesses operating in non-corporate form, such as pass-through entities, repeal of the LIFO inventory method will severely damage such businesses, which are the life-blood of job creation in the United States. Moreover, without such rate reductions, the effect of the repeal of the LIFO method on small businesses would be devastating.

THE LIFO COALITION

1325 G Street N.W., Suite 1000, Washington, DC 20005 TEL: 202-872-0885

June 6, 2012

Mr. Jeffrey D. Zeints
Acting Director
Office of Management and Budget
Washington, D.C. 20503

Dear Mr. Zeints:

On January 27th, a bi-partisan group of 22 Members of the House of Representatives sent a letter to President Obama urging that LIFO repeal not be included in the Administration's Fiscal Year 2013 Budget. On April 2nd, you responded to the letter from the Members of Congress on behalf of the Obama Administration.

The LIFO Coalition, a coalition of more than 120 business organizations and trade associations, was provided a copy of both the letter to the President and your response on his behalf.

The Coalition has prepared a detailed response to the points you raised in your letter to the Members of Congress.

Please find enclosed the LIFO Coalition's response to your letter with a list of the members of the coalition, a copy of your letter to the Members of Congress, and a copy of their original letter to the President.

Sincerely,

Jade West

Jade West, Senior Vice President-Government Relations
National Association of Wholesaler-Distributors
Executive Secretariat, The LIFO Coalition

Enclosures:

1. *Coalition response and membership list (pages 2-10)*
2. *OMB Letter to Members of Congress (page 11-12)*
3. *Members of Congress letter to the President (pages 13-15)*

cc: Honorable Timothy F. Geithner
Secretary
U.S. Department of the Treasury

THE LIFO COALITION

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June 2012

LIFO Coalition Response to the Administration's Proposal to Repeal the Last-in, First-out (LIFO) Inventory Method

Executive Summary

LIFO has been permitted in the tax code since 1939, is an accepted general accounting principle, and is used by millions of companies in a wide range of industries. Repeal of LIFO would have a major damaging impact on the U.S. economy and job creation, particularly among small and mid-sized businesses, and most of the revenue that would be generated by LIFO repeal would be from the "recapture tax" – an unprecedented retroactive tax increase.

In January, a bi-partisan group of 22 Members of Congress sent a letter to President Obama urging the Administration to exclude repeal of LIFO from its Fiscal Year 2013 Budget. On April 2nd, the Office of Management and Budget (OMB) responded to the Congressional letter, rejecting their request and defending the proposal to repeal LIFO on three separate grounds.

The LIFO Coalition believes that the three arguments outlined by OMB for the Administration's proposal fail to justify repeal of the LIFO method.

OMB: *The LIFO inventory method provides unwarranted deferral of income taxes for taxpayers experiencing increasing costs in their inventories.*

Coalition response: The LIFO method simply recognizes the reality that inflationary gains should not be taxed until the benefits from those gains are permanently withdrawn from the business. In order for a business selling merchandise to remain in operation, that business must consistently reinvest the profits that it earns from the sale of merchandise in order to replenish the merchandise that has been sold. When costs increase due to inflation, the business must invest an ever increasing amount of capital simply to maintain the status quo. If the business must pay taxes currently on that inflationary income, it would have to either acquire additional capital in order to maintain existing inventory levels, or shrink the level of operations and thereby reduce employment, so as to be able to afford the additional taxes.

OMB: *LIFO repeal would simplify the Internal Revenue Code by eliminating a complex and burdensome accounting method that has been the source of tax controversies.*

Coalition response: Any complexities or burdens under the LIFO method have generally been eliminated. When LIFO was initially adopted by Congress over 70 years ago, there were a number of complexities and uncertainties about the way that the LIFO method operated. However, approximately 30 years ago, the IRS made a concerted effort to simplify the most complicated aspect of LIFO usage, permitting taxpayers to use standardized industry-wide statistics to compute the inflation in their inventories. The adoption of this method transformed the LIFO calculation process into a relatively formulaic process.
In fact, the Administration's default method, first-in, first-out (FIFO), is the basis for LIFO calculations. Moreover, FIFO and LIFO serve the same function – most closely matching the cost of goods sold with the cost of replacement inventory – so eliminating LIFO would force companies which use it into a disadvantaged position vis a vis companies for which FIFO is the more economically appropriate method.

OMB: The *LIFO Method is an Impediment to the Adoption of IFRS in the U.S.*

Coalition response: The presence of LIFO as a proper method of inventory valuation is not having the slightest effect on the adoption of IFRS in the U.S. All recent news reports indicate that the SEC is leaning towards an "endorsement" model under which the U.S. would continue to evaluate what accounting principles would be acceptable for use in the financial statements of U.S. issuers. Moreover, numerous articles in the financial press have highlighted far more serious differences between IFRS and U.S. GAAP than the treatment of the LIFO method. Finally, if an initial decision is made by the SEC to require or permit IFRS to be used by U.S. issuers of financial statements, such a decision will simply be the beginning of a long process whereby the two sets of accounting rules will be brought into closer alignment, and that evolutionary process does not mean that the LIFO method will necessarily be prohibited for financial reporting purposes in the U.S.

Conclusion: ***The LIFO Coalition believes that the Administration has failed to make an effective case for LIFO repeal, and that the additional federal revenue that repeal would generate would be more than offset by the economic harm that repeal would cause. The negative impact of LIFO repeal would be felt by companies of all sizes and in a wide range of industries. The prospective and retroactive tax increases imposed by LIFO repeal will take valuable resources away from business operations, investment and job creation and can be expected to result in the decline or failure of many currently viable companies. We strongly urge policy makers to reject efforts to repeal this long-standing and widely accepted accounting method.***

THE LIFO COALITION

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June 2012

LIFO Coalition Response to the Administration's Proposal to Repeal the

Last-in, First-out (LIFO) Inventory Method

Background: On January 27, 2012, a bi-partisan group of 22 Members of Congress sent a letter to President Obama urging the Administration to exclude from its Fiscal Year 2013 Budget Proposal a proposal to repeal the last-in, first-out (LIFO) inventory method, which had been included in prior budget proposals. The Administration ultimately rejected this request and included in its Fiscal Year 2013 Budget Proposal a proposal to repeal the LIFO inventory method for federal income tax purposes.

On April 2, 2012, Jeffrey Zients, Acting Director, Office of Management and Budget (OMB), responded to the January 27, 2012, Congressional letter and explained the Administration's decision. In the letter, OMB defended the Administration's decision to propose the repeal of the LIFO inventory method on three separate grounds –

1. The LIFO inventory method provides unwarranted deferral of income taxes for taxpayers experiencing increasing costs in their inventories;

2. The repeal of the LIFO method would simplify the Internal Revenue Code by eliminating a complex and burdensome accounting method that has been the source of tax controversies in the past; and

3. The repeal of the LIFO method would remove an impediment to the adoption of International Financial Reporting Standards (IFRS) in the United States by the Securities and Exchange Commission (SEC).

The LIFO Coalition (the Coalition), which represents trade associations and businesses of every size and industry sector that employ the LIFO method, was organized in April 2006, when LIFO repeal was first proposed in the Senate as a revenue offset to fund unrelated policies. Since then, the Coalition has grown to include more than 120 members including trade associations representing a wide swath of American industry – including manufacturing, wholesale distribution and retailing – and companies of all sizes. The Coalition's mission is to preserve the option of companies to value their inventories pursuant to the LIFO method for federal income tax purposes. A list of the Coalition members is attached to this document, and can be found at http://www.savelifo.org/pdf/LIFOMemberList.pdf

Coalition's Position: As discussed in more detail below, the LIFO Coalition believes that the three arguments outlined by OMB for the Administration's proposal do not justify repeal of the LIFO method.

1. The LIFO Method as an Unwarranted Deferral of Taxes

OMB's assertion that the LIFO method results in an unwarranted deferral of income taxes ignores the fact that the LIFO method has been included in the Internal Revenue Code (the Code) as a permissible method of inventory valuation for federal income tax purposes since 1939. Moreover, the LIFO method has been a part of generally accepted accounting principles (GAAP) in the United States for more than 70 years.

In fact, the LIFO method is widely used as an inventory valuation method for both tax and financial reporting purposes in a wide range of industries. According to two separate recent studies, one by Georgia Institute of Technology and the other by the American Institute of Certified Public Accountants, LIFO is used by between 36% and 40% of businesses in every industry sector that maintains inventories.

Accordingly, the LIFO method is not an unintended loophole or, in any sense, a tax expenditure. The LIFO method is based on sound economic principles and operates on the economic theory that in order for a business selling merchandise to remain in operation, the business must consistently reinvest the profits it earns from the sale of merchandise to replenish the merchandise that has been sold and/or the raw materials that are used in the production process. As a result, unless the business chooses to either reduce the level of its operations or terminate its business altogether, the profits from the business must be permanently reinvested in merchandise offered for sale by the business or raw materials used for production.

When a business operates in this type of environment and costs increase due to inflation, the capital investment in the business is placed in an even more precarious state. Thus, a business must reinvest the same amount of capital that financed the original quantity of merchandise necessary to maintain the operations of the business and invest an ever increasing amount of capital simply to maintain the status quo. While in some abstract sense one might view the business as having "realized" additional income due to the effect of inflation on the sales prices of the merchandise, the additional income resulting from that increased sales revenue must remain permanently invested in the capital of the business to preserve the ongoing business' operations. If the business must pay taxes currently on that inflationary income, the business will be unable to preserve its ongoing operations without either locating additional capital or shrinking the size of its operations.

As a matter of tax policy, the LIFO method recognizes that inflationary gains should not be taxed until the benefits from those gains are permanently withdrawn from the business. Under the LIFO method, the inflation element in a business' profits is taxed only when that profit is permanently withdrawn from the business through reductions in inventory levels. The tax law deals with inflation in a number of different ways, depending on the type of property involved. In the case of machinery and equipment, accelerated depreciation methods and shorter recovery periods than the physical life of the machinery and equipment enables a business to replace the machinery and equipment that wears out with more costly machinery and equipment. In the case of capital assets, preferential rates for capital gains are designed, in part, to compensate for the fact that a portion of the gain taxed is due to the effects of inflation. Similarly, the LIFO method addresses the effects of inflation on business inventories.

LIFO is a necessary and appropriate inventory valuation method under any economic circumstances. However, given the present business environment and the fragility of the economic recovery, eliminating the LIFO inventory method at this time would be particularly inadvisable. If adopted, this proposal would require businesses to either acquire additional capital to maintain their existing inventory levels or shrink the level of operations and reduce employment to afford the additional taxes that would accrue on inflation-induced profits.

In conclusion, the LIFO method addresses the effects of inflation on inventory and does not constitute a tax loophole or subsidy. The method has a sound economic underpinning and should be preserved to enable businesses to reinvest their profit in inventory that becomes more costly due to inflation.

2. The Repeal of LIFO Would Facilitate Simplification of the Tax Law

The Coalition also disagrees with OMB's argument that the LIFO method is complex and repeal would simplify U.S. tax laws.

When the LIFO method was initially adopted by Congress over 70 years ago, there were a number of complexities and uncertainties about how the LIFO method operated. Over the past seven decades, however, a series of court decisions and Internal Revenue Service (IRS) rulings have addressed these issues.

One of the most complex aspects of the LIFO method was the computation procedure that a taxpayer must use to compute inflation, i.e., a taxpayer's method of computing its LIFO price index. Approximately 30 years ago, IRS issued regulations to simplify this aspect of the LIFO calculations. These rules, issued in 1981, allow taxpayers to elect to use standardized, industry-wide statistics as a basis for computing the inflation. This simplified index method is referred to as the Inventory Price Index Computation (IPIC) and these regulations were further refined almost ten years ago. The adoption of this method transformed the LIFO calculation process into a relatively formulaic process, and the use of this simplified method is widespread among taxpayers that use LIFO.

As a result, there are very few remaining complexities and uncertainties under the LIFO method. In fact, very few rulings issued by the IRS deal with the LIFO method. Similarly, there have been very few court decisions in the last ten years involving the operation of the LIFO method.

The LIFO Coalition submits that, at this point, the LIFO method has ceased to be a particularly complex and/or controversial provision. In fact, the Administration's default method, first-in, first-out (FIFO) is the basis for LIFO calculations. Consequently, eliminating LIFO would not eliminate any perceived complexities. Moreover, since FIFO and LIFO serve the same function – most closely matching the cost of goods sold with the cost of replacement inventory – eliminating LIFO would place current LIFO companies at a competitive disadvantage as compared to companies for which FIFO is the more economically appropriate method. (In this regard, the Coalition continues to have concerns that the Administration's approach remains critical of deferrals associated with the use of LIFO when corresponding deferral opportunities are also integral to the FIFO method.)

3. The LIFO Method is an Impediment to the Adoption of IFRS in the U.S.

Similarly, the Coalition does not agree with the Administration that the presence of the LIFO method in the U.S. tax law, together with the effect of the financial conformity requirement for LIFO users, is an impediment to the adoption of International Financial Reporting Standards (IFRS) in the United States. The OMB reasoning is premised on the fact that the LIFO method is prohibited by IFRS for financial reporting purposes. At the same time, the "conformity requirement" in the Code requires companies that use LIFO for tax purposes to use LIFO for financial reporting. Specifically, OMB is concerned that the Securities and Exchange Commission (SEC) will be reluctant to adopt IFRS for issuers of financial statements regulated by the SEC because that will force users of IFRS to discontinue the use of LIFO for tax purposes.

In reality, however, the presence of LIFO as a proper method of inventory valuation for tax purposes, together with the LIFO conformity requirement, is not having any effect on the adoption of IFRS in the United States. Based on news reports, the SEC is leaning towards an "endorsement" model for the adoption of IFRS in the United States. Under an "endorsement" model, the Financial Accounting Standards Board (FASB), which currently sets the standards for Generally Accepted Accounting Principles (GAAP) in the United States, would retain its authoritative role in evaluating what accounting principles would be acceptable for use in the financial statements of U.S. issuers. Thus, rather than adopting IFRS on a wholesale basis, FASB would evaluate each accounting principle adopted by IFRS to determine its suitability for U.S. GAAP. If the accounting principle that is part of IFRS is deemed suitable for U.S. GAAP purposes, FASB would endorse that principle and accept it as part of U.S. GAAP. In contrast, if FASB determined that a particular accounting principle that is part of IFRS was not suitable for U.S. GAAP, the FASB would decline to endorse that principle and the FASB would adopt its own separate accounting standard for U.S. GAAP.

It is important to note that the LIFO method was not widely used in Europe and, as a result, the LIFO method was not included in the list of acceptable inventory valuation methods under IFRS. However, that does not mean that the FASB would reach the same conclusion for U.S. GAAP. In light of the long-standing acceptance and broad usage of the LIFO method in the United States, FASB could conclude the LIFO method should continue to be acceptable under U.S. GAAP, notwithstanding IFRS. In any event, it is premature at this point to predict what the FASB would do on this issue.

Moreover, the presence of the LIFO method and the LIFO conformity requirement in the Code does not prevent the adoption of IFRS for U.S. financial reporting purposes. As noted in numerous articles in the financial press, there are far more serious differences between IFRS and U.S. GAAP than the treatment of the LIFO method. If an initial decision is made by the SEC to require or permit IFRS to be used by U.S. issuers of financial statements, the decision will be the beginning of a long process of aligning two sets of accounting rules.

4. Repeal of LIFO Would be an Unprecedented Retroactive Tax Increase

Finally, the Coalition does not agree with the Administration that a ten-year amortization period for the recovery of the effects of discontinuing the LIFO method in any sense makes the LIFO repeal proposal acceptable.

It is important to note that the impact of LIFO repeal is not prospective only. Under the proposal, taxpayers also would be required to recapture into taxable income the entire benefit that a taxpayer received from the use of the LIFO method over the taxpayer's entire lifetime, i.e., the LIFO reserve. In fact, most of the revenue generated by this proposal comes from its retroactive effect.

The LIFO Coalition is not aware of any other serious revenue raising proposal that has this type of retroactive effect. For example, no proposal for the elimination of accelerated depreciation or the research credit or the mortgage interest deduction includes a requirement that taxpayers pay back the taxes that they saved from the prior use of these methods. No proposal to increase tax rates on dividends and/or capital gains ever suggests that taxpayers pay back the benefits of reduced rates on those types of income for past years. The proposal to repeal the LIFO method is the only serious tax proposal that The LIFO Coalition is aware of that has a retroactive effect of the magnitude that is contemplated. Accordingly, while a ten-year amortization of the effect of repeal of the LIFO method might otherwise seem reasonable, it in no way compensates for the double-barreled effect of repeal of LIFO for the future combined with repayment of the benefits of LIFO from the past.

Conclusion

As outlined above, the Coalition believes that the Administration has failed to make an effective case for LIFO repeal, and that the additional federal revenue that repeal would generate would be more than offset by the economic harm that repeal would cause. The negative impact of LIFO repeal would be felt by companies of all sizes and in a wide range of industries. The prospective and retroactive tax increases imposed by LIFO repeal will take valuable resources away from business operations, investment and job creation and can be expected to result in the decline or failure of many currently viable companies. We strongly urge policy makers to reject efforts to repeal this long-standing and widely accepted accounting method.

THE LIFO COALITION

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Alabama Grocers Association
American Apparel & Footwear Association
American Chemistry Council
American Forest & Paper Association
American Fuel and Petrochemical Manufacturers
American Gas Association
American International Automobile Dealers Association
American Petroleum Institute
American Road & Transportation Builders Association
American Supply Association
American Veterinary Distributors Association
American Watch Association
American Wholesale Marketers Association
Americans for Tax Reform
AMT-The Association for Manufacturing Technology
Associated Equipment Distributors
Association for High Technology Distribution
Association for Hose & Accessories Distribution
Association of Equipment Manufacturers
Automobile Dealers Association of Alabama
Automotive Aftermarket Industry Association
Brown Forman Corporation
Business Roundtable
Business Solutions Association
California Independent Grocers Association
Caterpillar Inc
Ceramic Tile Distributors Association
Connecticut Food Association
Copper & Brass Servicenter Association
Deep South Equipment Dealers Association
Deere & Company
East Central Ohio Food Dealers Association
Equipment Marketing & Distribution Association
Far West Equipment Dealers Association
Farm Equipment Manufacturers Association
Financial Executives International
Food Industry Alliance of New York State
Food Marketing Institute
Forging Industry Association
Gases and Welding Distributors Association
Greater Boston Chamber of Commerce
Healthcare Distribution Management Association
Heating, Airconditioning & Refrigeration Distributors International
Illinois Food Retailers Association
Independent Lubricant Manufacturers Association
Industrial Fasteners Institute
Industrial Supply Association
International Foodservice Distributors Association
International Franchise Association
International Sanitary Supply Association
International Sealing Distribution Association
International Wood Products Association
Iowa Grocers Industry Association
Iowa Nebraska Equipment Dealers Association
Jewelers of America
Kansas Food Dealers Association
Kentucky Association of Convenience Stores
Kentucky Grocers Association
Louisiana Retailers Association
Manitowoc Company Inc (The)
Maryland Retailers Association
MDU Resources Group
Metals Service Center Institute
Mid-America Equipment Retailers Association
Midwest Equipment Dealers Association
Minnesota Grocers Association
Minnesota-South Dakota Equipment Dealers Association
Missouri Grocers Association
Missouri Retailers Association

Montana Equipment Dealers Association
Moss Adams LLP
NAMM-The International Music Products Association
National Association of Chemical Distributors
National Association of Convenience Stores
National Association of Electrical Distributors
National Association of Manufacturers
National Association of Shell Marketers
National Association of Sign Supply Distributors
National Association of Sporting Goods Wholesalers
National Association of Wholesaler-Distributors
National Auto Dealers Association
National Beer Wholesalers Association
National Electrical Manufacturers Association
National Federation of Independent Business
National Grocers Association
National Lumber and Building Material Dealers Association
National Paper Trade Alliance
National Roofing Contractors Association
National RV Dealers Association
Nebraska Grocery Industry Association
New Hampshire Grocers Association
New Jersey Food Council
North American Equipment Dealers Association
North American Horticultural Supply Association
North American Wholesale Lumber Association
Ohio Grocers Association
Ohio-Michigan Equipment Dealers Association
Paperboard Packaging Council
Pet Industry Distributors Association
Petroleum Equipment Institute
Power Transmission Distributors Association
Printing Industries of America
Professional Beauty Association
Retail Grocers Association of Greater Kansas City
Retail Industry Leaders Association
Safety Equipment Distributors Association
SBE Council
Security Hardware Distributors Association
Society of Independent Gasoline Marketers of America
SouthEastern Equipment Dealers Association
Southern Equipment Dealers Association
SouthWestern Association
Souvenir Wholesale Distributors Association
SPI: The Plastics Industry Trade Association
State Chamber of Oklahoma
Textile Care Allied Trades Association
Tire Industry Association
U.S. Chamber of Commerce
Washington Food Industry Association
Wholesale Florist & Florist Supplier Association
Wine & Spirits Wholesalers of America
Wine Institute
Wisconsin Grocers Association, Inc.
Wood Machinery Manufacturers of America

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

April 2, 2012

The Honorable
U.S. House of Representatives
Washington, DC 20515

Dear Representative '

Thank you for your letter to the President concerning the Fiscal Year 2013 Budget proposal to repeal the Last In, First Out (LIFO) accounting method. I am responding on his behalf. The Administration is committed to a balanced approach to deficit reduction, and proposed in the Budget a number of measures to close special tax provisions such as LIFO accounting.

In the Administration's view, the repeal of the LIFO method of accounting would eliminate a tax deferral opportunity available to taxpayers that hold inventories with increasing costs. In addition, LIFO repeal would simplify the Internal Revenue Code by removing a complex and burdensome accounting method that has been the source of controversy between taxpayers and the Internal Revenue Service.

International Financial Reporting Standards do not permit the use of the LIFO method, and their adoption by the Securities and Exchange Commission would cause violations of the current LIFO book/tax conformity requirement. Repealing LIFO would remove this possible impediment to the implementation of these standards in the United States.

The Administration's proposal would repeal the use of the LIFO inventory accounting method for Federal income tax purposes. Taxpayers that currently use the LIFO method would be required to write up their beginning LIFO inventory to its First In, First Out value in the first taxable year beginning after December 31, 2013. However, this one-time increase in gross income would be taken into account ratably over 10 years, beginning with the first taxable year beginning after December 31, 2013.

Thank you again for expressing your concerns about the LIFO proposal in the FY 2013 Budget.

Sincerely,

Jeffrey D. Zients
Acting Director

Identical Letter Sent to:

The Honorable Geoff Davis
The Honorable John Yarmuth
The Honorable Mike Thompson
The Honorable Pat Tiberi
The Honorable Richard Neal
The Honorable Peter Roskam
The Honorable Ron Kind
The Honorable Vern Buchanan
The Honorable Bill Pascrell, Jr.
The Honorable Erik Paulsen
The Honorable Aaron Schock
The Honorable Ben Chandler
The Honorable Jim Metheson
The Honorable Mike McIntyre
The Honorable Michael H. Michaud
The Honorable Jim Costa
The Honorable Dan Boren
The Honorable Cynthia Lummis
The Honorable Randy Neugebauer
The Honorable Colin Peterson
The Honorable Reid Ribble
The Honorable Cedric Richmond

Congress of the United States
Washington, DC 20515

January 27, 2012

President Barack Obama
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear Mr. President:

As you draft your Fiscal Year 2013 Budget Proposal, we urge you not to include the repeal of the Last In, First Out (LIFO) accounting method. Repealing LIFO is more likely to exacerbate than solve our fiscal problems.

The well-established LIFO method of accounting has been expressly permitted by the tax code for more than seventy years. It is widely used by thousands of both public and privately-held businesses. LIFO allows a business to track their costs, minimize artificial inflation gains, accurately reflect replacement costs, and more precisely measure their income for tax and financial reporting purposes. According to a 2008 study by Georgia Tech, "approximately 36% of U.S. companies use LIFO for at least a portion of their inventories."

The repeal of LIFO and resulting retroactive tax increase would have a devastating impact on businesses that rely on this accounting method. The overall taxes owed by companies would increase by billions of dollars. For many businesses, this would significantly reduce available capital for investments in equipment or the hiring of new employees. In some cases it could even threaten the job security of current employees. While our economy is still recovering from a very severe economic recession, it would be unwise to significantly impair the cash flow of many businesses.

Businesses that rely on LIFO include hundreds of publicly-traded companies in the US and countless privately-owned businesses. Industries affected range from metals, paper, chemicals, and petroleum refining to auto parts, beverages, distilleries, groceries, textiles, building materials and industrial equipment. Repeal would impact manufacturers, wholesaler-distributors, and retailers; makers and sellers of virtually all products produced, sold and consumed in the United States. The impact of LIFO repeal would surely be felt in our Congressional Districts and every corner of America.

We hope that the Fiscal Year 2013 Budget will not include LIFO repeal. We believe that retaining LIFO will help struggling companies and small businesses across the nation remain valuable assets to our economy and globally competitive.

Again, thank you for listening to our concerns about these issues as you work on drafting your budget.

Sincerely,

Rep. Geoff Davis
Member of Congress

Rep. Mike Thompson
Member of Congress

Rep. Pat Tiberi
Member of Congress

Rep. Richard Neal
Member of Congress

Rep. Peter Roskam
Member of Congress

Rep. Ron Kind
Member of Congress

Rep. Vern Buchanan
Member of Congress

Rep. Bill Pascrell
Member of Congress

Rep. Erik Paulsen
Member of Congress

Rep. Aaron Schock
Member of Congress

Rep. Ben Chandler
Member of Congress

Rep. Jim Matheson
Member of Congress

Rep. Mike McIntyre
Member of Congress

Rep. Mike Michaud
Member of Congress

Rep. Jim Costa
Member of Congress

Rep. Dan Boren
Member of Congress

Rep. Cynthia Lummis
Member of Congress

Rep. Randy Neugebauer
Member of Congress

Rep. Colin Peterson
Member of Congress

Rep. Reid Ribble
Member of Congress

Rep. Cedric Richmond
Member of Congress

Rep. John Yarmuth
Member of Congress

National Association of Manufacturers

Statement
of the National Association of Manufacturers

For the Hearing Record
of the
Committee on Ways and Means
U.S. House of Representatives

Hearing on
"Tax Reform and the U.S. Manufacturing Sector"

July 19, 2012

The NAM is the largest industrial trade association in the United States, representing over 11,000 small, medium and large manufacturers in all 50 states. We are the leading voice in Washington, D.C., for the manufacturing economy, which provides millions of high wage jobs in the U.S. and generates more than $1.6 trillion in GDP. In addition, two-thirds of our members are small businesses, which serve as the engine for job growth. NAM members commend Chairman Camp and the Committee for holding a hearing on tax reform and the U.S. manufacturing sector.

Manufacturers have long believed that our current tax system is fundamentally flawed and discourages economic growth and U.S. competitiveness. To reverse these effects, the NAM supports lower tax rates on business income (including dividends and capital gains), a robust capital cost recovery system and a permanent and strengthened R&D incentive. We further support the adoption of a territorial tax system since current U.S. tax laws make it difficult for U.S. companies with worldwide operations to thrive and compete in the global marketplace. If U.S. companies cannot compete abroad, where 95 percent of the world's consumers are located, the U.S. economy suffers from the loss of both foreign markets and domestic jobs that support foreign operations.

The NAM supports current efforts to make the tax code more pro-growth, pro-competitive, fairer, simpler and predictable. Because of the critical importance of manufacturing to our nation's economy, any effort to rewrite the tax laws should result in a fiscally responsible plan that allows manufacturers in the United States to prosper, grow and create jobs.

While the NAM is a strong advocate for comprehensive reform of our current tax code, we also believe that it is important to keep our current tax system in place until policymakers agree on a final reform plan. In particular, we urge Congress to renew the tax extenders, like the R&D credit, the look-through rules and deferral for active financing, which will provide a bridge of certainty and predictability for manufacturers. These provisions help manufacturers innovate and compete in a global marketplace.

In contrast, the expiration or pending expiration of these and other business "tax extenders" represents a tax increase for manufacturers and businesses of all sizes that use these incentives. Similarly, other piece-meal changes or repeal of long-standing rules will inject more uncertainty into business planning, making U.S companies even less competitive and threaten economic growth and U.S. jobs.

As we move toward tax reform, we strongly urge you to revive and extend these important incentives that are part of the current system and avoid other changes that will make an uncompetitive system even worse.

Overview

In anticipation of the current tax reform effort, NAM members developed a set of principles for comprehensive tax reform that incorporate Manufacturers' tax reform goals and also serve as a framework for evaluating proposals and developments as the tax reform debate moves forward. The following principles, which were approved by NAM's Board of Directors in March 2012, touch on several areas including business tax rates, international competitiveness and research and technology investment. More generally, the principles focus on several issues that need to be addressed to ensure a simpler, fairer, more predictable and more balanced code.

Encouraging Investment and Job Creation

NAM members believe that any tax reform plan should encourage capital investment and job creation. To this end, a comprehensive tax reform plan should include:

- **Lower Corporate Tax Rates:** Reducing the corporate tax rate to 25 percent or lower would make the United States' tax system more competitive with our major trading partners. Any accompanying base broadening should recognize the impact of those changes on economic growth. Some current tax provisions, including capital cost recovery rules, are key to a strong manufacturing sector and broader economic growth and the benefits of these provisions should be maintained in a new system.

- **Lower Taxes for Flow-Through Businesses:** Two-thirds of manufacturers are organized as "flow-through" entities and pay taxes at individual rates. For these entities, it is critical that the tax rates on individuals be as low as possible. A new system should not increase the tax burden on these businesses to pay for other tax reform measures.

- **Permanent R&D Incentive:** It is critical that any tax reform plan recognize the important role of research and technology investment in the growth of U.S. jobs and innovation. The goal is for the United States to retain and attract global R&D activities. The certainty provided by a strengthened, permanent R&D provision would enhance its incentive value.

- **Taxation of Investment:** Keeping the tax rate on dividends and capital gains as low as possible and applying the same rate to all investment income will help public companies attract investors and allow them to finance investment and create jobs. An effective way to spur business investment and make the tax system more competitive is through a robust capital cost recovery.

Promoting International Competitiveness

Current U.S. tax laws make it difficult for U.S. companies with worldwide operations to thrive and compete in the global marketplace. If U.S. companies cannot compete abroad, where 95 percent of the world's consumers are located, the U.S. economy suffers from the loss of both foreign markets and domestic jobs that support foreign operations. In order to make U.S. multinationals more competitive, in addition to lower corporate tax rates and a permanent R&D

incentive, the NAM supports the adoption of a competitive territorial tax system that meetings the following criteria:

- **Elimination of the double tax burden:** A U.S. territorial system should be based on the principle that there should be no double tax burden imposed by the United States. At a minimum, a new system should exempt active foreign earnings from taxation and avoid the imposition of a stealth tax on foreign earnings through expense allocations.

- **Alignment with international norms:** A U.S. territorial system should be structured to enhance U.S. competitiveness, not raise revenue. Moving to a territorial system like those used by other industrialized countries will allow U.S.-based companies to be more competitive.

- **A smooth and effective transition:** A move to a territorial tax system should include fair transition rules that allow repatriation of foreign-earnings on a voluntary basis, minimize administrative and compliance costs on companies and allow existing foreign business entities to compete with foreign-headquartered companies.

Ensuring a Simpler, Fairer and Balanced System

A new tax system should be simpler and more administrable and should treat all businesses fairly without regard to size, type of entity or sector. Specifically, a comprehensive tax reform plan should meet the following criteria:

- **No Net Increase in Manufacturers' Tax Burden:** Any alternative that shifts more of the current tax burden on to manufacturers will hamper economic growth and job creation.

- **Elimination of the Alternative Minimum Tax:** A new system should eliminate both the individual and corporate alternative minimum tax rules, which are inherently complex and unfair.

- **Administerability:** A new system should incorporate rules that make it easier for Treasury to administer the law and for taxpayers to comply with the law. Unnecessary complexity is not productive from an economic perspective and undermines taxpayers' confidence in the fairness of the law.

- **Predictability:** A tax code that is predictable and that provides certainty is essential for effective business and tax planning. A fair and stable tax code will make it easier for U.S. manufacturers to complete in the global marketplace.

- **Transition Rules:** A new system must include broad transition rules that provide fair and equitable treatment for taxpayers that have generated substantial attributes based on current law. For example, it is important for transition rules to allow future timely utilization of tax attributes, e.g., net operating losses, alternative minimum tax credits, foreign tax credits, depreciation etc., that have been generated but not yet utilized under the current system.

Conclusion

As outlined in NAM's "A Manufacturing Renaissance: Four Goals for Economic Growth,[1] " a key objective for the Association is to create a national tax climate that enhances the global competitiveness of U.S. manufacturers. Manufacturers very much appreciate the efforts of Chairman Camp and the members of the House Ways and Means Committee for their diligent work to reform the U.S. tax system to put U.S. manufacturers on a level playing field with their competitors in other countries, as well as making the United States a more competitive environment in which to do business. We appreciate the opportunity to share our thoughts and concerns with you. Manufacturers look forward to further discussing these issues and working with the Committee to achieve a pro-growth, pro-competitiveness and pro-manufacturing tax system.

[1] Available at http://www.nam.org/

Supplemental Sheet

Statement of the National Association of Manufacturers (NAM)

For the Hearing Record

of the

Committee on Ways and Means

U.S. House of Representatives

On

"Tax Reform and the U.S. Manufacturing Sector"

July 19, 2012

Contact:

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R & D Credit Coalition

STATEMENT OF THE R&D CREDIT COALITION

SUBMITTED FOR THE RECORD OF THE HEARING ON

"TAX REFORM AND THE U.S. MANUFACTURING SECTOR"

BEFORE
COMMITTEE ON WAYS AND MEANS

ON

July 19, 2012

Introduction

The R&D Credit Coalition welcomes the opportunity to provide comments for the record of the July 19, 2012, Committee on Ways & Means ("Committee") hearing to examine "tax reform and the U.S. manufacturing sector."

The R&D Credit Coalition thanks Chairman Camp and Ranking Member Levin for holding this hearing on business tax issues currently facing U.S. manufacturing companies, and examining how comprehensive tax reform could improve the ability of manufacturers to contribute to job creation and economic growth. In addition, we would like to thank Ways & Means Committee members Kevin Brady (R-TX) and John Larson (D-CT) for their leadership in sponsoring H.R. 942, legislation that would provide a strengthened and permanent R&D tax credit, an important innovation incentive utilized by many manufacturers. The credit expired on December 31, 2011, and we look forward to continuing our work with them and the Committee to advance an extension that would provide U.S. businesses with the certainty and incentives they need to maintain and increase research and development (R&D) jobs here in the U.S.

The R&D Credit Coalition is a group of more than 100 trade and professional associations along with small, medium and large companies that collectively represent millions of American workers engaged in U.S.-based research throughout major sectors of the U.S. economy, including aerospace, agriculture, biotechnology, chemicals, electronics, energy, information technology, manufacturing, medical technology, pharmaceuticals, software and telecommunications.

Although the make-up of the R&D Credit Coalition is diverse, the member companies share a major characteristic—they collectively spend billions of dollars annually on research and development, which provides high-wage and highly-skilled jobs in the United States. There is significant global competition for R&D jobs, which means that companies have an array of choices on where to locate such jobs and where to invest research dollars—here in the U.S. or abroad. The high U.S. corporate income tax rate and the temporary nature of the U.S. R&D tax credit, compared to the lower corporate income tax rates and more stable, robust, and often permanent research incentives in most other developed countries, are key factors that companies consider in determining where they are going to create and maintain R&D jobs.

Given the focus of the hearing on manufacturing, it is important to note that manufactures are key beneficiaries of the R&D tax credit, and that the credit plays an important role in the strength of the manufacturing sector. As one of the witnesses at this hearing testified, the R&D tax credit was beneficial to his company during the recession and helped them develop a new product during a difficult time; an investment that may not have been made but for the credit.[1] The U.S. manufacturing sector provides millions of high wage jobs here in the U.S. and generates more than $1.6 trillion in GDP. With increased global competition, we need to ensure that the U.S. is the best place for companies to do business and conduct research. There are many other countries that offer BOTH lower corporate tax rates and more attractive R&D incentives. The credit is needed to keep the U.S. competitive in the global race for investment dollars.

The goal is for the U.S. to retain and attract global R&D activities across all sectors of the economy. The certainty provided by a permanent and strengthened R&D tax credit would enhance its incentive value.

The continued inability of Congress to seamlessly extend the R&D tax credit (retroactive to January 1, 2012) and to agree on a permanent incentive for U.S. research and development expenditures, will have a dramatic impact on the number of R&D jobs created and maintained in the U.S. Given the Committee's focus on finding a long term solution within the context of tax reform, the R&D Credit Coalition urges Congress to pass a permanent, strengthened credit (retroactive to January 1, 2012) to ensure that R&D jobs remain and increase here in the U.S.

Discussion

The R&D tax credit, originally enacted in 1981, was designed to be an important incentive in spurring private sector investment in innovative research by companies of all sizes and in a variety of industries. The enactment of this incentive helped establish the U.S. as a leader in cutting-edge research. The purpose of the R&D tax credit is to encourage U.S. based research activity and to ensure that companies create high-paying jobs here in the U.S. In fact, during the 1980s, the U.S. was the leader among OECD countries in providing the best R&D incentives for companies. However, in recent years, many other countries have instituted more generous and often permanent R&D incentives. As a result, according to an OECD study, the U.S. was ranked 24th in research incentives among industrialized countries[2].

In contrast to the incentives offered by a number of other countries, the temporary nature of the U.S. R&D tax credit makes it a less powerful incentive in terms of a company's R&D budgets and decisions about where to locate new R&D activities. The certainty of a strengthened, permanent credit, especially in a tax reform environment, is critical to maintaining U.S. leadership in advanced research and encouraging companies to continue to spend R&D funds here in the U.S.

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[1] Testimony of Kim W. Beck, president and CEO, Automatic Feed Company on Behalf of AMT – The Association for Manufacturing Technology before the U.S. House of Representatives, Committee on Ways and Means, July 19, 2012.

[2] OECD, "Science, Technology and Industry Scorecard," December 2009, p. 79.

The R&D credit has a significant impact on private R&D spending and the creation of research jobs. A recent study by the Center for American Progress concludes that, "the credit is effective in the sense that each dollar of foregone tax revenue causes businesses to invest at least an additional dollar in R&D.[3]" In addition, according to a recent study by Ernst & Young, "In total, the overall policy – the existing credit plus strengthening the alternative simplified credit – is estimated to increase annual private research spending by $15 billion in the short-term and $33 billion in the long-term."[4]

As noted above, many other countries offer *both* lower corporate tax rates and more attractive R&D incentives[5]. Accordingly, the U.S. should not engage in an "either/or" debate with respect to lower marginal rates and boosting U.S. job creation through R&D incentives when looking at options to reform the corporate tax code. To remain competitive in the global economy, the U.S. can and should provide an effective and permanent incentive for R&D even if the corporate tax rate is reduced.

Moreover, it is important to note that the R&D credit is a *jobs* credit—70 percent of credit dollars are used to pay the salaries of high skilled R&D workers in the U.S. The E&Y study also stated that, "the credit and its enhancement is estimated to increase research-related employment by 140,000 in the short term and 300,000 in the long-term."[6]

International R&D Tax Incentives

The U.S. must maintain a globally competitive tax system that supports high-skilled, high-paying jobs, here in the U.S. Failure to extend the credit retroactive to January 1, 2012 as soon as possible and failure to permanently strengthen the R&D tax credit will put current jobs at risk of moving abroad, and jeopardize the expenditure of R&D funds in the U.S. Research and development will continue; the question is where will the R&D jobs be located.

While the United States has offered an "on-again, off-again" incentive for more than 30 years, the number of OECD countries offering some sort of incentive for research has grown dramatically in recent years as countries attempt to become leaders in research. The U.S. share of global R&D fell from 39 percent in 1999 to 33 percent in 2007.[7] In addition, the following OECD chart shows that in 2009, the United States ranked 24 among 38 industrialized countries offering R&D tax incentives.[8]

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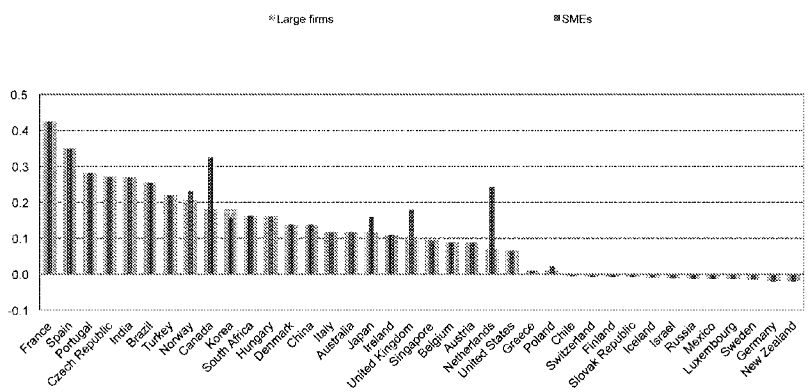
[3] Center for American Progress, "The Corporate R&D Tax Credit and U.S. Innovation and Competitiveness," by Laura Tyson and Greg Linden, January 2012, p.2.
[4] Ernst & Young, "The R&D Credit: An effective policy for promoting research spending," September 2011, p. i.
[5] Deloitte, "Global Survey of R&D Tax Incentives," July 2011.
[6] Ernst & Young, "The R&D Credit: An effective policy for promoting research spending," September 2011, p.11.
[7] OECD, Ministerial Report on the OECD Innovation Strategy, May 2010, p. 8.
[8] OECD, "Science, Technology and Industry Scorecard," December 2009, p. 79.

OECD Science, Technology and Industry Scoreboard 2009 - OECD © 2009 - ISBN 9789264063716
Tax subsidy rate for USD 1 of R&D, large firms and SMEs, 2008



A recent National Science Board report concluded that the United States' lead in science and technology is "rapidly shrinking" as R&D jobs and overall R&D spending continue to increase faster outside the U.S. than here at home. The report shows that "between 1999 and 2009...the U.S. share of global research and development (R&D) dropped from 38 percent to 31 percent, whereas it grew from 24 percent to 35 percent in the Asia region during the same time.[9]"

Bipartisan Support for a Strengthened, Permanent Research & Development Incentive

On a positive note, there is broad and bipartisan support for extending the research credit. Every Administration has supported the R&D tax credit since it was enacted. In a March 2011 study, the Treasury Department noted that, "[T]wo years ago, the President set an ambitious goal of achieving a level of research and development that is the highest share of the economy since the space race of the 1960's – 3 percent of GDP – a commitment he re-emphasized in his State of the Union address in 2011. The R&D tax credit is a vital component of achieving this goal and helping us out-innovate our competition. This is why, in addition to making it permanent, the President proposed...to expand and simplify the credit, making it easier and more attractive for businesses to claim this credit for their research investments. This proposal was subsequently included in the President's FY 2012 and FY

[9] National Science Foundation press release, "New Report Outlines Trends in U.S. Global Competitiveness in Science and Technology," January 17, 2011.

2013 Budget(s) and should be part of the reform of our corporate tax system currently under consideration."[10]

Moreover, Congress has extended the credit 14 times since it was first adopted in 1981. In 2011, Representatives Kevin Brady (R-TX) and John Larson (D-CT) introduced H.R. 942, the American Research and Competitiveness Act, and Senate Finance Committee Chairman Max Baucus (D-MT) and Ranking Member Orrin Hatch (R-UT) introduced S.1577, The Greater Research Opportunities With Tax Help Act. This legislation would provide important certainty for U.S.-based research spending by making the R&D tax credit permanent as well as simplifying and strengthening it, thereby increasing its effectiveness.

Conclusion

The R&D Tax Credit was designed to ensure that companies from varied industries, including manufacturers and services businesses, conduct their research activities in the United States and create well-paying, highly skilled jobs here. That original purpose still holds true today, although increasing global competition is making it more difficult. It is vitally important that U.S. policy makers support a strengthened and permanent research and development incentive as part of any tax reform measure and seamlessly extend the credit as soon as possible. A robust and permanent research and development tax credit is critical to competitiveness, innovation and U.S. jobs. In the global economy many companies have a choice as to where they are going to do their research—and with many other countries offering *both* lower corporate income tax rates and more robust R&D incentives, the U.S. tax system must provide globally competitive R&D incentives that can be counted on by businesses. The R&D Credit Coalition looks forward to assisting members of the Committee and their staffs in gaining a more detailed understanding of the competitive pressures faced by companies as well as of the research and development tax credit and its impact on U.S. jobs. We also look forward to working together to advance legislation to seamlessly extend, strengthen and make permanent the R&D tax credit.

Links to Studies:

Center for American Progress, "The Corporate R&D Tax Credit and U.S. Innovation and Competitiveness"
http://www.americanprogress.org/issues/2012/01/corporate_r_and_d.html

Ernst & Young, "The R&D Credit: An effective policy for promoting research spending"
http://www.investinamericasfuture.org/PDFs/EY_R&D_Credit_Report_2011_09_16.pdf

Deloitte, "Global Survey of R&D Tax Incentives,"
http://www.investinamericasfuture.org/PDFs/Global%20RD%20Survey%20Final%20-%202011.pdf

[10] *"Investing in U.S. Competitiveness: The Benefits of Enhancing the Research and Experimentation (R&E) Tax Credit,"* U.S. Department of the Treasury, March 25, 2011, page 1.

National Science Foundation press release, "New Report Outlines Trends in U.S. Global Competitiveness in Science and Technology"
http://www.nsf.gov/nsb/news/news_summ.jsp?cntn_id=122859&org=NSB&from=news

OECD, Ministerial Report on the OECD Innovation Strategy, May 2010
http://www.oecd.org/dataoecd/51/28/45326349.pdf

OECD, "Science, Technology and Industry Scorecard," December 2009
http://www.oecd.org/document/21/0,3746,en_2649_33703_48714517_1_1_1_1,00.html

U.S. Department of the Treasury, "*Investing in U.S. Competitiveness: The benefits of Enhancing the Research and Experimentation (R&E) Tax Credit*"
http://www.investinamericasfuture.org/PDFs/TreasuryRDReportMarch25.PDF

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I WANT MY COUNTRY BACK.

All New goods are taxed at the register.
All invoices include The State and Federal Tax.
No more wholesale tax,
No more resale tax.
Every business sends taxes to the Dept of the Treasury, each month. (Government too.)

There are no longer ANY other taxes.

No other taxes, No State, No Federal Taxes.

ABSOLUTELY NO OTHER TAXES.

Each grocery store, each car dealer, every business Sends taxes to the Dept of the Treasury at the end of each month.

Everyone's taxes are paid. No filing, no tax preparation.

The Federal Dept. of the Treasury receives The monthly taxes, and applies these to the government expenses.

The Dept. of the Treasury sends a percentage back each month, to each State, based on how much that State's businesses sent in.

Results Would Be:

Cost of goods would decline immediately.
Value of the dollar would go up.
Inflation would go down.
Manufacturing would come back.
Exports would come back.
Jobs would come back.
Businesses would come back to the country as well as new ones from all over the World.
Collusion and Graft in Congress would greatly diminish. Because no lobbies are paying politicians off.
Special interests and special agendas are largely reduced.

Simplified Explanation

A banana costs 1.00.
The store sells the banana for 1.30 .
30 cents on the dollar is collected and sent to the Dept. of the Treasury.

The Dept. of the Treasury puts 20 cents on the dollar toward Federal expenditure.

The Dept. of the Treasury sends 10 cents on the dollar back to each State.

Each Month.

Sure, costs go up for everyone, for a week.
Then businesses realize they are able to operate and

produce at lower cost.

If BF Goodrich realizes this and drops the price of their tires. Dunlop will have to drop their tire prices also.

The whole of the fabric of business will react the same way in a free market.

800 billion dollars saved in tax preparation costs.
800 billion dollars in payola to Congress eliminated.
Social security paid
Medicare paid
Medicaid paid
Welfare paid
Health care paid
Everyone who buys anything has paid their taxes, including those who are not citizens .

NOTE:
Destitute, indigent, mentally or physically unable,
Qualify for food, or pay 1.05 for the banana.

I want you to get this implemented. If the tax system is not replaced, we have all the evidence to show our economy is going to collapse.

Scott Bucknell
Haleiwa, Hawaii

Semiconductor Industry Association

SIA SEMICONDUCTOR INDUSTRY ASSOCIATION

House of Representatives Committee on Ways and Means
Hearing on "Tax Reform and the U.S. Manufacturing Sector"
(Hearing held July 19, 2012)

Statement for the Record
by
Brian Toohey, President and CEO
Semiconductor Industry Association

August 2, 2012

The Semiconductor Industry Association SIA ("SIA") appreciates this opportunity to submit comments to the Committee on Ways and Means ("Committee") in respect of the Committee's July 19, 2012 hearing on "Tax Reform and the U.S. Manufacturing Sector" and how the current tax system affects U.S. manufacturers and how comprehensive tax reform might affect their ability to expand and create jobs.

Background on SIA and the Semiconductor Industry

SIA is the voice of the U.S. semiconductor industry, America's second top export industry over the period of 2006-11, and a bellwether measurement of the U.S. economy. Semiconductor innovations form the foundation for America's $1.1 trillion technology industry affecting a U.S. workforce of nearly six million. Founded in 1977 by five microelectronics pioneers, SIA unites over 60 companies that account for 80 percent of the semiconductor production of this country. SIA seeks to strengthen U.S. leadership of semiconductor design and manufacturing by working with Congress, the Administration and other key industry groups. SIA works to encourage policies and regulations that fuel innovation, propel business and drive international competition in order to maintain a thriving semiconductor industry in the United States. For more information, see www.sia-online.org.

America's semiconductor industry is critical to our country's economic growth and recovery. Semiconductors are the fundamental enabling technology for the modern economy and an essential component of our nation's defense and homeland security, information and technology, global finance, transportation, health care, and many other sectors of our economy. Our industry serves very competitive markets and is engaged in R&D, manufacturing, marketing and customer support functions all over the world. Yet today, it has approximately two-thirds of its wafer fabrication capacity located in the U.S., and more than 80% of sales are sourced outside the United States. Thus, we offer these comments from the perspective of U.S. headquartered companies in a leading U.S. export industry. We also comment from the perspective of a U.S. industry that spends 18 percent of its sales on R&D in 2011, a total of $27 billion. This is one of the highest levels of investment in research and development of any sector of the economy.

Semiconductor companies generally fall into one of three business models. The first business model consists of companies that own and operate their own manufacturing facilities, which are located in the U.S. and other countries. These companies invest in operations that perform R&D related to proprietary product design and manufacturing processes, manufacturing and marketing. Their wafer fabrication facilities are in many cases multi-billion dollar investments representing the most advanced and most costly manufacturing operations in the world.

The second business model includes "fabless" semiconductor companies. These companies engage in product related R&D, design and marketing. They contract with other companies known as "foundries" to manufacture the wafers and perform assembly/test. This business model started about 25 years ago, when companies capable of manufacturing semiconductor devices from customer designs began to emerge. The evolution of this business model brought on a new era for the industry. Previously, a company did not have access to manufacturing capacity unless it invested a substantial amount of capital in wafer fabrication and assembly/test facilities. This was a significant barrier to entry into the semiconductor business. However, the evolution of semiconductor foundries and the fabless business model meant that small start-up companies with limited capital but the ability to develop and market creative new products, could become successful semiconductor companies.

The third business model is made up of those in the foundry business which engage in contract manufacturing for the companies engaged in the fabless business model. They do not develop and sell their own products in the marketplace. Foundries perform R&D related to manufacturing processes and manufacturing. In some instances they also help customers with product designs. The foundry business model began with foreign companies headquartered in Asia and these companies have grown significantly. Today, foundries exist in both the U.S. and foreign locations, but currently most of their manufacturing services exist outside the U.S. However, U.S. based foundry manufacturing capacity is expected to grow significantly over the next few years.

Each of these different business models generates high-paying jobs. The average salary in the semiconductor industry is approximately $100,000. In addition, the semiconductor industry produces significant levels of indirect employment through the supply chain of providers of capital equipment and basic materials. For this reason, countries around the world compete to attract investments by the semiconductor industry.

Countries Compete for Semiconductor Manufacturing

The presence of a healthy semiconductor industry, including R&D, engineering centers, and in particular wafer fabrication facilities, provides significant benefits to a country's economy, not only in the form of the economic value that comes from the presence of semiconductor companies, but also in the form of spillover benefits as a high-tech infrastructure and an engineering community evolve from the industry. The positive effects from the multiplier effect of these spillover benefits can be substantial.

Countries throughout the world are very much aware of these economic benefits and many of them have developed government incentives to attract investments in semiconductor manufacturing and R&D. These incentives appear in two forms.

- The first are incentives that are available to any company that meets the criteria under a statute, which would be similar to, for example, the tax credit for research and experimentation under the Internal Revenue Code. This type of incentive is aimed at the front end of the innovation process. Many countries have also adopted tax incentives for the back end of the innovation process. These incentives, referred to as patent and innovation boxes, typically provide low tax rates on the income stream, such as income from royalties or manufacturing, that flow from the IP that was developed.

- The second is incentives that are awarded on a discretionary basis to specific companies for proposed investments, where the companies go

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through an application and selection process for the incentives, which would be similar to, for example, the process under which the Department of Energy has awarded tax credits under section 48C of the Code. Depending on the extent of a proposed investment, it is common for these incentives to include a broad package of benefits such as tax benefits (including income tax holidays for manufacturing), financing, subsidized utilities and technical training for employees.

The incentives offered by countries around the world can be significant. One analysis of the potential cost differential from operating a wafer fabrication facility in the U.S. versus a foreign location offering a typical package of incentives, including an income tax holiday, indicates that the foreign operation would enjoy a $1 billion cost advantage over a ten-year period, and that about 70% of the savings would come from tax savings.[i]

Thus, our U.S.-based manufacturing faces competitive disadvantages on tax cost at two levels. First, as is widely known, the U.S. tax rate is not competitive. When Japan reduced its corporate rate in April 2012, the U.S. corporate statutory tax rate became the highest in the OECD and most emerging markets as well. A manufacturing facility in most of the OECD countries and the developing countries key to our industry will enjoy a tax rate lower than the U.S. rate (this is so even under the assumption that section 199 causes the relevant U.S. rate to be 32%).[ii] Second, foreign statutory rates are not relevant when comparing the tax cost associated with our U.S. manufacturing to the tax cost of a foreign operation that has been awarded company-specific incentives. In those cases, the foreign effective tax rate often approaches zero.

Criteria for Evaluating a Competitive Tax System

In addressing the competitive global landscape, SIA believes that it is important for the Committee and policymakers to understand that we should not focus on competitive comparisons between the tax cost environment for a company's operations in the U.S. to the environment for the operations of that company's foreign subsidiaries. Instead, the relevant debate should focus on comparisons of the tax cost applicable to the earnings of our foreign subsidiaries to the tax cost on the earnings of similarly situated foreign competitors, whether they be stand-alone companies or subsidiaries of parent companies headquartered elsewhere. The critical distinction here is that, under the tax systems of most countries, the

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local country tax imposed upon the active earnings of a competitor, or the foreign subsidiary of a competitor, is the final tax cost imposed on the entity's earnings. In contrast, the active earnings of our subsidiaries are potentially subject to a second level of tax, i.e., U.S. tax, depending on whether those earnings are repatriated to the U.S. The current system also provides a foreign tax credit up to the U.S. corporate rate, for foreign taxes paid. This "world-wide" tax system has been in existence for decades and is inefficient in today's global economy.

The competitive disadvantage of this system lies with the fact that potential foreign earnings are "locked out" of the U.S. economy because they are taxed on repatriation, albeit with a foreign tax credit for taxes paid. The competitive disadvantage of the current world-wide system would be worsened under an overly broad base erosion or a minimum tax proposal that would impose a new category of Subpart F income on the active earnings of our subsidiaries. Again, we urge the Committee to consider the effect of any tax reform proposal in the context of the competitive position of one of our foreign subsidiaries compared to that of a competitor in the same country, just across the street and engaged in the same business functions.

And we also submit to the Committee that this "company across the street" analogy is also relevant to the competitiveness of the U.S. as a manufacturing location for our industry, because of the importance of having a cost effective supply chain to customers. For example, in a typical product flow, the wafers produced from a U.S. fabrication facility may be destined for sale as finished semiconductor devices to customers in Asia. Those wafers may be shipped to an Asian subsidiary that completes assembly and testing processes, which yield marketable devices. Those devices may be shipped to another subsidiary to be held in inventory in a regional product distribution center that it operates. Other subsidiaries are based in the customers' countries and will assist customers with their product designs, engage in marketing and arrange logistics. They will obtain sales orders which ultimately result in shipments from the product distribution center to the customers. In this example, foreign subsidiaries have performed three critical downstream functions for the U.S. wafer fabrication facility. To the extent that the cost of these functions is higher than the cost experienced by peers who perform the same functions in the same countries, and that cost differential exists only because the parent company is headquartered in the U.S., the U.S. becomes a less attractive location for the wafer fabrication facility. The

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higher downstream costs produce a drag on the earnings from the wafer fabrication facility.

How Tax Reform Can Improve the U.S. Manufacturing Environment

SIA supports tax reform that places our operations in a more competitive position both domestically and globally. We believe that advancing the competitiveness of U.S. companies should be the overriding goal of tax reform. There are probably several ways to achieve this goal. For example, there are advocates of the principle that the corporate rate should be as low as possible, and that special provisions of the Code that confer tax benefits on specific classes of taxpayers or activities should be eliminated, i.e., the Code should not be used as a means to pick winners and losers in our economy. On the other hand, there are advocates for using the Code to incentivize selected behaviors such as, for example, engaging in research or hiring employees, or for penalizing behaviors such as using debt instead of equity for financing, or developing intellectual property offshore. SIA sees some potential benefits to the U.S. manufacturing sector from either approach, so long as the end result advances the primary goal of creating a competitive tax cost environment for U.S. companies.

With that goal in mind, we offer our three priorities for fundamental tax reform. These priorities are:

1. a significantly lower and globally competitive corporate tax rate;

2. a competitive territorial tax system, and

3. incentives for research and innovation which are competitive with incentives in other countries.

We believe that the Committee's corporate tax reform discussion draft of October 26, 2011 is a step in the right direction. The proposed 25% corporate rate would clearly be a positive move toward making the U.S. more attractive for manufacturing. However, we offer two comments on this proposed rate. First, as outlined above, other countries which have a developed semiconductor industry and infrastructure currently offer substantial tax and other incentives for new wafer fabrication facilities. They would tax the profits from a new facility at close to a zero rate for several years, and then tax at a rate materially below a 25% rate thereafter.[iii] Second, a 25% rate might be less attractive if it is effectively offset by

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changes to other provisions in the Code that affect manufacturers. Here, we again point to the example above of downstream business functions performed in foreign subsidiaries in support of a U.S. wafer fabrication facility.

Likewise, we believe that the draft's basic structure for a territorial tax system would appear to put U.S. companies on a level playing field with foreign competitors. This is significant to U.S.-based manufacturing because it would eliminate the "lock-out" effect under current law and free up capital for repatriation. However, we repeat once more our concerns that base erosion or minimum tax proposals might impose an additional tax cost on the earnings of our foreign subsidiaries that would not apply to "the competitor across the street." And in particular we are concerned that some of the base erosion proposals single out foreign subsidiaries that own intellectual property and/or have low foreign tax rates. These proposals are troubling because the semiconductor industry is rich in valuable intellectual property,[iv] we derive substantial income from the property, and because it is common that, as a result of the tax policies of other countries, foreign semiconductor manufacturing and R&D operations have low effective tax rates. Low tax cost is part of the semiconductor industry's competitive landscape outside of the U.S., and it extends to all companies, not just U.S. owned subsidiaries. Therefore, depending on facts and circumstances, it is possible for a base erosion provision to place a semiconductor company in a worse competitive position than one under which tax reform never occurred.

Our third priority for tax reform is a call for incentives for research and innovation which are competitive with incentives in other countries. As noted above, the semiconductor industry is a research intensive industry. R&D for both products and manufacturing processes is the lifeline for maintaining the leading edge that U.S. companies occupy in our industry. Today, most of our R&D is conducted in the U.S., and that is healthy for the U.S. economy, its technology infrastructure and its manufacturing. There is a natural linkage between R&D operations and manufacturing operations, and companies find advantages in the two being located in close proximity. And, just as with wafer fabrication operations, other countries have also established attractive and effective incentives for R&D. The Committee is aware that the U.S. credit for research and experimentation has, once again, expired, and even when it has been in effect, it has over the years become mediocre when compared to R&D incentives offered in other countries.[v] We urge the committee to extend the credit as soon as possible and not wait to include it as a part of fundamental tax reform. Moreover, as a part of tax reform, we urge the Committee to consider expanding the credit to include other significant costs that companies routinely incur as a part of their R&D, for example, depreciation expense.[vi]

The Committee is probably also aware that nine other countries have enacted a patent box[vii] incentive for R&D. A well constructed patent or innovation box could serve as an additional incentive for R&D and manufacturing in the U.S.

Lastly, as mentioned previously, we believe it is possible for the U.S. to establish a more attractive framework for domestic manufacturing under either a low rate/broad base approach to tax reform or an approach that offers targeted incentives for manufacturing. It is of course possible that tax reform will consist of a combination of a somewhat lower rate and incentives.[viii] If policymakers prefer to explore the latter approach, there are probably several effective ways to enhance section 199 to make the U.S. more attractive for manufacturing. .

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We appreciate this opportunity to provide the Committee with these comments. We hope they are useful. Our member companies have extensive experience in how other countries frame their tax systems to attract manufacturing. We offer ourselves as a resource for Committee staff to explore any aspect of these comments further.

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[i] The analysis was included in a March 14, 2012 letter from SIA to the Subcommittee on Select Revenue Measures. The letter provided SIA's comments on the November 17, 2011 hearing by the Subcommittee

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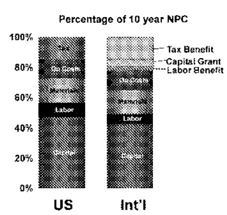
on the Ways and Means discussion draft for tax reform. An excerpt from that letter which illustrates the $1 billion cost differential is as follows:

> An example of this advantage is in Exhibit I below. It is an analysis prepared several years ago that illustrates the cost differential of a wafer fabrication operation located in the U.S. vs. one located in a country that offers a tax holiday.

Exhibit I – Almost a $1Billion Cost Difference Over 10 years In Building And Operating A Wafer Fab In The U.S. Vs. Overseas.

- **Wafer Cost model compares alternatives based on a 10 year Net present Cost**
  - Production starting in year 3
  - Ramp with "current generation" technology products and transition to next gen products after 5 years
- **What factors drive the analysis ?**
  - Cost differences driven by tax treatment, capital grants, other local factors
  - Other local factors: utilities, labor, logistics

	Conceptual 300mm FAB 10yr NPC
Int'l	$5.6B-$6.1B
US	$6.7B-$6.8B



> This analysis shows that there is almost a one billion dollar cost advantage in operating the facility in the foreign location. It is based a 10 year net present cost; it assumes production starting in the third year with "current generation" technology products and a transition to the next generation of products after five years. The cost differences result from tax savings, capital grants and other factors such as labor, utilities and logistics. Note, however, that the overwhelming cost advantage is the tax savings.

[ii] These are the statutory rates in some of the countries with significant semiconductor operations. Several of these countries would also offer tax holidays or other significant tax incentives for investing in a wafer fabrication facility.

Country	Statutory Rate %

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Ireland	12.5
Hong Kong	16.5
Taiwan	17
Singapore	17
Israel	24
Korea	24.2
Malaysia	25
China	25

[iii] We do not propose that the U.S. joins other countries in offering income tax holidays for wafer fabrication facilities. We describe this practice by other countries so that the Committee has a realistic presentation of the competitive landscape for semiconductor manufacturing.

[iv] We believe that the tax policy concern associated with a foreign subsidiary's ownership of intellectual property should be an inquiry into how the property was acquired, and not simply a policy of taxing it because it exists. The IRS has a long list of tools currently available for detecting whether a foreign subsidiary's IP was acquired through improper intercompany transactions, and then assessing any tax due. These tools include, for example, tax return disclosure procedures; "the commensurate with income" rule under section 482 which allows the IRS some degree of hindsight as it audits intercompany pricing; requirements that a taxpayer prepare a contemporaneous pricing study that supports its intercompany pricing policies; tax treaty processes for the exchange of taxpayer information between governments and rules administered by the IRS that establish minimum quality standards for tax opinions issued by practitioners.

[v] A recent report concludes that the United States currently ranks 27th in tax incentive generosity, out of a total of 42 countries studied. See Information Technology & Innovation Foundation, *"We're #27!: The United Stated Lags Far Behind in R&D Tax Incentive Generosity" (July 2012), available at* http://www2.itif.org/2012-were-27-b-index-tax.pdf

[vi] Depreciation was excluded from the definition of qualified research expenditures when the credit was initially enacted in 1981 because of the investment tax credit that was also in effect at the time. Absent this exclusion, a taxpayer could have obtained two tax credits for purchasing an asset that was used in R&D. The investment tax credit was repealed under the Tax Reform Act of 1986. Thus, the concern that a taxpayer could purchase an R&D asset and get two credits is obsolete.

[vii] Nine countries currently have a patent box: Belgium, Hungary, China, France, Ireland, Luxembourg, the Netherlands, Spain, and Switzerland. The UK has a patent box incentive that becomes effective in 2013.

[viii] For example, the President's framework for tax reform calls for a 28% corporate rate and a continuation of the section 199 deduction, which would provide a rate of approximately 25% for manufacturing. Additionally, the framework proposes an additional incentive for "advanced manufacturing".

Society of Chemical Manufacturers & Affiliates

SOCMA
Society of Chemical Manufacturers & Affiliates

July 18, 2012

The Honorable Dave Camp
Chairman, Committee on Ways and Means
U.S. House of Representatives
341 Cannon House Office Building
Washington, DC 20515

The Honorable Sander M. Levin
Ranking Member, Committee on Ways and Means
U.S. House of Representatives
1236 Longworth House Office Building
Washington, DC 20515

Dear Chairman Camp and Ranking Member Levin:

On behalf of the 200 members of the Society of Chemical Manufacturers and Affiliates (SOCMA), thank you for convening today's hearing on tax reform. As one of the most innovative manufacturing sectors in the U.S., the specialty chemical industry leads the development of chemistries that support virtually every type of American manufacturing. As manufacturers, our members have a meaningful interest in the future direction of our tax laws, especially the federal research & development tax credit. Much research and investment are devoted to developing new chemical products before they are sold in the marketplace. This makes the R&D tax credit important to our members and to manufacturers in general. On average, manufacturers claim approximately 70% of R&D credit amounts.

Furthermore, the R&D tax credit is needed to keep the U.S. competitive in the global race for R&D investment dollars. According to the Organization for Economic Cooperation and Development, in 2009, the United States ranked 24th among 38 industrialized countries offering R&D tax incentives. This needs to change.

As you know, the R&D tax credit expired at the end of 2011, leaving our industry uncertain about how to budget for R&D. Strengthening the R&D credit and making it permanent will provide new opportunities for businesses of all sizes to expand and invest in their future, ultimately creating jobs and growing our economy.

SOCMA stands ready to assist you as you consider ways to reform our tax laws, especially how R&D tax incentives benefit one of our nation's most innovative and heavily relied upon manufacturing sectors.

Respectfully submitted,

Lawrence D. Sloan
President & CEO

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Stephen Entin IRET 1

Written Submission of Stephen J. Entin
for the record of the
House Ways and Means Committee Hearing on
Tax Reform and the U.S. Manufacturing Sector
July 19, 2012

Mr. Chairman and Members of the Committee:

I am currently President and Executive Director of the Institute for Research on the Economics of Taxation. I served as Deputy Assistant Secretary for Economic Policy in the Treasury Department for eight years during the Reagan Administration.

The Committee is considering the state of U.S. manufacturing, and changes to the tax treatment of manufacturing under a possible tax reform effort. Taxes have a major effect on the profitability and competitiveness of U.S.-based manufacturing and U.S.-headquartered firms.

There are two broad issue areas to consider – tax rates and tax base. By tax rates, I mean the schedule of marginal tax rates applied to taxable income. The tax base is what is considered income subject to tax. Income as defined for tax purposes is often significantly different from the true income of the taxpaying business, making the effective tax rate quite different from the apparent statutory rate. As the Committee considers tax reform, it should give some very serious study to the combined effect of changes in tax rates and the tax base on the ability and incentive to invest and employ capital in the United States. Rate and base considerations are equally important, and they may affect different businesses and industries very differently. A "one-size-fits-all" reform could be very disruptive and damaging.

Tax rates. For Schedule C corporations, tax rates include the statutory tax rate of up to 35% at the corporate level, and the tax rates applied to corporate shareholders on dividends and capital gains. For non-corporate business owners and participants in pass-through entities, the key rates are the top rates on the taxpayers' personal income.

Tax base. The current definition of taxable income (the tax base) needs at least two major reforms. The one I shall discuss here is the capital cost recovery system, which dictates how rapidly a business can deduct the cost of plant, equipment, structures, and inventory as business expenses. The other key decision is whether the tax is to be imposed on activity within the United States (territorial taxation) or on the world-wide earnings of U.S.-based businesses (global taxation). I will not address the global versus territorial issues except to say that adopting territorial taxation would aid U.S. competitiveness, increase U.S. as well as foreign hiring by U.S. multinationals, and greatly simplify the tax system.

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Key points to guide reform.

- The income tax is heavily biased against saving and investment, hurting investment and lowering productivity and wages. All would gain by fixing the biases.

- Increasing the double taxation of corporate income by raising tax rates on capital gains and dividends would dramatically reduce capital formation and wages, and would not raise the expected revenue.

- Keeping the current treatment of capital gains and dividends while cutting the corporate tax rate would raise GDP, employment, and wages. It would increase, not decrease, federal revenue over time.

- The definition of the tax base (taxable income) is at least as important as the tax rate. Overstating business income by undercounting investment expenses (requiring depreciation instead of expensing) leads to less investment and lower wages. Expensing (immediately deducting the cost of the asset for tax purposes) is the right approach, and gains revenue over time.

- We should not repeat the Tax Reform Act of 1986, which tried to perfect the "broad-based income tax"; rather, we should adopt a different tax base that is more neutral in its treatment of saving and investment relative to consumption.

- Do not trade expensing for a corporate tax rate reduction. Do both. That is the only way to measure income correctly across businesses and impose a uniform, neutral tax. The combination would obviate the need for the manufacturers' credit. Both provisions are affordable on a dynamic basis, taking added growth into account. Use dynamic scoring.

Current tax system is biased against saving and investment.

Federal and state tax systems hit income that is saved harder than income used for consumption. The federal system has at least four layers of possible tax on income that is saved.

1) Income is taxed when first earned (the initial layer of tax). If one uses the after-tax income to buy food, clothing, or a television, one can generally eat, stay warm, and enjoy the entertainment with no additional federal tax (except for a few federal excise taxes).

2) But if one buys a bond or stock or invests in a small business with that after-tax income there is another layer of personal income tax on the stream of interest, dividends, profits or capital gains received on the saving (which is a tax on the "enjoyment" that one "buys" when one saves). The added layer of tax on these purchased income streams is *the basic income tax bias against saving*.

3) If the saving is in corporate stock, there is also the corporate tax to be paid before any distribution to the shareholder, or any reinvestment of retained after-tax earnings to increase the value of the business. (Whether the after-tax corporate income is paid as a dividend, or

reinvested to raise the value of the business, which creates a capital gain, corporate income is taxed twice — *the double taxation of corporate income.*)

4) If a modest amount is left at death (beyond an exempt amount barely big enough to keep a couple in an assisted living facility for a decade), it is taxed again by *the estate and gift tax.*

An additional problem is that business income is often overstated, raising the effective tax rate. In particular, employing depreciation to define capital cost recovery allowances understates costs, overstates income, and effectively raises the tax rate on investment returns. Depreciation makes businesses wait to claim part of the cost of their investment. The delay reduces the value of the write-offs due to the time value of money and inflation.

Real tax reform would end the biases.

Real tax reform would end these biases and over-statements or double counting of capital income by taking a few key steps. They would fundamentally shift the tax base from "broad-based income" to "consumed income", "personal expenditures", or "cash flow".

- Step 1: Give all saving the same treatment received by pensions; either defer tax on saving and its returns until the money is withdrawn for consumption, or tax the saving up front and do not tax the earnings.

- Step 2: Adopt expensing instead of depreciation; alternatively, adjust the depreciation allowances for the time value of money (index unused portions by an appropriate discount rate) to preserve their present value.

- Step 3: Tax income in the corporate sector either at the level of the firm or at the level of the shareholder, but not both; that is, integrate the corporate and personal income taxes.

- Step 4: Eliminate the estate tax.

- Step 5: Move to a territorial tax system.

Corporate reform: expensing, rate reduction, and the cost of capital.

It is impossible to create a good pro-growth reform by tinkering with the corporate tax system in isolation and clinging to "static revenue neutrality." Growth requires a net reduction in the tax on additions to the capital stock. Except for some blatant tax subsidies to uneconomical activities, as with alternative energy credits, there are no large anomalies in the corporate tax system that are not reductions in the marginal tax on capital. Many so-called tax expenditures are the proper tax treatment under a non-distorting, saving-consumption neutral tax. This includes expensing or accelerated depreciation, and other offsets to production costs. Ending these provisions would mismeasure income and offset the benefits of lower tax rates.

A good tax reform would adopt a system that measures income correctly, and then decide what rate to impose to meet the desired revenue target. It should not pre-select a set of tax rates and then distort the tax base and the definition of income to accommodate the revenue target. Tax reform should not become a process for devising a politically acceptable tax hike. It should be a move toward a more economically efficient tax system that allows the government to collect revenue with less collateral damage to economic activity, income, and employment.

A good tax reform should spur growth. The Committee must be given information on what the proposed tax changes would do the economy. That requires a calculation of the impact of the tax changes on the required return, or "service price" of capital. The service price is the pre-tax return on capital needed for it to be profitable and worth creating. If the service price is increased by the tax reform, the capital stock will be depressed, along with jobs, wages, and other tax revenue. If the service price is reduced by the tax reform, the capital stock will expand, along with jobs, wages, and revenue from other taxes. These effects will feed back into the federal revenue stream. The Committee is not receiving this information under current procedures, either from the Joint Tax Committee, the CBO, or the Treasury.

Don't trade expensing for a corporate rate cut. Do both.

Some reform plans, and some business representatives, would trade expensing for corporate rate cuts. This is a bad and unnecessary trade. Reduction or elimination of expensing, or lengthening of asset lives by other means, would raise the service price. Reduction of the corporate tax rate (and, for non-corporate businesses or pass-through entities, reduction of the top individual income tax rates) would reduce the service price. Also, increases in the tax rates on capital gains and dividends would raise the service price, directly offsetting the economic benefits of reduction in the corporate tax rate. Do not sell out the shareholders to please the executives.

The Bowles-Simpson plan, and the Wyden-Coats bill would end bonus expensing and shrply increase asset lives in exchange for a lower corporate tax rate. At the rates being offered, the trade would raise the cost of capital, depress investment, and reduce employment. The expected net revenue gain in Bowles Simpson would never happen. Restrictiing the deductibility of interest by corporate borrowers has also been suggested. For example, the Wyden-Coats bill would disallow the deduction of the inflation component of the interest rate and interest payments, while continuing to tax the inflation-related portion of interest to the lender. These ideas would harm the economy.

Expensing and neutrality. Expensing of equipment is akin to the neutral tax treatment of saving in pensions and IRAs. Tax neutrality between saving and consumption requires that we tax either the income that is saved or the returns on the saving, but not both. Income put into a regular IRA or pension is tax deferred (expensed) and the subsequent returns (principal and earnings) are taxed on withdrawal. (In a Roth IRA, the saving is taxed before it is put into the account, and the earnings are not taxed.) Fully expensing investment and taxing the returns (any earnings and residual scrap value) is neutral. Depreciation, which allows a deduction of only a portion of the full present value of the investment, results in a partial double tax on the returns on the income invested. Depreciation makes it less attractive to use income for investment than for consumption, distorting economic behavior and reducing capital formation and income.

Ordinary investments barely earn the time value of money. The present value of their returns just equals their up-front cost. Immediate expensing reduces the current tax by the identical present value amount as the tax levied on the future normal returns. Expensing offsets only the tax on normal returns. Higher returns, called "economic profits", are taxed even with expensing.

In effect, expensing recognizes time value as a cost. It treats consumption today and saving for consumption at a later date evenly. It is "saving-consumption neutral". Expensing is part of all the real tax reforms (Flat Tax, NRST, X-tax, personal expenditure tax or cash flow tax, etc.) that are saving-consumption neutral. By contrast, restricting capital consumption allowances to arbitrary depreciation schedules does not acknowledge the time value of money, mismeasures (overstates over time) the actual income of the affected business, and discriminates against saving in favor of consumption. A reform that reduces capital consumption allowances and overstates business income before lowering the tax rate would be like a store that doubles prices on Thursday to have a half-off, or worse, a third-off sale on Friday.

Expensing applies to non-corporate businesses and S-corps, not just C-corps. Ending expensing would hurt these other forms of businesses. They would bear a significant portion of the cost of cutting the C-corporation tax rate if it were "paid for" by ending expensing. Ending expensing would hurt those industries which are heavily capital intensive and whose capital must be replaced frequently to remain competitive. These sectors include some parts of the manufacturing sector and rapidly evolving sectors such as high tech. Expensing has less effect on the service industries. Utilizing deprecation instead of expensing overstates the income of the former while not affecting the latter. The degree to which depreciation understates costs and overstates income varies by asset class and industry. It is larger the longer the life of the asset. It increases as the rate of inflation rises. Many assets are assigned different asset lives if they are used in different industries. There are tens of thousands of different asset/write-off combinations. Industries have different mixes of assets and replace them at different rates. The result is a large degree of mismeasurement of income among businesses and widely varying effective tax rates. To measure income correctly across businesses, one must use expensing; then whatever tax rate is selected applies across industries without distorting the mix of investment and output.

Expensing as a targeted cost-effective route to growth. The following table shows the service price-induced economic changes from expensing and corporate rate cuts. We have estimated the corporate tax rate reductions that would provide roughly equivalent increases in GDP as would be expected from 50% and 100% expensing of equipment. Both methods of improving GDP are inexpensive in static terms compared to the massive stimulus spending of recent years. In dynamic terms, they are both costless in the longer term. Both expensing and corporate rate reductions are powerful spurs to investment, and both would eventually return their costs to the Treasury as higher revenues from other taxes due to added growth of GDP. We can afford both. Doing both at once would result in lower static costs than shown here. At a lower corporate tax rate, faster write-offs appear to lose less revenue. With faster write-offs, there is less taxable income, and a rate cut appears less expensive. In dynamic terms, both raise revenue over time.

Stephen Entin IRET 2

COMPARISON OF PARTIAL EXPENSING WITH THE MANUFACTURER'S CREDIT

VERSUS A LOWER CORPORATE TAX RATE

Gains to GDP and Changes in Federal Budget Resulting from:	GDP (%)	Private GDP (%)	Capital Stock (%)	Federal Revenues		% Reflow (%)	Federal Outlays (billions)	Change in Budget Surplus (billions)
				Static (billions)	Dynamic (billions)			
Adding 100% Expensing for Equipment	2.71%	2.81%	7.64%	-$34.20	$48.70	243%	$14.60	$34.10
Lowering Corporate Tax Rate to 22%	2.75%	2.85%	7.74%	-$64.50	$21.60	133%	$14.80	$6.80
Adding 50% Expensing for Equipment	1.36%	1.41%	3.80%	-$17.40	$24.60	241%	$7.40	$17.20
Lowering Corporate Tax Rate to 29%	1.30%	1.35%	3.62%	-$28.40	$12.20	143%	$7.00	$5.20

Numbers are comparative statics results after all economic adjustments (5-10 years). Base is 2008 GDP with MACRS, no PEPs and Pease.

The figures for expensing show the advantage added by expensing assuming the manufacturer's credit remains in place.

In the model runs, the reductions in the corporate tax rate are trimmed by a half percentage point to reflect a repeal of the manufacturer's credit, which is about its economy-wide value over manufacturing and non-manufacturing. Most proposals to reduce the corporate tax rate assume an end to the manufacturer's credit as a partial pay-for (a pay-for that would actually lose revenue).

Private sector labor income lies in line with private sector GDP, in the form of higher wages and higher hours worked. The federal wage bill rises in line with private sector hourly wages, which raises federal outlays as GDP increases.

Expensing boosts GDP, the capital stock, and labor income by more than a reduction in the corporate tax rate, per dollar of apparent static revenue loss. For the same gains in GDP, expensing costs less, generates more revenue reflow, and raises the budget surplus more than the tax cuts.

Both the rate cuts and the expensing increase the budget surplus (reduce the deficit), so there is no need to trade one for the other. Just use dynamic estimation and, if necessary, phase in the rate cuts over time.

Stephen Entin IRET 3

Expensing is more cost-effective, in terms of both static and dynamic government revenue effects, because it focuses on new investment. Both expensing and a reduction in the corporate tax rate reduce the cost of capital and lead to more capital formation. However, some of the corporate rate reduction applies to current income from past investment. Expensing is concentrated on reducing the cost of investment going forward. Expensing does more to increase the capital stock, sooner, than a corporate rate cut of equal "static" revenue cost to the government. Because expensing is a more powerful reduction in the cost of capital than corporate tax rate reduction, per dollar of static revenue loss, a revenue neutral trade of current expensing for a rate cut would raise the cost of capital and would lower capital formation, GDP, employment, and wages.

A switch to expensing has mainly a temporary effect on the federal budget while some old investment is being depreciated along with the outlays for new investment now being expensed. After old investment has been written off, write-offs decline to about the same amount as under a depreciation system with pieces of several years' past investments being deducted in any given year. Even in static terms, the annual cost of expensing largely disappears over a few years. Most is gone within a decade as old 3, 5, 7, and 10 year assets complete their tax lives. Only small amounts of residual write-offs for 15 and 20 year structures linger beyond the budget window. There is a modest residual static tax reduction of about 5% or 10% of corporate tax revenue going forward because the quantity of investment is rising over time. However, in dynamic terms, expensing raises revenues in the out years due to additional growth.

One way to lower the initial cost of cutting the corporate tax rate while extending expensing would be to implement 50% expensing on a permanent basis, and phase in a ten point cut in the corporate tax rate one point per year for ten years. That would slow the GDP gains, but we would get the full benefit eventually. However, the slower rise in GDP would be lost income for the public during the transition, about ten times the amount of tax revenue saved by the government. It is not worth the budget savings.

Corporate rate cuts needed too. Many typical firms in modest-profit industries that employ a typical mix of equipment and structures would benefit greatly from expensing. Some businesses, however, would prefer a corporate tax rate reduction, for several reasons. Some businesses have few assets to depreciate. Think of engineering, software, or architectural firms. All their work involves human capital, and salaries are naturally expensed. Others do not care because they have abnormal profits that dwarf the normal return (patents, market power). Those "economic profits" are taxed even under expensing. Those firms may prefer a lower corporate tax rate on these higher profits. A lower corporate tax rate would boost the competitiveness of such firms in the world economy and increase their hiring and output in the United States.

Accounting quirks cloud the issue. Other firms may favor rate cuts over expensing for less savory reasons. Old firms growing slowly may be jealous of new firms growing fast, with more new investment to write off. Some executives may be more concerned with the appearance of the bottom lines in their financial statements than with the real tax burden on their companies. Accounting conventions do not show accelerated depreciation as a tax reduction and a profit increase, even though it is both. The convention does show a tax rate cut as a profit increase. This quirk in the accounting may cause some business managers to recommend trading a bigger real tax saving from expensing for a smaller tax saving from a rate cut because it makes their annual reports look better. Congress may be talked into making a trade that reduces investment even though it seems to boost reported profits.

- The Financial Accounting Standards Board's Accounting Standards Codification of Generally Accepted Accounting Principles assumes a slow pattern of "economic depreciation" as the norm. Any taxes saved by more accelerated recovery allowances are reported as creating a future "deferred tax liability" of equal size, offsetting the current tax saving. The delay in the tax payment is not discounted to reflect the value of paying later, so the value to the firm is never shown.

- This is bad accounting, and contrary to what business school students are taught in deciding whether to invest or not. MBA candidates are correctly taught to ignore depreciation, and to evaluate an investment by looking at discounted cash flow.

- Similarly, stock analysts are trained in business school to back out expensing and value stocks on a cash flow basis. This is reflected in their reports, so the shareholders and the stock market are not fooled.

Lessons from past tax reforms.

Several major tax reforms in the past have altered the treatment of capital cost recovery as well as the corporate tax rate, capital gains, and dividends. After reductions in the tax on capital, the economy has done well. After increases, it has faltered. New proposals should bear these lessons in mind.

Capital taxes under Kennedy. The Kennedy tax reductions of 1962 reduced asset lives by moving from the Bulletin F lives to the Guidelines, and by introducing an investment tax credit. Combined, the effect was similar to expensing. In 1963, Kennedy and Congress also enacted a phased cut in the corporate tax rate from 52 percent to 48 percent, and reduced individual tax rates. The cuts in the business taxes provided about 55 percent of the economic kick from the Kennedy tax packages. The 1962 elements provided roughly two-thirds of the business tax cut contribution, about twice the effect of the corporate rate cuts of the 1963 Act. The Kennedy cuts spurred several years of above normal economic growth, until the Johnson Vietnam surtax reversed the effect.[1]

ADR. In 1971, the Treasury encouraged investment by modernizing the recovery allowances with the introduction of the asset depreciation range (ADR) and expanding the ITC. These changes had a slightly larger impact on the service price than the subsequent two point reduction in the corporate tax rate in the 1976 Act from 48% to 46%.[2]

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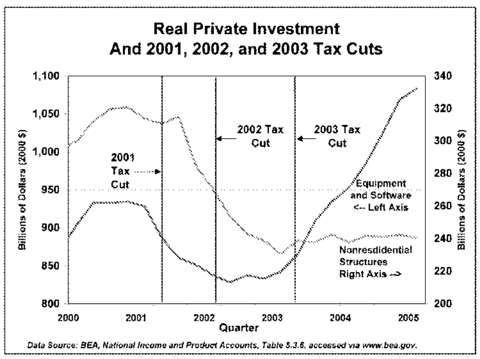
[1] Stephen J. Entin, "Economic Consequences Of The Tax Policies Of The Kennedy And Johnson Administrations," IRET Policy Bulletin, No. 99, September 6, 2011, http://iret.org/pub/BLTN-99.PDF

[2] Stephen J. Entin, "The Nixon, Ford, And Carter Era Tax Policies," IRET Policy Bulletin, No. 102, November 1, 2011, http://iret.org/pub/BLTN-101.PDF

The Reagan tax bills. The Economic Recovery Tax Act of 1981 (ERTA) provided a more rapid write-off of equipment and structures by moving from ADR to the Accelerated Cost Recovery System (ACRS). That, and reductions in marginal individual income tax rates, including capital gains, were responsible for the remarkable rebound from the 1981-82 recession, a rebound that puts the current miserable economic recovery to shame. Subsequent legislation in 1982 (TEFRA), 1984 (DEFRA), and the Tax Reform Act of 1986 (TRA86) reduced acceleration of depreciation or lengthened asset lives. In each case, the service price rose and investment was discouraged. TRA86 moved from ACRS to MACRS (Modified ACRS). TRA86 also raised the tax rate on capital gains, repealed the investment tax credit, and took other steps that raised the service price. Even though TRA86 cut the corporate tax rate from 46% to 34% and lowered the top tax rate on dividends, the other elements of the bill resulted in a slight rise in the service price, and the economy was weaker after its passage. The 1981 Act was good for growth, while the 1986 TRA was not. TRA86 and the percentage point increase in the payroll tax in the 1988-1990 period paved the way for the 1990 recession.[3]



The Bush tax cuts. The 2001 tax reduction (the first Bush tax cut) did almost nothing for investment, even though the slump in investment was the cause of the 2001 recession. Its individual marginal tax rate reductions were scheduled to be phased in over six years, and nothing specific was done to lower the service price of capital. Investment continued to fall throughout 2001. In 2002, Congress passed a 30% percent "bonus expensing" provision, which immediately halted the decline in equipment investment. In 2003, Congress bit the bullet. It moved to 50% expensing, lowered the tax rates on capital gains and dividends to 15%, moved forward the remaining individual marginal rate cuts, and lowered the estate tax. From that moment, equipment spending took off like a rocket, and investment in structures began to recover. (See chart.)[4]

Wyden-Coats. The Wyden-Coats bill (formerly Wyden-Gregg) and the Bowles-Simpson Commission emulate TRA86. They would cut tax rates on businesses in exchange for higher tax rates on capital gains and dividends, and provide much slower tax depreciation of plant, equipment, and structures. The Wyden-Coats bill would revert to the Guidelines with straight line depreciation, which would be worse treatment than under the pre-Kennedy Bulletin F lives

[3] Stephen J. Entin, "The Reagan Era Tax Policies", IRET Policy Bulletin, No. 102, November 11, 2011, http://iret.org/pub/BLTN-102.PDF

[4] Stephen J. Entin, "The Economic Consequences Of George W. Bush's Tax Policies, "IRET Policy Bulletin, No. 104, December 5, 2011, http://iret.org/pub/BLTN-104.PDF

in the Eisenhower Administration. Capital gains and dividends would be taxed at rates up to 22.75%. In spite of retaining the top business tax rates of 35% for individuals, and cutting the top corporate tax rate to 24% for corporations, Wyden-Coats would raise the service price of capital and depress the growth of GDP. I estimate that Wyden-Coats would reduce GDP over time by 4.3%, with 3.2% due to the change in depreciation alone. The adverse shift in the tax treatment of dividends and capital gains would more than cancel out the benefits of the proposed cut in the corporate tax rate. Although the bill is scored to be about revenue neutral, it would lose substantial revenue due to the drop in GDP.[5]

Tax treatment of interest.

Another tax change sometimes mentioned as a partial "pay-for" for a corporate tax rate reduction is the restriction of the interest deduction. (For example, the Wyden Coats bill curbs interest deductions for corporations by disallowing a deduction of the inflation portion of the interest rate, while continuing to tax lenders on the inflation portion.) Restricting the deduction of interest by borrowers, while continuing to tax lenders, is horrible tax policy. It exaggerates the tax base. It is not a fit response to the higher taxation of equity compared to debt finance. That problem arises from the double taxation of corporations and shareholders on the same income. That should be ended by one of the many methods of integrating the corporate and individual tax, or making all corporations pass-through entities. The double taxation should not be extended to debt finance to even out the differential. (Nor should pass-through entities be attacked in the process of tax reform. They are being taxed in a more nearly correct, more saving-consumption neutral manner than C-corporations.)

Financing a purchase is not additional GDP over and above the production of the machine or building or consumption item or service (except for the small amount of intermediation services provided by the bank or broker) that is part of national output and income. Taxes on financing flows should be a wash to the Treasury, as when you deduct the interest you owe me and I pay tax on it. Not allowing the deduction is wrong. Either interest should be deductible by the borrower and taxable to the lender, or non-deductible and non-taxable.

But aren't some savers/lenders tax exempt? Yes, but that is because Congress created a tax break for charities, presumably because it furthers important public policy goals. It is senseless to create an incentive at one end of a transaction only to take it back at the other end. In particular, it is wrong to punish all borrowers if some lenders are tax exempt. Note that tax exempt entities are not the marginal sources of lending, because they are limited as suppliers of funds by the amount of their grants and contributions, and by the distributions they are required by law to make. At the margin (where it matters), when people want to expand the capital stock, the lenders who provide the saving are taxable.

Conclusion. Expensing and corporate rate reductions are both powerful spurs to investment. Expensing is less costly in a static revenue sense, and its cost diminishes with time. In a dynamic sense, both would eventually return their costs to the Treasury by increasing revenues from other taxes due to added growth of GDP. Both should be part of a pro-growth tax reform.

[5] Stephen J. Entin and Michael Schuyler, "Economic Consequences Of The Wyden-Coats Tax Plan," IRET Policy Bulletin, No. 100, October 28, 2011, http://iret.org/pub/BLTN-100.PDF

100 Years Standing Up for American Enterprise
U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber of Commerce

ON: Hearing on Tax Reform and the U.S. Manufacturing Sector

TO: House Committee on Ways and Means

DATE: July 19, 2012

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

INTRODUCTION

The Chamber thanks Chairman Camp and Ranking Member Levin for the opportunity to comment on how comprehensive tax reform could improve the ability of U.S. manufacturers to contribute to job creation and economic growth.

The Chamber commends this Committee for its continuing work on fundamental tax reform and strongly supports these efforts. However, we believe that true fundamental tax reform will not take place before year end. The Chamber therefore urges the Committee and Congress to act immediately to extend all expiring 2001 and 2003 tax rates (including current marginal rates, dividend and capital gains rates, and estate tax relief), to extend vital expired and expiring business tax provisions, and to provide alternative minimum tax (AMT) relief. Extending all these provisions now will help to prevent the negative impact on jobs and the fragile economy that is likely to result from inaction. Simultaneously, the Chamber urges this Committee and Congress to continue to work toward comprehensive tax reform.

THE NEED FOR IMMEDIATE ACTION

Unless Congress and the President act, the 2001 and 2003 tax rates will expire on January 1, 2013. In addition, many traditional business "extenders" expired at the end of 2011, and others will expire at the end of 2012.

Failure to act on these rates and these expired and expiring provisions could be particularly hard for domestic manufacturers. Recent estimates suggest that between 70 percent and 81 percent of domestic manufacturers are organized as pass-through entities, meaning they pay their taxes under the individual tax code and will be subject to the higher marginal rates. Further, the traditional business extenders, such as the research and development (R&D) tax credit, help manufacturers innovate and compete in the global marketplace and contribute to economic growth and job creation in the United States.

The ramifications of failing to extend current tax rates and expired and expiring provisions are further compounded by the draconian, ill-designed, across-the-board discretionary spending cuts that are scheduled to begin on January 1. The Congressional Budget Office ("CBO") estimates that failure to address the expired and expiring provisions, combined with these looming spending cuts, will result in an estimated $600 billion fiscal policy reduction in 2013.[1]

The impact of inaction on the weak economy could be devastating. CBO estimates that growth is expected to slow from 2.2 percent in 2012 to only 0.5 percent in 2013 and to remain below its potential rate until the first half of 2018. CBO further projects that unemployment will increase by 2.0 million, raising the unemployment rate by about 1.0 percentage points.[2] According to CBO, "given the pattern of past recessions as identified by the National Bureau of

[1] See CBO | Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013.
[2] See id.

Economic Research, such a contraction in output in the first half of 2013 would probably be judged a recession."[3]

Similarly, Mark Zandi, from Moody's Analytics, estimates that without changes to fiscal policy, the fiscal drag will subtract more than 3.0 percentage points from GDP in 2013 while former Federal Reserve Vice Chairman Alan Blinder believes the "resulting fiscal contraction – consisting of both tax increases and spending cuts – would be about 3.5 percent of gross domestic product" and would be a "disaster for the United States."

Congress and the President need to act immediately to prevent the negative impact on jobs and the fragile economy that is likely to result from failure to extend the expired and expiring tax provisions. The best way to get the economy growing fast enough to create jobs and drive the unemployment rate down is to ensure that taxes do not increase for consumers and businesses.

The Chamber appreciates that all tax policies must be carefully examined in the context of fundamental tax reform. However, as we work towards that fundamental, comprehensive tax reform, we must not delay extending the 2001 and 2003 tax rates and expired and expiring provisions.

COMPREHENSIVE TAX REFORM AND THE MANUFACTURING SECTOR

Global Competitiveness

For American worldwide companies to compete in global markets, they need a level playing field. The United States currently has the highest corporate tax rate in the world. Moreover, the United States is the only major industrialized Organisation for Economic Cooperation and Development "OECD") country that continues to employ a worldwide system of taxation. This high tax rate and possibility of double taxation, while mitigated by provisions such as deferral and the foreign tax credit, harms the ability of American worldwide companies to compete against foreign companies who face little or no home country tax on their foreign earnings.

As noted, the U.S. tax code is lagging sadly behind its worldwide competitors. First, the U.S. marginal corporate tax rate, at 35 percent, is completely out of step with other major industrialized OECD nations. As noted by the Tax Foundation,[4] a nonpartisan organization, "2012 marks the 21st year in which the U.S. corporate tax rate has been above the simple average of OECD nations. Even if we account for country sizes, the weighted average of OECD nations fell below the U.S. rate in 1998 and has been getting lower ever since."

Further, we not only shackle our businesses with high rates, but we have taken no action to lower our rate as other countries have acted. As the Tax Foundation notes, "there have been

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[3] See id.

[4] See Hodge, "The Countdown is Over. We're #1," Tax Foundation, *available at* http://taxfoundation.org/article/countdown-over-were-1.

133 major corporate tax cuts globally since 2006. Indeed, between 2006 and 2010 alone, more than 75 countries cut their corporate tax rates - some more than once." Our major trading partners– Canada and Great Britain – have already taken steps to make themselves more competitive by dropping their corporate tax rates, while the United States has done nothing to reduce rates.[5]

In addition to our high rates, we remain the last major industrialized OECD country with a worldwide system of taxation. As countries like Great Britain not only lower rates but shift to quasi-territorial systems of taxation, the United States continues to overburden American businesses. Other countries are shifting to more efficient and globally conducive systems of taxation, while we are standing by and doing little to help American companies compete, let alone win.

We must act to address our high corporate tax rates and antiquated system of taxing foreign source income to allow American worldwide companies, including U.S. manufacturers, to compete globally. Tax reform legislation should lower the corporate tax rate to a level that will enable all American worldwide companies, including U.S. manufacturers, to compete successfully in the global economy. Further, the current worldwide tax system should be replaced with a territorial system for the taxation of foreign source income.

Pass-Through Entity Considerations

As mentioned above, between 70% and 81% of domestic manufacturers are organized as pass-through entities. These pass-through businesses are a critical source of job creation and innovation in the United States.

Further, according to a study by Ernst & Young, more than 90 percent of businesses in the United States are organized as pass-through entities. That study also found that individual owners of pass-through entities paid 44 percent of all federal business income taxes between 2004 and 2008 and, moreover, that pass-through businesses employ 54 percent of the private sector work force in the United States.[6] Pass-through businesses are a critical source of job creation and innovation in the United States that cannot be ignored in fundamental tax reform.

Under current law, the same top marginal income tax rate of 35% applies both to corporations and pass-through entities. In addition, business tax expenditures included in the code apply to both corporations and pass-through businesses. If corporate tax reform takes place separate from individual tax reform, pursuant to which the corporate rate is lowered in exchange for the elimination or reduction of business tax expenditures, pass-through entities, including manufacturers, will lose the benefit of business tax expenditures without a corresponding rate reduction. Tax reform therefore should lower both the corporate and individual rates and keep them synchronized.

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[5] See id.

[6] Carroll and Prante, "The Flow-Through Business Sector and Tax Reform," April 2011, *available at* http://www.scorp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf.

R&D Incentives

The Chamber has long advocated that R&D expenses, an integral component of manufacturing businesses, should be deductible in the year incurred, and a larger credit for increases in research expenditures should be allowed and made permanent.

The United States was the first country to introduce a tax credit to support business R&D. In the 1980's, the United States had the most generous tax treatment of R&D of all OECD countries. Since then, more and more countries have recognized the importance of research and innovation for economic growth, and they are aggressively pursuing R&D activity.

A recent Information Technology and Innovation Foundation paper[7] notes that many studies by independent academics have found that the R&D incentive has a positive impact on economic growth and that, as a result, other countries are outcompeting the United States for R&D investments, and the accompanying jobs and economic activity. Examining our position globally, the paper concludes:

> By 1996 the United States had fallen to seventh in R&D tax generosity among the 30 OECD nations, behind Spain, Australia, Canada, Denmark, the Netherlands, and France. And the slide continued. By 2004 we had fallen to 17th. Even with the recent expansion of the ASC from 12 to 14 percent the United States was only able to hold position at 17th (and 19th for small businesses R&D incentives), as other nations also expanded their R&D tax incentives. However, it is not just OECD nations that have overtaken the United States. A number of other nations, including China, India, Brazil, and Singapore, provide more generous tax treatment of R&D expenditures.

Because innovation is such a crucial long-term driver of growth and jobs, any reform to the tax code should contain incentives for companies to conduct research and development activities in the United States and locate the resulting intellectual property within U.S. borders.

Certainty

Any changes to the tax code should be permanent to ensure certainty for manufacturers and other business sectors that are striving to expand, create jobs, and remain competitive. U.S. businesses are disadvantaged by the uncertainty that results from the temporary nature of so many crucial business tax provisions.

Simplification

Tax reform also should ensure that the tax code contains simple, predictable and easy to understand tax rules to improve compliance and reduce the cost of tax administration. All businesses must grapple with the tremendous complexity of the current tax code. The National

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[7] See Information Technology and Innovation Foundation, "17 is Not Enough: The Case for a More Robust R&D Tax Credit," *available at* http://www.itif.org/files/2011-17-is-not-enough.pdf.

Taxpayer Advocate's 2010 report to Congress[8] stated that taxpayers spend an estimated 6.1 billion hours a year complying with the tax code and listed complexity of the tax code as the most serious problem facing taxpayers and the IRS.

Cost Recovery

Tax reform should eliminate the bias in the current U.S. tax system against capital investment. Capital investment should be expensed or recovered using a capital cost recovery system that provides the present value equivalent to expensing with due regard to the impact the system may have on cash flow.

Equitable Treatment of Industries

Tax reform should ensure industry-specific neutrality and avoid special tax benefits or penalties targeted to one industry versus another. Tax reform should allow the marketplace, not the tax system, to allocate capital and resources.

Transition Rules

Comprehensive tax reform should include realistic transition rules to provide adequate time for implementation and help minimize economic hardships businesses may encounter in transitioning to the new tax system.

CONCLUSION

The Chamber thanks the Committee for the opportunity to comment on tax reform and the manufacturing sector. We look forward to working with the Committee and Congress as the tax reform debate moves forward.

[8]See National Taxpayer Advocate 2010 Annual Report to Congress (Most Serious Problem #1: The Time for Tax Reform is Now, *available at* http://www.irs.gov/pub/irs-utl/2010arcmsp1_taxreform.pdf

U.S. Steel Corporation

Transmittal Supplement

DATE: August 2, 2012

TO: The Committee on Ways and Means
U.S. House of Representatives

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SUBJECT: Hearing on Tax Reform and the U.S. Manufacturing Sector

Attached please find a written statement to be included in the official record of the full committee hearing held on July 19, 2012 on Tax Reform and the U.S. Manufacturing Sector. Please direct questions concerning this statement to the name and address listed above.

WRITTEN STATEMENT SUBMITTED FOR CONSIDERATION TO:
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

HEARING ON TAX REFORM AND
THE U.S. MANUFACTURING SECTOR

HEARING DATE: JULY 19, 2012

SUBMITTED BY JOHN P. SURMA

CHAIRMAN OF THE BOARD OF DIRECTORS and
CHIEF EXECUTIVE OFFICER

ON BEHALF OF
UNITED STATES STEEL CORPORATION

600 Grant Street
Pittsburgh, PA 15219

AUGUST 2, 2012

JOHN P. SURMA
UNITED STATES STEEL CORPORATION

WRITTEN STATEMENT SUBMITTED FOR CONSIDERATION TO:
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

HEARING ON TAX REFORM AND THE U.S. MANUFACTURING SECTOR

Hearing Date: July 19, 2012

United States Steel Corporation ("U. S. Steel"), a Fortune 500 company, is an integrated steel producer of flat-rolled and tubular steel products with major production operations in North America and Europe. An integrated steel producer uses iron ore and coke as primary raw materials for steel production. According to World Steel Association's latest published statistics, we were the thirteenth largest steel producer in the world in 2011. U. S. Steel is also engaged in other business activities consisting primarily of iron ore mining, railroad transportation services, and real estate operations.

U. S. Steel appreciates the opportunity to contribute to the discussion that occurred during the Hearing on Tax Reform and the U.S. Manufacturing Sector (July 19, 2012). Our company also previously submitted a written statement in connection with the Hearing on the Interaction of Tax and Financial Accounting on Tax Reform (February 8, 2012).

My written testimony is based on my experience as the Chairman of the Board of Directors and Chief Executive Officer of U. S. Steel. One of the key goals of my job, simply put, is to guide our company's business decisions to ensure that shareholder capital is invested where it can produce the greatest return. Leading an enterprise as complex as U. S. Steel, of course, involves many other considerations that also determine our success, but return on capital is how the markets view and reward performance.

The fiscal situation our country presently faces requires pragmatic leadership and vision. There is a growing awareness that the U.S. is falling behind in the global competition for capital investment. Our manufacturing sector has been neglected for too long and our society and its citizens are worse for it. As this Committee recommends policies to revive economic growth, address fiscal imbalance, and increase revenues to fund government, I urge you to recognize that not all taxable income provides the same impact to our economy and that overly simplistic policies will not deliver optimal results.

I firmly believe in the role capital-intensive manufacturing must play in any large, healthy economy. Ours is an industry that creates value from the most basic of earth's elements. The transformations we effect create advanced materials that preserve and expand our food supply and that can be used to build our homes, our cars, our roads, bridges and other infrastructure. Manufacturing is an industry that supports good-paying jobs. Steel is an industry where, for every direct job, there exist another seven elsewhere in the economy. Similarly, for every $1 increase in sales of iron and steel mill products, total output in the U.S. economy increases by $2.66. Few other industries even come close. I submit that a vital manufacturing sector is something this Government should strive to encourage and preserve because it is a proven source of employment and an engine of economic growth and prosperity.

The main goal of business tax reform, while being mindful of current and projected fiscal considerations, should be to make the United States of America a more attractive venue for investment, especially in manufacturing, in order to promote economic growth and job creation. While we are encouraged by proposals for a reduction in the corporate tax rate to induce new capital investment, we continue to be extremely concerned that too narrow a focus on rates alone could lead to reduced economic growth. Specifically, the retention and even the enhancement of accelerated depreciation, the retention of the last-in, first-out (LIFO) inventory method, the ability to use existing minimum tax credit (MTC) carryfowards, and a significant reduction in the corporate tax rate would be powerful tools to promote new investment in the United States.

For U. S. Steel, and we would expect for most manufacturers, the availability of cash is extremely important in making investment decisions. Cash flow and liquidity considerations are major components of investment decisions and provide businesses with the confidence to continue to invest in projects that will grow America's manufacturing base. Cash flow is as important as book earnings, and companies that emphasize book earnings over cash flow may find themselves investing in projects that over the long term result in lower economic value and less job growth.

U. S. Steel requires significant capital investments for its steel manufacturing and iron ore facilities and we look to the net present value of future cash flows as a critical factor in making discretionary investments. Taxes are a major element of cash flow for any project, and are determined by taking into account both the tax rate and the timing of tax depreciation deductions. A lower tax rate will undoubtedly produce a future cash flow benefit, but that benefit may be more than offset by increased cash taxes due to delaying depreciation deductions. Accelerated depreciation and bonus depreciation have a substantial impact on all of U. S. Steel's investment decisions and are built into our models for evaluating the viability of capital projects. Eliminating accelerated depreciation, LIFO, and MTCs in order to pay for lower tax rates will likely increase taxes on capital-intensive manufacturers like U. S. Steel and thereby reduce capital investment in domestic manufacturing. This is not the direction that business tax reform should take.

Instead of eliminating accelerated depreciation in order to pay for lower tax rates, we respectfully propose the Committee consider a different approach, which is making 50% bonus depreciation permanent and retaining accelerated depreciation for the remaining 50% basis. To mitigate the negative revenue effects, the rate reduction could be phased in over time. The end result of rate reduction and accelerated depreciation would encourage new investment and allow American manufacturing to grow. Using dynamic scoring, this could even result in increased revenue to the Treasury.

Our company is presently undertaking a large capital investment program with total spending in 2011 and 2012 exceeding $1 billion. We are currently building a new coking facility in Pennsylvania and a coke substitute facility in Indiana, and recently completed a $100 million upgrade to pipe mill facilities in Ohio. A 50% owned joint venture is currently building a continuous annealing line in Ohio that will manufacture high strength steel for the domestic auto industry. We also have several dozen other projects underway for facilities in Alabama, Illinois, Indiana, Michigan, Minnesota, Texas and elsewhere. These investments have created thousands of construction jobs and will result in hundreds of permanent jobs and billions of dollars in goods and services being bought from local and national suppliers. However, these and future capital projects will not be as viable if accelerated depreciation is changed or eliminated, and some may not be economically supportable at all without accelerated depreciation.

A lower overall tax rate benefits hoth old and new investments—although on a present value basis it is more beneficial to existing facilities. To the extent that accelerated depreciation is eliminated to reduce the tax rate, new investment is actually penalized because it bears the full burden of reduced depreciation. This combination of lower tax rates and reduced depreciation deductions increases the cash flows (and profitability) of old investments relative to new ones, and ironically reduces the likelihood of new domestic investments in manufacturing being made. In contrast, a lower tax rate combined with accelerated depreciation provides a strong incentive for American businesses, like U. S. Steel, to invest in new domestic manufacturing projects, thus creating new jobs and expanding the U.S. economy.

Other countries with lower tax rates than the United States still encourage capital investment to fuel growth. For example, Canada, where we also have substantial operations, has made investment more attractive by reducing the corporate tax rate while continuing to allow accelerated depreciation. Canada has a lower federal corporate tax rate than the U.S. (the Canadian corporate rate in 2012 is 15%, which, when combined with provincial rates is approximately 25%), and it makes accelerated depreciation available to encourage investment. Even if the U.S. corporate income tax rate (about 40% for federal and states) is reduced to be closer to the Canadian rate, if accelerated depreciation is eliminated in the U.S. then companies with manufacturing operations in both countries will still have a tax incentive to invest in Canada rather than in the U.S. Keeping accelerated depreciation in place would better position the United States as a desirable location for new manufacturing investment.

Like the elimination of accelerated depreciation, the elimination of the last-in, first-out ("LIFO") method of inventory accounting would have a detrimental impact on U.S. manufacturers. The objective of LIFO is to permit taxpayers to properly match current revenues with current replacements costs, and thereby pay taxes on income that is actually realized. LIFO was first allowed for federal income taxes in the 1930s, and has continued through today without significant modification. U. S. Steel has consistently used the LIFO method for valuing inventories since 1941.

The elimination of the LIFO method would result in many U.S. manufacturers paying a one-time tax on their LIFO reserve for inventory on hand, which is the difference between current replacement costs compared to its value under LIFO. U. S. Steel estimates that the repeal of LIFO could cost us over $450 million at current tax rates, reducing our ability to invest in our U.S. operations and create new mannfacturing jobs. Many other domestic manufacturers, including many of our customers, also use the LIFO inventory method, and its repeal could also have as significant an impact on them as it would on us. As the result of increased taxes from the repeal of LIFO, these manufacturers would have less cash available for expansion, further slowing our nation's recovery, and reducing future job growth. Even if this tax increase due to the repeal of LIFO is spread over a number of years as has been suggested, the negative impact on capital available for future investment in domestic manufacturing would be significant.

Another item that tax reform should take into account is minimum tax credit ("MTC") carryforwards generated under the current corporate income tax regime. MTCs are generated when corporations have tentative minimum tax ("TMT") in excess of regular tax and are subject to the alternative minimum tax ("AMT"). MTCs can be carried forward to later years to reduce regular tax down to the TMT amount. MTCs available for carryover are generally recorded as assets under GAAP. U. S. Steel, like many companies in manufacturing and mining, are often subject to the AMT because of regular tax deductions for items such as accelerated depreciation, LIFO, and percentage depletion, all or a part of which are tax preferences in computing AMT.

Several tax reform proposals, including the recently proposed "Pathway to Job Creation Through a Simpler, Fairer Tax Code Act of 2012 (H.R. 6169)," recommend the elimination of AMT. While we support this, we are concerned about the treatment of unused MTCs if the AMT is eliminated. If existing MTCs available for carryover can't be used against income taxes generated after tax reform, U. S. Steel and many other manufacturing and mining companies will lose these assets and will have to take a financial book charge for MTC carryforwards reflected as assets on the financial books, impacting earnings and negatively affecting the ability to raise funds for future capital investments. We recommend that MTC carryforwards be retained under tax reform and either be refunded or allowed as a credit against income tax determined under tax reform.

While a lower tax rate would benefit U.S. corporate taxpayers, many manufacturers, especially those in capital intensive, cyclical industries would be disproportionately harmed by the elimination of accelerated depreciation, LIFO, and MTCs. Companies that make useful things in the U.S. and have the greatest multiplier effect on our economy should not bear the brunt of paying for lower taxes for other sectors, such as financial services and retail trade, activities which are not likely to lead to widespread prosperity.

When deciding how to compensate for a rate reduction, tax provisions that have been in place for many years and that help domestic manufacturers grow their businesses and create new jobs should not be abandoned. A reduction in the tax rate, combined with the retention of a limited number of growth-oriented provisions such as accelerated depreciation, retaining the option of LIFO inventory accounting, and the use of MTCs, is a winning formula that promotes capital investment and job creation, strengthening companies that produce products in the U.S. and the overall U.S. economy.

We welcome the ability to further contribute to the tax reform discussion and thank you, again, for the opportunity to address the Committee.

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US Tax Reform and the Manufacturing Sector

Rather than reducing taxes for just the Manufacturing Sector which will allow them to find more loopholes in the system, Congress should be holding hearings on reforming the entire tax system which would close loopholes and permit the government to reduce taxes on manufacturing but at the same time raise revenue to reduce the national debt. I believe that the President's plan for reducing taxes would exempt the "small companies" from the increase in taxes. And Republicans MUST stop calling corporations "job creators." If the current Bush Tax cuts were working, then unemployment would be much lower. Reforming the entire tax code would reduce taxes for everyone (not just manufacturers who contribute most to your political campaigns) and at the same time raise revenue. It doesn't make sense to anyone who is a critical thinker to believe that you can reduce taxes and at the same time reduce the deficit.