

**Written Testimony
Of**

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**And
Member, Board of Trustees, National Tooling and Machining Association**

**Before the
U.S. House of Representatives Committee on Small Business**

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Thank you for the opportunity to testify before you today about the impact of tax reform on small and medium sized manufacturing businesses. My name is Sam Griffith; I have been President and CEO of National Jet Company in LaVale, Maryland for the last 20 years having purchased the company in 1992. I am also a member of the Board of Trustees and Chairman of the Audit Committee of the National Tooling and Machining Association (NTMA) and I am testifying here today on behalf of my company and also representing the NTMA members and industry.

As further background, not only am I a manufacturer, I am also a Certified Public Accountant (CPA), and I remain involved with the Maryland Association of CPA's and American Institute of CPA's. I began my career practicing as a certified public accountant with the international firm of Coopers & Lybrand known today as Price Waterhouse Coopers. I practiced for 13 years and I was an Audit Manager when I left the firm to join York Oil Company as Chief Financial Officer.

National Jet Company was founded in 1937, and today is an internationally known expert in precision micro drilling technology. We have the capability to drill holes as small as two ten-thousandths of an inch in diameter. We can drill or EDM (electrically discharge machine) holes in any shape and we hold very close tolerances for our work. To give you an idea of size, we can drill a hole in a human hair. We service primarily the aerospace, automotive, electrical, medical, and textile industries. Some of the products we are involved with include extrusions dies for the production of man-made fiber for the carpet industry, AstroTurf for the athletic fields, injector plates for autos, spray nozzles and orifices. We are a small specialty shop with twenty-four employees and have added two new employees in the last four months.

National Jet is structured as a subchapter S Corporation, which means all income flows into my personal return and I then pay taxes at the individual rate which puts me into a much higher tax rate than I normally would be due to the pass through of the corporate income into my personal return.

As I mentioned earlier, prior to purchasing the company, I served as the Chief Operating Officer and the CFO of the York Oil Company in Hampton, Virginia, a subchapter C Corporation. Given my combined training as a CPA, and having worked in both a C and an S Corporation provides me with a unique perspective on tax policy.

The National Tooling and Machining Association represents roughly 1,500 manufacturing businesses who average 35-50 employees and are typically classified under the North American Industrial Classification System (NAICS) as 332(Fabricated Metal Product Manufacturing) and 333 (Machinery Manufacturing). These classifications include 80,000 manufacturing establishments nation-wide according to the U.S. Census. We are normally referred to as contract machine shops.

The National Tooling and Machining Association and I wholeheartedly support tax reform that includes real reform for both C Corporations and pass-through companies which make up the majority of small businesses in this country. We desperately need lower rates, simplification of rules and elimination of the sunset provisions in the tax code to allow us to compete globally. It is very difficult to plan into the future when there is such uncertainty in the tax code. No one likes a moving target and for the last ten years it has been a nightmare to plan.

A recent survey of NTMA members showed that sixty-seven percent are structured as a pass-through business. Eighty-one percent of all manufacturing businesses are structured as pass-throughs, further reinforcing the importance of including these types of companies in tax reform.

Why Most Manufacturers are Pass-throughs

The reason most small manufacturers structure themselves as pass-through is, in part, because many are family-owned businesses who want to keep the company in the family when the current owners retire. This is particularly true with most NTMA members who are now planning the transition from the third to the fourth generation of manufacturers.

The other reason is more obvious; the double taxation of C-Corporations' dividends which the owners pay when they take their earnings out of the business. No one wants to pay double taxes on their hard earned income. After all, when the owner pays a higher tax rate, it really means the company is paying more in taxes and has less to buy equipment and hire employees. Furthermore, what many people do not know is a small business owner has to personally guarantee loans for the company when buying equipment which can cost in the millions – the fewer resources we have available to show our lenders, the more difficult it is to obtain financing to expand.

To better understand the impact of various tax reform proposals on small and medium sized manufacturers, the Association worked with Michigan-based accounting firm Plante & Moran to develop a tax template to model different scenarios. Attached to these comments is Exhibit "A" for the record which is an example of a New England-based small manufacturing business structured as an S Corporation with five shareholders and two hundred employees. While larger than the average NTMA business, this company's tax template shown here demonstrates what happens to a manufacturer when Congress fails to stabilize tax policy.

A pre-fiscal cliff calculation showed this New England manufacturer paying a combined federal, state, and local effective tax rate of 31.5% in 2011. An examination of the Fiscal Cliff scenario which went into effect for a few hours on January 1, 2013 resulted in a 46.91% effective tax rate for this company with virtually all deductions and credits eliminated or reduced and a 39.6% statutory individual income tax rate. This scenario showed the company would owe an additional \$715,000 in federal taxes on \$4.6 million in adjusted taxable income. This 15% increase in their effective tax rate means they have fewer resources to purchase new equipment and hire more employees in New England as would we in Maryland.

Tax Credits and Deductions Manufacturers Use

Every manufacturing business is different and each company serves a variety of industries which has varying needs and requires specialty equipment. Based on a December 2012 survey of the National Tooling and Machining Association and Precision Metalforming Association, the 200 respondents identified using the following tax credits and deductions:

- Section 179 Equipment Expensing
- Bonus "Accelerated" Depreciation
- Research & Development Tax Credit (R&D)

- Section 199 Domestic Production Activities Deduction
- Last-In-First-Out (LIFO) inventory valuation
- Interest Charge Domestic International Sales Corporation (IC-DISC)
- Net Operating Loss (NOL)

We recognize that policymakers face many difficult decisions ahead in reforming the tax code. You will have to decide which deductions and credits you will eliminate or keep in place. However, to remain globally competitive, small businesses use several credits and deductions to free up resources to reinvest back in our business. While each year is different, in 2010, National Jet Company reinvested 137% of our net income into the company and in 2011 we reinvested 112% back into the company.

While most of our industry is made up of small businesses with fewer than fifty employees, our capital equipment needs are significant and many machines are very expensive and start at a few hundred thousand dollars and range into the millions. To further emphasize the importance of capital equipment to these businesses, eighty-nine percent of survey respondents claimed Section 179 Equipment Expensing in 2012 while eighty-eight percent used Bonus “Accelerated” Depreciation. This means that our members maxed out their Section 179 deduction and then still turned to accelerated depreciation to support their investments in the company. Remember, when you buy a machine, you usually need to hire someone to run it. Expansion equals jobs.

At National Jet, in 2011, we claimed \$400,000 in Section 179 Equipment Deduction. However, in 2012, the Section 179 limit was \$139,000 with a phase out if you purchased over \$560,000 in equipment. Our company needed a machine that cost \$611,000 but if we purchased this equipment we would lose the Sect. 179 deduction because it exceeded the phase out provision. This one piece of equipment exceeded the entire limit. Therefore, I only purchased \$130,000 worth of smaller equipment to stay within the threshold of the tax provision.

Then Congress on December 30, 2012 passed a provision allowing a Sect.179 deduction of \$500,000 and increased the phase out provision to \$2,000,000. Now how could any small business react to this? One day in which to purchase a machine that weighs 36,000 pounds, transport it, have electrical lines installed, run air lines to the machine and have it placed in service all in 24 hours? No one could do this. However, Congress pats themselves on the back for passing legislation to help small business and moves on to the next issue. Small business did not get the benefit because of the last minute action by an otherwise action less Congress. Thanks for nothing. This is exactly why I am here today.

If it were not for the uncertainty surrounding the status of the Section 179 Expensing provision on Capitol Hill last year, I would have invested another \$400,000 in equipment and hired two additional employees to run the machines. With all due respect, the failure of Congress to do its job should not prevent me from creating jobs.

The Section 199 Domestic Production Activities Deduction is one of the few provisions in the tax code which directly incentivizes manufacturing in America. Roughly half of our members claim Section 199 which amounts to an effective three percent rate reduction for most domestic manufacturers. We claimed \$31,000 in 2012 nearly double in 2011 because of a rebound in business after the Great Recession that still lingers among some small businesses today, especially those who are still suffering under a Net Operating Loss.

Another issue which receives many headlines when tax reform is discussed is the Alternative Minimum Tax, or AMT. Most members of Congress probably only think about the AMT in terms of its impact on the average “middle class” family. But its reach is far broader.

Because our business is captured under the AMT, we cannot claim the Research and Development Tax credit which would be available to us and is so popular among politicians. In addition, when I hired a long-term unemployed person in my shop last year, I thought I could claim the \$1,000 credit Congress passed into law to encourage this kind of action. Again, because I am under the AMT, I also cannot claim that credit. So you give us credits for R&D and employing workers who have lost their unemployment benefits and then you take them away because of the AMT. How does this make any sense?

As Washington explores comprehensive tax reform, you will decide which tax credits and deductions you will eliminate along the way – whether to reduce the rates, raise revenues, or both. I ask that you keep in mind which of these provisions help stimulate growth in the economy and truly create jobs. For example, if it were not for the \$400,000 in Section 179 we claimed in 2011, my effective tax rate would have been significantly higher and I would likely not have had the capital to purchase the equipment we needed to grow the company and hire employees.

Conclusion

As you can see, the current tax code is a maze of mismatched provisions which provide disincentives to grow our businesses and hire new employees. Good intentions by lawmakers often result in temporary tax provisions which do not allow a small business to plan, to secure loans, and to hire employees. While we are just starting 2013, I am already budgeting for growth and purchasing equipment in 2014 – and hopefully hiring more employees.

We can't just purchase a machine on December 31st by midnight based on a vote Congress just took. It takes time to place this equipment into service even if we had the free capital to make a last minute multi-million dollar purchase based on Congressional action, or inaction.

We fully support Chairman Dave Camp's approach and efforts by others to push for comprehensive tax reform and applaud this committee for holding this hearing to focus on the impact on small businesses. Our greatest concern is a seeming obsession with corporate-only tax reform – a path which leaves America's small businesses and eighty-one percent of U.S. manufacturers behind.

Thank you for the opportunity to testify before you today on this important issue. I believe we must develop a reformed tax code which encourages manufacturing in America and helps our small businesses compete globally in the 21st Century. We have a stake in this great country and we want our voice heard.

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

Current Law - 2011		Current Law - 2013		35% - Base Case		25% Case		39.6% - Worst Case	
C Corporation	Flow-Through	C Corporation	Flow-Through	C Corporation	Flow-Through	C Corporation	Flow-Through	C Corporation	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	1,229,660	1,214,197	1,388,748	1,498,005	1,229,660	1,263,790	1,153,439	1,268,360	1,574,401	1,928,685
Cash Used to Pay State Taxes	446,044	246,092	446,044	246,092	446,044	246,092	446,044	246,092	446,044	246,092
Cash Retained by Owner	495,030	680,712	399,446	644,004	495,030	631,119	399,919	519,484	334,768	499,510
Cash Reinvested in Business	2,465,345	2,495,079	2,401,842	2,247,979	2,465,345	2,495,079	2,636,677	2,602,144	2,280,867	1,961,793
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	26.52%	26.19%	29.96%	32.31%	26.52%	27.26%	24.88%	27.36%	33.96%	41.60%
% 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	10.68%	14.68%	8.62%	13.89%	10.68%	13.61%	8.63%	11.21%	7.22%	10.77%
% of Cash Reinvested	53.18%	53.82%	51.81%	48.49%	53.18%	53.82%	56.87%	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%

