ONE VOICE
National Tooling & Machining Association
NTMA 800-248-6862
Precision Metalforming Association
216-901-8800
PMA PRECISION METALFORMING ASSOCIATION
6363 Oak Tree Blvd. • Independence, OH 44131 • www.metalworkingadvocate.org

July 5, 2012

The Honorable Max Baucus
Chairman
Senate Finance Committee
219 Dirksen Office Building
Washington, D.C. 20510

The Honorable Orrin Hatch
Ranking Member
Senate Finance Committee
219 Dirksen Office Building
Washington, D.C. 20510

Dear Chairman Baucus and Ranking Member Hatch:

On behalf of One Voice, the joint effort between the National Tooling and Machining Association (NTMA) and the Precision Metalforming Association (PMA) and our nearly 3,000 nationwide metalworking member companies, thank you for your leadership and continued efforts to address tax reform. As the Committee considers how to proceed on tax provisions having already expired or expiring, please accept these comments focusing on expiring provisions included in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 and related expiring tax law.

We believe Congress should enact comprehensive tax reform which includes addressing these expiring provisions – the uncertainty in the tax code affects our members' ability to plan and invest. 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 equally 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 on 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		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%