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January 17, 2014

The Honorable Max Baucus
Chairman
Senate Finance Committee
U.S. Senate
Washington, D.C. 20510

RE: Tax Reform Discussion Draft Comments

Dear Chairman Baucus:

Thank you for the opportunity to submit these comments regarding the Senate Finance Committee Tax Reform Discussion Drafts. On behalf of the National Tooling and Machining Association (NTMA) and Precision Metalforming Association (PMA) who together as part of "One Voice" represent nearly 3,000 metalworking manufacturing companies in the U.S., please accept these comments as the Committee considers its approach.

These comments cover four areas

- Background on Metalworking Industry and Business Structure
- Comprehensive Tax Reform for All Businesses
- Cost Recovery and Accounting Discussion Draft
- International Business Tax Reform

Background on Metalworking Industry and Business Structure

One Voice members are small and medium-sized manufacturers averaging roughly 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 combined include 80,000 manufacturing establishments with 2.6 million employees. There are 300,000 manufacturing establishments nationwide according to the U.S. Census with approximately 12 million workers.

The manufacturing sector is among the strongest contributors to economic growth in this country providing family-sustaining careers. The average salary for an Ohio metalworking machinery manufacturing employee in his/her prime is more than $70,000 annually and significantly more for those with higher skills. A study by Rockwell Automation about the manufacturing multiplier effect showed that in some advanced manufacturing businesses, every one manufacturing job supports 15 other jobs throughout the economy. The study includes data from Boston Consulting which estimates that manufacturers will add up to 800,000 jobs in the U.S. by mid-decade and that even just a four times employment multiplier will create about 2.4 million indirect jobs in the U.S. as a result of this growth.

As you look at a comprehensive overhaul, we ask that all manufacturers have a similar rate structure regardless of how they are organized. An April 2011 Ernst & Young, LLP report showed that 81% of all manufacturers are structured as pass-through companies and the U.S. Census shows 89.5% of all manufacturing establishments have fewer than 500 employees. According to a January 2014 survey of One Voice members with 131 respondents (hereinafter One Voice survey), 55% are structured as Subchapter S, 10% are LLC, and 35% are C Corporations. This means two-thirds of our members pay income taxes as pass-throughs, meaning the individual rate as high as 39.6%.

In the One Voice survey, only 14% of respondents said they would convert to become a C-Corporation if that rate were lowered to 28%. Overall, One Voice members overwhelmingly believe the top business and individual tax rate should be no higher than 25%, regardless of the company's structure.

These statistics clearly demonstrate that the overwhelming majority of manufacturers are pass-through small businesses. The manufacturing supply chain is connected from the "mom and pop" machine shop to the multinational corporation and Washington should move comprehensive tax reform for all businesses.

We believe Congress has an opportunity in tax reform to make all U.S. manufacturers more globally competitive and spur domestic investment in equipment and employees. Many policymakers do not recognize that access to credit and the ability to secure affordable lending rates is connected to tax policy. When small businesses like our members seek credit to purchase a multi-million dollar machine, lenders examine a company's tax liability. A real-world example is a business in Ohio reported that without Bonus Depreciation, they would not have received the line of credit at the lower rate and not been able to purchase an additional machine and retain employees in 2012.

<u>Comprehensive Tax Reform for All Businesses</u>

Small and medium-sized manufacturers like members of One Voice need a globally competitive and stable tax code which allows them to plan. Small manufacturers must make business decisions well over a year in advance when budgeting for a machine costing into the millions. Our tax code inhibits job creation and business growth while our foreign competitors have the support of their government's tax policies – from lower corporate rates to a Value Added Tax (VAT) to stronger R&D incentives.

As Congress embarks on this task, it must consider comprehensive tax reform for both C-Corporations and pass-through businesses. Over the years, the code has become so intertwined we do not believe overhauling only one section of the code is possible without causing injury to hundreds of thousands of small businesses. It is important that the two broader business classification categories (generally referred to herein as C-Corporations and pass-throughs) remain unified in their desire for comprehensive reform that does not pit large companies against smaller businesses who in many cases are their suppliers. Roughly, one-third of One Voice members are C-Corporations and the majority of our customers are also typically structured as C-Corps.

For example, some have considered repealing the Section 199 Domestic Production Activities Deduction to pay for lower C-Corporation rates. This would amount to a 3.15% effective tax rate increase for those pass-throughs who would lose the Section 199 Deduction. Today, we remain concerned that policymakers will eliminate critical deductions and credits small businesses use,

thereby raising their effective tax rate while cutting the corporate rate and leaving pass-throughs to pay at the much higher individual levels.
As mentioned, C-Corporations and pass-throughs are connected at every step in the supply chain. While many small businesses are C-Corporations, it is especially difficult for downstream suppliers when larger corporate customers higher up in the chain experience higher tax liabilities and look for cost reductions from Tier II and Tier III suppliers like our members.

The C-Corporation rate is prohibitively high compared with global trading partners, even after using various credits and deductions to lower the effective rate. Based on research released by the Senate Finance Committee, various sectors in the economy pay a wide range of effective tax rates. Generally for our members, an unofficial survey with a handful of both C-Corps and pass-throughs in several states shows the effective federal tax rate in our industry after claiming deductions and credits tends to range from 27-34% and even higher in some states.

We are also concerned about attempts to rely on certain deductions and credits to reduce the effective tax rate for small businesses and pass-throughs to bring them closer to being "on par" with C-Corporations under tax reform. For example, some have cited using an expanded Section 179 Equipment Expensing provision to help small businesses reduce their tax burden. However, if a business is not purchasing equipment, it will not benefit from the Section 179 and will pay a higher effective tax rate leaving less money in the business to grow in other areas and hire employees.

Cost Recovery and Accounting Discussion Draft
While we appreciate the Committee's detailed discussion draft, we find it difficult and speculative to comment on the impact of specific provisions without knowing the Committee's intended statutory rate. As previously discussed, One Voice members support a rate no higher than 25%. We therefore, at this time, have no choice to advocate for the inclusion of all provisions used by metalworking manufacturers.

While each one of our member companies has different operations manufacturing products for a variety of industries, there are several core tax provisions used by our members to improve their global competitiveness. Based on the One Voice January 2014 survey and other inquiries, the following tax credits and deductions are the most commonly used which fall under Cost Recovery and Accounting and related areas:

- Section 179 Equipment Expensing
- MACRS
- Like-Kind Exchange
- Section 199 Domestic Production Activities Deduction
- Research & Development Tax Credit (R&D)
- Interest Deductability
- Last-In-First-Out (LIFO) Inventory Valuation

Section 179 Equipment Expensing
Background: In 2011, according to the U.S. Census Annual Capital Expenditures Survey, manufacturers spent almost $157 billion on equipment, far outspending any other industry. This is true throughout the manufacturing sector, regardless of the company's size.

In the January 2014 One Voice survey, 90% of respondents said they claimed Section 179 Equipment Expensing. In fact, our members are overwhelmingly maxing out their Section 179

deduction, turning to accelerated depreciation which 82% of our members use. While our companies may average 50 employees, the equipment they purchase can run in the millions. In the survey, roughly one quarter of members said Congress should set Section 179 permanently at $2,500,000, 40% supported $1 million while other responses varied and in several cases exceeded $2.5 million.

Recommendation: Based on review and discussion of expected industry growth in the next few years, One Voice recommends the Committee adopt a permanent Section 179 with a $2.5 threshold with a $5 million phaseout.

MACRS

Background: Over the past several years, metalworking manufacturers report that Bonus Depreciation was among the most important tax provisions to their company as they recovered from the Great Recession. For example, a manufacturer of components for the tractor-trailer and automotive industries reported last year their intention to purchase a $7 million stamping press to help them meet anticipated expansion in 2014. A company in Ohio recently told us they retained 11 employees directly as a result of Bonus Depreciation which enabled them to purchase new machines and used the saved tax dollars to keep the employees on the job. Other members repeatedly tell us without this depreciation provision they would not have been able to afford an additional machine to take on the new business. In our industry, despite continued automation, when we buy machines, you still need a programmer, operator, or another worker who is dependent upon this provision.

While we recognize that a permanent Bonus Depreciation is not likely feasible in the current fiscal environment, continuing some form of depreciation cost recovery system will help manufacturers grow their business, purchase equipment, and hire employees. As previously stated, 82% of One Voice members report using Bonus Depreciation.

As to Classes/Pools, One Voice members are typically classified under Manufacture of fabricated metal products; Manufacture of fabricated products – special tools; Manufacture of motor vehicles – special tools; among others. In the January 2014 survey, 43% of One Voice members said their equipment should have a 5 year depreciation schedule and 27% said a 3 year schedule is appropriate.

Recommendation: One Voice suggests the Committee allow no longer than a five year depreciation schedule, and possibly three year, for Manufacture of fabricated metal products; Manufacture of fabricated products – special tools; Manufacture of motor vehicles – special tools; among others.

Like-Kind Exchange

Background: While not utilized by an overwhelming number of One Voice members, many manufacturers in the metalworking industry actively conduct the exact types of transactions an LKE benefits. Virtually all equipment purchased is held for well more than one year and comes at significant investment expense to the purchaser. Further, the equipment purchased, sold, or discarded can cost in the hundreds of thousands to several million dollars.

These two credits and deductions have a tremendous impact reducing the effective tax rate for metalworkers due to the intense capital equipment nature of their businesses. However, as stated earlier, the temporary nature of these tax provisions can cause business disruption. One manufacturer reported they did not purchase any new equipment in 2012 but would have had expensing provisions been in place at the beginning of the calendar year.

Recommendation: One Voice believes that the Committee should maintain the LKE as a tool manufacturers can use to improve their ability to invest in new equipment.

Section 199 Domestic Production Activities Deduction

Background: The Section 199 Domestic Production Activities Deduction is one of the few provisions in the tax code which directly incentivizes manufacturing in America. Roughly 40% of One Voice members claim the Section 199 which amounts to an effective three percent rate reduction for most domestic manufacturers. This provision directly makes profitable manufacturers more competitive and frees up resources to invest back into the business.

Awareness and slow economic recovery has reduced the number of One Voice manufacturers who claim the deduction. However, we view this as an important tool to support manufacturing in America during tax reform. We believe, as referenced earlier by the manufacturing jobs multiplier effect, this industry generates more economic output than virtually any other does.

Recommendation: One Voice believes Congress has an opportunity to ensure future economic growth based on the manufacturing sector which supports millions of jobs. The Section 199 provides a more globally competitive business tax rate for manufacturers helping level the international playing field. A lower effective rate for manufacturers over other domestic industries is warranted because of the exponential job support and creation factor leveraged from manufacturing companies.

Research & Development Tax Credit (R&D)

Background: Among one of the most politically popular provisions which many manufacturers support is the Research & Development Tax Credit (R&D). Whether they realize it or not, most manufacturers of all sizes conduct their own R&D, which greatly contributes to the technological advancements and efficiencies throughout the industry.

In the January 2014 One Voice survey, 47% reported using the R&D Credit, an increase of 6% over 2012. One of the challenges for manufacturers claiming the R&D is that increasingly the businesses and their owners are captured under the Alternative Minimum Tax (AMT). Under current law, those subject to the AMT cannot claim the R&D Tax Credit. According to the Tax Policy Center, "for the typical manufacturing firm, gross receipts and deductions are 10 to 20 times larger than its net income. A 5 to 10 percent change in includable receipts or allowable deductions is sufficient to create an AMT liability."

Recommendation: Investing in domestic R&D is a top priority for the metalworking industry as they develop new technologies for the energy, automotive and aerospace, among other industries. The Committee should make permanent and expanded and strengthened R&D to 20% and not place limits on the amount of R&D expenses permitted to be deducted.

Interest Deductibility

Background: Interest Deductibility is one of the oldest provisions in the revenue code dating to 1921. Today, companies of all sizes and structures use this tool as a way to purchase equipment and invest in their facilities. Very few businesses in the metalworking industry still in existence today have a debt to equity ratio which would raise alarms with regulators. Since the beginning of the Great Recession, small manufacturers, particularly automotive suppliers, came under intense scrutiny by their lenders to ensure they were not overleveraged. While we recognize the intended target of the Committee may be financial institutions and larger multinational corporations, small and medium sized manufacturers also rely on the ability to deduct interest.

Recommendation: The Committee should not place any limits on interest deductibility which would increase the cost of purchasing capital equipment for manufacturers.

Last-In-First-Out (LIFO) inventory valuation

Background: One Voice strongly believes that as the Discussion Draft rightly points out, LIFO is an accounting methodology. To certain manufacturers, there are accounting practices which, if reversed, could have a devastating effect on a company. Switching from Last-in-First-out (LIFO) to a First-in-First-out (FIFO) accounting method could cost a small manufacturer millions, or worse, the business. Among One Voice manufacturing members, roughly 30% reported using the LIFO method.

However, this statistic is misleading because for those companies who utilize LIFO it has a six and seven figure impact. A One Voice member company reported accumulating over $4 million in LIFO reserves built up over the past 18 years and facing a potential $400,000 tax liability if Congress enacts certain LIFO repeal proposals.

Not only does LIFO directly affect our businesses, many raw material suppliers, particularly steel/metal service centers, rely on LIFO. A repeal of this provision will have significant impact on the price of the steel and raw materials we purchase, which in the case of some metalstampers accounts for 70% of their input costs.

Recommendation: In place since 1939, One Voice believes LIFO is an established accounting method and should not be part of the tax reform discussion. Especially any "reach back" for LIFO reserves to bankrupt many small manufacturers.

International Business Tax Reform

In the 2014 One Voice survey, roughly 12% of members reporting have non-U.S., overseas facilities. In most cases, these are businesses originally set up to "follow their customer" but have since grown to supply other OEMs in that market. As many of these ventures, particularly in Asia are still relatively new, very few return a profit and even fewer repatriate those funds to the U.S. Rather, any gains generated from those overseas facilities are typically reinvested into that plant. It is still too soon to tell whether this behavior will change as overseas operations become more prevalent or more profitable.

Interest Charge Domestic International Sales Corporation (IC-DISC)

Background: While not many metalworking businesses are foreign owned or have overseas facilities, they are increasingly looking at exporting for new market opportunities. 57% of One Voice members report they directly exported a manufactured product in 2013 and 77% are indirect exporters as they supply a customer who then ships overseas. As businesses continue to grow their exports, tax provisions such as the Interest Charge Domestic International Sales Corporation (IC-DISC) have helped manufacturers reach new markets and expand their businesses.

Nearly one in four One Voice members have an IC-DISC and those who report usage credit this tax provision with helping their company expand their exporting business. One Wisconsin company reports that exports now constitute over 60% of their business. As previously stated, 81% of manufacturers are pass-through businesses and are most likely to benefit from an IC-DISC.

Recommendation: Increasing export opportunities is key to growing manufacturing in America and the IC-DISC is particularly critical in assisting small businesses improve their overseas shipments. One Voice believes the Committee should continue this tax provision as a way to promote exports.

Conclusion

Effective April 1, 2012, the U.S. has the highest corporate tax rate in the developed world and pass-through businesses saw their tax rates increase January 1, 2013. In order 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 policy that restricts growth and reduces competitiveness.

The outdated and inefficient tax code has the single greatest impact on a business manufacturing in America. Many foreign governments use their tax policy to promote their domestic manufacturing industry leaving U.S. businesses at a competitive disadvantage.

U.S. manufacturing employers are more than willing to "pay their fair share" to help support government services and infrastructure. However, we cannot solve our nation's financial problems by increasing the tax burden on small businesses without addressing the budget and runaway spending.

Small manufacturers, whether C-Corporations or pass-throughs, are the backbone of the economy; and policymakers in Washington should reform the tax code to encourage these businesses to grow and hire more employees.

We commend the Committee for undertaking this important process and encourage you to move on comprehensive tax reform for all businesses. We look forward to continuing to work with the Committee and answer any questions you may have.

Sincerely,

Dave Tilstone
NTMA President

William E. Gaskin
PMA President