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The Honorable Roger Williams
Chairman
Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

The Honorable Nydia Velazquez
Ranking Member
Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Williams and Ranking Member Velazquez,

The National Association of Manufacturers appreciates the opportunity to submit a statement for the record as part of the committee's hearing on "Paying Their Fair Share: How Tax Hikes Crush the Competitiveness of Small Businesses."

The NAM is the largest manufacturing association in the United States, representing manufacturers in every industrial sector and in all 50 states. Manufacturing employs nearly 13 million men and women, contributes $2.90 trillion to the U.S. economy annually, pays workers over 18% more than the average for all businesses and has one of the largest sectoral multipliers in the economy. Taken alone, manufacturing in the United States would be the eighth-largest economy in the world.

Small manufacturers are the heart of the manufacturing industry in America, forming the backbone of their communities, creating jobs and driving economic growth. Nearly 75% of manufacturers have fewer than 20 employees, and nearly 88% have fewer than 50 employees. Given the importance of small manufacturers to the strength of the U.S. economy, a tax code that allows them to be competitive is critical to ensuring our country's future success.

The Tax Cuts and Jobs Act included many key reforms necessary to boost manufacturing in America: a lower, more competitive corporate tax rate, a reduced tax burden on pass-through income, incentives for investment in capital equipment and estate tax relief. Following the passage of the TCJA in 2017, manufacturers responded by hiring more workers, increasing wages and benefits and investing in their businesses and communities.

Consider the following:

- Manufacturers created 263,000 jobs in 2018, the best year for manufacturing job creation in the previous 21 years.
- Wages rose for production workers 3.4% year-over-year in March and April of 2018 (at the time, the highest rate since February 2003).
- Manufacturing capital expenditures increased by 4.5% and 5.7% in 2018 and 2019, respectively.

Increasing the tax burden on manufacturers would reverse these gains and result in significant job losses and harm to the economy. According to an NAM-commissioned analysis by economists from Rice University, adopting tax policy changes including but not limited to increasing the corporate tax rate to 28%, increasing the top individual tax rate to 39.6% and repealing the 20% deduction for certain pass-through business income would cost the United States 1 million jobs in just the first two years after enactment and result in an average loss of 600,000 jobs each year over the next decade.[1] In addition to these job losses, wages, investment and U.S. GDP would all decline under a less competitive tax code.[2] Moreover, in the NAM's latest quarterly survey of manufacturers, more than 90% of respondents said higher tax burdens on manufacturing income would make it difficult for their companies to expand their workforce, invest in new equipment or expand their facilities.[3]

Unfortunately, several harmful tax changes have recently gone into effect that make it more costly to perform research, buy machinery and finance capital investments. If not reversed, these policies will hurt manufacturers' ability to create jobs in the United States, invest in their communities and effectively compete in the global economy. Moreover, starting in 2026 several scheduled tax increases affecting pass-throughs and family-owned businesses are set to go into effect that would make it even harder for manufacturers to compete and succeed.

The NAM respectfully urges members of this committee to strengthen manufacturing's competitiveness by supporting the tax policies described below.

1. **Ensure the tax code continues to support innovation.**

Manufacturers in the United States drive more innovation than any other sector, performing 55% of private-sector research and development in the U.S. In 2021 alone, manufacturers spent nearly $350 billion on R&D. Research is the lifeblood of manufacturing: new products, new materials and new processes help propel manufacturing in America forward. Unless Congress acts, manufacturers' ability to innovate and create new products, technologies and lifesaving medicines will be harmed.

Since 1954, the tax code has recognized the important role of R&D in creating jobs and spurring innovation by providing a critical incentive for investments in R&D. Specifically, the tax code has allowed businesses to immediately deduct 100% of their R&D expenses in the same year in which they are incurred. However, as of Jan. 1, 2022, businesses have been required to amortize these expenses (deducting them over a period of years), making R&D more costly to conduct in the U.S.

Coming at a time of increasingly fierce global competition for research dollars, this policy—if not reversed—will hurt jobs, innovation and competitiveness. According to a recent economic analysis, the U.S. economy would lose 263,382 jobs and experience a GDP reduction of $82.39 billion in 2023, with the manufacturing industry projected to lose nearly 60,000 jobs, if the harmful R&D amortization policy is not reversed quickly.[4] For small manufacturers, the impact is especially onerous because the tax change took effect in 2021, creating unexpectedly higher

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[1] Diamond, John W. and George R. Zodrow. *Dynamic Estimates of the Macroeconomic Effects of Tax Rate Increases and Other Tax Policy Changes* (April 2021). *Available at* https://www.nam.org/wp-content/uploads/2021/04/NAM-Tax-Study-2021.pdf.

[2] *Ibid.*

[3] *Manufacturers' Outlook Survey: First Quarter 2023*, National Association of Manufacturers (March 27, 2023). *Available at* https://www.nam.org/wp-content/uploads/2023/03/Manufacturers_Outlook_Survey_March_2023.pdf.

[4] *New Data: Taxing R&D Will Cost U.S. More Than 260,000 Jobs Next Year If Congress Doesn't Act*, National Association of Manufacturers (Dec. 16, 2022). *Available at* https://www.nam.org/new-data-taxing-rd-will-cost-u-smore-than-260000-jobs-next-year-if-congress-doesnt-act-19948/.

tax bills for this filing season, which significantly reduces the amount of capital available to reinvest in the business.

Unless Congress acts, the U.S. will continue to be just one of two developed countries with an amortization requirement for R&D expensing (the other being Belgium). Meanwhile, China, which has made no secret of its ambition to become the world leader in advanced manufacturing, currently provides a 200% deduction for R&D expenses for manufacturers.

For these reasons, the NAM strongly encourages members of the committee to support expeditious passage of the American Innovation and R&D Competitiveness Act, bipartisan legislation introduced by Reps. Ron Estes (R-KS) and John Larson (D-CT) that would repeal the R&D amortization provision, so that manufacturers in the U.S. can continue leading the world in innovation, growing the economy and creating well-paying jobs.

2. **Enable manufacturers to continue to finance growth.**

Debt financing plays an important role in supporting manufacturing growth. Many manufacturers borrow funds to finance long-term investments in equipment and facilities, which in turn help create jobs and enable manufacturers to compete effectively in today's global economy. At the beginning of 2022, a stricter limitation on the deductibility of the interest payments on business loans went into effect, increasing the cost of financing critical investments in machinery and equipment.

The maximum interest deduction under section 163(j) is now limited to 30% of a company's earnings before interest and tax ("EBIT"), a substantial change from the standard in place prior to 2022, which was based on earnings before interest, tax, depreciation and amortization ("EBITDA"). By excluding depreciation and amortization, the EBIT-based limitation makes it more expensive for capital-intensive companies to finance critical purchases, grow their businesses and hire new workers. This stricter limitation effectively acts as a tax on investment and has a disproportionate impact on manufacturers given that long-lived manufacturing investment can generate significant depreciation and amortization.

The EBIT standard also makes the U.S. a global outlier and directly harms the competitiveness of manufacturers in the United States. Of the more than 30 OECD countries with an earnings-based interest limitation, the U.S. is the only one that employs an EBIT standard.

According to a recent study, failing to reverse this harmful change could cost the U.S. economy 467,000 jobs and reduce U.S. GDP by $43.8 billion.[5] These job losses will be felt across the country, as the depth of manufacturing supply chains and the broad impact of this tax increase will ensure that small and medium-sized businesses are directly affected.

The NAM encourages members of the committee to support job-creating manufacturing investments here in the U.S. by acting expeditiously to pass bipartisan legislation introduced by Reps. Adrian Smith (R-NE) and Joe Morelle (D-NY) that would permanently preserve the EBITDA standard for interest deductibility.

[5] *Economic Impact of Not Addressing the More Stringent 163(j) Interest Expense Limitation*, EY (September 2022). *Available at* https://documents.nam.org/tax/nam_interest_deductibility_study.pdf.

3. Make permanent a key incentive for capital equipment purchases.

For the past several decades, the tax code has provided businesses with varying degrees of first-year expensing (i.e., accelerated depreciation). A 100% deduction for the purchase of equipment and machinery in the tax year purchased has been in place since 2017. This critical incentive for capital-intensive industries like manufacturing reduces the after-tax cost of investments that support job creation. According to recent analysis by the nonpartisan Joint Committee on Taxation, manufacturers led all sectors in the use of expensing by a wide margin.[6] Unfortunately, the 100% level of full expensing began to phase out this year and will be eliminated completely by 2027. If this occurs, it will become costlier for manufacturers to undertake job-creating investments and effectively compete on a global scale.

The NAM encourages members of the committee to support job-creating manufacturing investments here in the U.S. by acting expeditiously to pass H.R. 2406, the Accelerate Long-Term Investment Growth Now (ALIGN) Act, legislation introduced by Rep. Jodey Arrington (R-TX) which would make permanent the ability to fully expense new investments.

4. Protect pass-through manufacturers from damaging tax increases.

Beginning in 2018, pass-through entities (including partnerships, S corporations and sole proprietorships) have been eligible for a qualified business income deduction under the new section 199A of the Internal Revenue Code, which allows eligible taxpayers to deduct up to 20% of the income earned by their business from their taxable ordinary income. This deduction was put in place to provide targeted tax relief for small business owners that pay tax at individual rates, and it was coupled with a reduction in individual rates. However, both the individual rates and the Section 199A deduction are set to expire at the end of 2025, increasing the tax burden on small and medium-sized businesses that are organized as pass-through entities.

The NAM strongly urges members of the committee to prevent the expiration of Section 199A and make permanent the individual tax rates. These looming tax increases make it difficult for small businesses to plan for long-term investments.

5. Preserve family-owned manufacturers’ ability to pass their business on to the next generation.

Family-owned businesses are central to the manufacturing industry. These companies have often been pillars of their communities for generations, creating jobs, bolstering economic development, supporting charitable endeavors and investing for the future.

The estate tax can have a significant impact on family-owned manufacturers’ ability to continue to operate following the death of an owner. The estate tax has a disproportionate impact on family-owned manufacturers because their companies consist largely of illiquid assets that would need to be sold or leveraged to pay the tax burden. Limiting the impact of the estate tax allows family-owned manufacturers to continue operating following the death of a loved one. Conversely, increasing the estate tax burden could force these businesses to close their doors.

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[6] *Tax Incentives for Domestic Manufacturing*, Joint Committee on Taxation (Mar. 12, 2021). *Available at* https://www.jct.gov/publications/2021/jcx-15-21/.

In 2017, the TCJA increased the exemption threshold for the estate tax, allowing more of a family-owned business's assets to be passed on to the next generation without the company incurring a tax burden. The increased exemption is set to expire in 2026, which will expose more of family-owned businesses' assets to taxation, making it more difficult for them to continue operating and supporting local jobs following the death of a loved one.

The NAM strongly encourages members of the committee to prevent a reduction to the estate tax exemption threshold. Manufacturers also support efforts to permanently repeal the estate tax.

Additionally, the NAM encourages members of the committee to fully preserve stepped-up basis, which prevents a business owner's heirs from being forced to pay capital gains tax on the appreciation in value of the business's assets that occurred during the owner's lifetime. A recent study found that taxing these unrealized gains would cost the U.S. economy 80,000 jobs per year over the course of a decade and 100,000 jobs per year thereafter.[7]

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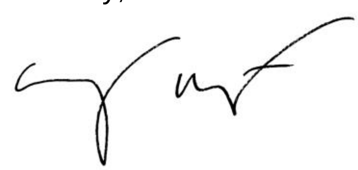
After decades of advocating for a pro-growth, competitive tax code, manufacturers in America kept their promises following the enactment of the TCJA by raising wages and benefits, hiring more workers and investing in their communities. Tax policy plays a critical role in the ability of manufacturers to thrive in the United States and effectively compete in a global economy, and the NAM urges members of the committee to support a competitive tax regime that allows manufacturing in America to continue to grow.

Sincerely,



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[7] *Repealing step-up of basis on inherited assets: Macroeconomic impacts and effects on illustrative family businesses*, EY (April 2021). *Available at* https://documents.nam.org/tax/ey-fbetc-stepupreport.pdf.