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Committee on Small Business
"Tax Day: Exploring the Adverse Effects of High Taxes and a Complex Tax Code"
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Good morning Chairman Williams, Ranking Member Velázquez and distinguished members of the committee. Thank you for holding today's important hearing regarding the U.S. tax code's impact on small manufacturers in America.

My name is Chuck Wetherington, and I am president of BTE Technologies, a 40-person small manufacturer located in Hanover, Maryland. For more than 45 years, BTE has been a top medical device provider, offering advanced solutions for physical testing and rehabilitation. We have continuously innovated technologies and advanced the field in treatment, evaluation and research to provide success to modern orthopedic hospitals and physical therapy clinics. BTE also has developed world-class workplace injury avoidance solutions, which have been utilized by numerous Fortune 500 companies. We are a small and dedicated team that prides ourselves on our domestic manufacturing capabilities.

The world is rapidly changing. When I became BTE's president in the early 2000s, the dream of competing on a global scale seemed out of reach. Only the largest companies with the resources and infrastructure in place were able to send their products overseas in a meaningful way and have their name receive worldwide recognition. Today, however, BTE Technologies is able to produce and ship high-quality medical devices around the world from a 40-employee operation just 30 miles from the room we sit in now. This would not be possible without a U.S. tax code with pro-growth and consistent tax policies that promote small and medium manufacturers.

A few basic truths should guide Congress's efforts to promote manufacturing growth through the tax code:

- The tax code must be simple;
- The tax code must be consistent; and
- The tax code must support growth and job creation here in America.

These are not partisan priorities—I would be shocked if any of you introduced legislation that would intentionally make the tax code more difficult for small manufacturers to comprehend.

However, the tax code has started to work against BTE and our fellow small manufacturers in recent years. Critical provisions that made it easier for small manufacturers to prosper have expired or are set to expire in the near future. I applaud every member of this committee who voted to advance the Tax Relief for American Families and Workers Act in January of this year, but as we all know, our work is not done, and a larger tax policy reckoning is looming.

I. The Tax Code Must Support U.S. Manufacturing

Prior to 2017, our tax code had not been given a thorough review in 30 years, causing the United States to fall behind globally. The Tax Cuts and Jobs Act cut the corporate income tax rate from 35% (one of the highest in the developed world) to 21%. To support investments in growth, the TCJA allowed businesses to immediately deduct the full cost of new capital purchases and doubled the expensing limit for investments by small businesses. Almost as significant as the corporate rate being lowered to a globally competitive level, the TCJA created a new deduction for pass-through business income, allowing businesses that pay tax at the higher individual rates to deduct 20% of their qualified business income each year. Individual tax rates were reduced as well, working with the pass-through deduction to bolster small business competitiveness throughout the economy. There also were a host of changes to our international tax system, shifting the U.S. from a "worldwide" approach to a new modified territorial tax system, as well as other changes.

These changes, all significant in their own right, worked in concert to drive a tsunami of economic activity and industrial growth for small and medium manufacturers. Following the TCJA's passage, the manufacturing sector experienced the best year for manufacturing job creation in the previous 21 years and the best year for manufacturing wage growth in the previous 15 years.[1] Manufacturing capital spending grew 4.5% and 5.7% in 2018 and 2019, respectively.[2]

Unfortunately, the United States is now falling behind once again. Beginning in 2022, crucial policies enacted by the TCJA began expiring or phasing out, including the ability to immediately deduct research and development expenses, enhanced interest deductibility on business loans and the ability to deduct the cost of capital investments in the year acquired. It is bad enough that these changes went into effect, but they are symptoms of a larger problem: domestic manufacturers rely on stability within the tax code, and Congress has been unable to deliver that predictability.

Due to the uncertainty over whether Congress will address the expiration of federal tax incentives related to R&D, interest deductibility and expensing for capital investments, 40% of respondents in a recent survey of manufacturing executives reported that they have already been forced to pull back on hiring and investing.[3] In the same survey, 94% of respondents said that it is important for the federal tax code to help reduce manufacturers' costs for conducting R&D, accessing capital via business loans and investing in capital equipment purchases.

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[1] National Association of Manufacturers, "Competing to Win" (September 2022). *Available at* https://documents.nam.org/ctw22/competing%20to%20win%202022%20-%20tax.pdf.
[2] *Ibid.*
[3] NAM Manufacturers' Outlook Survey, First Quarter 2024 (March 2024). *Available at* https://nam.org/wp-content/uploads/2024/03/Outlook-Survey-March-2024-Q1.pdf.

At BTE, the loss of immediate R&D expensing has had a detrimental impact. Bringing a new medical device to market is a multiyear process, necessitating significant investments in R&D. Being required to amortize our R&D expenses has forced us to staff our technical team at a reduced level, slowing down the development of new products.

Our suppliers have felt the pain of Congress's failure to extend these provisions as well. We purchase parts from companies that are now less able to make capital investments—both because debt financing is more expensive and because they can no longer immediately deduct the costs of those investments. This makes BTE's supply chain more vulnerable and increases our operational costs.

Solving problems and innovating are what manufacturers do, but if policymakers do not establish and maintain a pro-growth tax code, we can't stay competitive and continue to be economic drivers for the U.S. economy.

At the end of the day, small manufacturers need two things from Congress in order to succeed: consistency and simplicity. A constantly changing tax code means that small businesses like mine have to divert time and resources away from what we do best—making things in America—and hire outside experts to help us navigate the complexity. Over the past decade, we've had to function under a changing tax code seemingly every other year, and more changes are on the horizon. Manufacturers require tax policy that allows us to plan well into the future so we can remain pillars of our communities.

II. Congress Must Immediately Address Expired Tax Policies

On January 31, 2024, the House passed the Tax Relief for American Families and Workers Act by a bipartisan vote of 357–70. This legislation would reinstate several of the pro-growth TCJA provisions that expired in 2022—each of which is critical to manufacturing growth.

Immediate R&D Expensing

For more than 70 years, taxpayers were allowed to immediately deduct 100% of their R&D expenses in the year they incurred. In 2022, however, the tax code began requiring so-called "amortization" of these expenses, forcing manufacturers to recover only a small portion of their costs over several years. This is devastating for BTE, as the ability to immediately deduct these expenses allowed us to hire more qualified workers, invest in advanced robotics and increase our production capabilities by several magnitudes.

We are currently in the process of updating and improving our flagship products, which account for more than 70% of our sales—but the R&D amortization requirement has slowed our progress, ultimately delaying the expansion and increased sales that we expect to significantly increase our employee headcount.

Taxing manufacturers' investments in critical R&D expenditures means that we will have less capital to invest in workers and our future growth. The private sector accounts for more than

75% of total R&D spending, with small businesses accounting for approximately $90 billion of all private-sector R&D investments. With this recent change, Congress has now made the U.S. one of only two developed countries in the world that require the amortization of R&D expenses. Companies like BTE now face *increased* costs and *reduced* global competitiveness when we seek to undertake job-creating R&D.

A recent report from the European Union found that both the EU and China gained a significant advantage after the expiration of the TCJA R&D tax policies. In 2022, the first full year after immediate expensing for R&D expired in the United States, EU R&D growth surpassed the U.S. for the first time in nearly a decade. Even more worrisome, China's R&D growth tripled that of the United States that year. Chinese companies enjoy a super-deduction on research spending, while BTE and other manufacturers in the U.S. must now compete with weights strapped to their ankles following the expiration of immediate R&D expensing. China is not the only country offering better R&D incentives—17 countries now provide a deduction that is more than 100% of eligible R&D expenses, further making the United States a less attractive place to conduct R&D. At a time of increasingly fierce global competition for research dollars, Congress must act to ensure the next R&D dollar is spent in the United States to secure our global leadership in innovation and strengthen our nation's economic and national security.

Pro-Growth Interest Deductibility

The expiration of the TCJA's pro-growth interest deductibility standard also disproportionately harms manufacturers. At the beginning of 2022, the deduction for interest on business loans was reduced, with the maximum deduction allowed under Section 163(j) of the tax code narrowed from 30% of earnings before interest, tax, depreciation and amortization (EBITDA) to 30% of earnings before interest and tax (EBIT). Excluding depreciation and amortization reduces the amount of interest businesses can deduct, making it more expensive for manufacturers to finance capital equipment purchases.

Allowing this stricter limitation to continue greatly affects manufacturers' ability to compete globally. Among the 35 countries that have a rule that restricts interest deductibility based on a ratio of interest expense to some measure of earnings, the United States is the only country that has an EBIT-based rule. Generally, China does not limit any third-party interest deduction. According to a recent study, keeping the EBIT standard could cost the U.S. economy 467,000 jobs and reduce U.S. GDP by $43.8 billion.[4]

Cost-effective debt financing is crucial to small businesses that are trying to buy and sell large pieces of capital equipment, which requires debt financing. We see this throughout manufacturing given how capital-intensive the industry is—many of BTE's suppliers utilize debt financing to expand their operations and invest in growth, yet their ability to do so is limited by

[4] "Economic impact of a stricter 163(j) interest expense limitation," EY (September 2022). *Available at* https://documents.nam.org/tax/nam_interest_deductibility_study.pdf.

the more-restrictive interest deductibility standard. Ultimately, this switch to an EBIT standard weakens the manufacturing supply chain and increases BTE's costs.

Additionally, at BTE we offer a rental program for some of our equipment. When we rent out a product, we are required to depreciate the cost of the equipment over several years. That accounting treatment widens the difference between our EBITDA and our EBIT (because it increases our depreciation expenses—the "DA"). Under the new interest deductibility standard, this results in a lower cap on how much interest we can deduct, making it more expensive for us to debt finance additional investments. Without congressional action to reverse this harmful change, both our rental program and our ability to finance additional growth could be at risk.

Full Expensing

Finally, the ability to immediately deduct the full cost of a purchased machine or capital investment began phasing out in 2022 and will be eliminated completely by 2027. According to the Joint Committee on Taxation, the manufacturing sector, and specifically small manufacturers, overwhelmingly utilize accelerated depreciation more than any other sector.[5] Allowing accelerated depreciation to continue to phase out will increase the cost of capital investments for small companies across the manufacturing sector. It also could encourage companies in the manufacturing supply chain to rely on older pieces of equipment.

New equipment designed and produced by manufacturers in America creates jobs here at home and drives the American competitive spirit. BTE's shop floor is full of expensive, complex equipment that is vital to our operations. Yet the phase out of full expensing makes it more difficult for manufacturers like BTE to invest in capital equipment. It also undermines certainty in the tax code—there has been some form of accelerated depreciation for capital equipment in the tax code for decades, and allowing it to completely expire would force companies in the U.S. to compete with one hand tied behind their back as countries around the world are implementing their own expensing schedules.

Again, I thank every member of this committee who supported the Tax Relief for American Families and Workers Act. This critical legislation would extend immediate R&D expensing, pro-growth interest deductibility and full expensing until 2025. Reversing these harmful tax changes will have an immediate impact on BTE and small manufacturers throughout the manufacturing supply chain. Acting now also will give Congress time to plan for a more permanent solution for these vital incentives by aligning them with the full suite of important TCJA provisions that will expire at the end of 2025.

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

III. The Upcoming Tax Battle

Tax reform was rocket fuel for U.S. manufacturing. Even after the pandemic, significant supply chain challenges and the current uncertainty surrounding R&D, interest deductibility and full expensing—tax reform's benefits are still felt at BTE and throughout the industry. But many of the TCJA's key provisions, including several that directly impact small manufacturers, are at risk. Critical policies are set to expire at the end of 2025, threatening the gains we've seen over the past several years.

- Many small manufacturers are organized as pass-throughs, including most of BTE's key suppliers. These companies are able to utilize the 20% deduction on pass-through business income enacted by the TCJA. This deduction will expire at the end of 2025. A tax increase on pass-throughs would have a damaging, disproportionate impact on the manufacturing industry.
- Similarly, the TCJA's reduction in the individual tax rates that pass-through businesses use to calculate their taxes will sunset at the end of 2025. This will result in a direct tax increase on American families and on pass-through manufacturers that pay tax at these individual rates.
- The TCJA also 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 incurring a tax burden. The increased exemption is set to expire at the end of 2025, which will expose more of a family-owned business's assets to taxation, making it increasingly difficult for them to continue operating and supporting local jobs following the death of a loved one.

Congress must prevent these tax increases from taking effect in 2026 so that small manufacturers are able to grow, create jobs and invest in their communities. At BTE, we are expecting growth of over 50% in the next five years—if the tax code allows us to invest in the R&D necessary to continue to improve our flagship products, and if we don't experience additional tax increases in 2026.

Small manufacturers face an uphill battle and a daunting set of challenges, and it is well known that small businesses often fail. Entrepreneurs who go into business despite these obstacles—and their hardworking employees—deserve a tax code that not only promotes innovation but demonstrates to the rest of the world what our values will be for the next decade and beyond. Congress must implement simple, commonsense, pro-growth tax policies that support small manufacturers across the country. The U.S. must attract more industrial dollars to our shores—not encourage, or in some cases force, companies to conduct their business overseas.

This committee has a lot of work ahead of it. I hope you keep the manufacturing sector at the forefront of your thoughts as you deliberate the next incarnation of the tax code for the greatest country in the world.

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I want to thank Chairman Williams and Ranking Member Velázquez for giving me the chance to testify today. Manufacturing truly is the backbone of our nation, and I appreciate all members of the committee for continuing to give our industry the attention it deserves. Through sound tax policy, we will continue to create jobs, innovate, compete globally and provide a better future for all Americans.