Statement for the Record

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HOUSE COMMITTEE ON SMALL BUSINESS'S SUBCOMMITTEE ON GROWTH, TAX AND CAPITAL ACCESS HEARING

"ENABLING SUCCESS: EXAMINING THE COMPETITIVE LANDSCAPE FOR SMALL BUSINESSES"

Sept. 13, 2023

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Subcommittee on Growth, Tax, and Capital Access Hearing
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The National Association of Manufacturers appreciates the opportunity to submit written comments for the record as part of the House Committee on Small Business's Subcommittee on Growth, Tax, and Capital Access hearing on "Enabling Success: Examining the Competitive Landscape for Small Businesses."

The NAM is the largest manufacturing association in the United States, representing large and small manufacturers in every industrial sector and in all 50 states. Manufacturing employs nearly 13 million men and women, contributes $2.91 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.

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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 93.1% have fewer than 100 employees. Given the importance of small manufacturers to the strength of the U.S. economy, a competitive tax code that supports small businesses is critical.

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 for production workers rose 3.4% year-over-year in March and April of 2018 (at the time, the highest since February 2003).
- Manufacturing capital expenditures increased 4.5% and 5.7% in 2018 and 2019, respectively.

Unfortunately, several harmful tax changes have recently gone into effect.

Manufacturing is a capital-intensive industry and many manufacturers borrow funds to finance their growth however at the beginning of 2022, a stricter interest deductibility limitation went into effect, increasing the cost of financing critical investments in machinery and equipment.

The maximum interest deduction under Section 163(j) of the tax code is now limited to 30% of a company's earnings before interest and tax, a significant change from the standard in place prior to 2022, which was based on earnings before interest, tax, depreciation and amortization. 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. Moreover, this limitation has gone into effect at a time when the cost of capital itself has increased due to rising interest rates.

The EBIT standard also makes the U.S. a global outlier and directly harms the competitiveness of manufacturers in the U.S. 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.

Failing to reverse this harmful change could cost the U.S. economy 467,000 jobs and reduce U.S. GDP by $43.8 billion.[1] These job losses will be felt across the country, as the breadth and depth of manufacturing supply chains and the spillover effects of this tax increase will ensure that small and medium-sized businesses are affected directly.

With debt financing playing an important role in manufacturing growth, the NAM encourages members of the committee to support the expeditious passage of H.R. 2788, the American Investment in Manufacturing (AIM) Act, bipartisan legislation introduced by Reps. Adrian Smith (R-NE) and Joe Morelle (D-NY) that would permanently preserve the EBITDA standard for interest deductibility.

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As Congress acts to reverse the damaging limitation on interest deductibility discussed above, two additional changes are necessary to protect manufacturing jobs.

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. This change has been particularly harmful for small businesses, which account for about 15% of all private-sector R&D investments.[2]

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.[3] For small manufacturers, the impact is especially onerous because the tax change took effect in 2022, creating unexpectedly higher tax bills during the 2023 filing season and significantly reducing the amount of capital available to reinvest into these businesses.

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[1] "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.

[2] National Center for Science and Engineering Statistics, National Science Foundation, InfoBrief, NSF 22-343, Oct. 4, 2022, https://ncses.nsf.gov/pubs/nsf22343

[3] "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-nextyear-if-congress-doesnt-act-19948/.

Unless Congress acts, the U.S. will remain 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, provides a 200% deduction for R&D expenses for manufacturers. In fact, 17 countries, including 10 OECD countries, provide for recovery of more than 100% of eligible R&D expenses.[4]

For these reasons, the NAM strongly encourages members of the committee to support expeditious passage of H.R. 2673, 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.

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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 was in place from 2017 through 2022. This critical incentive decreases a company's tax bill in the year of purchase and frees up cash for that purchase. For capital intensive industries like manufacturing, where the latest technology is key to production, this kind of support can be vital, especially among smaller manufacturers with tighter margins.

According to recent analysis by the nonpartisan Joint Committee on Taxation, manufacturers led all sectors in the use of expensing by a wide margin.[5] 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, make it more difficult to strengthen domestic supply chains and harm the ability of manufacturers to compete effectively on a global scale. The NAM thanks Chairman Arrington for introducing H.R. 2406, the Accelerate Long-Term Investment Growth Now (ALIGN) Act, which would make permanent the ability to fully expense new investments. Manufacturers urge committee members to support its passage.

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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.

[4] "Tax Incentives for R&D and Innovation," OECD. Available at https://stip.oecd.org/innotax/.
[5] "Tax Incentives for Domestic Manufacturing," Joint Committee on Taxation (March 12, 2021). Available at https://www.jct.gov/publications/2021/jcx-15-21/.