CHALLENGES AND SOLUTIONS FOR THE NEXT PRESIDENT AND CONGRESS

COMPETING TO WIN

TAX IN FOCUS

NATIONAL ASSOCIATION OF Manufacturers

TAX IN FOCUS

Introduction

Inaction on modernizing our nation's tax code is no longer an option. Indeed, by standing still, we are falling further behind as a nation while our peers compete to attract and grow their tax base. While this realization has finally led to broad agreement that comprehensive tax reform is an economic imperative, it is still not yet a reality. Policymakers must be committed to enacting pro-growth, pro-competitive, pro-manufacturing comprehensive business tax reform, and that effort must begin as soon as possible.

The last major overhaul of the U.S. tax code was in 1986. Manufacturers have innovated, expanded and evolved over the past 30 years, but the U.S. tax system has not kept pace.

In January 2015, the National Association of Manufacturers (NAM) released a study, titled *A Missed Opportunity: The Economic Cost of Delaying Pro-Growth Tax Reform*, showing a five-pronged pro-growth tax package would substantially fuel the economy and result in increased jobs and investment. Over a 10-year period, a pro-growth tax reform plan would:

- Contribute more than $12 trillion in GDP;
- Increase investment by more than $3.3 trillion; and
- Add more than 6.5 million jobs to the U.S. economy.

Inaction on reforming the U.S. tax system is taking its toll on the economy. Slow growth, static investment and an employment rate that does not match our growth potential are all immediate consequences of an outdated tax system. In contrast, reduced tax rates on corporate and "pass-through" business income, a robust capital cost-recovery system, strong research and development (R&D) incentives and modern, competitive international tax rules would help ensure robust economic growth in the United States.

We can no longer afford to waste this opportunity to improve our global competitiveness and grow the economy. The NAM looks forward to working with the incoming president and the 115th Congress to achieve comprehensive business tax reform that will reduce tax rates for all manufacturers, strengthen capital investments, improve our competitiveness and make the United States an attractive place to manufacture.

Three Big Trends Shaping the Changing Tax Landscape

Trend 1: Manufacturers in the United States face higher tax rates on business income than their competitors in other nations.

With a combined (state and local) corporate tax rate that tops 39 percent, manufacturers in the United States face the highest corporate statutory tax rate among the 34 industrialized nations of the Organisation for Economic Co-operation and Development (OECD), far higher than the average OECD nation's tax rate of 25 percent. Meanwhile, tax rates for some manufacturers organized as pass-throughs are even higher and, in some cases, can hit almost 50 percent.

According to the 2016 Manufacturers' Outlook Survey for the third quarter, 73.6 percent of respondents cited an unfavorable business climate due to taxes and regulations as their primary business challenge, with many manufacturers continuing to be frustrated with the lack of comprehensive tax reform.

Trend 2: Business investment continues to lag, slowing economic growth.

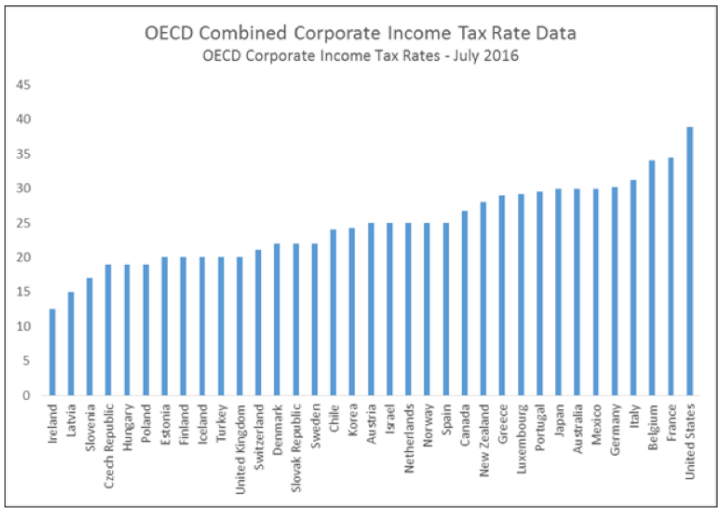
In general, we have seen slower capital investment growth rates since 2000. The NAM's quarterly Manufacturers' Outlook Survey continues to reflect concerns over ongoing economic challenges. Surveys in recent years find that ranking at the top of manufacturers' concerns was the continued need for pro-growth tax reform. One key element for pro-growth tax reform is policy that encourages capital investment. When business owners are uncertain about tax policies surrounding investment incentives for equipment and other business expenses, they hold back on purchases, slowing down broader economic growth.

Trend 3: Outdated rules for taxing international income make us less competitive.

Despite the benefits of global competitiveness to the U.S. economy, our nation's tax laws make it more difficult for global U.S. companies to thrive and compete in the worldwide marketplace. Most OECD countries have territorial tax systems that enable their resident multinational companies to pay little or no additional "home country" tax when they bring back foreign earnings as a dividend to the parent corporation. In contrast, the United States has a worldwide system that taxes income regardless of where it is earned. Thus, global U.S. companies generally are subject to taxes in the foreign countries where they are doing business and in the United States when they repatriate foreign earnings back home. This added tax burden on global U.S. companies is a significant disadvantage when U.S. companies are competing against non-U.S. multinationals and local firms for business in a global marketplace. When U.S. companies cannot compete effectively abroad, where 95 percent of the world's consumers are located, the U.S. economy suffers from both the loss of foreign markets and domestic jobs that support foreign operations.

America's Challenge: A Fair and Competitive Tax Agenda That Spurs Economic Growth

We must reduce the corporate tax rate to 15 percent to keep up with our overseas trading partners.



The Challenge

For more than three years, the United States has had the highest corporate tax rate among developed economies. While the top U.S. federal statutory corporate tax rate has remained at 35 percent for almost 25 years, other major developed countries have realized that lower corporate tax rates encourage economic growth and have significantly reduced their statutory tax rates. As a result, the United States is at a significant disadvantage in the global economy.

The Stakes

Manufacturers in particular feel the brunt of our high tax rates. Indeed, inaction on lowering the corporate tax rate is taking its toll on investment, job creation and broader economic growth. Thus, a key NAM objective is to create a national tax climate that enhances the global competitiveness of our nation's manufacturers and encourages investment and job creation in the United States.

The Solution

An important step to achieving this goal is to adopt a federal statutory corporate tax rate of 15 percent, which will put us more in line with our major competitors. A lower corporate tax rate will make it easier for our nation's manufacturers to compete in the global marketplace, encourage greater investment in the United States and promote U.S. job creation and overall growth.

We must lower the tax rate for the two-thirds of manufacturers that pay taxes as pass-through entities.

The Challenge

For more than 60 years, many manufacturers and other business owners have chosen to organize as S corporations or other pass-through entities to benefit from comprehensive liability protection and a single level of federal taxation. Pass-throughs are the most common business form in the United States. Of the 27.7 million firms in 2011, about 94 percent were pass-through businesses according to the Census Bureau. Pass-through businesses' income is taxed at their owners' individual marginal rates; thus, when the top rate went up to 39.6 percent from 35 percent in early 2013, many manufacturers saw their tax rates increase. Indeed, when taking into account local and state taxes, many pass-through manufacturers today are paying upward of 44 percent in income taxes.

The Stakes

Manufacturing is a capital-intensive industry, and in smaller companies, the capital to grow and expand operations, increase product lines and hire additional workers most often comes directly from the owners. Thus, the tax treatment of pass-through businesses impacts the decisions and the ability of small and medium-sized manufacturers to hire and retain workers and reinvest in their companies.

The Solution

Congress needs to pass comprehensive business tax reform, making the nearly two-thirds of manufacturers organized as pass-through businesses more competitive by reducing the tax on their business income and allowing these owners to reinvest at greater levels in their business. In addition, Congress must consider the unique impact that individual tax rates and base broadening may have on pass-through businesses.

We must maintain a robust capital cost-recovery system to spur business investment and expansion.

The Challenge

In addition to lower tax rates for businesses of all sizes, one of the most effective ways to spur business investment—and make manufacturing in the United States more competitive—is through a strong capital cost-recovery system. An ideal system would allow companies to expense capital equipment in the tax year purchased.

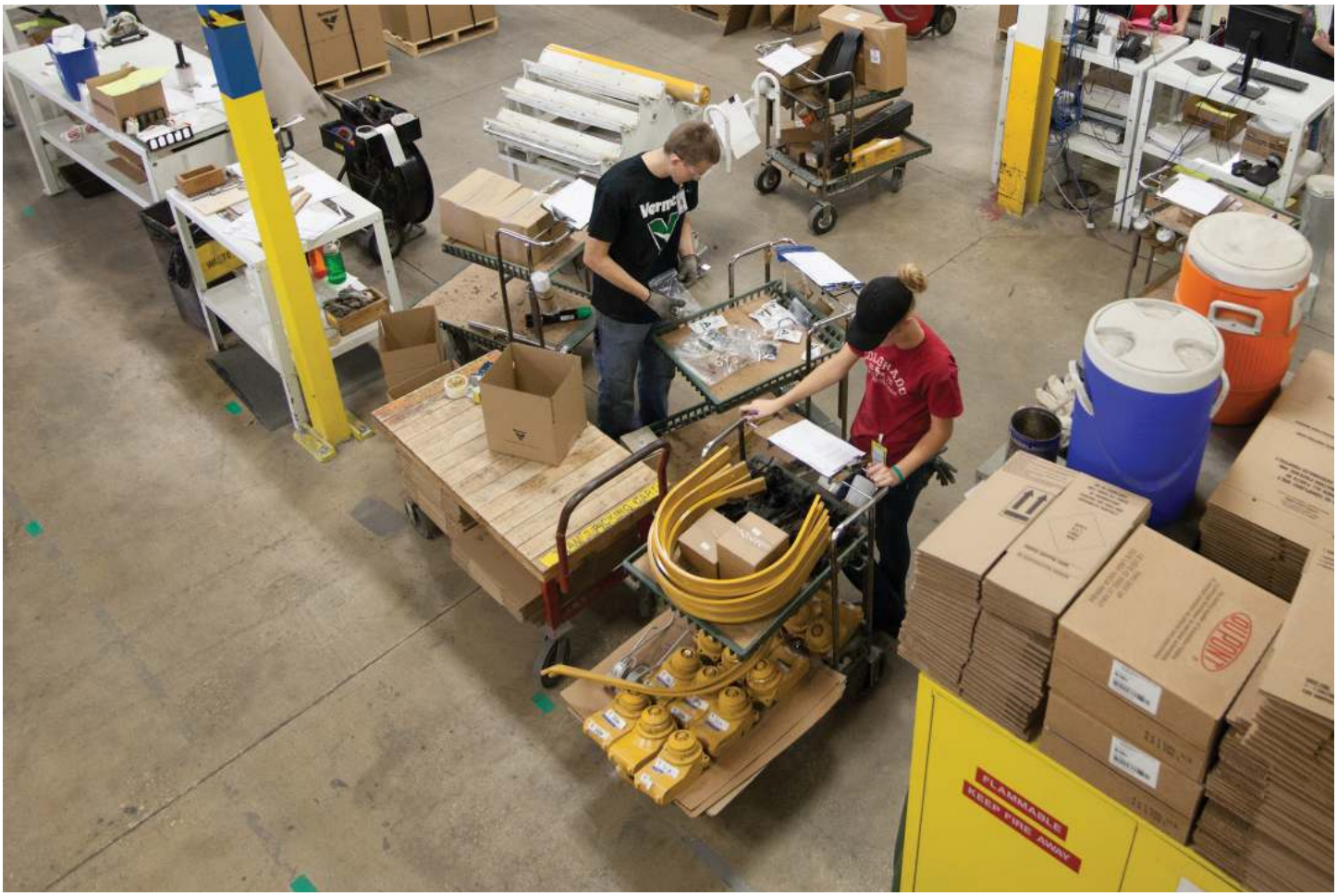
The Stakes

Legislative and regulatory proposals that increase the cost of domestic investment impact economic growth negatively. Recent data released by the Bureau of Economic Analysis reinforces the role that a healthy manufacturing sector strengthens the nation's economy. Manufacturing in the United States is in the midst of a comeback, but for the nation to fully reap the benefit of this resurgence, manufacturers need tax policies that allow them to compete in today's global economy and do not tip the scales against investment.

The Solution

The positive economic impact of expensing capital equipment is well recognized throughout economic literature. The cost of capital to a firm includes three components: the price of capital equipment, the cost of financing the equipment and the tax treatment of the investment. Expensing lowers the after-tax cost of capital and increases the number of profitable projects a firm can undertake, helping to spur investment. *A Missed Opportunity* finds that the tax policy changes advocated in this section "would add nearly 1.5 percentage points to investment growth on an annual basis, amounting to a cumulative increase of more than $3.3 trillion between 2015 and 2024….Most—about four-fifths—of the combined impact is the result of full expensing, with the corporate and individual tax rate reductions contributing about 10 and 3 percent, respectively."

Manufacturers of all sizes take into account the tax impact of cost-recovery mechanisms on project cash flows in making investment decisions. For manufacturers large and small, cash flows are managed carefully to support key growth objectives, and cash flow is critical when access to credit is difficult, especially for small and medium-sized manufacturers. Comprehensive business tax reform that includes pro-investment provisions will help drive the increased growth our economy needs.



We must move from a worldwide to a modern territorial international tax system to make U.S. companies more competitive.

The Challenge

Manufacturers have a strong interest in our nation's international tax regime. Almost half of American worldwide companies are manufacturers, and 57 percent of all manufacturing employees in the United States are employed by U.S. companies with operations overseas. Global investment by American companies plays an important role in the growth and vitality of the U.S. economy. Despite the economic benefits of having American companies expand beyond our shores, U.S. tax laws make it difficult to compete globally. In addition to high corporate tax rates and highly taxed exports, the U.S. system taxes income even when it is earned outside of the United States. As a result, American businesses with customers around the world generally have a higher tax burden than their competitors. This higher cost of capital is a significant disadvantage for companies competing for customers in a global economy.

The Stakes

If American companies cannot compete abroad, where 95 percent of the world's consumers are located, the U.S. economy suffers from the loss of both foreign markets and domestic jobs that support foreign operations. To make U.S. multinationals more competitive, the NAM supports moving from the United States' current worldwide tax system to a territorial tax system similar to those in most industrialized countries, structured to enhance U.S. competitiveness, not raise additional revenue.

The Solution

Territorial systems are now the international norm. The vast majority of our trading partners have territorial systems that tax income earned within their borders but do not tax the foreign profits repatriated to their own economies. In recent years, Japan and the United Kingdom—two of the largest economies—abandoned worldwide taxation systems in favor of a territorial approach. Adopting a tax system that is comparable to tax systems in other industrial countries is critical to the ability of manufacturers in the United States to compete in the global marketplace. A competitive tax system will impact jobs at U.S. headquarters, increase exports from manufacturers in the United States and improve the efficiency of their supply chains.

A territorial system should allow for the free flow of capital back to the United States from foreign operations for reinvestment in the domestic economy. The current high corporate tax rate of 35 percent, even though it is partially offset by foreign tax credits at lower tax rates imposed outside the United States, often results in a high U.S. tax charge on earnings repatriated from foreign subsidiaries. This additional charge causes what is often referred to as a "lockout" of earnings, preventing them from being brought back to the United States.

Enactment of a well-crafted territorial system also would simplify U.S. tax law by eliminating several complex tax rules. For example, a territorial system could significantly reduce the importance of the foreign tax credit. Eliminating the use of the foreign tax credit system as the primary means of preventing international double taxation will reduce the possibility of double taxation experienced by U.S. multinationals. In addition, the rules for allocating and apportioning interest expense have long been criticized for over-allocating interest expense to foreign source income, resulting in double taxation. By limiting the importance of the foreign tax credit rules, this and other inequities in the rules would be minimized.

Businesses headquartered outside the United States that invest in our nation also play an important role in the growth and vitality of the U.S. economy. Like their domestic counterparts, they provide high-paying jobs for millions of Americans and are an important source of U.S. exports. As a result of the growing importance of foreign direct investment to the U.S. economy, it is critical that policymakers avoid imposing discriminatory taxes on foreign-owned companies. Congress should focus on tax policies that attract and maintain more capital investment, rather than discourage it.

We must adopt robust R&D incentives to maintain leadership in global innovation.

The Challenge

Manufacturers in the United States account for more than three-quarters of all private-sector R&D in the nation. The United States has been a leader in promoting R&D for more than 30 years but has slipped behind in recent years as more and more countries have provided robust R&D incentives. A top NAM priority is to ensure manufacturers in the United States are the world's leading innovators. The tax treatment of R&D, including the current deduction for R&D expenses and a strengthened R&D credit, is critical to achieving this goal.

The Stakes

The R&D tax credit is a proven incentive for spurring private-sector investment in R&D and creating domestic, high-wage jobs. The R&D credit is a true U.S. jobs credit with 70 percent of credit dollars going toward the salaries of high-skilled domestic R&D workers. Enacted more than 30 years ago, the credit was only recently made permanent by Congress in December 2015.

The certainty provided by the now-permanent credit is a major step in boosting U.S. innovation, but more needs to be done.

The Solution

Strengthening the R&D incentive by increasing the alternative simplified credit formula from 14 to 20 percent would make it easier for companies of all sizes to use the R&D credit, fueling more research investment and creating more high-wage research jobs. Similarly, a strengthened R&D incentive should be coupled with the current-law ability to deduct R&D expenses in the year incurred. A strong R&D incentive is the only way to keep the United States competitive in the global race for R&D investment dollars.

Tax reform must include a strengthened R&D incentive to keep manufacturers performing R&D and ensure the United States stays on the front lines of global innovation.

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Conclusion

Manufacturers want the United States to be the best place in the world to manufacture and attract foreign direct investment, and there is no doubt that the U.S. tax code is a drag on economic growth and competitiveness. Business tax reform that will reduce the corporate tax rate to 15 percent, lower rates for pass-through entities, shift to a modern territorial international tax system, strengthen R&D incentives and maintain a robust capital cost-recovery system will drive job creation.

These changes would result in a boost of more than $3.3 trillion in investments, more than $12 trillion in GDP and more than 6.5 million jobs to the U.S. economy. Making comprehensive business tax reform a near-term priority will promote manufacturing in America and enhance the global competitiveness of manufacturers in the United States well into the future.

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