Comments of

The National Association of Manufacturers

Submitted to the Senate Finance Committee

Savings and Investment Tax Reform Working Group

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I. Introduction

The National Association of Manufacturers (NAM) welcomes the opportunity to submit comments to the Senate Finance Committee Savings and Investment Tax Reform Working Group.

The NAM is the largest manufacturing association in the United States, representing manufacturers of all sizes in every industrial sector and in all 50 states. Manufacturing employs nearly 12 million men and women, contributes more than $1.8 trillion to the U.S. economy annually, has the largest economic impact of any major sector and accounts for three-quarters of private-sector research and development.

NAM members know firsthand that our current tax system is fundamentally flawed and discourages economic growth and U.S. competitiveness. As outlined in the NAM's A Growth Agenda: Four Goals for a Manufacturing Resurgence in America, a key objective for the association is to create a national tax climate that promotes manufacturing in America and enhances the global competitiveness of manufacturers in the United States. A pro-manufacturing tax policy must acknowledge that a high tax burden makes manufacturers in the United States less competitive.

To achieve these goals, we need a comprehensive tax reform plan that both reduces the corporate tax rate to 25 percent or lower and includes lower rates for the nearly two-thirds of manufacturers organized as flow-through entities. We also believe that comprehensive tax reform must include a shift from the current worldwide system of taxation to a modern and competitive international tax system, a permanent and strengthened research and experimentation (R&E) incentive and a strong capital cost-recovery system.

The NAM very much appreciates the current focus on improving our nation's tax system. Enactment of a pro-growth, pro-manufacturing tax reform plan will go a long way to strengthen our economy and ensure vibrant economic growth in the future. ***A Missed Opportunity: the Economic Cost of Delaying Pro-Business Tax Reform***, a study released by the NAM in January 2015, takes a close look at the economic impact of enacting a five-prong pro-business tax package similar to NAM's priorities and concludes that lack of action on pro-business tax reform is costing the U.S. economy in terms of slower growth in Gross Domestic Product (GDP), investment and employment. In contrast, the report finds that over a ten-year period, a pro-business tax plan would increase GDP over $12 trillion relative to CBO projections, increase investment by over $3.3 trillion and add over 6.5 million jobs to the U.S. economy.

The following comments reflect NAM Board-approved policy on tax reform and are based on the premise that any changes would be part of a comprehensive tax reform plan.[1]

II. Encouraging Investment

NAM members know firsthand that capital investment is key to economic growth, job creation and competitiveness. Consequently, promoting investment should be a focus of any tax reform effort and an integral part of U.S. tax policy. An effective way to spur business investment and make manufacturing in the United States more competitive is through a strong capital cost-recovery system.

Manufacturers also believe that any tax reform plan should recognize that capital is not income, but that investment in capital produces income, and only the resulting income stream should be subject to an income tax. The tax rate on capital gains for both individuals and corporations should be as low as possible.

The tax treatment of dividends is also important to investment. Under current federal tax law, dividend income is taxed twice: once to the corporation and again to the individual recipient. The NAM has long held that this double-tax burden creates a bias against corporate earnings and should be eliminated. Absent elimination, keeping the tax rate on dividends as low as possible and maintaining the parity with capital gains will help dividend-paying public companies attract investors and allow them to finance investment and create jobs. An Ernst & Young study released in February 2012 found that most developed countries provide relief from the double tax on corporate profits because it distorts important economic decisions that waste economic resources and adversely affect economic performance.[2]

a. Tax Increases and the Cost of Capital

Raising taxes on investment income will increase the cost of capital, slowing economic growth and hurting investors, retirees and the companies that rely on investment capital. The Ernst & Young study concluded that investment tax increases discourage capital investment, particularly in the corporate sector, reducing capital formation and, ultimately, living standards.[3]

In addition, a tax policy that discourages the payment of dividends can impact corporate governance as investors' decisions about how to allocate capital are disrupted by the absence of signals that dividend payments would normally provide.[4]

Finally, capital-intensive businesses, such as manufacturing, use some debt financing to reduce the cost of their investment. The NAM opposes proposals to impose limits on corporate taxpayers' interest expense. The deductibility of interest is an important capital structure measure and limiting or eliminating the deductibility of interest would have a chilling impact on capital markets and reduce the ability to invest to spur the economy.

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[1] See also NAM Comments on Camp Discussion Draft, August 2014

[2] Robert Carroll and Gerald Prante, *Corporate Dividend and Capital Gains Taxation: A comparison of the United States to other developed nations,* February 2012.

[3] Ibid.

[4] Ibid.

b. Recent Changes to Investment Taxes

Nearly a decade ago, policymakers acknowledged the importance of the taxation of investment income to economic growth and lowered the top dividend tax rate in 2003 to 15 percent to mirror the capital gains tax rate that had been reduced in 2001. Reducing the tax rate on capital gains and dividends was an important and significant step toward eliminating the double tax on corporate profits and removing taxes from economic decisions.

Unfortunately, the American Taxpayer Relief Act of 2012, enacted in early 2013, raised the top tax rate on capital gains and dividends to 20 percent. Effective January 1, 2013, an additional 3.8 percent surtax included in the Affordable Care Act also applies to investment income for individuals earning more than $200,000 and couples earning more than $250,000. With the surtax, individuals with income greater than $400,000 (individuals) and $450,000 (couples) pay a top dividends and capital gains tax rate of 23.8 percent.

Because of the benefit of lower investment taxes to economic growth, jobs and competitiveness, manufacturers believe that any tax reform effort should keep taxes on investment income as low as possible. The NAM has long held that an important objective of long-term tax policy is to maintain competitive tax rates that are low enough to attract the capital formation and investment necessary to ensure durable economic growth. In the context of comprehensive tax reform, the NAM supports synchronized, lower rates on capital gains and dividends.

III. Employee Benefits

Manufacturers have long provided generous benefits to their employees, reflecting their commitment to their workforce—an essential factor in the success of manufacturing in the United States. To that end, it is important to manufacturers that an improved, pro-job, pro-growth, pro-competitive tax code maintains some key priorities specifically regarding the tax treatment of employee benefits.

In particular, NAM members believe that a tax reform plan should continue to recognize that private-sector employee benefit plans efficiently offer medical, health and retirement benefits to workers. The tax treatment of employee medical, health and retirement benefit plans should permit employers to exercise reasonable discretion in determining the types, coverage, conditions of eligibility, contributions and investments necessary to attract and retain qualified workers in a globally competitive market.

To this end, the NAM supports repeal of the so-called "Cadillac tax," a 40 percent excise tax on the value of employee benefits above certain thresholds. This employee benefits tax, included in the Affordable Care Act, will go into effect in 2018. Towers Watson estimates that this tax will hit 48 percent of businesses in 2018 and 82 percent by 2023.[5] The new excise tax will translate into higher benefit costs for both employers and employees and/or erosion in employer-provided benefit coverage.

[5] Towers Watson (2014).

a. Retirement Savings

Tax policy should encourage, rather than impede, the adequate funding of private, voluntary retirement plans. Accordingly, income and gains of the assets of such plans should be permitted to accumulate free of all taxes. The federal government can best help individuals attain economic security by fostering economic conditions and incentives that encourage individuals to seek retirement security through personal savings and investment.

A strong Social Security system is also critical to workers' long-term retirement security. Consequently, manufacturers believe that the Social Security system should be adequately funded to preserve the current safety net for American workers. However, the NAM believes that the system's projected shortfalls should not be paid for by increased employer costs.

The NAM believes tax policy should encourage the adequate funding of private voluntary retirement plans and allow employers flexibility in designing their employees' retirement benefits. Employer-sponsored retirement plans help to encourage employees to save for retirement, with 70 percent of employees reporting that they are offered a retirement plan with their current employer and 77 percent reporting that they contribute money to the employer-provided plan.[6]

Manufacturers lead other industries in offering retirement benefits and promoting retirement savings: 83 percent of employees in manufacturing jobs have access to retirement benefits, compared to 65 percent of employees across all industries.[7] Given these statistics, Congress should not take away incentives to retirement savings or discourage employers from continuing to sponsor plans.

b. Traditional Pension Plans

Many manufacturers—particularly long-established businesses—offer or have offered their employees "traditional pension" or defined benefit plans (DB plans). For a variety of reasons, including complex regulatory compliance requirements, legal liability, the advent of fierce global competition, longer life expectancies and changing career paths, companies have been exiting the DB plan system. Despite this trend, employers continue to fund these plans long after they are closed. In doing so, employers provide important benefits to long-serving employees who continue to work for the company or have deferred settlement with the plan until their retirement. As Congress works to reform our tax system, we urge you to address several issues that will help foster a better DB system and enable manufacturers to continue to provide these important benefits to employees.

The growing cost of Pension Benefit Guaranty Corporation (PBGC) premiums imposes a significant financial burden on sponsors of DB plans. While the PBGC was established to serve as the backstop to DB plans, in reality the overwhelming majority of companies will pay out all the dollars they owe their participants without any help from PBGC. Nonetheless, some plan sponsors are forced to pay hundreds of dollars per participant, which can amount to hundreds of thousands—and in some cases millions—of dollars per year to the PBGC. Manufacturers have

[6] Employee Benefits Research Institute, Ruth Helman, Nevin Adams, Craig Copeland, and Jack VanDerhei, "The 2014 Retirement Confidence Survey: Confidence Rebounds—for Those With Retirement Plans," EBRI Issue Brief, no. 397 (March 2014). 18.
[7] U.S. Department of Labor U.S. Bureau of Labor Statistics. "National Compensation Survey: Employee Benefits in the United States, March 2014," Table 2. September 2014.

historically been a leading provider of DB pension plans, and as a result pay the most in PBGC premiums out of any industry, funds that could otherwise be used for productive business investments. Every additional dollar that employers must pay to the PBGC is one less dollar that can be used to fund participant benefits, expand their businesses, create jobs, and grow the economy.

Manufacturers oppose any additional increase in PBGC premiums as part of tax reform or any other legislative vehicle. Any additional PBGC premium increases, when added to the multi-billion dollar increases enacted in 2006, 2012, and 2013, could divert additional resources from job creation and business investment. According to a recent study, adding the Administration's budget proposal to the recent premium hikes equates to a potential loss of 42,000 jobs per year on average, peaking at 67,000 jobs in 2017, which would equate to a $51.4 billion hit to the U.S. economy over 11 years[8]. Companies must budget and plan in advance for cost increases, and in many cases, a PBGC tax hike means less money for other investments. Congress could save an average of 24,500 jobs per year by rejecting additional premium increases.

We also strongly oppose any effort to grant the PBGC the authority to set its own premiums. We believe such an arrangement would result in premiums being set based on a much narrower set of priorities than under current practice and would give too much authority to the PBGC while simultaneously relinquishing Congress's authority to set premiums.

In addition to preventing further PBGC premium increases, Congress can help to ease some of the burdens associated with sponsoring DB plans by providing a permanent solution to the pension nondiscrimination testing issue facing manufacturers transitioning from a DB plan to a defined contribution (DC) plan structure. Many manufacturers have designed their transition from a DB plan to a DC plan to allow older, long-service employees close to retirement to maintain their DB plan benefits by grandfathering this group of employees into the plan. Unfortunately, to pass the nondiscrimination tests, some companies may now be forced to completely close these plans—the very outcome employers sought to avoid by implementing the transition period.

Recently, the IRS provided temporary nondiscrimination relief for closed DB plans, allowing manufacturers to satisfy the nondiscrimination requirements through 2016. While the temporary relief is helpful in the near-term, manufacturers still need a permanent solution to allow for an adequate transition from DB to DC plans in 2017 and beyond. The NAM supports changes to the nondiscrimination rules providing that if the nondiscrimination tests are satisfied as of the date of the plan freeze, then they are deemed satisfied thereafter unless the employer amends the plan to make a material change to the grandfathered group or to the benefit formula.

Tax reform can also provide an opportunity for employers of all sizes to retain their critical talent as large numbers of employees near retirement age through a voluntary phased retirement system. According to the Pew Research Center, approximately 10,000 Americans will turn 65 every day until 2030. Currently manufacturers lose the services of these highly skilled, experienced workers because the benefits laws create limited options: either continue to work or fully retire. Both the tax code and ERISA impose requirements that limit flexibility in retirement plans sponsored by private employers. The NAM supports a voluntary phased retirement system as a way to gradually ease long-serving workers into retirement and enable the transfer of valuable skills and institutional knowledge to the next generation of workers.

[8] Inforum, *Increasing Pension Premiums: the Impact on Jobs and Economic Growth* (2014)

c. Executive Compensation

To grow a strong and competitive manufacturing economy, manufacturers need to find and attract world-class talent at all levels. The NAM supports flexibility in the design of benefit packages, including executive compensation, to ensure manufacturers can recruit and retain leaders who will grow the business, create more jobs and contribute to our overall economic growth. The NAM believes that reducing or eliminating deductions for executive compensation and other benefit packages unnecessarily targets a valid business expense and does not represent sound tax policy. To that end, the NAM opposes limiting deductions of certain employee benefits, including executive compensation, which would restrict manufacturers' ability to attract and retain the top talent needed for a 21st century global economy.

IV. Conclusion

The NAM wants the United States to be the best place in the world to manufacture and attract foreign direct investment. Thus, manufacturers very much appreciate the efforts of Chairman Hatch, Ranking Member Wyden and the members of the Senate Finance Committee for their diligent work to reform the U.S. tax system. Manufacturers thank you for the opportunity to share our thoughts and concerns with you.

While the NAM strongly advocates for comprehensive reform of our current tax code, we also believe that it is important to keep our current tax system in place until policymakers agree on a final comprehensive reform plan. Piecemeal changes or repeal of longstanding rules will inject more uncertainty into business planning, making U.S. companies even less competitive, and threaten economic growth and U.S. jobs.

Manufacturers look forward to further discussing these issues with you and working with the Savings and Investment Tax Reform Working Group and the rest of the Committee to achieve a pro-growth, pro-competitiveness and pro-manufacturing tax system.