

AMERICAN INGENUITY: PROMOTING INNOVATION
THROUGH THE TAX CODE

HEARING
BEFORE THE
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TAX,
AND CAPITAL ACCESS
OF THE
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TUESDAY, JUNE 6, 2023

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX, AND CAPITAL ACCESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building, Hon. Daniel Meuser [chairman of the Subcommittee] presiding.

Present: Representatives Meuser, Van Duyne, Williams, and Landsman.

Also Present: Representative Estes.

Chairman MEUSER. Good morning, everyone.

I now call the Committee on Small Business to order.

Without objection, the Chair is authorized to declare a recess—let me put my mike on; that might help—of the Committee at any time.

Before we get going, I am going to ask you to stand and say the Pledge of Allegiance, please.

ALL. I pledge allegiance to the Flag of the United States of America, and to the Republic for which it stands, one nation, under God, indivisible, with liberty and justice for all.

Chairman MEUSER. Thank you.

Before we begin, I would like to ask unanimous consent to waive Mr. Estes from Kansas, from the Ways and Means Committee, here to our Committee for the purpose of giving an opening statement.

Without objection, so ordered.

The Subcommittee is here today to hear testimony on the impact of changes to research and development expensing and bonus depreciation and the effects they have on small business.

I will now recognize myself for my opening statement.

Again, welcome.

This Subcommittee hearing will be highlighting the importance of having a Tax Code that promotes innovation for small businesses. Tax Codes are very important for revenue growth and to make our American businesses more competitive. That is the whole idea. We need to have the most competitive small businesses—or, an environment for small businesses in the world. That, I believe, is government's role, to create that environment for you all to do your thing, as opposed to us meddling any further.

First, though, I do want to thank our witnesses for joining us today. Your time here is greatly appreciated by all of us on the Subcommittee. And I am very happy, as I just informed the Ranking Member, that we have business leaders from Pennsylvania's Ninth District who made the trip down. So thank you very much.

Innovation requires risk and, with it, investment in research and development. As our witnesses will discuss, research and development for small businesses is often more difficult due to the issues with capital access and smaller workforce that requires a longer time horizon to realize any potential possible return on investment. In many circumstances, these risks make small-business owners gamble their entire company on propositions that may never pay off.

We need to incentivize this innovation. The American Tax Code has provided incentives for businesses to invest into research and development. For small businesses that don't have endless cash flow and reserves, consistent R&D tax incentives are often their only option—"consistent and understood" should be added. These include two different provisions, R&D expensing and bonus depreciation, which allow a small business to make significant investments they otherwise wouldn't be able to make.

In 2017, the Tax Cuts and Jobs Act took the successful bonus depreciation credit to the next level, allowing 100-percent bonus depreciation for qualifying purchases. This law, which was a resounding success on main street, changed deductions, depreciation, expensing, tax credits, and other items that truly significantly benefited small businesses.

Unfortunately, the immediate expensing of R&D expired in 2022, and now small businesses are required to amortize their R&D costs over 5 years rather than deducting them immediately. For example, take a small business with \$1 million in revenue—and this is interesting—\$500,000 in R&D costs, and \$500,000 in deductible expenses. Under the 2021 tax law, it would have had zero profit and its owners would owe no income taxes. But here now in 2022, it could deduct only \$50,000 in research costs and its owners would now pay on \$450,000 in income. Significant difference.

Analysis by the Tax Foundation, an independent tax policy research organization, found that restoring immediate expensing of R&D will benefit both businesses and workers by increasing economic output and wages and creating an estimated 20,000 jobs.

It would also help build on the broad success of the Tax Cuts and Jobs Act. By cutting tax across the board, we saw the federal government take in record rates of revenue. This is a fact, and the numbers prove it. Thanks to lower rates, overall corporate tax revenue surged by 43 percent last year and federal revenue jumped 48 percent relative to before the law was enacted.

Additionally, bonus depreciation is set to decrease 20 percent annually through 2027. Unless Congress acts soon, private-sector innovation, especially within the small-business economy, will be hamstrung and unable to invest in R&D.

Although the sunset of these provisions has been known for several years and even though there is broad, bipartisan support for reinstating the expensing option for R&D expenditures, Con-

gress, as a whole, continues to hold negotiations hostage by insisting unrelated measures be included in any legislative remedy.

I am glad to have Congressman Ron Estes, a distinguished Member of the Ways and Means Committee, joining us today to discuss his efforts to ensure we continue to incentivize small-business investment in R&D. Congressman Estes's bill, the American Innovation and R&D Competitiveness Act, would permanently restore full and immediate R&D expensing for small businesses. I am a proud cosponsor of this legislation, which has immense bipartisan support, with 93 cosponsors equally split among Republicans and Democrats.

Small businesses are able to fill gaps in innovation that larger corporations may miss and are built around fresh perspectives and new approaches to everyday challenges, as we were just discussing.

Over 99 percent of business in America are small businesses, accounting for 44 percent of all domestic activity and two-thirds of jobs in the country. And 70 percent of those employed in the Ninth District are employed by a small business.

These roadblocks against America's small business also jeopardize our standing on the world stage as the premier innovator for tax year 2022. The Organization for Economic Cooperation and Development ranked the U.S. 30th out of 36 based on the strength of our nation's R&D tax incentives—and far behind China. For decades, this country has out-innovated the world at every turn, and without a strong innovative base, we will risk falling further behind dangerous adversaries on the world stage.

Before immediate R&D tax expensing was repealed, China's R&D tax incentive was already 2.7 times more generous than the U.S. That was before we allowed the R&D tax credit to sunset. So, while I have every confidence in the ingenuity of our innovators in America, we cannot continue to force our small-business innovators to compete on a world stage with one hand tied behind their back.

In closing, I ask unanimous consent to insert the following letters from the National Association of Manufacturers and the Small Business and Entrepreneurship Council for the record.

Without objection, so ordered.

Once again, thank you all very much.

And I will now yield to our distinguished Ranking Member from Ohio, Mr. Landsman.

Mr. LANDSMAN. Thank you, Mr. Chairman, for holding this important hearing.

I agree, American innovation is absolutely key to our country's success as a global economic powerhouse. Our standing in the world is built on our collective investments in new ideas, cutting-edge technology, and competition between talent and among our country's best and brightest.

Our entrepreneurs play a crucial role in the innovation ecosystem by attracting investment and bringing ideas from university labs to market, advancing our quality of life and growing our productive capacity.

However, as we have heard, these innovative ideas, turning them into reality, these businesses need a supportive and nurturing Tax Code, among other things. For nearly 7 years, section 174 of the Internal Revenue Code has allowed companies to write off all of

their R&D costs immediately. So that is what we are talking about, the ability to write off all of your R&D costs immediately.

Unfortunately, the 2017 tax law upended this long history. As a result, starting this year, businesses will be forced to claim only 20 percent of their R&D tax benefit every year for 5 years, instead of all at once in 1 year. In effect, this will negatively impact small businesses, particularly many early-stage startups.

Right now, our Tax Code is sending mixed signals to our country's innovators. On one hand, we invested over \$300 billion for advancing clean energy in the Inflation Reduction Act, but, on the other hand, we are stifling this development by weakening this tax credit. And to continue this country's robust economic recovery, my hope is that this hearing will give us the opportunity to bring these tax credits back online.

And I agree with the Chair that there is bipartisan support. But getting it done is another issue, requiring real leadership. And I am glad that Congressman Estes is here and leading on this. We have to be able to get it to the floor, and that does mean saying, "Hey, it is not going to have everything that everybody wants in it, but this particular fix needs to get done sooner rather than later."

I hear this a lot when I am back in the district and talking with small businesses. We have had roundtables. We will pop in to a small business, tour. It is a top-three issue for them.

So, with that, I would like to thank all the witnesses for joining us. I look forward to their testimony.

And I yield back.

Chairman MEUSER. Thank you, Ranking Member Landsman.

I now recognize the Chair of the full Committee, Mr. Roger Williams from Texas, for his opening statement.

Mr. WILLIAMS. Well, good morning.

I want to thank the witnesses for being here. Thank you very much.

And I want to thank my friend and colleague, Congressman Dan Meuser, for holding today's Small Business Subcommittee on Economic Growth, Tax, and Capital Access hearing.

You know, our nation's small businesses continue to face persistently high inflation, interest rates that are being raised at the fastest pace since the 1980s—and I remember that—a labor shortage that has windows plastered with "Help wanted" signs across the country, and an increasingly uncertain credit environment. With these economic headwinds, it is vital that our Tax Code work for our nation's job creators, not against them.

And as a current small-business owner for over 52 years—I am a car dealer, I am a car dealer in Texas—I know firsthand how a burdensome federal Tax Code can make a small business less likely to invest in their own operations.

Now, the full and immediate expensing provision of the Tax Cuts and Jobs Act is the perfect example. Businesses were more willing—I can tell you firsthand—more willing to make these long-term investments knowing that they could write off the full value in the first year. We need to build on successful tax policies like this one that will help our small businesses invest in their futures.

And Main Street America is not Republican; it is not Democrat. It is Main Street America. And here on the Committee on Small Business, we strive to create an environment where small businesses can thrive, can grow. And that includes commonsense initiatives that encourage entrepreneurial risk-taking, because risk and reward is what built our country.

Now, with that, I am looking forward to today's discussion.

And, Mr. Chairman, I ask for unanimous consent to insert the following letters for the record: letters from the Competitive Carriers Association; Engine, signed by 66 startups and innovators; and the Biotechnology Innovation Organization.

So thank you, Mr. Chairman, and I yield my time back.

Chairman MEUSER. Without objection, so ordered.

Chairman Williams yields back his time, and we thank you very much, Chairman Williams.

I now recognize Mr. Estes, the sponsor of H.R. 2673, the American Innovation and R&D Competitiveness Act of 2023, for his opening statement.

Mr. ESTES. Well, thank you, Chairman Meuser and Ranking Member Landsman and Chairman Williams and all of the Members of the Small Business Committee, for allowing me to testify today on this critical, bipartisan bill that impacts all of our districts, the American Innovation and R&D Competitiveness Act.

On tax day this year, I reintroduced this commonsense bill with my colleague John Larson, along with Representatives LaHood, DelBene, Arrington, Panetta, and 56 additional original cosponsors. The bill will continue to gain support—or, has continued to gain support and has nearly 100 cosponsors today, evenly split between Republican and Democrat.

The bill is straightforward. It corrects a tax issue businesses face when conducting research and development. The American Innovation and R&D Competitiveness Act allows for immediate expensing of eligible R&D expenses, bringing us back to where we were just a few years ago and securing American dominance in research and development.

Full expensing for R&D was allowed through the end of 2021. However, since the beginning of 2022, businesses have been required to spread out, or amortize, the R&D expenses over 5 years for domestic R&D and over 15 years for foreign R&D.

Rather than extend the immediate expensing for only a few years, this is a permanent solution in this bill that provides clarity and stability for innovators, businesses, and workers. And the legislation will certainly help small businesses here in the United States and encourage economic development.

In fact, the Association of Equipment Manufacturers said the bill offers a much-needed boost for the equipment manufacturing industry at a time when America faces adverse inflation and strained supply chains.

AEM isn't the only organization praising the bill. The National Taxpayers Union featured this legislation on their "No-Brainer" list in 2020. The list is a collection of 10 bills that NTU deems as no-brainer bills that have bipartisan support and should easily pass in Congress. However, they only recognize bills once, but they did include this legislation as an honorable mention in the following

year and sent letters of support to Members of the House Ways and Means Committee in this Congress.

The Aerospace Industries Association, Semiconductor Industry Association, Plastics Industry Association, Information Technology Industry Council, and National Association of Manufacturers have written op-eds and issued statements of support. They all know: Where R&D occurs, jobs and economic opportunities also follow.

And this isn't just about major corporations. R&D supports businesses of all sizes. According to the R&D Coalition, about 15 percent of private U.S. R&D investments are made by small businesses with fewer than 500 employees. And, to some degree, that has a major—a more outline of impact than it does for larger businesses.

Right now, the United States is lagging behind in R&D, a trend that has been happening for a while. According to the R&D Coalition, the United States' share of global R&D investment in 2019 was 30 percent, down from 40 percent in 1999.

Unlike the United States, China's global share of R&D investment has gone up. It was 24 percent in 2019, a big jump from just 5 percent in the year 2000. That means China's R&D investment has increased by 400 percent in just two decades.

And here is how they changed the direction of their R&D presence. China has implemented a deduction of up to 200 percent of the eligible R&D investments. That is the equivalent of 10 times the amount the current U.S. Tax Code allows.

Without an incentive for homegrown R&D, the United States also loses out on creating new jobs. The R&D Coalition says, for every \$1 billion in U.S. R&D spending, 17,000 jobs, earning \$1.4 billion, are supported in the United States.

They also note that, unless the R&D amortization policy is reversed, the United States stands to lose 410,000 jobs, \$57.5 billion in labor income, and \$71 billion in R&D spending over the next 10 years.

The American Innovation and R&D Competitiveness Act is the right solution to help small businesses in our districts, from Kansas to Texas, to New York, to Pennsylvania and everywhere else that could benefit from jobs, opportunities, and economic growth.

As a former Member of this Committee, I know you all have a vested interest in supporting the small businesses that are economic engines for our country, and I hope you will consider joining me as cosponsors.

Today's research-and-development dollars creates tomorrow's jobs. And we need to keep R&D dollars inside our country, where they can help strengthen American businesses and workers.

I want to thank my friend from Connecticut, Congressman Larson. We have worked over multiple Congresses to make this legislation a reality. And now that American companies have had a year without immediate expensing, I am cautiously optimistic that this is the year that that commonsense bill will become law.

Thank you again for allowing me to testify today, and I yield back.

Chairman MEUSER. Mr. Estes, we thank you for participating in this hearing with us and for this important bill.

We will now proceed with witness introductions.

So it is my pleasure to introduce first our first witness, Ms. Julie Masser Ballay.

Ms. Masser Ballay is the chief financial officer and vice president of Sterman Masser, Incorporated, located in Sacramento, Pennsylvania—the original Sacramento—which is right in the heart of my district, in Schuylkill County.

After working for Weyerhaeuser as a structural frame engineer for 6 years, Ms. Masser Ballay rejoined her family business in her current position in 2009, where she oversees finances, technologies, and engineering for the business. Today, Sterman Masser employs approximately 300 people in a variety of positions and distributes over 250 million pounds of potatoes each year.

In addition to working for her family business, she gives her time to a number of industry groups, including the Food and Vegetable Industry Advisory Committee for the USDA, and serves her community on the board of the Hegins-Hubley Authority and in many other capacities that I am familiar with.

Ms. Masser Ballay is a graduate of the great Penn State University, where she received her Bachelor of Science and Master of Science in Agriculture and Biological Engineering, as well as a Master of Business Administration.

Ms. Masser Ballay, thank you very much for being here, and we look forward to our conversation and your testimony.

Our next witness today is Mr. Bill Wydra. Mr. Wydra is the founder and president of Ashland Technologies, Incorporated, located in beautiful Hegins, Pennsylvania, also in Schuylkill County.

Founded in 1996 by Mr. Wydra, Ashland Technologies has over 25 years of experience servicing many industries and has expanded to become a one-stop shop for various manufacturing needs, including everything from roller-coasters—which I have seen, not ridden on, but seen—to vending machines.

In 2009, Ashland Technologies was ranked as the fastest-growing manufacturer in Pennsylvania and was 55th in the country—a truly impressive feat for which we definitely applaud Mr. Wydra.

With 4 plants and over 30 employees in total, Mr. Wydra uses his expertise in marketing to find new customers and optimize their manufacturing process to best fit the needs of their customers.

Mr. Wydra is a graduate of George Mason University with a bachelor's degree in marketing, economics, and finance.

Last year, Mr. Wydra joined myself and Vice Chairman Luetkemeyer for a small-business roundtable here in Washington, which we appreciated. And we want to thank him again for coming here then and today to testify on what is a very important topic.

I now recognize the Ranking Member, Mr. Landsman, to introduce the minority witness for today's hearing.

Mr. LANDSMAN. Thank you, Mr. Chair.

Michael Kaercher is a senior attorney advisor and director of the Climate Tax Project at the Tax Law Center at NYU Law. He has over a decade of experience on a broad range of complex federal tax issues. He is currently focusing on the Tax Law Center's work on the implementation of the climate tax provisions of the Inflation Reduction Act and contributes to the Center's work across a range of other issue areas.

Prior to joining the Tax Law Center, Mr. Kaercher spent several years on detail to the House Ways and Means majority tax staff. While there, he designed and advanced tax policy in various ways, including green-energy tax policy, excise taxes, and COVID relief.

For 7 years, Mr. Kaercher served at the Office of Associate Chief Counsel (International) at the Internal Revenue Service, where he advised them on interpretation, administration, and enforcement of various international tax agreements.

Mr. Kaercher holds a J.D. from Harvard Law School and a B.A. from Colgate University and is admitted to practice law in Washington, D.C., and Maryland.

Welcome.

Chairman MEUSER. I thank the Ranking Member.

And, again, I appreciate all of you being here today.

Before recognizing the witnesses, I would like to remind you all that your oral testimony is restricted to 5 minutes in length. If you do see the red light turn on in front of you, it means your 5 minutes have concluded, and you should wrap up your testimony.

I now recognize Ms. Julie Masser Ballay for her 5-minute opening remarks.

STATEMENTS OF JULIE MASSER BALLAY, VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, STERMAN MASSER INC.; BILL WYDRA, PRESIDENT, ASHLAND TECHNOLOGIES; AND MICHAEL KAERCHER, DIRECTOR OF THE CLIMATE TAX PROJECT, THE TAX LAW CENTER AT NYU LAW, ON BEHALF OF THE TAX LAW CENTER AT NYU LAW

STATEMENT OF JULIE MASSER BALLAY

Ms. MASSER BALLAY. Thank you, Chairman Meuser. And good morning. Thank you, Chairman Williams, Representative Estes, and distinguished Members of the Small Business Committee. I appreciate the opportunity to give testimony today.

As Chairman Meuser stated, my name is Julie Masser Ballay, and I am CFO and vice president of Sterman Masser, Inc., here on behalf of our companies, Sterman Masser, Inc., Masser Logistic Services, Keystone Potato Products, and Lykens Valley Grain, with headquarters located in Sacramento, Pennsylvania.

For more than 50 years, Sterman Masser, Inc., has been a potato grower, packer, and shipper of potatoes. We are a family business, started by my grandfather, Sterman, in 1970, and now owned by my parents, Keith and Helen Masser; my brother, David Masser; and me. Dave and I are eighth-generation farmers, and we have high hopes that one or more of our children will become the ninth generation.

We currently are farming approximately 1,000 acres of potatoes, along with 2,300 acres of corn, 1,500 acres of soybeans, 850 acres of wheat, with the remaining acreage dedicated to a variety of cover and rotation crops, totaling over 6,000 acres in production.

As the Congressman stated, we are distributing retail packed potatoes, mainly, throughout the Eastern Seaboard and have farming, packing, distribution operations supported by our team, with an updated number of almost 400 employees at this point.

The year 2020 marked our 50th year in business as well as the start of the pandemic. Our business is focused on feeding people, and that did not stop during the pandemic. Our doors stayed open, and our workforce showed up. On behalf of the Masser family, I would like to give our heartfelt thanks to our employees that helped keep food on the table of families in America.

But like any other company, we had to adjust our way of doing business in recent years. One of those adjustments was increasing the automation in our packing operation to transition difficult-to-fill, labor-intensive positions into machine-operator positions by mechanizing our bag-filling and palletizing functions within our packing shed. These steps in automation improved employee safety by reducing the risk of sprains and strains, while also improving production efficiency.

We started the process of automation prior to 2020, and with the assistance of bonus depreciation and the positive impact that had on our company's cash flow, we were able to continue installing this machinery throughout the pandemic.

This example demonstrates what I believe to be an important impact of bonus depreciation for a company like ours, which is the ability to reinvest in our family business with improved cash flow. Reinvesting helps us increase the speed of our innovation and help make necessary investments that allow us to stay up to date with technology and keep pace in the marketplace.

By taking advantage of bonus depreciation, we have been able to redirect cash back into our business so that we can improve employees' work environment, increase our efficiency, and continue to remain competitive in the marketplace, particularly as we combat tighter margins through this inflationary period.

As a family business, the concern always exists that we will not be able to keep pace with larger companies or with rising costs while still addressing the needs of our employees.

With a tight labor market in our region, we are always looking for ways to improve the work environment for our employees, improving safety and efficiency. Innovation allows us to be in a position to compete for employees and create higher-paying positions.

Additionally, with interest rates on the rise, smaller businesses are able to benefit by utilizing cash instead of locking in loans with high rates. Although our business is fortunate to have a very good banking relationship, small companies, in general, do not have the ability to negotiate with banks as well as large corporations.

This is where the SBA is able to step in to offer assistance with small-business loans. But the ability to utilize cash to reinvest in your own business is another useful tool that a business owner can have in their tool belt.

Small and family-owned businesses are the backbone of the American economy. In order to remain competitive, particularly in the agricultural sector, we need to be able to keep up with the speed of innovation of larger corporations. Taking advantage of bonus depreciation and using that to reinvest into our business assists us in accomplishing this so that we can continue to provide a good work environment for our employees and put food on the tables of families in America.

Thank you again for the opportunity to take part in today's discussion. I appreciate the interest from the Subcommittee.

Chairman MEUSER. Thank you. Thank you very much, Ms. Julie Masser Ballay, for your opening remarks.

We now recognize Mr. Bill Wydra for your 5-minute opening remarks.

STATEMENT OF BILL WYDRA

Mr. WYDRA. Good morning.

And thank each and every one of you for further advancing my belief in the American way. The fact that we are all sitting here having this particular subject discussed is very important to us. And, again, it just reinforces that for me, that you care.

You know, a lot of times when you are on the front line, you think you are fighting the battle all by yourself, but meetings like this and the fact you have taken the time to organize this and want to hear from us—and genuinely want to hear from us—that goes a long way in helping us want to grow this company and grow this country even further.

So thank you, each and every one of you.

I had a lifelong, you know, entrepreneurial spirit, starting my first bicycle repair business at the age of 5 and growing that into a wide variety of things, which you have heard a little bit about. We design and build roller-coasters and manufacture those in both Florida and Pennsylvania. We have amusement attraction development, including virtual reality. We have unique food concepts, such as Honolulu Hotdog. We even have developed ice cream vending machines, as Congressman Meuser has mentioned.

At the backbone of all this is an enterprise which is one of the mid-Atlantic region's most complete contract metals manufacturing companies. We do CNC machining, welding, fabricating, powdercoating, assembly, testing, engineering—all under one roof. Very, very innovative for a small manufacturing company. Very, very innovative in our industry.

There are very, very few out there that can do all of those things under one roof. That comes with a lot of trial, it comes with a lot of tribulation, it comes with a lot of failures. So these programs that you have in place allow us to do that and create that competitive advantage for ourselves.

These companies have won many innovation awards. We have won five Brass Ring Awards for new product development in the amusement industry. As a new company, that almost never happens. To get five has been unprecedented. So it is this culture of innovation that has really driven that for us.

We have been awarded the Manufacturing Innovation Award by the Manufacturing Resource Center. We have been in the Top Ten Machine Shops; earned 5 straight years on the Inc. 500 List of private companies, as you have heard.

At the core of this, it really boils down to the talented teams. You know, me sitting here, I am only representing them, okay? This is all about the people that we employ, and it is all about giving them that inspiration for developing something new.

We were talking about it before. You know, somebody that works all day just pressing a button, not even sure what they are devel-

oping, they don't have inspiration, they don't have excitement, they are not interested in their work. But you give them the opportunity to innovate and create something new and go home and tell their kids what they have been working on, that makes a difference in our households. And that is very, very important.

You know, we truly believe that, you know, our success is going to be determined by as much as we endeavor to anticipate the future needs of our customers and proactively deliver unique solutions to their emerging challenges. And that can only be gained through research and development.

You know, there is an incredible rush that comes with this. You know, creating something new and seeing it come to life, like being able to design a roller-coaster on a piece of paper, sometimes on napkins, and then be able to go ride that with your 8-year-old daughter and say, "We did this"? Wow. I mean, it brings a tear to my eye right now just thinking about that.

That is what we are talking about here today. We are not talking about laws; we are not talking about this. We are talking being able to inspire people, inspire growth, inspire our country to move forward.

And I only pray that, you know, really, I can transfer that spirit to my kids. You know, I have four kids, and, you know, they are cluttered with so many things now, you know, with all the internet. And everyone knows those complaints. We are not here to talk about that today. But being able to get them in programs—you know, I was talking earlier, I had a little disk that I brought in case I needed to transfer my testimony to something. The only other thing on that disk was, my 13-year-old daughter, at the time, she created her own business card for a collapsible pencil that she wanted to make a bracelet out of. Like, that is the type of thing that we need to be inspiring in our kids. And that is truly where we are with this program.

So, you know, everyone has already talked about, you know, what this is going to do to cash flow, and I will tell you right now: It will kill it. You know, if you don't figure out a way to get this advanced and we get rid of this amortization program, it will kill innovation. Because not only are we dealing with all the problems you have already talked about, we have, you know, the fact that we might do away with bonus depreciation. It will put the most significant cash-flow crunch on our businesses.

So, not only does innovation go away, employee development programs go away, training goes away, you know. And training can really inspire people as well. You know, once you give them the confidence that they know the language, they know what they are doing, they know what they want to talk about, the ideas that start flowing from them are just unbelievable.

So the timing is bad right now. We have all already talked about that.

So, with my 15 seconds, I just want to close with this. I would like to quote Walt Disney. You know, when you are in the amusement industry, you have to do that. "It is kind of fun to do the impossible." And that is what we are talking about here today.

So continue with this path. Thank you, Congressman Estes, for pushing this. And that will maintain the spirit of innovation.

Chairman MEUSER. Well, thank you, Mr. Wydra. That was excellent.

Now we recognize Mr. Michael Kaercher for your 5-minute opening remarks.

STATEMENT OF MICHAEL KAERCHER

Mr. KAERCHER. Chairman Meuser, Chairman Williams, Mr. Estes, and distinguished Members of this Committee, thank you for the opportunity to testify today.

Tax policy can support investment in innovative activities through targeted tax credits, deductions, and other tax breaks. It can lift up children, who are the future innovators, entrepreneurs, and workers needed for a dynamic economy. And it can raise revenue to fund investments outside the tax system, including federal research grants for small-business innovation.

The 117th Congress enacted tax benefits intended to spur innovation and created new tools to give small and startup businesses access to those tax benefits. The bipartisan CHIPS and Science Act, the Bipartisan Infrastructure Law, and the Inflation Reduction Act created major new tax credits for investment in domestic manufacturing and equipment and for innovation across the energy sector.

For example, one of the IRA's tax credits for advanced manufacturing invests \$10 billion in projects with high potential for innovation and commercialization. And starting in 2025, the law transitions to a tech-neutral regime intended to spur innovations in producing zero-emissions electricity and fuels.

Most tax benefits, including credits and deductions, can reduce income tax owed by a small business, but many small businesses, and especially startup small businesses, have limited or no tax liability. Both the CHIPS Act and the IRA create new ways of giving smaller and startup businesses better access to tax breaks for investment in innovation, such as the ability to transfer certain tax credits or to receive others paid out as refunds.

The 117th Congress also temporarily expanded the Child Tax Credit, which is an investment in the future innovators, entrepreneurs, and workers needed for a dynamic and innovative economy. Research shows that such credits make children likelier to grow up healthier and do better in school, which, in turn, delivers long-run benefits for workplaces, communities, and the economy.

Researchers find that America is losing out on having more innovators who are women, people of color, or from low-income families because children with equal talent and potential are growing up in households that are too poor or not connected enough to become innovators and entrepreneurs. Tax policy that reduces child poverty and increases opportunity, like a fully refundable Child Tax Credit, can help unlock that potential.

The tax system also supports innovation in small business by raising revenues to fund investments outside of the tax system, including federal R&D grants for small business innovation. So it is unfortunate that the deal to avert U.S. default cuts parts of the budget that funds these programs.

That same deal also cut IRS funding. This will hurt honest small businesses. The IRS won't be able to do as much to transform service for small businesses who want clear and timely help under-

standing and meeting their tax obligations. More unscrupulous businesses will continue to have unfair competitive advantage by avoiding or evading the taxes they owe.

To close, let me note that the TCJA prioritized large, corporate, permanent rate cuts over investing in future workers and innovation. It paid for corporate tax rates in part by requiring deductions for certain research expenses to be taken over time rather than deducted immediately.

But some lawmakers are proposing reversing nearly all scheduled revenue-raising provisions of the 2017 law. That would lead to a combination of tax subsidies that aren't well-targeted to small businesses or innovation.

Under that proposal, certain businesses would be able to claim deductions for investments but also would be able to fully deduct the cost of that interest. That set of tax subsidies would be especially valuable for the leveraged buyout industry as well as for large, multinational corporations that avoid taxes by making large interest payments to their foreign affiliates.

Going forward, small-business innovation will be best served by tax policy that does four things:

First, the tax system can use well-targeted tools to efficiently reach small and innovative businesses and give them the level of service they deserve from the IRS.

Second, the tax system can invest in future workers and innovators through measures like an expanded fully refundable CTC.

Third, the tax system can eliminate unfair competitive advantages that large tax evaders and avoiders currently enjoy over honest small businesses.

And, fourth, the tax system can raise revenue to fund public R&D and private innovation.

Thank you for inviting me to testify today, and I would be glad to take any questions.

Chairman MEUSER. The gentleman yields back. We appreciate your testimony very much.

We will now move to the Member questions under the 5-minute rule. And I am going to recognize myself for 5 minutes.

So, Mr. Wydra, I am going to start with you.

So this Committee is, of course, Economic Growth, Taxes, and Access to Capital. We are about oversight of the SBA, but we are the advocates for small business in Congress. So, as you stated, this is a very important issue for us and one that we need to overcome, as far as the R&D tax credit issue and bonus depreciation.

I was in small business, into a large business, for almost 25 years. I have spent a lot of time visiting small businesses. And it is really not a pretty picture, for the most part—and I visited both of your companies—between inflation; workforce unavailability, which means longer hours for you and others; supply-chain issues; wages, which is normally a good thing but, you know, not when they go up incredibly rapidly and you lose people faster; and such. Dealing with, now, tax increases is—the threat thereof, as well, that we see—is very difficult. And many are selling more but making less and, of course, as stated, working more hours.

So the questions are: With the type of R&D reduction, bonus depreciation reduction, the threat that we hear of the 20-percent small-business income deduction, what is that doing to your business, Mr. Wydra? Is it affecting your expansion? Is it affecting your hiring? Is it affecting your CapEx? Is it mitigating your willingness to take a risk on some new innovations? Tell us about that.

Mr. WYDRA. Yeah. All of the above.

You know, I think it changes your mental state, you know, I think is the first thing that it changes. You know, you have got one thing; maybe you could deal with that. You have got another thing; well, okay, now we come up with a solution for that. All of these things are compounding at the exact same time. This is just an awful time to consider, you know, going forward with the implementation of amortizing those expenses over 5 years.

It is that little bit of extra cash flow that is going into employee development programs. It is helping them gain the confidence that they need to be innovators, you know? And I think that is one of the first things that begins to go away, because is it necessary? No. We could still push a button today. You know, we are moving into some automation; we could still do those kinds of things today. So what we are doing by not doing this, we are robbing from the future.

So, yeah, we can get through today. You know, companies are going into survival mode. They are failing to do the right things—

Chairman MEUSER. Yeah.

Mr. WYDRA.—because they are looking at this being implemented. And that is why people are starting to think differently and act differently.

Chairman MEUSER. Okay.

Interest rates and access to capital. You mentioned cash flow.

Mr. WYDRA. Oh, it is awful.

Chairman MEUSER. That is one of the most important parts of any business, particularly small business.

Mr. WYDRA. Yep.

Chairman MEUSER. So how is your banking?

Mr. WYDRA. And it is really rough. It is really rough in manufacturing. So, you know, we have a double whammy here. You know, number one, if this comes back, we are going to be shorter on cash than we would have been otherwise. And if the bonus depreciation goes away, we can no longer now, you know, really expand that additional capital into investing.

You know, so with interest rates where they are right now, it is very difficult, you know, to look at doing that type of expansion even if you can get it. We have a very good banking relationship with Mid Penn, you know, the local regional bank, very good relationship. But the problem is, you know, do we want to? You know, it is very expensive.

So now we are looking at more innovative ways to utilize some of the equipment that we already have. But, now, if that goes away, well, now, you know, we can no longer even afford to do that.

So I think it is the compounding of those two issues that really, really, really makes it difficult, and the timing—

Chairman MEUSER. Thanks.

Ms. Masser Ballay, you have a farm, a family business in between a large and small. You mentioned about speed of innovation, the importance there.

Can you expand upon what Mr. Wydra is saying and how some of these new factors, particularly taxes, R&D, and bonus depreciation, would negatively affect you?

Ms. MASSER BALLAY. Sure.

And I think, from our perspective, since we are really using the research and development of other companies to implement automation, it creates even a greater lag time, right? So, you know, they are not able to have the speed of innovation because they are being impacted, you know, with this. So then, for us, in terms of the lead time for equipment that we are purchasing and installing, then that would extend it for us as well.

You know, it is about having that access to capital. With the interest rates going up, to Mr. Wydra's point, you know, yes, we have a good banking relationship, but do we want to put in place these high-interest loans right now? Having access to that capital and being able to work that with your cash flow is a better option in these types of inflationary times.

So it really is about speed, and, from our perspective, with the workforce challenges that we can face, we are competing outside of our industry where we are at in central Pennsylvania. We are nestled right in between the 81/78 corridor. There are a lot of warehouses, with a variety of different industries going in there. And we are all competing for the same people. So our wage rates are keeping up with these other industries, as opposed to keeping up with agricultural industries.

So, with that, you know, with trying to make a better work environment for our employees—

Chairman MEUSER. Thank you.

Ms. MASSER BALLAY.—to keep them satisfied—yeah.

Chairman MEUSER. Thank you. Yeah, we need to give advantages to American food, American roller-coasters, and not give the advantage to China.

So thank you. I am over time. My apologies to the Committee. I now yield to the Ranking Member for his 5 minutes of questions.

Mr. LANDSMAN. Thank you.

I guess this is first to you, Mr. Kaercher, but, you know, happy for others to weigh in.

I really liked the way in which the bill to deal with the R&D question is a no-brainer. And I suspect there are a few other no-brainers as it relates to the Tax Code and supporting small businesses.

And so I am wondering if you have strong feelings about what other sort of changes Congress should pursue to help small business, particularly now, as it relates to, you know, the big barriers for small business.

I mean, one is obviously the cost of capital. That is one of the things that we take on in this Subcommittee, and interest rates in particular. Workforce-related issues. I am curious, what are a few other, you know, no-brainers that you would want us to lift up?

Mr. KAERCHER. Thank you for the question.

So I think that you should—I would think about this in terms of tradeoffs, right? What kind of activity are you trying to support? And what are sort of the problems that you are trying to solve? And how much does it cost? Right?

If you want to sort of make sure that small businesses are getting full access to innovation subsidies and credits and that sort of thing, that leads you down one sort of path.

If you want to sort of provide a more level playing field for small businesses, where you think that that is not currently in effect, that is a different kind of path.

And if you want to work on workforce development, that is a totally separate sort of direction.

So it really depends on what you want to prioritize and then, ultimately, how to pay for it. So I think those are the ways that I would think about how to think about that problem.

Mr. LANDSMAN. Thank you.

And I would love to hear—but if you had to pick one, if you had to go down one path, what path do you go down and what change do we make?

Mr. KAERCHER. Yeah, I think one really historic change is the adoption of the global tax deal. That is a provision that would ensure that large multinationals pay sort of a set rate of tax, at least 15 percent.

And for the small-business community, of course, this helps level the playing field, because they don't have the ability to sort of shift profits overseas to low-tax jurisdictions.

Mr. LANDSMAN. Yeah.

Mr. KAERCHER. And so that is a disadvantage that they have in the current system.

Mr. LANDSMAN. Thank you.

Mr. WYDRA. So I was just going to say, you know, obviously, I don't know all of the Tax Code, but, you know, these two things, to me, make sense as the tip of the spear.

You know, you innovate, you grow, you develop a new product, and you hire people. Then you need to train those people. So, you know, it creates the catalyst for growth faster than anything else. So, if we can support innovation, however that is, then that is the thing that we should be working on.

Secondarily is the buildings and the expansion that goes with that. So that is cost of capital; it is the bonus depreciation. Those two things literally are the leading mechanisms for growth. I cannot think of another thing that would be in advance of that or, you know, furthering our cause as a country better than those two.

Ms. MASSER BALLAY. And just to add to that, I think that goes to the speed. When you have those two things in place and you are able to now take advantage of that increase of cash flow, you can now implement the speed and continue to grow much faster—much faster and really keep up with competitors. A lot of this is all about competition and making sure that everybody can keep pace.

Mr. LANDSMAN. Thank you.

Last question: My understanding was that, in talking to small businesses back home, one of the biggest issues—the R&D piece comes up a lot, but the other big issue, outside of just, you know, workforce-related issues, is the issue of interest payments.

I mean, the interest rates—and it has been mentioned here—have really crushed a lot of small businesses in terms of their ability to access affordable capital and then be able to pay all their bills every month.

So I am curious, Mr. Kaercher, do you see this as a big issue? If so, is there a Tax Code solution here?

You know, my understanding was, for years, you know, small businesses could write that off, their interest payments. That is no longer the case.

Is this a big issue? If so, is it, you know, up to Congress to solve?

Mr. KAERCHER. This is another question of tradeoffs, right? In the 2017 bill, one of the tradeoffs was reducing the corporate rate, paid for in part by limiting the ability to deduct these interest payments. That is something that policymakers can certainly consider unwinding.

But it sort of leads to some of the same tradeoffs as we have talked about before: Is this the most important way to spend the money? The most productive way to spend the money? And how do you pay for it?

Chairman MEUSER. Thank you.

The gentleman's time has expired.

We now will recognize Ms. Van Duyne from Texas for 5 minutes.

Ms. VAN DUYNÉ. Excellent. Thank you very much, Mr. Chairman.

In 2017, the previous administration, as you know, as we have been discussing, enacted the Tax Cuts and Jobs Act. And this comprehensive tax reform not only stimulated economic growth but also generated record revenues, while significantly reducing taxes for individuals and for businesses across the board.

Under TCJA, tax revenues outpaced CBO projections and reached record highs. In the first 2 years after TCJA, GDP growth was a full percentage point higher than CBO's pre-TCJA forecast. And prior to TCJA, the growth rate of business R&D investment had averaged only 4.5 percent over 5 years. However, with TCJA in effect, companies were provided with enhanced incentives to invest in R&D, leading to increased innovation and technological advancement. And this led to an increase, now, instead of just being 4.5 percent, to 18 percent.

However, as we know, these are being expired. Companies are now required to deduct R&D costs over a period of 5 years. So, as a result, the reduced deductions have led to increased taxable income and a higher tax bill for companies. To manage their cash flow, larger companies have resorted to borrowing more, while smaller companies have experienced a slowdown in their growth due to the impact of these changes.

Which is why I am very proud to be able to join my colleague, Mr. Estes, in introducing legislation to extend these provisions. We have been going across the country in some of our Ways and Means field hearings, and what we have heard from literally every area of the country in every industry is: This R&D tax credit will be very disruptive and will harm, hurt their ideas of innovation.

So I am going to ask Mr. Wydra: Before TCJA, the U.S. was uncompetitive globally when it came to corporate and small-business

taxes. Now, with the current R&D tax provisions being expired, where does that put us on the world stage?

Mr. WYDRA. You know, two steps forward, nine steps back, you know, is exactly what is happening here.

You know, you are inspiring this growth, you know—you are making decisions in policy here that guides our decisions, you know, and it is a great responsibility that you have to guide that.

And I think you have said, “Green-light innovation. Let’s be innovators. Let’s do this.” And now we are saying, “Well, now let’s put the brakes on it.”

And, again, I think everyone is kind of surprised that that was in there—you know, like, even us. It is like, oh, wow, we didn’t think about that, or we didn’t think that this was going to come to a point that we would have to start amortizing that and really calculate that into our plans.

But, you know, without a nice runway—to say, “Okay, here is a nice, well-lit runway, a clear path; there is no disruption to this; go,” you can unleash one of the greatest periods of innovation in the world just with this decision.

And, again, I think that is why I am here. That is why we are trying to take the time out.

And it is all about—you know, really, again, it is all about—for me, it is all about our employees. It is all about our teams. It is all about giving them the spirit of innovation and just letting them loose.

And if you can do that with all the small businesses and even the large businesses, you are going to have unprecedented growth on your hands.

Ms. VAN DUYNE. Thank you, Mr. Wydra.

Ms. Ballay, what do you think, on global competitiveness, that getting rid of these tax incentives, the TCJA and our Innovation in America, will do to us long-term in being able to compete globally?

Ms. MASSER BALLAY. Yes, I think it slows down how quickly we can implement, you know, business strategies, whereas in other jurisdictions they are not being hampered quite as much.

And that, you know, slowing down really impacts our ability to plan. You know, I think Mr. Wydra touched on it, you know, which is that we want to be able to plan out our expansions. You know, we are looking at, you know, 1, 2, 3, 4, 5 years out. We really want to plan out those expansions. And if it is uncertain what our access to capital is going to be, what our access to the cash flow is, what our tax liabilities are going to be, our ability to plan out is hampered. And so then that slows down our ability to compete on the local scale, on the regional scale, and also then on the global scale.

Ms. VAN DUYNE. All right.

Do you have any thoughts on our global competitiveness and what this does to us around the world from an R&D tax credit perspective?

Mr. KAERCHER. Thank you for the question.

I think the, sort of, evidence on the impact of expensing, from the research, is somewhat mixed for a couple of reasons. Large companies, multinationals, often focus more on book profits than tax, and so the level of incentive effect there is a little bit unclear.

For small businesses, it does seem to have a larger effect, and that is very important. But many small and startup businesses, as I mentioned in the testimony, don't have the tax liability to actually access expensing. So that is just sort of a tradeoff in the policy.

Ms. VAN DUYNE. No, and I understand—oh, oops, I am actually out of time. So thank you very much.

I yield back.

Chairman MEUSER. The gentlelady's time has expired and yields back.

I now recognize Mr. Williams of Texas for 5 minutes.

Mr. WILLIAMS. Thank you, Chairman.

In full disclosure, I love profits. I like to make money—and pay taxes, if I make money. But let me just say this: "Profit" is not a dirty word. It is a dirty word to the government, okay? They don't understand small business.

You touched on competition. Competition drives everything. Competition tells you if you are doing a good job. Competition tells you if you are doing a bad job. If your prices are competitive, it tells you. Okay? We need to create more competition.

The greatest asset we have is small business in this country. And one way we can fix a lot of this is make these tax cuts permanent, just make them permanent, so we know the rules, right?

And, you know, this conversation about interest expensing—interest is an expense. Interest is not cash. There is no way you should be paying tax on an expense. That will run you right out of business. And we fight for that every single day, and I was responsible for getting interest deductibility in 2016. Because it is an expense. The government talks about it like it is income. So we have to fix that.

And I could talk forever on this, but the thing we say to the government is, if we have to worry about taxes and we have to worry about this and can't be aggressive, you end up saving money to pay your taxes, which means you cut back on employees, you cut back on advertising, you cut back everything to pay a business that is broke money.

And what they don't understand is that we need to make these tax cuts permanent so we can spend for growth. Because what the government doesn't understand—if we make money, they think we save money. We don't save money; we spend money. We grow, we hire people, we create more jobs, create all kinds of things.

So that is kind of where we need to be, and that is kind of where we are, a lot of us.

So let me get into my question here. I think there is one thing that we all agree on, that when a small business is able to keep more of their hard-earned dollars, it makes it easier for them to weather tough economic times but also grow. Okay? We also can grow when we have cash.

And we have seen interest rates rising. I have been in business since 1971. I paid 20-percent interest. I know what that is like. And we have seen these interest rates rising on these huge principal balances. And the inflation, we haven't mentioned that—inflation and supply chain.

So it makes it harder for all of us, as small-business people, to maintain our margins and stay profitable. Margins. A sale is one thing; a margin is something else, you see?

So, now, more than ever, we need a Tax Code that is working toward growing the economy and making it easier to operate rather than harder.

And, frankly, personally, I don't care what they do in Europe. We need to be driving the economy. They need to be following us, we not follow them.

So, when the Tax Cuts and Jobs Act was passed, I thought one of the most important provisions was bonus depreciation. It allowed us to buy. It allowed us—also, Tier 1 and Tier 2 suppliers were affected, right? Because we bought. And this allowed businesses to invest in hard assets, which made our operations more efficient. And it allowed employees to work with better equipment. That is important to stay ahead of the competition, making jobs easier and more efficient, and it allowed customers to be serviced by the most up-to-date technology.

And I also am a calf-cow operator, Angus cattle, in Texas. And so you have touched on this, but I want you to say it again, Ms. Masser Ballay. You know better than anyone that farming has turned into a high-tech endeavor. And can you share with us again how the bonus depreciation affected family farms like yours and Tier 1 and Tier 2 suppliers that benefited from what you purchased?

Ms. MASSER BALLAY. Absolutely.

You know, I had brought up our palletization and bag-filling, but we have invested in higher-tech harvesters, you know, for our potato operation. We have invested in combines, new planters. You know, we have really done a very—you know, updating a lot of our equipment in the last few years.

Mr. WILLIAMS. And this is money that went to Main Street America too, because you bought it from them, right?

Ms. MASSER BALLAY. Absolutely. Absolutely. You know, we always look to U.S. suppliers, you know, to go there first to try and implement in our facilities and in our fields.

And, yeah, so we did quite a bit of investment, and it is all about, you know, creating an environment for our employees so they enjoy working for us and, you know, so that they have a good work-life balance and so that they are able to work safer, more comfortably.

Mr. WILLIAMS. Well, if you didn't have that, you would have paid that money to the government.

Ms. MASSER BALLAY. Correct, yes.

Mr. WILLIAMS. And so the government would have created a job with your money, but with your money you create net worth. And that is the difference.

Ms. MASSER BALLAY. Yeah.

Mr. WILLIAMS. So I will have some more questions, but I yield my time back, Mr. Chairman. Thank you.

Chairman MEUSER. The Chairman of the full Committee yields back, is very much appreciated.

We are coming to a conclusion, but we do have the bounds to have a second round. I am going to take that privilege myself. I am

not sure if any of my colleagues will be able to participate. So I yield myself an additional 5 minutes.

Now, I think the participation here was not as robust as normal because we have a bipartisan understanding that this is that important and we will, in fact, work towards enhancing and augmenting the R&D tax credit. And I do hope that also means—and I may turn to my Ranking Member here, colleague—the bonus depreciation as well.

I think your testimony, all of you, was very compelling—succinct, but compelling—all very consistent: the need for predictability, the need for a lower-cost environment in order for you to thrive, the need to have less burdens on your overhead, and less regulations—that is another story, of course—so as you can innovate.

And, as you put it, it is the point of the spear, Mr. Wydra, as you put it. That creates new products innovations, new customers, which requires new advanced increases in your workforce, which leads to growth, which leads to profitability, as the Chairman mentioned, but profitability leads to higher levels of tax revenue, as we all know. So it all works together when it works together.

But an overly burdensome set of regulations, usually imposed by the federal and state government, can very much diminish all that. And that is not what has made America great, and we have to recognize it. Because we are not alone in this world, and there are countries that are looking out for their interests and making themselves as competitive as possible.

As I said earlier, the role of government is to do all possible to create a competitive work environment. It is not to create jobs. Your role is the job creator, not government.

So I just want to ask this one question. Sometimes, you know, the word “profits,” again—and Chairman Williams brought up—seems to be not such a favorable word. But what do you do with your profits? I would like to ask that.

Julie Masser Ballay, I would like to ask you first.

Ms. MASSER BALLAY. So, with us being a family company, we keep it in the business. It goes right back to the business.

Within our industry, it is very competitive. The grocery store—you know, we work a lot with grocery stores and produce distribution. That is an ever-growing industry, so you have to keep up with that pace of growth.

So we are always keeping that profit in the business and reinvesting. Again, part of that is trying to keep our workforce, you know, safe and content. And so we are always putting that money right back in.

Chairman MEUSER. Making yourselves built to last, making yourselves stronger.

Mr. Wydra, same question.

Mr. WYDRA. Yeah, same answer. Yeah, I mean, it goes into people development, it goes into equipment, it goes into expansion, it goes into, you know, automation—you know, all the things that you need to do.

You know, we were talking about earlier about, you know, the bonus depreciation and, you know, how it helps you buy equipment, helps us buy equipment. For every bit of equipment you buy, you need to hire people to be able to run that, you know? And it

just creates an engine of momentum forward. And that is where it goes.

Chairman MEUSER. That is great. Well, we want to give you more predictability, because that roller-coaster business can be up and down, huh?

Mr. WYDRA. You were waiting all day for that one, huh?

Chairman MEUSER. With that, I will yield back.

I will ask the Ranking Member, do you have any final comments?

Mr. LANDSMAN. Yes. Thank you.

Just to say, thank you all for being here and weighing in, your expertise.

You know, as I think the Chair is alluding to, there is a reason why this is a shorter hearing—in part, because I think, you know, the consensus is there, in terms of resolving this, fixing what is a no-brainer. And, you know, what this helped reinforce for me is, one, how important it is, but also, two, that we have to help them get it over the finish line and get it done.

So I appreciate you all and your work here today. Thank you.

And I yield back.

Chairman MEUSER. The gentleman yields. Appreciate that.

Mr. WYDRA. What is it that will help you get over that finish line?

Mr. LANDSMAN. It sounds like—thank you.

Mr. Chair, is that okay?

Chairman MEUSER. The gentleman is recognized.

Mr. LANDSMAN. Yeah, thanks.

It is good question. As a freshman, you know, I say this with some appreciation, or a lot of appreciation, for the fact that, you know, this is very complicated place. My hope is that it is a matter of leadership on Ways and Means and, you know, those of us who aren't on Ways and Means pushing, advocating, you know, making sure that it gets marked up, gets to the floor, talking to leadership, which I know the Chairman and I will both do.

So it is really just getting it moving. I think, you know, the hope is, coming out of the last week's vote, that that was sort of a deck-clearing vote, in the sense that, you know, hopefully that will allow us to get a bunch of other things done. And this is one of them.

Mr. WYDRA. Thank you.

Chairman MEUSER. All right. The gentleman yields back.

The Chairman of the full Small Business Committee, Mr. Williams, is now recognized for 5 minutes.

Mr. WILLIAMS. Yeah, I want to bring up something that is not so bipartisan, okay?

And so let me give you a scenario. In 1989, both—I am the only child—both of my parents passed away. My father—they left me with a lot of assets. He left me with no cash.

And 3 days after we buried my father, I had the IRS sitting at my desk, wanting their money. And back in 1989, I think it was 60 percent with a threshold of \$600,000. They wanted their money.

I didn't have the money. I was employing 300 people in a profitable business. I didn't know what to do. I came this close to taking bankruptcy. But, fortunately, I had two older gentlemen that were

able to talk to the IRS and we worked a deal out. And 20 years later, I paid them off.

Now, this is money that could have gone to my church, this is money that could have gone back into my business, this is money that could have done a lot of things, okay? But it went to the government. And we are still operating at a deficit. I didn't pay the deficit off with the money I gave them, okay?

So the biggest problem we have—we talk about that around here—is the inheritance tax. In my opinion, the inheritance tax needs to be zero. It is double taxation. And if you knew that, you would be able to manage your business even more differently and more aggressively, knowing that, in a family business, you wouldn't have to pay all the money to the government.

So I know you are probably not prepared for this question, both of you, but talk a little bit about the death tax and how you operate and how you think about it. And it is a form of double taxation, as I said. And does that make it harder for you to run your business, or does it take you another direction sometimes, because you are worried about it?

Ms. MASSER BALLAY. If I can speak to that first.

Our family, in, you know, concern for that, took steps a number of years ago to prepare for that, before the changes that had been done with the postponing of that were in place. And so we had taken steps so that that was off the table. But those weren't—you know, those weren't inexpensive, by any means.

Mr. WILLIAMS. But you buy an insurance policy.

Ms. MASSER BALLAY. Well, right. Exactly.

Mr. WILLIAMS. And you pay money for that.

Ms. MASSER BALLAY. Yes, yes, exactly, exactly. So we were fortunately in the position where we were able to do that.

What I would say is, especially for the small family farmer, you know, the smaller operations, they may not have the means for that. They may not have the ability to do that. That is always—you know, I sit on, you know, our local farm bureau. That is always a concern that comes up, is estate planning. That is something that is always addressed at a lot of different meetings, because that is a huge concern for family farms.

You know, it is the exact same position you were in, which is land-rich, cash-poor. And, you know, a lot of people's only option is to liquidate and lose their family farm.

Mr. WILLIAMS. Well, we raised the threshold to \$11 million in 2016. Now we have people who want to bring it down to \$5 million and this and that.

Do you want to answer that?

Mr. WYDRA. Yeah.

I mean, I think it is the—the biggest risk that I see with this is the collapsing of a company, you know? So, if somebody doesn't take the steps to plan correctly for this and they are forced into a situation similar to what you explained, that is an immediate elimination of a company at fire-sale prices.

So, again, I have been here today to advocate for our employees and our families of our employees. And that becomes a devastating decision for them. So, you know, if that remains the way that it is,

I could see a lot of small businesses struggling to make the tax bill, which is going to result in a lot of closures.

And, you know, if you look at our population, it is moving to a point that a lot of that could potentially happen at a very common time. And I think that we need to be prepared for that as a country.

Mr. WILLIAMS. Yeah. When you have 87,000 IRS agents running around out there——

Mr. WYDRA. Yeah.

Mr. WILLIAMS.—something bad is going to happen.

Mr. WYDRA. Yeah.

Mr. WILLIAMS. Anyway, I thank you for being here. Thank you for being entrepreneurs and risk-takers. You are what America is about.

And, with that, Mr. Chairman, I yield my time back.

Chairman MEUSER. The Chairman yields back.

We now would like once again just to thank our witnesses for being here, making the trip, for all of your testimony.

I am going to close this hearing.

Without objection, Members have 5 legislative days to submit additional materials and written questions for the witnesses to the Chair, which will be forwarded to the witnesses.

I ask the witnesses to please respond promptly.

If there is no further business, without objection, the Subcommittee is adjourned.

[Whereupon, at 11:12 a.m., the Subcommittee was adjourned.]

APPENDIX



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TESTIMONY TO THE SUBCOMMITTEE ON ECONOMIC GROWTH, TAX AND CAPITAL ACCESS

AMERICAN INGENUITY: PROMOTING INNOVATION THROUGH THE TAX CODE

JULIE E. MASSER BALLAY

VICE-PRESIDENT AND CFO STERMAN MASSER, INC.

JUNE 6, 2023

Good morning, Chairman Meuser and distinguished members of the subcommittee on Economic Growth, Tax, and Capital Access. Thank you for the opportunity to give testimony today. My name is Julie Masser Ballay and I am CFO and Vice President of Sterman Masser, Inc.

I am here on behalf of our family of companies, Sterman Masser, Inc., Masser Logistic Services, Keystone Potato Products, and Lykens Valley Grain. Our corporate headquarter is located in Sacramento, PA, in Schuylkill County, with land and facilities also located in Dauphin and Northumberland counties.

BACKGROUND

For more than 50 years, Sterman Masser Inc. has been a grower, packer, and shipper of potatoes. We are a family business, started by my grandfather, Sterman Masser, in 1970, and now owned by my parents, Keith and Helen Masser, my brother, David Masser, and me. Dave and I are 8th-generation farmers and we have high hopes that one or more of our children will become the 9th generation.

We currently farm approximately 1000 acres of potatoes, along with 2300 acres of corn, 1500 acres of soybeans, and 850 acres of wheat annually. The remaining acreage is dedicated to a variety of cover and rotation crops, totaling over 6000 acres in production. We distribute approximately 350 million pounds of potatoes annually throughout the eastern United States, with a primary focus on retail packaged potatoes. Our farming, packing, and distribution operations are supported by a team of approximately 400 employees.

IMPACTS OF BONUS DEPRECIATION ON SMALL BUSINESSES

The year 2020 marked our 50th year in business, as well as the start of the pandemic. Our business is focused on feeding people and that did not stop during the pandemic. Our doors stayed open and our workforce showed up. On behalf of the Masser Family, I would like to give my heartfelt thanks to our employees that helped keep food on the tables of families in America.



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Like any other company, we had to adjust our way of doing business in recent years. One of those adjustments was increasing the automation in our packing operation to transition difficult-to-fill, labor-intensive positions into machine operator positions, by mechanizing our bag filling and palletizing functions within our packing shed. These steps in automation improved employee safety, by reducing the risk of sprains and strains, while also improving production efficiency. We started the process of this automation prior to 2020 and, with the assistance of bonus depreciation and the positive impact that had on our company's cash flow, we were able to continue installing this machinery through the pandemic.

This example demonstrates what I believe to be an important impact of bonus depreciation for a company like ours, which is the ability to reinvest in our family business with improved cash flow. Reinvesting helps us increase the speed of our innovation and make necessary investments that allow us to stay up-to-date with technology and keep pace in the marketplace. By taking advantage of bonus depreciation, we have been able to redirect cash back into our business so that we can improve our employee's work environment, increase our efficiency and continue to remain competitive in the marketplace, particularly as we combat tighter margins through this inflationary period.

As a family business, the concern always exists that we will not be able to keep pace with larger companies or with rising costs, while still addressing the needs of our employees. With a tight labor market in our region, we are always looking for ways to improve the work environment for our employees, improving safety and efficiency. Innovation allows us to be in a position to compete for employees and create higher-paying positions.

Additionally, with interest rates on the rise, smaller businesses are able to benefit by utilizing cash, instead locking in loans with high rates. Although our business is fortunate to have very good relationships with our banks, small companies in general do not have the ability to negotiate with banks as well as large corporations. This is where the SBA is able to step in to offer assistance with small business loans but the ability to utilize cash to reinvest in your own business is another useful tool in a business owner's toolbelt.

Small and family-owned businesses are the backbone of the American economy. In order to remain competitive, particularly in the agricultural sector, we need to be able to keep up with the speed of innovation of larger corporations. Taking advantage of bonus depreciation, and using that to reinvest in our business, assists us in accomplishing this so that we can continue to provide a good work environment for our employees and put food on the tables of families in America.

Thank you for the opportunity to be a part of today's discussions; I appreciate the interest from the subcommittee.

American Ingenuity: Promoting Innovation Through the Tax Code

William Wydra, Jr.
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 (717)503-5252

Thank you, Congressman Williams and Congresswoman Velazquez for the opportunity to testify on this important issue and how it impacts both small business and US manufacturing. Innovation has been and will continue to be the cornerstone of growth and competitive advantage for the United States in this global economy. History shows how our innovative business leaders have been a major catalyst for job growth and social prosperity. Promoting innovation through the tax code is not only important for economic growth, and job creation, it also makes life much more interesting and exciting with all of the new products and services that increase citizen safety, health and longevity, sustainable food and energy, living conditions and all those things that make us laugh and smile.

As an owner of several small businesses especially those in manufacturing, we already have so many obstacles for growth. It feels like we are often running up hill in quicksand – today's top challenges include a significant trade skills gap, general labor shortages, supply chain challenges, high interest rates and the looming uncertainty of recession to name a few. These challenges already limit our ability to confidently invest in our future and the future of our employees.

During the covid-recovery years, we have invested very heavily in employee talent development, including the creation of a CNC Training Academy that accelerates learning from machine operator to programmer in twelve months. We are very proud of this program and plan to expand it to our welding and fabrication division. We have several pending equipment investments that are priced, planned and ready to go. We are also actively exploring a sizable expansion onto one of our Pennsylvania factory locations and the purchase of another industrial property in the Cincinnati area to grow our roller-coaster business.

The proposed tax changes scheduled to go into effect regarding bonus depreciation and research and development tax credits will add one more significant mark for the negative column as we weigh these decisions and would most likely put a stop to these for several years or potentially permanently. Cash flow is always tight for most small businesses and this is particularly true of manufacturers who are much more capital intensive. These tax code changes put an increased burden on already limited cash flow in form of increased estimated quarterly and annual tax payments. This will limit our ability to support debt coverage for new building expansion and equipment investments and reduce available cash for hiring and further talent development programs.

These tax changes de-incentivize investment and innovation. I would encourage the permanent continuation of 100% bonus depreciation. Additionally, I support removing the requirement to capitalize R&D related expenses over 5 years. If nothing else, I suggest delaying the implementation of these program changes until we have a much healthier and predictable economy. This is just simply the wrong time to do this!

I understand the need to increase tax revenues to fund a healthy and productive government, but just do not think this is the way to do it. Growth of jobs, especially those in manufacturing have a significant multiplier effect on the economy which leads to higher payroll and income tax revenue as well as higher property tax revenue. I feel this "additive" approach is much more in-line with the American Way!

Respectfully submitted,

~William Wydra



Written Testimony for Hearing, “American Ingenuity: Promoting Innovation Through the Tax Code”

Michael Kaercher

Senior Attorney Advisor and Director of the Climate Tax Project, Tax Law Center at NYU Law
Committee on Small Business, Subcommittee on Economic Growth, Tax, and Capital Access
June 6, 2023

Chairman Meuser, Ranking Member Landsman, and distinguished members of the Committee, thank you for the opportunity to testify today.

The U.S. federal tax system funds investments in public research and innovation. It also directly invests in private sector innovation and future innovators through various tax deductions, exemptions, credits and other mechanisms. My testimony focuses on three key points.

1. **Reaching small businesses with direct tax subsidies requires careful policy design.** Most federal tax subsidies take the form of non-refundable tax credits, deductions, accelerated cost-recovery, or income exclusions. Each of these types of subsidy requires the taxpayer to have income tax liability. Often, startup and small businesses do not have substantial (or any) income tax liability. Furthermore, even profitable small and startup firms may find that complexity can erode the value of tax subsidies.
2. **The tax system supports critical investments in innovation outside of direct business subsidies.** Investments like the Child Tax Credit can help future U.S. workers, researchers, innovators, and entrepreneurs realize their full potential. And the core function of the tax system is to raise revenue, which can be used to fund the public research and investment that supports a dynamic economy.
3. **Tradeoffs matter.** Choosing among different methods of supporting innovation often involves tradeoffs, as the options must be weighed against each other and prioritized within fiscal and political constraints.

Part 1: Reaching small businesses

Many small businesses do not owe much federal income tax, especially in early years when they have significant startup expenses. This can limit their ability to access many of the federal tax subsidies available to large businesses, and can be a downside of delivering subsidies through the tax system as opposed to spending programs.¹ Prior to the Inflation Reduction Act (“IRA”),

¹ Tax breaks (in the form of deductions, credits, and other preferences targeted towards specific types of activities or filers) can have the same dollar impact on the federal budget as grant programs. This is why economists refer to them as “tax expenditures.” For more on federal tax expenditures, and considerations involved in delivering subsidies as tax breaks rather than spending programs, see Congressional Research Service, R44530, *Spending and*

Congress and the private market developed several tools to address this problem. Three approaches are (i) the ability to offset payroll tax liability with income tax credits, (ii) the ability to effectively transfer credits, and (iii) refundability (including “direct pay”).²

(i) *Ability to offset payroll tax liability with income tax credits.*

The research credit in section 41 of the tax code adopts this first approach – at least for certain small businesses.³ Section 41 is a complex credit regime, with four distinct credits:

1. The general credit is a 20% credit on qualified research expenses for the taxable period.⁴ It is an incremental credit, and so only applies to qualified research expenses above a base amount.⁵
2. There is an alternative simplified credit of 14%. Like the general credit, it is incremental, though based on a different historic baseline.⁶
3. The third incremental research and development credit is a 20% credit related to collaboration with universities and other tax-exempt entities.⁷
4. Finally, there is a 20% credit related to amounts paid to tax-exempt energy consortiums for energy research.⁸ This credit is flat, rather than incremental.

The research credit is not refundable. In other words, it can only be used to offset income tax liability. If the taxpayer claiming the credit does not have enough income tax liability to offset the credit, then the excess can be carried forward up to 20 years, or carried back one year.⁹ “Critics contend that the credit’s lack of complete refundability could be especially problematic for small, young firms that spend substantial sums on R&D during their early years while recording a string of net operating losses. For them, the [research] credit provides no immediate benefit.”¹⁰ In place of refundability, companies with less than \$5 million in gross receipts in the current year may offset payroll tax liability related to their employees.¹¹ In this way, they can

Tax Expenditures: Distinctions and Major Programs (2019); Frank Sammartino & Eric Toder, Tax Policy Center, *Are Tax Expenditures Worth the Money?* (2020). For a more comprehensive discussion of tax expenditures targeted at small businesses, see William G. Gale & Samuel Brown, *Small Business, Innovation, and Tax Policy: A Review*, Nat’l Tax J. 871, 878-881 (2013). There is no uniform definition of small business, for tax purposes or other purposes. *Id.*, at 872-81 (describing various definitions of “small business” used for different purposes).

² A refundable tax credit is currently the most efficient form of delivering subsidies through the tax system. See Lily L. Batchelder et. al, *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 Stan. L. Rev. 23, 42-44 (2006) (arguing that, at least for externality-correction elements within individual tax provisions, “a uniform refundable credit minimizes the deadweight loss associated with errors in an incentive’s application, assuming evidence is nonexistent or inconclusive regarding how different income groups vary in the marginal externalities generated by their engaging in the subsidized activity and in their responsiveness to the incentive. This is the case irrespective of whether a delivery of tax subsidy is delivered through the tax or transfer system and irrespective of whether the subsidized behavior actually generates positive externalities.”).

³ 26 U.S.C. § 41.

⁴ 26 U.S.C. § 41(a)(1).

⁵ 26 U.S.C. § 41(c).

⁶ 26 U.S.C. § 41(c)(4).

⁷ 26 U.S.C. § 41(a)(2).

⁸ 26 U.S.C. § 41(a)(3).

⁹ 26 U.S.C. § 39(a)(1).

¹⁰ Gary Guenther, Congressional Research Service, RL31181, *Federal Research Tax Credit: Current Law and Policy Issues* 22 (2022).

¹¹ 26 U.S.C. § 3111(f). This provision is generally limited to companies that are not more than five years old.

access at least some of the credit even if they have losses for tax purposes. Prior to the IRA, this option was available for up to \$250,000 of the credit, but the IRA doubled that limitation to \$500,000.¹²

(ii) *Ability to effectively transfer credits through either “tax equity investments” or direct transfers*

Businesses without sufficient tax liability to use credits have historically turned to private “tax equity” transactions to access the value of certain credits by, in effect, transferring them to other taxpayers. “Tax equity investments” describe transactions in which one taxpayer “assign[s] the rights to claim the tax credits to another party in exchange for a [cash investment].”¹³

For example, a developer that plans to build a solar farm and receive a tax credit for the electricity generated might partner with an investor in a tax equity arrangement if the developer had no income tax liability to offset. In one type of tax equity transaction, the developer and the investor would form a partnership. The tax equity investor would make an upfront cash investment to help finance the solar farm and, in exchange, would receive most of the tax credit and depreciation associated with the project until it received the pre-determined rate of return on its investment.

Tax equity transactions have several drawbacks. Tax equity investments involve significant complexity and fixed costs, as the parties must conduct extensive due diligence and pay for legal counsel. These fixed costs, along with the return the investor receives, effectively reduce the credit’s subsidy of the desired activity.¹⁴ In addition, tax equity investment appetite fluctuates with macroeconomic conditions: when there is a recession, tax equity investor demand dries up.¹⁵ Finally, “investors typically prefer larger projects and established technologies; as a result, it is usually more difficult for smaller projects and newer technologies to find financing.”¹⁶

Congress has allowed certain taxpayers to instead *directly* transfer certain tax credits. Two examples from the energy space are the advanced nuclear power production credit and the energy efficient commercial buildings deduction. The advanced nuclear power production credit gives taxpayers a credit based on how much electricity their nuclear power facility produces. Government entities, electric co-ops, and public utilities can transfer this credit to certain project partners, such as the person who constructed the nuclear facility.¹⁷ The energy efficient commercial buildings subsidy is a deduction, meaning it reduces a taxpayer’s taxable income. The deduction is based on the size of the building and the reduction in energy and power costs by certain energy efficient upgrades.¹⁸ Prior to the IRA, federal, state, and local governments could

¹² 26 U.S.C. § 41(h)(4)(B)(i)(II).

¹³ Mark P. Keightley et al., Congressional Research Service, R45693, *Tax Equity Financing: An Introduction and Policy Considerations* 1 (2019).

¹⁴ *Id.*, at 4.

¹⁵ See, e.g., *id.*, at 12 (“During the Great Recession, falling corporate tax liabilities reduced investor demand for credits . . .”).

¹⁶ Peter Richman, *Direct Pay, Transferability, and the Corporate AMT*, 179 Tax Notes Federal 601, 602 (2023) (citing Brian R. Murphy & Dorian Hunt, *Tax Equity in a Direct-Pay World*, 174 Tax Notes Federal 631, 631 (2022)).

¹⁷ 26 U.S.C. § 45J(e).

¹⁸ 26 U.S.C. § 179D(b).

transfer the deduction to the person responsible for designing the property.¹⁹ As explained further below, the IRA expanded the group that could transfer the deduction to include other tax-exempt entities, and adopted a broader regime to allow taxpayers to transfer credits (often called “transferability”).²⁰

(iii) *Refundability (including “direct pay”)*

Most business tax credits are nonrefundable. However, Congress has recognized that this can make credits inaccessible for small and startup businesses.²¹ The 117th Congress took a different approach to tax incentives for innovation. For example, the Chips and Science Act created a new 25% tax credit for investments in facilities that manufacture semiconductors or semiconductor equipment.²² These facilities can cost billions of dollars, meaning even large corporations may lack tax capacity to absorb these credits in a single year. Partially for this reason, Congress first enacted a novel “direct pay” provision for this new credit.²³ Direct pay allows a taxpayer to treat a tax credit as a payment of tax. Economically, this makes the credit similar to a refundable credit, in that the taxpayer can get a check from the government even if the credit exceeds the taxpayer’s income tax liability.

A key policy tradeoff is that refundability of business tax credits expands access to those credits, but also raises administrative issues. On the one hand, policymakers want to encourage certain behavior, and whether the taxpayer has tax liability is largely irrelevant to that policy. On the other hand, refundable business tax credits raise fraud concerns that are not fully present for nonrefundable credits or individual tax credits. For example, a fraudulent actor could make up a fake business, claim credits, and then abscond with the refund as soon as it is received. Because the IRS generally audits returns long after any credits or refunds are processed, it is important that the IRS have confidence that a business credit is properly calculated before it is paid as a refund. Therefore, these new direct pay regimes include guardrails, such as authority for Treasury to establish a registration system and request information from the taxpayer regarding the project on the front end.²⁴ These guardrails require investment in systems at the IRS, and so appropriate IRS funding is critical to a well-functioning direct pay system.²⁵

¹⁹ 26 U.S.C. § 179D(d)(4) (2021).

²⁰ 26 U.S.C. § 179D(d)(3).

²¹ The 116th Congress passed several laws creating fully-refundable business tax credits for certain behaviors. For example, with broad bipartisan support, Congress enacted a fully-refundable paid leave tax credit for businesses with fewer than 500 employees. *See, e.g.*, Families First Coronavirus Response Act, Pub. L. No. 116-127, §§ 7001-7003, 136 Stat. 177, 210-219 (2020).

²² Chips and Science Act, Pub. L. No. 117-167, § 107, 136 Stat. 1366, 1393-99 (2022) (establishing new 26 U.S.C. § 48D).

²³ Direct pay was initially introduced in 2019 for certain energy credits, and was included in the House-passed Build Back Better Act. *See* Growing Renewable Energy and Efficiency Now (GREEN) Act of 2020, H.R. 7330, 116th Cong. § 104 (2020); Build Back Better Act, H.R. 5376, 117th Cong. § 136104 (as passed by House, November 19, 2021).

²⁴ 26 U.S.C. § 48D(d)(2)(E).

²⁵ The IRA included significant, long-term investments to modernize the tax system. *See* Inflation Reduction Act of 2022, Pub. L. No. 117-169, § 10301, 136 Stat. 1818, 1831-33 (2022). However, the Fiscal Responsibility Act, passed by the Senate on June 1, 2023, included a significant clawback of that investment, including a \$1.4 billion rescission, and a side deal to remove an additional \$20 billion in funding over the next two years. *See* Fiscal

The IRA

The IRA modifies existing tax credits for clean energy and investment, creates new tax credits, and adopts and expands the innovations of transferability and direct pay from prior tax code provisions.

The IRA offers a broad range of tax credits and deductions, with the goals of “accelerating the deployment of clean energy to lower energy costs for American families, strengthening the U.S. industrial base, securing our clean energy supply chains in collaboration with our allies and partners, and creating jobs and economic opportunity.”²⁶ It makes historic investments in proven technologies, while creating flexibility for the development of new technologies over time. The law spreads across the clean economy, from domestic electricity generation, to clean vehicles and alternative fuels, to nuclear and manufacturing.

One provision to note is section 48C. It includes a competitive tax credit for advanced energy projects. The Treasury Department, in consultation with the Department of Energy, is to establish a qualifying advanced energy project program to consider and award \$10 billion of tax credits to projects with a reasonable expectation of commercial viability, considering the following criteria:

- (i) will provide the greatest domestic job creation (both direct and indirect) during the credit period,
- (ii) will provide the greatest net impact in avoiding or reducing air pollutants or anthropogenic emissions of greenhouse gases,
- (iii) have the greatest potential for technological innovation and commercial deployment,
- (iv) have the lowest levelized cost of generated or stored energy, or of measured reduction in energy consumption or greenhouse gas emission (based on costs of the full supply chain), and
- (v) have the shortest project time from certification to completion.²⁷

At least \$4 billion must be awarded to projects in coal closure communities.²⁸ This provision is intended to spur innovation and job creation within coal closure communities.

This March, the Department of Energy issued a set of reports titled “Pathways to Commercial Liftoff.”²⁹ The first three reports relate to clean hydrogen, long duration energy storage, and advanced nuclear. According to the Department of Energy, by 2030, “cumulative investments must increase to approximately \$300 billion across the hydrogen, nuclear, and long duration energy storage sectors, with continued acceleration until 2050 required to stay on track to realize

Responsibility Act of 2023, H.R. 3746, 118th Cong. § 251 (as passed by House, May 31, 2023); Kate Dore, *Proposed debt ceiling deal would cut part of \$80 billion IRS funding*, CNBC (May 30, 2023).

²⁶ Lily Batchelder, Assistant Secretary for Tax Policy, U.S. Department of Treasury, *Remarks by Assistant Secretary for Tax Policy Lily Batchelder on Implementation of the Inflation Reduction Act’s Clean Energy Provisions* (March 22, 2023).

²⁷ 26 U.S.C. § 48C(d)(3).

²⁸ 26 U.S.C. § 45(b)(11)(B)(iii). A mapping tool to help identify energy communities is in development. See U.S. Department of Energy, *Energy Community Tax Credit Bonus* (last visited June 2, 2023).

²⁹ U.S. Department of Energy, *DOE Releases new Reports on Pathways to Commercial Liftoff to Accelerate Clean Energy Technologies* (March 21, 2023).

long-term decarbonization targets.”³⁰ The Infrastructure Investment and Jobs Act invested \$7 billion to create regional clean hydrogen hubs across America, to “create networks of hydrogen producers, consumers, and local connective infrastructure to accelerate the use of hydrogen as a clean energy carrier that can deliver or store tremendous amounts of energy.”³¹

Together, these three industries have the potential to increase zero-emissions generation, store renewable energy cheaply so that it is available even when the sun is not shining and the wind is not blowing, and make energy easier to transfer, addressing transmission bottlenecks and difficult to decarbonize industries. These industries are relatively young and will require significant investment and innovation to have their potential fully realized. The tax credits in the IRA support each of these three industries, and many more.

Starting in 2025, the IRA calls for a major transition in credit structure, with the goal of automatically adapting to new and innovative methods to create zero-emissions electricity and clean fuels. Under this new “tech neutral” regime, any facility that can produce electricity with a greenhouse gas emissions rate of 0 or less can qualify for tax credits. Similarly, any fuel with lifecycle emissions below 50 kilograms of CO₂e per million British thermal units can be eligible for credits. In other words, the law transitions to adapt to innovative ways to create new sources of clean energy and fuels.

The IRA includes direct pay and transferability provisions to allow taxpayers without tax liabilities to monetize their credits. Certain taxpayers, such as governments (including tribal governments) and tax-exempt entities are eligible for direct pay. For certain credits related to emerging technologies and manufacturing activities, for-profit entities are also eligible for direct pay, at least for the first five years of the project. For other IRA credits available to businesses, a new transferability regime is available that is significantly broader than the limited transfer provisions that existed prior to the IRA. Under transferability, taxpayers (including those who do not have sufficient tax capacity) can sell their credits to other taxpayers. This has the potential to be significant for small businesses who invest in clean technologies but have been locked out of traditional monetization options such as the tax equity market.³²

A host of design considerations

Allowing small, and particularly start-up, businesses to access the economic benefit of tax subsidies may be important to achieving policymakers’ goals of spurring publicly beneficial innovation in a cost-efficient way. Research suggests that small business, rather than large public corporations, are most likely to respond to certain investment incentives.³³ Research also suggests that young, fast-growing businesses have especially high innovation intensity and job growth.³⁴ If small, and especially start-up, firms are unable to access tax benefits intended to

³⁰ *Id.*

³¹ Office of Clean Energy Demonstrations, U.S. Department of Energy, [Regional Clean Hydrogen Hubs](#) (last visited June 2, 2023).

³² See generally Murphy & Hunt, *supra* note 16, at 631 (noting that “it has proven difficult to widely structure tax equity partnerships for smaller onshore wind and solar projects, which is likely a consequence of the high fixed transaction costs typically incurred in the establishment of partnership flips and inverted leases.”).

³³ Lily L. Batchelder, *Accounting for Behavioral Considerations in Business Tax Reform: The Case of Expensing* 36-37 (2017) (available at SSRN).

³⁴ Ryan Decker et al., *The Role of Entrepreneurship in US Job Creation and Economic Dynamism*, 28 J. Econ. Persp. 3, 13 (2014).

spur innovation, that could lock out businesses most likely to respond to the intended tax incentive and mean that a larger share of the tax benefit flows as a windfall to large corporations for activity they would have undertaken anyway. Furthermore, if large established businesses can access tax benefits intended for innovation that small and startup businesses cannot, this could create a competitive advantage for innovation done by already large, entrenched firms. And, if not well-designed, large profitable businesses may be able to leverage tax benefits intended for innovation to simply avoid taxes without undertaking *any* new economic activity, through complex and sometimes cross-border structures.³⁵ This may create incentives for large companies to invest not in real new innovative economic activity, but instead in using tax avoidance as a competitive strategy, to the disadvantage of small and startup businesses.

There are a host of other design decisions that are important for ensuring that any tax (or indeed spending) subsidies meet their intended goals of spurring innovation with public benefits. These include ensuring that subsidies target only the types of investment or activities most likely to deliver public benefits,³⁶ and creating guardrails and compliance measures to ensure that these tax benefits are not improperly used for tax avoidance or evasion.³⁷

It is also important to consider the suite of tax (and grant) benefits available for any particular business or activity. Complex layers of tax benefits might be more accessible for large corporations with access to sophisticated tax planners than smaller and startup businesses.³⁸ And it is the *total* tax subsidy delivered by the tax system – which rests on combinations of tax benefits – that ultimately matters for tax filers and their behavior, rather than any single subsidy in isolation. When taking into account many different tax benefits available to them, many small businesses face negative marginal tax rates on new investment (i.e. the tax system makes investments that are unprofitable before tax profitable after tax).³⁹

³⁵ For example, it is commonplace for a large controlled foreign corporation to achieve a lower rate of taxation by transferring IP rights to a CFC in a low-taxed jurisdiction, even where the IP right is derived from research and development funded with the benefit of a domestic U.S. tax credit. See Stephen Shay et al., *R&D Tax Incentives: Growth Panacea or Budget Trojan Horse?*, 69 Tax L. Rev. 419, 436-439 (2016). Additionally, while a U.S. taxpayer that has deductible research and development expenses and earns foreign income from overseas operations is required to allocate and apportion the R&D expense between foreign and U.S. income, the rules are so taxpayer-friendly and flexible that a taxpayer could significantly under-allocate R&D to foreign income to receive a more favorable tax outcome. *Id.* at 439.

³⁶ Guenther, *supra* note 10, at 22-24 (“According to critics, another concern about the current R&E credit is that it does not target research projects with relatively large social returns. . . . An increased business focus on applied research and development after 1980 has led some to argue that the R&E credit may subsidize mostly research projects with relatively small spillover benefits. The social returns to R&E-credit-subsidized R&D are not known. To the extent that they generally are not much larger or smaller than private returns, the credit may fall short of its primary economic justification: that it spurs increased investment in R&D with social returns much greater than private returns.”).

³⁷ See *supra* note 35 at 436-439.

³⁸ See, e.g., *id.* at 448 (“Large multinational businesses are able to use various tax planning strategies to take advantage of cross-border income shifting to increase their after-tax return” while “[s]mall- and medium-sized businesses and entrepreneurs generally will not have the same resources.”).

³⁹ William G. Gale, *On the President's Recommendations to the Joint Select Committee*, TaxVox blog, Urban Institute-Brookings Institution Tax Policy Center (September 19, 2011).

Whether the large federal subsidies represented by highly negative tax rates are sound policy depends on whether those subsidies do in fact spur new activity that has public benefits sizeable enough to justify their fiscal cost.

In some cases, combinations of subsidies may be most beneficial for large firms undertaking activity that has questionable public benefit. For instance, some lawmakers are proposing to reverse a series of revenue-raising provisions in the 2017 tax law. If this were to happen, certain businesses would be able to access a combination of tax breaks for various expenditures *plus* be able to fully deduct interest costs for any borrowing that financed those expenses. The result would be even more highly negative tax rates for leveraged expenses.⁴⁰ That particular combination of tax subsidies could be very valuable for large multinational corporations (because they can make large interest payments to foreign affiliates as a way to lower their taxes) as well as the private equity industry.⁴¹

Part 2: Reaching beyond businesses

The tax system's impact on innovation is far broader than specific tax credits or deductions for certain types of research expenses or innovative activity. The tax system also raises revenues to fund public research and investments, and makes investments in potential future innovators, entrepreneurs, and workers who are needed for a dynamic economy, such as through the Child Tax Credit.

In 2021, the federal government spent less than 3% of total outlays on research and development.⁴² Federal research and development can have large impacts on the economy, research finds.⁴³ Examples of key technological advancements that federal research and development spending supported range from the Google search engine to the first antiretroviral drug.⁴⁴ Some of the federal funding for innovation is specifically directed at small and startup businesses. For example, the Small Business Innovation Research and Small Business Technology Transfer programs provide competitive opportunities to fund a “diverse portfolio of startups and small businesses across technology areas and markets to stimulate technological innovation, meet Federal research and development needs, and increase commercialization to transition [research and development] into impact.”⁴⁵ Last year, program awards exceeded \$4.3 billion.

⁴⁰ William G. Gale & Claire Haldeman, Brookings Institution, *The Tax Cuts and Jobs Act: Searching for supply-side effects* 20 (2021).

⁴¹ Chuck Marr & Samantha Jacoby, Center on Budget and Policy Priorities, *Corporate Lobby's New Math Doesn't Add Up for Kids* 4 (2022).

⁴² In 2021, total outlays were \$6.8 trillion, and total federally funded research was estimated to be \$153.3 billion. See Gary Anderson et al., *U.S. R&D Increased by \$51 Billion in 2020 to \$717 Billion; Estimate for 2021 Indicates Further Increase to \$792 Billion*, National Center for Science and Engineering Statistics (January 4, 2023).

⁴³ See, e.g., Andrew J. Fieldhouse & Karel Mertens, *The Returns to Government R&D: Evidence from U.S. Appropriations Shocks* (Federal Reserve Bank of Dallas, Working Paper No. 2305, 2023); Peter L. Singer, The Information Technology and Innovation Foundation, *Federally Supported Innovations: 22 Examples of Major Technology Advances that Stem from Federal Research Support* 4 (2014).

⁴⁴ Singer, *supra* note 43, at 10-24.

⁴⁵ *Small Business Innovation Research (SBIR)* (last visited June 2, 2023).

Another key way that the tax system can support innovation is by supporting a broader pool of potential innovators, entrepreneurs, and workers needed for a dynamic and inclusive economy:⁴⁶

Income and wealth inequality are high in the U.S. relative to other countries and heavily skewed by race due to historic and current barriers to full economic opportunity for people of color. Children in low- and moderate-income families in the U.S. have lower rates of upward economic mobility than their counterparts in nearly all other rich countries.

Tax policy can help address these challenges by raising revenue for sound investments that together: (1) directly raise living standards for low- and moderate-income American workers and families; and (2) promote economic growth that is sustainable, increases mobility, and helps U.S. workers, researchers, innovators, and entrepreneurs realize their full potential.⁴⁷

Researchers have found that if “women, minorities, and children from low-income families were to invent at the same rate as white men from high-income families, there would be four times as many inventors in the United States as there are today.”⁴⁸ “Studies indicate that the reason for these ‘missing inventors’ is that children with equal talent and potential are growing up in households too poor and/or not connected enough to make use of those talents.”⁴⁹ Therefore, investments in children, such as through a strengthened Child Tax Credit available to children in the poorest families, permanently, are investments in innovation.

Part 3: The tradeoffs

As this testimony describes, there are a number of different ways to try to promote innovation that is intended to have social benefits. Some options take the form of direct tax incentives, and others are funded by tax revenues. Choosing from these different methods often involves tradeoffs, as they have to be weighed against each other and prioritized within fiscal and political constraints.

For example, one tradeoff that the Tax Cuts and Jobs Act made was to eliminate current-year deductibility of research and experimentation expenditures and software development costs in favor of amortization. The savings from this change were used to help fund a corporate rate cut on old, less innovative economic activity. That deal also prioritized making and financing deep permanent corporate rate cuts rather than choosing to permanently invest in a more robust Child Tax Credit that represents investment in future innovators, business owners, and workers.

The recent debt ceiling deal faced similar fiscal tradeoffs. But ironically, and apparently in a political tradeoff that overlooked those fiscal realities, the deal adopts tax measures that will *increase* deficits while *cutting* investment in innovation. Deficits can be addressed by raising tax

⁴⁶ This section draws heavily on the prior work of the Executive Director of the Tax Law Center. See Chye-Ching Huang, “Building Back Better: Raising Revenue to Invest in Shared Prosperity,” Prepared Testimony for the United States Joint Economic Committee (October 6, 2021).

⁴⁷ *Id.*, at 2.

⁴⁸ Raj Chetty et al., *Who Becomes an Inventor in America? The Importance of Exposure to Innovation*, 134 Q. J. Econ. 647, 710 (2019). See also Wesley Tharpe et al., Center on Budget and Policy Priorities, Tapping More People’s Capacity to Innovate Can Help States Thrive (2020).

⁴⁹ Huang, *supra* note 46, at n.11.

revenue. And two options for raising substantial tax revenue are to increase taxes, or to collect taxes that are due but not paid. But instead of taking either of these approaches, policymakers cut IRS funding, resulting in an **estimated net \$19 billion increase in federal deficits**⁵⁰ over the next decade, with the revenue loss representing fewer filers paying what they owe. Small businesses that simply want to accurately file their taxes stand to lose from cuts to IRS funding. More large and unscrupulous businesses will be able to gain an unfair competitive advantage by being able to cheat and avoid taxes. Fewer improvements in IRS service mean less help for small businesses owners who simply want clear instructions on filing for taxes and claiming the tax benefits intended to help them innovate and grow.

Additionally, under the debt ceiling deal, nondefense discretionary spending – including for programs supporting research and development – will be reduced in 2024.⁵¹ Spending on nondefense research and development increases long-term economic productivity, research finds, so cuts to spending on these programs will hurt the economy for years to come.⁵²

These tradeoffs matter, and are an important part of considering how best to promote innovation through the tax code.

⁵⁰ Congressional Budget Office, *Letter on Scoring IRS Recissions*, (June 1, 2020) The precise cost across the budget window will depend on when and how these cuts are implemented. Regardless, this estimate (assuming cuts spread across the budget window) shows that cuts to IRS funding will on net substantially increase deficits.

⁵¹ The largest portions of nondefense discretionary spending on research and development fund programs at the Department of Energy, the National Aeronautics and Space Administration, the National Institutes of Health, and the National Science Foundation. See Fieldhouse & Mertens, *supra* note 43, at 9. Other agencies, including the Department of Health and Human Services, also rely on nondefense discretionary funding to support their research and development programs. *Id.* at 2.

⁵² See *id.*, at 34-38.



**Biotechnology Innovation Organization
Statement for the Record
U.S. House Committee on Small Business
Subcommittee on Economic Growth, Tax, and Capital Access
"American Ingenuity: Promoting Innovation Through the Tax Code"
June 6, 2023**

The Biotechnology Innovation Organization (BIO) appreciates the opportunity to submit a statement for the record to the House Small Business Subcommittee on Economic Growth, Tax, and Capital Access hearing entitled "American Ingenuity: Promoting Innovation Through the Tax Code." Helping small biotechs attract and retain capital is a significant focus for BIO, and we have identified many ways Congress could bolster small biotech companies through Tax Code incentives and reforms.

BIO represents 1,000 members in a biotech ecosystem with a central mission: to advance public policy that supports a wide range of companies and academic research centers that are working to apply biology and technology in the energy, agriculture, manufacturing, and health sectors to improve the lives of people and the health of the planet. BIO is committed to speaking up for the millions of families around the globe who depend upon our success. We will drive a revolution that aims to cure patients, protect our climate, and nourish humanity.

Our recommendations are summarized here and further detailed below:

- 1) Restore the R&D deduction that was replaced by 5-year amortization in the 2017 Tax Cuts and Jobs Act;
- 2) Reform Section 382 [of the Internal Revenue Code], which can unintentionally limit a startup's use of its Net Operating Losses (NOLs) as a result of accepting investment;
- 3) Advance improvements to the payroll tax credit (such as extending the eligibility period);
- 4) Allow small biotechs to unlock a portion of their NOLs to provide an immediate infusion of much-needed capital during these challenging economic times;
- 5) Encourage investment in small biotechs through tax incentives such as expanding section 1202 (the investor capital gains exemption) and creating R&D partnerships;
- 6) Encourage Domestic Advanced Manufacturing and Pandemic Preparedness; and
- 7) Provide Incentives to Encourage the Development of Cleaner Energy Sources through Biotechnology.

Tax Policies to Promote Innovation in the Biotechnology Industry

1. Restore the R&D deduction that was replaced by 5-year amortization in the 2017 Tax Cuts and Jobs Act (TCJA)

The United States is a leader in biotech innovation due to significant investment in early-stage biotech companies. However, eliminating R&D expensing by the TCJA is a step backward that threatens US leadership. The current amortization regime, if maintained, could have long-term damaging effects on the economy and the biotech industry. Understanding the implications of R&D amortization on investment is crucial, particularly in lengthy, risky, and costly biotech projects.

The full scope of the damaging impacts of the provision on the smallest companies continues to reveal itself. For example, the current R&D amortization provision may impose significant tax burdens on recipients of Small Business Innovation Research/Small Business Technology Transfer (SBIR/STTR) grants. Recipients of SBIR/STTR and other government grants are generally very early-stage companies just transitioning their promising technology from an academic research institution to a company to start the development process. However, the switch to amortization has left many of these companies with a significant tax liability and left many more companies reconsidering whether even receiving the grants – which are intended to provide a critical lifeline at such an early stage of the company – is worth it.

These grants are often the first major investment the company has received, and virtually all of it is devoted to R&D expenditures. While these grants are considered taxable income to the recipient, immediate expensing previously allowed an immediate deduction that offset any tax liability. Now, however, many of these companies will face a large upfront tax bill, forcing them to divert critical funds from their research at an early make-or-break moment for the company's technology. In short, R&D amortization threatens to stifle innovative discoveries before they are even launched.

Small-to-medium companies may also feel the harmful impacts of the provision even though they don't yet have a product on the market. At this stage, small biotechs often depend on partnerships with larger companies to help fund their research. Payments received under these collaboration agreements may be treated as taxable income. These growing companies may also face a new tax liability without the ability to offset this income with the R&D deduction.

Accordingly, BIO urges immediate action to restore the R&D deduction. The current R&D amortization provision worsens the funding difficulties small biotech companies face in an already challenging investment environment. Urgent action is needed to reverse the R&D amortization provision and safeguard the future of R&D companies and the development of life-saving treatments and cures.

2. Reform Section 382, which can unintentionally limit a startup's use of its Net Operating Losses (NOLs) as a result of accepting investment

Tax rules relating to the treatment of losses can unintentionally punish start-ups for investing in the growth of their companies. The rules, in Section 382 of the tax code, were written in the mid-

1980s with the intent of preventing loss trafficking, or the strategy of companies acquiring failing firms with enormous losses on their books for the sole purpose of using the tax losses to offset other unrelated income.

While we recognize the importance of preventing abusive loss trafficking, the excessive application of these rules has created an impediment for start-ups that depend on investment capital and often accumulate net operating losses (NOLs) due to substantial R&D expenditures and rapid hiring.

Under Section 382, accepting these critical equity investments can limit a start-up's ability to utilize its NOLs in the future by causing a so-called "ownership change." Thus, Section 382 discourages investment in innovation and works at cross purposes with tax policy that generally seeks to encourage R&D, such as the R&D credit.

BIO strongly supports the "American Innovation Act" which would preserve the NOLs of small companies while in their start-up stage.

3. Advance improvements to the payroll tax credit (such as extending the eligibility period)

Under current law, companies with less than \$5 million in annual gross receipts in their first five years of operation can utilize up to \$500,000 in R&D credits annually toward their payroll taxes. The original law, passed in the Protecting Americans from Tax Hikes (PATH) Act in 2015, allowed for a \$250,000 credit. The increase to \$500,000 under the Inflation Reduction Act (IRA) served as an acknowledgement from Congress of the incredible potential of this credit in supporting high-tech small businesses.

Unfortunately, the current size restrictions leave many start-ups unable to access the benefits of the payroll R&D credit. A typical biotech start-up will still be relatively early in the development process – and years away from realizing revenue from a product on the market – when the five-year and \$5 million gross receipts limits kick in to deny them the benefit from the payroll R&D credit.

BIO supports the "Furthering Our Recovery With American Research and Development (FORWARD) Act" which would allow a broader range of companies to utilize this critical capital conserving tool. The FORWARD Act would expand eligibility for the credit to companies less than 8 years old with up to \$20 million in gross receipts and increase the credit amount to \$1 million. Finally, a new de minimis threshold would delay the start of the 8-year window until gross receipts exceed \$25,000, meaning that small amounts of gross receipts, like interest on a savings account, would not trigger the 8-year period.

4. Allow small biotechs to unlock a portion of their Net Operating Losses to provide an immediate infusion of much-needed capital during these challenging economic times.

NOLs can represent substantial tax benefits typically realized over an extended period as tax credits or deductions against future profits. However, for young and emerging biotech firms, waiting for these benefits to materialize can significantly hinder their operations. Allowing biotechs to receive the value of a portion of their NOLs upfront will provide a critical cash

infusion, enabling them to invest in R&D, advance cutting-edge technologies, and hire skilled scientists. This influx of capital would help accelerate biotech development timelines and enhance their ability to bring innovative therapies and solutions to patients sooner.

Furthermore, by enabling biotech firms to monetize their NOLs, biotechs would enhance their financial attractiveness to potential investors. Biotech companies that had converted NOLs could demonstrate a more robust financial position and increase their liquidity, which would reduce the financial uncertainty for investors.

Congress should take steps to encourage risk-taking and innovation within the biotech industry. Biotech companies often face high failure rates during the R&D process, as developing new therapies and technologies can be inherently unpredictable and costly. By allowing these companies to monetize their NOLs upfront, the policy mitigates some of the financial risks associated with early-stage R&D activities. It provides a safety net that incentivizes companies to undertake more ambitious projects, explore novel approaches, and tackle complex medical challenges.

BIO supports the “IGNITE American Innovation Act” which would allow companies to access up to \$25 million in NOL carryforwards.

5. Encourage investment in small biotechs through tax incentives such as expanding Section 1202 (the investor capital gains exemption) and creating R&D partnerships

As investment in the biotech industry is high-risk and long-term, the economics must work for people to invest in start-ups and early-stage innovators. Without a tax structure that encourages this activity, our innovators and entrepreneurs will be disadvantaged at a time when the rest of the world is doing everything possible to compete with our leadership.

Congress recognized this when it made permanent the 100% exemption of gains on investments in Qualified Small Business Stock (QSBS) in the PATH Act of 2015. We believe Section 1202 has the potential to be one of the most powerful federal policies for encouraging an expansion of entrepreneurship across the country, and that Congress should build on this success by simplifying and expanding QSBS so it can encourage more investment in start-ups across the country.

Congress should raise the maximum gross assets threshold for Qualified Small Businesses (QSBs). The existing gross assets test in Section 1202 limits the universe of QSBs to companies with gross assets below \$50 million. The high costs of innovative research, valuable intellectual property and successive rounds of financing, often push growing innovators over the \$50 million gross assets limit and thus out of the QSBs definition. Raising the gross assets threshold to \$100 million, and indexing the threshold to inflation, would drive investment to capital-intensive small businesses conducting groundbreaking research and creating high-quality jobs across the country.

Before the 1986 Tax Reform Act, innovative R&D was often conducted through so-called “R&D Limited Partnerships,” in which individual investors financed R&D projects through entities that were taxed as pass-throughs. These individual investors could then offset other income with the losses and tax credits generated by the R&D project. However, enacting the passive activity

loss (PAL) rules under Section 469 of the tax code significantly restricted the ability of losses and credits to flow from project to investor.

Relaxing the PAL limitations for R&D-focused pass-through entities would allow small biotechs to enter into a joint venture with an R&D project's investors via R&D Partnership Structures. The losses and credits generated by the research would then flow through to the company and investors, who would be able to use the tax assets to offset other income. Relaxing the PAL rules to allow investors to enjoy a more immediate return on their investment, despite the long and risky timeline usually associated with groundbreaking research, would incentivize them to invest at an earlier stage, when the capital is most needed, thus stimulating capital formation for growing innovative businesses and speeding the development of groundbreaking technologies.

BIO supports "the Infectious Disease Therapies Research and Innovation Act" which would allow R&D Partnership Structures for investments in specified medical research small business pass-through entities. We believe a broader application of this legislation to support the widespread applications of the biotechnology industry would unlock significant investment in the industry and hasten the timeline to bring exciting advancements to market.

6. Encourage Domestic Advanced Manufacturing and Pandemic Preparedness

Domestic advanced manufacturing is a critical part of bolstering the global supply chain. A robust advanced manufacturing sector ensures better domestic oversight of quality control, flexibility in responding to changes in demand, and more technologically advanced facilities at potentially lower costs. New advanced manufacturing technologies can speed up the entry of new treatments to market and improve production processes, leading to less waste and environmental impacts.

It is also a high-growth, high-wage sector that provides jobs of all levels across the country. The biotech industry operates over 1,000 plants in the production of human-use medicines across 45 states and Puerto Rico, paying wages on average more than \$117,000. Incentives to grow and maintain the domestic advanced manufacturing sector, such as tax credits, workforce development initiatives and physical infrastructure improvements, can help bolster the advanced manufacturing sector and support small high-tech businesses.

BIO supports tax credits for investment in advanced manufacturing equipment and a reduced tax rate on income from domestic production of specific medical products.

Also, BIO supports several bills which aim to spur investment in and development of medical countermeasures to protect Americans from future threats. These include:

- **The "American Made Medicine Act" which aims to lower the tax rate on domestic manufacturing and sales of active pharmaceutical ingredients and medical countermeasures and implemented an advanced medical manufacturing equipment credit of 30% over 10 years for investments in advanced manufacturing equipment or machinery used in the US to manufacture drugs, medical devices, and biological products;**

- The “Start-up for Cures Act” would allow start-ups with less than \$1 million in gross receipts engaged in research toward medical countermeasures to monetize unused tax credit; and
- The “More Cures Act” which would provide startups with an enhanced credit of 14% for qualified research expenses toward medical countermeasures.

Finally, BIO supports grants and credits for hiring, training, or retraining employees to adapt to the advanced manufacturing sector, and incentives such as creating a targeted biopharma manufacturing group eligible for the Work Opportunity Tax Credit would help offset the high cost of the highly-educated and well-trained workforce.

7. Provide Clean Energy Incentives to Encourage the Development of Cleaner Energy Sources through Biotechnology

BIO estimates that more than 1.66 million U.S. workers -- in biofuels, renewable chemicals and polymers, industrial biotechnology and agriculture -- contribute \$205 billion to the U.S. economy. Since these direct jobs create additional employment and economic opportunities, the U.S. biobased economy has an overall impact of \$505 billion and 4.63 million well-paying jobs. The United States generates 58 percent of the direct value in the \$355 billion global biobased economy. To retain a competitive edge, the United States must support continued investment in fields such as but not limited to sustainable aviation fuels, biofuels, and advanced energy projects. Availability of tax incentives is critical as our companies make significant investments to create new agricultural supply chains, build infrastructure, and develop innovative technologies. The biobased economy is reaching a tipping point. Federal policy must adapt to keep pace. As the U.S. looks to address the climate crisis, the biotechnology industry will play a key role. With that, BIO continues to support tax incentives such as:

- **Extension of Second-Generation Biofuel Tax Credit (Section 13202/26 USC 40).**
- **Sustainable Aviation Fuel Credit (Section 13203/26 USC 40B).** Provides a tax credit for the sale or use of that achieves a lifecycle greenhouse gas emissions reduction of at least 50% compared to petroleum-based jet fuel.
- **Clean Fuel Production Credit (Section 13704/26 USC 45Z).** Provides a production tax credit for domestic production of clean transportation fuels, including sustainable aviation fuels.
- **Advanced Energy Project Credit (Section 13501/26 USC 48C).** Provides a tax credit for investments in advanced energy projects. Eligible recipients include:
 - A project that: (1) re-equips, expands, or establishes an industrial or manufacturing facility for the production or recycling of a range of clean energy equipment and vehicles;
 - (2) re-equips an industrial or manufacturing facility with equipment designed to reduce greenhouse gas emissions by at least 20 percent; or
 - (3) re-equips, expands, or establishes an industrial facility for the processing, refining, or recycling critical materials.

BIO also supports additional tax incentives that would further support the development of clean energy alternatives, including:

- **Biodiesel and Renewable Diesel blenders credits**
- **Extension of the begin construction date for section 45Q,**
- **Direct pay option for 45Q credits.**
- **Investment credit for Alternative Fuel Refueling Infrastructure**

BIO urges long-term extensions or permanent provisions for clean energy through biotechnology.

Conclusion

We thank the Subcommittee for this opportunity to offer BIO's views on tax policies to support innovation within the biotech industry. We look forward to working with Congress on these important issues and stand ready to support in any way we can.



June 6, 2023

The Honorable Dan Meuser
United States House of Representatives
Chairman, Committee on Small Business
Subcommittee on Economic Growth, Tax, and
Capital Access
2361 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Greg Landsman
United States House of Representatives
Ranking Member, Committee on Small Business
Subcommittee on Economic Growth, Tax, and
Capital Access
2069 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Meuser and Ranking Member Landsman:

Competitive Carriers Association (CCA)¹ respectfully submits this letter for the record for today's hearing titled "American Ingenuity: Promoting Innovation Through the Tax Code." CCA applauds the Subcommittee for holding this important hearing focusing on the impacts that changes to the tax code, including research and development expensing and bonus depreciation, have on small businesses. CCA represents competitive wireless carriers that strive to innovate and lead the world in developing and providing communications technologies and services. Indeed, competitive wireless carriers serving rural, unserved, and underserved Americans are key contributors to a strong wireless ecosystem, and tax laws have real world effects on these carriers, including the ability to innovate and invest in next generation network technologies and services.

Allowing wireless carriers to receive tax deductible treatment for research and development costs as incurred, as well as to maximize bonus depreciation incentives on their investments, facilitates innovation. Further, many wireless carriers borrow funds to finance long-term investments in mobile telecommunications equipment and services, which in turn deliver 4G and 5G wireless connectivity. These advanced technologies are key to innovation and economic development. Tax code changes related to business interest deductibility negatively impact smaller carriers and carriers serving rural markets not only in terms of immediate costs, but also in the ability to finance important investments in their networks and to purchase the necessary components for next-generation technologies. For CCA members, network investments expand connectivity in the communities they serve. Alleviating tax burdens on competitive carriers results in further investment in innovation and connectivity as work continues to bridge the digital divide.

¹CCA is the nation's leading association for competitive wireless providers and stakeholders across the United States. Members range from small, rural carriers serving fewer than 5,000 customers to regional and national providers serving millions of customers, as well as vendors and suppliers that provide products and services throughout the wireless communications ecosystem.

COMPETITIVE CARRIERS ASSOCIATION
601 New Jersey Ave. NW, Suite 820 | Washington, DC 20001 | ccamobile.org

CCA thanks you for your leadership and stands ready to work with you on these and other important issues.

Sincerely,

A handwritten signature in black ink, appearing to read "Tim Donovan", with a long horizontal stroke extending to the right.

Tim Donovan
President and CEO

cc:

The Honorable Roger Williams, Chairman, Committee on Small Business

The Honorable Nydia Velázquez, Ranking Member, Committee on Small Business

June 6, 2023

Chairman Jason Smith
House Committee on Ways and Means

Ranking Member Richard Neal
House Committee on Ways and Means

Chairman Ron Wyden
Senate Committee on Finance

Ranking Member Mike Crapo
Senate Committee on Finance

Chairman Roger Williams
House Committee on Small Business

Ranking Member Nydia Velázquez
House Committee on Small Business

Chairman Ben Cardin
Senate Committee on Small Business and
Entrepreneurship

Ranking Member Joni Ernst
Senate Committee on Small Business and
Entrepreneurship

Dear Chairmen Smith, Wyden, Williams, and Cardin and Ranking Members Neal, Crapo, Velázquez, and Ernst,

We represent founders, innovators, and support organizations throughout the U.S.' vibrant startup ecosystem. While our companies reflect diverse industries, we have in common a commitment to undertaking research and development activities in support of our startups and the broader innovation economy. As such, we write to you to encourage you to take action to mitigate the effects of Research and Experimentation (R&E) capitalization and amortization as mandated by the 2017 Tax Cuts and Jobs Act on the startup ecosystem by implementing a return to immediate expensing.

Our nation's startups are scrappy companies, often operating on lean budgets with minimal staff, particularly in their initial stages. Even for startups that have reached seed stage, they typically have limited capital—roughly \$55,000 a month—to operate.¹ These limited funds must cover a lot—from office space, to salaries, to insurance, to research and development, and more. Research, development, and experimentation costs can quickly eat away at a growing startup's budget, but immediate expensing for R&E expenditures helps to offset these costs, allowing startups to propel the U.S. as a leader in global innovation.

Unfortunately, the ability of a startup to invest heavily in research, development, and experimentation is at risk. This work is expensive, and immediate expensing allowed many startups to offset the cost, particularly as startups may have high research, development, and experimentation costs relative to the size of their companies. But under the newly implemented section 174 capitalization, startups will no longer be able to immediately expense qualifying costs and will instead be forced to amortize the costs over five years (15 years for international expenses), causing a significant hit to startups' cash flow. For startups that continue to engage in R&D, they will be forced to dedicate more of their limited funds to tax payments, eschewing

¹ Engine, *The State of the Startup Ecosystem*, <https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/60819983b7f8be1a2a99972d/1619106194054/The+State+of+the+Startup+Ecosystem.pdf>.

other critical areas for startup success, like hiring. For many startups, research, development, and experimentation will simply become unaffordable, requiring founders to limit expenditures in order to pay operating costs like rent, legal services, and salaries. The end result is slowed innovation and stunted startup growth.

Many industries, like software development, have already seen a hit from the change. As it stands, the U.S. remains now one of the only countries without immediate expensing for R&E expenditures.² As tax season rolled around, many companies expected Congress to have already implemented a return to immediate expensing, as policymakers had indicated they supported a fix. Instead, these companies were met with significant tax bills and uncertainty as to whether or not they will be able to survive the year.³ And for startups that are generating revenue but are pouring that revenue back into research, development, and experimentation, the shift to amortization could be catastrophic,⁴ especially as not all expenses falling under section 174 are clearly eligible for the R&D tax credit.⁵

While many believe only large companies avail themselves of tax benefits that support research, development, and experimentation, many small companies throughout the U.S. startup ecosystem rely on these provisions. Policymakers in both chambers, from both sides of the aisle support a fix. The startup community does not have the time to wait for a fix. We urge your committees to act quickly to investigate this issue and advance a legislative solution that includes a return to immediate expensing, to ensure the startup ecosystem can continue to innovate and prosper, supported by research and development efforts.

Sincerely,

² Vanessa Cruze, *Unprofitable Startups May Owe 2022 Taxes* (Nov. 18, 2022), <https://www.cpapracticeadvisor.com/2022/11/18/unprofitable-startups-may-owe-2022-taxes/73373/>.

³ Eric Rosenbaum, *Software Firms Across U.S. Facing Massive Tax Bills that Threaten Tech Startup World Survival* (April 18, 2023), <https://www.cnbc.com/2023/04/18/software-firms-face-huge-tax-bills-that-threaten-tech-startup-survival.html>.

⁴ Cruze, *supra* note 2.

⁵ Josh Zagorsky, *How the New 174 Capitalization Rules Punish Innovation* (April 21, 2023) <https://blog.taxcredit.ai/en/blog/section-174-capitalization-changes-punish-innovation>.

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Oppti Westminster, CA	SmolTech LLC Rochdale, MA	Via New York, NY
People Clerk Miami, FL	Social Impact Capital New York, NY	Voatz Boston, MA
PILOT Inc. New York, NY	Tampa Bay Wave Tampa, FL	VODIUM Nashville, TN
Planship Seattle, WA	The Alliance for Longevity Initiatives Arlington, VA	Wearable Tech Ventures Baltimore, MD
PolyGone Systems, Inc Princeton, NJ		Zagaran, Inc. Boston, MA
Privacy Vaults Online, Inc. Dumfries, VA	TheraTec, Inc Horace, ND	Zylinium Research LLC Atlanta, GA

cc: Members of the House Ways and Means Committee, Senate Finance Committee, House Small Business Committee, and Senate Committee on Small Business and Entrepreneurship



Chris Netram

*Managing Vice President,
Tax and Domestic Economic Policy*

June 6, 2023

The Honorable Dan Meuser
Chairman
Committee on Small Business
Subcommittee on Economic Growth,
Tax, and Capital Access
U.S. House of Representatives
Washington, DC 20515

The Honorable Greg Landsman
Ranking Member
Committee on Small Business
Subcommittee on Economic Growth,
Tax, and Capital Access
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Meuser and Ranking Member Landsman,

The National Association of Manufacturers appreciates the opportunity to submit a statement for the record as part of the subcommittee's hearing on "American Ingenuity: Promoting Innovation Through the Tax Code."

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 businesses are the heart of the manufacturing industry in America. Located in every small town and big city, small manufacturers serve as critical suppliers to larger manufacturers, create jobs, uplift their communities and drive 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 competitive, pro-growth tax code is critical to ensuring their future success.

Unfortunately, several harmful tax changes have gone into effect recently that make it more costly to perform research, buy machinery and finance capital investments. If not reversed, these policies will hurt manufacturers' ability to innovate, 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.

These changes will fall hardest on the small and medium-sized manufacturers who are the backbone of our economy. These tax changes will also stall some of the momentum our industry gained after the passage of the Tax Cuts and Jobs Act in 2017, which 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 innovation and capital equipment and estate tax relief. Following the passage of 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 since Feb. 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

The NAM respectfully urges members of this subcommittee to support a competitive manufacturing economy 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. This change has been particularly harmful for small businesses, which account for about 15% of all private-sector R&D investments.⁴

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

¹ Diamond, John W. and George R. Zodrow. *Dynamic Estimates of the Macroeconomic Effects of Tax Rate Increases and Other Tax Policy Changes* (Apr. 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 National Center for Science and Engineering Statistics, National Science Foundation, *InfoBrief*, NSF 22-343, Oct. 4, 2022, <https://ncses.nsf.gov/pubs/nsf22343>.

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.⁵ For small manufacturers the impact is especially onerous because the tax change took effect in 2021, creating unexpectedly higher tax bills during the 2023 filing season and significantly reducing the amount of capital available to reinvest into these businesses.

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, currently 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.⁶

For these reasons, the NAM strongly encourages members of the subcommittee 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.

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 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) of the tax code 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, as investments in long-lived assets like machinery and innovation produce depreciation and amortization. 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 American manufacturers. 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.⁷ These job losses will be felt across the

⁵ *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/>.

⁶ OECD, Tax Incentives for R&D and Innovation, <https://stip.oecd.org/innotax/>.

⁷ *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.

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 directly affected.

The NAM encourages members of the subcommittee to support job-creating manufacturing investments here in the U.S. by acting expeditiously to pass H.R. 2788, the American Investment in Manufacturing 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.

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 decreases the company's tax bill in the year of purchase and frees up cash for that purchase. For a capital-intensive industry 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.⁸ 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. This, too, will make it more difficult to strengthen domestic supply chains and reduce our dependence on overseas expectations.

The NAM encourages members of the subcommittee to support job-creating manufacturing investments here in the U.S. by supporting passage of H.R. 2406, the Accelerate Long-Term Investment Growth Now (ALIGN) Act, legislation introduced by Rep. Jodey Arrington (R-TX) that 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 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 businesses that are organized as pass-through entities.

The NAM strongly urges members of the subcommittee 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.

⁸ *Tax Incentives for Domestic Manufacturing*, Joint Committee on Taxation (March 12, 2021). Available at <https://www.jct.gov/publications/2021/jcx-15-21/>.

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.

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 subcommittee 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 subcommittee 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.⁹

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. The NAM urges members of the subcommittee to support competitive tax policies that build on these advances, which will help manufacturers continue to thrive in the United States and effectively compete in a global economy.

Sincerely,



Chris Netram
Managing Vice President, Tax and Domestic Economic Policy
National Association of Manufacturers

⁹ *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>.



Statement for the Record by:

Karen Kerrigan, President & CEO

On Behalf of the Small Business & Entrepreneurship Council

"American Ingenuity: Promoting Innovation Through the Tax Code"

June 6, 2023

Small Business Committee

Subcommittee on Economic Growth, Tax, and Capital Access

U.S. House of Representatives

The Honorable Dan Meuser, Chairman

The Honorable Greg Landsman, Ranking Member

On behalf of the Small Business & Entrepreneurship Council (SBE Council), thank you hosting this important hearing and for the opportunity to submit a statement for the record. There is a long list of policy measures that Congress can and must consider to promote U.S. innovation and we are particularly pleased that the subcommittee is exploring how the tax code can encourage investment, which is the fuel for innovation and a vibrant competitive economy.

SBE Council has long supported tax measures and tax reforms that promote capital formation and investment. Our organization strongly supports 100% bonus depreciation, as it is a critical measure for encouraging investment, innovation and keeping the U.S. economy and our businesses competitive. This statement will focus on immediate expensing for qualified R&D expenditures, and our organization's support for restoring, enhancing and making permanent this important measure. SBE Council supports the bipartisan "American Innovation and Jobs Act" **introduced by Senators Maggie Hassan (D-NH) and Todd Young (R-IN)** in the U.S. Senate, and the bipartisan "American Innovation and R&D Competitiveness Act" **introduced by Representatives Ron Estes (R-KS) and John Larson (D-CT)** in the U.S. House.

As background, SBE Council is an advocacy, research and education organization dedicated to promoting entrepreneurship and protecting small businesses. For nearly 30 years, SBE Council has worked to advance a wide range of policy and private sector initiatives to improve the ecosystem for strong startup activity and small business growth. Our network of more than 100,000 member supporters, including entrepreneurs and small business owners, state and local business organizations, corporate partners and associations work with us to strengthen the environment for entrepreneurship, investment, innovation and job creation. Since our founding in 1994, SBE Council has helped to strengthen the ecosystem for small business and entrepreneurial success not only in the U.S., but across the globe.

Tax Certainty is Critical During This Period of Time

Inflation and economic uncertainty continue to bear down on small business America. On top of high prices, small firms are enduring labor shortages and higher labor costs, a more difficult time accessing capital, and an economy that remains challenging. That is why Congress must identify practical solutions to help entrepreneurs through this uncertain economic period, and beyond.

Small business owners and their employees across industries have had to continuously innovate in order to survive and thrive over the last several years. While the COVID economy imposed significant burdens and restrictions on small businesses, digital tools and changing consumer needs provided opportunities for innovation and new risk-taking. Many entrepreneurs and new startups tapped into immediate R&D expensing to support innovative investments and business growth.

For several decades, American businesses of all sizes have expensed R&D investments in the same year they occurred. This tax measure has helped to fuel hundreds of billions of dollars in R&D investments each year, and by extension has powered U.S. innovative leadership in the global marketplace. The tax credit's value to U.S. economic and technological leadership alone should move Congress to not only restore the credit but improve it so that more startups and new firms can effectively utilize it.

The immediate expensing of R&D investments has remained a long-term policy priority – through Democratic and Republican administrations alike – and right now is an ideal time to restore this effective policy. The stakes are quite high for this expensing measure.

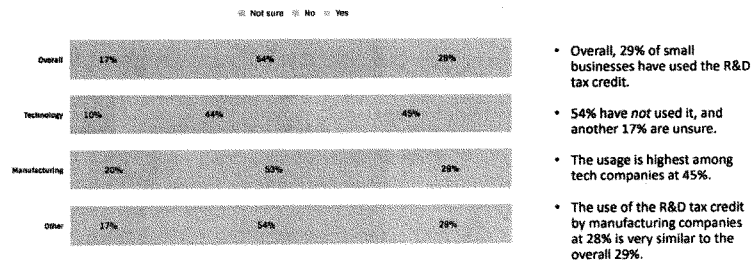
Failing to restore immediate R&D expensing would put all American businesses – but especially small businesses – at a competitive disadvantage. If not restored, the change in R&D tax credits would require companies to amortize their R&D expenses over five years. That extended timeline significantly limits businesses’ ability to develop new products, from medical devices to everyday consumer products. For smaller firms operating on thin margins and in a competitive and challenging environment, the inability to expense R&D costs for a given year means they cannot recover those costs in the same year. This makes it even more difficult for small businesses to effectively compete, invest, and take on bigger risks. Moreover, many small businesses are now looking at an expensive tax bill that threatens the competitiveness and innovative capacity of their firms, and the survival for a surprising number of firms.

Costly Impact for Small Businesses

In a new SBE Council/TechnoMetrica survey that will be released on June 6 – “Emerging Technology, Innovation and Small Business” – we specifically explore the small business impact of not restoring immediate R&D expensing. The results reveal harm and damage for our economy, local economies, investment, employees, and to the small businesses who have utilized this tax incentive.

The survey reveals that 29% of the small businesses we surveyed used immediate R&D expensing, and that 72% of those business owners who reported they used it knew that the write off was no longer available. So, for 28% of small business owners who used this tax incentive but were unaware that it is was no longer available, this was shocking news to a fair number of the entrepreneurs we surveyed.

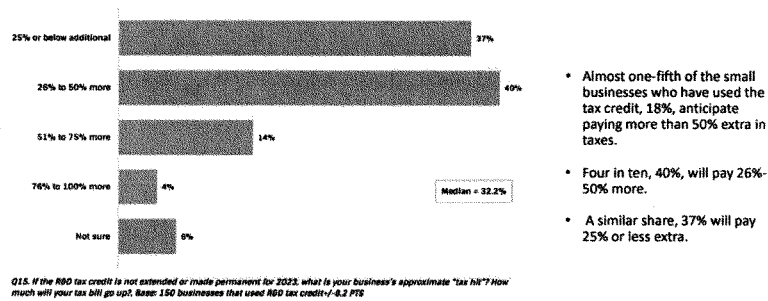
R&D Tax Credit Is Used By One In Four Small Businesses, With Over Half Of All Small Technology Companies Taking Advantage Of It.



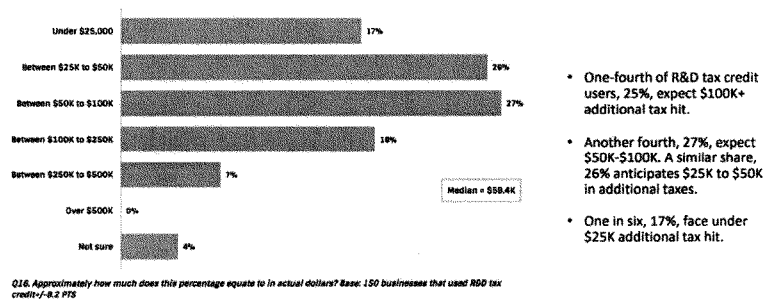
Q12: Many small businesses use the Research and Development (R&D) tax credit that allows for immediate expensing of research and development costs in the year these costs are incurred. Has your small business used this tax credit?
+/-4.7 PTS

In terms of financial impact, the small business owners we surveyed reported that the new (and unexpected for some) tax burden would be significant (see following two graphs). The median "tax hit" for small businesses is a 32% increase in their tax bill. The median dollar estimate is \$59,000. For some firms, the burden is much higher.

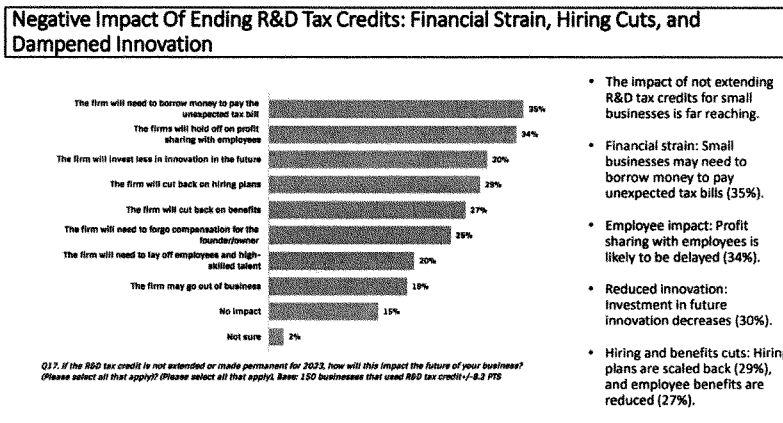
The Median Additional "Tax Hit" Is 32% If The R&D Tax Credit Is Not Renewed



The Median Additional Tax Hit Small Businesses Face Is \$59K



The negative effects of ending immediate R&D expensing extends beyond the financial strain on businesses. Indeed, 35% of small business owners report they will need to borrow money to pay the new tax bill, and 19% report that their firm *may go out of business*. Other impacts include: holding off profit sharing for employees, decreased investment in future innovations, scaled-back hiring plans, reduced employee benefits, laying off employees, and forgoing compensation for the owners or founder.



SBE Council Survey: Emerging Technology, Innovation and Small Business

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Not surprisingly, small business owners that have utilized immediate R&D expensing overwhelmingly support bipartisan legislation to restore and make it permanent. Approximately 86% of small enterprises support a bill that aims to make immediate expensing of R&D costs a permanent provision, with additional enhancements for small businesses. Only 6% oppose this legislation, while 8% remain unsure.

As an important sidenote, I would like to add that the firms we surveyed are true small businesses. Of the 461 small businesses surveyed, only 11% are firms with between 51-100 employees. The remainder have 50 employees and fewer. The median number of employees on the payroll of small businesses surveyed was 11.5, and 36% have between 2 and 5 employees. These are the small businesses that drive innovation and local economies. Therefore, a new “tax hit” on the magnitude of between \$25,000-\$50,000 or more is very significant. It is likely why we see that 19% of the business owners we surveyed report that they may need to close the business due to this new financial burden. We anticipate that many of these businesses will also have a more difficult time accessing the loans that are needed to pay these new tax bills.

Challenging economic forecasts on top of the enduring pain points that have kept small businesses reeling for several years demand a policy response that will promote investment, certainty, and relief. Measures that stand behind and support the innovative practices and

investments of American small businesses are especially important now - for boosting the economy, moving to full recovery, and reaffirming America's role as an innovation powerhouse.

Small business owners and their employees need our elected leaders to come together on key issues such as this one. Immediate R&D expensing must be restored, made permanent, and hopefully enhanced without delay. Please let SBE Council how we can help the committee in advancing this important issue, or answering any questions you may have.

Thank you for your consideration in submitting this statement into the official record of this important hearing.

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Protecting Small Business, Promoting Entrepreneurship

