Bipartisanship on display as Finance Committee explores tax issues facing US manufacturers

On issues ranging from the deductibility of research expenditures to tax incentives for the US semiconductor industry, Democrats and Republicans on the Senate Finance Committee found areas of agreement during a March 16 hearing focused on the effects of the federal tax code on domestic manufacturers.

Protecting US supply chains

At a high level, all Finance Committee members agreed on the need to better protect US manufacturing supply chains from disruption, an issue that has been brought into sharp relief by the coronavirus pandemic.

"When COVID-19 exploded, factories around the globe shut down and supply chains were cut," Chairman Ron Wyden, D-Ore., said in his opening statement.

While those disruptions were most visible with respect to health care-related personal protective equipment (PPE) and related items, Wyden noted that "over the last year there have been concerns about the supply of batteries, medications, and minerals used in electronics."

CHIPS Act: That sentiment was echoed by several committee members, most notably Sens. Mark Warner, D-Va., and John Cornyn, R-Texas, who last year introduced the Creating Helpful Incentives to Produce Semiconductors for America Act (or CHIPS Act), which proposed a 40 percent refundable investment tax credit for investments in qualified semiconductor equipment and manufacturing facilities through 2024 (with a phase-down over two years thereafter), as well as a $10 billion federal matching program for state and local incentives designed to encourage construction of advanced semiconductor manufacturing facilities.
URL: https://www.congress.gov/bill/116th-congress/senate-bill/3933/text?q=%7B%22search%22%3A%5B%22%5C%22Creating+Helpful+Incentives+to+Produce+Semiconductors+for+America+Act%5C%22%22%5D%7D&r=1&s=1

"…[A]s we think about areas where America needs to lead, the semiconductor industry is a clear example of that," Warner said.

"If there's one thing the virus has taught us, it's about the vulnerability of our supply chains, starting with PPE, but it doesn't end with PPE," Cornyn added later in the hearing. "…[O]bviously semiconductors – China's building 17 foundries as we are thinking about building one. …"

Pending changes to R&E, business interest deductibility

Another major focus of the hearing related to a pair of revenue-raising provisions set to take effect in 2022 pursuant to the 2017's Tax Cuts and Jobs Act (TCJA, P.L. 115-97) that several members argued would disproportionately impact US manufacturers.

Research expenditures: The first pending change, which would generally require research and experimentation (R&E) expenditures under tax code section 174 to be amortized over five years (15 years in the case of foreign R&E) rather than deducted currently, came in for heavy criticism from taxwriters on both sides of the aisle.

For his part, Chairman Wyden noted that he would support addressing the 2022 R&E cliff as part of a broader plan that provided long-term certainty to taxpayers.

"…[I]t's also going to be important to look at changes to the [TCJA], which in fact created a disincentive for [R&E]," Wyden said. "Fixing that issue and creating strong and reliable long-term incentives is going to be key. Because the US will not out-compete China and other countries with short-term legislation and never-ending uncertainty."

Among the other committee members expressing support for preserving the current deductibility treatment of research expenditures were Democratic Sens. Maggie Hassan of New Hampshire and Catherine Cortez-Masto of Nevada and GOP Sens. Todd Young of Indiana and Rob Portman of Ohio, who on March 15 reintroduced the American Innovation and Jobs Act – legislation that would repeal the pending change to section 174 (for both domestic and foreign research), and also separately expand the R&E credit against payroll taxes for certain start-up businesses.
URL:
https://www.hassan.senate.gov/imo/media/doc/2021%20American%20Innovation%20and%20Jobs%20Act%20(MCG21349).pdf

The bipartisan bill received broad support from the hearing's witnesses as well, including from George Davis, executive vice president and CFO at Intel Corporation.

"If we don't go back to [R&E] deductibility, we will be completely out-of-step from a competitiveness standpoint with the rest of the world," Davis said during an exchange with Sen. Young.

Business interest expense deduction: The second TCJA-related cliff occurring next year – a taxpayer-unfavorable change to the 30 percent limitation on adjusted taxable income (ATI) under section 163(j) – also came under fire, particularly from Republicans. Under the TCJA, the limitation is determined based on the earnings before interest, taxes, depreciation, and amortization (EBITDA) standard through 2021, with the more restrictive earnings before interest and taxes (EBIT) standard scheduled to take effect in 2022.

Some observed that manufacturers, which generally are very capital intensive and potentially reliant on debt financing, could be particularly affected by the pending change.

"…[A]t the end of the year, depreciation and amortization will be removed [from the ATI threshold], further limiting the deduction," said Sen. Portman. "…[I]t's interesting because right now a lot of these companies have taken on debt, so it makes it even more difficult to recover from the pandemic."

Several Republican taxwriters also expressed concern that any legislative action to stave off or repeal one or both of these TCJA-related changes set to occur in 2022 would be muted by a concurrent rise in the corporate rate – a policy broadly supported by congressional Democrats and President Biden.

"…[W]e should not look at offsetting the needed stability…in the [R&E] and investment tax credit arena with a corporate tax rate increase," said Finance Committee ranking member Mike Crapo, R-Idaho.

As a general matter, that particular sentiment among the committee's Republicans also extended to the scheduled phase-out beginning in 2023 of the policy that allows for full bonus depreciation of certain capital assets, as well as to the expiration of the deduction under section 199A for the qualified business income of certain passthrough entities, which is scheduled to expire beginning in 2026. GOP taxwriters contended that the expiration of the section 199A deduction would affect smaller manufacturers, many of which are organized as passthroughs.

"One part of the Tax Cuts and Jobs Act I'm particularly proud of is that 20 percent deduction for passthrough businesses," said Sen. Steve Daines, R-Mont., who recently introduced legislation with Sen. Portman, Finance Committee member Bill Cassidy, R-La., and Sen. Rick Scott, R-Fla., that would make the deduction permanent.

Advanced energy manufacturing, electric vehicles

A handful of tax provisions related to clean energy manufacturing also received attention at the hearing. One of these – the section 48C credit for advanced energy manufacturing – received some bipartisan praise.

Finance Committee member Debbie Stabenow, D-Mich., and GOP Sen. Daines of Montana touted legislation they recently introduced with Sen. Joe Manchin, D-W.Va. – the American Jobs in Energy Manufacturing Act of 2021 – that would expand the section 48C credit and focus a portion of its benefits on communities that have suffered the closure of coal mines or coal power plants.
URL: https://www.manchin.senate.gov/imo/media/doc/AJEM%20Bill%20Text.pdf

Stabenow noted that she was "pleased to see everyone embracing the bipartisan effort we have to reconstitute the 30 percent tax credit for clean energy manufacturing in the United States."

Stabenow also spoke in favor of bipartisan legislation she introduced during the previous Congress with Sen. Susan Collins, R-Maine, and former Sen. Lamar Alexander, R-Tenn., that would expand the tax credit under section 30D for purchasers of certain electric vehicles (EVs) by, in part, increasing the number of qualifying vehicles a manufacturer can sell before the credit begins to phase out. This concept has wide appeal among congressional Democrats and seems likely to be discussed as part of any upcoming infrastructure and climate legislation developed with the Biden administration.

"We know that Americans are taking advantage of the EV consumer tax credit today," said witness Jonathan Jennings, a vice president at the Ford Motor Company. "And we believe in order for us to keep that momentum, we have to look at that additional 400,000 units that I believe your 2019 legislation had proposed."

In many ways going hand-in-hand with the section 30D electric vehicle credit is the credit under section 30C for alternative fuel vehicle refueling property. Sens. Stabenow and Tom Carper, D-Del., expressed their support for extending the section 30C credit, which – along with several other tax incentives renewable energy and energy efficiency – is set to expire after this year.

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