

Testimony

of Carolyn Lee

Senior Director, Tax Policy
National Association of Manufacturers
733 10th Street, NW, Suite 700
Washington, DC 20001

(202) 637-3079

clee@nam.org

for the Record of the Senate Finance Committee Hearing

on “Reforming America’s Outdated Energy Tax Code”

September 17, 2014



Comments of
The National Association of Manufacturers for the
Record of the
Senate Finance Committee Hearing
“Reforming America’s Outdated Energy Tax Code”
September 17, 2014

I. Introduction

The National Association of Manufacturers (NAM) welcomes the opportunity to submit this statement for the record for the Senate Finance Committee Hearing, “Reforming America’s Outdated Energy Tax Code” held on September 17, 2014.

The NAM is the largest manufacturing association in the United States, representing manufacturers of all sizes in every industrial sector and in all 50 states. Manufacturing employs nearly 12 million men and women, contributes more than \$2.08 trillion to the U.S. economy annually, has the largest economic impact of any major sector and accounts for two-thirds of private-sector research and development.

NAM members know firsthand that our current tax system is fundamentally flawed and discourages economic growth and U.S. competitiveness. As a result of manufacturing’s critical importance to our nation’s economy, any effort to rewrite the federal tax code should result in a balanced, fiscally responsible plan that allows manufacturers in the United States to prosper, grow and create jobs and also enhances their global competitiveness.

The following comments, which focus specifically on the energy tax provisions in the tax code, reflect NAM Board-approved [policy](#) on tax reform and do not reflect the entirety of our views of what is required in a comprehensive tax reform plan.

II. Promoting Investment

One of the most effective ways to spur business investment, particularly in the energy sector—and make U.S. manufacturing more competitive—is through a strong capital-cost recovery system. An ideal system would allow companies to expense capital equipment in the tax year purchased.

The positive economic impact of expensing capital equipment is well recognized. A basic premise of economic theory is that investment is a positive function of an increase in demand and a negative function of cost. The cost of capital to a firm includes three components: the price of capital equipment, the cost of financing the equipment and the tax treatment of investment. Expensing lowers the after-tax cost of capital and increases the number of profitable projects a firm can undertake, helping spur the growth in business investment. The enhanced Section 179 and bonus depreciation provisions

enacted in recent years have temporarily moved us toward an expensing system. Manufacturers believe that, where possible, these policies should be expanded and made a permanent part of any pro-growth tax reform.

Moreover, the fact that increased investment leads to job creation cannot be overemphasized. Indeed, cost recovery is not merely timing. Manufacturers of all sizes take into account the tax impact of cost recovery mechanisms on project cash flows in making investment decisions. For manufacturers large and small, cash flows are carefully managed to support key growth objectives and, especially for small and medium-sized manufacturers, cash flow is critical when access to credit is difficult.

The BEA's release of [new quarterly statistics](#) of GDP by industry reinforces the role that a healthy manufacturing sector plays in the health of the nation's economy. Manufacturing in the United States is poised for a comeback, in part due to the recent boom in energy production in the U.S., but for the nation to fully reap the benefit of this resurgence, manufacturers need tax policies that allow them to compete in today's global economy and do not tip the scales against investment.

Manufacturers recognize the important role a favorable tax climate plays in attracting high-value jobs and investment to the United States and improving competitiveness. Consequently, we urge policy makers to advance reforms that encourage investment and job creation in the United States rather than penalize companies struggling to compete in a global economy.

III. Promoting Energy Security

Manufacturers, both energy producers and energy consumers, support policies that will help advance domestic energy production. Indeed, manufacturers support an energy strategy that embraces all forms of domestic energy production while expanding existing conservation and efficiency efforts. Oil, natural gas and clean coal remain essential contributors to our energy security. The U.S. nuclear energy industry is well-positioned to expand its critical role in providing safe, affordable power. Alternative fuels and renewable energy sources like wind energy and solar power will also gain increasing importance in the future.

Developing domestic energy resources, which is critical to energy independence, economic growth and job creation, requires large capital investments in energy production by the private sector. The NAM has long believed that provisions promoting capital investment should be an integral part of comprehensive tax reform, particularly as it relates to investments in developing our nation's energy supplies.

Finding and producing domestic oil and natural gas requires large and continuing capital investments. Drilling oil and gas wells involves a number of costs, including labor, repairs, fuel, chemicals, supplies and other expenses that have no salvage value. Indeed, these costs—known as intangible drilling costs (IDCs)—cover about 70–80 percent of the cost of a shale gas well.

Under longstanding tax policy rules, IDCs are deductible as ordinary and necessary business expenses, reducing the cost of exploring for and producing oil and gas. While

not an incentive, IDCs are an important piece of our cost-recovery system and should be maintained in a reformed tax code.

The development of shale natural gas in the United States has been a “game-changer” for manufacturers and other energy consumers and recent studies by PWC¹ and IHS² have confirmed that the development of shale resources has not only enhanced our nation’s energy security but also support job creation and economic growth. The NAM believes strongly that tax reform should result in a pro-growth tax code and as such, when considering energy tax policies, policymakers must consider the growth associated with energy production. It is critical that tax reform not undermine the development of these and other new energy sources, removing what is becoming a cost advantage for domestic manufacturers.

The NAM also supports the existing percentage depletion deduction. This long-standing deduction is vitally important to domestic companies producing natural resources including mineral, coal and aggregates and independent oil and gas producers.

Percentage depletion allows taxpayers producing from mines, wells and other natural deposits to claim a deduction for a percentage of the gross income from these properties, recognizing the unique nature of these investments, which require significant financial commitments to long-term projects to deliver a competitive product at a low margin.

The percentage depletion provision also reflects the large risk inherent in these activities and the fact that the value of a mine or well declines as production progresses. Congress created percentage depletion because the otherwise available cost depletion rules resulted in a cost of capital too high to permit producing from important mineral resources. It is important to note also that even with the percentage depletion tax deduction; the U.S. tax burden on mining and other American resources operations puts them at a significant competitive disadvantage.

IV. Promoting Energy Efficiency and Renewable Energy Sources

As major consumers of energy in the United States, manufacturers are committed to reducing our energy intensity and producing more energy-efficient consumer products to help decrease our national overall demand for energy, lower costs and reduce greenhouse gas emissions. Manufacturers have made significant improvements in the efficiency of their own operations by using cost-effective distributed generation, combined heat and power technologies, waste heat recovery systems, water reuse and recycling, intelligent energy systems and advanced manufacturing technology. Similarly, manufacturers embrace every energy resource at our disposal and support the development of renewable energy sources like wind, solar and hydropower.

As is the case with energy security, NAM members believe that a positive tax climate for capital investment in new and existing plants and equipment will help increase industrial

¹ Available at:

http://www.nam.org/~media/01A2FACA40ED41F3A20FA08FBD6522C0/Shale_Gas_A_renaissance_in_Manufacturing.pdf

² Available at <http://www.nam.org/~media/A585A7F78C8D48149777F91D734ABC8D.ashx>

energy efficiency and the development of renewable and alternative energy sources in the long run. To that end, the NAM supports favorable capital cost-recovery tax policies.

V. The Domestic Manufacturing Deduction

For energy producers, Section 199—or the Domestic Manufacturing Deduction (DMD)—has the effect of effectively reducing the federal tax rate on income from domestic manufacturing and production activities and helps mitigate their tax burden. By reducing the tax burden on income from U.S. manufacturing activities, the DMD encourages more manufacturing in this country and helps attract needed capital to spur new investment.

This deduction creates a financial incentive to keep production in the United States and influences decisions on where corporations build new production facilities. Since the DMD is directly linked to domestic production, the loss of the DMD would result in higher effective tax rates for many domestic manufacturers, which could outweigh the overarching goal of lower tax rates.

VI. Manufacturers' Opposition to a Carbon Tax

As outlined in our comments above, a strong capital cost-recovery system will encourage energy production and promote energy efficiency and the development of new sources of energy, spurring U.S. economic growth and competitiveness. In contrast, environmental taxes, such as a carbon tax, would impair the ability of U.S.-based producers to compete in the global marketplace. As a method for inducing behavioral changes, penalty taxes increase the cost of production at the expense of economic growth.

An economic study performed for the NAM last year by NERA Economic Consulting³ on the potential impacts of a carbon tax on the U.S. economy concluded that a carbon tax would have a devastating impact on U.S. jobs, energy costs and industrial output, under two scenarios: a \$20 per ton carbon tax increasing at 4 percent and a stricter tax designed to achieve 80 percent reductions in domestic carbon dioxide (CO₂) emissions.

According to the NERA report, the increased costs of coal, natural gas and petroleum products due to a carbon tax would ripple throughout the economy, resulting in higher production costs, less spending on non-energy goods, fewer jobs and slower economic growth. Nationally, a carbon tax designed to reduce CO₂ levels by 80 percent could place tens of millions of jobs at risk and raise gasoline prices by over \$10 a gallon, natural gas prices by almost \$60 per MMBtu and residential electricity prices by over 40 percent.

NERA also found that a carbon tax it modeled would have a negative impact on manufacturing output. In energy-intensive sectors, manufacturing output could drop by as much as 15.0 percent and in non-energy-intensive sectors by as much as 7.7 percent. The overall impact on jobs would be substantial, with a loss of worker income

³ Available at <http://www.nam.org/Issues/Energy-and-Climate/Carbon-Tax.aspx>

equivalent to between 1.3 million and 1.5 million jobs in 2013 and between 3.8 million and 21 million jobs by 2053.

NAM members continue to develop and implement measures that use energy more efficiently, utilize alternative sources of energy and develop new technologies leading to fewer GHG emissions. Through innovation, manufacturers have led a quantum shift in energy production in this country that, along with the potential to create millions of new jobs, will help lead to a sustainable future for generations to come.

VII. Conclusion

The NAM recognizes the need to promote domestic energy production, promote energy efficiency and develop renewable sources of energy, and the important role a favorable tax climate plays in achieving these goals. Consequently, we urge policymakers to advance reforms that encourage investment in these critical areas through a strong capital cost-recovery system.

On a broader note, any changes to energy tax provisions should be addressed in the context of comprehensive tax reform. Given that all the components of a comprehensive tax reform package have yet to be determined, the comments above are based on the premise that any changes to our energy tax provisions would be part of a comprehensive tax reform plan.

As essential as comprehensive tax reform is to the long-term competitiveness of our nation, a new system must not result in a net increase in manufacturers' tax burden—a change that would derail efforts to enhance U.S. economic growth, investment, competitiveness and jobs.