NATIONAL ASSOCIATION OF
Manufacturers

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*Vice President,
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June 27, 2024

Rep. Lloyd Smucker
Chair, Main Street Tax Team
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Rep. Greg Steube
Vice Chair, Main Street Tax Team
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U.S. House of Representatives
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Rep. Vern Buchanan
Main Street Tax Team
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U.S. House of Representatives
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Rep. Adrian Smith
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Rep. Jodey Arrington
Main Street Tax Team
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Rep. Beth Van Duyne
Main Street Tax Team
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Chair Smucker, Vice Chair Steube, Rep. Buchanan, Rep. Smith, Rep. Arrington and Rep. Van Duyne:

On behalf of the National Association of Manufacturers and the 13 million people who make things in America, I write to you today as you begin your work to prevent the devastating tax increases that will take effect for manufacturers and manufacturing families at the end of next year. Manufacturers look forward to working with the Ways and Means Main Street Tax Team to preserve the critical 20% pass-through deduction and the individual income tax rate reductions implemented in the Tax Cuts and Jobs Act.

Tax reform was revolutionary for the manufacturing sector. Tax reform kickstarted years of economic growth throughout the industry, providing a new foundation for the manufacturing economy to thrive:

- In 2018, manufacturers added 263,000 new jobs, the best year for job creation in manufacturing in 21 years.[1]
- In 2018, manufacturing wages increased 3% and continued going up—by 2.8% in 2019 and by 3% in 2020. Those were the fastest rates of annual growth since 2003.[2]
- Manufacturing capital spending grew 4.5% and 5.7% in 2018 and 2019, respectively.[3]

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[1] Bureau of Labor Statistics, Current Employment Statistics, Manufacturing Employment, Seasonally Adjusted. *Available at* https://www.bls.gov/ces/data/.
[2] Bureau of Labor Statistics, Current Employment Statistics, Average Hourly Earnings for Production and Nonsupervisory Employees, Manufacturing, Seasonally Adjusted. *Available at* https://www.bls.gov/ces/data/.
[3] U.S. Census Bureau, Annual Survey of Capital Expenditures, Table 2A, Manufacturing. *Available at* https://www.census.gov/data/tables/2019/econ/aces/2019-aces-summary.html.

- Overall, manufacturing production grew 2.7% in 2018, with December 2018 being the best month for manufacturing output since May 2008.[4]

Manufacturers have used the savings from tax reform to grow their businesses, create jobs, raise wages, add new benefits for employees, fund research and development, purchase new equipment, expand their facilities and give back to their communities. However, critical tax reform provisions are set to expire at the end of 2025, resulting in significant tax increases for virtually all manufacturers. Congress and the president *must act* to prevent tax hikes from stunting manufacturing job creation, growth and innovation.

Manufacturers are the heart of Main Street America. Our industry employs millions of people, in every state and every congressional district. Preserving the pass-through deduction and retaining TCJA's tax rate reductions is crucial to enabling manufacturers to invest in job-creating projects and life-changing innovation throughout the country.

The Pass-Through Deduction is Vital for Small Manufacturers

Congress has long understood the importance of ensuring that small and family-owned businesses have a chance to succeed. Congress has provided for different tax treatment of business structures like S-corporations, partnerships, limited liability companies and sole proprietorships—all forms of pass-through businesses—as compared to their peers organized as C-corporations. In short, pass-throughs are not subject to corporate income taxes like their C-corporation counterparts, but instead their business profits are "passed through" to the owners and taxed at their individual income rates. Today, more than 96% of businesses in America are organized as pass-throughs.[5] These companies, the vast majority of which are small businesses, employ millions of Americans and are a vital economic engine for local communities across the country. In the manufacturing sector, an overwhelming number of manufacturers are organized as pass-throughs, as this structure allows individuals seeking to innovate and solve problems an easier path to creating their business.

At the time of 2017 tax reform, 64% of pass-throughs had fewer than five employees, 81% had fewer than 10 employees and 99% had fewer than 100 employees.[6] Policymakers noticed the critical role pass-through businesses were playing in the economy and in their communities, and there was broad bipartisan recognition that relief for pass-throughs must be considered in any comprehensive business tax reform package. The Senate Finance Committee Business Income Tax Bipartisan Working Group stated in report to the committee: "Clearly, business tax reform needs to ensure that these businesses are not ignored in an effort to reduce the corporate tax rate…Pass-through businesses need to benefit from business tax reform for any such effort to be considered a success."[7]

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[4] Federal Reserve Board of Governors, Industrial Production, Manufacturing, Seasonally Adjusted. *Available at:* https://www.federalreserve.gov/releases/g17/Current/default.htm .

[5] Congressional Research Service, "Section 199A Deduction for Pass-Through Business Income: An Overview" (March 2024). *Available at:* https://www.everycrsreport.com/files/2024-03-22_IF11122_827ba9d5373fd4f44d9054bfb20376459d05e20b.pdf

[6] U.S. Census Bureau, 2015 Statistics of U.S. Businesses, "U.S., NAICS sectors, legal form of organization (LFO)," https://www.census.gov/data/tables/2015/econ/susb/2015-susb-annual.html.

[7] Senate Finance Committee, "The Business Income Bipartisan Taw Working Group Report". *Available At:* https://www.finance.senate.gov/imo/media/doc/The%20Business%20Income%20Bipartisan%20Tax%20Working%20Group%20Report.pdf

In 2017, the TCJA instituted a new deduction for pass-throughs while also reducing the individual income tax rate for their owners. The new Section 199A deduction allowed pass-through manufacturers to deduct up to 20% of their qualified business income on their personal returns, freeing up capital to reinvest in their employees and their growth. The combination of the new deduction and the lower individual income rates were crucial to pass-throughs across the country, and these new pro-growth policies translated directly to increased investments and higher wages.

The 20% deduction for pass-throughs is set to expire at the end of 2025. Additionally, the individual income rates are scheduled to revert to their pre-TCJA levels. This will result in a one-two punch for pass-throughs across the country. The situation is potentially dire for manufacturers: a recent NAM survey found that 93% of pass-through manufacturers reported that the loss of this deduction will harm their ability to grow, create jobs and invest in their business. If Congress allows the pass-through deduction to expire and the individual income tax rates to rise, pass-throughs' effective tax rate will increase at least 10 percentage points—a drastic tax hike for small businesses across the country.

Congress should act swiftly to provide certainty to small businesses by making the pass-through deduction permanent. The 96% of American businesses organized as pass-throughs are depending on Congress to protect them from devastating tax increases.

Pass-Throughs are Subject to the Individual Tax Rates

Prior to tax reform in 2017, the top individual income tax rate was 39.6%. The TCJA reduced the top rate to 37% while also modifying the income brackets at which the top rate is effective. For married couples, the top rate now takes effect at $600,000 of income, as opposed to $480,050 prior to TCJA. Beyond the top rate, tax reform reduced income tax rates for manufacturing families at every income level, but these families will be facing a higher tax burden in 2026 if Congress does not act.

Manufacturers organized as pass-throughs generally pay tax on their business profits at the top individual tax rate. Pass-throughs' earnings do not go into the owners' pockets, but rather are reinvested in new equipment, machinery and facilities. The combination of the reduction in the top rate and the 20% pass-through deduction enabled pass-throughs in the manufacturing industry to make more of these job-creating investments.

It is crucial that Congress preserve tax reform's pro-growth tax system for small businesses, as more than 74% of manufacturers have fewer than 20 employees. If Congress wants to see the manufacturing sector succeed, the individual income tax rates must remain as low as possible. If the individual income rates are allowed to revert back to their pre-TCJA levels, Congress will be sending a clear message that manufacturers should have fewer resources to invest and create jobs here in America.

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Manufacturing employs 13 million Americans, contributes $2.81 trillion to the U.S. economy annually and has one of the largest multiplier effects in the economy. Taken alone, manufacturing in the United States would be the seventh-largest economy in the world. But that economic leadership, and therefore the economic security of American families, is in jeopardy if Congress fails to preserve a competitive tax code.

Manufacturers appreciate the thoughtful consideration that the Main Street Tax Team is giving to how the tax code impacts our sector—and in particular the small pass-through businesses that make up the majority of manufacturers across the country. Failing to act in 2025 to preserve the pass-through deduction will cost millions of jobs and put the American manufacturing sector at a severe disadvantage globally. Congress should pursue tax policies that strengthen manufacturing in the U.S., ensuring that America remains a globally competitive home for manufacturing investment.

Sincerely,

Charles Crain
Vice President, Domestic Policy
National Association of Manufacturers