IDEA BRIEF

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A Bonus Manufacturing Tax Credit

By Anne Kim, John Lageson, and Tess Stovall

Since 2000, America has lost more than 5.5 million manufacturing jobs. As part of the recovery effort, saving and creating solid middle-class manufacturing jobs in America must be a top priority. A new bonus manufacturing tax credit can both support the research that can lead to new technologies while rewarding U.S. companies that keep jobs in America.

THE PROBLEM

American manufacturers need support

The last eight years have been devastating for American manufacturers. Between 2000 and 2006, the U.S. lost a net total of more than 23,000 manufacturing companies.[1] Although some of the manufacturing job losses of the last decade are due to gains in efficiency, the fact that other countries do a better job of supporting their manufacturers with job-friendly tax and economic policies has disadvantaged domestic companies. New policies that support America's manufacturing sector can help American companies keep their global edge.

American manufacturing jobs are disappearing.

Since 2000 America has lost over 5.5 million manufacturing jobs, including the 2.1 million lost since the beginning of the recession.[2] The loss of manufacturing jobs threatens America's standing as one of the world's largest manufacturers. The United States now produces about one-fourth of the world's total manufacturing output,[3] and even though manufacturing makes up only about 12% of the U.S. economy, its total value (over $1.6 trillion in 2008[4]) still exceeds the gross domestic product of Canada.[5] Manufactured goods also account for more than 60% of America's overall exports, which totaled over $1 trillion in 2008.[6]

Foreign manufacturers get more help from their governments.

In their efforts to catch up with America, countries around the world have implemented aggressive tax and economic policies to support domestic businesses. One example of such policies is the research and development (R&D)

tax credit, which provides critical help for companies—particularly manufacturers—that are investing in new products and technologies.

While the United States once offered the most robust R&D tax credit in the world, it has since slipped to 17th among OECD nations in the generosity of this credit, behind Spain, Mexico, Canada, Korea, Denmark, the United Kingdom, Australia, and others.[7] The current R&D tax credit offered in the U.S. also trails several non-OECD countries including China, Brazil, and India.[8]

This imbalance particularly affects American manufacturers, who are now the biggest beneficiaries of the R&D credit. But because they are not receiving the same level of support as foreign companies, American manufacturers face a tilted playing field in the global market.

THE SOLUTION

A bonus manufacturing tax credit

To support American manufacturing, Third Way proposes: (1) to make the Research and Development (R&D) Tax Credit permanent and (2) to create a new R&D bonus incentive to reward companies that both research and manufacture their products in the U.S.

This proposal would reward and stimulate American job creation, help keep research and development in the U.S. and take steps toward making the R&D credit comparable to the research and development credits offered by competitor countries.

Boosting the R&D credit will boost American manufacturers.

In 2005, 71% ($4.5 billion) of the R&D credit was claimed by manufacturers.[9] Many R&D credit beneficiaries are also small or medium-sized companies. In 2005, nearly 30% of companies claiming the R&D tax credit had assets of $1 million or less. Another 25% had assets of $1 million to $5 million.[10]

Boosting the R&D credit would create jobs.

The R&D credit is a jobs credit. More than 70% of the dollars received by companies for the R&D credit goes directly toward the salaries of American workers. Moreover, the vast majority of these jobs are in industries where the U.S. is leading the world in innovation. The sectors that currently benefit from the credit include aerospace, agriculture, biotechnology, chemicals, electronics, energy, information and communications technology, manufacturing, medical technology, pharmaceuticals and software.[11]

Increasing the credit would help create more jobs in sectors where America's competitive edge is greatest.

Examples of potential beneficiaries of the proposed bonus credit

	Location	Product	Employees
Ohio Willow Wood Company.[12]	Mt. Sterling, Ohio	Prosthetic and orthotic devices	100-250
Defiance Metal Products, Inc.[13]	Defiance, Ohio	Metal parts	250+
Union Tool, Inc.[14]	Warsaw, Indiana	Manufacturing machinery and equipment	50
Power Technology, Inc.[15]	Alexander, Arkansas	Laser diode systems	10-20
DR Technologies[16]	San Diego, California	Electrical components for military and aerospace applications	95
Yardney Technical Products[17]	Pawcatuck, Connecticut	Batteries for use in industrial, aerospace and military applications	150

Making the R&D credit permanent would help create jobs.

Despite having first been enacted almost 30 years ago, the R&D tax credit has never benefited from a permanent authorization. Since its enactment in 1981, the credit has been extended 13 times (some of those being retroactive), including most recently through the end of 2009 as part of the *Emergency Economic Stabilization Act.*[18] At one point during that period, the credit was allowed to lapse for an entire year from July 1995 to June 1996.[19] Due to the lengthy interval between product research and realized returns, the inability of businesses to plan on the long-term availability of the credit undermines its effectiveness.[20] Even short-term gaps in the credit's authorization can create sizeable economic risks. According to an estimate by the Information Technology Association of America, the temporary expiration of the credit in 2008 placed over $13 billion and 10,000 jobs in jeopardy.[21]

THE ROLLOUT

Ideas for launching and publicizing a bonus R&D tax credit

- **Hold a press event at a local business or factory** that could benefit from the credit.
- **Hold a press event with local workers** who could fill new jobs that would be created by the credit.

CRITIQUES & RESPONSES

A bonus manufacturing tax credit

It doesn't benefit all companies equally.

It's not intended to. This proposal is intended to help support companies that are creating new jobs here in America. There is no penalty for companies that are ineligible for the credit because the majority of their manufacturing takes place overseas—for them, the current law is unchanged.

This credit could help tip the scales for companies with global operations that are deciding whether to manufacture in America or abroad. Many other countries have more generous tax breaks for manufacturers than the United States, and American workers are more expensive to employ than workers in many other countries. A bonus tax credit, however, could help level the playing field by reducing the costs of doing business in America.

It could be challenged as a violation of international trade rules.

Actually, this proposal is perfectly consistent with international trade rules. Under the rules of the World Trade Organization (WTO), governments are generally prohibited from subsidizing exports. For example, giving U.S. manufacturers a tax credit based on the volume of their exports would be considered illegal under international trade laws. This proposal, however, simply promotes U.S. manufacturing activity, regardless of whether the resulting products are exported. U.S. subsidiaries of foreign-owned companies are also eligible for the bonus credit.

It's expensive.

It could be, but the cost is directly proportionate to the number of jobs created or saved in the United States. That is the best use of our corporate tax code.

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APPENDIX

Current law[22] allows companies to claim the R&D credit using one of two statutory formulas. The "traditional" formula calculates the credit according to a company's revenues. Under this formula, companies can receive a tax credit equal to 20 percent of the amount spent on R&D in excess of a calculated base amount, based on historic gross receipts.

The Alternative Simplified Credit (ASC), which became available in 2007, calculates the credit according to a company's historical R&D spending. Under this formula, companies can receive a tax credit equal to 14 percent of R&D spending in excess of 50 percent of the company's average R&D spending over the prior three years.[23]

Under this proposal, companies that also manufacture in the U.S. would be allowed to use a larger percentage in calculating the credit, depending on the extent of their domestic production activities.

The maximum bonus percentage would be 10%, meaning that a company could receive a maximum credit equal to 24% of its R&D spending under the ASC or 30% under the traditional formula. The credit could also be made refundable.[i]

The size of this bonus percentage would depend on the share of total gross production receipts that are "domestic production gross receipts" (DPGR) as defined by Section 199 of the American Jobs Creation Act of 2004.[24]

A proposed "sliding scale" for the R&D bonus percentage would be as follows:

Domestic share of total gross production receipts	Bonus percentage
51% to 60%	2%
61% to 70%	4%
71% to 80%	6%
81% to 90%	8%
91% to 100%	10%

For example, if 80% of Company X's worldwide total gross receipts of $1 billion are domestic, Company X would be entitled to increase its R&D credit percentage by 6%—that is, to 26% under the traditional credit and to 20% under

i The American Recovery and Reinvestment Act includes a five-year net operating loss carryover provision. If this credit is made refundable, refundability should apply to years preceding the last five years to avoid a double benefit.

the ASC. That's a reward of $60 million because of the high proportion of American manufacturing.

Companies with 50% or less in domestic production gross receipts would still be allowed to take the current credit as is—there is no penalty.

ENDNOTES

1 U.S. Census Bureau, Statistics of U.S. Businesses, available online at http://www.census.gov/csd/susb/index.html.

2 The United had 17,263,000 manufacturing jobs in 2000, compared to 11,719,000 in September, 2009. The United States Bureau of Labor Statistics, "Employees on non-farm payrolls by major industry sector, 1959 to date," available at ftp://ftp.bls.gov/pub/suppl/empsit.ceseeb1.txt and "The Employment Situation: September 2009," available at http://www.bls.gov/news.release/empsit.nr0.htm.

3 United Nations Industrial Development Organization, Industrial Statistics, available at http://www.unido.org/index.php?id=o3472. The U.S.' share of world manufacturing output is shown in manufacturing value added (MVA) terms. For more data on U.S. manufacturing, see also Edward Gresser, "Lou Dobbs Is Wrong," Blueprint Magazine, April 23, 2007, available at http://www.ppionline.org/ppi_ci.cfm?contentid=254269&knlgAreaID=108&subsecid=206.

4 U.S. Bureau of Economic Analysis, Gross Domestic Product by Industry Accounts, available at http://www.bea.gov/industry/gpotables/gpo_action.cfm?anon=104329&table_id=24752&format_type=o.

5 World Development Indicators database, World Bank, revised September 10, 2008, available at http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf.

6 National Association of Manufacturers, "Manufactured Goods Deficit Fell $60 Billion in 2008," February 11, 2009, available at http://www.nam.org/NewsFromtheNAM/Press%20Releases/IEAP/NAMNotesSurplusFreeTradePartners.aspx.

7 Robert D. Atkinson and Scott M. Andes, "U.S. Continues to Tread Water in Global R&D Tax Incentives," The Information Technology & Innovation Foundation, August 12, 2009, available at http://www.itif.org/files/WM-2009-03-rd.pdf.

8 Ibid.

9 National Association of Manufacturers, "ManuFACTS: R&D Tax Credit," August, 2009, available at http://www.nam.org/~/media/PolicyIssueInformation/SiteContent/Manufacts/LeaveBehindRDCredit5.ashx.

10 National Association of Manufacturers, "NAM Tells House Small Business Committee R&D Tax Credit is Vital to Small Firms," Press Release, September 11, 2008, available at http://www.nam.org/NewsFromtheNAM/Press%20Releases/TTDEP/NAMTellseHSSmallBizCommRDTaxCredit%20Vital.aspx.

11 National Association of Manufacturers, "ManuFACTS: R&D Tax Credit."

12 http://www.owwco.com/home_usa.php.

13 http://www.defiancemetal.com/default.htm.

14 http://www.uniontoolcorp.com/default.htm.

15 http://www.powertechnology.com/.

16 http://www.drtechnologies.com/default.htm.

17 http://www.yardney.com/index2.html.

18 Between 1981 and 2005 the credit was extended on eleven separate occasions (a detailed list is available at http://www.investinamericasfuture.org/PDFs/233051.pdf). The credit was subsequently extended through December 31, 2007 as part of the Tax Relief and Health Care Act of 2006. The most recent extension was enacted as Section 301 of Division C of the Emergency Economic Stabilization Act, entitled the "Tax Extenders and Alternative Minimum Tax Relief Act of 2008," which retroactively extended the R&D credit until December 31, 2009. Joint Committee on Taxation, "General Explanation of Tax Legislation Enacted in the 110th Congress," March 18, 2009, available at http://www.jct.gov/publications.html?func=startdown&id=1990.

19 R&D Credit Coalition, "Legislative History of R&D Credit Extensions," February 3, 2005, available at http://www.investinamericasfuture.org/PDFs/233051.pdf.

20 Dominique Guellec and Bruno van Pottelsberghe de la Potterie, "Does Government Support Stimulate Private R&D?" OECD Economic Studies No. 29, 1997/II, available at http://www.oecd.org/dataoecd/21/38/2733427.pdf.

21 Information Technology Association of America, "ITAA Applauds Senate Compromise on R&D Tax Credit Extension," Press Release, September 17, 2008, available at http://www.itaa.org/policy/tax/release.cfm?ID=2985.

22 The most recent changes to the R&D Tax Credit were made as part of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (TEAMTRA), passed in October 2008. TEAMTRA retroactively extended the credit through December 31, 2009, eliminated the alternative incremental credit for tax years ending after December 31, 2008 and increased the rate of the Alternative Simplified Credit (ASC) to 14%.

23 The R&D Credit Coalition provides a detailed description of how the traditional credit is calculated at http://www.investinamericasfuture.org/.

24 "Domestic gross production receipts" are defined in part to mean "the taxpayer's gross receipts that are derived from any lease, rental, license, sale, exchange, or other disposition of qualifying production property that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States. 'Qualifying production property' means (A) tangible personal property; (B) any computer software; and (C) any property described in section 168(f)(4)(certain sound recordings)." See Internal Revenue Bulletin No. 2007–17, April 16, 2007, page 957.