Written Testimony
Of

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Before the
Joint Economic Committee, U.S. Congress

Wednesday, April 15, 2015

Thank you for the opportunity to testify before you today about the impact of taxes on small and medium-sized manufacturing businesses. My name is Jody Fledderman; I have been President and CEO of Batesville Tool and Die in Batesville, Indiana since 1989. For over 30 years, Batesville Tool & Die has been providing quality metal stamping and stamping assemblies for our automotive, appliance, industrial and other industry customers. We currently have 395 employees and would hire more if we could find qualified workers.

In addition, I was the 2014 Chairman of the Precision Metalforming Association and serve on Board of Directors for both the Indiana Manufacturers Association and the Indiana Chamber of Commerce. I think my positions on state and national boards and running my own business, provide me a unique perspective of the challenges facing manufacturers in Indiana and across the country.

The single greatest obstacle to growing my business in the longterm is the uncertainty surrounding our tax code. How can Congress expect us to plan when we do not know what the rates will be in the future? How can lawmakers carelessly continue putting off their responsibilities until the last hour? Too often it feels as if people in Washington are so insulated from the real world they do not recognize their inaction has significant consequences for families and businesses throughout the country. It is very difficult to plan for the future when you don’t even know the rules for today.

I truly believe our economy would have recovered more quickly if businesses felt comfortable that Washington would set the rules and stop meddling for a while. This is why we need comprehensive tax reform. Not just to lower our rates to globally competitive levels but also to provide stability and predictability in the Internal Revenue Code. Washington should develop tax policy that encourages investment and manufacturing in America – not penalize companies and their owners for doing business.

Tax Reform for All Businesses

A January 2015 industry survey by the Precision Metalforming Association and National Tooling and Machining Association showed that 61% of companies are structured as a pass-through business, often paying income taxes at the higher individual rates. Sector-wide, 81% of all manufacturing companies are structured as pass-throughs, meaning C-Corporation only reform would leave behind eight in ten manufacturers, most small and medium-sized family-owned businesses. We are one of those millions of manufacturers Corporate-only reform would leave behind.

Batesville Tool and Die is structured as an S-Corporation. As a multi-generational manufacturing company with strong ties to the community, over the years our company has awarded shares to certain employees and family members. Maybe we’ve been overly generous in the past, but we now have 72 shareholders. We are not your typical manufacturing pass-through, which in our industry tends to average

3-5 shareholders. However, being a pass-through allows us to reward employees with shares in the company without the penalty of double taxation that a C-Corporation structure brings.

The main reason most family-owned or tightly held manufacturers structure themselves as pass-throughs is so they can keep the company within the family. Underscoring this point is that many in our industry are nearing their retirement and planning to pass the business along to the third or fourth generation of manufacturers. If our company was a C-Corporation, when I'm set to retire, the tax penalties just on my portion alone would mean I'd have to plan years ahead how to cover the dividend tax rate – even if I knew what it was ahead of time.

Unfortunately, I'm still a ways away from retiring, but think what would happen to these 72 small shareholders if we sold the company – some of them are retirees in their eighties while others are high school students. How would they come up with the resources to pay the income and dividend taxes were we structured as a C-Corporation?

While there are many benefits to our pass-through structure, the main drawback is the most obvious – Congress raised our rates a few years ago. While publicly most believe the top rate is 39.6%, in reality we pay roughly 43.4% in federal income taxes when you calculate the surcharges and other additions. Keep in mind we have 72 shareholders, with one drawing fully passive income. This means we are withholding 43.4% from all of their taxes and leaving it up to the individual shareholder to seek a refund if their overall income levels do not reach the highest brackets. More importantly, that is money taken out of the business to pay taxes on their behalf and even if the individual receives a refund, the company will never see any of that money again – valuable resources we could have used to invest in the business.

As Washington contemplates tax reform, I asked our CFO to explore how various scenarios affect our company. Based on current tax law and after deductions and credits, Batesville Tool and Die paid roughly $1.6 million in taxes. Had the individual tax rate not increased to 39.6%, we would have paid $1.1 million in taxes using the same figures. If the rate is reduced to 28% and the key investment provisions are kept in place, our tax liability drops to $928,000, freeing up $700,000 to invest in the business, more if lowered to 25%.

This is where public perception plays a big role. The average person and politician would assume the owners pocket that $700,000. In reality, that is not the way small and medium-sized manufacturers operate. In the metalworking industry, our profit margins are typically 1-3%. The cost of manufacturing in America is not cheap and we use every resource available to make ourselves more globally competitive through investing in new technologies and hiring skilled workers.

Furthermore, what many people do not know is most small business owners have to personally guarantee loans for the company when buying equipment that can cost in the millions. The fewer resources our lenders see in the business, combined with the higher personal tax liability for each shareholder, often leads to increased borrowing rates and stricter terms. Small and medium-sized manufacturing businesses rarely self-finance, and with a 1-3% profit margin we are not the most attractive borrower in the best of circumstances.

Tax Credits and Deductions Used by Manufacturers

Every manufacturing business is different and each company serves a variety of industries which have varying needs requiring specialty equipment. Some of our equipment can cost $2-10 million, much of which we could not afford without Bonus Depreciation. For others the R&D Tax Credit is worth hundreds of thousands as opposed to general deductions.

While traveling the country as Chairman of the PMA last year, I heard from countless manufacturers that they are holding back investments because they do not know whether Congress will extend critical tax provisions. The recent association survey of our industry showed that 91% of metalworking manufacturers claimed Section 179 Equipment Expensing in 2014. An equally impressive 89% used Bonus Depreciation while roughly half claimed the R&D Tax Credit. This January, Congress allowed the R&D credit to lapse for the sixteenth time, Bonus Depreciation to expire, and 179 to revert to $25,000, rendering it completely useless for manufacturers like us.

To our company, the R&D and Bonus are by far the most important. We claimed $544,000 in R&D and while that was among a peak year for us, we see this provision as one of the few in our tax code that actually incentivizes manufacturing in America. I know many smaller companies shy away from the R&D as not being worth their time to defend in an audit. Some will say they cannot substantiate the $20,000 in expenses to claim $40,000 in R&D credits. But at Batesville, our exposure to the R&D is significant, so I guess we will just have to keep the faith in Congress that you will extend or make permanent the R&D, I just ask that you don’t wait until the eleventh hour this time.

Bonus Depreciation really is a game changer for manufacturers who invest heavily in equipment and talented people to run them. Had Congress not extended Bonus Depreciation in December of last year, countless manufacturers in the metalworking industry would have faced an average $400,000 tax liability due in 2015. The typical small manufacturer does not have that kind of cash on hand and would eliminate 2015 purchases and hiring to pay the added tax liability.

However, before Congress pats themselves on the back for a job well done, extending expired provisions in November and December each year clearly stunts economic growth. Machines in our industry take eight weeks to eighteen months to place into service. This makes it impossible for the average manufacturer to benefit from Bonus Depreciation or Section 179 Equipment Expensing extended on December 11 with only three weeks to finance, purchase, and place into service machinery weighing several thousand tons.

The other real world impact of Congressional inaction was witnessed firsthand at Batesville Tool and Die last year. Due to the uncertainty over whether Congress would extend the R&D, Bonus and other key tax provisions, we overpaid our quarterly estimates to account for a potential massive tax liability if the provisions remained expired for 2014. This meant we overpaid our taxes by $580,303 because lawmakers waited until a lame duck Congressional session before acting. While our employees and other shareholders benefit from this structure, it causes significant challenges for the business when we have to overpay based on which tax credits and provisions Congress keeps in place.

As a pass-through, we pay the taxes for our shareholders quarterly based on estimates of revenue and existing tax law. This meant that last year we withheld roughly 44% from each shareholder for income taxes and overpaid on their behalf based on not knowing which tax provisions Congress would put in place for the taxable year. The individual shareholders will receive a refund for the overpayments on their personal tax returns, but they will never give that money back to the business who overpaid on their behalf. This means, the company will never see that $580,000 again. With over half a million dollars I could hire seven or eight new employees or purchase a new machine that would have also required new workers. Instead, we sent that money to Washington, who will just turn it around and give to it the individuals, while the small business is left footing the bill.

Comprehensive tax reform would immediately fix this problem. Our company would know the rules at the beginning of the year and withhold or pay the appropriate estimate. But the current system is like shooting a moving target, but never giving you a chance to lock on. Absent comprehensive tax reform, we need Congress to make permanent these investment provisions or at least extend them for a significant number of years. As I mentioned earlier, some of our equipment takes eighteen months or longer to place into service and our planning process is often two to ten years as we anticipate future growth.

The Alternative Minimum Tax, or AMT, is another issue which receives attention from politicians when discussing tax reform. The reach of the AMT is much broader than just affecting the “middle class.” When a business is captured under the AMT, they cannot claim the Research and Development Tax Credit, which would be available to them and is so popular among lawmakers. In addition, an AMT captured business could not benefit from the politically popular $1,000 credit for hiring the long-term unemployed. Again, this is why we need comprehensive reform, the Internal Revenue Code is riddled with outdated and conflicting provisions stifling U.S. companies and deterring foreign investment.

Conclusion

In towns such as Batesville, Indiana with a population of 6,500, the community needs employers like us but we need a partner in Washington that sets the rules and sticks with them. Manufacturers of all sizes need time to plan. We may not be a billion-dollar company but businesses in our industry routinely spend millions each year to remain competitive. Virtually every other industrialized nation has a tax code that fosters innovation and encourages investment. It is time the U.S. Government caught up to the rest of the world the way its manufacturers have.

Thank you for the opportunity to testify before you today on this important issue.