John Engler

President and CEO

National Association of Manufacturers

April 29, 2005

The President's Advisory Panel on Federal Tax Reform
1440 New York Avenue N W., Suite 2100
Washington, DC 20220

Re: Requests for Comments #2 (Posted April 5, 2005)

Dear Advisory Panel Members:

On behalf of the National Association of Manufacturers—and our thousands of small, medium and large manufacturers—we applaud the Administration's efforts to develop reform proposals to move towards a simpler and fairer tax code that promotes economic growth As you work toward this goal, we strongly encourage you to recommend, in connection with any tax reform option, an enhanced capital-cost recovery system.

Earlier this year, we sent you NAM's principles on tax reform that will serve as a framework for us to use in evaluating proposals and developments as the tax reform debate moves forward The principles touch on several areas including international competitiveness, research and technology investment and the alternative minimum tax and incorporate the need for a tax code that both encourages investment and makes U.S. manufacturers more competitive in the global marketplace

We believe strongly that one of the most effective ways to spur business investment — and make U.S. manufacturing more competitive—is through an enhanced capital-cost recovery system that would allow all taxpayers to expense capital equipment in the tax year it is purchased

The "bonus" depreciation provisions and expanded write-offs for small businesses enacted in recent years temporarily moved us closer to an expensing system. The bonus depreciation and expanded small business expensing provisions spurred the growth in business investment that was a critical factor in our recent economic recovery. Now it is time to build on these pro-growth changes.

In a July 2000 "Report to Congress on Depreciation Recovery Periods and Methods," the Treasury Department concluded that the current depreciation system is dated, but that changing it would be a costly and time-consuming undertaking Determining new class lives alone would add a new layer of complexity and consume valuable Treasury and taxpayer resources, both in design and in administration. In contrast, expensing of capital investments would be a simple, direct and expeditious solution.

Moreover, 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 costs 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 cost of capital and thus leads to increased investment.

The goal of a capital recovery system should be to make the after tax cost of capital low enough to help American businesses keep pace with technological change, to improve the competitiveness of American goods in world markets, to simplify tax compliance and to reduce the burden of inflation on the replacement cost of capital. A system that provides for immediate expensing achieves these goals. Moreover, workers also benefit from an enhanced capital-cost recovery system. Increased investment raises labor productivity, which leads to higher wages.

If full expensing is not possible in the context of a revenue-neutral tax reform package, substantial economic growth could be achieved through the adoption of one or more incremental alternatives, for example, reducing the depreciation lives of all asset classes (e.g., ten years to seven, etc.); providing an expensing allowance for all assets, patterned after highly successful "bonus depreciation" legislation in effect in 2001-2004; or some combination. Any movement towards expensing should not be phased in but should be made effective immediately because a phase-in would have the deleterious effect of postponing business investment decisions.

As with other tax reform proposals, fair and workable transition rules for companies that have made business decisions based on current law are critical to the success of an enhanced capital cost recovery system. Many of our members have sizable amounts of remaining tax basis that might be lost altogether if they are not allowed to utilize accrued, but unused, tax attributes. The "bonus depreciation" provisions enacted in 2002 and 2003 recognized this fact. Finally, whatever expensing/depreciation reform is adopted should be made available to all companies, regardless of their size and/or tax status. For example, AMT taxpayers should not be denied the competitive benefits of the movement towards expensing.

NAM members have long believed that the current capital cost recovery rules of the tax code impede U.S. economic growth. Reforms, like expensing described above, will go a long way toward making the tax code fairer, simpler and more pro-growth. We look forward to working with you, the Congress and the Administration on these important issues.

Sincerely,

John Engler

JE/dc