

**Written Testimony before the  
House Committee on Small Business  
Subcommittee on Economic Growth, Tax, and Capital Access**

*Delivered by*

**Mr. William R. Smith, President and CEO**

**Termax Corporation**

*On behalf of the*

*Precision Metalforming Association*

*November 3, 2011*

Chairman Walsh, Ranking Member Schrader, members of the committee, thank you for the opportunity to testify today. My name is William Smith, President and CEO of Termax Corporation based in Lake Zurich, Illinois. We are members of the Precision Metalforming Association (PMA), which has roughly 1,000 member companies like ours throughout the country representing the \$113 billion precision metal products industry using stamping, fabricating, and other technologies. Roughly two-thirds of our member companies are structured as Sub Chapter S Corporations or similar pass-throughs, as is Termax Corporation. The industry averages about 50 employees per business, most of which are family owned like ours.

My father founded the company in 1971, and in 1998, my brother and I took over operations where we have seen the company grow to 250 employees and holding over 60 patents. While primarily servicing the automotive industry, Termax products and services are used by many organizations that require quality engineered clips and fasteners including appliances, lighting, toys, construction, and automotive aftermarket providers. Before taking over the family business in 1998, I worked as a Certified Public Accountant (CPA) for roughly twenty years, giving me a unique perspective to understand both the production and finance sides of manufacturing in America.

In my experience as a CPA, the vast majority of manufacturers are structured as an S Corporation, Limited Liability Corporation (LLC), partnership or other form of pass-through. Recent statistics show that 54% of all private employers are structured this way and among PMA member companies, 64% of manufacturers are a pass-through entity.

Many companies like ours are structured this way because we are family owned businesses with a limited number of shareholders and owners who are often our siblings and increasingly our children and grandchildren. We initially became an S Corporation to avoid the double-taxation that a C Corporation faces.

First, I would like to provide a quick analysis from the standpoint of a CPA and then show the impact of the current tax code on a manufacturer in Illinois. Small and medium sized manufacturing business owners (such as my brother and me) pay our income taxes at the individual rate, and claim all deductions and credits at the personal level as well as the company level when appropriate. This means that the financial and manufacturing success of our employees and business are directly tied to that of the business owners – the Smith Family.

The vast majority of company owners like us leave most of the money in the business, directly reinvesting in our employees, facilities, and equipment. This is an important point. Due to our current U.S. tax code, we are taxed on income we do not take out of the company but leave in the business to reinvest. This means we have fewer resources to put towards hiring, training, and buying new machines. In speaking to a few companies in our industry from Illinois, Wisconsin, and Ohio, small and medium sized manufacturers, based on wage and K-1 income, pay 36% in taxes, distribute 18% to owners, and reinvest 46% in the business.

In addition, those funds are taxed at the individual rate which for most of us is at the current 35% level set to increase to 39.6% on January 1, 2013 without Congressional action. If statutory rates increase by nearly 5%, as business owners we have to take it out of the pie somewhere, either from the owner's families or from reinvestment in the employees and company – usually both.

Tax increases resulting in reduced cash flow in the business causes a major unintended ripple effect on a small business – access to capital. Banking and other lending requirements have toughened forcing more owners to leave retained earnings in the business for capitalization purposes. Therefore, increased tax liability means less money in the business which will restrict the ability of a small business to access timely and sufficient credit to purchase machines, expand their facility, and hire new employees. This is particularly true for a passthrough entity like ours who is taxed regardless of the actual distribution made to the owner.

Tax rates are clearly a politically charged issue but from the standpoint of the small business owner, we must take whatever steps we can to reduce our effective tax rate in order to free up funds to reinvest in new technologies and people to remain globally competitive. Over the last few years, Termax Corporation has seen our American competitors decrease to just two (2) from approximately eight (8); while our foreign competitors have increased dramatically. This is where tax deductions and credits come in as the only tool we have to reduce our effective tax rate and incentivize us to take actions we might otherwise not take at that time.

Companies of all structures and sizes claim deductions and credits for certain activities or property, from the Research and Development Tax Credit to Bonus Depreciation. As I mentioned, our company holds over 60 patents and in 2011 we expect to spend \$1,500,000 on R&D to develop new technologies for the automotive and construction industries among others.

Another good example is the Section 199 Domestic Production Activity Deduction, where manufacturing businesses and other qualified production activities are eligible for a 9% deduction. This amounts to an *effective* rate reduction of 3.19%, lowering the tax burden on the manufacturer and freeing funds for reinvestment.

This is why removing deductions and credits such as the Section 199 for all businesses to reduce the rate for traditional C Corporations will *increase* the effective tax rate and burden on all S Corporations and other pass-throughs like our business. We need a comprehensive approach to tax reform that addresses corporate, pass-through business, and individual tax rates, deductions, and credits. Due to the complicated and interwoven nature of the tax code, a piecemeal approach to reform will not work and will inevitably disadvantage the smaller businesses.

Some have asked why we S Corporations and LLCs simply do not convert to becoming a traditional C Corporation. First the costs associated with the conversion are astronomical and it is extremely time consuming, especially for a company of smaller resources. Another reason is due to the family owned structure of the business, when a business owner passes a company down to the next generation, there is a greater tax liability for a C Corporation. This is akin to the family farm being sold to pay taxes.

Tax reform is possibly the single most important barrier to improving manufacturing growth in the U.S. but it is about so much more than just statutory rates. If you ask them, most manufacturers want stability, simplification, and globally competitive effective rates. We each need to pay our fair share and there is no question the tax code is filled with outdated provisions and loopholes that have long outlived their effectiveness. A prime example of this is the Alternative Minimum Tax, the forerunner of the current Millionaires' Tax.

As a business owner, the most important questions are: what is my total federal, state, and local tax liability, what is my effective rate, and what is left over for me to invest and grow my business? On behalf of small and medium sized businesses manufacturing in America, we ask that Washington move on comprehensive tax reform to help us all grow our businesses and create jobs in the U.S.

Thank you for the opportunity to present testimony today. I look forward to continuing to work with this Committee.

	Base Case		#NAME?	
	Assumptions		Assumptions	
Sales	\$ 25,000,000		\$ 25,000,000	
PreTax Profit %	6.0%		6.0%	
Wages (Salaries + Bonus)	\$ 200,000		\$ 200,000	
Self Employed Health	\$ 10,500		\$ 10,500	
Section 199 %	9.0%		9.0%	
LIFO to FIFO	\$ -		\$ -	
Federal Tax Rate	35.0%		25.0%	
Local Tax Rate	2.0%		2.0%	
State tax Rate	5.93%		5.93%	
S Corp Medicare Tax Rate	2.90%		2.90%	
LLC Medicare Tax Rate	2.90%		2.90%	
Donations (\$)	\$ 25,000		\$ 25,000	
Other (\$)	\$ 15,000		\$ 15,000	
Social security tax	12.40%		12.40%	
Itemized Deduction Phaseout \$	\$ 166,000		\$ 166,000	
Itemized Deduction Phaseout %	3.0%		3.0%	
R&D Tax Credit	\$ 50,000		\$ 50,000	
Millionaires Tax Threshold	\$ 1,000,000		\$ 1,000,000	
Millionaires Tax Rate %	0.00%		0.00%	
S Corp Medi. Tax Increase 2014	0.00%		0.00%	
LLC Medi. Tax Increase 2014	0.00%		0.00%	
Investment Tax Credit				
Social Security max income	\$ 106,800			
S Corp or LLC?	S Corp		S Corp	

	Base Case		#NAME?		
	P&L View	Taxes	P&L View	Taxes	Taxes
Sales	\$ 25,000,000		\$ 25,000,000		
S Corp and LLC K1 Income	\$ 1,500,000		\$ 1,500,000		
Wages + K1 Income	\$ 1,700,000		\$ 1,700,000		
<b>Adjustments</b>					
Self Employed Health	\$ 10,500		\$ 10,500		
Section 199	\$ (135,000)		\$ (135,000)		
LIFO to FIFO	\$ -		\$ -		
Total Adjustments	\$ (124,500)		\$ (124,500)		
Adjusted Gross Income	\$ 1,575,500		\$ 1,575,500		
<b>Deductions</b>					
Local Tax	\$ 31,510		\$ 31,510		\$ -
State Tax	\$ 93,427		\$ 93,427		\$ -
Social Security tax	\$ 13,243	\$ 13,243	\$ -	\$ 13,243	\$ -
Medicare Tax	\$ 5,800	\$ 5,800	\$ 5,800	\$ 5,800	\$ -
Donations	\$ 25,000		\$ 25,000		
Other	\$ 15,000		\$ 15,000		
Subtotal Deductions	\$ 183,980		\$ 170,737		
Itemized Deduction Phaseout	\$ 42,285		\$ 42,285		
Total Deductions	\$ 141,695		\$ 128,452		
Taxable Income	\$ 1,433,805	\$ 501,832	\$ 1,447,048	\$ 361,762	\$ (140,070)

**Credits**

R&D Tax Credit	\$ 50,000	\$ (50,000)	\$ 50,000	\$ (50,000)	\$ -
Investment Tax Credit	\$ -	\$ -	\$ -	\$ -	\$ -
Total Taxes		\$ 470,875		\$ 330,805	\$ (140,070)

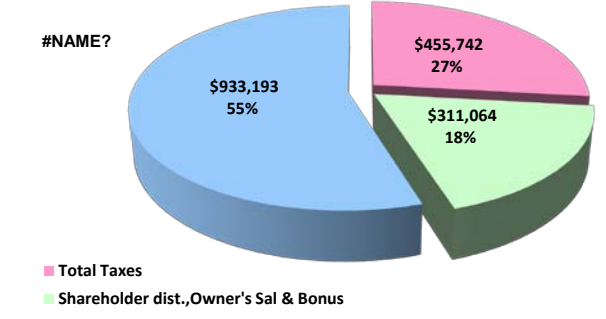
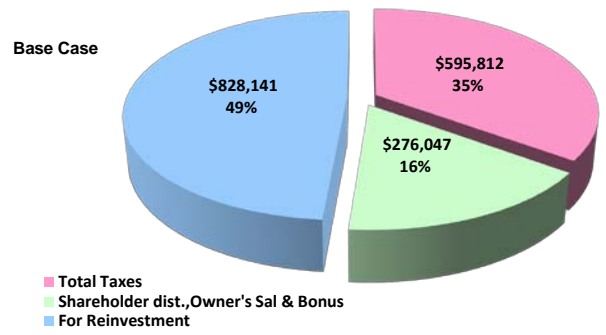
**Potential Changes**

S Corp Medi. Tax Increase	\$ -	\$ -	\$ -	\$ -	\$ -
LLC Medicare Tax Increase	\$ -	\$ -	\$ -	\$ -	\$ -
Millionaires Tax	\$ -	\$ -	\$ -	\$ -	\$ -
Total Changes	\$ -	\$ -	\$ -	\$ -	\$ -

<b>Total Federal Taxes After Changes</b>	\$ 470,875	27.7%	\$ 330,805	19.5%	\$ (140,070)
State and local taxes	\$ 124,937		\$ 124,937		
<b>TOTAL TAXES</b>	\$ 595,812	35.0%	\$ 455,742	26.8%	

**Comments**

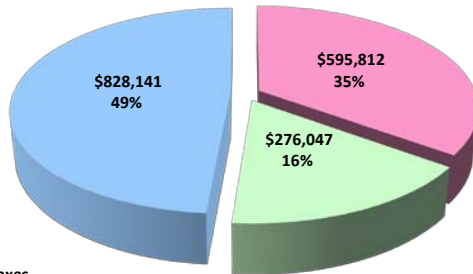
Example based on a metalworking company in Ohio with a 25% statutory rate assumption removing most deductions.



	Base Case		#NAME?	
	Assumptions	Assumptions	Assumptions	Assumptions
Sales	\$ 25,000,000	\$ 25,000,000		
PreTax Profit %	6.0%	6.0%		
Wages (Salaries + Bonus)	\$ 200,000	\$ 200,000		
Self Employed Health	\$ 10,500	\$ 10,500		
Section 199 %	9.0%	0.0%		
LIFO to FIFO	\$ -	\$ -		
Federal Tax Rate	35.0%	39.6%		
Local Tax Rate	2.0%	2.0%		
State tax Rate	5.93%	5.93%		
S Corp Medicare Tax Rate	2.90%	2.90%		
LLC Medicare Tax Rate	2.90%	2.90%		
Donations (\$)	\$ 25,000	\$ 25,000		
Other (\$)	\$ 15,000	\$ 15,000		
Social security tax	12.40%	12.40%		
Itemized Deduction Phaseout \$	\$ 166,000	\$ 166,000		
Itemized Deduction Phaseout %	3.0%	3.0%		
R&D Tax Credit	\$ 50,000	\$ -		
Millionaires Tax Threshold	\$ 1,000,000	\$ 1,000,000		
Millionaires Tax Rate %	0.00%	0.00%		
S Corp Medi. Tax Increase 2014	0.00%	0.00%		
LLC Medi. Tax Increase 2014	0.00%	0.00%		
Investment Tax Credit				
Social Security max income	\$ 106,800	\$ 106,800		
S Corp or LLC?	S Corp	S Corp		

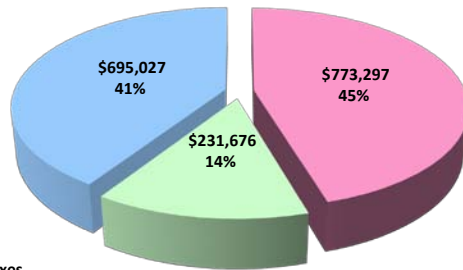
	Base Case		#NAME?		
	P&L View	Taxes	P&L View	Taxes	Taxes
Sales	\$ 25,000,000		\$ 25,000,000		
S Corp and LLC K1 Income	\$ 1,500,000		\$ 1,500,000		
Wages + K1 Income	\$ 1,700,000		\$ 1,700,000		
<b>Adjustments</b>					
Self Employed Health	\$ 10,500		\$ 10,500		
Section 199	\$ (135,000)		\$ -		
LIFO to FIFO	\$ -		\$ -		
Total Adjustments	\$ (124,500)		\$ 10,500		
Adjusted Gross Income	\$ 1,575,500		\$ 1,710,500		
<b>Deductions</b>					
Local Tax	\$ 31,510		\$ 34,210		\$ -
State Tax	\$ 93,427		\$ 101,433		\$ -
Social Security tax	\$ 13,243	\$ 13,243	\$ 13,243	\$ 13,243	\$ -
Medicare Tax	\$ 5,800	\$ 5,800	\$ 5,800	\$ 5,800	\$ -
Donations	\$ 25,000		\$ 25,000		
Other	\$ 15,000		\$ 15,000		
Subtotal Deductions	\$ 183,980		\$ 194,686		
Itemized Deduction Phaseout	\$ 42,285		\$ 46,335		
Total Deductions	\$ 141,695		\$ 148,351		
Taxable Income	\$ 1,433,805	\$ 501,832	\$ 1,562,149	\$ 618,611	\$ 116,779

Base Case



■ Total Taxes  
■ Shareholder dist., Owner's Sal & Bonus  
■ For Reinvestment

#NAME?



■ Total Taxes  
■ Shareholder dist., Owner's Sal & Bonus

	Base Case	#NAME?	Base Case	#NAME?	Base Case	#NAME?
<b>Credits</b>						
R&D Tax Credit	\$ 50,000	\$ (50,000)	\$ -	\$ -	\$ 50,000	\$ -
Investment Tax Credit	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Taxes		\$ 470,875	\$ 637,654	\$ 166,779		
<b>Potential Changes</b>						
S Corp Medi. Tax Increase	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
LLC Medicare Tax Increase	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Millionaires Tax	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Changes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

<b>Total Federal Taxes After Changes</b>	\$ 470,875	27.7%	\$ 637,654	37.5%	\$ 166,779
State and local taxes	\$ 124,937		\$ 135,643		
<b>TOTAL TAXES</b>	\$ 595,812	35.0%	\$ 773,297	45.5%	

**Comments**  
 Example based on metalworking manufacturing company in Ohio with a 39.6% statutory rate assumption

## TaxTemplate-medium 25% 111101, "EXPLANATION" - 11/2/2011

	Assumptions	Assumptions
Sales		PMA average rate for 2008
PreTax Profit %		Can be multiple owner operators - represents total salaries and bonus
Wages (Salaries + Bonus)		W2 earnings from businesses
Self Employed Health		This represents value for self employed health care - will be an arbitrary number selected by
Section 199 %		Domestic production activities deduction
LIFO to FIFO		A fixed number based on 10 year phase in - to start by 2013
Federal Tax Rate		federal - returns to Pre Bush tax cuts
Local Tax Rate		City
State tax Rate		State
S Corp Medicare Tax Rate		Medicare tax paid by employee and employer - W2 only for S Corp
LLC Medicare Tax Rate		Medicare tax paid by employee and employer - unlimited in LLC
Donations (\$)		Total donations within K1 plus personal donations of filer
Other (\$)		Investment fees, tax preparation fees, non-covered expenses, real estate taxes above thres
Social security tax		12.4% up to \$ 106,800 - doesn't change in 2013
Itemized Deduction Phaseout \$		Phaseout threshold
Itemized Deduction Phaseout %		Reimposed in 2013
R&D Tax Credit		Amount calculated annually - goes away in 2013
Millionaires Tax Threshold		Not scheduled for 2013
Millionaires Tax Rate %		Charged to LLC and K1 earnings ???
S Corp Medi. Tax Increase 2014		Additional tax set at .9% on W2 but not K1 for S Corps
LLC Medi. Tax Increase 2014		Additional tax set at .9% on wages and bonus including K1
Investment Tax Credit		10% tax credit on machinery purchased (not presently used)
Social Security max income		Maximum income that social security is paid on (remains unchanged in 2013)
S Corp or LLC?		Place Cursor in cell and select S Corp or LLC from dropdown list

### General Notes:

- Enable Macros
- to create a new sheet, ONLY press "New Case" in upper left corner of sheet. Do not copy sheet because pie chart will be invalid.
- renaming the sheet title will automatically rename titles on the active sheet
- "Resize this Row" will accommodate longer case names
- password to unprotect all sheets is "mcgregor"

**This tax template is a representation of the potential effects of tax reform. It is not intended to be an exact calculation of a business's tax liability.**