Biotechnology Innovation Organization

James C. Greenwood
President & CEO

July 3, 2018

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Vern Buchanan
Chairman
Tax Policy Subcommittee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Brady and Chairman Buchanan,

On behalf of the Biotechnology Innovation Organization (BIO) and its 1,000 members, I want to thank you for your continued dedication to reforming America's corporate tax code to make it competitive on the global stage. As the Ways and Means Committee begins to develop new tax legislation, we believe it is imperative that you include policies that will incentivize, or at a minimum remove obstacles that impede, the emerging biotechnology companies that are conducting life-changing and life-saving innovation.

The biotechnology industry is discovering groundbreaking cures and treatments for devastating diseases. It is also developing advanced biofuels, renewable chemicals, biobased products and improved agricultural products for everyday consumer products. Many early-stage innovative companies generate little revenue and do not have a tax liability. Therefore, tax rate reductions and the R&D Tax Credit do not have an immediate impact as they do for larger, profitable corporations.

According to the 2018 Bloomberg Innovation Index, America has recently fallen out of the top ten most innovative nations. For the United States to regain its status in the world as a leader of innovation, tax reform must support the growth of small business innovators and incentivize investment in breakthrough technologies. BIO believes the guiding principle of future tax reform should be the promotion of innovation. BIO supports the following tax reform proposals.

Section 382 Net Operating Loss Reforms

Tax rules relating to the treatment of losses can unintentionally punish start-ups for investing in the growth of their companies. The rules, in Section 382 of the tax code, were written in the mid-1980s with the intent of preventing loss trafficking, or the strategy of companies acquiring failing firms with enormous losses on their books for the sole purpose of using the tax losses to offset other unrelated income. While we recognize the importance of preventing abusive loss trafficking, the excessive application of these rules has created an impediment for start-ups, which depend on investment capital and often accumulate net operating losses (NOLs) as a result of substantial R&D expenditures and rapid hiring. Under Section 382, raising new capital investments can limit a start-up's ability to utilize its NOLs in the future. Thus, Section 382 discourages investment in innovation and works at cross purposes with tax policy that generally seeks to encourage R&D, such as the R&D credit.

Congress can foster economic growth and job creation without creating a new tax expenditure by preserving these small company NOLs related to R&D and providing a narrow safe harbor from Section 382 NOL limitations (and related Section 383 credit limitations) for start-ups going through viable fundraising rounds.

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Section 1202 Qualified Small Business Stock Reforms

Investment in this type of groundbreaking innovation is high-risk and long-term. Without a tax structure that encourages this activity, our innovators and entrepreneurs will be placed at a disadvantage at a time when the rest of the world is doing everything it can to compete with our leadership.

We believe that maintaining the permanent 100% exemption of gains on investments in Qualified Small Business Stock (QSBS) under IRC Section 1202 is vital to encourage the early-stage investment necessary to spur groundbreaking innovation. We applaud lawmakers for retaining this incentive in the new tax law.

Section 1202 has the potential to be one of the most powerful federal policies for encouraging an expansion of entrepreneurship across the country. We believe that Congress should build on this success by simplifying and expanding QSBS to encourage more investment in start-ups across the country.

Changes that would make 1202 more effective include:

- Raising the maximum gross assets threshold for QSBs to $100 million. The high costs of innovative research, coupled with valuable intellectual property and successive rounds of financing, often push growing innovators over the $50 million gross assets limit and thus out of the QSB definition.
- Directing the IRS to adopt reporting obligations for companies that make it clear to the investor whether the company is a QSB.
- Allowing investors to count up to four years of the time they held LLC interests which are then converted into C Corporations into the five-year holding period.

Section 41 Payroll R&D Credit Expansion

We applaud Congress for creating the payroll R&D Credit in the Protecting Americans from Tax Hikes (PATH) Act in 2015. This was an important recognition by Congress that R&D tax credits do not yet benefit pre-revenue companies. Unfortunately, the size and age restrictions associated with the provision leave many start-ups unable to access the benefits of the payroll R&D credit. A typical start-up will still be quite early in the process of development when the size/age limits eliminate their ability to benefit from the payroll R&D credit. Meanwhile, their pre-revenue nature prevents them from taking advantage of the traditional R&D credit. This creates a strange contradiction where start-up companies cannot access the benefits of the R&D credit when they need it the most.

Under current law, companies in their first five years of operation with less than $5 million in annual gross receipts can utilize up to $250,000 in R&D credits annually under the PATH Act reforms. While we believe this change was an important first step, we also support expanding this provision to encompass a wider, more representative universe of start-ups and emerging innovators. Given the long development timelines of the biotechnology industry's groundbreaking innovation and the high costs of breakthrough research, targeted expansions to the payroll credit would ensure that more innovative pre-revenue companies can take full advantage of this new incentive.

Specifically, we propose that start-ups with less than $100 million in gross assets be able to offset up to $1 million in employer-side payroll taxes annually with R&D credits. The $100 million gross assets test would bring the definition of "qualified small business" under the payroll R&D credit in line with the same expanded definition that BIO supports under Section 1202's QSBS capital gains exclusion.

Biofuels Tax Incentives

Since 2009, the advanced biofuels industry has invested billions of dollars to build first-of-a-kind demonstration and commercial-scale biorefineries across the country. Despite the recent successes of building commercial-scale facilities, this is a new and developing industry. There are great benefits to developing these technologies, however.

Over the past 10 years, the biofuels industry has displaced nearly 1.9 billion barrels of foreign oil by replacing fossil fuels with homegrown biofuels. This has saved consumers an average of one dollar a gallon at the pump. Unfortunately, policy instability undermines certainty and predictability for investors and other market participants. The uncertain cycle of expirations and reinstatements for tax incentives for advanced and cellulosic biofuels make it difficult for the industry to take advantage of these tax incentives that could help move these projects to commercial production by attracting investment and reducing the cost of production. Even with these benefits, this sector needs predictable federal tax policy to continue to attract investment in order to grow and compete with incumbent industries that have long received favorable tax preferences.

BIO has long supported a suite of tax incentives important for the development of advanced and cellulosic biofuels – the Second Generation Biofuel Producer Tax Credit (PTC), the Special Depreciation Allowance for Second Generation Biofuel Plant Property, the Biodiesel and Renewable Diesel Fuels Credit, and the Alternative Fuel Vehicle Refueling Property Credit. Unfortunately, the Second Generation Biofuel PTC and associated depreciation provisions have never been enacted for a sufficient length of time to allow investors to depend upon their existence once the facilities are eventually placed in service. BIO supports the extension of these provisions, especially the Second Generation Biofuel PTC, which expired in December 2017. Further, BIO would encourage Congress to reject the creation of a phase-out. Ending the tax credits on an arbitrary date in the near term will hamper the utilization of these incentives for an industry where financing and constructing new facilities takes on average five to six years.

Renewable Chemicals and Biobased Products Tax Incentives

Companies are using industrial biotechnologies to help resolve important challenges in synthesizing new products, whole cell systems, and other biological processes to improve all types of manufacturing and chemical processes. This progress is enabling the production of a new generation of renewable chemicals, biobased products, and bioplastics produced from renewable biomass, which can supplement or substitute for traditional petroleum-based chemicals and products. The emergence of this technology represents a historic opportunity to reverse job losses in the U.S. chemicals and plastics sectors while simultaneously improving energy security and the environment.

Investment and production tax credits are currently offered to incumbent fossil energy industries. To realize the renewable chemical industry’s potential for domestic job creation and reduced reliance on foreign oil, Congress must ensure that renewable chemical technologies are incentivized in the tax code, and at a minimum, receive tax parity with other renewable energy technologies.

BIO also supports efforts to amend the tax code to extend availability of the master limited partnership (MLP) business structure to renewable chemicals and biofuels companies that are publicly traded. Should this important change be made, the use of the MLP structure would reduce the cost of private capital for renewable chemicals and biofuels projects.

Conclusion

Federal tax policy that recognizes the special demands placed on biotech companies and other highly innovative industries will speed the development of products to vastly improve the lives of

Americans and people around the world. By recognizing the importance of innovation and the economic potential of the biotech industry, Congress can incentivize further development and improve America's economic health.

BIO supports a U.S. tax code that recognizes innovation as a crucial part of the 21st Century American economy and encourages innovative research and new technologies to enter the market. The tax code should promote research-intensive and advanced manufacturing businesses as they continue to create high-quality American jobs, stimulate long-term economic growth, and bolster America's competitiveness on an increasingly global stage.

We look forward to working with you on these important improvements to the tax code.

Sincerely,

Jim Greenwood

James C. Greenwood
President and CEO

cc:
The Honorable Sam Johnson
The Honorable Devin Nunes
The Honorable Dave Reichert
The Honorable Peter Roskam
The Honorable Adrian Smith
The Honorable Lynn Jenkins
The Honorable Erik Paulsen
The Honorable Kenny Marchant
The Honorable Diane Black
The Honorable Tom Reed
The Honorable Mike Kelly
The Honorable Jim Renacci
The Honorable Kristi Noem
The Honorable George Holding
The Honorable Jason Smith
The Honorable Tom Rice
The Honorable David Schweikert
The Honorable Jackie Walorski
The Honorable Carlos Curbelo
The Honorable Mike Bishop
The Honorable Darin LaHood
The Honorable Brad Wenstrup