An Extension of *AdvaMed's Tax Reform Principles*: Promoting Innovation in Emerging Companies

March 25, 2013

As noted in *AdvaMed's Tax Reform Principles*[1], small firms play a key role in sustaining the medical technology industry. An estimated 62% of medical technology firms have fewer than 20 employees[2] – the majority of these companies being in pre-revenue or early revenue stages. A lower corporate tax rate alone will not support the establishment and survival of these fledgling entities critical to economic growth.

Emerging and early-growth companies are facing extreme drought in terms of required capital to develop new technologies and create new jobs. In 2012, venture capital investments in the Medical Device industry fell by 13% in dollars and 15% in deals – with a total of $2.4 billion going into 313 deals. Much of the decline occurred in first-time financings, where Medical Devices saw the lowest number of deals since 1995.[3] Prior to the financial crisis of 2008, the industry began experiencing a significant decline in the number of first-time financings, as shown in Figure 1[4]. Total investments have also declined to levels below those present prior to the financial crisis (Figure 2).

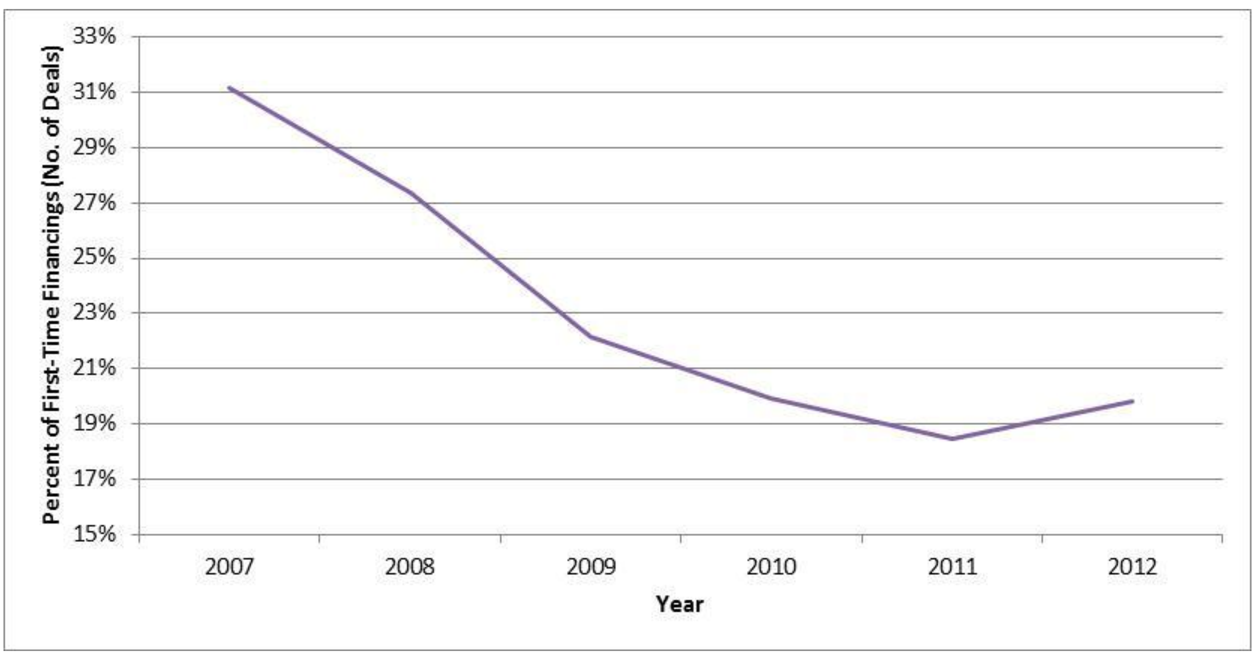

Figure 1. First-Time Investment Decline since 2007 (based on number of deals)[4] – Medical Device Industry

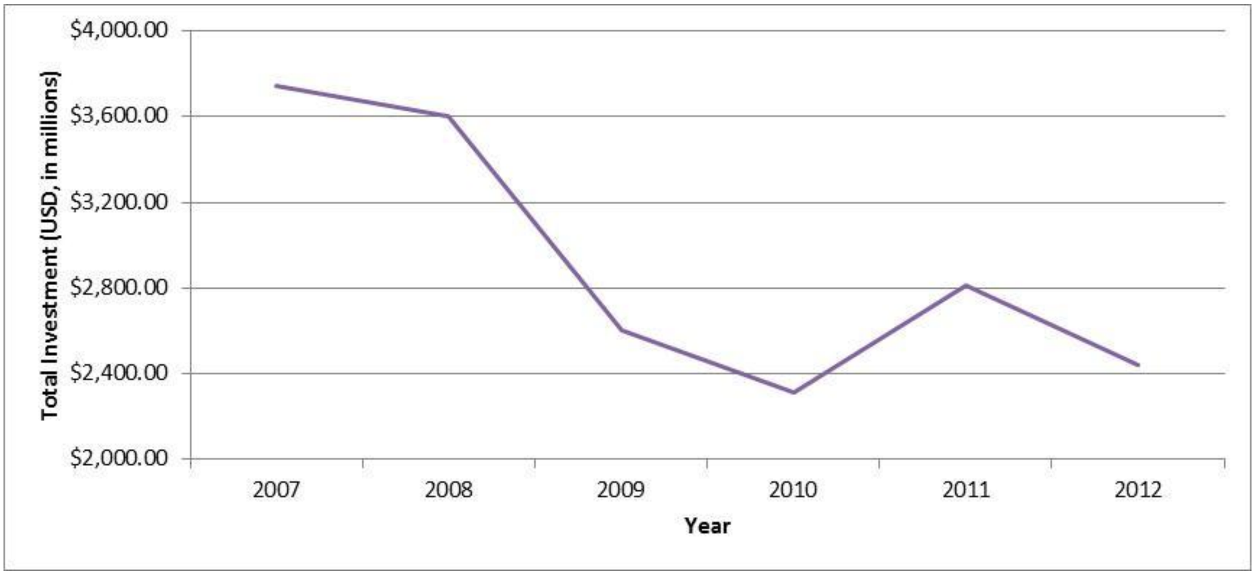

Figure 2. Total Venture Capital Investment in the Medical Device Industry[4]

As stated in *AdvaMed's Tax Reform Principles*, "tax reform should provide incentives for the investment in research and development, which is key to the growth of the knowledge-based, high value-added industries on which America's economic future depends." Policymakers must consider promoting these small innovative research-intensive businesses through incentives that encourage investments from other companies, individuals, and funds – and organic growth to create new jobs and commercialize life-changing technologies.

"Broadening the base and lowering the rate" alone will not promote survival and growth of these companies, especially those not yet realizing a revenue stream. Comprehensive tax reform should also encourage current – and new – investors to finance companies sooner. As the regulatory environment in the United States becomes increasingly challenging for the medical device industry, more capital is needed to fund life-changing innovation. AdvaMed believes that the following policies should also be part of tax reform:

Device Tax Repeal

The 2.3% Medical Device Excise Tax poses an enormous burden for small companies. From their first sale, these companies are subject to the tax, even with millions of dollars in net operating losses incurred over years of development. AdvaMed continues to advocate for full repeal of this detrimental tax burden, as described in *AdvaMed's Tax Reform Principles*.

Section 469 R&D Partnership Structures

AdvaMed, along with the Coalition of Small Business Innovators (CSBI), supports a limited exception from the passive activity loss (PAL) rules for R&D-focused pass-through entities. Relaxing the PAL rules will incentivize investors to finance companies at an earlier stage when capital is most needed – and where current investments in the Medical Device industry have dried up most since 2007.

Section 382 Net Operating Loss (NOL) Reform

AdvaMed, along with CSBI, supports the exemption of NOLs generated by qualifying research and development conducted by a small business from Section 382. Currently, the usage of NOLs by companies who have undergone an "ownership change" is restricted. Such reform would encourage additional outside financing and help make such businesses more attractive to investors.

In addition, AdvaMed encourages policymakers to review tax certificate transfer programs, such as the program in New Jersey, where a capped percentage of NOLs may be transferred to raise capital for qualifying pre-revenue companies.

Section 1202 Capital Gains Reform

AdvaMed, along with CSBI, supports changing the qualified small business (QSB) definition to include companies with gross assets up to $150 million (from $50 million), with that cap indexed to inflation. This change would also include S-Corps and LLCs in the definition of a QSB. Furthermore, AdvaMed and CSBI support excluding the value of a company's IP when calculating gross assets. These changes would also encourage investment into emerging and early-growth medical device companies.

Permanent Extension of Section 179 Depreciation Deduction

AdvaMed supports the permanent extension of the Section 179 expense, which allows qualifying small business owners to deduct the cost of depreciating business assets on their tax returns at a limit of $500,000. Furthermore, AdvaMed supports the permanent extension of bonus depreciation in Year 1 (50% of cost) of a qualified business asset purchase. Such incentives allow companies to invest more heavily in their businesses and encourage job creation and growth.

Permanent Extension of Sections 992-996 IC-DISC Status

AdvaMed supports the permanent extension of IC-DISC status for qualified small companies exporting to other countries. Many medical device companies are forced to commercialize their products first overseas. The tax rate reduction to 15% provides these companies with capital to fuel organic growth, finance clinical studies and regulatory approvals in the United States, and develop new technologies.

---

[1] Advanced Medical Technology Association, *AdvaMed's Tax Reform Principles*, March 25, 2013.
[2] U.S. Department of Commerce, unpublished data, 2002.
[3] Pricewaterhouse Coopers and NVCA, "MoneyTree Report," January 2013.
[4] Thomson Reuters, MoneyTree Report Aggregate Data Q1 1995 – Q4 2012.