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United States Senate

COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
WASHINGTON, DC 20510-6350

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BY FACSIMILE
ORIGINALS BY U.S. MAIL

The Honorable Pamela Olson
Assistant Secretary for Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Mr. Robert Wenzel
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Dear Assistant Secretary Olson and Acting Commissioner Wenzel:

On June 6, 2002, the Treasury Department and the Internal Revenue Service (IRS) issued proposed regulations that will change a long-standing exemption from a variety of fuel and highway-vehicle excise taxes for mobile machinery (REG-103829-99, 67 Fed. Reg. 38,913 (June 6, 2002)). I greatly appreciate your providing additional time for affected small businesses and their advocacy groups to submit comments on these regulations, as I requested in my letter of August 1, 2002.

This letter describes my grave concerns about the proposed regulations. As discussed below, I believe they will have a substantial adverse economic impact on small businesses and that the Treasury Department and the IRS have failed to comply with the procedural requirements designed to reduce burdens on small enterprises. Accordingly, I request that you withdraw the proposed regulations to conduct further analysis of the economic consequences and regulatory burdens that would result if they were implemented.

Taxes should not be raised by regulatory fiat, especially on small businesses.

Under the current regulations, certain machinery that is permanently mounted to a vehicle chassis is exempt from a variety of excise taxes, provided it satisfies a stringent three-part test set forth in the regulations (hereinafter referred to as the mobile-machinery exemption or MME). These taxes include the fuel excise tax on gasoline (\$0.184 per gallon) and on diesel fuel (\$0.244 per gallon), the excise tax on certain tires (varies by tire type), the retail tax on heavy-truck and trailer chassis (12% of the sales price), and the heavy-vehicle excise tax (up to \$550 per year).

The Honorable Pamela Olson

Mr. Robert Wenzel

Page 2

This exemption affects businesses in a vast array of industries, including water- and oil-drilling, commercial construction, logging, utilities, mining, tower erectors, and equipment leasing, to name just a few. For those businesses, this exemption recognizes the fact that mobile machinery spends the vast majority of its time at the work site and uses the nation's road ways an insubstantial amount of time to reach that job site.

While I have long been a strong proponent of improving our nation's highways, the proposed regulation is not an appropriate means of accomplishing that goal. In addition, it is certainly beyond the purview of the IRS to address national transportation-funding policy by regulatory fiat.

For small firms with operations using mobile machinery, the effects of this regulation will be devastating. For more than two decades, these businesses have based their business plans on the existence of the MME. By eliminating it, they will now have to bear the various excise taxes applicable to their mobile machinery under the proposed regulations. And to make matters worse, as currently drafted, the proposed regulations apply to all mobile machinery, whether the machinery is a new purchase or has been in service for many years. In other words, a small company whose equipment was exempt under the current rules, would be subject to thousands of dollars in fuel, tire and heavy-use-vehicle excise taxes under the proposed rule, even if the company buys no new machinery. As a result, the proposed rule cuts to the very heart of the business' pricing of its services and the past and future financing decisions it makes with regard to this kind of equipment.

Moreover, according to reports that I have received from affected companies, the cost of purchasing mobile machinery is enormous – on the order of \$175,000 for a single digger derrick or \$1.8 million for one lattice boom truck crane, to cite just two examples. For many companies, especially the small ones, the ability to buy new or replace existing equipment depends greatly on current exemption from the various excise taxes. Adding the manufacturer's excise tax of 12% to a new concrete pump costing between \$400,000 and \$1 million will have an obvious negative impact. As a small concrete pumping company in Missouri put it, "you can be certain such an increase will slow, or halt, any decision to replace or add new equipment." Clearly that cannot be the policy goal of these proposed regulations.

Similarly, such a disincentive as the removal of the MME would dramatically reduce orders for new mobile machinery, further depressing the already struggling manufacturing sector of our economy. Moreover, for inventory produced with the expectation that the MME would apply, the proposed regulations reduce the ability of manufacturers and retailers to sell existing inventory, thereby economically penalizing them through a rule they could not foresee and are powerless to prevent.

In the current economic climate, a tax increase is the last thing needed by small businesses utilizing mobile machinery and the manufacturers producing it. Nevertheless, that is exactly what the proposed regulations will deliver. As the Ranking Member of the Senate

Committee on Small Business and Entrepreneurship, I continue to hear from the small business community in Missouri and across the nation that the economic climate is far bleaker than the national statistics would have us believe. In light of these facts, I am bewildered that the IRS would propose to remove the MME and effectively increase taxes by regulatory fiat on small businesses struggling to cope with this prolonged economic downturn.

Furthermore, the proposed regulations turn a blind eye to the fact that most states have parallel excise taxes, many of which piggyback on the Federal system of transportation excise taxes. Accordingly, while the proposed rule significantly increases the Federal tax burden on small firms, it dooms them to additional taxes imposed by many of the states in which they do business.

The proposed rules have unanticipated economic consequences.

The proposed regulations are contrary to the national energy strategy that we are currently seeking to implement. As described above, the proposed rule will increase the cost of purchasing and utilizing new mobile equipment such as drilling rigs and well-service equipment used by energy and mining companies. These enterprises are essential to the nation's energy sector and are instrumental to our goal of ensuring greater availability of domestic energy supplies. If we hinder these firms' ability to succeed, we prolong our nation's vulnerability to foreign influences over our energy supplies – a result I trust was never envisioned by the drafters of this proposal.

Similarly, the proposed regulations will eviscerate a significant provision of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), which Congress enacted in March of this year to stimulate our nation's economy. Under Section 101 of the Act, businesses may claim "bonus depreciation" of 30% for the first year that property is placed in service beginning in taxable years ending after September 10, 2001. Congress' intent was to provide an incentive for businesses to purchase new equipment, thereby enabling them to increase productivity and expand. Congress also anticipated that such purchases would have the added effect of stimulating the manufacturing sector. By repealing the MME and applying the resulting excise taxes, the benefit of that bonus depreciation will be virtually nonexistent. Inexplicably, what the Congress' stimulus bill giveth, the IRS' proposed regulation taketh away!

What is the impetus for the drastic changes proposed in the regulations?

Putting aside the negative economic implications of the proposed rule, it is even less clear what is motivating the need for this proposal. I am not aware of any judicial decision that directs the IRS to repeal the MME. Similarly, I am not aware of any direction by the Congress that the MME should be removed. In fact, the Congress has implicitly approved the MME each time it has reauthorized the applicable transportation excise taxes.

The current MME has been on the books since 1977. When it was implemented 25 years ago, the IRS presumably made a determination that some nominal level of highway use by

mobile machinery was acceptable, hence, the exemption. According to the preamble to the proposed regulations, "it has become apparent that the assumption that most mobile machinery vehicles would make minimal use of the public highway is incorrect." I would appreciate your providing me with the specific analysis pertaining to the "minimal use" that is acceptable for the current MME and a detailed explanation of what factors have changed and why they support the elimination of the MME.

For their part, IRS employees have suggested that the current MME has been broadened beyond its original intent by a series of IRS rulings and judicial decisions. If the agency perceives that taxpayers are abusing the MME based on published or private ruling by the IRS, the agency should revoke or modify those rulings. If the perceived abuse is based on judicial interpretations of the MME and/or those rulings, changing the rulings should again address the issue. At most, I believe the agency should tailor any changes to the MME in order to deal with the specific abuses identified. Taking the draconian approach of eliminating the MME altogether is simply not a reasonable course of action.

The proposed regulation fails to comply with procedural protections for small businesses.

Regrettably, the preamble to the proposed regulations indicates that the procedural protections provided by Executive Order 12866, the Regulatory Flexibility Act of 1980 (Reg Flex), and the Small Business Regulatory Enforcement Fairness Act (SBREFA) have been disregarded. The relevant portions of the "Special Analysis" section state:

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that Section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required.

First, the statement that Executive Order 12866 does not apply is in direct conflict with the estimates I have received from affected industries. These figures indicate that the impact of the proposed rule will well exceed \$100 million for all affected businesses. Accordingly, if the IRS intends to pursue these proposed regulations, I request that you resubmit them to the Office of Information and Regulatory Affairs for the required regulatory assessment.

Second, as the author of the 1996 amendments to the Reg Flex, known as SBREFA or the Red Tape Reduction Act, I continually monitor agency compliance with these statutes. Like regulations issued by other departments of the Executive Branch, Treasury regulations must be issued in accordance with these important laws.

In passing SBREFA in 1996, Congress reiterated its insistence that every agency comply with the statutory requirements under the Reg Flex Act. Accordingly, each agency must analyze a new regulation's impact on small businesses and reduce such impacts whenever possible. More specifically, SBREFA includes specific provisions applicable to IRS interpretative rules. Section 241 of SBREFA amended the Reg Flex Act to cover IRS interpretative rules when these interpretative rules impose on small entities a collection of information or recordkeeping requirement.

The previous Administration either ignored or grossly misunderstood its statutory obligation when reviewing new IRS regulations. In fact, that Administration adopted the flawed interpretation of the collection of information or recordkeeping requirements under Section 241 to mean that the law only applied if the regulation in question involved a new tax form.

It had been my hope that the new Treasury Department would have abandoned this position and embraced the Congressional intent that IRS regulations must comply with SBREFA if they involve the collection of information or additional recordkeeping by small businesses regardless of how that information collection or recordkeeping occurs. Such an enlightened interpretation would be consistent with the very positive steps that the IRS has been taking in recent years to establish a new burden measurement model for individual and small business taxpayers and to identify opportunities in general for burden reduction. Sadly, the preamble to the proposed regulations raises questions about whether a more small-business-friendly approach is being applied when it comes to new regulations.

Had the Treasury and the IRS properly conducted a preliminary analysis of the small business impact of these rules, they would have discovered that the proposal represents a significant increase in burden for businesses in many industries. In addition to increasing tax burdens through regulatory action, the whole-scale elimination of the MME will dramatically change the amount of recordkeeping that businesses will have to maintain in order to comply with the host of excise taxes that will then apply.

Moreover, for those few taxpayers who may still qualify for the new off-highway exemption, the vagaries in the proposed regulations are an additional burden that small firms cannot afford. Sorting out whether equipment qualifies as "capable of being used on the road," for example, will surely force these taxpayers to engage expensive accountants and lawyers to provide legal opinions or to navigate the costly labyrinth of obtaining a private letter ruling (for which the IRS also charges a substantial processing fee).

With these facts in mind, I cannot agree with the preamble's unsupported, conclusionary statement that, "because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply." In fact, this is exactly the kind of new regulation to which we intended the burden-reduction requirements in SBREFA to apply.

Nevertheless, even if the Clinton Administration's flawed interpretation of Section 241 continues to be applied, the proposed regulations still fail because many small businesses will be required to deal with a new IRS form if the proposed regulations become final. Specifically, under the current exemption, IRS Form 2290 is not required since the Heavy Highway Vehicle Use Tax does not apply. Under the proposed rules, taxpayers would be burdened by this additional form and the corresponding excise tax on heavy highway-vehicles each year. Moreover, taxpayers will still have to report their fuel, tire, and retail excise taxes on IRS Form 720 every quarter. And it is little consolation that without the MME they will no longer have to bear the burden of completing the refund portion of Form 720. With the proposed rules, they will simply have to pay more taxes.

Regardless of the SBREFA interpretation that is applied, the proposed regulation should clearly be subjected to a Regulatory Flexibility Analysis. As Congress envisioned, the IRS must analyze the proposed regulations' impact on small businesses and then take steps to reduce those effects to the greatest extent possible.

The proposed regulations are contrary to the President's call for reducing the burden on small businesses.

Finally, in keeping with the Congressional intent behind the Reg Flex Act and SBREFA, the President stated his support for reducing the regulatory burdens on small business. On March 19, 2002, the President addressed attendees at the Women's Entrepreneurship in the 21st Century Summit and made the following commitment:

And so today, I want to make sure people understand that we're going to do everything we can to clean up the regulatory burdens on small businesses, starting with this: Every agency – already it's under current law – but every agency is required to analyze the impact of new regulations on small businesses before issuing them. That's an important law. The problem is, it's oftentimes being ignored. The law is on the books; the regulators don't care that the law is on the books. *From this day forward, they will care that the law is on the books.* (President George W. Bush, March 19, 2002; emphasis added).

As a result of this statement, we now have a new Executive Order 13272, which makes it clear that agencies must take into consideration the cost burden of regulations on small businesses. Unfortunately, the proposed regulations are inconsistent with both the President's expressed commitment and the intent of the new Executive Order.

Conclusion.

Given the proposal's adverse economic consequences and failure to comply with the statutory small business procedural protections, I request that you withdraw the proposed regulations. If after further consideration and analysis consistent with the foregoing statutory

The Honorable Pamela Olson
Mr. Robert Wenzel
Page 7

requirements you find that changes to the MME are still warranted, I urge you to proceed with great care and ensure that such changes are narrowly tailored and impose the least economic and regulatory burdens possible.

Thank you for your consideration. If you have any questions or need additional information, please do not hesitate to contact me or have your staff call Mark Warren, my Tax Counsel on the Committee, at 202.

Sincerely,



Christopher S. Bond
Ranking Member

cc: Mr. Lawrence Lindsey
Assistant to the President and
Director of the National Economic Council

The Honorable John Graham
Administrator
Office of Information and Regulatory Affairs

IRS Comment Submissions
CC:ITA:RU
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