AED Government Affairs Office
121 North Henry Street
Alexandria, VA 22314
Telephone: 703.739.9513
Facsimile: 703.739.9488
Electronic Mail: aeddc@aednet.org

April 15, 2015

The Honorable John Thune
U.S. Senate
Washington, D.C. 20510

The Honorable Mike Crapo
U.S. Senate
Washington, D.C. 20510

The Honorable Dean Heller
U.S. Senate
Washington, D.C. 20510

The Honorable Ben Cardin
U.S. Senate
Washington, D.C. 20510

The Honorable Sherrod Brown
U.S. Senate
Washington, D.C. 20510

The Honorable Michael Bennet
U.S. Senate
Washington, D.C. 20510

AED Tax Reform Comments to Senate Finance Committee Business Income Tax, Savings & Investment, and Community Development & Infrastructure Working Groups

Dear Senators Thune, Crapo, Heller, Cardin, Brown, and Bennet:

Thank you for the opportunity to submit comments on tax reform to the Senate Finance Committee's working groups on business income tax, savings and investment, and community development and infrastructure. We commend you, Chairman Hatch, and Ranking Member Wyden for the transparent, inclusive, and collaborative process you have designed to gather ideas.

1. Introduction

Associated Equipment Distributors (AED) is the trade association representing distributors of construction, mining, energy, forestry, industrial, and agricultural equipment.[1] Our positions, which are explained in more detail below, are as follows:

1. AED members believe the Internal Revenue Code's ("the code") complexity and uncertainty are undermining the nation's economic growth. <u>We therefore strongly support simplifying and restoring long-term certainty to the nation's tax laws.</u>

2. AED's membership is dominated by pass-through entities. We therefore believe that <u>corporate and pass-through reform must proceed simultaneously to ensure both large and small businesses benefit from improvements to the code.</u>

3. AED's members and their customers are capital-intensive companies. We believe the code must be improved to create a more favorable climate for capital investment. We encourage you to <u>reject proposals to lengthen cost recovery periods for capital assets, to eliminate Sec. 1031 like-kind exchanges, and to change the tax treatment of business interest</u>. <u>AED strongly supports making increased Sec. 179 expensing and phase out levels permanent.</u> We also urge the committee to

[1] A state-by-state listing of our members and dealer locations is available at http://www.aedauthorized.com.

consider additional ways to encourage capital investment by companies of all sizes and to equalize the tax treatment of construction and farm equipment.

4. Because rental is an increasingly popular way for contractors to acquire equipment, the code's tangled web of passive income rules has ensnared equipment companies in the Affordable Care Act's new unearned income tax. <u>We urge the committee to ensure these active, brick and mortar companies are held harmless from this new tax they were never intended to pay.</u>

5. The equipment industry is dominated by family-owned companies. Even with recent changes, the tax is still a burden, particularly to companies in capital intensive sectors like construction. <u>We urge the committee to pursue legislation to protect family businesses and farms from the threat of being destroyed by the estate tax when an owner dies.</u>

6. The LIFO ("last in, first out") accounting method has been widely used by equipment distributors and other inventory-intensive small businesses since the 1930s. Repealing LIFO would subject these businesses to considerable retroactive tax liability and eliminate an important tax and accounting tool. <u>The committee should reject any proposal to repeal LIFO.</u>

7. Existing Highway Trust Fund (HTF) revenue streams are inadequate to support current surface transportation investment levels, let alone to add the additional capacity necessary to support the nation's economic growth. <u>AED therefore urges the committee to pursue legislation to increase the gas tax and create new user fee revenues dedicated solely to infrastructure investment to put the HTF back on solid, long-term fiscal footing.</u> Congress should also create new incentives to attract private capital for infrastructure investment, for example by <u>raising the volume cap on private activity bonds for water projects</u>.

2. Background on AED

AED has more than 500 members, ranging in size from small dealerships with one location and a handful of employees to larger companies with hundreds of employees and dozens of locations across several states. However, the overwhelming majority of AED's members are small, family businesses; AED's average member achieves about $40 million per year in revenues and employs 80 people.

In anticipation of the tax reform debate, in late 2012 AED conducted the most comprehensive tax survey ever of its members (hereinafter "the survey").[2] The results provide important insights about how our members are affected by the current code and proposed changes; they also paint a vivid picture of how the construction equipment distribution sector fits into the overall economy. Survey respondents reported collective annual revenues of approximately $11.3 billion in 2011 and more than 20,000 employees. Average sales per employee were $562,108. Projected across AED's entire membership, the association estimates its U.S. dealer members earned $26.67 billion in total revenues in 2011 and employ close to 47,000 people.

Based on an earlier economic study conducted by Stephen Fuller, Ph.D., the Dwight Shar faculty chair at George Mason University (GMU) in Fairfax, Virginia, and director of GMU's Center for Regional Analysis, which

---

[2] "Impact of the Current Tax Code & Proposed Changes on U.S. Equipment Distributors: An Analysis of AED's 2012 Tax Survey", AED, Feb. 19, 2013 <http://www.aednet.org/government/pdf-2013/AED-2012TaxSurveyResults-20130213.pdf>

found that each dollar spent at an equipment distributorship creates $3.19 in direct, indirect, and induced economic activity,[3] AED estimates its membership's total annual economic impact at $85 billion.

3. Simplify and Restore Long-Term Certainty to the Nation's Tax Laws

The code's complexity has driven compliance costs through the roof. The Internal Revenue Service's National Taxpayer Advocate (NTA) reported in 2013 that the complexity of the code is the most serious problem facing taxpayers:

> The existing tax code makes compliance difficult, requiring taxpayers to devote excessive time to preparing and filing their returns … It obscures comprehension, leaving many taxpayers unaware how their taxes are computed and what rate of tax they pay; it facilitates tax avoidance by enabling sophisticated taxpayers to reduce their tax liabilities and provides criminals with opportunities to commit tax fraud; and it undermines trust in the system by creating an impression that many taxpayers are not compliant, thereby reducing the incentives that honest taxpayers feel to comply.[4]

The NTA also found that:

- Since 2001, Congress has made nearly 5,000 changes to the code (an average of more than one a day) and it now contains nearly four million words.
- Individuals and businesses spend about 6.1 billion hours a year complying with tax-filing requirements, the equivalent of more than three million full-time workers.
- The code is so complex that nearly 60 percent of taxpayers hire paid preparers and another 30 percent rely on commercial software to complete their returns. "In other words, taxpayers must spend money just to figure out how much money they owe."[5]

The fact that so many code provisions change and expire on an annual basis has layered uncertainty on top of the complexity. For example, the Joint Committee on Taxation recently reported that 52 tax provisions expired at the end of 2014.[6]

In a separate AED member Government Affairs survey conducted in early 2012, 96 percent of survey respondents agreed or strongly agreed that "the uncertainty surrounding the tax code is undermining the nation's economic vitality." At the same time, our members also understand that the nation's tax and fiscal woes are complicated and that will require comprehensive solutions. Seventy-two percent of respondents to that same survey agreed or strongly agreed that "balancing the federal budget will require a combination of spending cuts, entitlement reform, and across-the-board tax increases," and that "everyone should shoulder

---

3 "Sales of Heavy Construction Equipment as a Percentage of Construction Spending and Related Economic Impacts", Stephen Fuller, Ph.D., George Mason University, Sept. 2008 <http://www.aednet.org/government/pdf-2008/Fuller-Report.pdf>.

4 "National Taxpayer Advocate Delivers Annual Report to Congress", Internal Revenue Service, Jan. 9, 2013, <http://www.taxpayeradvocate.irs.gov/2012-Annual-Report/News-Release>.

5 *Id.*

6 "List of Expiring Federal Tax Provisions 2014-2025", Joint Committee on Taxation, Jan. 9, 2015 <https://www.jct.gov/publications.html?func=startdown&id=4683>.

some of the burden." Fewer than one-third (only 32 percent) agreed or strongly agreed that "tax increases should be off the table as a way to address the budget deficit." But 63 percent disagreed or strongly disagreed that "high earners should be taxed at higher rates to prevent tax increases on low- and middle-income families.

In other words, our members are desperate for tax reform and are willing to consider tax increases to help bring the federal government back into balance, but if – and only if - the changes are fair and the burden is shared by all Americans.

4. Corporate and Pass-Through Reform Must Proceed Simultaneously to Ensure Large and Small Businesses all Benefit from a Better Tax Environment

The equipment industry is dominated by closely-held, pass-through entities. Two-thirds of our tax survey respondents classified themselves as either S-corporations, limited liability companies (LLCs), or limited liability partnerships (LLPs), while 34 percent of AED dealer member companies are C-corporations. The respondents classifying themselves as either C or S-corporations had 5.5 shareholders on average; partnerships had an average of 2.4 owners. Congress should reject calls to proceed with corporate tax reform alone, particularly if doing so would mean the elimination of tax code provisions that benefit and are employed by corporations and pass-through entities alike.

5. Promote Economic Growth through Capital Investment

Capital investment is an engine for economic growth. When a business invests in new technology, it becomes more productive; manufacturers, distributors, and retailers involved in making and selling the capital asset benefit from increased demand; there are safety and efficiency gains for workers; and newer, greener technology lessens the company's environmental impact. Given the broad economic and societal benefits, AED believes encouraging capital investment should be an overarching theme and priority for tax reform. With that in mind, in addition to maintain parts of the current tax code that encourage business asset acquisition, we urge the committee to explore ways to encourage companies of all sizes to make capital investments to enhance their efficiency and create economic activity for large and small companies throughout the supply chain.

A. Reject Proposals to Extend Cost Recovery Periods for Capital Assets

For the foregoing reasons, we are concerned that tax reform proposals from both the Senate Finance and House Ways & Means Committees during the 113th Congress included provisions that would discourage capital investment. For example, the asset pooling concept included in the Finance Committee's 2013 proposal to reform cost recovery and tax accounting rules would have significantly extended cost recovery periods for the equipment AED members sell, rent, service, and purchase for their own rental fleets. Similarly, the reform proposal unveiled by the House Ways & Means Committee last year would have repealed the modified accelerated cost recovery system (MACRS) and, for tangible personal property like construction equipment, apply rules similar to the current alternative depreciation system (ADS). This would also have had the effect of extending cost recovery periods for capital assets. We urge the committee to reject any proposal that would do so.

B. Maintain Sec. 1031 Like-Kind Exchange

AED members are similarly concerned about proposals to repeal Sec. 1031 of the Internal Revenue Code, which encourages capital investment by allowing for like-kind exchanges (LKE). Sec. 1031 is used frequently by both AED members and our customers to manage tax consequences of buying and selling equipment. Indeed, based on 2012 member tax survey and other industry research, we estimate that approximately a quarter of our members have LKE programs in place to manage their rental fleets. We believe that number has risen in the time since. The potential tax liability associated with selling a fully depreciated asset acts as a disincentive to purchase newer, more efficient machinery. By allowing companies to defer that tax liability if they buy a new machine to replace the old, LKE frees up resources that makes the capital investment possible.

C. Maintain Tax Code Provisions That Encourage Capital Investment in Diverse Industries

We are also concerned about past proposals from both the House and Senate to repeal of a host of cost recovery provisions upon which our members' customers rely. For example, changing intangible drilling cost (IDC) tax treatment would undermine the booming energy sector, which has a $1.1 trillion impact on the U.S. economy, directly supports nearly 2.2 million jobs, is supported by seven million workers in other industries, and has become such an important market driver for AED members. IDCs can account for as much as 80 percent of the cost of drilling and completing a well. Because IDCs have no residual salvage value, producers have been allowed to expense them for more than a hundred years. The tax code currently allows producers to recover their investment costs quickly so they can be reinvested to explore for and produce new domestic oil and natural gas supplies. Over the past century, IDC expensing has been the catalyst to hundreds of billions of dollars in new investment and has helped oil and gas producers mitigate some of the economic risk associated with the uncertain business of energy exploration and development.

Changing the IDC tax treatment would mean energy companies have less capital to invest in exploration and site development, which would significantly limit business activity for AED members supporting the industry. For similar reasons, we object to the committee's proposal to repeal percentage depletion, which is widely used by our members' mining and aggregate customers.

D. Permanently Increase Sec. 179 Expensing

Rather than eliminating tax code provisions that encourage capital investment and economic activity, we urge the committee to explore other ways to incentivize companies of all sizes to buy new machinery that will enhance their efficiency and create economic activity. One example is Sec. 179 expensing.

Multiple AED studies have demonstrated that higher Sec. 179 small business expensing levels and temporary bonus depreciation encourage construction industry capital investment.[7] Most recently, 92 percent of the respondents to AED's spring 2012 Government Affairs Survey said the depreciation bonus had a positive impact on their 2011 sales. Seventy percent said their companies had themselves taken advantage of temporary capital investment incentive to add equipment to their rental fleets.

AED has been a leading proponent for capital investment tax incentives. In addition to leading numerous coalition letters to Congress on bonus depreciation and Sec. 179 over the past decade, the association maintains DepreciationBonus.org to help AED members, their customers, the media, Congress, and other audiences understand the benefit and application of these laws.

---

[7] *See, e.g.,* "Economic Stimulus Having Positive Effect, But Additional Stimulus Needed: A Study of the Impact of Capital Investment Incentive and Infrastructure Spending on Utility Contractors", AED and National Utility Contractors Association, July 2008 <http://www.aednews.com/aednuca/2008-NUCA-AED-Survey-Report-Summary.pdf>;"Capital Investment Incentives Work: A Study of the Past and Future Impact of the Depreciation Bonus and Small Business Expensing Level Increases On Utility Contractor Equipment Purchasing", AED and NUCA, May 2003 <http://www.depreciationbonus.org/pdf/NUCA_AED_Tax_Study.pdf>.

Earlier this year, the U.S. House of Representatives passed legislation[8] to permanently increase Sec. 179 expensing and phase-out levels to $500,000 and $2 million, respectively, and indexing them for inflation. AED strongly supports this change to the code, which would make it more attractive for smaller contractors, farmers, and other equipment users to purchase new machinery.

E. Equalize Tax Treatment for Farm and Construction Equipment

The bipartisan support for increasing Sec. 179 levels reflects the importance of cost recovery to business decision-making and economic growth. We therefore urge the committee to reconsider current cost recovery laws that treat the same piece of equipment differently depending on whether it is used in a construction or agricultural application. Construction machinery is generally depreciable over five years, while the cost recovery period for farm equipment is seven years. This inequitable situation means that farmers must take longer to depreciate their equipment, which in turn makes it more difficult for them to acquire newer, more efficient, more environmentally-friendly equipment. AED therefore urges the committee to pursue legislation reducing the cost recovery period for farm equipment to five years.

F. Ensure Deductibility of Business Interest

Credit is the lifeblood of the equipment industry. It makes it easier for farmers, contractors and others to buy equipment and for AED members to finance their rental fleets. Eliminating or limiting business interest deductions would increase real borrowing costs for businesses in capital intensive industries and reduce investment and risk-taking. We therefore urge the committee to consider the broader economic consequences of revenue-raising proposals that would do more harm than good.

6. Clarify Inapplicability of New Investment Income Tax to Equipment Industry Pass-Through Entities

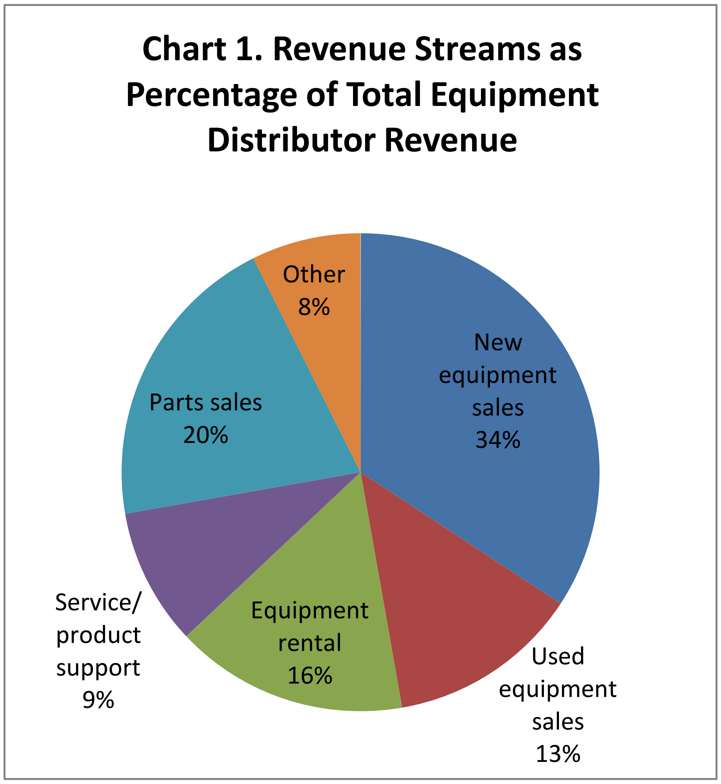
Equipment distributors do more than just sell and service new and used equipment. To provide maximum flexibility to their customers, most dealers also allow contractors and others to rent and lease equipment. The rental trend has accelerated in recent years as a weak economy and uncertainty surrounding government infrastructure programs have made contractors more hesitant to buy new equipment.

Equipment rental transactions take the form of a "rental with the option to buy" or a pure rental. Our recent tax survey determined that rental accounts for 16 percent of the average dealer's revenues (see Chart 1). Our survey respondents earned $1.29 billion in total rental revenues in 2011, an average of $12.03 million per company. AED projects its members' total 2011 rental revenues were more than $3.3 billion.

While passive loss rules adopted in the 1980s were designed to prevent wealthy individuals from using losses from passive activities to avoid paying income taxes, due to anomalies in the code and related regulations, the income and losses that equipment companies and their owners derive from renting bulldozers and other machines to contractors are considered "passive." The passive loss issue has long caused headaches for equipment companies, but the issue has taken on new urgency since the enactment of the Affordable Care Act, which imposes a new 3.8 percent tax on passive income, effective this year. In 2013, equipment dealers became subject to a tax they were never meant to pay.

---

[8] America's Small Business Tax Relief Act of 2015, H.R. 636, 114th Congress (2015) <https://www.congress.gov/bill/114th-congress/house-bill/636>.



As part of tax law changes in 1986, Congress imposed limitations on deductions from losses from passive activities. Those rules generally define rental income – including income from renting construction equipment – as passive. When the passive loss rules were adopted, rental in the equipment industry was far less common and Congress simply did not contemplate equipment distributors and other businesses would be affected. This is illustrated by the fact that Congress passed legislation in 1993[9] to clarify that real estate rental activities are not passive activities for those in the real property business (i.e., "real estate professionals" as described above under code Sec. 469 (c)(7)).

The IRS has carved out other exceptions through regulation. Specifically, 26 C.F.R. Sec. 1.469-1T(e)(3)(ii)) excepts rental from the rule under code Sec. 469(j)(8) (that a rental activity is any activity where payments are principally for the use of tangible property) when:

A. The average period of customer use is seven days or less;
B. The average period of customer use is 30 days or less and significant personal services are provided by the owner in connection with the rental;
C. Extraordinary personal services are provided by the owner in connection with the rental of the tangible property without regard to the average period of customer use;
D. The rental of tangible property is incidental to a nonrental activity of the taxpayer;
E. The taxpayer customarily makes the property available during defined business hours for nonexclusive use by various customers; or
F. The property is provided for use in an activity conducted by a partnership, S corporation, or joint venture in which the taxpayer owns an interest.

Unfortunately, construction equipment companies are not in a position to take advantage of these exceptions. Regarding (A) and (B), 26 C.F.R. 1.469-1(e)(3)(iii) provides that the determination of days is made by using actual periods of customer use and not dictated by the contract terms. In the industry, generally the contract terms run for 28 days, but are renewable. Customers often do renew the terms. Exception (B) would work only if based on the 28 day contract provision without taking into account renewals and extensions. Exception (C) is not practicable because 26 C.F.R. Sec. 1.469-1T(e)(3)(v) provides that the use by the customer of the property must be incidental to their receipt of services. Case law and rulings suggest this threshold could only be reached by the equipment lessor by providing the equipment operator and, in general terms, the services would

---

9 Pub. Law 103-66.

have to be greater in value to the lessee then the rent itself. Exception (D) as provided under 26 C.F.R. Sec. 1.469-1T(e)(3)(vi)(C) applies when the gross rental income is less than two percent of the lesser of the unadjusted basis of the property or the fair market value of the property. However, the two percent threshold is exceeded consistently in the industry. Exception (E) would never apply to equipment rentals because the rents give the customer exclusive use of the piece of equipment. Exception (F) is not applicable in the context of this discussion.

One more added exception used on a limited bases by equipment dealers is found at 26 C.F.R. Sec. 1.469-4(d)(1)(i)(A), which provides that a rental activity that is insubstantial in relation to the trade or business activity may be grouped with the trade or business activity if part of an appropriate economic unit. This does not help companies that do nothing but rent and only applies to equipment dealers whose rental activity is insubstantial. "Insubstantial" is not defined in the regulations. Case law and private letter rulings do not give a clear indication as to what constitutes insubstantial, so it does give equipment dealers latitude to use this regulation if the rental activities are not "substantial."

<u>While the passive rules have long been a thorn in the side of the industry, the issue has taken on new urgency because the rules are used to help to define who is subject to the new tax on passive income imposed by Sec. 1402 of the Affordable Care Act.</u>[10] The tax was designed as an "unearned income Medicare contribution tax." In the case of an individual (as indicated above, most equipment distribution companies are pass-through entities, so the companies' taxes are those of the individual owners), the tax is 3.8 percent of the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount ($250,000 in the case of joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case).

According to the Joint Committee on Taxation, "In the case of trade or business, the tax applies if the trade or business is a passive activity with respect to the taxpayer or the trade or business consists of trading financial instruments or commodities … The tax does not apply to other trades or businesses conducted by a sole proprietor, partnership, or S corporation."[11]

In other words, in creating the new tax, Congress sought to limit its applicability and only ensnare a select group of individuals (those deriving income from passive activities and financial traders). Congress did not intend the law to apply to companies like equipment distributors. However, due to the complexity of the tax code and related regulations, companies that rent equipment have fallen into a trap and will be forced to pay a tax that was not meant for them.

One way for Congress to solve the problem would be to add a new paragraph 8 to code Sec. 469(c) granting equipment distributors the same treatment as those in the real estate industry found under paragraph 7. An alternative solution would be to direct the IRS to conduct a rulemaking within a specified time (e.g., 180 days of enactment of the law) to clarify the inapplicability of the new tax to businesses and individuals actively engaged

---

[10] Pub. Law. 111-148, now IRC Sec. 1411.

[11] "Technical Explanation of the Revenue Provisions of the 'Reconciliation Act of 2010,' As Amended, In Combination with the 'Patient Protection and Affordable Care Act", Joint Committee on Taxation, March 21, 2010, at 142 <https://www.jct.gov/publications.html?func=startdown&id=3673>.

in companies that rent equipment. We welcome the opportunity to work with the committee on these or other solutions, either in the context of comprehensive tax reform or outside of it.

7. Reform Estate Tax Laws to Protect Family Companies and Farms from Being Destroyed at Death

As AED has documented in study after study, the federal estate tax takes an enormous toll on the capital-intensive, family business-dominated construction equipment industry. The American Taxpayer Relief Act[12] permanently fixed the top estate tax rate at 40 percent and the personal exemption rate at $5 million, indexed for inflation. Restoring predictability to the estate tax was a good start, but Congress needs to do more.

AED's survey provides a snapshot of how resources are diverted because of the estate tax. For example, it is a common practice for family businesses to buy life insurance to provide cash to pay the tax that comes due when an owner dies. Forty-four percent of AED tax survey respondents said that their company had done so. The total expended by survey respondents on estate tax-related life insurance was $11.3 million. The average was $221,100 per company.

Similarly, 45 percent reported having hired attorneys and accountants to create estate plans to protect their business from the federal estate tax. The total spent by respondents on estate planning lawyers and accountants over the past three years was $2.83 million, an average of $54,000 per company.

We project that AED members annually spend a combined $31.82 million on estate tax-related insurance premiums and that over the past three years our members have spent a combined $6.69 million on estate planning lawyers and accountants.

While Congress has sought to mitigate the estate tax's impact on family businesses and farms, those efforts have generally resulted in overly complicated structures for which few qualify.[13] AED maintains its long-standing position that the estate tax is unfair, punishes hard work and risk, discourages saving and investment, leads to gross economic distortions, and amounts to double taxation. We urge Congress to repeal the tax, which we believe would unleash additional activity and free up resources that would more than offset any lost federal revenue. At a minimum, in the immediate term, the committee should pursue legislation to eliminate the estate tax's impact on family companies, for example, by taxing assets when they are sold, rather than when they are inherited.

8. Oppose LIFO Repeal

LIFO (which stands for "last in, first out") is an inventory accounting method that has been used by companies in a range of inventory-intensive industries since the 1930s to manage the impact of inflation. LIFO takes into account the greater costs of replacing inventory, providing a more accurate measure of the financial condition of the business and the income to which tax should apply.

LIFO is an accounting method, not a tax loophole. When inventory costs are rising, using the LIFO method will mean less tax liability in a given year than under the FIFO ("first in, first out") method. However, if prices fall, the taxpayer would repay the LIFO benefit through greater tax liability. Moreover, taxpayers may not change

---

12 Pub. Law 112-240.

13 *See., e.g.,* 26 USC § 2032A - Valuation of certain farm, etc., real property.

between LIFO and FIFO without IRS approval, thus once a company elects to use the LIFO method, it assumes the risk of artificially increased tax liability if inventory costs should fall.

Repealing LIFO, as has been proposed by lawmakers in both chambers over the last decade, would have a devastating impact on large and small companies alike - particularly those in the equipment industry. Thirty percent of AED members reported using the LIFO inventory accounting method and 28 percent use FIFO. The average reported LIFO reserve was $8.16 million. Survey respondents reported combined LIFO reserves of $220 million. AED projects that its members have approximately $588 million in combined LIFO reserves and repeal would mean close to $200 million in retroactive tax liability for the equipment industry alone.

The committee should reject any proposal to repeal LIFO.

9. Create New User Fee Revenues to Restore Certainty to Federal Infrastructure Programs and New Tax Incentives to Encourage Private Infrastructure Investment

Transportation infrastructure is critical to America's economic growth and competitiveness. Gas taxes and other highway user fee revenues are insufficient to support even the current inadequate level of transportation investment, let alone the additional construction needed to rebuild America's crumbling infrastructure. Without new revenues, the highway program is in true jeopardy.

In fact, according to College of William & Mary researchers, over the next 23 years, as Corporate Average Fuel Economy (CAFE) standards rise, gasoline consumption will decline.[14] This will lead to a drop in gas tax payments to the federal Highway Trust Fund (HTF), the highway program's primary funding source. Failing to change the existing tax structure while maintaining current investment will cause the HTF's account to incur a $365.5 billion deficit over the next 23 years, the study concludes.

The highway program is already in dire straits. Although it has been self-sustaining for many years thanks to the gas tax and other user fees, declining revenues have made transfers from the general fund necessary to prevent road and bridge spending cuts. Many studies have shown that merely maintaining current spending is insufficient to build the infrastructure our growing economy needs. One report by the Texas Transportation Institute found that traffic congestion, largely resulting from inadequate capacity, costs the country more than $121 billion per year in wasted time and fuel.[15]

The William & Mary study offers a few possible solutions. The gas tax was last increased - to 18.4 cents per gallon - in 1993. The research team determined that restoring the gas tax's 1993 spending power by raising it to 25 cents and indexing it for future inflation would raise $167 billion above current baseline spending requirements over the next two decades. The study also examined ways to implement a vehicle mileage-based user fee.

Congress must create new HTF revenue streams through a gas tax increase, a vehicle miles traveled tax, or some other innovative solution. These could and should happen (as they have in the past) as part of a broader budget and tax reform deal.

---

[14] "The Impact of Fuel Use Trends on the Highway Trust Fund's Present and Future", Devin Braun, Ryan Endorf, Stephen Parker, The College of William & Mary, Jan. 2013 < http://www.aednet.org/government/pdf-2013/WM-HTF-Report.pdf>.

[15] "2012 Urban Mobility Report", Texas Transportation Institute, Dec. 2012, <http://mobility.tamu.edu/ums/>.

Finally, AED strongly supports removing the private activity bond (PAB) volume cap for water projects. Doing so will increase private investment in water infrastructure, create jobs, and address years of underfunding in one of our nation's greatest resources—clean water. It is estimated that removing the PAB cap could generate as much as $5 billion annually in private capital for water infrastructure projects with a nominal cost to the federal government. Tight federal budgets and mounting needs make it more important than ever that Congress look for new ways to encourage private infrastructure investment and reject proposals to change the treatment of tax favored bonds.

Conclusions

We appreciate the time and energy members of the Finance Committee are committing to the tax reform process. We look forward to working with the committee in a bipartisan manner to create a more favorable tax and economic environment for all Americans.

Sincerely,

Christian A. Klein
Vice President of Government Affairs

c.c. The Honorable Orrin Hatch
Chairman
Senate Finance Committee

The Honorable Ron Wyden
Ranking Member
Senate Finance Committee

All Senate Finance Committee members