April 15, 2014

Chairman Orrin Hatch (R-UT)
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510-6200

Ranking Member Ron Wyden (D-OR)
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510-6200

Dear Chairman Hatch, Ranking Member Wyden, and Committee members:

Steptoe & Johnson LLP, on behalf of its clients the National Association of Convenience Stores ("NACS")[1] and the Society of Independent Gasoline Marketers of America ("SIGMA")[2], submit these comments to the Senate Finance Committee in response to the Committee's solicitation from interested members of the public and stakeholders on how best to reform the tax code.

Overview

As the Committee considers proposals to reform the tax code, its objective should be to raise revenue in a manner that promotes investment and economic activity. This will have a multiplier effect on revenue while minimizing economic disruption to productive entities. It would be counter-productive to make capital formation more difficult in the name of tax reform. This would only serve to encumber those entities that drive job creation and economic growth, and thereby reduce the federal government's ability to raise revenue effectively.

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[1] NACS is an international trade association representing more than 2,200 retail and 1,800 supplier company members. NACS member companies do business in nearly 50 countries worldwide, with the majority of members based in the United States. The U.S. convenience store industry, with approximately 1.8 million employees and 151,000 stores across the United States, posts nearly $700 billion in total sales, and accounts for approximately $500 billion in motor fuel sales alone each year.

[2] SIGMA represents approximately 260 independent chain retailers and marketers of motor fuel. SIGMA members represent significant diversity within the industry. While 92 percent are involved in gasoline retailing, 66 percent are involved in wholesaling, 36 percent transport product, 25 percent have bulk plant operations, and 15 percent operate terminals. Member retail outlets come in many forms including travel plazas, traditional "gas stations," convenience stores with gas pumps, cardlocks, and unattended public fueling locations. Some members sell gasoline over the Internet, many are involved in fleet cards, and a few are leaders in the mobile refueling movement.

NACS and SIGMA offer the following suggestions for the Committee's consideration as it analyzes proposals to reform the tax code:

- Define the terms "gasoline gallon equivalent" ("GGE") and "diesel gallon equivalent" ("DGE") for sales of compressed natural gas ("CNG") and liquefied natural gas ("LNG"); uniform definitions of these terms will create a national standard for sale of these fuels;

- Maintain the Work Opportunity Tax Credit ("WOTC");

- Maintain Last-In, First-Out ("LIFO") as an acceptable inventory accounting method;

- Provide estate tax relief so small business owners are incentivized to invest in their companies;

- Maintain (i) current depreciation schedules for fuel retailers, (ii) bonus depreciation, and (iii) increased expensing limits under Section 179;

- Develop a permanent funding solution to the Highway Trust Fund;

- Recognize and account for the consequences that piecemeal tax reform efforts would have on companies that operate as pass-through entities; and

- Extend the $1-per-gallon biodiesel tax credit.

Defining the Terms GGE and DGE for sales of CNG and LNG

NACS and SIGMA urge the Committee to pass legislation defining the terms "gasoline gallon equivalent" ("GGE") and "diesel gallon equivalent" ("DGE") for sales of CNG and LNG. Natural gas is a cleaner fuel relative to petroleum-based products, and it is produced domestically. A mismatch in state and federal standards relating to the definition of a "gasoline gallon equivalent" ("GGE") and lack of a uniform definition of a "diesel gallon equivalent" ("DGE") in the context of CNG and LNG sales, however, currently impairs the regulated community's ability to sell natural gas products. The Committee's adoption of NACS's and SIGMA's suggestions in this regard will encourage further proliferation of these fuels into the market. NACS and SIGMA have worked cooperatively with other associations representing fuel marketers, and the fuel marketing community is supportive of this effort.

- *Gasoline Gallon Equivalence* – There are currently two standards for selling CNG as gasoline products: The *federal* standard used on IRS Form 720 defines a GGE as 126.67 cubic feet, and the National Conference on Weights and Measures ("NCWM")[3]

[3] The NCWM is comprised of state, regional, and local officials and receives advice and technical support from the National Institute of Standards and Technology ("NIST") within the Department of Commerce.

handbook standard defines a GGE as 123.55 cubic feet.[4] Many states have adopted the NCWM standard.[5] This has led to a discrepancy that, if not rectified promptly, may cause consumer confusion and lead plaintiff's lawyers to initiate costly litigation against retailers and marketers who are simply trying to comply with state requirements.

- *Diesel Gallon Equivalence* – Section 4041(a)(2) of the Internal Revenue Code presently equates one gallon of LNG with one gallon of diesel fuel by taxing the two fuels at roughly the same rate, even though one gallon of LNG contains only a fraction of the energy of one gallon of diesel, as measured in British Thermal Units ("BTUs").[6] In addition, there is currently no federal standard for diesel gallon equivalence for CNG.

  NCWM is considering proposals to rectify this flawed state of affairs. These proposals would define a "diesel gallon equivalent" as 2.894 kg/6.380lb. of CNG per DGE, and would adopt a mass-based LNG DGE standard of 2.749 kg/6.060 lb of LNG per DGE. Unlike the current federal standard for taxation of LNG, NCWM's proposed LNG DGE standard was developed based on the relative energy content (in BTUs) of LNG and diesel. Today, fuel marketers sell DGEs based on the proposed NCWM standards.

  These definitions should be codified into a federal law. This would: 1) avoid future discrepancies like the one marketers are encountering today with GGE; 2) simplify the process of introducing natural gas into the retail fuels market; 3) equalize the tax rate on an energy-content basis for petroleum-based diesel fuels and LNG-based diesel fuels; and 4) provide uniformity for consumers in all parts of the country.

The lack of uniform definitions of GGE and DGE unnecessarily hinders the introduction of natural gas into the market. Consumers are accustomed to thinking about fuel purchases exclusively in terms of gasoline or diesel per-gallon prices. The NCWM's GGE standard, and its proposed DGE definitions – which have been developed for inclusion in NIST Handbooks 44 and 130 and for enforcement by state officials – stipulate that:

- 2.567 kg. (5.660 lb. or approx. 123.55 cu. ft.) of CNG equals one GGE[7]

- 2.894 kg. (6.380 lb.) of CNG equals one DGE

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[4] See IRS Form 720 (Rev. April 2014), No. 120 and Notice 2006-92-Section 6(c).

[5] Not all states adopt the Handbook Standards. Thus a statutory and federal standard will bring uniformity to consumers throughout the country.

[6] The Alternative Fuels Data Center (AFDC) lists LNG as containing 74,720 BTU/gal and Diesel as containing 128,450 BTU/gal. AFDC fuel comparison information is available at http://www.afdc.energy.gov/fuels/fuel_comparison_chart.pdf.

[7] See Appendix A of the NCWM Laws and Regulations Committee 2014 Interim Report. (The NCWM arrived at this standard in 1994, taking into account a nationwide survey of natural gas samples concluding that the "average" natural gas in the US had an energy content (lower heating value or LHV) of 923.7 BTU/cubic foot, and a density of 0.0458172 lbs/cubic foot. This translates into 20,160.551 BTU/lb. Dividing gasoline's 114,118 BTU/gallon by CNG's 20,160.551 BTU/lb gives 5.660 lbs of natural gas = 1 GGE.)

- 2.749 kg. (6.060 lb.) of LNG equals one DGE

Given that natural gas is on the verge of widespread acceptance as a transportation fuel, prompt action is needed to resolve the issues outlined above. An NCWM Handbook 130 definition that results in a consumer lawfully receiving an amount of natural gas that differs from the amount stipulated by the IRS's Form 720 could generate consumer distrust and invite claims of fraud. Many retailers will likely avoid selling the product solely to avoid such litigation. In the case of CNG, for example, if the Federal standard is not revised, consumers would receive approximately 123.55 cubic feet of natural gas as a "gallon equivalent" in accordance with the NCWM standards many states have adopted, and not the 126.67 cubic feet called for by IRS Form 720. Moreover, a continuing discrepancy between NCWM and IRS gallon equivalence definitions will hugely and unnecessarily complicate marketers' tax compliance burden.

<u>To resolve this problem, the Committee should develop federal standards for GGE and DGE that are consistent with final and proposed NCWM standards. Specifically, the Committee should revise the IRS's CNG GGE definition of 126.67 cu. ft. to 123.55 cu. ft. and codify NCWM's widely accepted mass-based standards for CNG and LNG sales (2.567 kg./5.660 lb. of CNG per GGE; 2.894 kg./6.380 lb. of CNG per DGE; 2.749 kg./6.060 lb. of LNG per DGE).</u> In addition, if Congress passes legislation equalizing excise taxes for diesel and LNG by basing excise tax rates on energy content, the Committee should ensure that such rates are based on the latest NCWM DGE definitions.

The above suggestions would benefit consumers, the Federal government, and taxpayers:

- *Consumers* – Consumers will have more clarity regarding what they are buying. This proposal would enable them to price-compare and obtain equity in the market.

- *Federal Government* – This proposal would enable the Federal Government to <u>collect more revenue</u>. A simpler standard will facilitate a more widespread introduction of natural gas products in the retail motor fuels market. More natural gas would be sold, and the Treasury would accordingly realize more revenue. In addition, this proposal would avoid an unnecessarily complicated audit process for revenue agents. Rather than having to comprehend the predicament outlined above, revenue agents would be able to efficiently enforce harmonized GGE and DGE standards, respectively.

- *Taxpayers* – Taxpayers' (*i.e.*, fuel retailers') compliance burden would be greatly diminished, since they would be subject to a single standard rather than two standards (one state, one federal). Importantly, this proposal would <u>not</u> "raise taxes." NACS and SIGMA understand that the overwhelming preponderance of sellers of GGE of CNG are <u>today</u> reporting on the basis of the handbook/NCWM standard rather than the federal 126.67 cu. ft. standard. The reason for this is simply to avoid confusing revenue agents.

> Indeed, the cost to retailers of explaining the predicament outlined above vastly exceeds any benefit from reporting on the basis of the higher Federal GGE standard.

Work Opportunity Tax Credit

The Committee should support making permanent the work opportunity tax credit ("WOTC"). The WOTC provides employers a credit against federal income tax liabilities for hiring individuals from certain targeted groups, such as unemployed veterans and recipients of certain government assistance programs. Individuals in these groups have historically faced significant barriers to employment. The WOTC is a temporary tax provision, recently extended through tax year 2014 in the Tax Increase Prevention Act of 2014 (Public Law 113-295).

Fuel retailers and convenience store operators are major employers for WOTC-qualifying individuals. NACS and SIGMA members often serve as these individuals' first employer and entrance to the labor market. They are able to provide these individuals an opportunity to earn a steady income and move to self-sufficiency. According to Department of Labor data, as compiled by the Congressional Research Service, the WOTC has successfully incentivized employers to hire targeted individuals. In Fiscal Years 2008-2012, for example, employers hired over four million WOTC-qualifying individuals.[8] The tax benefits associated with employing these individuals is responsible for many of these hiring decisions.

The WOTC provides significant benefits to an important segment of the labor force that has historically faced employment barriers. For instance, Gulf War II-era veterans (those serving from September 2001-present) have an unemployment rate of 6.5% for March 2015, a full percentage point above nonveterans in the labor force.[9] That difference has been more pronounced in recent years. The WOTC allows employers to expand payrolls and hire these heroic veterans struggling to reenter the workforce. For other targeted groups, such as Supplemental Nutrition Assistance Program ("SNAP") or Temporary Assistance for Needy Families ("TANF") beneficiaries, the WOTC provides an avenue to earn steady incomes and move off of government assistance. By facilitating a policy environment where SNAP and TANF recipients are more likely to earn stable incomes, the WOTC can serve to *reduce* government expenditures for these assistance programs.

Employers need certainty when making hiring decisions, and the WOTC is a significant incentive to expand payroll. Codifying the WOTC as a permanent provision in the tax code would benefit employers and employees alike.

[8] U.S. Congressional Research Service. The Work Opportunity Tax Credit (WOTC) (RL30089; Feb. 4, 2013), by Christine Scott.

[9] Bureau of Labor Statistics, U.S. Department of Labor. The Employment Situation – March 2015 (USDL-15-0530; Apr. 3, 2015). http://www.bls.gov/news.release/pdf/empsit.pdf

Last-In, First-Out ("LIFO") Accounting

The Committee should maintain LIFO as an acceptable inventory accounting method. NACS and SIGMA members, including many "pass-through" entities, utilize LIFO as a more accurate accounting method for measuring operations' current economic performance. Repeal or modifications of LIFO would result in significant, unfunded tax liabilities for LIFO businesses when those businesses have no corresponding cash with which to satisfy the resulting liabilities. This will create illiquidity events, resulting in job losses and business closures.

In general, businesses must track and account for inventory to determine the cost of goods sold and to determine taxable income. Both LIFO and First-In, First-Out ("FIFO") serve similar purposes for the companies that use them: creating a consistent measure of the cost of goods sold. This allows businesses to determine their economic performance.

Businesses that sell products in volatile markets or sell products that tend to rise in price are likely to use LIFO. Companies in stable markets or that sell products likely to decline in price are likely to use FIFO. FIFO is not the default method, and LIFO is not an exception. In fact, LIFO has been a generally approved accounting method for over seventy years.

LIFO does not affect only large, integrated oil companies. Instead, LIFO is used by more than one third of all U.S. companies, including hundreds of thousands of pass-through small and mid-sized businesses. Prospectively disallowing the use of LIFO as an acceptable accounting method would overstate a business's profits, generating tax liabilities that would decrease the business owner's ability to replace inventory or to reinvest in the company and create jobs.

While LIFO repeal is a serious concern, recent repeal proposals are particularly alarming due to the inclusion of a "recapture tax" on LIFO reserves. Retroactively changing the law and recapturing LIFO reserves outside of existing recapture events (*e.g.*, reduction in inventory levels, business liquidation, etc.) would amount to a substantial, unforeseen tax liability for past business activities. A business's LIFO reserve is not an accumulation of funds to which the business necessarily has access. Indeed, as a practical matter, these funds have been either reinvested into the businesses or disbursed as income (for which the recipient already would have incurred tax liability).

For a business to pay a recapture tax, it must have a corresponding business activity that generates sufficient funds to pay that tax. Current law accommodates this reality by limiting recapture events to when inventories are reduced or the business is liquidated – these activities generate cash flow.

A recapture tax on past business activities is divorced from this business reality. Indeed, it presumes sufficient business activity to generate the necessary cash flow when such activity may not exist. If business owners are faced with such impractical tax liabilities, they will be forced to generate inefficient liquidity events by assuming debts, selling their business, or potentially entering bankruptcy proceedings. In those instances where a business has sufficient cash reserves, the recapture tax would deprive that businesses of capital that otherwise would be used for reinvestment and job creation.

The recapture tax is even more onerous considering the unreasonably short time frames contained in recent LIFO repeal proposals. For instance, former Ways and Means Committee Chairman Dave Camp's draft tax reform legislation released in the previous Congress required LIFO reserves to be recaptured and included in income over a four year period. NACS and SIGMA members, and other small businesses that utilize LIFO, do not have the cash reserves or liquidity to recapture their LIFO reserves in such a short time frame. The recapture tax and its short transition time frame would result in illiquidity events and the forced sale of many businesses. If Congress modifies current LIFO accounting methods, taxpayers should be permitted to include LIFO reserve funds in income over an extended period of time, substantially longer than Mr. Camp's proposal of four years.

Both LIFO and FIFO are appropriate inventory accounting methods. If Congress repeals LIFO, it would create a preference in the tax code favoring one type of business over another. Furthermore, subjecting LIFO reserves to a recapture tax is a breach of faith with taxpayers utilizing LIFO. These businesses have dutifully followed tax laws for decades, properly accounting for changes in their inventories and paying the required taxes on their reserves.

Those who support repealing LIFO do not oppose the merits of the accounting system, but are simply trying to find additional sources of revenue. Although NACS and SIGMA understand and support the need to raise revenues to reduce rates, this should be accomplished without imposing debilitating tax liability on a large percentage of the American tax base. NACS and SIGMA urge the Committee to recognize the severe economic consequences that could result from the repeal or modification of LIFO, and instead maintain LIFO as an acceptable inventory accounting method.

Estate Tax and Basis Calculation for Capital Gains

NACS and SIGMA have long urged Congress to provide estate tax relief. The estate tax discourages savings and investment, creates a disincentive to expand a business, and requires the diversion of resources for costly estate planning. Many NACS and SIGMA members operate small, family-owned businesses, and far too often the estate tax literally taxes family businesses right out of the family.

The estate tax imposes a 40% tax on the taxable estate of any person at the time of death, subject to a certain exemption threshold. Additionally, when appreciated assets are bequeathed, the heir receives a basis in that asset equal to its fair market value, commonly referred to as a step-up in basis.

NACS and SIGMA are particularly concerned with proposals that would modify current provisions on the step-up in basis. NACS and SIGMA members have invested decades of their lives in their businesses, often with the help of family members, and many would prefer to pass on their business to their heirs upon death. If Congress modifies current provisions related to the step-up in basis, these heirs may be unable to retain the family business due to potential tax liability. Such changes would impose new capital gains taxes and could create unintended illiquidity events. Furthermore, any attempt to properly value the original owner's basis would generate a plethora of logistical complexities. Combined with the estate tax, this change would further disincentivize small business owners from investing in their companies and could cause families to lose their family businesses. NACS and SIGMA urge the Committee to reject this proposal, and instead provide estate tax relief for American businesses.

Depreciation Schedules

NACS and SIMGA urge the Committee to maintain the current recovery periods for retail motor fuel outlets and to make permanent bonus depreciation and the increased expensing limits under Section 179.

Current law allows fuel retailers, for Federal income tax purposes, to recover the costs of certain capital assets through annual depreciation deductions. The 15-year recovery period, set by a combination of federal law and administrative guidance,[10] is intended to mirror the economic reality of an asset's useful life. Specifically, this schedule reflects more accurately the real-world decline in value of tangible assets and the time period in which those assets are likely to be replaced than does the schedule for "other commercial real estate." Shorter depreciation schedules generate capital that can be reinvested in a business. The Committee should pursue policies that produce such results. If the depreciation schedules were to be extended, businesses would not necessarily be able to recover their costs and replace their capital assets at the appropriate time. This decreases the likelihood that the business will be able to create jobs and succeed in the marketplace.

NACS and SIGMA also urge the Committee to make permanent the "bonus depreciation" and the increased expensing limits under Section 179. Both are temporary provisions of the tax code that were recently extended through tax year 2014. Bonus depreciation allows businesses to claim an additional first-year depreciation allowance of 50% of the adjusted basis of qualified property. Section 179 allows businesses to expense certain property as a current expense, rather than a capital expense. Prior to its expiration at the beginning of this year, businesses were able to expense up to $500,000 in qualified assets with an investment limitation of $2,000,000. Unless Congress takes further action, Section 179 levels have reset to $25,000 and $200,000, respectively, for tax year 2015.

[10] *See* 26 U.S.C. Section 168; *see also* S. Rep. No. 281, 104th Cong., 2d Sess. 14-16 (1996); Rev. Rul. 97-29; IRS Publication 946.

These two provisions act as an economic stimulant for capital expenditures. They greatly reduce the upfront cost of capital asset purchases, allowing businesses to make the needed investments to further grow their businesses and create additional jobs. Increased expensing limits under Section 179 are especially helpful to small businesses. Businesses with thin profit margins are often unable to make needed capital investments due to cash flow restraints. The increased expensing limits provide small businesses the flexibility they need to invest back in their businesses to stay competitive in the marketplace. NACS and SIGMA urge the Committee to permanently extend bonus depreciation and the increased expensing limits under Section 179.

Highway Trust Fund and Fuel Excise Taxes

NACS and SIGMA urge Congress to find a permanent funding solution to the Highway Trust Fund. Our nation's highways and surface infrastructure are in disrepair. Providing stable and consistent funding to the Highway Trust Fund will benefit the country economically and generate additional revenue for the Federal government.

The Federal government has imposed an excise tax on gasoline since 1932. The current rates of 18.3 cents per gallon on gasoline and 24.3 cents per gallon on diesel fuel have been in place since 1993 with no subsequent increases. An additional 0.1 cent per gallon tax is credited to the Leaking Underground Storage Tank (LUST) Trust fund. Due to increasing motor vehicle fuel efficiency, fewer vehicle miles traveled, and inflation, funding for the Highway Trust Fund has fallen behind historical levels.

To supplement the shortfall, Congress has been forced to find alternative sources of funding. This has included transfers from Treasury's general fund and the LUST Trust fund. The LUST Trust fund was created to ensure tank owners take appropriate measures to protect the environment and to assist States in cleaning up contamination from abandoned tanks. The entire retail fuel community strongly opposed the transfer from the LUST Trust fund, and opposes any future transfers that are not aligned with the fund's intended purpose.

Congress must devise a permanent solution for the Highway Trust Fund. NACS and SIGMA urge Congress to abide by the following core principles if Congress determines that the funding of these projects must be "user based":

- All energy sources should pay the same per gallon equivalent to support the vehicles powered by that source for use of the road;
- Whenever possible, government should seek to broaden the base that pays for roads from just user based sources;
- In any "user based" system, transparency with respect to taxes is essential. Specifically, the consumer must be able to understand the amount he or she is being charged by a taxing entity in the price of motor fuel; and

- Funds raised in the name of supporting infrastructure maintenance must be dedicated to infrastructure.

Pass-through Entities

NACS and SIGMA urge the Committee to undertake comprehensive tax reform, including reforms to both individual and corporate taxes. If the Committee pursues business-only tax reform, many tax provisions vital to NACS and SIGMA members may be eliminated or curtailed in exchange for a reduction in marginal tax rates on the business side of the tax code. While this is a laudable goal, it would harm retailers and fuel marketers that operate as pass-through entities. Indeed, pursuing corporate tax reform without concomitant individual tax reform would have the practical effect of limiting such entities' current credits or deductions with no corresponding reduction in tax rates. In other words, they would see a tax increase when they can least afford it. Pursuing business-only tax reform will create disparities in the tax code that favor one business structure over another and could have the unintended effect of raising taxes on our nation's small businesses.

Between 2003 and 2012, the top statutory marginal income tax rates for both individuals and corporations were 35%. The Health Care and Education Reconciliation Act of 2010 (Public Law 111-152) imposed an additional 3.8% surtax on certain investment income, and the American Taxpayer Relief Act of 2012 (Public Law 112-240) raised the top statutory marginal income tax rate for individuals to 39.6%. Combined, these two modifications raise the top individual rate to 43.4%, significantly higher than the 35% rate imposed on the business side of the tax code.

The net effect of these higher marginal rates is to drain capital from businesses. For example, because S corporation taxes must be paid when the income is earned, they are due *regardless* of whether a business distributes its earnings to shareholders. This flawed policy becomes self-fulfilling, as most S corporations make quarterly distributions to shareholders sufficient to cover the taxes owed. This lowers a business's retained earnings, which in practice means less money to invest and hire new workers.

Making the tax code simple, fair, and efficient for all taxpayers is a laudable goal, and comprehensive tax reform could result in broad economic growth and job creation. We urge the committee to lower the tax rates for all businesses, including those operating as "pass-through" entities.

Biodiesel Blender's Tax Credit

NACS and SIGMA support the $1-per-gallon biodiesel tax credit. This credit helps to displace the use of petroleum products with renewable sources of energy. It makes biodiesel more cost-competitive with petroleum diesel, stimulating growth and economic activity at biodiesel refineries around the country while reducing CO2 emissions and strengthening our energy security by diversifying our sources of fuel. The tax credit helps marketers that blend biodiesel into conventional diesel fuel to offer more competitive prices to their customers and has helped facilitate the growth of this still-developing industry.

Conclusion

NACS and SIGMA appreciate the Committee's efforts to enact comprehensive tax reform. Such efforts could result in increased business growth for retailers and fuel marketers and broad economic growth for the country as a whole. Thank you for your attention to these important matters, and please let us know if we can provide any further information to the Committee.

Sincerely,

R. Timothy Columbus
General Counsel
NACS and SIGMA

NACS

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SIGMA

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