



Associated Equipment Distributors
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The Honorable Orrin G. Hatch
Chairman
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Hatch and Ranking Member Wyden:

These comments are submitted on behalf of Associated Equipment Distributors (AED) in response to the Senate Finance Committee's request for stakeholder feedback on reforming the tax code.

AED is the international trade association representing companies involved in the sale, rental, and servicing of construction, mining, farm, energy, forestry and industrial equipment. Our more than 500 member companies, which are predominantly small-medium-sized, family-owned businesses, have over 3,000 locations throughout North America, employing 40,000 people and accounting for \$15 billion in annual sales of construction equipment and related supplies.

AED members believe the Internal Revenue Code's complexity and uncertainty are undermining the nation's economic growth. We therefore strongly support your efforts to simplify and restore long-term certainty to the nation's tax laws while creating economic growth. As you craft tax reform legislation, we ask the Senate Finance Committee to be mindful of the potential impact of certain proposals and keep the following AED positions in mind:

- AED's membership is dominated by pass-through entities. We therefore believe that corporate and pass-through reform must proceed simultaneously to ensure both large and small businesses benefit from improvements to the code and reduced rates.
- 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 and the parts of the code that encourage investment should be preserved. Specifically, we encourage the committee to maintain the deductibility of business interest and preserve Sec. 1031 of the Code (relating to like-kind exchanges).
- Because rental is an increasingly prevalent option for contractors to acquire equipment, the code's tangled web of passive income rules has ensnared equipment companies in the Affordable Care Act's (ACA) new unearned income tax. We urge the committee to ensure – whether as part of efforts to repeal, replace, or reform the ACA or as part of tax reform – that these active, brick and mortar companies are held harmless from this tax they were never intended to pay.
- The equipment industry is dominated by family-owned companies. Even with recent changes, the estate tax is still a burden, particularly to companies in capital intensive sectors like construction. 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, preferably through full repeal of this burdensome and onerous tax.
- 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. The committee should reject any proposal to repeal LIFO.

- 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. 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.

Tax Reform Must Benefit All Businesses, Not Just Corporations

The equipment industry is dominated by closely-held, pass-through entities. More than three quarters of AED members are classified as either S-corporations, limited liability companies (LLCs), or limited liability partnerships (LLPs) while the remainder are C-corporations. Consequently, AED urges the Senate Finance Committee to continue to ensure that the benefits of tax reform legislation are widespread and benefit all the types of business entities that contribute to the U.S. economy.

Tax Reform Should Encourage 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 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, and while there is support for proposed 100 percent expensing among AED members, we are concerned about proposals to eliminate the business interest deduction. Credit is the lifeblood of the equipment industry. It makes it easier for contractors and others to buy equipment and for AED members to finance their rental fleets. Construction equipment is costly and our members and their customers borrow heavily to finance equipment acquisition.

Eliminating or limiting business interest deductions would increase real borrowing costs for businesses in capital intensive industries and reduce investment and risk-taking. It would also make it difficult for new start-ups and smaller companies to compete with large, entrenched players in many economic sectors since debt financing is how small businesses often survive and operate. We therefore urge the committee to reject efforts to eliminate the business interest deduction.

Similarly, Sec. 1031 of the Internal Revenue Code encourages ongoing capital investment by allowing for like-kind exchanges (LKE). In the equipment industry, distributors use LKE to help manage the tax consequences of buying and selling equipment in their rental fleets. LKE allows distributors to defer taxes associated with selling equipment when the sale price exceeds the tax basis. Deferring taxes on the gains allows dealers to reinvest the sales proceeds into new equipment for their fleets. 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 new capital investment possible.

Even in an environment with 100 percent expensing, Sec. 1031 continues to have value and should be preserved. Doing so would allow companies to defer gains at the state level if states do not adopt changes to parallel federal reform. Additionally, LKE could continue to be used for land sale transactions.

Repeal or Clarify Inapplicability of ACA Investment Income Tax to Rental Income

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.

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 (ACA), which imposes a new 3.8 percent tax on passive income. In 2013, equipment dealers became subject to a tax they were never meant to pay.

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 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. Unfortunately, construction equipment companies are not always able to take advantage of these exceptions. 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 ACA. 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).

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, some companies that rent equipment have fallen into a trap and are now being forced to pay a tax that was not meant for them. Whether as part of tax reform or repealing, replacing, or reforming the ACA, we urge the committee to resolve this inequity by repealing the tax or taking other legislative action to clarify its inapplicability to dealer rental income.

Repeal the Estate Tax to Protect Family Companies

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 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.

Family businesses are continuing to divert resources to estate planning to mitigate the impact of the estate tax on their companies when the current generation of owners dies. According to a recent AED tax survey, almost half (48.89 percent) of respondents reported that their companies purchased estate tax-related life insurance to provide liquidity to pay estate tax bills. The average amount spent on insurance premiums was \$186,009; the total amount reported by all survey participants was \$4.650 million. We estimate AED members collectively spend \$25.429 million per year on estate tax-related insurance.

Similarly, survey participants were asked whether their companies had hired lawyers and accountants to design estate tax-mitigation plans and, if so, how much the company had spent on those professional services over the past three years. The 48.89 percent of respondents who said they had hired estate planning professionals had collectively spent \$1.170 million, an average of \$45,000 per company. We estimate AED’s members have collectively spent \$5.886 million over the past three years on professional services to mitigate the impact of the estate tax.

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. AED maintains its

long-standing position that the estate tax is unfair, 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.

Maintain LIFO

LIFO (“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 considers 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 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.

Because LIFO has been determined by companies that use it to be the most accurate measure of the financial condition of the business and the income to which tax should apply and because of the economic disruption LIFO repeal would create, we urge the committee maintain this important accounting method.

Create New User Fee Revenues to Restore Certainty to Federal Infrastructure Programs

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.

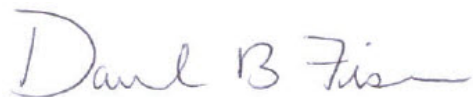
The highway program is already in dire straits. Although it was self-sustaining for many years thanks to the gas tax and other user fees, declining revenues have made transfers from the general fund necessary to prevent road and bridge spending cuts. Many studies have shown that merely maintaining current spending is insufficient to build the infrastructure our growing economy needs.

The gas tax was last increased - to 18.4 cents per gallon - in 1993. 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.

Conclusion

Thank you for the opportunity to submit input as the Senate Finance Committee drafts tax reform legislation. 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,



Daniel B. Fisher
Vice President of Government Affairs