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CC:ITA:RU (REG-103829-99)
Room 5226
Internal Revenue Service
POB 7604
Ben Franklin Station
Washington, DC 20044

Re: Notice of Proposed Rulemaking: *Excise Taxes; Definition of Highway Vehicle* (67 Fed. Reg. 38913; June 6, 2002)

Comments and Request to Speak at Hearing

Dear Sir or Madam:

The Office of Advocacy of the U.S. Small Business Administration offers the following comments in response to the above-referenced notice of proposed rulemaking (NPRM) published by the Department of the Treasury's Internal Revenue Service (IRS). IRS did not measure the impact of the proposal on small businesses or consider less burdensome alternatives, which are basic requirements for regulating under the Administrative Procedure Act (APA), the Regulatory Flexibility Act (RFA), Executive Order 12866 and Executive Order 13272.

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. The Office of Advocacy is an independent entity within the U.S. Small Business Administration (SBA), so the views expressed by the Office of Advocacy do not necessarily reflect the views of the SBA or the Administration. Section 612 of the Regulatory Flexibility Act (RFA) also requires the Office of Advocacy to monitor agency compliance with the RFA.¹ On August 13, 2002, President Bush underscored the importance of agency compliance with the RFA and the Office of Advocacy's role in giving a voice to small businesses in the rulemaking process when he signed Executive Order 13272, titled "Proper Consideration of Small Entities in Agency Rulemaking."

Pursuant to our statutory authority, the Office of Advocacy regularly disseminates information to, and solicits comments from, small businesses regarding Federal

¹ *Codified at* 5 U.S.C. §612(a).

government activities affecting them. The Office of Advocacy convenes roundtables as one effective means of gathering information from small businesses. We held a roundtable on August 6, 2002, to obtain small business comments on this NPRM. This comment letter is based on information exchanged at that roundtable and received thereafter.

IRS Conclusions in the NPRM

In the Special Analyses Section of the preamble to the NPRM, the IRS makes three critical assessments about the proposal:

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 has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) does not apply to these regulations and, because these regulations do not impose on small businesses 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.²

We disagree with their conclusions.

Significant Impact on a Substantial Number of Small Businesses – The Need to Understand the Regulated Community

The IRS assertion that Executive Order 12866 does not apply overlooks the real impact of this proposed rule. According to information provided to Advocacy, thousands of businesses would be subject to significant additional taxes under the IRS proposal. The taxes can include the following: fuel tax on gasoline at \$.184 per gallon and on diesel fuel at \$.244 per gallon; a heavy-duty tire excise tax; a truck and trailer tax at 12% of the purchase price for any new trucks and trailers; and an annual heavy vehicle tax capped at \$550 per vehicle. Advocacy solicited and received industry estimates of additional costs that would be borne for three industries (mobile cranes, utilities, and drilling industries). In addition, small businesses would have to incur additional and substantial costs to determine whether formerly exempt “mobile machines” are still exempt in the new categories. Tax practitioners tell us that “private letter rulings” and opinions of counsel can cost thousands of dollars and are limited to very specific factual patterns. Advocacy has encouraged small businesses and trade associations representing the sectors to submit to the IRS with their comments detailed estimates of the impact on their industry.

The impact of this proposal is clear. The number of small businesses that will pay more tax is considerable. For example, the North American Industry Classification System

² 67 Fed. Reg. at 38914 (June 6, 2002).

(NAICS) code 213, *Support Activities for Mining* (which includes actual drilling and support activities for mineral, oil, and gas wells) contains over 7,600 firms; 98% of them are small businesses.³ Many of these firms use drilling, fuel pumping, and hoisting equipment that is exempt under the current regulations. Among a number of other industries in which exempt equipment is commonly used are commercial construction, logging, and utility maintenance.

We believe the above impact-estimates trigger the analysis requirements of the RFA (discussed below) and Executive Order 12866 (EO 12866).⁴

Application of the Administrative Procedure Act

Advocacy believes this rule is legislative, not interpretative, which means that the requirements of the APA would apply. If the APA applies, then RFA must also apply.

Generally, a determination of whether a rule is “legislative” (subject to the RFA), or “interpretative” (not subject to the RFA unless there is an information collection requirement) rests on two considerations: 1) whether the rule is the “product of an exercise of delegated legislative power to make law through rules,”⁵ and 2) the degree of discretion left to the IRS to fashion a rule and the scope of the rule that was fashioned.⁶

In establishing the Highway Trust Fund, the Congress expressed its intention to employ taxes “involving vehicles used on or suitable for use on highways.”⁷ The IRS exercised discretion years ago to decide which vehicles were or were not suitable (and therefore exempt from tax) by regulation. Over the years, to supplement its regulatory structure, the IRS issued revenue rulings and private letter rulings to specifically designate vehicles that

³ The number of firms in NAICS code 213 was derived from tables that can be accessed on the Office of Advocacy website (www.sba.gov/advo/stats/data.htm). Advocacy contracts with the U.S. Bureau of the Census to provide employer firm size data.

⁴ EO 12866 defines a “significant regulatory action” as any regulatory action that is likely to result in a rule that may: (1) have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities. EO 12866 also defines a significant regulatory action as one which will (4) raise novel legal or policy issues arising out of legal mandates. The Job Creation and Worker Assistance Act of 2002 (P.L. 107-147) provides bonus depreciation (30% immediate depreciation in the year of purchase) to stimulate the economy by encouraging the purchase of business related equipment. The NPRM calls for a 12% tax imposed on a new class of equipment owners (mostly small businesses) which greatly reduces the value of the stimulus.

⁵ Kenneth Culp Davis, *Administrative Law Treatise* 36 (1979).

⁶ See testimony of Commissioner Roscoe Egger, Internal Revenue Service, Implementation of the Regulatory Flexibility Act: Hearings before the Subcom. On Special Small Business Problems of the House Committee on Small Business, 99th Cong., 2nd Sess. (1986) p. 70. The difference between legislative and interpretative is: “primarily the degree of discretion that we have in applying the rules. In other words, if the statute is not specific but says ‘this is the objective we want to achieve and you (IRS) write the rules to achieve it’ we regard those as legislative; but when they say ‘these are the rules,’ obviously then they are interpretative.”

⁷ H. Rept. 84-2022, p.39.

fit into the regulatory classes it created. Court cases further marked and amplified the categories of vehicles that the IRS established as exempt under its regulatory scheme.⁸

The history in this case shows that this proposal is legislative and thus subject to the APA.

Application of the Regulatory Flexibility Act

If the APA applies to this legislative rule, as Advocacy believes, then the RFA requires the IRS to issue an initial regulatory flexibility analysis (IRFA) or certify that this proposed rule will not have a significant economic impact on a substantial number of small entities. In view of the thousands of small businesses that would pay millions more tax dollars and spend hours on paperwork and forms, an IRFA is necessary and desirable.

However, even if the NPRM were an interpretative rule, Advocacy believes that the IRS would still be required to do an IRFA because it imposes a collection of information on small businesses. The Small Business Regulatory Enforcement Fairness Act amended the RFA to address cases where IRS interpretative rules created significant burdens on small businesses. Section 603(a) of the RFA says: “Whenever any agency... publishes a notice of proposed rulemaking for an interpretative rule involving the internal revenue laws of the United States, the agency shall prepare and make available for public comment an initial regularity flexibility analysis.”⁹ Those burdens on small business were to be analyzed so that regulatory decisionmakers would have the benefit of knowing the impact of their decisions.

If the rule becomes final, thousands of businesses that own newly non-exempt equipment will need to start filing IRS form 2290 in order to calculate and pay the annual Heavy Highway Vehicle Use tax. More important, Advocacy is concerned that the vagueness of the proposed rule will create a significant administrative burden for the small business that owns the vehicle. Under the proposed rule, determinations about a continued exemption are made on a case-by-case basis. The NPRM lists some factors to weigh in the determination, such as: “size of the vehicle; whether it is subject to the licensing, safety, and other requirements applicable to highway vehicles; and whether it can transport a load at a sustained speed of at least 25 miles per hour,”¹⁰ but such factors do not provide a clear standard. Business owners unsure of the reach of the new rules and the status of their previous exemption need certainty to operate. Prudent owners of a vehicle that has any or all of these “factors” would seek a private letter ruling from the IRS to be certain they will not face back taxes, penalties, and interest. Those owners who believe they still qualify but do not have a ruling are well advised to keep extensive records that outline the use of their vehicles to defend their determination and be able to verify their eligibility for refunds on fuel excise taxes and annual Heavy Vehicle Use Tax exemptions.

⁸ A list of such rulings and court cases is attached for your reference.

⁹ 5 U.S.C. §603(a).

¹⁰ See proposed §48.4051-1(a)(2)(ii), 67 Fed. Reg. 38914.

Conclusion and Request to Testify

Last August, President Bush issued Executive Order 13272, requiring agencies to give proper consideration of small entities in agency rulemaking.¹¹ The Executive Order makes clear the Administration's intention for Federal agencies to take small businesses into account when regulating. The proposed regulation will have a significant economic impact on a substantial number of small entities by raising the tax payments on thousands of small businesses and imposing regulatory burdens.

In accordance with the RFA, E.O. 12866, and the APA, the IRS should review the impact of its proposed rules and publish an analysis. The Office of Advocacy encourages the IRS to carefully review the comments of affected small entities and take appropriate steps to bring this NPRM into compliance with the requirements of the RFA.

The Office of Advocacy would like to reserve the right to appear at the hearing scheduled for February 28, 2003, and to have this letter serve as the outline of our comments. If you have any questions or require additional information, please contact Russell Orban at 202-205-6946 or russell.orban@sba.gov. Thank you for this opportunity to contribute to the record and for granting an extension of the comment period so that more interested parties had a chance to participate in this proceeding.

Sincerely,

/s/

Thomas M. Sullivan
Chief Counsel for Advocacy

/s/

Russell Orban
Assistant Chief Counsel

cc: Bob Wenzel, Acting Commissioner, Internal Revenue Service

Pamela Olsen, Acting Assistant Secretary for Tax Policy, U.S. Department of the Treasury

Dr. John Graham, Administrator, Office of Information and Regulatory Affairs

¹¹ Exec. Order 13272; 67 Fed. Reg. 53461 (August 12, 2002).

