

Testimony before the Internal Revenue Service:

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U.S. Small Business Administration

February 27, 2003

Notice of Proposed Rulemaking - (REG – 103829-99)

*Excise Taxes; Definition of Highway Vehicle*

Members of the review panel:

Thank you for this opportunity to present testimony on the proposed rule entitled *Excise Taxes: Definition of Highway Vehicle*. Thank you as well for extending the comment period on this rulemaking to give small businesses extra time to review and comment on the proposal. My name is Russell Orban and I am appearing for the Office

of Advocacy (Advocacy) to offer comments and answer questions about the application of the Regulatory Flexibility Act to this rulemaking. Advocacy filed written comments on December 4, 2002. We believe the IRS should measure the impact of the proposal on small businesses and 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 to represent the views of small entities before Federal agencies and Congress. The Office of Advocacy is an independent entity so the views expressed in our testimony do not necessarily reflect the views of the SBA or the Administration. Section 612 of the Regulatory Flexibility Act (RFA) requires the Office of Advocacy to monitor agency compliance with the RFA. Recently, Executive Order 13272 entitled "Proper Consideration of Small Entities in Agency Rulemaking" underscored the importance of agency compliance with the RFA.

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

The IRS assertion that Executive Order 12866 does not apply overlooks the real impact of this proposed rule. As you have seen in the comments and heard here today,

thousands of businesses would be subject to significant additional taxes under the IRS proposal. In addition, small businesses would incur substantial costs for opinions of counsel, private letter rulings, or even litigation to determine whether formerly exempt “mobile machines” are still exempt under the new regulations. Such remedies are expensive, time-consuming and limited in their application by the facts of the specific case.

Advocacy also disagrees with the assertion that this is an interpretative rule and therefore exempt from analysis by section 553(b) of the Administrative Procedure Act. Advocacy believes this rule is a legislative rule requiring compliance with the APA and the RFA.

Briefly, whether a rule is legislative or interpretative depends on the amount of discretion exercised by the agency. In this case, Congress established the Highway Trust Fund and funded it with excise taxes on “highway vehicles.” No definition was provided for that general term. The IRS defined the term in 1977 but excluded “mobile machines” from the tax. This is the section the IRS now wants to repeal. The rule filled the gap left in the legislation and has the force and effect of law. It confers a benefit that the IRS now proposes to change (or take away). This exercise of discretion by the IRS is a textbook case of legislative regulation and thus the rule should be subject to the full requirements of the APA and the RFA.

The RFA requires the agency to perform a regulatory flexibility analysis of the impact of proposal on small entities including a review of alternative methods of regulating that may be less burdensome. Section 605(b) allows the IRS to avoid doing the analysis if it certifies that the proposal would not have a “significant economic impact

on a substantial number of small entities.” The comments and testimony the panel has received make it clear that the proposal has a big impact. Some estimates of the costs provided to us were hundreds of millions of dollars. Also, the rule could apply to hundreds of different vehicles and the thousands of small businesses that own and operate them.

Even if the NPRM were an interpretative rule, Advocacy believes that the IRS would still be required to do an analysis because the rule imposes a collection of information on small businesses. Congress amended the RFA in 1996 to specifically address cases where IRS interpretative rules created significant and specific 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 regulatory flexibility analysis.” Those burdens on small business were to be analyzed so that regulatory decision-makers would have the benefit of knowing the impact of their decisions. (Advocacy recommends the comments filed December 4 by the author of the RFA Amendments, Senator Bond, for a discussion of the intent of the amendments.)

In conclusion, we believe that the IRS must do an analysis regardless of whether proposed rule is considered legislative or interpretative. As a further, practical consideration, the IRS is the custodian of the most comprehensive data that is reasonably available about the scope of this rule. Existing business requests for refund of fuel taxes, for example, could provide detailed information about the number of vehicles regulated and the amount of tax paid.

Last August, President Bush issued Executive Order 13272, 67 Fed. Reg. 53461 (August 12, 2002), requiring agencies to give proper consideration of small entities in agency rulemaking. The Executive Order makes clear the Administration's intention for Federal agencies to take small businesses into account when regulating. Advocacy believes this proposed regulation is a good example of the kind of rulemaking that deserves extra attention. We encourage the IRS to review the comments and testimony and thoroughly analyze the proposal rule to bring this rulemaking into compliance with the APA, the RFA, E.O. 12866 and E.O. 13272..

I would be happy to answer any questions you have and I will stay for the entire hearing should you have questions later.