August 2, 2012

The Honorable Dave Camp
Chairman
U.S. House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Sander Levin
Ranking Member
U.S. House Committee on Ways and Means
1106 Longworth House Office Building
Washington, D.C. 20515

RE: Committee Hearing on Tax Reform and the U.S. Manufacturing Sector

Dear Chairman Camp and Ranking Member Levin:

AFPM, the American Fuel & Petrochemical Manufacturers, respectfully submits this letter for the record regarding the U.S. House Ways and Means Committee’s July 19th, 2012 hearing on “Tax Reform and the U.S. Manufacturing Sector.”

AFPM is a trade association representing high-tech American manufacturers of virtually the entire U.S. supply of gasoline, diesel, jet fuel, other fuels and home heating oil, as well as the petrochemicals used as building blocks for thousands of products vital to everyday life. AFPM’s members operate in a highly competitive international market, where fractions of a penny on a per gallon basis can mean the difference between a refinery continuing operations or shuttering its doors.

As the U.S. economy continues to struggle in its recovery, AFPM applauds the Committee’s commitment to examining the tax code in order to explore reforms that will make U.S. business more competitive and promote new investment in America. Although U.S. refiners provide more than 95 percent of the fuel consumed in the United States, a blizzard of reduced demand, the high price of crude oil, increased regulatory costs, and government mandates have posed significant challenges for several refineries in the past few years, particularly those on the East Coast. Lowering the statutory tax rate would provide welcome relief to domestic refiners, but only if it resulted in a net decrease in their overall effective tax burden. In contrast, raising the tax burden on U.S. refiners would only exacerbate these challenges, further increasing the real cash costs of doing business in our own country and serving to make domestic industry less competitive. Thus, reducing the regulatory and effective tax burdens on U.S. refiners and petrochemical manufacturers, and all other domestic manufacturers, should be the goal—these changes will have a positive effect by helping to keep companies competitive and providing high-quality, high-paying jobs in the U.S.

As the Committee explores reforms to the tax code and, in particular, lowering the statutory rate, AFPM urges Committee members to tread cautiously when dealing with so-called “base
“Last-In, First-Out” (LIFO): LIFO is a well-accepted accounting method used by American businesses and approved by the IRS since the 1930s. It is primarily used to determine book and taxable income for companies that anticipate inflation or rising prices over the course of their operations. For refiners, it is an effective way to better take into account replacement costs, particularly as the cost of crude oil increases. Repealing LIFO accounting for all taxpayers, and in particular the oil and gas industry, would amount to a multi-billion dollar tax penalty in retroactive tax hikes that would adjust inventory on hand as income. Refineries keep large inventories in order to maintain supplies and keep an even predictive flow of crude costs. Repealing LIFO would require companies to redirect cash or sell assets in order to cover the tax payment—potentially devastating businesses and American jobs. There is no justification to enact a retroactive tax on American businesses.

• **Section 199:** The American Jobs Creation Act of 2004 contains the “Section 199 Domestic Production Activities Deduction”, often—but incorrectly—referred to as the “domestic manufacturing deduction.” The Section 199 deduction applies broadly to income from property “manufactured, produced, grown, or extracted by the taxpayer” in the U.S., and further applies to qualified films, electricity, natural gas, or potable water produced in the U.S. and construction of real property in the U.S., including associated engineering or architectural services (see I.R.C. Section 199(c)). It provides needed tax relief for domestic production activities of all kinds—which support middle class jobs—including support to help stimulate manufacturing activity in the United States. Petroleum refining and the production of domestic oil and natural gas resources are one of many sectors eligible for this credit, which incentivizes the expansion of U.S. refining capacity, energy supplies, and infrastructure. The deduction is needed to keep American fuel and petrochemical manufacturers competitive in an increasingly tough global marketplace. Since 2010, the oil and gas industry has received a discriminatory smaller deduction (6 percent) than every other manufacturer or producer (9 percent), including Hollywood film producers. This discrimination should be eliminated in any tax reform.

• **Depreciation:** US taxpayers have been using the Modified Accelerated Cost Recovery System (MACRS) since the 1980s. This long-standing method of depreciation has a positive impact on cash flow, which is an important determinant in the level of investment in new tangible property. In an increasingly uncertain world in which market demand and production costs can shift quickly, the rapid cash payback from MACRS depreciation substantially reduces the risk premium and hurdle rate to make new investments attractive. Studies have shown that US depreciation rates are not more
generous than our trading partners. Recent tax reform discussions have focused on the potential repeal of MACRS, and replacing it with a longer depreciation rate as a way to finance corporate tax rate reduction. Studies have shown that such a change will increase the cost of capital and the cost of new equipment—this change has been projected to reduce the amount of new investment in the US and US jobs.

- **Publicly Traded Partnerships:** Publicly traded partnerships (PTPs), sometimes referred to as master limited partnerships (MLPs), are an important component of our domestic refining and petrochemical operations. A significant amount of the natural gas, crude oil, and refined products (such as gasoline) manufactured and consumed daily in America is transported by the pipelines and stored in the facilities owned by these PTPs. During the upcoming consideration of tax reform initiatives, there will be an effort by some to tax these pass-through entities more like corporations. We believe such an outcome would be unfortunate for several reasons. First, the PTP structure, sanctioned by Congress in 1987 and relied upon by businesses as well as investors for over thirty years, has been extremely successful at encouraging investment in the domestic energy infrastructure. Second, this level of investment operates in the best interests of the sector by creating easier access to capital as well as inuring to the benefit of individual investors by providing a dependable source of income. The capital intensive nature of building and maintaining energy infrastructure projects that is somewhat ameliorated by the lower cost of equity capital associated with PTPs should not be discounted. We ask that the Committee retain the current treatment of PTPs within the Code.

AFPM appreciates your consideration of our views. Please contact Geoff Moody, AFPM’s director of government relations, with any questions. He can be reached at gmoody@afpm.org or 202-552-8489.

Sincerely,

Charles T. Drevna
President