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Congress of the United States

U.S. House of Representatives

Committee on Small Business

2361 Rayburn House Office Building

Washington, DC 20515–6315

Memorandum

To:	Members, Subcommittee on Investigations, Oversight, and Regulations
From:	Committee Staff
Date:	July 9, 2012
Re:	Hearing: "Sinking the Marine Industry: How Regulations are Affecting Today's Maritime Businesses"

Introduction

At 10:00 AM on July 12, 2012 in room 2360 of the Rayburn House Office Building, the Subcommittee on Investigations, Oversight, and Regulations will meet for the purpose of receiving testimony on federal policy and regulatory impediments for small businesses in the marine industry. This will be a wide-ranging examination of regulatory actions by the Department of Labor, the planning and permitting processes for the United States Army Corps of Engineers maintenance of navigable waterways, and intra-state taxation of small businesses. Specifically, the hearing will examine these issues in the context of job creation and economic growth within the small businesses segment of the maritime industry.

Background

Recreational boating is an important contributor to the United States economy, generating $32.3 billion in sales and services in 2011.[1] Of the 238 million adults living in the United States in 2011, 34.8 percent, or 83 million people, participated in recreational boating on the estimated 16.35 million recreational boats in the United States. Boating has an estimated annual economic impact of $72 billion and 73 percent of boat owners in the United States in 2011 had an annual household income less than $100,000.[2]

The recreational boating industry is also a strong exporter. A total of 179,652 powerboats were manufactured in the United States in 2011, of which 20.5 percent were exported to other countries.[3] This represents an increase for the second straight year, up 10 percent to a three-year high total of nearly 129,000 units.

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[1] NATIONAL MARITIME MANUFACTURERS ASSOCIATION, 2011 RECREATIONAL BOATING STATISTICAL ABSTRACT, iv. [hereinafter NMMA Abstract].

[2] http://www.nmma.org/press/pressreleaselibrary/pressrelease.aspx?id=18166.

[3] NMMA Abstract, at v.

H.R. 1439, The "Business Activity Simplification Act of 2011"

The Constitution prohibits a state from imposing any tax on a taxpayer that lacks a "substantial nexus" with the state.[4] What constitutes a ''substantial nexus'' with respect to a state's ability to impose net income or other business activity taxes (collectively, ''BATs'') upon a business, however, is unclear.[5] If read narrowly, the Supreme Court's 1992 decision in *Quill Corp. v. North Dakota*[6], which requires physical presence in the state to satisfy a substantial nexus, applies only to a state's imposition of sales and use tax collection and remittance requirements upon taxpayers[7]. A narrow reading of *Quill Corp.* then would allow states to impose BATs other than sales and use taxes. Many states have done so.

States lack a uniform definition for "substantial nexus" for BATs. The patchwork of tests to determine whether a business has "economic presence" in a state leads to considerable uncertainty for businesses attempting to estimate and reserve capital for their putative tax liability.[8] This puzzling hodgepodge of state requirements and laws can be especially difficult for small businesses dealing in intra-state commerce as they do not have the resources to research the requirements of all of the states in which they may do business or have an "economic presence." This issue has become more important in recent years with the advent of Internet-based sales and marketing campaigns that allow small businesses to reach potential customers in states and regions other than their own.

H.R. 1439[9] seeks to reduce such uncertainty by confirming that *Quill*'s bright-line "physical presence" standard applies to a state's imposition of BATs. The act has three primary legislative features. First, it establishes a bright-line physical presence nexus requirement in order for states to impose or collect net income taxes or other BATs on multistate enterprises. Second, the act updates Public Law 86-272, enacted in 1959, to prohibit states from imposing taxes on the net income of interstate sellers of tangible personal property if the only business activity within the state consists of the solicitation of certain sales orders, so that the law applies equally to intangible goods and services. Finally, it restricts the means by which a state may apportion the income of a unitary group of affiliated businesses so that only that portion of the business activity conducted in a state may be taxed by that state. As secondary matters, the bill also lists conditions that a business must satisfy in order to be considered physically present for

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[4] *See Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 277-78 (1977)

[5] *See generally Hearing on H.R. 1439 Before the Subcomm. on Courts, Commercial and Admin. Law of the House Comm. on the Judiciary,* 112th Cong. (April 13, 2011) [hereinafter 2011 Hearing]; *State Taxation: The Role of Congress in Defining Nexus: Hearing Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary,* 111th Cong. (February 4, 2010).

[6] *Quill Corp. v. North Dakota*, 504, U.S. 298 (1992).

[7] *Id. at* 317-18.

[8] *2011 Hearing* (statement of Corey Schroeder, Vice President and Chief Financial Officer, Outdoor Living Brands, Inc., on behalf of the International Franchise Association), *available at* http://judiciary.house.gov/hearings/hear_04132011_2.html.

[9] On July 7, 2011, the House Committee on the Judiciary ordered the bill favorably reported without amendment by voice vote. For more detailed background information, legislative history and analysis of H.R. 1439, see http://www.gpo.gov/fdsys/pkg/CRPT-112hrpt257/pdf/CRPT-112hrpt257.pdf.

nexus purposes and clarifies that each person in a group of affiliated businesses has legal separateness so that physical presence may not be imputed.

Regulations Implementing The Longshore and Harbor Workers' Compensation Act[10]

The Department of Labor oversees the implementation of the LHWCA, a federal program which requires employment-injury protection for workers who are injured on the navigable waters of the United States or in adjoining areas.[11] Until 2009, the LHWCA excluded from coverage any employee covered by a state workers compensation plan and "employed to build, repair, or dismantle any recreational vessel under sixty-five feet in length."[12] Employers with employees subject to the LHWCA are required to purchase insurance or self-insure. 33 U.S.C. §932. For small businesses, self-insurance is usually not an option and they must then purchase expensive LHWCA coverage. The American Recovery and Reinvestment Act of 2009 (ARRA)[13] amended §902 (3)(F) in two ways. First, it defined as an employee only those individuals *building* recreational vessels of more than sixty-five feet. Second, it excluded from the definition of employee any individual employed to repair a recreational vessel or dismantle it (in connection with repair) *without regard to length.*[14]

On August 17, 2010, the Department of Labor (DOL) issued a proposed rule[15] executing the changes contained in the ARRA. In addition to implementing the ARRA amendments, the Department of Labor added to the definition of a "recreational vessel."[16]

The AARA amendment was designed to completely exempt businesses that repair and dismantle recreational vessels of any length, including those greater than sixty-five feet that had been previously required to purchase the traditionally more expensive LHWCA insurance. However, by proposing to amend the definition of "recreational vessel, the DOL has added confusion concerning which coverage is required for repair or recreational vessels—LHWCA or state workers compensation.

Several industry trade associations, members of Congress, and the Small Business Administration's Chief Counsel for the Office of Advocacy all submitted comment letters stating

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[10] 33 U.S.C. §§901-50 (hereinafter LHWCA)
[11] Department of Labor Website, *available at* http://www.dol.gov/owcp/dlhwc/lsmiss.htm.
[12] 33 U.S.C. §902 (3)(F) (2008).
[13] American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009).
[14] *Id.* at §803 of Title VIII, Div. A., 123 Stat. at 187 [codified at 22 U.S.C. §902 (3)(F)(2010)] No changes were made to the requirements concerning coverage by state workers compensation plans.
[15] Regulations Implementing the Longshore and Harbor Workers' Compensation Act: Recreational Vessels, 75 Fed. Reg. 50,719, 50730 (Aug. 17, 2010) (to be codified at 20 C.F.R. Part 701).
[16] The DOL definition incorporated the Coast Guard's standards for categorizing vessels as recreational and non-recreational. The final rule contains two additional provisions. First, the final rule provides that manufacturers and builders may determine whether a vessel is recreational by the nature of the vessel's design rather than the end use of the vessel. And second, the rule includes within the definition of recreational vessels non-military vessels that are recreational by design and owned or chartered by federal, state or municipal governments. This definition change could impact boat builders as well as boat repairers. Importantly, the definition of recreational vessel attempts to exclude non-recreational uses (e.g., passenger, commercial). As crafted this new definition may create problems for manufacturers who are producing boats intended for the recreational market but who have no way of knowing the ultimate use by the retail purchaser.

that they did not believe the DOL's proposed rule conformed to the congressional intent of the ARRA amendment to exempt repairers and dismantlers (in conjunction with repairs) of recreational vessels from LHWCA coverage. The more significant impact is that it may increase the numbers of small entities in the recreational marine industry that would be required to obtain the more expensive LHWCA insurance, resulting in higher compliance costs than DOL estimates in its initial Regulatory Flexibility Analysis.[17]

For example, a letter on the proposed rule written by Representatives Ron Klein and Debbie Wasserman Schultz stated: "We are deeply troubled with the scope and intent of certain aspects of the proposed regulations, believing that it undermines clear congressional intent."[18] According to the Representatives, Congress intended this provision to exempt all entities conducting repair and dismantling of recreational vessels from the more expensive federal LHWCA coverage because recreational vessels exceeding 65 feet in length are now quite common.[19] According the comment letter, the DOL modification of the definition of recreational vessel "fundamentally alters" the scope of vessels and employees that were to be excluded from the requirements of the LHWCA.[20]

Similarly, the National Marine Manufacturers Association (NMMA) submitted comments regarding the expected ambiguity of the rule. The NMMA states in its letter that "because the recreational industry is made of small firms it is especially important to have a clear regulation for the recreational marine exemption from LHWCA. These firms do not have the ability to hire attorneys or workers compensation specialists to assist in parsing out confusing regulations and classifying employees." The letter continues that "any ambiguity will force these companies to turn down important work or face unnecessary LHWCA costs . . . . in addition, uncertainty in the scope of liability for marine businesses will result in a reduction in the number and variety of insurance firms willing to write policies for these businesses leading to increased costs."[21]

The NMMA also is concerned about this definition of recreational vessel because it requires boat manufacturers and boat repairers to know and keep track of the intent of the purchaser of the boat and utilize this information to determine LHWCA coverage. According to NMMA, recreational boats are typically sold through a dealer network and can be sold and resold numerous times. Since a recreational vessel manufacturer is generally without any knowledge of what use the ultimate retail purchaser will make of the vessel, this manufacturer

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[17] *Id.* at 50,725.

[18] Letter from Debbie Wasserman Schultz and Ron Klein, to Michael Niss, Director, Division of Longshore and harbor Workers' Compensation, Office of Workers' Compensation Programs, United States Department of Labor 1 (Nov. 17, 2010) (on file with author).

[19] *Id.*

[20] *Id.* at 2.

[21] Letter from Cindy Squires, Esq., Chief Counsel for Public Affairs and Director of Regulatory Affairs, National Marine Manufacturers Association, to Michael Niss, Director, Division of Longshore and Harbor Workers' Compensation, Office of Workers' Compensation Programs, United States Department of Labor 6 (Nov. 12, 2010), *available at* http://www.nmma.org/assets/cabinets/Cabinet214/NMMA%20%20Comments%20to%20DOL%20re%20Recreational%20Exemption%20from%20Longshore%20Insurance%2011-11-2010.pdf.

only should be required to determine that it is building boats to the recreational boat regulations and industry standards. Additionally, boat repairers may encounter and fix recreational vessels but have no knowledge how the actual owner/operator is utilizing that boat.

On December 30, 2011, the DOL issued the final rule[22] implementing these changes. Regulators made little to no changes of the proposed rule to reflect the concerns raised by industry, the congressional authors, nor the Office of Advocacy in regard to the definition of "recreational vessel." As a result, recreational vessels undergoing repair that were intended to be exempt from the HWCA are now covered thereby imposing unnecessary costs on small businesses.

Maintenance of Navigable Waterways and the Inland Waterways Transportation System

Background

Federal interest in navigation in the United States stems from the Commerce Clause of the Constitution. The history of federal improvements to inland navigation in the United States dates back to the 1820's when Congress authorized construction of a canal connecting Lake Michigan to the Illinois River and authorized the United States Army Corps of Engineers (Corps) to remove snags, debris, and other obstructions from the Mississippi and Ohio Rivers.[23] These rivers and coastal ports then became the primary routes of commerce for the new nation.

For nearly two centuries the federal government has dredged channels and built locks and dams, wing dikes, and other structures to create an inland waterways transportation system for the efficient movement of goods. The system includes major rivers such as the Mississippi, Missouri, Ohio, and Columbia Rivers, as well as smaller waterways such as the Tennessee, Arkansas, Monongahela, and the Intracoastal Waterway.

Today the inland waterways transportation system provides an alternative to truck and rail; it is the most cost effective and energy efficient means for transporting commercial goods. The inland waterways transportation system is also a key component of state and local economies, job creation efforts, and is essential to America's economic and national security.

The Corps operates and maintains 221 lock chambers at 185 sites of 27 inland rivers and intracoastal waterways. This amounts to approximately $235 billion worth of water resources infrastructure assets.

Condition of the Inland Waterways Transportation System

Aging infrastructure along the inland waterways transportation system presents a challenge. Nearly 60 percent of these facilities have been in service for longer than 50 years, while almost 40 percent are more than 70 years old. Yet, reliability of this critical and economical transportation network is critical to the nation's economy. The inland water

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[22] Regulations Implementing the Longshore and Harbor Workers' Compensation Act: Recreational Vessels, 76 Fed. Reg. 82,117, (Dec. 30, 2011) 20 C.F.R. Part 701.

[23] http://www.usace.army.mil/About/History/BriefHistoryoftheCorps/ImprovingTransportation.aspx.

transportation system is often the economic lifeblood of the regions where they are located. A healthy and vibrant inland water transportation system is critical to the small businesses that directly use the system, as well as those who indirectly support those firms. While this infrastructure has served the nation well, operation and maintenance expenditures will only slightly prolong the life of a depreciating asset that will continue to diminish in performance.

Challenges to maintain the inland waterway transportation system can be associated with both process and funding. In recent decades, it has become increasingly difficult to get project approval through the congressional and Corps processes. Even if a project is approved, funding for repair and maintenance are difficult to obtain given budgetary constraints. Those inland waterways transportation system projects authorized in the Water Resources Development Act of 1986[24] were completed within an average of six years. However, according to the House Committee on Transportation, projects authorized since 1986 have on average taken 20 years to complete and cost more than twice the authorized amount.[25]

The Olmstead locks and dam project on the Ohio River between Illinois and Kentucky was authorized in 1988 for $775 million to replace two aging locks completed in 1929. While the project broke ground in 1992 and was expected to be completed no later than 2005, the project today remains incomplete. Cost estimates have ballooned to approximately $3.1 billion with an expected completion date after 2020.[26]

The Corps is seen as the last barrier in the project permitting process; a process that is perceived by some as repetitive and slow to respond. Special conditions added by the Corps can be subjective, adding additional time and imposing prohibitive costs to proposed projects which are necessary to accommodate boats that use the nation's waterways and sustain the inland water transportation industry.

Our nation's navigable waterways were our nation's first highways. While proven as being one of the most efficient and environmentally friendly methods of transporting goods across the country, an aging system of locks, dams, and undredged channels threatens the continued viability of these waterways as reliable shipping avenues. Current fiscal constraints should not be compounded by unnecessary regulatory impediments imposed by the Corps.

Conclusion

Inland waterways and ports are often the lifeblood of the economies of the regions in which they are located. This hearing represents an opportunity to hear testimony from experts and small business owners on the most pressing impediments to job creation and economic growth in the maritime industry as well as to listen to potential solutions to those problems.

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[24] Pub. L. No. 99-662, 100 Stat. 4082 (1986) (Codified, as amended, at 33 U.S.C. §§2201-2348).
[25] Memorandum from the House Comm. on Transportation and Infrastructure Subcomm. on Water Resources and Environment to Comm. Members 5 (Ap. 13, 2012) (on file with author).
[26] *Id.*