American Rental Association

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The Honorable Roger Williams The Honorable Nydia Velázquez
Chair, Committee on Small Business Ranking Member, Committee on Small Business
United States House of Representatives United States House of Representatives

Dear Chair Williams and Ranking Member Velazquez:

The American Rental Association, representing the equipment and event rental industry, appreciates the opportunity to submit a statement to the record for the April 18, 2023, full Committee hearing entitled: *Paying Their Fair Share: How Tax Hikes Crush the Competitiveness of Small Businesses.* We request that our full statement which is attached to this letter is included in the hearing record. If you or your colleagues on the Committee have any questions regarding our policy positions or prescriptions, please do not hesitate to contact me directly.

With Kindest Regards,

John W. McClelland Ph.D.

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Statement for the Record
American Rental Association
Committee on Small Business
United States House of Representatives

Background

This statement is submitted to the record of the April 18, 2023, hearing entitled: *Paying Their Fair Share: How Tax Hikes Crush the Competitiveness of Small Businesses.* The American Rental Association (ARA) represents the equipment and event rental industry. ARA's 5,600 members operate approximately 12,000 locations throughout the United States with locations in every Congressional district. ARA members buy equipment used in construction and related activities as well as equipment used for staging events large and small. The vast majority of ARA members are small independent businesses with less than $30 million in annual revenues, and a majority of those have revenues of less than $5 million. Moreover, most ARA members are organized as pass-through entities.

ARA members rent the equipment in their inventories to other businesses and to the public. ARA estimates that equipment rental companies own approximately 55 percent of the construction equipment in the U.S. on a value basis. In 2023, the equipment and event rental industry will generate about $60 billion in aggregate revenues in the U.S. Approximately 90 percent of those revenues will come from the rental of construction equipment and tools used in the construction industry as well as by small contractors and homeowners. Two general statements about the equipment and event rental industry are 1) the industry is very capital intensive, and 2) equipment and event rental companies are constantly turning over their inventories; retiring older equipment and replacing it with new equipment.

Equipment and event rental businesses can be characterized using the concepts of stocks and flows. The inventory (fleet) is the stock of equipment owned by the company. There is a constant flow of equipment in and out of the fleet as old equipment is retired and new equipment is added to the fleet. When flows of assets into the fleet are greater than the flow of assets out of the fleet, the asset base is expanding. When the opposite occurs, the fleet contracts. Over the past fifteen years, from the beginning of the financial crisis through the Covid pandemic, the equipment and event rental industry has experienced cycles of significant fleet expansions and contractions.

Annual fleet turnover is necessary because rental equipment experiences high levels of utilization. It is not uncommon for some assets to be on rent for more than 60 percent of the time. When equipment is brought back to the rental business it must be cleaned and maintained to get it ready for its next rental. Managing an equipment or event rental inventory is complex and a large part of this is related to financial management.

Bonus Depreciation/Full Expensing

For more than twenty years, Congress has enacted provisions in the tax code that created incentives for businesses to increase capital expenditures that stimulate economic growth. This is one of the reasons the equipment and event rental industry has essentially tripled in size since 2000. Another reason is the growing cost of owning and maintaining equipment that is underutilized by a single owner.

Tax incentives that have helped small equipment and event rental businesses expand their fleets are Section 179 and Bonus Depreciation provisions in Section 168. In 2017 the Tax Cuts and Jobs Act of 2017 (TCJA) made Section 179 permanent and indexed for inflation. In 2022, businesses using Section 179 could expense up to $1,080,000 if their aggregate investment in qualified equipment was less than $2,700,000. Once the $2,700,000 limit is reached, the allowable expensing under Section 179 is reduced dollar-for-dollar. Any amount of expenditures between $1,080,000 and $2,700,000 could be fully expensed using the 100% bonus depreciation available in tax year 2022. The combination of Section 179 and 100% Bonus Depreciation has meant that since 2017, capital intensive businesses like equipment and event rental businesses have been able to fully expense all of their equipment purchases in fleets with very dynamic asset flows.

Another factor affecting the equipment and event rental industry is the significant inflation in equipment costs and the residual value of these assets on the secondary market. Price increases by as much as 60 percent for some pieces of equipment over the last few years, and the already high cost of owning and maintaining this equipment has significantly increased capital outlays for the equipment and event rental industry. With investment rates equal to about 25 percent of industry revenues, these price increases for equipment have driven revenues higher because increasing costs have driven rental rates higher. As revenues have increased, and the cost of owning and maintaining these assets has increased, the demand for equipment has also continued to grow because of the economic environment created by increases in infrastructure spending as well as renewed spending on events following the Covid pandemic. The result is that many small businesses that were strictly covered by Section 179 are now being pushed into a situation where they need both Section 179 and Bonus Depreciation if they choose to fully expense their equipment purchases. Inflated equipment prices mean other ARA members that are small family-owned enterprises are now exceeding the limits of Section 179 and can only use Bonus Depreciation. Still other equipment rental companies that are defined as small businesses according to the Small Business Administration size standards have only been able to use Bonus Depreciation for the past 20-year period. In 2022, the size standard for an equipment rental business classified as NAICS 532412 (construction equipment rental) was $40 million in annual revenues.

Under TCJA, Section 168 Bonus Depreciation was set at 100 percent from 2017 through 2022. Beginning in 2023, Bonus Depreciation is reduced to 80 percent with additional 20 percent reductions in 2024, 2025, and 2026, respectively. If these reductions in Bonus Depreciation are allowed to take effect, equipment and event rental companies will face a two-edged sword. First, as retired equipment flows out of the fleet and into the secondary market, the proceeds from those sales will be subject to capital gains taxes which will be significant because the assets have a tax basis of zero and used equipment prices are relatively high. At the same time, new equipment is being purchased to replace equipment that has been retired and this new equipment cannot be fully expensed. Thus, the capital gains liability created by the sale of retired assets will not be offset by a tax write-off created by expensing the newly acquired assets. The aggregate result will be the creation of a fiscal drag on the economy because businesses either must curtail their purchases of new equipment or incur debt to pay the capital gains taxes that are no longer offset by expensing their purchases of new equipment. Moreover, if the current provisions of TCJA go unchanged, the signal to small, capital-intensive businesses is do not grow too much or you will fall off a tax cliff that could have long term consequences for the business.

We note that this is not only true for small businesses, but for all equipment and event rental businesses going forward. However, it will make small equipment and event rental businesses less competitive vis-à-vis their larger competitors because smaller firms do not have the financial resources or flexibility that are characteristic of larger firms. In addition, Section 1031 for like-kind-exchanges that allowed businesses to forgo capital gains taxes on exchanges of like-kind assets was eliminated for business personal property in TCJA. For this reason, the American Rental Association supports a permanent extension of the 100-percent expensing provisions of TCJA.

Section 199(A)

TCJA lowered the corporate tax rate from 35 percent to 21 percent. In an effort to maintain tax rate parity between small and large businesses the TCJA created Section 199(A). This provision allows businesses that are organized as pass-through entities to have a portion of their income taxed at a rate significantly less than the ordinary individual tax rate. This has allowed small pass-through businesses in the equipment and event rental industry to remain competitive relative to their larger competitors with a traditional corporate structure.

We believe Section 199(A) has been successful in maintaining robust competition within the equipment and event rental industry. However, under TCJA, Section 199(A) will expire in 2025 and every small business using the deductions allowed in Section 199(A) will be subjected to a massive tax increase. The result will be significantly less competition in the equipment and event rental industry because small businesses in the industry will be paying more in taxes instead of buying more equipment and hiring more employees. In the aggregate, the expiration of Section 199(A) will create an additional fiscal drag on the economy causing economic contraction and increases in unemployment. These costs will be primarily borne by small businesses and their employees but will ultimately ripple through the economy with negative impacts.

Conclusions

The equipment and event rental industry is a textbook example of a competitive industry. There are many firms participating in the industry and barriers to entry are relatively low. While there are large corporations in the industry, small firms still generate a significant amount of industry revenues. Moreover, the industry is decentralized because markets are local in cities and towns large and small across the U.S. The TCJA created a tax environment that has allowed the equipment and event rental industry to grow as the demand for equipment has increased and as the “sharing economy” has become prevalent throughout the U.S. economy. If Congress does not act and 100 percent Bonus Depreciation and Section 199(A) are allowed to expire there will be a significant and negative impact of the equipment and event rental industry in particular, but also on the entire U.S. economy. That is why the American Rental Association fully supports the permanent extension of 100 percent Bonus Depreciation and Section 199(A).