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WHERE THERE'S SMOKE, THERE'S TAX REVENUE

By Kathryn A. Wolfe

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Smoke 'em if you've got 'em — before the taxman comes.

Tucked into the Senate's transportation bill, currently being debated in conference committee, is a provision that would reclassify tobacco shops that rent "roll your own" cigarette machines as manufacturers. Why? To collect more tax revenue.

The machine's manufacturer says it's nothing more than an attempt by Big Tobacco and convenience store chains to shut them down. Tobacco companies such as Liggett Group, which makes Salem and other generic cigarettes, and Altria Group, the parent company of Philip Morris, are backing the change, saying they want a level playing field for their products.

Proponents say it's about closing a loophole increasingly being used to circumvent vice taxes.

The machines can produce the equivalent of about a carton of cigarettes in eight minutes, allowing smokers to make quick work of a bag of loose tobacco and pre-formed cigarette papers with filters already attached — for a lot cheaper than a carton of Marlboros.

The problem, according to proponents of the change, is that smokers are increasingly using pipe tobacco — which is subject to a much lower tax rate than other cuts of tobacco — in the machines. And manufacturers are increasingly mislabeling "roll your own" tobacco as pipe tobacco.

The loophole that proponents are looking to close was created in 2009 with the enactment of an expansion of State Children's Health Insurance Programs, paid for by tax increases on some kinds of tobacco. Taxes on "roll your own" tobacco and pre-made cigarettes were increased, but pipe tobacco was left at a much lower tax rate.

According to the Government Accountability Office, monthly sales of pipe tobacco increased from 240,000 pounds to more than 3 million pounds between January 2009 and September 2011. During the

same time period, sales of tobacco classified as “roll your own” dropped from about 2 million pounds to about 315,000 pounds.

Phil Accordino, president of Ohio-based RYO Machine, the largest maker of the contraptions with machines in about 1,000 tobacco stores nationwide, called the reclassification attempt “ridiculous.”

RYO has enlisted some help lobbying against the provision and other standalone bills, in the form of Arent Fox, Liberty Partners Group and HBW Resources.

Beyond lobbying Congress, RYO is also engaged in a court battle with the Alcohol and Tobacco Tax and Trade Bureau, which in 2010 attempted to regulate the machines as manufacturers. RYO has won injunctions against the change in some states, and the fight is ongoing.

“They want to classify anything that comes out of our machine as a manufactured cigarette. It makes no sense,” Accordino said. “Which is as ridiculous as saying ... [you’re a manufacturer] if you make your own Slushee or ice cream cone or hot dog, or grind your own coffee beans in a grocery store.”

Accordino said if a retailer gets categorized as a manufacturer, it raises a whole host of other questions, including those related to zoning and licensure.

“If you categorize a retailer as a manufacturer, then he is automatically out of business because there’s not a retail outlet in the country that is zoned for commercial manufacturing,” Accordino said. “It’s impossible. This is not anything but an attempt to remove us from the category.”

Accordino said if Congress wants to capture more tax revenue, it should just harmonize pipe tobacco taxation rates with other kinds of tobacco — and leave the machines out of the picture.

Seth Mailhot, an attorney with Sheppard Mullin Richter & Hampton, who is following the case, said reclassification may be a more favorable tack for a politician because it’s not seen as raising taxes.

“No one wants to be seen as raising taxes on anything, even pipe tobacco. So there’s sort of this perception that Congress would rather just change the rules on who’s a manufacturer because that doesn’t look like a tax increase,” Mailhot said.

Sen. Dick Durbin (D-Ill.), along with Frank Lautenberg (D-N.J.) and Richard Blumenthal (D-Conn.), has introduced a bill separately that would grant Accordino’s wish.

Instead of going after reclassifying the machines, it seeks to harmonize the tax rates of several tobacco products, including pipe tobacco — which would be set at \$24.78 per pound, the same as the current rate for “roll your own” tobacco.

Durbin, the bill’s main sponsor, is a conferee on the transportation bill, though an aide refused to discuss whether he preferred the approach in his standalone bill enough to fight to have the reclassification language scrapped from the final transportation bill.

“Tobacco has been something he’s crusaded against and about for a long time. At every opportunity he has been looking for ways to prevent children from taking up the habit,” said Christina Mulvey, a Durbin spokeswoman.

The Senate Finance Committee said the provision in the transportation bill is estimated to raise about \$99 million over 10 years, but the money wouldn’t be used for transportation programs — it would go to deficit reduction.

GOP HINTS IT’LL PART WITH KEYSTONE XL PIPELINE TO FINISH HIGHWAY BILL

By Ben Geman

The Hill

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Republicans are pressing for approval of the Keystone XL oil pipeline in a final House-Senate transportation bill but appear unlikely to draw a line in the sand that jeopardizes the infrastructure legislation.

While the proposed Alberta-to-Texas pipeline is a top GOP and oil-industry priority, Republicans might have incentive to keep the matter unresolved, enabling them to continue using Keystone as a political weapon during the campaign season.

The House version of the sweeping transportation funding measure grants a permit to TransCanada’s pipeline to bring oil sands to Gulf Coast refineries, but the Senate package omits the provision. Bicameral negotiations are under way to resolve differences between the bills.

“The overall Republican conference position is not to sink the conference report over [Keystone XL], however, as keeping that issue alive through the elections is also acceptable,” an oil industry source told The Hill.

Some other Capitol Hill sources similarly suggested that Republicans won’t allow the Keystone provision — which fell short of the 60 Senate backers needed in a recent vote — to derail talks over the bill, which extends popular transportation and infrastructure programs.

GOP lawmakers are nonetheless calling the pipeline a top priority, and express confidence that there is growing support for including it in a final transportation bill.

But asked if they would insist on Keystone as a condition for an agreement, several GOP lawmakers said they didn’t want to discuss “hypotheticals,” while others hinted that they’re flexible on the matter.

Sen. Kay Bailey Hutchison (R-Texas), one of six Senate GOP negotiators, told The Hill in an interview that going forward with Keystone is “essential” and criticized the White House for failing to grant a cross-border permit. The White House argues that more review is needed.

Hutchison also, however, emphasized the importance of the wider highway bill.

“So many states are dependent on it, so I do think that the paramount view is that we need a transportation bill, but there is a strong feeling that the president is being very unrealistic in his rejection [of Keystone] since the states where the pipeline goes have approved it, the environmental concerns have been, I think, alleviated, there is a strong feeling that the president is not being reasonable on this,” Hutchison said in the Capitol.

But Hutchison also said there are other factors and competing priorities, noting that the Senate measure includes bus safety legislation that she sponsored.

“There are many other parts of it, so I am not going to take a Sherman-esque stand one way or the other,” Hutchison said.

The make-up of the formal House-Senate conference committee creates a hurdle for Keystone backers. Senate Democrats outnumber Republicans 8-6, and among the Democrats only Sen. Max Baucus (D-Mont.) voted in March for a failed GOP plan to attach Keystone to the Senate bill.

Even Sen. Max Baucus's support would create a 7-7 deadlock. An aide to the Montana Democrat said recently that while he wants Keystone in the highway bill, he wouldn't put the whole legislation in jeopardy over it. The aide noted that the highway provisions would provide more jobs for Montana than Keystone.

“[I]f there aren't enough votes from other conferees to get a highway bill done with Keystone included, we end up with zero jobs, and Sen. Baucus won't sacrifice 14,000 Montana highway jobs over a couple thousand that can't pass into law,” the aide said.

Sen. John Thune (R-S.D.), who is a member of the Senate GOP leadership team, told reporters Tuesday that Republicans want a highway bill with Keystone included, but stopped short of predicting victory.

Thune said Republicans have a political advantage on the issue no matter how the talks turn out.

“It is certainly going to be an important point of debate either way, because if [Keystone] gets done, and I hope that it does, it is good for the country and everybody is going to be able to get out there and talk about it, what we are doing to decrease our dependence on foreign energy,” said Thune, the chairman of the Senate Republican Conference.

“If it doesn't, obviously it is going to be an opportunity for Republicans to make the argument that the Democrats are not serious about, and the president is not serious about, an all-of-the-above energy strategy,” he added.

The White House, which argues the pipeline needs further evaluation, has threatened to veto the House version of the highway bill over the provision that approves its construction.

Republicans could face their own political risks if insistence on Keystone jeopardizes the transportation-funding bill, opening them up to charges that they're costing the country jobs by blocking funding for bridges, highways and other projects.

Sen. James Inhofe (R-Okla.), also a member of the House-Senate panel trying to hammer out a final bill, declined to speculate when asked if Republicans would jettison Keystone if that were the only way to get a final highway bill. The current funding authorization expires at the end of June.

"I am all for the Keystone provision, and hopefully that will be included. You are getting into hypotheticals I am not willing to respond to," said Inhofe, the top Republican on the Environment and Public Works Committee.

The Senate, when debating its highway package in March, turned back a GOP amendment that would authorize construction of the pipeline. Sen. John Hoeven's (R-N.D.) plan received 56 votes, four shy of the 60 needed, a tally that included 11 Democrats.

Republicans see a floor of 58 votes, however, because Thune and Sen. Mark Kirk (R-Ill.) were absent from the March vote.

Senate Environment and Public Works Committee Chairwoman Barbara Boxer (D-Calif.) reminded reporters Tuesday that Keystone fell shy of the needed Senate votes.

"We already had a vote on Keystone and we didn't get 60 votes, so we'd have to figure out a way to get through that hurdle," Boxer said.

"I'm in a conference representing the Senate and what I've said from the start is if you load this up with controversy and it can't get through either house, it's a problem. So we have to work together to find the sweet spots so we can get 60 votes, because if somebody doesn't like it, as you know, they'll filibuster it," she said.

Keystone has been at the heart of election-year energy battles. Republicans, industry groups and a number of unions — and some Democrats — call TransCanada Corp.'s project a way to boost energy security and create jobs.

But environmental groups — which like unions are a key part of Obama's political base — bitterly oppose Keystone over greenhouse gas emissions from oil sands extraction and use, ecological damage from the projects and other factors.

The White House, facing competing political pressures, has delayed a final permit decision on the project until well after the elections.

The administration rejected a permit in January, claiming that Republicans had demanded an "arbitrary" decision timeline in a late 2011 payroll tax cut bill. TransCanada recently reapplied.

Over in the House, a top Republican maintained that they're making progress on pushing Keystone in the transportation bill talks.

"I think in the end it will be part of the bill," said House Transportation and Infrastructure Committee Chairman John Mica (R-Fla.).

House Energy and Commerce Committee Chairman Fred Upton (R-Mich.), a prominent advocate of the pipeline, didn't go as far when asked about the prospects, and noted that discussions are at an early stage.

"Keystone is a priority for the House. Period. We are going to do all that we can to get it included as part of the package. But it is difficult to say how things are going to work out until you really start talking, and that is what we have begun to do," he said.

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