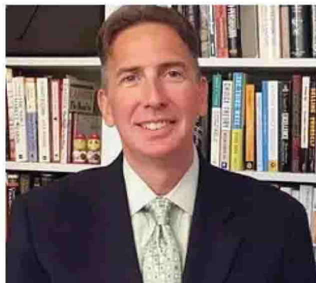
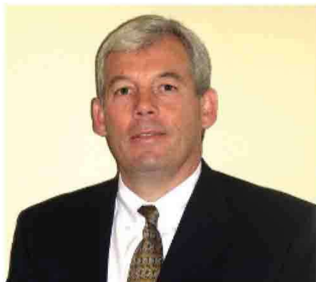
The Trump Effect on the C-store Industry: An Update

The President's first year in office has been very controversial and had many highs and lows





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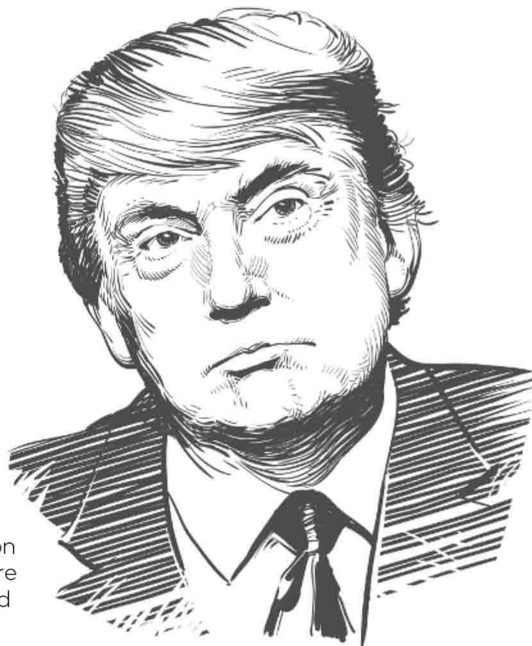
PRESIDENT DONALD TRUMP RECENTLY CELEBRATED HIS FIRST YEAR IN OFFICE and it can certainly be said it was anything but dull. The President's ongoing and very open warfare with most of the largest cable and television news outlets and national newspapers, such as the *Washington Post* and *New York Times*, continued as if the election had never ended. In addition, Trump's desire to communicate directly to the country and bypass the national media via his Twitter account continued at a breakneck pace, much to the chagrin and absolute horror of the Washington D.C. political establishment.

While it was very easy to get caught up in the almost-daily media circus that seemed to surround the new administration — such as the ongoing Russian collusion investigation headed by Special Counsel Robert Mueller — the President and the Republican-controlled Congress were able to accomplish many of the pro-growth and pro-business goals outlined in our first article, "The Potential Trump Effect" (*Convenience Store News*, February 2017 issue), which was published shortly after the inauguration last year.

Most importantly to the business community, the President's White House economic team, his cabinet, House Speaker Paul Ryan and Senate Leader Mitch McConnell shepherded through Congress the most sweeping corporate tax reform legislation since the 1980s, while most of the national news media and the Washington political establishment stayed primarily focused and obsessed on the Russian investigation and the President's latest provocative and controversial tweets. While the tax reform legislation's favorability rating was polling below 30 percent in many of the nationwide polls just before it passed both Houses of Congress in December 2017, most of corporate America believes the country as a whole will benefit in the long run from the new flat federal corporate tax rate, the lowest rate in eight decades.

The remaining portion of this article will highlight in more detail some of the major policy proposals the unified Republican government passed, or accomplished by executive order, in the first year of the new



President's term. It will also touch on several features of the new tax law that became effective in 2018 and did not receive a lot of media attention prior to the passing of the legislation, but may have a major impact on the ongoing consolidation in the convenience and gas (C&G) industry in particular.

Revisions to the U.S. Tax Code

The movement of the federal corporate income tax rate to a flat 21 percent from the generally stated rate of 35 percent for most corporations in the U.S., and the provision in the legislation that made most of the changes to the treatment of businesses permanent while the revisions to the tax code impacting individual taxpayers are temporary, was the headline story that drew most of the media's attention throughout the tax reform debate. The President originally proposed a flat 15 percent corporate tax rate, but in the end, accepted the 21 percent rate that the House and Senate conference committee members settled on just before the Christmas holiday.

Prior to the passing of the new law, corporate tax rates, like individual tax rates, were progressive in nature. For business income produced in 2017, the corporate rate still varies based on the level of income generated and the tax rates range from 15 percent to 39 percent, while individual tax rates range from 10 percent to 39.6 percent. Although the brackets vary, the rates for individuals and corporations were pretty closely aligned under the old tax code.

In order to offset the potential tax savings the new flat rate granted to corporations, the final tax package also includes a new tax break for businesses that are organized as a sole proprietorship and a pass-through

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entity (S-corporation, limited liability company, partnership, etc.). Business income that passes through to an individual from a pass-through entity and income attributable to a sole proprietorship will now be taxed at the new individual tax rates less a deduction of up to 20 percent to bring the rate lower.

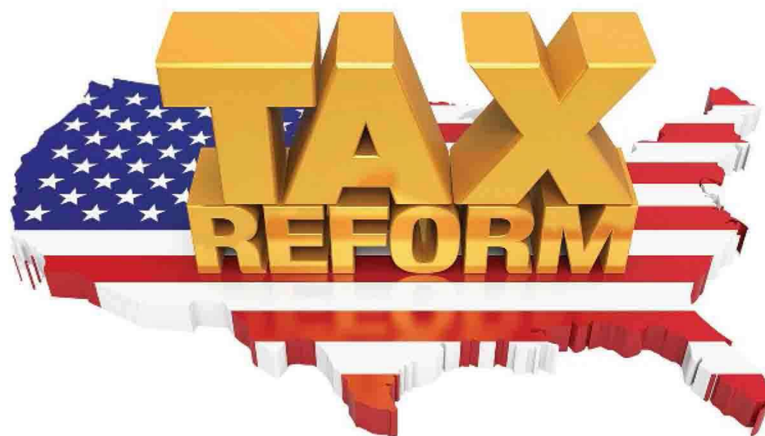
However, this new tax break is subject to numerous income limitations and restrictions and, as a result, the new law has added a layer of complexity to the tax code for businesses that are organized as a pass-through entity and sole proprietorship. How the new deduction will precisely impact the amount of federal taxes these business entities will pay in 2018 will not be fully understood until further guidance is issued by Congress or the Internal Revenue Service later in the year.

Another provision of the new tax law that should help many retailers is the ability to write off the cost of capital equipment immediately, instead of depreciating it over several years. This revision to the tax code should certainly help the numerous retailers that still need to upgrade their existing motor fuel dispensing equipment over the next several years to meet the new EMV standards. Unfortunately, like many of the favorable changes to the individual tax code, this provision is not permanent and will expire after five years. That said, given the low level of productivity growth the U.S. economy has been achieving over the past decade, many experts expect a future Congress will extend this section of the new legislation.

A revision to the business tax code that has not received a lot of attention may fundamentally change the way C&G industry operators have been historically financing their growth and could offset some of the benefits realized from other more favorable provisions of the new law.

The tax overhaul limits the net interest payments a company can deduct to 30 percent of its EBITDA, or earnings before interest, taxes, depreciation and amortization. The new standard also gets tougher starting in 2022. Beginning then, companies will no longer be able to deduct depreciation and amortization from the formula and the tax code will move to a more restrictive deduction standard of 30 percent of its EBIT.

This new tax treatment of net interest expense will certainly impact companies that are carrying a higher level of leverage due to prior merger and acquisition (M&A) activity that was funded primarily by issuing debt. These revisions are also occurring during a time period in which most experts expect the Federal Reserve to continue to



raise market interest rates over the next several years.

The new treatment of net interest expense could very likely change a long-term fixture of corporate finance; debt is a more attractive way for companies to raise cash than issuing new stock. Many companies will certainly be less likely to use debt financing to fund share buybacks, pay dividends, and potentially force them to reevaluate their long-term expansion plans if the company's interest payments are a large portion of profits.

The new tax law also contains another relatively obscure provision that may have a fairly important impact on M&A activity in our industry over the next several years. Under the new legislation, investors in real estate investment trusts (REITs) will have a smaller tax bill on the dividend income they receive from their investment in 2018. The new law now permits investors to deduct 20 percent of the income received, with the remainder of the income taxed at the investor's marginal rate. Shareholders of REITs who will pay the top income tax rate of 39.6 percent on dividends received in 2017 will see that rate drop to 29.6 percent in 2018, according to the National Association of Real Estate Investment Trusts.

Please keep in mind, REITs distribute at least 90 percent of their income as dividends and don't typically pay corporate taxes. It is their shareholders who pay the income tax on the dividends issued. A lower tax burden on REIT dividends should boost the appeal of REITs relative to other yield-oriented investment opportunities. REITs have been a major source of capital for numerous companies that have been active players in the M&A marketplace.

Any positive impact on REIT valuations that may occur over time because of the new tax law should enhance

the amount of capital REITs can raise in the future and invest in our industry. It is equally important that this critical source of capital for the C&G industry was not negatively impacted or put in a competitive disadvantage by the numerous revisions contained in the new tax legislation.

New Regulatory Environment

President Trump moved very quickly to keep his pre-election promise to reduce government regulation and reshape the federal government's relationship with the business community — the U.S. energy industry, in particular. This new attitude toward the domestic energy industry was quickly demonstrated when the President decided almost immediately after being sworn in to office to remove the remaining federal regulatory roadblocks that had prevented the Dakota Access Pipeline and Keystone XL Pipeline from moving forward toward completion.

Due to the President's quick and unambiguous actions, the Dakota Access Pipeline opened for business in June 2017. The opening of the new pipeline has already led to an increase in the number of drilling rigs in service and the overall level of oil production activity in the state of North Dakota.

Interior Secretary Ryan Zinke announced in January of this year that the administration would open more than 90 percent of America's Outer Continental Shelf for potential energy development. This announcement was in sharp contrast with President Obama's decision after the 2010 Deepwater Horizon oil spill to disallow energy extraction on approximately 94 percent of the Outer Continental Shelf.

While several states, such as California and Florida, have indicated they will oppose any exploration activity off their state's Outer Continental Shelf, the important energy-producing states of Alaska and Louisiana have already embraced this new approach.

This decision, coupled with a special provision included in the recently passed tax reform legislation that opens a portion of the Arctic National Wildlife Refuge (ANWR) in Alaska to future drilling activity is great news for the entire petroleum industry. The vast petroleum resources situated below ANWR have been closed for energy development since 1980.

While most experts are projecting it will take seven to 10 years to develop the petroleum reserves located in ANWR and the Outer Continental Shelf, these are the types of strategic actions from the federal government that are needed to guarantee that reasonably priced liquid motor fuel products will be available to the U.S. motoring public over the next several decades.

President Trump also filled two vacant seats on the five-member National Labor Relations Board and gave Republicans control of the board for the first time in a decade. In December of last year, the board reversed a controversial 2015 joint employment ruling that made it easier for workers at franchises to organize into unions.

Labor Secretary Alexander Acosta put on hold and is reconsidering an Obama administration regulation that greatly expanded eligibility for time-and-a-half overtime pay that was temporarily blocked by a federal judge's ruling in 2016. The Department of Labor under President Obama approved the new regulation in 2016 and it nearly doubled the salary threshold whereby virtually all workers would be eligible for time-and-a half pay, from $23,360 to $47,476, starting in 2017. The overtime rule would have had a real economic impact on many of the smaller retailers in the C&G industry. Secretary Acosta has indicated he will issue a final ruling on this issue in the second half of 2018. It is currently assumed by numerous leaders in the business community that he will raise the income ceiling, but far below the level proposed by the Obama administration and any increase could be phased in over a number of years.

While President Trump's first year in office has been very controversial and had many highs and lows, it is certainly fair to say our industry could be facing numerous economic and new regulatory challenges by now if Hillary Clinton had been elected President. Mrs. Clinton made it abundantly clear during the election that she was no fan of the fossil fuel industry. CSN

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