DESCRIPTION OF THE CHAIRMAN'S MODIFICATION TO THE PROVISIONS OF THE "ENERGY ADVANCEMENT AND INVESTMENT ACT OF 2007"

Scheduled for Markup
By the
SENATE COMMITTEE ON FINANCE
on June 19, 2007

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

June 18, 2007
JCX-33-07

CONTENTS

Page

INTRODUCTION 1

A. Provisions Modifying the Proposal in the Chairman's Mark 2

1. Modification to item I.A. of the Chairman's Mark relating to the credit for the production of electricity from renewable resources and of the credits for producing refined coal and Indian coal 2
2. Modification to item I.B. of the Chairman's Mark relating to clean renewable energy bonds ("CREBs") 2
3. Modification to item I.C. of the Chairman's Mark relating to clean coal energy bonds 3
4. Modification to item I.D. of the Chairman's Mark relating to the extension and modification of the energy credit 3
5. Modification to item I.E. of the Chairman's Mark relating to the special depreciation allowance for certain power generation equipment used in alternative fuel production facilities 3
6. Modification to item I.F. of the Chairman's Mark relating to the extension of special rule to implement FERC restructuring policy 4
7. Modification to item I.G. of the Chairman's Mark relating to the credit for residential energy efficient property 4
8. Modification to item I.H. of the Chairman's Mark relating to the credit for residential wind property 4
9. Modification to item I.I. of the Chairman's Mark relating to the advanced coal project investment credit 4
10. Modification to item I.J. of the Chairman's Mark relating to the coal gasification investment credit 5
11. Modification to item II.A. of the Chairman's Mark relating to the small producer credit for cellulosic alcohol 5
12. Modification to item II.B. of the Chairman's Mark relating to the expansion of special depreciation allowance for cellulosic biomass ethanol property 5
13. Modification to item II.E. of the Chairman's Mark relating to the extension of credits for biodiesel 5
14. Modification to item II.F. of the Chairman's Mark relating to the extension and modification of renewable diesel incentives 6
15. Modification to item II.H. of the Chairman's Mark relating to extension and modification of alternative fuel excise tax credit 6
16. Modification to item II.J. of the Chairman's Mark relating to the extension of election to expense certain refineries 6
17. Modification to item III.A. of the Chairman's Mark relating to the credit for alternative fuel motor vehicles 6
18. Modification to item IV.B. of the Chairman's Mark relating to the credit for new energy efficient homes 7
19. Modification to item IV.C. of the Chairman's Mark relating to the energy efficient commercial buildings deduction 7

20. Modification to item VI.C. of the Chairman's Mark relating to the Oil Spill Liability Trust Fund tax ... 7

B. Additional Energy Tax Incentives ... 8
1. Seven-year cost recovery for qualified energy management devices ... 8
2. Landowner incentive to encourage electric transmission build-out ... 8
3. Credit for carbon dioxide captured from industrial sources and permanently disposed of in geologic formations ... 9
4. Seven-year cost recovery for qualified carbon dioxide pipeline property ... 10
5. Small fossil-free alcohol producer credit ... 11
6. Heavy vehicle excise tax exemption for idling reduction devices and advanced insulation ... 12
7. Extension and modification of energy efficient appliances credit ... 13
8. Study on tax-credit bonds ... 16
9. Deduction for qualified timber gain and timber REIT provisions ... 18
10. Temporary procedures for excise tax refunds on exported coal ... 25
11. Rural Renaissance bonds ... 29
12. Treatment of publicly traded partnerships with income from carbon dioxide and certain fuels ... 32

C. Revenue Raising Provisions ... 34
1. Excise tax on crude oil and gas removed from the outer continental shelf in the Gulf of Mexico ... 34
2. Elimination of certain refunds of duty involving oil spill liability tax ... 35
3. Tax treatment of certain inverted corporate entities ... 35
4. Modifications to corporate estimated tax payments ... 40

D. Technical Corrections ... 42
1. Energy-related technical corrections ... 42

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's modification to the provisions of the "Energy Advancement and Investment Act of 2007," which is to be marked up by the Senate Committee on Finance on June 19, 2007.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Modification to the Provisions of the "Energy Advancement and Investment Act of 2007,"* (JCX-33-07), June 18, 2007. This document can also be found on the web at www.house/jct.

A. Provisions Modifying the Proposal in the Chairman's Mark

1. Modification to item I.A. of the Chairman's Mark relating to the credit for the production of electricity from renewable resources and of the credits for producing refined coal and Indian coal

The Chairman's modification extends the placed-in-service date period by three years (through December 31, 2013) for all qualified facilities other than solar and Indian coal facilities. The Chairman's modification extends the credit eligibility period by one year (through December 31, 2013) for qualified Indian coal facilities. The Chairman's modification permits electricity produced after December 31, 2007, at a qualified open-loop biomass facility that (1) is equipped with net metering to determine electricity consumption or sale and (2) has such consumption or sale verified by an unrelated party, to be eligible for credit notwithstanding the absence of a sale to an unrelated third party. The Chairman's modification freezes at the 2007 level the credit rate inflation adjustment for electricity produced and sold after December 31, 2007.

The Chairman's modification modifies the definition of qualified trash combustion facilities to permit facilities that gasify municipal solid waste and then burn such gas as part of an electricity generation process to qualify for the electricity production credit. The modification to this definition is effective for electricity produced and sold before, on, or after December 31, 2007.

The Chairman's modification adds wave, current, tidal, and ocean thermal energy as a qualified resource for purposes of the electricity production credit. The credit available for electricity produced using this resource is one half of the full electricity production credit. The term wave, current, tidal, and ocean thermal energy means electricity produced from: (1) free flowing ocean water derived from tidal currents, ocean currents, waves, or estuary currents and (2) ocean thermal energy. The Chairman's modification also adds wave, current, tidal, and ocean thermal facilities as qualified facilities under the credit. The addition of wave, current, tidal, and ocean thermal energy is effective for facilities originally placed in service after the date of enactment and before January 1, 2014.

2. Modification to item I.B. of the Chairman's Mark relating to clean renewable energy bonds ("CREBs")

The Chairman's modification authorizes $900 million of CREBs allocations annually in calendar years 2008, 2009, 2010, and 2011. The maximum annual allocation to qualified projects of governmental bodies is $563 million.

The Chairman's modification provides that the amendments to CREBs generally are effective on the date of enactment. The proposal in the Chairman's Mark to modify the amortization requirement for CREBs is effective for bonds issued with respect to allocations of the national annual limitations established under the proposal.

3. Modification to item I.C. of the Chairman's Mark relating to clean coal energy bonds

The Chairman's modification establishes a national limitation for clean coal energy bonds of $3 billion. The maximum allocation to qualified projects of governmental bodies is $1.875 billion.

The Chairman's modification provides that clean coal energy bonds must be issued before December 31, 2012.

4. Modification to item I.D. of the Chairman's Mark relating to the extension and modification of the energy credit

The Chairman's modification removes the $500 per half kilowatt of capacity credit cap with respect to fuel cells and extends the energy credit for an additional six years, through December 31, 2016. The modification clarifies that the effective date of the changes related to the energy credit is periods after the date of enactment.

The Chairman's modification also makes combined heat and power ("CHP") property eligible for the 10-percent energy credit through December 31, 2016.

CHP property is property: (1) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) that has an electrical capacity of not more than 15 megawatts or a mechanical energy capacity of no more than 2000 horsepower or an equivalent combination of electrical and mechanical energy capacities; (3) that produces at least 20 percent of its total useful energy in the form of thermal energy that is not used to produce electrical or mechanical power, and produces at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof); and (4) the energy efficiency percentage of which exceeds 60 percent. CHP property does not include property used to transport the energy source to the generating facility or to distribute energy produced by the facility.

Additionally, the Chairman's modification provides that systems whose fuel source is at least 90 percent biomass and that would qualify for the credit but for the failure to meet the efficiency standard are eligible for a credit that is reduced in proportion to the degree to which the system fails to meet the efficiency standard. For example, a system that would otherwise be required to meet the 60-percent efficiency standard, but which only achieves 30-percent efficiency, would be permitted a credit equal to one half of the otherwise allowable credit (i.e., a 5-percent credit).

5. Modification to item I.E. of the Chairman's Mark relating to the special depreciation allowance for certain power generation equipment used in alternative fuel production facilities

In order to qualify for the special depreciation allowance, the Chairman's modification requires that specified electric transmission property be used in the United States as a generator tie to solely transmit electricity from any qualified facility described in section 45(d) (without regard to any placed in service date) to the grid.

The Chairman's modification removes the exception from adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the proposal applies.

The Chairman's modification extends the placed in service date requirements from January 1, 2011 to January 1, 2014.

6. Modification to item I.F. of the Chairman's Mark relating to the extension of special rule to implement FERC restructuring policy

The Chairman's modification changes the definition of an independent transmission company whose facilities are required to be placed under the operational control of a FERC-approved independent transmission provider. Under the modified proposal, the facilities must be placed under such control no later than two years after the date of the qualifying electric transmission transaction.

7. Modification to item I.G. of the Chairman's Mark relating to the credit for residential energy efficient property

The Chairman's modification extends the credit for residential energy efficient property for an additional four years, through December 31, 2014.

The Chairman's modification also advances the effective date of the provision to apply to expenditures after December 31, 2007.

8. Modification to item I.H. of the Chairman's Mark relating to the credit for residential wind property

The Chairman's modification removes the 100-kilowatt limitation on the size of eligible wind property and extends the credit for residential energy efficient property for an additional four years, through December 31, 2014. Additionally, the Chairman's modification adds a rule that prevents receipt of the credit if any production tax credit is claimed under section 45 with respect to the property.

9. Modification to item I.I. of the Chairman's Mark relating to the advanced coal project investment credit

The Chairman's modification increases by $937.5 million the amount of credits the Secretary may allocate to qualifying integrated gasification combined cycle projects and increases by $625 million the amount of credits the Secretary may allocate to other advanced coal-based electricity generation projects. The Chairman's modification reduces by five percent (to 65 percent) the amount of carbon dioxide that qualifying projects must capture and store. The Chairman's modification also increases the credit rate to 30 percent.

10. Modification to item I.J. of the Chairman's Mark relating to the coal gasification investment credit

The Chairman's modification increases by $937.5 million the amount of credits the Secretary may allocate to qualifying coal gasification projects. The Chairman's modification increases by five percent (to 75 percent) the amount of carbon dioxide that qualifying projects must capture and store. The Chairman's modification also increases the credit rate to 30 percent.

11. Modification to item II.A. of the Chairman's Mark relating to the small producer credit for cellulosic alcohol

Under the modification to the Chairman's mark regarding the small producer credit for cellulosic alcohol, the credit terminates on the later of December 31, 2012 or December 31st of the calendar year in which the Secretary, in consultation with the Environmental Protection Agency, certifies that one billion gallons of cellulosic alcohol has been produced or imported into the United States. The modification also changes the credit amount to an amount equal to $1.11 less the credit amount for alcohol fuel and the credit amount for small ethanol producers as of the date the cellulosic alcohol fuel is produced. However, a small cellulosic alcohol fuel producer is not precluded from also claiming the alcohol or alcohol fuel mixture credit, or the small ethanol producer credit, if the requirements for those credits also are met. For example, in the case of a gallon of ethanol, a small producer may be able to claim 50 cents as a cellulosic alcohol producer, plus 51 cents under the alcohol fuel mixture credit, and an additional 10 cents as a small ethanol producer.

Like the small ethanol producer credit and small agri-biodiesel credit, as modified by item VI.H of the Chairman's mark, the small cellulosic alcohol producer credit also is limited to domestic production. However, the small cellulosic alcohol producer credit is subject to the general restrictions of item VI.H of the Chairman's mark, i.e., only domestically produced cellulosic alcohol sold for use, or used, in the United States qualifies for the credit.

12. Modification to item II.B. of the Chairman's Mark relating to the expansion of special depreciation allowance for cellulosic biomass ethanol property

The Chairman's modification changes the definition of qualified property to any alcohol produced from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis.

13. Modification to item II.E. of the Chairman's Mark relating to the extension of credits for biodiesel

Section 40A(d)(2) defines agri-biodiesel as meaning biodiesel derived solely from virgin oils, "including" esters derived from virgin vegetable oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, and mustard seeds, and

from animal fats. The language "including" indicates that this list is not exclusive.[2] Camelina is a plant from which oil can be extracted.

The Chairman's modification adds camelina to the illustrative and nonexclusive list of sources of virgin oils for agri-biodiesel.

14. Modification to item II.F. of the Chairman's Mark relating to the extension and modification of renewable diesel incentives

Under the modification, co-produced renewable diesel is entitled to a credit of one dollar per gallon for the first 60 million gallons per facility. No credit is allowable for gallons in excess of 60 million gallons produced at a facility.

15. Modification to item II.H. of the Chairman's Mark relating to extension and modification of alternative fuel excise tax credit

The modification extends the alternative fuel excise tax incentives (e.g. the alternative fuel excise tax credit, alternative fuel mixture credit, and related payment provisions) through December 31, 2012 for non-hydrogen fuels. The modification also provides that alternative fuel that is not in a mixture may be used, or sold for use, as a fuel in aviation for purposes of the credit.

16. Modification to item II.J. of the Chairman's Mark relating to the extension of election to expense certain refineries

The Chairman's modification changes the placed-in-service date requirement to January 1, 2014 and the binding construction contract date requirement and self-constructed property commencement date to January 1, 2010.

The Chairman's modification also permits the production capacity requirement to be met if a portion of a qualified refinery enables the existing qualified refinery to increase total volume output (determined without regard to asphalt or lube oil) by five percent or more on an average daily basis.

The Chairman's modification also expands the primary purpose test in the definition of qualified refinery to include processing directly from shale or tar sands. The production capacity test for processing qualified fuels is also expanded to include the processing of shale or tar sands.

17. Modification to item III.A. of the Chairman's Mark relating to the credit for alternative fuel motor vehicles

The Chairman's modification modifies the limitation on the number of qualified plug-in vehicles eligible for credit. Under the Chairman's modification, no plug-in vehicle credit is permitted for any new qualified plug-in vehicle in any calendar year following the calendar year

[2] Treasury Notice 2005-62.

which includes the first date on which the total number of such new vehicles sold for use in the United States after December 31, 2007, is at least 250,000.

The Chairman's modification adds a plug-in vehicle conversion credit to the credit for alternative fuel motor vehicles. The conversion credit is a 10-percent credit up to $2,500 per vehicle converted into a qualified plug-in vehicle. In the case of a plug-in vehicle conversion in which the plug-in battery is leased to the taxpayer, the credit is available to the vehicle lessor. The conversion credit is available for property placed in service after December 31, 2007, but does not apply to conversions made after December 31, 2009.

18. Modification to item IV.B. of the Chairman's Mark relating to the credit for new energy efficient homes

The Chairman's modification extends the proposal in the Chairman's Mark for an additional year, through December 31, 2011.

19. Modification to item IV.C. of the Chairman's Mark relating to the energy efficient commercial buildings deduction

The Chairman's modification extends the proposal in the Chairman's Mark for an additional three years, through December 31, 2013. The modification clarifies that the proposal applies to property placed in service after the date of enactment.

20. Modification to item VI.C. of the Chairman's Mark relating to the Oil Spill Liability Trust Fund tax

The Chairman's modification provides that beginning in the first quarter that is more than 60 days after the date of enactment, the oil spill tax will be increased from five cents to 10 cents per barrel.

B. Additional Energy Tax Incentives

1. Seven-year cost recovery for qualified energy management devices

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[3] The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[4] Assets included in class 49.14, describing assets used in the transmission and distribution of electricity for sale and related land improvements, are assigned a class life of 30 years and a recovery period of 20 years.

Description of Proposal

The proposal provides a seven-year recovery period for any qualified energy management device. For purposes of the proposal, a qualified energy management device means any energy management device which is placed in service before January 1, 2011, by a taxpayer who is a supplier of electric energy or a provider of electric energy services. An energy management device is any two-way communications network and associated equipment, including equipment installed on the premises of a consumer, which is used by the taxpayer to measure and record electricity usage data on a time-differentiated basis of at least 60 minutes, and to provide such data on demand to both consumers and the taxpayer.

Effective Date

The proposal is effective for property placed in service after the date of enactment.

2. Landowner incentive to encourage electric transmission build-out

Present Law

Gross income includes all income from whatever source derived unless a specific exclusion applies.[5]

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[3] Sec. 168.

[4] 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

[5] Sec. 61.

Description of Proposal

The proposal provides an exclusion from gross income for any qualified electric transmission easement payment. For purposes of the proposal, a qualified electric transmission easement payment is any payment by an electric utility or electric transmission entity pursuant to an easement or other agreement granted by the payee for the right to locate on the payee's property transmission lines and equipment used to transmit electricity at 230 or more kilovolts primarily from qualified facilities described in section 45(d) (without regard to any placed in service date).

Effective Date

The proposal is effective for payments received after the date of enactment.

3. Credit for carbon dioxide captured from industrial sources and permanently disposed of in geologic formations

Present Law

Taxpayers engaged in petroleum extraction activities may generally deduct qualified tertiary injectant expenses used while applying a tertiary recovery method, including carbon dioxide augmented waterflooding and immiscible carbon dioxide displacement.[6] In addition, taxpayers may claim a credit equal to 15 percent of their qualified enhanced oil recovery ("EOR") costs, which include tertiary injectant expenses associated with an EOR project.[7] The EOR credit is ratably reduced over a $6 phase-out range when the reference price for domestic crude oil exceeds $28 per barrel (adjusted for inflation after 1991). At the current reference price, the EOR credit is fully phased out.

Description of Proposal

The proposal allows a credit of $20 (adjusted for inflation) per ton of qualified carbon dioxide captured by the taxpayer at a qualified facility and permanently sequestered in geological storage. The proposal also allows a credit of $10 (adjusted for inflation) for qualified carbon dioxide captured by the taxpayer at a qualified facility and used as a tertiary injectant in an EOR project.

Qualified carbon dioxide is defined under the proposal as carbon dioxide captured from an industrial source that would otherwise be released into the atmosphere as an industrial emission of greenhouse gas and is measured at the source of capture and verified at the point or points of disposal or injection. Qualified carbon dioxide includes the initial deposit of captured carbon dioxide used as a tertiary injectant but does not include carbon dioxide that is recaptured, recycled, and re-injected as part of an EOR process. A qualified facility is a facility owned by

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[6] Sec. 193.

[7] Sec. 43.

the taxpayer at which carbon capture equipment is placed in service and which captures at least 500,000 metric tons of carbon dioxide during the taxable year.

The credit is part of the general business credit and is available to the taxpayer that captures, treats, compresses, and physically performs or contractually ensures the injection and permanent disposal of the carbon dioxide in geologic formations, except to the extent otherwise provided in regulations. The proposal applies only to qualified carbon dioxide capture occurring in the United States[8] or one of its possessions.[9] The credit terminates at the end of the calendar year in which the Secretary, in consultation with the Environmental Protection Agency, certifies that 75,000,000 metric tons of qualified carbon dioxide have been captured and disposed of or used as a tertiary injectant.

Effective Date

The proposal is effective for carbon dioxide captured after the date of enactment.

4. Seven-year cost recovery for qualified carbon dioxide pipeline property

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[10] The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[11] Assets included in class 46.0, describing assets used in the private, commercial, and contract carrying of petroleum, gas and other products by means of pipes and conveyors, are assigned a class life of 22 years and a recovery period of 15 years.

Description of Proposal

The proposal provides a seven-year recovery period for qualified carbon dioxide pipeline property placed in service before January 1, 2014. For purposes of the proposal, the term qualified carbon dioxide pipeline means property, the original use of which commences with the taxpayer and the original purposes of which is to transport qualified carbon dioxide, used in the United States solely to transmit qualified carbon dioxide from the point of capture to the point of disposal in secure geological storage or the point at which such qualified carbon dioxide is used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project.

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[8] Sec. 638(1).

[9] Sec. 638(2).

[10] Sec. 168.

[11] 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

Qualified carbon dioxide is defined under the proposal as carbon dioxide captured from an industrial source that would otherwise be released into the atmosphere as an industrial emission of greenhouse gas and is measured at the source of capture and verified at the point or points of disposal or injection. Qualified carbon dioxide includes the initial deposit of captured carbon dioxide used as a tertiary injectant but does not include carbon dioxide that is recaptured, recycled, and re-injected as part of an EOR process.

Effective Date

The proposal is effective for property placed in service after the date of enactment.

5. Small fossil-free alcohol producer credit

Present Law

The alcohol fuels credit is the sum of three credits: the alcohol mixture credit, the alcohol credit, and the small ethanol producer credit. Generally, the alcohol fuels credit expires after December 31, 2010.[12]

Taxpayers are eligible for an income tax credit of 51 cents per gallon of ethanol (60 cents in the case of alcohol other than ethanol) used in the production of a qualified mixture (the "alcohol mixture credit"). A "qualified mixture" means a mixture of alcohol and gasoline, (or of alcohol and a special fuel) sold by the taxpayer as fuel, or used as fuel by the taxpayer producing such mixture. The term "alcohol" includes methanol and ethanol but does not include (1) alcohol produced from petroleum, natural gas, or coal (including peat), or (2) alcohol with a proof of less than 150.

Taxpayers may reduce their income taxes by 51 cents for each gallon of ethanol, which is not in a mixture with gasoline or other special fuel, that they sell at the retail level as vehicle fuel or use themselves as a fuel in their trade or business ("the alcohol credit"). For alcohol other than ethanol, the rate is 60 cents per gallon.[13]

In the case of ethanol, the Code provides an additional 10-cents-per-gallon credit for up to 15 million gallons per year for small producers. Small producer is defined generally as a producer whose production capacity does not exceed 60 million gallons per year. The ethanol must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified alcohol fuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such ethanol at retail to another person and places such ethanol in the fuel tank of

[12] The alcohol fuels credit is unavailable when, for any period before January 1, 2011, the tax rates for gasoline and diesel fuels drop to 4.3 cents per gallon.

[13] In the case of any alcohol (other than ethanol) with a proof that is at least 150 but less than 190, the credit is 45 cents per gallon (the "low-proof blender amount"). For ethanol with a proof that is at least 150 but less than 190, the low-proof blender amount is 37.78 cents.

such other person; or (2) used by the producer for any purpose described in (a), (b), or (c). A cooperative may pass through the small ethanol producer credit to its patrons.

The alcohol fuels credit is includible in income and is treated as a general business credit, subject to the ordering rules and carryforward/carryback rules that apply to business credits generally. The credit is allowable against the alternative minimum tax.

Description of Proposal

The modification adds a new component to the alcohol fuels credit, the small fossil-free alcohol producer credit. The credit provides an additional 25-cents-per-gallon credit for up to 60 million gallons of alcohol produced at a fossil-free facility during the calendar year for small producers. Small producer is defined generally as a producer whose fossil free alcohol production capacity does not exceed 60 million gallons per year. A fossil-free facility is one at which 90 percent of the fuel used in the production of alcohol at such facility is from biomass as defined in sec. 45K(c)(3).

The alcohol must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified alcohol fuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such ethanol at retail to another person and places such ethanol in the fuel tank of such other person; or (2) used by the producer for any purpose described in (1)(a), (b), or (c). Only domestically produced alcohol, sold for use or used in the United States qualifies for the credit. A cooperative may pass through the small producer credit to its patrons.

The credit terminates after December 31, 2012.

Effective Date

The proposal is effective after December 31, 2007.

6. Heavy vehicle excise tax exemption for idling reduction devices and advanced insulation

Present Law

A 12-percent excise tax (the "heavy vehicle excise tax") is imposed on the first retail sale of automobile truck chassis and bodies, truck trailer and semitrailer chassis and bodies, and tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.[14] The heavy vehicle excise tax does not apply to automobile truck chassis and bodies suitable for use with a vehicle which has a gross vehicle weight of 33,000 pounds or less. The tax also does not apply to truck trailer and semitrailer chassis and bodies suitable for use with a trailer or semitrailer which has a gross vehicle weight of 26,000 pounds or less, or to

[14] Sec. 4051.

tractors having a gross vehicle weight of 19,500 pounds or less if such tractor in combination with a trailer or semitrailer has a gross combined weight of 33,000 pounds or less.

If the owner, lessee, or operator of a taxable article installs any part or accessory within six months after the date such vehicle was first placed in service, a 12 percent tax applies on the price of such part or accessory and its installation.

Description of Proposal

The proposal provides an exemption from the heavy vehicle excise tax for the cost of qualifying idling reduction devices. A qualifying idling reduction device means any device that (1) is installed on automobile truck chassis and bodies, truck trailer or semitrailer chassis and bodies, or tractors, which are subject to the heavy vehicle excise tax, (2) is designed to provide such vehicle those services (such as heat, air conditioning, or electricity) that would otherwise require the operation of the main drive engine while the vehicle is temporarily parked or remains stationary using either (i) an all electric unit, such as a battery powered unit or from grid-supplied electricity, or (ii) a dual fuel unit powered by diesel or other fuels, and capable of providing such services from grid-supplied electricity or on-truck batteries alone, and (3) is certified by the Secretary of Energy, in consultation with the Environmental Protection Agency and the Secretary of Transportation, to reduce long-duration idling of such vehicle at a motor vehicle rest stop or other location where such vehicles are temporarily parked or remain stationary. Long duration idling means the operation of a main drive engine for a period greater than 15 consecutive minutes, when the main drive engine is not engaged in gear. Such term does not apply to routine stoppages associated with traffic movement or congestion.

The proposal also provides an exemption for the installation of "advanced insulation" in a commercial refrigerated truck or trailer that is subject to the heavy vehicle excise tax. Advanced insulation means insulation that has an R value of not less than R35 per inch.

Both exemptions apply regardless of whether the device or insulation is factory installed or later added as an accessory.

Effective Date

The proposal is effective for retail sales or installations made after December 31, 2007.

7. Extension and modification of energy efficient appliances credit

Present Law

The provision provides a credit for the eligible production of certain energy-efficient dishwashers, clothes washers and refrigerators.

The credit for dishwashers applies to dishwashers produced in 2006 and 2007 that meet the Energy Star standards for 2007. The credit amount equals $3 multiplied by 100 times the "energy savings percentage," but may not exceed $100 per dishwasher. The energy saving percentage is defined as the change in the energy factor (EF) required by the Energy Star program between 2007 and 2005 divide by the EF requirement for 2007. The EF required in

2005 for the Energy Star program was 0.58 and it was 0.65 in 2007, for a change of 0.07. The energy saving percentage is thus 0.07 / 0.65, which when multiplied by 100 times $3 equals $32.31 per refrigerator.

The credit for clothes washers equals $100 for clothes washers manufactured in 2006-2007 that meet the requirements of the Energy Star program which are in effect for clothes washers in 2007.

The credit for refrigerators is based on energy savings and year of manufacture. The energy savings are determined relative to the energy conservation standards promulgated by the Department of Energy that took effect on July 1, 2001. Refrigerators that achieve a 15 to 20 percent energy saving and that are manufactured in 2006 receive a $75 credit. Refrigerators that achieve a 20 to 25 percent energy saving receive a (i) $125 credit if manufactured in 2006-2007. Refrigerators that achieve at least a 25 percent energy saving receive a (i) $175 credit if manufactured in 2006-2007.

Appliances eligible for the credit include only those produced in the United States and that exceed the average amount of U.S. production from the 3 prior calendar years for each category of appliance. In the case of refrigerators, eligible production is U.S. production that exceeds 110 percent of the average amount of U.S. production from the 3 prior calendar years.

A dishwasher is any a residential dishwasher subject to the energy conservation standards established by the Department of Energy. A refrigerator must be an automatic defrost refrigerator-freezer with an internal volume of at least 16.5 cubic feet to qualify for the credit. A clothes washer is any residential clothes washer, including a residential style coin operated washer, that satisfies the relevant efficiency standard.

The taxpayer may not claim credits in excess of $75 million for all taxable years, and may not claim credits in excess of $20 million with respect to clothes washers eligible for the $50 credit and refrigerators eligible for the $75 credit. A taxpayer may elect to increase the $20 million limitation described above to $25 million provided that the aggregate amount of credits with respect to such appliances, plus refrigerators eligible for the $100 and $125 credits, is limited to $50 million for all taxable years.

Additionally, the credit allowed in a taxable year for all appliances may not exceed two percent of the average annual gross receipts of the taxpayer for the three taxable years preceding the taxable year in which the credit is determined.

The credit is part of the general business credit.

Description of Proposal

The proposal extends and modifies the energy efficient appliances credit.

The proposal provides modified credits for eligible production as follows:

Dishwashers

1. $75 in the case of a dishwasher which is manufactured in calendar year 2008, 2009, or 2010 and which uses no more than 307 kilowatt hours per year and 5.0 gallons per cycle (5.5 gallons per cycle for dishwashers designed for greater than 12 place settings).

Clothes washers

2. $125 in the case of a residential top-loading clothes washer manufactured in calendar year 2008 or 2009 which meets or exceeds a 1.8 modified energy factor and does not exceed a 7.5 water consumption factor,

3. $150 in the case of a residential or commercial clothes washer manufactured in calendar year 2008, 2009 or 2010 which meets or exceeds 2.0 modified energy factor and does not exceed a 6.0 water consumption factor, and

4. $250 in the case of a residential or commercial clothes washer manufactured in calendar year 2008, 2009, or 2010 which meets or exceeds 2.2 modified energy factor and does not exceed a 4.5 water consumption factor.

Refrigerators

1. $75 in the case of a refrigerator which is manufactured in calendar year 2008 or 2009, and consumes at least 23 percent but no more than 24.9 percent less kilowatt hours per year than the 2001 energy conservation standards,

2. $100 in the case of a refrigerator which is manufactured in calendar year 2008, 2009 or 2010, and consumes at least 25 percent but not more than 29.9 percent less kilowatt hours per year than the 2001 energy conservation standards, and

3. $200 in the case of a refrigerator manufactured in calendar year 2008, 2009 or 2010 and which consumes at least 30 percent less energy than the 2001 energy conservation standards.

Appliances eligible for the credit include only those that exceed the average amount of production from the 2 prior calendar years for each category of appliance, rather than the present law 3 prior calendar years. Additionally, the special rule with respect to refrigerators that requires production in excess of 110 percent of prior production is eliminated.

The aggregate credit amount allowed with respect to a taxpayer for all taxable years beginning after December 31, 2007 may not exceed $75 million.

The term "modified energy factor" means the modified energy factor established by the Department of Energy for compliance with the Federal energy conservation standard.

The term "gallons per cycle" means, with respect to a dishwasher, the amount of water, expressed in gallons, required to complete a normal cycle of a dishwasher.

The term “water consumption factor” means, with respect to a clothes washer, the quotient of the total weighted per-cycle water consumption divided by the cubic foot (or liter) capacity of the clothes washer.

Effective Date

The proposal applies to appliances produced after December 31, 2007.

8. Study on tax-credit bonds

Present law

Tax-exempt bonds

Interest on State and local governmental bonds generally is excluded from gross income for Federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. Activities that can be financed with these tax-exempt bonds include the financing of electric power facilities (i.e., generation, transmission, distribution, and retailing).

Interest on State or local government bonds to finance activities of private persons (“private activity bonds”) is taxable unless a specific exception is contained in the Code (or in non-Code provision of a revenue Act). The term “private person” generally includes the Federal Government and all other individuals and entities other than States or local governments. The Code includes exceptions permitting States or local governments to act as conduits providing tax-exempt financing for certain private activities. In most cases, the aggregate volume of these tax-exempt private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2007, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $256.24 million, if greater.

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[15] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[16] In general, arbitrage profits may be earned only during specified periods (e.g., defined “temporary periods”) before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., “reasonably required reserve or replacement funds”). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

[15] Secs. 103(a) and (b)(2).

[16] Sec. 148.

Tax-credit bonds

As an alternative to traditional tax-exempt bonds, the Code permits three types of tax-credit bonds. States and local governments have the authority to issue qualified zone academy bonds ("QZABS"), clean renewable energy bonds ("CREBS"), and "Gulf tax credit bonds."[17] In lieu of tax-exempt interest, these bonds entitle eligible holders to a tax credit.

Unlike tax-exempt bonds, tax-credit bonds are not interest-bearing obligations. Rather, the taxpayer holding a tax-credit bond on a credit allowance date is entitled to a tax credit. The amount of the credit is determined by multiplying the bond's credit rate by the face amount on the holder's bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits issuance of tax-credit bonds without discount and interest cost to the holders of such bonds. The credit on such bonds accrues quarterly and is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability.

Description of Proposal

The proposal directs the Secretary to undertake a study of the use of tax-credit bonds as a means of subsidizing the borrowing costs of the beneficiaries of such financing. In particular, the study should examine the efficacy of the existing tax-credit bond programs. The study also should provide a general examination of the Federal subsidy provided by tax-credit bonds relative to the subsidy provided by tax-exempt bonds, the study should examine the extent to which projects eligible for tax-credit bonds also receive other Federal tax benefits under present law.

The study also should examine any market or administrative issues associated with present-law tax-credit bonds, including, but not limited to: the effect of Treasury setting the credit rate; Treasury selection of projects eligible for financing; the potential for arbitrage earnings and the extent to which this may affect the level of subsidy; the lack of uniform rules for tax-credit bonds; and the direct issuance of tax-credit bonds by private parties.

Finally, the study should discuss the changes to present-law that would be necessary to provide a tax-credit bond that delivers a subsidy comparable to that provided by tax-exempt bonds and reduces the market and administrative issues associated with present-law tax-credit bonds.

The Secretary is to submit a report on the results of the study to the Senate Committee on Finance and House Committee on Ways and Means by the end of the second calendar year after the date of enactment of this proposal.

Effective Date

The proposal is effective on the date of enactment.

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[17] Secs. 1397E, 54, and 1400N(l), respectively.

9. Deduction for qualified timber gain and timber REIT provisions

Present Law

Treatment of certain timber gain

Under present law section 631(a), if a taxpayer cuts standing timber, the taxpayer may elect to treat the cutting as a sale or exchange eligible for capital gain treatment. The fair market value of the timber on the first day of the taxable year in which the timber is cut is then used for purposes of determining the gain attributable to such cutting and the cost of the cut timber for purposes of the taxpayer's income from later sales of the timber or timber products. Under section 631(b), if a taxpayer disposes of timber with a retained economic interest or makes an outright sale of timber, the gain is eligible for capital gain treatment. Capital gain treatment under either section 631(a) or section 631(b) requires that the taxpayer have owned the timber or held the contract right for a period of more than one year.

Under present law, for taxable years beginning before January 1, 2011, the maximum rate of tax on long-term capital gain ("adjusted net capital gain") of an individual, estate, or trust is 15 percent.[18] Any adjusted net capital gain that otherwise would be taxed at a 10- or 15-percent rate is taxed at a 5-percent rate (zero for taxable years beginning after 2007). These rates apply for purposes of both the regular tax and the alternative minimum tax.[19]

For taxable years beginning before January 1, 2011, the maximum rate of tax on ordinary income of an individual, estate, or trust is 35 percent.[20] The maximum rate of tax on long-term capital gain ("net capital gain") of a corporation is 35 percent, the same as the maximum rate on ordinary income of a corporation.

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[18] For taxable years beginning after December 31, 2010, the maximum rate of tax on the adjusted net capital gain of an individual is 20 percent. Any adjusted net capital gain that otherwise would be taxed at a 10- or 15-percent rate is taxed at a 10-percent rate. In addition, any gain from the sale or exchange of property held more than five years that would otherwise have been taxed at the 10-percent rate is taxed at an 8-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which began after December 31, 2000, which would otherwise have been taxed at a 20-percent rate is taxed at an 18-percent rate.

[19] Because the entire amount of the capital gain is included in alternative minimum taxable income ("AMTI"), for taxpayers subject to the alternative minimum tax with AMTI in excess of $112,500 ($150,000 in the case of a joint return), the gain may cause a reduction in the minimum tax exemption amount and thus effectively tax the gain at rates of 21.5 or 22 percent. Also, the gain may cause the phase-out of certain benefits in computing the regular tax.

[20] For taxable years beginning after December 31, 2010, the maximum rate of tax on ordinary income of an individual, estate, or trust is 39.6 percent.

Real estate investment trusts

In general

Under present law, a real estate investment trust ("REIT") is a U.S. entity that derives most of its income from passive real estate-related investments and that elects to be taxed as a REIT rather than as a regular "C" corporation that would be subject to all the rules of subchapter C of the Code. A C corporation may not deduct its dividends paid to shareholders. By contrast, if an electing entity meets the requirements for REIT status, the portion of its income that is distributed to its investors each year as dividends out of its earnings and profits is deductible by the REIT and includible in income by its investors. In this manner, the distributed income of the REIT is not taxed at the entity level. The distributed income is taxed only at the investor level. A REIT that has net capital gain can declare a dividend that shareholders are entitled to treat as long-term capital gain.

REITs must satisfy a number of tests on an annual basis that relate to the entity's organizational structure, the source of its income, the nature of its assets, and its required distribution of income.

Distribution requirements and long-term capital gain

A REIT generally must distribute 90 percent of its income (other than long-term capital gain) to its shareholders each year. Any undistributed income is subject to tax at regular corporate rates. However, net capital gain of the REIT is not required to be distributed. For undistributed long-term capital gain, the REIT can pay corporate-level tax at regular corporate rates on the retained amounts, while the shareholders also include such amounts in their income and receive a credit or refund for the tax paid by the REIT. In effect, long-term capital gain of a REIT (including but not limited to timber gain) can be taxed as long-term capital gain of the REIT shareholders, whether or not the gain is distributed to them. The shareholders receive an upward basis adjustment in their REIT stock in the case of undistributed gain to reflect the amount of retained gain that was taxed to them. If a REIT shareholder has obtained such an upward basis adjustment for a REIT interest and disposes of the interest before having held the interest for at least 6 months, then any loss on disposition of the interest is treated as a long-term capital loss.

A REIT is also subject to a four-percent excise tax to the extent it does not distribute specified percentages of its income within any calendar year. The required distributed percentage is 85 percent in the case of the REIT ordinary income, and 95 percent in the case of the REIT capital gain net income (as defined).[21] The amount of the excess of the required distribution over the actual distribution is subject to the four-percent tax.

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[21] Sec. 4981.

Income requirements

A REIT generally is restricted to earning certain types of passive income. Among other requirements, at least 75 percent of a REIT's gross income in a taxable year must consist of certain types of real estate related income, including rents from real property, interest on mortgages secured by real property or interests in real property, and income from the sale or exchange of real property (including interests in real property) that is not stock in trade, inventory, or property held for primarily for sale to customers in the ordinary course of business.[22] Interests in real property are specifically defined to exclude mineral, oil, or gas royalty interests.[23] In addition, 95 percent of a REIT's gross income for the taxable year must consist of income that is either qualified for the 75-percent test or that is income from specified other generally passive income (such as dividends, capital gains, and interest income). A REIT will not qualify as a REIT, and will be taxable as a regular C corporation, for any taxable year if it does not meet these income tests.

Some REITs have been formed to hold land on which trees are grown. Upon maturity of the trees, the standing trees are sold by the REIT. The Internal Revenue Service has issued private letter rulings in particular instances stating that the income from the sale of the trees that is treated as capital gain under section 631(b) can qualify as REIT real property income because the uncut timber and the timberland on which the timber grew is considered real property and the sale of uncut trees can qualify as capital gain derived from the sale of real property. The Internal Revenue Service has also indicated in private letter rulings that income from the cutting of timber can qualify as real estate income for REIT qualification purposes if the income would have qualified under section 631(b) but for the fact that the one-year holding period under that section was not met.[24]

Asset requirements

Seventy-five percent of REIT assets, determined as of the close of each quarter of the REIT taxable year, must be real-estate assets (as defined), including interests in real property. Interests in real property are specifically defined to exclude mineral, oil, or gas royalty interests.[25]

A REIT generally cannot own more than 10 percent of the vote or value of the securities of a single entity; and no more than five percent of the fair market value of REIT assets can be

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[22] Secs. 856(c) and sec. 1221(a). Income from sales that are not prohibited transactions solely by virtue of section 857(b)(6) is also qualified REIT income.

[23] Sec. 856(c)(5)(C).

[24] *See, e.g.,* PLR 200052021; *see also* PLR 199945055; PLR 199927021;, PLR 8838016. A private letter ruling may be relied upon only by the taxpayer to which the ruling is issued. However, such rulings provide an indication of administrative practice.

[25] Sec. 856(c)(5)(C).

securities of any one issuer. However, there is an exception for ownership of securities of a taxable REIT subsidiary ("TRS") that is taxed as a corporation, provided that TRS securities do not represent more than 20 percent of the value of REIT assets.[26] A TRS can generally engage in any kind of business activity, with certain limitations and exceptions relating to lodging facilities and health care facilities.

Prohibited transactions tax

A REIT is subject to a 100-percent excise tax on gain from any sale that is a "prohibited transaction," defined as a sale of property that is stock in trade, inventory, or property held primarily for sale to customers in the ordinary course of trade or business.[27] This determination is based on facts and circumstances. However, a safe-harbor provides that no excise tax is imposed if certain requirements are met.

In the case of timber property, the safe harbor is met, regardless of the number of sales that occur during the taxable year, if (i) the REIT has held the property for not less than four years in connection with the trade or business of producing timber; (ii) the aggregate adjusted bases of the property sold (other than foreclosure property) during the taxable year does not exceed 10 percent of the aggregate bases of all the assets of the REIT as of the beginning of the taxable year, and certain other requirements are satisfied. These include requirements that limit the amount of expenditures the REIT can make during the four-year period prior to the sale that are includible in the adjusted basis of the property,[28] a requirement that marketing must be done by an independent contractor, and a requirement that the sales price cannot be based on the income or profits of any person.[29]

Non-timber property has a similar but separate safe harbor from the prohibited transactions tax, with rules similar to the rules for timber property, including a four-year holding

[26] REITs are also subject to a tax equal to 100 percent of redetermined rents, redetermined deductions, and excess interest. These are defined generally as the amounts of specified REIT transactions with a TRS of the REIT that differ from an arm's length amount.

[27] Secs. 857(b)(6) and 1221(a)(1). There is an exception for certain foreclosure property. The definition of a prohibited transaction for this purpose is the same as the definition of a transaction the gain on which for any taxpayer (not limited to a REIT) would otherwise be ordinary income, rather than capital gain, because it is "stock in trade of the taxpayer or other property which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Sec. 1221(a)(1).

[28] Aggregate expenditures (other than timberland acquisition expenditures) during such period made by the REIT or a partner of the REIT, which are includible in basis, may not exceed 30 percent of the net selling price in the case of expenditures that are directly related to operation of the property for the production of timber or the preservation of the property for use as timberland, and may not exceed five percent of the net selling price in the case of expenditures that are not directly related to those purposes.

[29] Sec. 857(b)(6)(D).

period requirement and a limit on the percentage of the aggregate adjusted basis of property that can be sold in one taxable year.[30]

Description of Proposal

Elective deduction for 60 percent of qualified timber gain

The proposal allows a taxpayer to elect to deduct an amount equal to 60 percent of the taxpayer's qualified timber gain (or, if less, the net capital gain) for the taxable year. In the case of an individual, the deduction reduces adjusted gross income. Qualified timber gain means the net gain described in section 631(a) and (b) for the taxable year.

The deduction is allowed in computing the regular tax and the alternative minimum tax (including the adjusted current earnings of a corporation).

If a taxpayer elects the deduction, the 40 percent of the gain subject to tax is taxed at ordinary income tax rates.[31]

In the case of a pass-thru entity other than a REIT, the election may be made separately by each taxpayer subject to tax on the gain. The Treasury Department may prescribe rules appropriate to apply this proposal to gain taken into account by a pass-thru entity.

In the case of a REIT, the election to take the 60-percent deduction is made by the REIT. If a REIT makes the election, then the qualified timber gain is excluded from the computation of capital gain or loss of the REIT for purposes of applying the tax rates, and can no longer be designated as a long-term capital gain dividend to shareholders. The gain is treated as ordinary income for purposes of applying the REIT income distribution requirements for qualification as a REIT, but for this purpose 60 percent of the amount of the gain is deductible by the REIT in computing its income. REIT earnings and profits also exclude the portion of the timber gain that is deductible. Thus, 40 percent of the gain is subject to the REIT distribution requirements; and 40 percent of the gain increases REIT earnings and profits. Thus, when the 40 percent is distributed it is treated as an ordinary REIT dividend distribution to shareholders. Because this dividend is from a REIT and is not derived from an entity that was taxed as a C corporation, it is not qualified for the current 15-percent qualified dividend rates and will be taxed at the ordinary income rates of the shareholders.[32]

Under the proposal, REIT shareholders obtain an upward basis adjustment in their REIT interests that is equal to the 60 percent of the timber gain that is deductible by the electing REIT. Because the 60 percent of timber gain that was deductible by the REIT does not increase REIT

[30] Sec. 857(b)(6)(C).

[31] Under the proposal, because only 40 percent of the gain is included in adjusted gross income and AMTI, only that amount of gain would result in the phase-out of tax benefits.

[32] Sec. 857(c)(2).

earnings and profits, a distribution of such 60 percent to the shareholders generally would not be treated as a dividend (in the absence of other retained earnings) but as a return of basis under the general rules of section 301(c). Because the shareholders' basis has been increased by this 60 percent, this distribution would not exceed the shareholders' basis and thus would be nontaxable return of basis, rather than capital gain in excess of basis. However, under the proposal, if a REIT shareholder has obtained such an upward basis adjustment for a REIT interest and disposes of the interest before having held the interest for at least six months, then any loss on disposition of the interest is disallowed to the extent of such upward basis adjustment.

For purposes of the section 4981 excise tax on amounts not distributed within a calendar year, qualified timber gain continues to be treated as a capital gain item, but 60 percent of that gain is deducted.

Additional REIT proposals

Timber gain qualified REIT income without regard to one-year holding period

The proposal includes timber gain under section 631(a) as a category of qualified real estate income of a REIT if the cutting is provided by a taxable REIT subsidiary, and also includes gain recognized under section 631(b). For purposes of such qualified income treatment under those proposals, there is no requirement of a one-year holding period. Thus, for example, a REIT can acquire timber property, and harvest the timber on the property within one year of the acquisition, with the resulting income being qualified real estate income for REIT qualification purposes, even though such income is not eligible for long term capital gain treatment under section 631(a) or section 631(b). The proposal provides, however, that for all purposes of the Code, such income shall not be considered to be gain described in section 1221(a)(1), that is, it shall not be treated as income from the sale of stock in trade, inventory, or property held by the REIT primarily for sale to customers in the ordinary course of its trade or business.

For purposes of determining REIT income, if the cutting is done by a taxable REIT subsidiary, the cut timber is deemed sold on the first day of the taxable year to the taxable REIT subsidiary (with subsequent gain, if any, attributable to the taxable REIT subsidiary).

REIT prohibited transaction safe harbor for timber property

For sales to a qualified organization exclusively for conservation purposes, (as those terms are defined in section 170(h)(3) and 170(h)(1)(C), respectively), the proposal reduces to two years the present-law four-year holding period requirement under the section 857(b)(6) (D) safe harbor from "prohibited transaction" treatment for certain timber property sales. Also, in the case of such sales, the safe-harbor limitations on how much may be added, within the four-year period prior to the date of sale, to the aggregate adjusted basis of the property, are changed to refer to the two-year period prior to the date of sale.

The proposal also removes the safe-harbor requirement that marketing of the property must be done by an independent contractor and permits a TRS of the REIT to perform the marketing.

The proposal states that any gain that is eligible for the timber property safe harbor is considered for all purposes of the Code not to be described in section 1221(a)(1), that is, it shall not be treated as income from the sale of stock in trade, inventory, or property held by the REIT primarily for sale to customers in the ordinary course of its trade or business.

Special rules for timber REITs

The proposal contains several proposals applicable only to a "timber REIT," defined as a REIT in which more than 50 percent of the value of its total assets consists of real property held in connection with the trade or business of producing timber.

First, mineral royalty income from real property owned by a timber REIT and held, or once held, in connection with the trade or business of producing timber by such REIT, is included as qualifying real estate income for purposes of the REIT income tests.

Second, a timber REIT is permitted to hold TRS securities with a value up to 25 percent, (rather than 20 percent) of the value of the total assets of the REIT.

Effective Date

The proposals allowing the 60-percent deduction for qualified timber gain, and providing for the application of the deduction in the case of a REIT, apply to taxable years that end after the date of enactment and that begin before the end of the one-year period following the date of enactment. These provisions apply only to qualified timber gain from dispositions after the date of enactment and before the date that is one year after the date of enactment.

The proposals treating certain timber gains as qualifying REIT income and changing the rules relating to the safe-harbor provisions apply to dispositions after the date of enactment and before the date that is one year after the date of enactment. The provision treating mineral royalty income of a timber REIT as qualifying income applies to income earned after the date of enactment and before the date that is one year after the date of enactment. The provision increasing the permitted amount of TRS securities for a timber REIT applies to quarters closing after the date of enactment and before date that is one year after the date of enactment.

10. Temporary procedures for excise tax refunds on exported coal

Present Law

In general

Excise tax is imposed on coal, except lignite, produced from mines located in the United States.[33] The producer of the coal is liable for paying the tax to the IRS. Producers generally recover the tax from their purchasers.

The Export Clause of the U.S. Constitution provides that "no Tax or Duty shall be laid on Articles exported from any State."[34] Courts have determined that the Export Clause applies to excise tax on exported coal, and therefore such taxes are subject to a claim for refund.[35] The courts have further determined that there are two procedural means to judicially obtain such refunds, under the Code or the Tucker Act.

Claims under the Code

Unless a claimant proceeds under the Tucker Act, claims by coal producers and exporters for refunds or credits of excise taxes on exported coal are governed by the general Code rules for refunds of tax on exported items. A claimant must satisfy the following requirements of the Code and case law:

1. A claim for refund must be filed within three years from the time the return was filed, or within two years from the time the tax was paid, whichever period expires later;[36]

2. The person must establish that the goods were in the stream of export when the excise tax was imposed;[37]

3. The claimant must establish that it has borne the tax. More specifically, the claimant must establish that the tax was neither included in the price of the article nor collected from the purchaser (or if so, that the claimant has repaid the amount

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[33] Sec. 4121(a). Throughout the relevant period, the rate of tax on coal from underground mines has been $1.10 per ton and the rate of tax on coal from surface mines has been $0.55 per ton. These rates are subject to a limitation of 4.4 percent of the producer's sale price. Sec. 4121(b).

[34] U.S. Const., art. I, sec. 9, cl. 5.

[35] See *Ranger Fuel Corp. v. United States*, 33 F. Supp. 2d 466 (E.D. Va. 1998).

[36] Sec. 6511(a).

[37] See *Ranger Fuel Corp. v. United States*, 33 F. Supp. 2d 466 (E.D. Va. 1998). See also *United States v. International Business Machines Corp.*, 517 U.S. 843 (1996); *Joy Oil, Ltd. v. State Tax Commission*, 337 U.S. 286 (1949).

of tax to the ultimate purchaser), that the claimant has repaid or agreed to repay the tax to the ultimate vendor or has obtained the written consent of such ultimate vendor to the allowance of the claim, or that the claimant has filed the written consent of the ultimate purchaser to the allowance of the claim;[38]

4. In the case of an exporter or shipper of an article exported to a foreign country or shipped to a possession, the amount of tax may be refunded to the exporter or shipper if the person who paid the tax waives its claim to such amount;[39] and

5. A civil action for refund must not be begun before the expiration of six months from the date of filing the claim (unless the claim has been disallowed during that time), nor after the expiration of two years from the date of mailing the notice of claim disallowance.[40]

In 2000, the Internal Revenue Service ("IRS") issued Notice 2000-28,[41] which summarizes the IRS position regarding claims for credits or refunds of excise taxes on exported coal and sets forth procedural rules relating to such claims. Under Notice 2000-28, a coal producer or exporter must provide the following information as part of its claim:

1. A statement by the person that paid the tax to the government that provides the quarter and the year for which the tax was reported on Form 720, the line number on such Form, the amount of tax paid on the coal, and the date of payment;

2. In the case of an exporter, a statement by the person that paid the tax to the government that such person has waived the right to claim a refund;

3. A statement that the claimant has evidence that the coal was in the stream of export when sold by the producer;

4. In the case of an exporter, proof of exportation;

5. In the case of a coal producer, a statement that the coal actually was exported; and

6. A statement that the claimant:

    a. has neither included the tax in the price of the coal nor collected the amount of the tax from its buyer,

    b. has repaid the amount of the tax to the ultimate purchaser of the coal, or

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[38] Sec. 6416(a)(1).

[39] Sec. 6416(c).

[40] Sec. 6532(a).

[41] Notice 2000-28, 2001-1 C.B. 1116.

c. has obtained the written consent of the ultimate purchaser of the coal to the allowance of the claim.

If the IRS disallows the claim, the claimant may proceed in a Federal district court or the Court of Federal Claims under 28 U.S.C. sec. 1346(a)(1), which affords the Federal district courts concurrent jurisdiction with the Court of Federal Claims over "[a]ny civil action against the United States for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected … or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws."

Claims under the Tucker Act

Instead of proceeding under the Code, a person may claim a refund in the Court of Federal Claims under the Export Clause and the Tucker Act, which confers jurisdiction upon such court "to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department …."[42] A claim for such a refund under the Tucker Act is not bound by the Code requirements described above (it is bound by the case law requirement that the claimant must establish that the goods were in the stream of export when the excise tax was imposed) and is entitled to the benefit of a six-year statute of limitations.[43] The Court of Appeals for the Federal Circuit held that such claims accrue prejudgment interest, reversing the Court of Federal Claims on that issue.[44] In addition, the claimant in such a proceeding is subject to general rules of judicial standing, which may bar certain exporters from prevailing in such a proceeding.[45]

Description of Proposal

The proposal creates a new procedure under which certain coal producers and exporters may claim a refund of excise taxes imposed on coal exported from the United States. Coal producers or exporters that exported coal during the period beginning on or after October 1, 1990 and ending on or before the date of enactment of the proposal, with respect to which a return was filed on or after October 1, 1990, and on or before the date of enactment, and that file a claim for refund not later than the close of the 30-day period beginning on the day of enactment, may obtain a refund from the Secretary of the Treasury of excise taxes paid on such exported coal and any interest accrued from the date of overpayment. Interest on such claims is computed under

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[42] 28 U.S.C. sec. 1491(a).

[43] *Venture Coal Sales Co. v. U.S.*, 93 AFTR 2d 2004-2495 (Fed. Cir. 2004); *Cyprus Amax Coal Co. v. U.S.*, 205 F.3d 1369 (Fed. Cir. 2000).

[44] *Clintwood Elkhorn Mining Company, v. U.S.*, 473 F.3d 1373 (Fed. Cir. 2007), *rev'g sub. nom. Andelex Resources, Inc. v. U.S.*, No. 00-cv-249 (Fed. Cl. July 21, 2004).

[45] See, e.g., *Emerald Int'l Corp. v. U.S.*, 90 AFTR 2d 2002-7710 (Ct. Fed. Cl. 2002) (exporter lacked standing because tax was imposed upon the producer, which had no obligation to pass on the tax to exporter).

the Code.[46] The Secretary is required to determine whether to approve the claim within 180 days after such claim is filed, and to pay such claim not later than 180 days after making such determination.

In order to qualify for a refund under the proposal, a coal producer must establish that it, or a party related to such coal producer, exported coal produced by such coal producer to a foreign country or shipped coal produced by such coal producer to a U.S. possession, the export or shipment of which was other than through an exporter that filed a valid and timely claim for refund under the proposal. An exporter must establish that it exported coal to a foreign country, shipped coal to a U.S. possession, or caused such coal to be so exported or shipped. Refunds to producers are to be made in an amount equal to the tax paid on exported coal. Exporters are to receive a payment equal to $0.825 per ton of exported coal.

Special rules apply if a court has rendered a judgment. If a coal producer or a party related to a coal producer has received, from a court of competent jurisdiction in the United States, a judgment in favor of such coal producer (or party related to such coal producer) that relates to the constitutionality of Federal excise tax paid on exported coal, then such coal producer is deemed to have established the export of coal to a foreign country or shipment of coal to a possession of the United States. The amount of any payment due to a coal producer under the proposal is reduced by any amount awarded under such court judgment. In the event such judgment is later overturned, the coal producer must pay to the Secretary the amount of any payment received under the proposal unless the coal producer establishes the export of the coal to a foreign country or shipment of coal to a possession of the United States. Subject to the rules below, a coal exporter may file a claim notwithstanding that a coal producer or a party related to a coal producer has received a court judgment relating to the same coal.

Under the proposal, the term "coal producer" means the person that owns the coal immediately after the coal is severed from the ground, without regard to the existence of any contractual arrangement for the sale or other disposition of the coal or the payment of any royalties between the producer and third parties. The term also includes any person who extracts coal from coal waste refuse piles or from the silt waste product which results from the wet washing or similar processing of coal. The term "exporter" means a person, other than a coal producer, that does not have an agreement with a producer or seller of such coal to sell or export such coal to a third party on behalf of such producer or seller, and that is indicated as the exporter of record in the shipper's export declaration or other documentation, or actually exported such coal to a foreign country, shipped such coal to a U.S. possession, or caused such coal to be so exported or shipped. The term "a party related to such coal producer" means a person that is related to such coal producer through any degree of common management, stock ownership, or voting control, is related, within the meaning of section 144(a)(3), to such coal producer, or has a contract, fee arrangement, or any other agreement with such coal producer to sell such coal to a third party on behalf of such coal producer.

[46] See sec. 6621.

The proposal does not apply with respect to excise tax on exported coal if a credit or refund of such tax has been allowed or made, or if a "settlement with the Federal Government" has been made with and accepted by the coal producer, a party related to such coal producer, or the exporter of such coal, as of the date that the claim is filed under the proposal. The term "settlement with the Federal Government" does not include a settlement or stipulation entered into as of the date of enactment, if such settlement or stipulation contemplates a judgment with respect to which any party has filed an appeal or has reserved the right to file an appeal. In addition, the proposal does not apply to the extent that a credit or refund of tax on exported coal has been paid to any person, regardless of whether such credit or refund occurs prior to, or after, the date of enactment.

The proposal does not confer standing upon an exporter or a coal producer to commence, or intervene in, any judicial or administrative proceeding concerning a claim for refund by a coal producer or exporter, respectively, of any Federal or State tax, fee, or royalty.

Effective Date

The proposal applies to claims on coal exported on or after October 1, 1990, through the date of enactment, with respect to amounts of tax for which a return was filed on or after October 1, 1990, and on or before the date of enactment, and for which a claim for refund is filed not later than the close of the 30-day period beginning on the date of enactment.

11. Rural Renaissance bonds

Present law

Tax-exempt bonds

Interest on State and local governmental bonds generally is excluded from gross income for Federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. Activities that can be financed with these tax-exempt bonds include the financing of electric power facilities (i.e., generation, transmission, distribution, and retailing).

Interest on State or local government bonds to finance activities of private persons ("private activity bonds") is taxable unless a specific exception is contained in the Code (or in non-Code provision of a revenue Act). The term "private person" generally includes the Federal Government and all other individuals and entities other than States or local governments. The Code includes exceptions permitting States or local governments to act as conduits providing tax-exempt financing for certain private activities. In most cases, the aggregate volume of these tax-exempt private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2007, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $256.24 million, if greater.

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[47] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[48] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

An issuer must file with the IRS certain information about the bonds issued by them in order for that bond issue to be tax-exempt.[49] Generally, this information return is required to be filed no later the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

Clean renewable energy bonds

As an alternative to tax-exempt bonds, States and local governments may issue clean renewable energy bonds ("CREBs"). CREBs are defined as any bond issued by a qualified issuer if, in addition to the requirements discussed below, 95 percent or more of the proceeds of such bonds are used to finance capital expenditures incurred by qualified borrowers for qualified projects. "Qualified projects" are facilities that qualify for the tax credit under section 45 (other than Indian coal production facilities), without regard to the placed-in-service date requirements of that section.[50] The term "qualified issuers" includes (1) governmental bodies (including Indian tribal governments); (2) mutual or cooperative electric companies (described in section 501(c)(12) or section 1381(a)(2)(C), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act); and (3) clean renewable energy bond lenders. The term "qualified borrower" includes a governmental body (including an Indian tribal government) and a mutual or cooperative electric company. A clean renewable energy bond lender means a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002.

Unlike tax-exempt bonds, CREBs are not interest-bearing obligations. Rather, the taxpayer holding CREBs on a credit allowance date is entitled to a tax credit. The amount of the credit is determined by multiplying the bond's credit rate by the face amount on the holder's bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits

[47] Secs. 103(a) and (b)(2).

[48] Sec. 148.

[49] Sec. 149(e).

[50] In addition, Notice 2006-7 provides that qualified projects include any facility owned by a qualified borrower that is functionally related and subordinate to any facility described in sections 45(d)(1) through (d)(9) and owned by such qualified borrower.

issuance of CREBs without discount and interest cost to the qualified issuer. The credit accrues quarterly and is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability.

CREBs are subject to a maximum maturity limitation. The maximum maturity is the term which the Secretary estimates will result in the present value of the obligation to repay the principal on a CREBs being equal to 50 percent of the face amount of such bond. The discount rate used to determine the present value amount is the average annual interest rate of tax-exempt obligations having a term of 10 years or more which are issued during the month the CREBs are issued. In addition, the Code requires level amortization of CREBs during the period such bonds are outstanding.

CREBs also are subject to the arbitrage requirements of section 148 that apply to traditional tax-exempt bonds. Principles under section 148 and the regulations thereunder apply for purposes of determining the yield restriction and arbitrage rebate requirements applicable to CREBs.

In addition to the above requirements, at least 95 percent of the proceeds of CREBs must be spent on qualified projects within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified projects during the five-year spending period, bonds will continue to qualify as CREBs if unspent proceeds are used within 90 days from the end of such five-year period to redeem bonds. The five-year spending period may be extended by the Secretary upon the qualified issuer's request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Issuers of CREBs are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds. There is a national CREB limitation of $1.2 billion. The maximum amount of CREBs that may be allocated to qualified projects of governmental bodies is $750 million. CREBs must be issued before January 1, 2009.

Description of Proposal

The proposal provides a tax credit to holders of a new category of tax-credit bonds, "Rural Renaissance Bonds." A Rural Renaissance Bond means any bond if: (1) the bond is issued by a qualified issuer pursuant to an allocation of the national limitation on such bonds; (2) 95 percent or more of the proceeds of the bond are to be used for capital expenditures incurred by qualified borrowers for one or more qualified projects; (3) the qualified issuer designates the bond as a Rural Renaissance Bond and such bond is issued in registered form; (4) the bond meets the five-year spending requirement (described below); and (5) the bond is not Federally guaranteed (i.e., no portion of the bond is guaranteed in whole or in part by the United States).

Under the proposal, the term "qualified issuer" means: (1) a rural renaissance bond lender; (2) a cooperative electric company; and (3) a governmental body. A "rural renaissance bond lender" means a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002, including any affiliated lender which is controlled by such lender. The term "cooperative electric company" means a

mutual or cooperative electric company (described in section 501(c)(12) or section 1381(a)(2)(C), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act. The term "governmental body" means a State, territory, possession of the United States, the District of Columbia, Indian tribal government, and any political subdivision thereof. Under the proposal, a "qualified borrower" means a cooperative electric company or a governmental body.

The term "qualified projects" means: (1) a utilities program described in section 381E(d)(2) of the Consolidated Farm and Rural Development Act; (2) a distance learning or telemedicine program authorized pursuant to chapter 1 of subtitle D of title XXIII of the Food, Agriculture, Conservation, and Trade Act of 1990; (3) the rural electric programs authorized pursuant to the Rural Electrification Act of 1936; (4) the rural telephone programs authorized pursuant to the Rural Electrification Act of 1936; (5) the broadband access programs authorized pursuant to title VI of the Rural Electrification Act of 1936; and (6) the rural community facility programs as described in section 381E(d)(1) of the Consolidated Farm and Rural Development Act.

Under the proposal, at least 95 percent or more of the proceeds of Rural Renaissance Bonds must be spent on qualified projects within the five-year period that begins on the date of issuance of such bonds. To the extent less than 95 percent of the proceeds are spent as required during the five-year spending period, bonds will continue to qualify as Rural Renaissance Bonds only if unspent proceeds are used within 90 days from the end of such five-year period to redeem outstanding bonds. The five-year spending period may be extended by the Secretary upon the qualified issuer's request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence. In addition, the proposal requires level amortization of Rural Renaissance Bonds during the period such bonds are outstanding.

The proposal establishes a national limitation of $400,000,000 on the amount of bonds that may be designated as Rural Renaissance Bonds. The Secretary, in consultation with the Secretary of Agriculture, shall make allocations of the national limitation to at least 20 qualified projects, or such lesser number of qualified projects based on the number of applications filed 12 months after applications for allocations have been solicited by the Secretary. In addition, no more than 15 percent of the national limitation may be allocated to qualified projects located in any one State. Under the proposal, Rural Renaissance Bonds may not be issued after December 31, 2008.

Effective Date

The proposal is effective for bonds issued after the date of enactment.

12. Treatment of publicly traded partnerships with income from carbon dioxide and certain fuels

Present Law

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes (sec. 7704(a)). For this purpose, a publicly traded partnership means any

partnership if interests in the partnership are traded on an established securities market, or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income (sec. 7704(c)(2)).

Qualifying income includes income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber). Qualifying income also includes interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held for the production of income that is qualifying income. Qualifying income also includes rents from real property, gains from the sale or other disposition of real property. It also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) in the case of partnership, a principal activity of which is the buying and selling of such commodities, futures, options or forward contracts.

Description of Proposal

The proposal provides that qualifying income of a publicly traded partnership includes income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of industrial source carbon dioxide.

The proposal provides that qualifying income of a publicly traded partnership includes income and gains from transportation or storage of any fuel described in section 6426(b), (c), or (d). This fuel includes alcohol fuel mixtures, biodiesel mixtures, liquefied petroleum gas, P Series Fuels (as defined by the Secretary of Energy under 42 U.S.C. 13211(2)), compressed or liquefied natural gas, liquefied hydrogen, any liquid fuel derived from coal (including peat) through the Fischer-Tropsch process, and liquid hydrocarbons derived from biomass (as defined in section 45K(c)(3)).

Effective Date

The proposal is effective on the date of enactment, for taxable years ending after that date.

C. Revenue Raising Provisions

1. Excise tax on crude oil and gas removed from the outer continental shelf in the Gulf of Mexico

Present Law

Under present law, there is no Federal severance tax on oil and gas produced on the outer Continental Shelf (OCS). The United States leases Federal lands containing oil and gas deposits from offshore or submerged lands under the Outer Continental Shelf Lands Act of 1953, as amended.[51] Offshore oil and gas lessees generally must pay the United States a royalty of not less than 12.5 percent, which is sometimes paid in kind.[52] The royalty rate for most newly-issued OCS leases was recently raised by administrative action to 16 2/3 percent.

In general, excise taxes are not deductible as taxes under section 164 of the Code; however, such taxes may be deductible as ordinary and necessary business expenses.

Description of Proposal

The proposal establishes an excise tax equal to 13 percent of the removal price of any crude oil or natural gas produced from Federal submerged lands on the outer continental shelf in the Gulf of Mexico pursuant to a lease entered into with the United States that authorizes the production ("taxable crude oil or natural gas") during the taxable period. The tax is to be paid by the producer of the taxable crude oil or natural gas. For this purpose, crude oil includes condensates and natural gasoline. Under the proposal, each calendar year is a taxable period. The Secretary is to provide for the filing, and time for filing of the return of tax imposed under the proposal.

The removal price is defined as the amount for which the barrel of taxable crude oil (or dollars per thousand cubic feet in the case of natural gas) is sold by the taxpayer. In the case of sales between related parties, and crude oil or natural gas removed from the property before it is sold, the removal price is the constructive sales price. If the manufacture or conversion of crude oil into refined products begins before such oil is removed from the property, such oil is treated as removed on the day such manufacture or conversion begins, and the removal price is the constructive sales price. In determining the removal price of oil or natural gas from a property in the case of any transaction, the Secretary may adjust the removal price to reflect clearly the fair market value of oil or natural gas removed.

The proposal allows as a credit against the excise tax imposed by the proposal an amount equal to the aggregate amount of royalties paid under Federal law with respect to the production of taxable crude oil or natural gas produced from Federal submerged lands on the outer

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[51] 43 U.S.C. secs. 1335 and 1137.

[52] 43 U.S.C. secs. 1335, 1337 and 1353(a)(1).

continental shelf in the Gulf of Mexico. In no event may the aggregate amount of the credit exceed the aggregate amount of tax imposed by the proposal in any calendar year.

The Secretary is authorized to prescribe such regulations and guidance as is necessary for the withholding and quarterly deposit of the tax imposed by the proposal, as well as other guidance as is necessary to carry out the proposal.

The proposal provides that the amount of the excise tax imposed, net of the credit for royalty payments, is deductible as a tax under section 164 of the Code.

Effective Date

The proposal is effective for crude oil and natural gas removed after date of enactment.

2. Elimination of certain refunds of duty involving oil spill liability tax[53]

Present Law

Present law permits a drawback claimant to obtain a refund equal to the money deposited into a Federal trust fund such as the fund established to reimburse the cost of cleanup of the oil spills.

Description of Proposal

This proposal prevents the amount of fees and taxes that are deposited into special purpose Federal Trust Funds from being refunded through the general fund of the Treasury.

Effective Date

The proposal is effective for any good exported on or after the fifteenth day after enactment.

3. Tax treatment of certain inverted corporate entities

Present Law

Determination of corporate residence

The U.S. tax treatment of a multinational corporate group depends significantly on whether the parent corporation of the group is domestic or foreign. For purposes of U.S. tax law, a corporation is treated as domestic if it is incorporated under the law of the United States or of any State. Other corporations (i.e., those incorporated under the laws of foreign countries or U.S. possessions) generally are treated as foreign.

U.S. taxation of domestic corporations

[53] Description prepared by the staff of the Senate Committee on Finance.

The United States employs a "worldwide" tax system under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. In order to mitigate the double taxation that may arise from taxing the foreign-source income of a domestic corporation, a foreign tax credit for income taxes paid to foreign countries is provided to reduce or eliminate the U.S. tax owed on such income, subject to certain limitations.

Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income generally is deferred, and U.S. tax is imposed on such income when repatriated. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F (secs. 951-964) and the passive foreign investment company rules (secs. 1291-1298). A foreign tax credit is generally available to offset, in whole or in part, the U.S. tax owed on this foreign-source income, whether such income is repatriated as an actual dividend or included under one of the anti-deferral regimes.

U.S. taxation of foreign corporations

The United States taxes foreign corporations only on income that has a sufficient nexus to the United States. Thus, a foreign corporation is generally subject to U.S. tax only on income that is "effectively connected" with the conduct of a trade or business in the United States. Such "effectively connected income" generally is taxed in the same manner and at the same rates as the income of a U.S. corporation. An applicable tax treaty may limit the imposition of U.S. tax on business operations of a foreign corporation to cases in which the business is conducted through a "permanent establishment" in the United States.

In addition, foreign corporations generally are subject to a gross-basis U.S. tax at a flat 30-percent rate on the receipt of interest, dividends, rents, royalties, and certain similar types of income derived from U.S. sources, subject to certain exceptions. The tax generally is collected by means of withholding by the person making the payment. This tax may be reduced or eliminated under an applicable tax treaty.

U.S. tax treatment of inversion transactions prior to the American Jobs Creation Act of 2004

Prior to the American Jobs Creation Act of 2004 ("AJCA"), a U.S. corporation could reincorporate in a foreign jurisdiction and thereby replace the U.S. parent corporation of a multinational corporate group with a foreign parent corporation. These transactions were commonly referred to as inversion transactions. Inversion transactions could take many different forms, including stock inversions, asset inversions, and various combinations of and variations on the two. Most of the known transactions were stock inversions. In one example of a stock inversion, a U.S. corporation forms a foreign corporation, which in turn forms a domestic merger subsidiary. The domestic merger subsidiary then merges into the U.S. corporation, with the U.S. corporation surviving, now as a subsidiary of the new foreign corporation. The U.S.

corporation's shareholders receive shares of the foreign corporation and are treated as having exchanged their U.S. corporation shares for the foreign corporation shares. An asset inversion could be used to reach a similar result, but through a direct merger of the top-tier U.S. corporation into a new foreign corporation, among other possible forms. An inversion transaction could be accompanied or followed by further restructuring of the corporate group. For example, in the case of a stock inversion, in order to remove income from foreign operations from the U.S. taxing jurisdiction, the U.S. corporation could transfer some or all of its foreign subsidiaries directly to the new foreign parent corporation or other related foreign corporations.

In addition to removing foreign operations from U.S. taxing jurisdiction, the corporate group could seek to derive further advantage from the inverted structure by reducing U.S. tax on U.S.-source income through various earnings stripping or other transactions. For example, the corporate group could engage in earnings stripping through payment by a U.S. corporation of deductible amounts such as interest, royalties, rents, or management service fees to the new foreign parent or other foreign affiliates. In this respect, the post-inversion structure could enable the group to employ the same tax-reduction strategies that are available to other multinational corporate groups with foreign parents and U.S. subsidiaries, subject to the same limitations (e.g., sections 163(j) and 482).

Inversion transactions could give rise to immediate U.S. tax consequences at the shareholder and/or the corporate level, depending on the type of inversion. In stock inversions, the U.S. shareholders generally recognized gain (but not loss) under section 367(a), based on the difference between the fair market value of the foreign corporation shares received and the adjusted basis of the domestic corporation stock exchanged. To the extent that a corporation's share value had declined, and/or it had many foreign or tax-exempt shareholders, the impact of this section 367(a) "toll charge" was reduced. The transfer of foreign subsidiaries or other assets to the foreign parent corporation also could give rise to U.S. tax consequences at the corporate level (e.g., gain recognition and earnings and profits inclusions under sections 1001, 311(b), 304, 367, 1248, or other provisions). The tax on any income recognized as a result of these restructurings could be reduced or eliminated through the use of net operating losses, foreign tax credits, and other tax attributes.

In asset inversions, the U.S. corporation generally recognized gain (but not loss) under section 367(a) as though it had sold all of its assets, but the shareholders generally did not recognize gain or loss, assuming the transaction met the requirements of a reorganization under section 368.

<u>U.S. tax treatment of inversion transactions under AJCA</u>

<u>In general</u>

AJCA added new section 7874 to the Code, which defines two different types of corporate inversion transactions and establishes a different set of consequences for each type. Certain partnership transactions also are covered.

Transactions involving at least 80 percent identity of stock ownership

The first type of inversion is a transaction in which, pursuant to a plan[54] or a series of related transactions: (1) a U.S. corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity in a transaction completed after March 4, 2003; (2) the former shareholders of the U.S. corporation hold (by reason of holding stock in the U.S. corporation) 80 percent or more (by vote or value) of the stock of the foreign-incorporated entity after the transaction; and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50 percent ownership (i.e., the "expanded affiliated group"), does not have substantial business activities in the entity's country of incorporation, compared to the total worldwide business activities of the expanded affiliated group. The provision denies the intended tax benefits of this type of inversion ("80-percent inversion") by deeming the top-tier foreign corporation to be a domestic corporation for all purposes of the Code.[55]

In determining whether a transaction meets the definition of an inversion under the provision, stock held by members of the expanded affiliated group that includes the foreign incorporated entity is disregarded. For example, if the former top-tier U.S. corporation receives stock of the foreign incorporated entity (e.g., so-called "hook" stock), the stock would not be considered in determining whether the transaction meets the definition. Similarly, if a U.S. parent corporation converts an existing wholly owned U.S. subsidiary into a new wholly owned controlled foreign corporation, the stock of the new foreign corporation would be disregarded, with the result that the transaction would not meet the definition of an inversion under the provision. Stock sold in a public offering related to the transaction also is disregarded for these purposes.

Transfers of properties or liabilities as part of a plan a principal purpose of which is to avoid the purposes of the provision are disregarded. In addition, the Treasury Secretary is to provide regulations to carry out the provision, including regulations to prevent the avoidance of the purposes of the provision, including avoidance through the use of related persons, pass-through or other noncorporate entities, or other intermediaries, and through transactions designed to qualify or disqualify a person as a related person or a member of an expanded affiliated group. Similarly, the Treasury Secretary has the authority to treat certain nonstock instruments as stock, and certain stock as not stock, where necessary to carry out the purposes of the provision.

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[54] Acquisitions with respect to a domestic corporation or partnership are deemed to be "pursuant to a plan" if they occur within the four-year period beginning on the date that is two years before the ownership threshold under the provision is met with respect to such corporation or partnership.

[55] Since the top-tier foreign corporation is treated for all purposes of the Code as domestic, the shareholder-level "toll charge" of section 367(a) does not apply to these inversion transactions.

Transactions involving at least 60 percent but less than 80 percent identity of stock ownership

The second type of inversion is a transaction that would meet the definition of an inversion transaction described above, except that the 80-percent ownership threshold is not met. In such a case, if at least a 60-percent ownership threshold is met, then a second set of rules applies to the inversion. Under these rules, the inversion transaction is respected (i.e., the foreign corporation is treated as foreign), but any applicable corporate-level "toll charges" for establishing the inverted structure are not offset by tax attributes such as net operating losses or foreign tax credits. Specifically, any applicable corporate-level income or gain required to be recognized under sections 304, 311(b), 367, 1001, 1248, or any other provision with respect to the transfer of controlled foreign corporation stock or the transfer or license of other assets by a U.S. corporation as part of the inversion transaction or after such transaction to a related foreign person is taxable, without offset by any tax attributes (e.g., net operating losses or foreign tax credits). This rule does not apply to certain transfers of inventory and similar property. These measures generally apply for a 10-year period following the inversion transaction.

Other rules

Under section 7874, inversion transactions include certain partnership transactions. Specifically, the provision applies to transactions in which a foreign-incorporated entity acquires substantially all of the properties constituting a trade or business of a domestic partnership, if after the acquisition at least 60 percent (or 80 percent, as the case may be) of the stock of the entity is held by former partners of the partnership (by reason of holding their partnership interests), provided that the other terms of the basic definition are met. For purposes of applying this test, all partnerships that are under common control within the meaning of section 482 are treated as one partnership, except as provided otherwise in regulations. In addition, the modified "toll charge" rules apply at the partner level.

A transaction otherwise meeting the definition of an inversion transaction is not treated as an inversion transaction if, on or before March 4, 2003, the foreign-incorporated entity had acquired directly or indirectly more than half of the properties held directly or indirectly by the domestic corporation, or more than half of the properties constituting the partnership trade or business, as the case may be.

Description of Proposal

The proposal generally extends the 80-percent inversion regime of section 7874 to 80-percent inversions completed after March 20, 2002, but on or before March 4, 2003, with certain modifications as described below. A transaction otherwise meeting the definition of an 80-percent inversion under the proposal (i.e., one completed after March 20, 2002, but on or before March 4, 2003) is not treated as an 80-percent inversion if, on or before March 20, 2002, the foreign-incorporated entity had acquired directly or indirectly more than half the properties held directly or indirectly by the domestic corporation, or more than half the properties constituting the partnership trade or business, as the case may be.

Under the proposal, an 80-percent inversion that is completed after March 20, 2002, but on or before March 4, 2003, is respected until the end of the last day of the foreign-incorporated entity's taxable year that began in 2006. At the end of that day, the inverted foreign-incorporated entity that completed the 80-percent inversion (or, if relevant, any successor entity) is deemed to have transferred all of its assets and liabilities to a domestic corporation in a transaction that is generally treated as a nontaxable inbound reorganization ("repatriation"). The basis of the assets of the foreign-incorporated entity generally remains the same in the hands of the domestic corporation, subject to any special adjustments for importing built-in losses (e.g., section 362(e)). Shareholders of the domestic corporation inherit the respective bases of their shares of the foreign-incorporated entity.

On the day of the repatriation, the earnings and profits of the inverted foreign-incorporated entity transfer over to the domestic corporation. The transfer of such earnings and profits is not a deemed dividend and does not result in a tax upon the domestic corporation or its shareholders. In addition, any foreign taxes attributable to such earnings and profits are not creditable. However, shareholders may be subject to tax on distributions of such earnings and profits.

Beginning on the day after the repatriation, the inverted foreign-incorporated entity is treated for all tax purposes as a domestic corporation. Thus, any income earned by the inverted foreign-incorporated entity after the date of repatriation is deemed to be earned by a domestic corporation, and, therefore, is fully taxable at U.S. corporate income tax rates. As a further consequence of the repatriation of the inverted foreign-incorporated entity, foreign subsidiaries become controlled foreign corporations, subject to the rules of subpart F.

It is intended that the Treasury Secretary will prescribe regulations that are necessary or appropriate to carry out the proposal, including, but not limited to, regulations to prevent the avoidance of the purposes of the proposal.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2006.

4. Modifications to corporate estimated tax payments

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability. For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15.

The Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA") provided that in the case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, shall be increased to 106.25 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

The Small Business and Work Opportunity Tax Act of 2007 as contained in the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007 increased the 106.25 percent to 114.25.

Explanation of Provision

The provision increases the 114.25 percent to 118 percent.

Effective Date

The provision is effective on the date of enactment.

D. Technical Corrections

1. Energy-related technical corrections

Except as otherwise provided, the amendments made by the technical corrections contained in the bill take effect as if included in the original legislation to which each amendment relates.

Amendments to the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users

Timing of claims for excess alternative fuel (not in a mixture) credit and liquid hydrocarbons from biomass (Act sec. 11113)

The Code makes the alternative fuel (not in a mixture) credit refundable. Section 6427(i)(3) permits claims to be filed on a weekly basis with respect to alcohol, biodiesel, and alternative fuel mixtures if certain requirements are met. This rule, however, does not reference the alternative fuel credit (for alternative fuel not in a mixture). The amendment clarifies that the same rules for filing claims with respect to fuel mixtures applies to the alternative fuel credit.

The Code provides that alternative fuel includes "liquid hydrocarbons derived from biomass." It was intended that liquid hydrocarbons from biomass include fuels made from biomass such as fish oil, which contains some oxygen in addition to hydrogen and carbon. The amendment provides that alternative fuel includes "liquid fuel from biomass" and clarifies that fuels described in sections 6426(b) or (c), or sections 40 or 40A (alcohol, biodiesel, and renewable diesel), do not qualify for the alternative fuel credit or alternative fuel mixture credit.

Amendments to the Energy Policy Act of 2005

Clarify limitation on the credit of installing alternative fuel refueling property (Act sec. 1342)

The present-law credit for qualified alternative fuel vehicle refueling property for a taxable year is limited to $30,000 per property subject to depreciation, and $1,000 for other property (sec. 30C(b)). The provision clarifies that the $30,000 and $1,000 limitations apply to all alternative fuel vehicle refueling property placed in service by the taxpayer at a location. The provision is consistent with similar deduction limitations imposed under section 179A(b)(2)(A) (relating to the deduction for clean-fuel vehicles and certain refueling property).

In addition, Code section 30C(c)(1) provides that qualified alternative fuel vehicle refueling property has the meaning given to the term by section 179A(d). However, section 179A(d) defines a different term, qualified clean-fuel vehicle refueling property. The provision coordinates the reference to this definition.

Double taxation of rail and inland waterway fuel resulting from the use of dyed fuel on which the Leaking Underground Storage Tank Trust Fund tax has already been imposed; off-highway business use (Act sec. 1362)

Section 4081(a)(2)(B) imposes tax at the Leaking Underground Storage Tank Trust Fund financing tax rate of 0.1 cent per gallon on diesel fuel at the time it is removed from a terminal. Section 4082(a) provides that none of the generally applicable exemptions other than the exemption for export apply to this removal even if the fuel is dyed. When dyed fuel is used or sold for use in a diesel powered highway vehicle or train (sec. 4041), or such fuel is subject to the inland waterway tax (sec. 4042), the Code inadvertently imposes the Leaking Underground Storage Tank Trust Fund tax a second time. Section 6430 prohibits the refund of taxes imposed at the Leaking Underground Storage Tank Trust Fund financing rate, except in the case of fuel destined for export. The amendment eliminates the imposition of the 0.1 cent tax a second time if the Leaking Underground Storage Tank Trust Fund financing tax rate previously was imposed under section 4081. The amendment permits a refund in the amount of the Leaking Underground Storage Tank Trust Fund financing rate if such tax was imposed a second time under 4041 or 4042. The amendment also clarifies that off-highway business use is not exempt from the Leaking Underground Storage Tank Trust Fund Financing rate, effective for fuel sold for use or used after the date of enactment.

Exemption from the Leaking Underground Storage Tank Trust Fund financing rate for aircraft and vessels engaged in foreign trade (Act. sec. 1362)

Fuel supplied in the United States for use in aircraft engaged in foreign trade is exempt from U.S. customs duties and internal revenue taxes, so long as, where the aircraft is registered in a foreign State, the State of registry provides substantially reciprocal privileges for U.S.-registered aircraft. However, the Energy Policy Act of 2005 imposed, without exemption, the Leaking Underground Storage Tank Trust Fund financing rate on all taxable fuels, except in the case of export. As a result, aviation fuel is no longer exempt from the Leaking Underground Storage Tank Trust Fund financing rate. According to the State Department, almost all of the United States' bilateral air services agreements contain provisions exempting from taxation all fuel supplied in the territory of one party for use in the aircraft of the other party. The United States has interpreted these provisions to prohibit the taxation, in any form, of aviation fuel supplied in the United States to the aircraft of airlines of the foreign countries that are parties to these air services agreements. The amendment provides that fuel for use in vessels (including civil aircraft) employed in foreign trade or trade between the United States and any of its possessions is exempt from the Leaking Underground Storage Tank Trust Fund financing rate.

Amendment to the American Jobs Creation Act

Interaction of rules relating to credit for low sulfur diesel fuel (Act. sec. 339)

Section 45H of the Code allows a credit at the rate of five cents per gallon for low sulfur diesel fuel produced at certain small business refineries. The aggregate credit with respect to any refinery is limited to 25 percent of the costs of the type deductible under section 179B of the Code. Section 179B allows a deduction for 75 percent of certain costs paid or incurred with respect to these refineries. The basis of the property is reduced by the amount of any credit

determined with respect to any expenditure (sec. 45H(d)). Further, no deduction is allowed for the expenses otherwise allowable as a deduction in an amount equal to the amount of the credit under section 45H (sec. 280C(d)). The interaction of these provisions is unclear, and the basis reduction and deduction denial rules may have an unintentionally duplicative effect. Under the provision, deductions are denied in an amount equal to the amount of the credit under section 45H, and the provisions of present law reducing basis and denying a deduction are repealed.