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DESCRIPTION AND TECHNICAL EXPLANATION OF THE CONFERENCE AGREEMENT OF H.R. 6, TITLE XIII, THE "ENERGY TAX INCENTIVES ACT OF 2005"

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation at the request of House Ways and Means Committee Chairman, Bill Thomas, and Senate Finance Committee Chairman, Chuck Grassley, provides a description and technical explanation of the conference agreement to H.R. 6, Title XIII, the "Energy Tax Incentives Act of 2005." This document reproduces the description and technical explanation of the conference agreement included in the *Congressional Record* of July 27, 2005, by Chairman Grassley.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description and Technical Explanation of the Conference Agreement of H.R. 6, Title XIII, the "Energy Tax Incentives Act of 2005"* (JCX-60-05), July 28, 2005.

A. Energy Infrastructure Tax Incentives

1. Natural gas gathering lines treated as seven-year property (sec. 1301 of the House bill, sec. 1326 of the conference agreement, and sec. 168 of the Code)

Present Law

The applicable recovery period for assets placed in service under the Modified Accelerated Cost Recovery System is based on the "class life of the property." The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[2] Revenue Procedure 87-56 includes two asset classes either of which could describe natural gas gathering lines owned by nonproducers of natural gas. Asset class 46.0, describing pipeline transportation, provides a class life of 22 years and a recovery period of 15 years. Asset class 13.2, describing assets used in the exploration for and production of petroleum and natural gas deposits, provides a class life of 14 years and a depreciation recovery period of seven years. The uncertainty regarding the appropriate recovery period of natural gas gathering lines has resulted in litigation between taxpayers and the IRS. In each of three recent cases, appellate courts have held that natural gas gathering lines owned by nonproducers fall within the scope of Asset class 13.2 (*i.e.,* seven-year recovery period).[3] The appellate court in each case reversed a lower court holding that natural gas gathering lines owned by nonproducers fall within the scope of Asset class 46.0 (*i.e.,* 15-year recovery period). The IRS has not yet indicated whether it acquiesces in the result in these three appellate decisions in cases arising in other circuits.

House Bill

The House bill establishes a statutory seven-year recovery period and a class life of 14 years for natural gas gathering lines. In addition, no adjustment will be made to the allowable amount of depreciation with respect to this property for purposes of computing a taxpayer's alternative minimum taxable income. A natural gas gathering line is defined to include any pipe, equipment, and appurtenance that is (1) determined to be a gathering line by the Federal Energy Regulatory Commission, or (2) used to deliver natural gas from the wellhead or a common point to the point at which such gas first reaches (a) a gas processing plant, (b) an interconnection with an interstate transmission line, (c) an interconnection with an intrastate transmission line, or (d) a direct interconnection with a local distribution company, a gas storage facility, or an industrial consumer.

Effective date.−The House bill provision is effective for property placed in service after April 11, 2005. No inference is intended as to the proper treatment of natural gas gathering lines placed in service on or before April 11, 2005.

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

[3] *Clajon Gas Co, L.P. v. Commissioner*, 354 F.3d 786 (8th Cir. 2004), *rev'g* 119 T.C. 197 (2002); *Saginaw Bay Pipeline Co. v. United States*, 338 F.3d 600 (6th Cir. 2003), *rev'g* 88 A.F.T.R.2d 2001-6019 (E.D. Mich. 2001); *Duke Energy v. Commissioner*, 172 F.3d 1255 (10th Cir. 1999), *rev'g* 109 T.C. 416 (1997).

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except that the provision requires that the original use of the property begin with the taxpayer. The provision does not apply to property with respect to which the taxpayer (or a related party) had a binding acquisition contract on or before April 11, 2005.

2. Natural gas distribution lines treated as fifteen-year property (sec. 1302 of the House bill, sec. 1515 of the Senate amendment, sec. 1325 of the conference agreement, and sec. 168 of the Code)

Present Law

The applicable recovery period for assets placed in service under the Modified Accelerated Cost Recovery System is based on the "class life of the property." The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[4] Natural gas distribution pipelines are assigned a 20-year recovery period and a class life of 35 years.

House Bill

The House bill establishes a statutory 15-year recovery period and a class life of 35 years for natural gas distribution lines.

Effective date.−The House bill provision is effective for property placed in service after April 11, 2005.

Senate Amendment

The Senate amendment is the same as the House bill, except the Senate amendment requires that the original use of the property begin with the taxpayer and that the property be placed in service prior to January 1, 2008.

Effective date.−The Senate amendment provision is effective for property placed in service after the date of enactment. However, the provision does not apply to property subject to a binding contract on or before June 14, 2005.[5]

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

[5] In the case of self-constructed property, the provision does not apply to property under construction on or before June 14, 2005.

Conference Agreement

The conference agreement follows the House bill, with the following modifications. The conference agreement is effective for property, the original use of which begins with the taxpayer after April 11, 2005, which is placed in service after April 11, 2005 and before January 1, 2011. The provision does not apply to property subject to a binding contract on or before April 11, 2005.[6]

3. Transmission property treated as fifteen-year property (sec. 1303 of the House bill, sec. 1308 of the conference agreement, and sec. 168 of the Code)

Present Law

The applicable recovery period for assets placed in service under the Modified Accelerated Cost Recovery System is based on the "class life of the property." The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[7] Assets used in the transmission and distribution of electricity for sale and related land improvements are assigned a 20-year recovery period and a class life of 30 years.

House Bill

The House bill provision establishes a statutory 15-year recovery period and a class life of 30 years for certain assets used in the transmission of electricity for sale and related land improvements. For purposes of the provision, section 1245 property used in the transmission at 69 or more kilovolts of electricity for sale, the original use of which commences with the taxpayer after April 11, 2005, will qualify for the new recovery period.

Effective date.−The House bill provision is effective for property placed in service after April 11, 2005.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except that the provision does not apply to property which is the subject of a binding contract on or before April 11, 2005.[8]

[6] In the case of self-constructed property, the provision does not apply to property under construction on or before April 11, 2005.

[7] 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

[8] In the case of self-constructed property, the provision does not apply to property under construction on or before April 11, 2005.

4. Amortization of atmospheric pollution control facilities (sec. 1304 of the House bill, sec. 1309 of the conference agreement, and sec. 169 of the Code)

Present Law

In general, a taxpayer may elect to recover the cost of any certified pollution control facility over a period of 60 months.[9] A certified pollution control facility is defined as a new, identifiable treatment facility which (1) is used in connection with a plant in operation before January 1, 1976, to abate or control water or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes or heat; and (2) does not lead to a significant increase in output or capacity, a significant extension of useful life, a significant reduction in total operating costs for such plant or other property (or any unit thereof), or a significant alteration in the nature of a manufacturing production process or facility. Certification is required by appropriate State and Federal authorities that the facility complies with appropriate standards.

For a pollution control facility with a useful life greater than 15 years, only the portion of the basis attributable to the first 15 years is eligible to be amortized over a 60-month period.[10] In addition, a corporate taxpayer must reduce the amount of basis otherwise eligible for the 60-month recovery by 20 percent.[11] The amount of basis not eligible for 60-month amortization is depreciable under the regular tax rules for depreciation.

House Bill

The House bill expands the provision allowing a taxpayer to recover the cost of certain certified air pollution control facilities (but not water pollution control facilities) over 60 months by repealing the requirement that only certified pollution control facilities used in connection with a plant in operation before January 1, 1976 qualify. Under the House bill, a certified air pollution control facility which used in connection with an electric generation plant which is primarily coal fired will be eligible for 60-month amortization regardless of whether the associated plant or other property was in operation prior to January 1, 1976. In the case of a facility used in connection with a plant or other property not in operation before January 1, 1976, the facility must be property that either (i) the construction, reconstruction, or erection of which is completed by the taxpayer after April 11, 2005 (to the extent of the portion of the basis properly attributable to the construction, reconstruction, or erection after that date), or (ii) is acquired after April 11, 2005, if the original use of the property commences with the taxpayer after that date. The House bill does not change the present-law rules relating to corporate

[9] Sec. 169. For purposes of computing alternative minimum taxable income, the depreciation deduction is determined using the straight-line method over the applicable regular tax recovery period.

[10] The amount attributable to the first 15 years is equal to an amount which bears the same ratio to the portion of the adjusted basis of the facility, which would be eligible for amortization but for the application of this rule, as 15 bears to the number of years of useful life of the facility.

[11] Sec. 291(a)(5).

taxpayers or to pollution control facilities with a useful life greater than 15 years, and the House bill does not modify in any way the treatment of water pollution control facilities.

Effective date.−The provision is effective for air pollution control facilities placed in service after April 11, 2005.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except that the amortization period is 84 months (rather than 60 months) for certified air pollution control facilities used in connection with an electric generation plant which is primarily coal fired and which was not in operation before January 1, 1976.

5. Modification of credit for producing fuel from a non-conventional source (sec. 1305 of the House bill, secs. 1321 and 1322 of the conference agreement, and sec. 29 and new sec. 45K of the Code)

Present Law

Certain fuels produced from "non-conventional sources" and sold to unrelated parties are eligible for an income tax credit equal to $3 (generally adjusted for inflation)[12] per barrel or Btu oil barrel equivalent ("section 29 credit"). Qualified fuels must be produced within the United States.

Qualified fuels include:

- oil produced from shale and tar sands;
- gas produced from geopressured brine, Devonian shale, coal seams, tight formations, or biomass; and
- liquid, gaseous, or solid synthetic fuels produced from coal (including lignite).

Generally, the section 29 credit has expired, except for certain biomass gas and synthetic fuels sold before January 1, 2008, and produced at facilities placed in service after December 31, 1992, and before July 1, 1998.

The section 29 credit may not exceed the excess of the regular tax liability over the tentative minimum tax. Unused section 29 credits may not be carried forward or carried back to other taxable years. However, to the extent the section 29 credit is disallowed because of the

[12] The value of the credit in 2004 was $6.56 per barrel-of-oil equivalent produced, which is approximately $1.16 per thousand cubic feet of natural gas.

tentative minimum tax, the minimum tax credit allowable in future years is increased by the amount so disallowed.

Other business credits are included in the general business credit (sec. 38). Generally, the general business credit may not exceed the excess of the taxpayer’s net income tax over the greater of the taxpayer's tentative minimum tax or 25 percent of so much of the taxpayer's net regular tax liability as exceeds $25,000. General business credits in excess of this limitation may be carried back one year and forward up to 20 years. The section 29 credit is not part of the general business credit.

The section 29 credit includes definitional cross-references and a credit limitation relating to the Natural Gas Policy Act of 1978. The Natural Gas Policy Act of 1978 has been repealed.

House Bill

The provision makes the credit for producing fuel from a non-conventional source part of the general business credit. Thus, the credit for producing fuel from a non-conventional source will be subject to the limitations applicable to the general business credit. Any unused credits may be carried back one year and forward 20 years.

The provision also makes certain clerical changes in cross-references to the Natural Gas Policy Act of 1978, which has been repealed.

Effective date.−The provision applies to credits determined for taxable years ending after December 31, 2005.[13] The clerical changes are effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House provision with modifications. In addition to making the section 29 credit part of the general business credit, the conference agreement adds a production credit for qualified facilities that produce coke or coke gas. Qualified facilities must have been placed in service before January 1, 1993, or after June 30, 1998, and before January 1, 2010. The conferees understand that a single facility for the production of coke or coke gas is generally composed of multiple coke ovens or similar structures.

The production credit may be claimed with respect to coke and coke gas produced and sold during the period beginning on the later of January 1, 2006, or the date such facility is placed in service and ending on the date which is four years after such period began. The amount of credit-eligible coke produced may not exceed an average barrel-of-oil equivalent of

[13] The credit may not be carried back to a taxable year ending before January 1, 2006 (sec. 39(d)).

4,000 barrels per day. The $3.00 credit for coke or coke gas is indexed for inflation using 2004 as the base year instead of 1979. A facility that has claimed a credit under Code section 29(g) is not eligible to claim the new credit for producing coke or coke gas.

The conferees understand that the Internal Revenue Service has stopped issuing private letter rulings and other taxpayer-specific guidance regarding the section 29 credit. The conferees believe that the Internal Revenue Service should consider issuing such rulings and guidance on an expedited basis to those taxpayers who had pending ruling requests at the time the moratorium was implemented.

6. Modification to special rules for nuclear decommissioning costs (sec. 1306 of the House bill, sec. 1310 of the conference agreement, and sec. 468A of the Code)

Present Law

Overview

Special rules dealing with nuclear decommissioning reserve funds were enacted in the Deficit Reduction Act of 1984 ("1984 Act"), when tax issues regarding the time value of money were addressed generally. Under general tax accounting rules, a deduction for accrual basis taxpayers is deferred until there is economic performance for the item for which the deduction is claimed. However, the 1984 Act contains an exception under which a taxpayer responsible for nuclear powerplant decommissioning may elect to deduct contributions made to a qualified nuclear decommissioning fund for future decommissioning costs. Taxpayers who do not elect this provision are subject to general tax accounting rules.

Qualified nuclear decommissioning fund

A qualified nuclear decommissioning fund (a "qualified fund") is a segregated fund established by a taxpayer that is used exclusively for the payment of decommissioning costs, taxes on fund income, management costs of the fund, and for making investments. The income of the fund is taxed at a reduced rate of 20 percent for taxable years beginning after December 31, 1995.[14]

Contributions to a qualified fund are deductible in the year made to the extent that these amounts were collected as part of the cost of service to ratepayers (the "cost of service requirement").[15] Funds withdrawn by the taxpayer to pay for decommissioning costs are

[14] As originally enacted in 1984, a qualified fund paid tax on its earnings at the top corporate rate and, as a result, there was no present-value tax benefit of making deductible contributions to a qualified fund. Also, as originally enacted, the funds in the trust could be invested only in certain low risk investments. Subsequent amendments to the provision have reduced the rate of tax on a qualified fund to 20 percent and removed the restrictions on the types of permitted investments that a qualified fund can make.

[15] Taxpayers are required to include in gross income customer charges for decommissioning costs (sec. 88).

included in the taxpayer's income, but the taxpayer also is entitled to a deduction for decommissioning costs as economic performance for such costs occurs.

Accumulations in a qualified fund are limited to the amount required to fund decommissioning costs of a nuclear powerplant for the period during which the qualified fund is in existence (generally post-1984 decommissioning costs of a nuclear powerplant). For this purpose, decommissioning costs are considered to accrue ratably over a nuclear powerplant's estimated useful life. In order to prevent accumulations of funds over the remaining life of a nuclear powerplant in excess of those required to pay future decommissioning costs of such nuclear powerplant and to ensure that contributions to a qualified fund are not deducted more rapidly than level funding (taking into account an appropriate discount rate), taxpayers must obtain a ruling from the IRS to establish the maximum annual contribution that may be made to a qualified fund (the "ruling amount"). In certain instances (e.g., change in estimates), a taxpayer is required to obtain a new ruling amount to reflect updated information.

A qualified fund may be transferred in connection with the sale, exchange or other transfer of the nuclear powerplant to which it relates. If the transferee is a regulated public utility and meets certain other requirements, the transfer will be treated as a nontaxable transaction. No gain or loss will be recognized on the transfer of the qualified fund and the transferee will take the transferor's basis in the fund.[16] The transferee is required to obtain a new ruling amount from the IRS or accept a discretionary determination by the IRS.[17]

Nonqualified nuclear decommissioning funds

Federal and State regulators may require utilities to set aside funds for nuclear decommissioning costs in excess of the amount allowed as a deductible contribution to a qualified fund. In addition, taxpayers may have set aside funds prior to the effective date of the qualified fund rules.[18] The treatment of amounts set aside for decommissioning costs prior to 1984 varies. Some taxpayers may have received no tax benefit while others may have deducted such amounts or excluded such amounts from income. Since 1984, taxpayers have been required to include in gross income customer charges for decommissioning costs (sec. 88), and a deduction has not been allowed for amounts set aside to pay for decommissioning costs except through the use of a qualified fund. Income earned in a nonqualified fund is taxable to the fund's owner as it is earned.

[16] Treas. reg. sec. 1.468A-6.

[17] Treas. reg. sec. 1.468A-6(f).

[18] These funds are generally referred to as "nonqualified funds."

House Bill

Repeal of cost of service requirement

The House bill repeals the cost of service requirement for deductible contributions to a nuclear decommissioning fund. Thus, all taxpayers, including unregulated taxpayers, are allowed a deduction for amounts contributed to a qualified fund.

Permit contributions to a qualified fund for pre-1984 decommissioning costs

The House bill also repeals the limitation that a qualified fund only accumulate an amount sufficient to pay for a nuclear powerplant's decommissioning costs incurred during the period that the qualified fund is in existence (generally post-1984 decommissioning costs). Thus, any taxpayer is permitted to accumulate an amount sufficient to cover the present value of 100 percent of a nuclear powerplant's estimated decommissioning costs in a qualified fund. The House bill does not change the requirement that contributions to a qualified fund not be deducted more rapidly than level funding.

Exception to ruling amount for certain decommissioning costs

The House bill permits a taxpayer to make contributions to a qualified fund in excess of the ruling amount in one circumstance. Specifically, a taxpayer is permitted to contribute up to the present value of total nuclear decommissioning costs with respect to a nuclear powerplant previously excluded under section 468A(d)(2)(A).[19] It is anticipated that an amount that is permitted to be contributed under this special rule shall be determined using the estimate of total decommissioning costs used for purposes of determining the taxpayer's most recent ruling amount. Any amount transferred to the qualified fund under this special rule is allowed as a deduction over the remaining useful life of the nuclear powerplant.[20] If a qualified fund that has received amounts under this rule is transferred to another person, the transferor will be permitted a deduction for any remaining deductible amounts at the time of transfer.

Effective date.−The provision is effective for taxable years beginning after December 31, 2005.

[19] For example, if $100 is the present value of the total decommissioning costs of a nuclear powerplant, and if under present law the qualified fund is only permitted to accumulate $75 of decommissioning costs over such plant's estimated useful life (because the qualified fund was not in existence during 25 percent of the estimated useful life of the nuclear powerplant), a taxpayer could contribute $25 to the qualified fund under this component of the provision.

[20] A taxpayer recognizes no gain or loss on the contribution of property to a qualified fund under this special rule. The qualified fund will take a transferred (carryover) basis in such property. Correspondingly, a taxpayer's deduction (over the estimated life of the nuclear powerplant) is to be based on the adjusted tax basis of the property contributed rather than the fair market value of such property.

Senate Bill

No provision.

Conference Agreement

The conference agreement follows the House bill, with the following modification. The conference agreement requires that a taxpayer apply for a new ruling amount with respect to a nuclear powerplant in any tax year in which the powerplant is granted a license renewal, extending its useful life.

7. Arbitrage rules not to apply to prepayments for natural gas (sec. 1307 of the House bill, sec. 1327 of the conference agreement, and sec. 148 of the Code)

Present Law

Arbitrage restrictions

Interest on bonds issued by States or local governments to finance activities carried out or paid for by those entities generally is exempt from income tax. Restrictions are imposed on the ability of States or local governments to invest the proceeds of these bonds for profit (the "arbitrage restrictions").[21] One such restriction limits the use of bond proceeds to acquire "investment-type property." The term investment-type property includes the acquisition of property in a transaction involving a prepayment if a principal purpose of the prepayment is to receive an investment return from the time the prepayment is made until the time payment otherwise would be made. A prepayment can produce prohibited arbitrage profits when the discount received for prepaying the costs exceeds the yield on the tax-exempt bonds. In general, prohibited prepayments include all prepayments that are not customary in an industry by both beneficiaries of tax-exempt bonds and other persons using taxable financing for the same transaction.

On August 4, 2003, the Treasury Department issued final regulations deeming to be customary, and not in violation of the arbitrage rules, certain prepayments for natural gas and electricity.[22] Generally, a qualified prepayment under the regulations requires that 90 percent of the natural gas or electricity purchased with the prepayment be used for a qualifying use. Generally, natural gas is used for a qualifying use if it is to be (1) furnished to retail gas customers of the issuing municipal utility who are located in the natural gas service area of the issuing municipal utility, however, gas used to produce electricity for sale is not included under this provision (2) used by the issuing municipal utility to produce electricity that will be furnished to retail electric service area customers of the issuing utility, (3) used by the issuing municipal utility to produce electricity that will be sold to a utility owned by a governmental person and furnished to the service area retail electric customers of the purchaser, (4) sold to a

[21] Sec. 148.

[22] Treas. Reg. sec. 1.148-1(e)(2)(iii).

utility that is owned by a governmental person if the requirements of (1), (2) or (3) are satisfied by the purchasing utility (treating the purchaser as the issuing utility) or (5) used to fuel the pipeline transportation of the prepaid gas supply. Electricity is used for a qualifying use if it is to be (1) furnished to retail service area electric customers of the issuing municipal utility or (2) sold to a municipal utility and furnished to retail electric customers of the purchaser who are located in the electricity service area of the purchaser.

Private activity bond tests

State and local bonds may be classified as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or the debt is repaid with governmental funds. Private activity bonds are bonds where the State or local government serves as a conduit providing financing to private businesses or individuals. A bond will be treated as a private activity bond if more than five percent of the proceeds of the bond issue, or, if less, more than $5,000,000 is used (directly or indirectly) to make or finance loans to persons other than governmental units (the "private loan financing test") or if it meets the requirements of a two-part private business test.[23]

The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain purposes permitted by the Code. Section 141(d) of the Code provides that the term "private activity bond" includes any bond issued as part of an issue if the amount of the proceeds of the issue which are to be used (directly or indirectly) for the acquisition by a governmental unit of nongovernmental output property exceeds the lesser of five percent of such proceeds or $5 million. "Nongovernmental output property" generally means any property (or interest therein) which before such acquisition was used (or held for use) by a person other than a governmental unit in connection with an output facility (other than a facility for the furnishing of water). An exception applies to output property which is to be used in connection with an output facility 95 percent or more of the output of which will be consumed in (1) a qualified service area of the governmental unit acquiring the property, or (2) a qualified annexed area of such unit.

House Bill

In general

The House bill creates a safe harbor exception to the general rule that tax-exempt bond-financed prepayments violate the arbitrage restrictions. The term "investment type property" does not include a prepayment under a qualified natural gas supply contract. The provision also

[23] Sec. 141(b) and (c). Under the private business test, a bond is a private activity bond if it is part of an issue in which: (1) more than 10 percent of the proceeds of the issue (including use of the bond-financed property) are to be used in the trade or business of any person other than a governmental unit ("private business use"); and (2) more than 10 percent of the payment of principal or interest on the issue is, directly or indirectly, secured by (a) property used or to be used for a private business use or (b) to be derived from payments in respect of property, or borrowed money, used or to be used for a private business use ("private payment test").

provides that such prepayments are not treated as private loans for purposes of the private business tests.

Under the House bill, a prepayment financed with tax-exempt bond proceeds for the purpose of obtaining a supply of natural gas for service area customers of a governmental utility is not treated as the acquisition of investment-type property. A contract is a qualified natural gas contract if the volume of natural gas secured for any year covered by the prepayment does not exceed the sum of (1) the average annual natural gas purchased (other than for resale) by customers of the utility within the service area of the utility ("retail natural gas consumption") during the testing period, and (2) the amount of natural gas that is needed to fuel transportation of the natural gas to the governmental utility. The testing period is the 5-calendar-year period immediately preceding the calendar year in which the bonds are issued. A retail customer is one who does not purchase natural gas for resale. Natural gas used to generate electricity by a utility owned by a governmental unit is counted as retail natural gas consumption if the electricity was sold to retail customers within the service area of the governmental electric utility.

Adjustments

The volume of gas permitted by the general rule is reduced by natural gas otherwise available on the date of issuance. Specifically, the amount of natural gas permitted to be acquired under a qualified natural gas contract for any period is to be reduced by the applicable share of natural gas held by the utility on the date of issuance of the bonds and natural gas that the utility has a right to acquire for the prepayment period (determined as of the date of issuance). For purposes of the preceding sentence, "applicable share" means, with respect to any period, the natural gas allocable to such period if the gas were allocated ratably over the period to which the prepayment relates.

For purposes of the safe harbor, if after the close of the testing period and before the issue date of the bonds (1) the government utility enters into a contract to supply natural gas (other than for resale) for a commercial person for use at a property within the service area of such utility and (2) the gas consumption for such property was not included in the testing period or the ratable amount of natural gas to be supplied under the contract is significantly greater than the ratable amount of gas supplied to such property during the testing period, then the amount of gas permitted to be purchased may be increased to accommodate the contract.

The calculation of average annual retail natural gas consumption for purposes of the safe harbor, however, is not to exceed the annual amount of natural gas reasonably expected to be purchased (other than for resale) by persons who are located within the service area of such utility and who, as of the date of issuance of the issue, are customers of such utility.

Intentional acts

The safe harbor does not apply if the utility engages in intentional acts to render (1) the volume of natural gas covered by the prepayment to be in excess of that needed for retail natural gas consumption, and (2) the amount of natural gas that is needed to fuel transportation of the natural gas to the governmental utility.

Definition of service area

Service area is defined as (1) any area throughout which the governmental utility provided (at all times during the testing period) in the case of a natural gas utility, natural gas transmission or distribution services, or in the case of an electric utility, electricity distribution services; (2) limited areas contiguous to such areas, and (3) any area recognized as the service area of the governmental utility under State or Federal law. Contiguous areas are limited to any area within a county contiguous to the area described in (1) in which retail customers of the utility are located if such area is not also served by another utility providing the same service.

Ruling request for higher prepayment amounts

Upon written request, the Secretary may allow an issuer to prepay for an amount of gas greater than that allowed by the safe harbor based on objective evidence of growth in gas consumption or population that demonstrates that the amount permitted by the exception is insufficient.

Nongovernmental output property restrictions

A qualified natural gas supply contract as defined in the provision is not nongovernmental output property for purposes of subsection (d) of section 141. Subsection (d) of section 141 does not apply to prepayment contracts for natural gas or electricity that either under the Treasury regulations or statutory safe harbor are not investment-type property for purposes of the arbitrage rules under section 148. No inference is intended regarding the application of subsection 141(d) to prepayment contracts not covered by the statutory safe harbor or Treasury regulations.

Application to joint action agencies

In a number of States, joint action agencies serve as purchasing agents for their member municipal gas utilities. The provision is intended to allow municipal utilities in a State to participate in such buying arrangements as established under State law, subject to the same limitations that would apply if an individual utility were to purchase gas directly. When acting on behalf of its municipal gas utility members, the total amount of gas that can be purchased by a joint action agency under the provision’s exception to the arbitrage rules is the aggregate of what each such member could purchase for itself on a direct basis. Thus, with respect to qualified natural gas supply contracts entered into by joint action agencies for or on behalf of one or more member municipal utilities, the requirements of the safe harbor are tested at the individual municipal utility level based on the amount of gas that would be allocated to such member during any year covered by the contract.

Effective date.−The provision is effective for bonds issued after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

8. Determination of small refiner exception to oil depletion deduction (sec. 1308 of the House bill, sec. 1328 of the conference agreement, and sec. 613A of the Code)

Present Law

Present law classifies oil and gas producers as independent producers or integrated companies. The Code provides special tax rules for operations by independent producers. One such rule allows independent producers to claim percentage depletion deductions rather than deducting the costs of their asset, a producing well, based on actual production from the well (i.e., cost depletion).

A producer is an independent producer only if its refining and retail operations are relatively small. For example, an independent producer may not have refining operations the runs from which exceed 50,000 barrels on any day in the taxable year during which independent producer status is claimed.[24] A refinery run is the volume of inputs of crude oil (excluding any product derived from oil) into the refining stream.[25]

House Bill

The bill increases the current 50,000-barrel-per-day limitation to 75,000. In addition, the bill changes the refinery limitation on claiming independent producer status from a limit based on actual daily production to a limit based on average daily production for the taxable year. Accordingly, the average daily refinery runs for the taxable year may not exceed 75,000 barrels. For this purpose, the taxpayer calculates average daily refinery runs by dividing total refinery runs for the taxable year by the total number of days in the taxable year.

Effective date.−The provision is effective for taxable years ending after date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

[24] Sec. 613A(d)(4).

[25] Treas. Reg. sec. 1.613A-7(s).

9. Extension and modification of renewable electricity production credit (secs. 1501 - 1503 of the Senate amendment, secs. 1301 and 1302 of the conference agreement, and sec. 45 of the Code)

Present Law

In general

An income tax credit is allowed for the production of electricity from qualified facilities sold by the taxpayer to an unrelated person (sec. 45). Qualified facilities comprise wind energy facilities, closed-loop biomass facilities, open-loop biomass (including agricultural livestock waste nutrients) facilities, geothermal energy facilities, solar energy facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities. In addition, an income tax credit is allowed for the production of refined coal.

Credit amounts and credit period

In general

The base amount of the credit is 1.5 cents per kilowatt-hour (indexed for inflation) of electricity produced. The amount of the credit is 1.9 cents per kilowatt-hour for 2005. A taxpayer may claim credit for the 10-year period commencing with the date the qualified facility is placed in service. The credit is reduced for grants, tax-exempt bonds, subsidized energy financing, and other credits. The amount of credit a taxpayer may claim is phased out as the market price of electricity (or refined coal in the case of the refined coal production credit) exceeds certain threshold levels.

Reduced credit amounts and credit periods

In the case of open-loop biomass facilities (including agricultural livestock waste nutrient facilities), geothermal energy facilities, solar energy facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities, the 10-year credit period is reduced to five years commencing on the date the facility is placed in service. In general, for eligible pre-existing facilities and other facilities placed in service prior to January 1, 2005, the credit period commences on January 1, 2005. In the case of a closed-loop biomass facility modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, the credit period begins no earlier than October 22, 2004.

In the case of open-loop biomass facilities (including agricultural livestock waste nutrient facilities), small irrigation power facilities, landfill gas facilities, and trash combustion facilities, the otherwise allowable credit amount is 0.75 cent per kilowatt-hour, indexed for inflation measured after 1992 (currently 0.9 cents per kilowatt-hour for 2005).

Credit applicable to refined coal

The amount of the credit for refined coal is $4.375 per ton (also indexed for inflation after 1992 and equaling $5.481 per ton for 2005).

Other limitations on credit claimants and credit amounts

In general, in order to claim the credit, a taxpayer must own the qualified facility and sell the electricity produced by the facility (or refined coal in the case of the refined coal production credit) to an unrelated party. A lessee or operator may claim the credit in lieu of the owner of the qualifying facility in the case of qualifying open-loop biomass facilities originally placed in service on or before the date of enactment and in the case of a closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass. In the case of a poultry waste facility, the taxpayer may claim the credit as a lessee or operator of a facility owned by a governmental unit.

For all qualifying facilities, other than closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, the amount of credit a taxpayer may claim is reduced by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits, but the reduction cannot exceed 50 percent of the otherwise allowable credit. In the case of closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, there is no reduction in credit by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits.

The credit for electricity produced from renewable sources is a component of the general business credit (sec. 38(b)(8)). Generally, the general business credit for any taxable year may not exceed the amount by which the taxpayer's net income tax exceeds the greater of the tentative minimum tax or so much of the net regular tax liability as exceeds $25,000. Excess credits may be carried back one year and forward up to 20 years.

A taxpayer's tentative minimum tax is treated as being zero for purposes of determining the tax liability limitation with respect to the section 45 credit for electricity produced from a facility (placed in service after October 22, 2004) during the first four years of production beginning on the date the facility is placed in service.

Qualified facilities

Wind energy facility

A wind energy facility is a facility that uses wind to produce electricity. To be a qualified facility, a wind energy facility must be placed in service after December 31, 1993, and before January 1, 2006.

Closed-loop biomass facility

A closed-loop biomass facility is a facility that uses any organic material from a plant which is planted exclusively for the purpose of being used at a qualifying facility to produce electricity. In addition, a facility can be a closed-loop biomass facility if it is a facility that is modified to use closed-loop biomass to co-fire with coal, with other biomass, or with both coal and other biomass, but only if the modification is approved under the Biomass Power for Rural Development Programs or is part of a pilot project of the Commodity Credit Corporation.

To be a qualified facility, a closed-loop biomass facility must be placed in service after December 31, 1992, and before January 1, 2006. In the case of a facility using closed-loop biomass but also co-firing the closed-loop biomass with coal, other biomass, or coal and other biomass, a qualified facility must be originally placed in service and modified to co-fire the closed-loop biomass at any time before January 1, 2006.

Open-loop biomass (including agricultural livestock waste nutrients) facility

An open-loop biomass facility is a facility using open-loop biomass to produce electricity. Open-loop biomass is defined as (1) any agricultural livestock waste nutrients, or (2) any solid, nonhazardous, cellulosic or lignin waste material which is segregated from other waste materials and which is derived from certain forest-related resources, solid wood waste materials, or agricultural sources. Eligible forest-related resources are mill residues, other than spent chemicals from pulp manufacturing, precommercial thinnings, slash, and brush. Solid wood waste materials include waste pallets, crates, dunnage, manufacturing and construction wood wastes (other than pressure-treated, chemically-treated, or painted wood wastes), and landscape or right-of-way tree trimmings. Agricultural sources include orchard tree crops, vineyard, grain, legumes, sugar, and other crop by-products or residues. However, qualifying open-loop biomass does not include municipal solid waste (garbage), gas derived from biodegradation of solid waste, or paper that is commonly recycled. In addition, open-loop biomass does not include closed-loop biomass or any biomass burned in conjunction with fossil fuel (co-firing) beyond such fossil fuel required for start up and flame stabilization.

Agricultural livestock waste nutrients are defined as agricultural livestock manure and litter, including bedding material for the disposition of manure.

To be a qualified facility, an open-loop biomass facility must be placed in service after October 22, 2004 and before January 1, 2006, in the case of a facility using agricultural livestock waste nutrients and must be placed in service at any time prior to January 1, 2006 in the case of a facility using other open-loop biomass.

Geothermal facility

A geothermal facility is a facility that uses geothermal energy to produce electricity. Geothermal energy is energy derived from a geothermal deposit which is a geothermal reservoir consisting of natural heat which is stored in rocks or in an aqueous liquid or vapor (whether or not under pressure). To be a qualified facility, a geothermal facility must be placed in service after October 22, 2004 and before January 1, 2006.

Solar facility

A solar facility is a facility that uses solar energy to produce electricity. To be a qualified facility, a solar facility must be placed in service after October 22, 2004 and before January 1, 2006.

Small irrigation facility

A small irrigation power facility is a facility that generates electric power through an irrigation system canal or ditch without any dam or impoundment of water. The installed capacity of a qualified facility must be not less than 150 kilowatts but less than five megawatts. To be a qualified facility, a small irrigation facility must be originally placed in service after October 22, 2004 and before January 1, 2006.

Landfill gas facility

A landfill gas facility is a facility that uses landfill gas to produce electricity. Landfill gas is defined as methane gas derived from the biodegradation of municipal solid waste. To be a qualified facility, a landfill gas facility must be placed in service after October 22, 2004 and before January 1, 2006.

Trash combustion facility

Trash combustion facilities are facilities that burn municipal solid waste (garbage) to produce steam to drive a turbine for the production of electricity. To be a qualified facility, a trash combustion facility must be placed in service after October 22, 2004 and before January 1, 2006.

Refined coal facility

A qualifying refined coal facility is a facility producing refined coal that is placed in service after October 22, 2004 and before January 1, 2009. Refined coal is a qualifying liquid, gaseous, or solid synthetic fuel produced from coal (including lignite) or high-carbon fly ash, including such fuel used as a feedstock. A qualifying fuel is a fuel that when burned emits 20 percent less nitrogen oxides and either SO_2 or mercury than the burning of feedstock coal or comparable coal predominantly available in the marketplace as of January 1, 2003, and if the fuel sells at prices at least 50 percent greater than the prices of the feedstock coal or comparable coal. In addition, to be qualified refined coal the fuel must be sold by the taxpayer with the reasonable expectation that it will be used for the primary purpose of producing steam.

Summary of credit rate and credit period by facility type

Table 1.–Summary of Section 45 Credit for Electricity Produced from Certain Renewable Resources and Refined Coal

Electricity produced from renewable resources	Credit amount for 2005 (cents per kilowatt-hour; dollars per ton)	Credit period (years from placed-in-service date)[1]
Wind	1.9	10
Closed-loop biomass	1.9	10
Open-loop biomass (including agricultural livestock waste nutrient facilities)	0.9	5
Geothermal	1.9	5
Solar	1.9	5
Small irrigation power	0.9	5
Municipal solid waste (including landfill gas facilities and trash combustion facilities)	0.9	5
Refined Coal	**5.481**	**10**

[1] For eligible pre-existing facilities and other facilities placed in service prior to January 1, 2005, the credit period commences on January 1, 2005. In the case of certain co-firing closed-loop facilities, the credit period begins no earlier than October 22, 2004.

Taxation of cooperatives and their patrons

For Federal income tax purposes, a cooperative generally computes its income as if it were a taxable corporation, with one exception--the cooperative may exclude from its taxable income distributions of patronage dividends. Generally, cooperatives that are subject to the cooperative tax rules of subchapter T of the Code[26] are permitted a deduction for patronage dividends from their taxable income only to the extent of net income that is derived from transactions with patrons who are members of the cooperative.[27] The availability of such deductions from taxable income has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative. Present law does not permit cooperatives to pass any portion of the income tax credit for electricity production through to their patrons.

[26] Sec. 1381, et seq.

[27] Sec. 1382.

House Bill

No provision.

Senate Amendment

Extension of placed-in-service date for qualifying facilities

The provision extends the placed-in-service date by three years (through December 31, 2008) for the following qualifying facilities: wind facilities; closed-loop biomass facilities (including a facility co-firing the closed-loop biomass with coal, other biomass, or coal and other biomass); open-loop biomass facilities; geothermal facilities; small irrigation power facilities; landfill gas facilities; and trash combustion facilities. The proposal does not extend the terminating placed-in-service date for solar facilities (December 31, 2005) or refined coal facilities (December 31, 2008).

New qualifying energy resources

The provision adds three new qualifying energy resources: fuel cells; hydropower; and wave, current, tidal, and ocean thermal energy.

Fuel cells

A qualifying fuel cell facility is an integrated system composed of a fuel cell stack assembly and associated balance of plant components that converts a fuel into electricity using electrochemical means. A qualifying facility must have an electricity-only generation efficiency of greater than 30 percent, generate at least 0.5 megawatt of electricity, and be placed in service after December 31, 2005 and before January 1, 2009.[28]

Hydropower

A qualifying hydropower facility is (1) a facility that produced hydroelectric power (a hydroelectric dam) prior to the date of enactment at which efficiency improvements or additions to capacity have been made after the date of enactment and before January 1, 2009, that enable the taxpayer to produce incremental hydropower or (2) a facility placed in service before the date of enactment that did not produce hydroelectric power (a nonhydroelectric dam) on the date of enactment and to which turbines or other electricity generating equipment have been added after the date of enactment and before January 1, 2009.

At an existing hydroelectric facility, the taxpayer may only claim credit for the production of incremental hydroelectric power. Incremental hydroelectric power for any taxable year is equal to the percentage of average annual hydroelectric power produced at the facility attributable to the efficiency improvement or additions of capacity determined by using the same

[28] A qualifying fuel cell facility does not include any property for which credit was claimed under section 48.

water flow information used to determine an historic average annual hydroelectric power production baseline for that facility. The Federal Energy Regulatory Commission will certify the baseline power production of the facility and the percentage increase due to the efficiency and capacity improvements.

At a nonhydroelectric dam, the facility must be licensed by the Federal Energy Regulatory Commission and meet all other applicable environmental, licensing, and regulatory requirements and the turbines or other generating devices are added to the facility after the date of enactment and before January 1, 2009. In addition there must not be any enlargement of the diversion structure, or construction or enlargement of a bypass channel, or the impoundment or any withholding of additional water from the natural stream channel.

In the case of electricity generated from a qualifying hydropower facility, the taxpayer may claim a credit equal to one-half the otherwise allowable amount.

Wave, current, tidal, and ocean thermal energy

A qualifying wave, current, tidal, and ocean thermal energy facility is a facility placed in service after the date of enactment and before January 1, 2009 that uses free flowing ocean water derived from tidal currents, ocean currents, waves, or estuary currents, ocean thermal energy, or free flowing water in rivers, lakes, man-made channels , or streams to produce electricity. However, a qualifying facility does not include any facility that includes impoundment structures or a small irrigation power facility.

Equalization of credit period for all qualifying renewable resources

The provision extends the credit period from five years to 10 years for electricity produced from qualifying open-loop biomass facilities (including agricultural livestock waste nutrient facilities), geothermal facilities, solar facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities placed in service after the date of enactment. The provision also provides that for electricity produced from the energy resources newly qualified under the bill - fuel cells, hydropower, and wave, current, tidal, and ocean thermal energy - the credit period is 10 years.

Clarification of units added to pre-existing trash combustion facilities

The provision clarifies that a qualifying trash combustion facility includes a new unit, placed in service after October 22, 2004, that increases electricity production capacity at an existing trash combustion facility. A new unit generally would include a new burner/boiler and turbine. The new unit may share certain common equipment, such as trash handling equipment, with other pre-existing units at the same facility. Electricity produced at a new unit of an existing facility qualifies for the production credit only to the extent of the increased amount of electricity produced at the entire facility.

Taxation of cooperatives and their patrons

The Senate amendment allows eligible cooperatives to elect to pass any portion of the credit through to their patrons. An eligible cooperative is defined as a cooperative organization that is owned more than 50 percent by agricultural producers or entities owned by agricultural producers.

Under the Senate amendment, the credit may be apportioned among patrons eligible to share in patronage dividends on the basis of the quantity or value of business done with or for such patrons for the taxable year. The election must be made on a timely filed return for the taxable year, and once made, is irrevocable for such taxable year.

The amount of the credit apportioned to patrons is not included in the organization's credit for the taxable year of the organization. The amount of the credit apportioned to a patron is included in the taxable year the patron with or within which the taxable year of the organization ends. If the amount of the credit for any taxable year is less than the amount of the credit shown on the cooperative's return for such taxable year, an amount equal to the excess of the reduction in the credit over the amount not apportioned to patrons for the taxable year is treated as an increase in the cooperative's tax. The increase is not treated as tax imposed for purposes of determining the amount of any tax credit.

Effective date.−The provision generally is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment with modifications.

Extension of placed-in-service date for qualifying facilities

The conference agreement extends the placed-in-service date by two years (through December 31, 2007) for the following qualifying facilities: wind facilities; closed-loop biomass facilities (including a facility co-firing the closed-loop biomass with coal, other biomass, or coal and other biomass); open-loop biomass facilities; geothermal facilities; small irrigation power facilities; landfill gas facilities; and trash combustion facilities. The conference agreement does not alter the terminating placed-in-service date for solar facilities (December 31, 2005) or refined coal facilities (December 31, 2008).

New qualifying energy resources

The conference agreement adds two new qualifying energy resources: hydropower; and Indian coal.

Hydropower

The conference agreement follows the Senate amendment with respect to hydropower.

Indian coal

The conference agreement adds Indian coal as a new energy source. The taxpayer may claim a credit for sales of coal to an unrelated third party from a qualified facility for the seven-year period beginning on January 1, 2006, and ending after December 31, 2012. The value of the credit is $1.50 per ton for the first four years of the seven-year period and $2.00 per ton for the last three years of the seven-year period. The credit amounts are indexed for inflation. A qualified Indian coal facility is a facility that produces coal from reserves that on June 14, 2005, were owned by a Federally recognized tribe of Indians or were held in trust by the United States for a tribe or its members.

Equalization of credit period for all qualifying renewable resources

The conference agreement follows the Senate amendment with respect to equalization of the credit period for qualifying open-loop biomass facilities (including agricultural livestock waste nutrient facilities), geothermal facilities, solar facilities, small irrigation power facilities, landfill gas facilities, trash combustion facilities, and hydropower facilities. The conference agreement provides a seven-year credit period for Indian coal facilities, as explained above.

Clarification of units added to pre-existing trash combustion facilities

The conference agreement follows the Senate amendment with respect to clarification of units added to pre-existing trash combustion facilities.

Taxation of cooperatives and their patrons

The conference agreement follows the Senate amendment with respect to the taxation of cooperatives and their patrons.

Effective date.−The provision generally is effective on the date of enactment. With respect to the taxation of cooperatives and their patrons, the provision applies to taxable years ending after the date of enactment.

10. Clean renewable energy bonds (sec. 1504 of the Senate amendment, sec. 1303 of the conference agreement, and new sec. 54 of the Code)

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. Subject to certain restrictions, activities that can be financed with these tax-exempt bonds include electric power facilities (i.e., generation, transmission, distribution, and retailing).

Generally, 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. 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 2005, the State volume cap is the greater of $80 per resident or $239 million. The Code imposes several additional restrictions on tax-exempt private activity bonds that do not apply to bonds for governmental activities.

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[29] 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.[30] 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 in order for a bond issue to be tax-exempt.[31] 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.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments may issue "qualified zone academy bonds."[32] "Qualified zone academy bonds" are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds. A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community designated under the Code, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

Financial institutions that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate multiplied by the face amount of the bond. The Treasury Department sets the credit rate at a rate estimated to allow issuance of

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

[30] Sec. 148.

[31] Sec. 149(e).

[32] Sec. 1397E.

qualified zone academy bonds without discount and without interest cost to the issuer. The credit is includable in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and AMT liability. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond.

There is an annual limitation of $400 million on the amount of qualified zone academy bonds that may be issued in calendar years 1998 through 2005. The $400 million aggregate bond cap is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

Tax credits for production of electricity from renewable sources

An income tax credit is allowed for the production of electricity from qualified facilities sold by the taxpayer to an unrelated person.[33] The base amount of the credit is 1.5 cents per kilowatt-hour (indexed for inflation) of electricity produced. The amount of the credit is 1.9 cents per kilowatt-hour for 2005. A taxpayer may claim credit for the 10-year period commencing with the date the qualified facility is placed in service. The credit is reduced for grants, tax-exempt bonds, subsidized energy financing, and other credits. The amount of credit a taxpayer may claim is phased out as the market price of electricity (or refined coal in the case of or refined coal production credit) exceeds certain threshold levels.

Qualified facilities comprise wind energy facilities, closed-loop biomass facilities, open-loop biomass (including agricultural livestock waste nutrients) facilities, geothermal energy facilities, solar energy facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities. In addition, an income tax credit is allowed for the production of refined coal.

For purposes of the credit, qualified facilities must be placed in service by certain dates. However, with the exception of qualifying refined coal facilities, in no event may qualifying facilities be placed in service after December 31, 2005.

House Bill

No provision.

Senate Amendment

The provision creates a new category of tax credit bonds: 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 facilities that qualify for the tax

[33] Sec. 45.

credit under section 45 ("qualified projects"), without regard to the placed-in-service date requirements of that section.

Like qualified zone academy bonds, CREBs are not interest-bearing obligations. Rather, the taxpayer holding CREBs on a credit allowance date would be 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 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.

The provision also imposes a maximum maturity limitation on any CREBs. 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. Moreover, the provision requires level amortization of CREBs during the period such bonds are outstanding.

For purposes of the provision, "qualified issuers" include (1) governmental bodies (including Indian tribal governments); (2) the Tennessee Valley Authority; (3) 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 (4) clean energy bond lenders. A clean 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. The term "qualified borrower" includes a governmental body, the Tennessee Valley Authority, and a mutual or cooperative electric company.

Under the provision, CREBs are subject to the arbitrage requirements of section 148 that apply to traditional tax-exempt bonds. Principles under section 148 and the regulations thereunder shall apply for purposes of determining the yield restriction and arbitrage rebate requirements applicable to CREBs. For example, for arbitrage purposes, the yield on an issue of CREBs is computed by taking into account all payments of interest, if any, on such bonds, i.e., whether the bonds are issued at par, premium, or discount. However, for purposes of determining yield, the amount of the credit allowed to a taxpayer holding CREBs is not treated as interest, although such credit amount is treated as interest income to the taxpayer.

In addition, to qualify as CREBs, the qualified issuer must reasonably expect to and actually spend 95 percent or more of the proceeds of such bonds 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 any "nonqualified bonds." For these purposes, the amount of nonqualified bonds is to be determined in the same manner as Treasury regulations under section

142.[34] In addition, the provision provides that the five-year spending period may be extended by the Secretary upon the qualified issuer's request.

Unlike qualified zone academy bonds, the provision requires issuers of CREBs to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds. Under the provision, there is a national limitation of $1 billion of CREBs that the Secretary may allocate, in the aggregate, to qualified projects. The authority to issue CREBs expires December 31, 2008.

Effective date.−The provision is effective for bonds issued after December 31, 2005.

Conference Agreement

The conference agreement follows the Senate amendment with modifications. Under the conference agreement, 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 energy bond lenders. The term "qualified borrower" includes a governmental body (including an Indian tribal government) and a mutual or cooperative electric company.

Under the conference agreement, there is a national limitation of $800 million of CREBs that the Secretary may allocate, in the aggregate, to qualified projects. Qualified projects are any "qualified facilities" within the meaning of section 45 (without regard to the placed-in-service date requirements of that section), other than Indian coal production facilities. In addition, the conference agreement provides that the authority to issue CREBs expires December 31, 2007. However, the Secretary shall not allocate more than $500 million of CREBs to finance qualified projects for qualified borrowers that are governmental bodies (as defined under the conference agreement).

11. Treatment of income of certain electric cooperatives (sec. 1505 of the Senate amendment, sec. 1304 of the conference agreement, and sec. 501(c)(12) of the Code)

Present Law

In general

Under present law, an entity must be operated on a cooperative basis in order to be treated as a cooperative for Federal income tax purposes. Although not defined by statute or regulation, the two principal criteria for determining whether an entity is operating on a cooperative basis are: (1) ownership of the cooperative by persons who patronize the cooperative; and (2) return of earnings to patrons in proportion to their patronage. The Internal Revenue Service requires that cooperatives must operate under the following principles: (1) subordination of capital in control over the cooperative undertaking and in ownership of the

[34] Treas. Reg. sec. 1.142-2(e).

financial benefits from ownership; (2) democratic control by the members of the cooperative; (3) vesting in and allocation among the members of all excess of operating revenues over the expenses incurred to generate revenues in proportion to their participation in the cooperative (patronage); and (4) operation at cost (not operating for profit or below cost).[35]

In general, cooperative members are those who participate in the management of the cooperative and who share in patronage capital. As described below, income from the sale of electric energy by an electric cooperative may be member or non-member income to the cooperative, depending on the membership status of the purchaser. A municipal corporation may be a member of a cooperative.

For Federal income tax purposes, a cooperative generally computes its income as if it were a taxable corporation, with one exception--the cooperative may exclude from its taxable income distributions of patronage dividends. In general, patronage dividends are the profits of the cooperative that are rebated to its patrons pursuant to a pre-existing obligation of the cooperative to do so. The rebate must be made in some equitable fashion on the basis of the quantity or value of business done with the cooperative.

Except for tax-exempt farmers' cooperatives, cooperatives that are subject to the cooperative tax rules of subchapter T of the Code[36] are permitted a deduction for patronage dividends from their taxable income only to the extent of net income that is derived from transactions with patrons who are members of the cooperative.[37] The availability of such deductions from taxable income has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative.

Cooperatives that qualify as tax-exempt farmers' cooperatives are permitted to exclude patronage dividends from their taxable income to the extent of all net income, including net income that is derived from transactions with patrons who are not members of the cooperative, provided the value of transactions with patrons who are not members of the cooperative does not exceed the value of transactions with patrons who are members of the cooperative.[38]

Taxation of electric cooperatives exempt from subchapter T

In general, the cooperative tax rules of subchapter T apply to any corporation operating on a cooperative basis (except mutual savings banks, insurance companies, other tax-exempt organizations, and certain utilities), including tax-exempt farmers' cooperatives (described in

[35] Announcement 96-24, "Proposed Examination Guidelines Regarding Rural Electric Cooperatives," 1996-16 *I.R.B.* 35.

[36] Sec. 1381, et seq.

[37] Sec. 1382.

[38] Sec. 521.

sec. 521(b)). However, subchapter T does not apply to an organization that is "engaged in furnishing electric energy, or providing telephone service, to persons in rural areas."[39] Instead, electric cooperatives are taxed under rules that were generally applicable to cooperatives prior to the enactment of subchapter T in 1962. Under these rules, an electric cooperative can exclude patronage dividends from taxable income to the extent of all net income of the cooperative, including net income derived from transactions with patrons who are not members of the cooperative.[40]

Tax exemption of rural electric cooperatives

Section 501(c)(12) provides an income tax exemption for rural electric cooperatives if at least 85 percent of the cooperative's income consists of amounts collected from members for the sole purpose of meeting losses and expenses of providing service to its members. The IRS takes the position that rural electric cooperatives also must comply with the fundamental cooperative principles described above in order to qualify for tax exemption under section 501(c)(12).[41] The 85-percent test is determined without taking into account any income from: (1) qualified pole rentals; (2) open access electric energy transmission services; (3) open access electric energy distribution services; (4) any nuclear decommissioning transaction; (5) any asset exchange or conversion transaction.[42]

Income from open access transactions

Income received or accrued by a rural electric cooperative (other than income received or accrued directly or indirectly from a member of the cooperative) from the provision or sale of electric energy transmission services or ancillary services on a nondiscriminatory open access basis under an open access transmission tariff approved or accepted by FERC or under an independent transmission provider agreement approved or accepted by FERC (including an agreement providing for the transfer of control−but not ownership−of transmission facilities) is excluded in determining whether a rural electric cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12).

In addition, income is excluded for purposes of the 85-percent test if it is received or accrued by a rural electric cooperative (other than income received or accrued directly or indirectly from a member of the cooperative) from the provision or sale of electric energy distribution services or ancillary services, provided such services are provided on a nondiscriminatory open access basis to distribute electric energy not owned by the cooperative: (1) to end-users who are served by distribution facilities not owned by the cooperative or any of its members; or (2) generated by a generation facility that is not owned or leased by the

[39] Sec. 1381(a)(2)(C)

[40] See Rev. Rul. 83-135, 1983-2 C.B. 149.

[41] Rev. Rul. 72-36, 1972-1 C.B. 151.

[42] Sec. 501(c)(12)(C).

cooperative or any of its members and that is directly connected to distribution facilities owned by the cooperative or any of its members.

The exclusion for income from open access transactions does not apply to taxable years beginning after December 31, 2006.

Income from nuclear decommissioning transactions

Income received or accrued by a rural electric cooperative from any "nuclear decommissioning transaction" also is excluded in determining whether a rural electric cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12). The term "nuclear decommissioning transaction" is defined as—

1. any transfer into a trust, fund, or instrument established to pay any nuclear decommissioning costs if the transfer is in connection with the transfer of the cooperative's interest in a nuclear powerplant or nuclear powerplant unit;

2. any distribution from a trust, fund, or instrument established to pay any nuclear decommissioning costs; or

3. any earnings from a trust, fund, or instrument established to pay any nuclear decommissioning costs.

The exclusion for income from nuclear decommissioning transactions does not apply to taxable years beginning after December 31, 2006.

Income from asset exchange or conversion transactions

Gain realized by a tax-exempt rural electric cooperative from a voluntary exchange or involuntary conversion of certain property is excluded in determining whether a rural electric cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12). This provision only applies to the extent that: (1) the gain would qualify for deferred recognition under section 1031 (relating to exchanges of property held for productive use or investment) or section 1033 (relating to involuntary conversions); and (2) the replacement property that is acquired by the cooperative pursuant to section 1031 or section 1033 (as the case may be) constitutes property that is used, or to be used, for the purpose of generating, transmitting, distributing, or selling electricity or natural gas.

The exclusion for income from asset exchange or conversion transactions does not apply to taxable years beginning after December 31, 2006.

Treatment of income from load loss transactions

Tax-exempt rural electric cooperatives

Under present law, income received or accrued by a tax-exempt rural electric cooperative from a "load loss transaction" is treated under section 501(c)(12) as income collected from members for the sole purpose of meeting losses and expenses of providing service to its members.[43] Therefore, income from load loss transactions is treated as member income in determining whether a rural electric cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12). In addition, income from load loss transactions does not cause a tax-exempt electric cooperative to fail to be treated for Federal income tax purposes as a mutual or cooperative company under the fundamental cooperative principles described above.

The term "load loss transaction" is generally defined as any wholesale or retail sale of electric energy (other than to a member of the cooperative) to the extent that the aggregate amount of such sales during a seven-year period beginning with the "start-up year" does not exceed the reduction in the amount of sales of electric energy during such period by the cooperative to members. The "start-up year" is defined as the first year that the cooperative offers nondiscriminatory open access or, if later and at the election of the cooperative, 2004.

Present law also excludes income received or accrued by rural electric cooperatives from load loss transactions from the tax on unrelated trade or business income.

The special rule for income received or accrued by a tax-exempt rural electric cooperative from a load loss transaction does not apply to taxable years beginning after December 31, 2006.

Taxable electric cooperatives

The receipt or accrual of income from load loss transactions by taxable electric cooperatives is treated as income from patrons who are members of the cooperative.[44] Thus, income from a load loss transaction is excludible from the taxable income of a taxable electric cooperative if the cooperative distributes such income pursuant to a pre-existing contract to distribute the income to a patron who is not a member of the cooperative. In addition, income from load loss transactions does not cause a taxable electric cooperative to fail to be treated for Federal income tax purposes as a mutual or cooperative company under the fundamental cooperative principles described above.

The special rule for income received or accrued by a taxable electric cooperative from a load loss transaction does not apply to taxable years beginning after December 31, 2006.

House Bill

No provision.

Senate Amendment

The Senate amendment eliminates the sunset date for the rules excluding income received or accrued by tax-exempt rural electric cooperatives from open access electric energy

[43] Sec. 501(c)(12)(H).

[44] Sec. 501(c)(12)(H).

transmission or distribution services, any nuclear decommissioning transaction, and any asset exchange or conversion transaction for purposes of the 85-percent test under section 501(c)(12). The provision also eliminates the sunset date for the rule that allows income from load loss transactions to be treated as member income in determining whether a rural electric cooperative satisfies the 85-percent test. In addition, the provision eliminates the sunset date for the rule that permits taxable electric cooperatives to treat the receipt or accrual of income from load loss transactions as income from patrons who are members of the cooperative.

Effective date.−The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

12. Dispositions of transmission property to implement FERC restructuring policy (sec. 1506 of the Senate amendment, sec. 1305 of the conference agreement, and sec. 451 of the Code)

Present Law

Generally, a taxpayer selling property recognizes gain to the extent the sales price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

One such special tax provision permits taxpayers to elect to recognize gain from qualifying electric transmission transactions ratably over an eight-year period beginning in the year of sale if the amount realized from such sale is used to purchase exempt utility property within the applicable period[45] (the "reinvestment property"). If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain is recognized to the extent of such excess in the year of the qualifying electric transmission transaction.

A qualifying electric transmission transaction is the sale or other disposition of property used by the taxpayer in the trade or business of providing electric transmission services, or an ownership interest in such an entity, to an independent transmission company prior to January 1, 2007. In general, an independent transmission company is defined as: (1) an independent transmission provider[46] approved by the FERC; (2) a person (i) who the FERC determines under section 203 of the Federal Power Act (or by declaratory order) is not a "market participant" and (ii) whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider before the close of the period specified in such authorization,

[45] The applicable period for a taxpayer to reinvest the proceeds is four years after the close of the taxable year in which the qualifying electric transmission transaction occurs.

[46] For example, a regional transmission organization, an independent system operator, or an independent transmission company.

but not later than January 1, 2007; or (3) in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, (i) a person which is approved by that Commission as consistent with Texas State law regarding an independent transmission organization, or (ii) a political subdivision, or affiliate thereof, whose transmission facilities are under the operational control of an organization described in (i).

Exempt utility property is defined as: (1) property used in the trade or business of generating, transmitting, distributing, or selling electricity or producing, transmitting, distributing, or selling natural gas, or (2) stock in a controlled corporation whose principal trade or business consists of the activities described in (1).

If a taxpayer is a member of an affiliated group of corporations filing a consolidated return, the reinvestment property may be purchased by any member of the affiliated group (in lieu of the taxpayer).

House Bill

No provision.

Senate Amendment

The Senate amendment provision extends the treatment under the present-law deferral provision to sales or dispositions to an independent transmission company prior to January 1, 2008.

Effective date.−The Senate amendment provision is effective for transactions occurring after the date of enactment. However, because the provision is an extension of a present law provision which expires on December 31, 2006, only transactions occurring after December 31, 2006 and prior to January 1, 2008 will be affected.

Conference Agreement

The conference agreement follows the Senate amendment.

13. Credit for production from advanced nuclear power facilities (sec. 1507 of the Senate amendment, sec. 1306 of the conference agreement, and new sec. 45J of the Code)

Present Law

An income tax credit is allowed for production of electricity from qualified facilities sold by the taxpayer to an unrelated person (sec. 45). Qualified facilities comprise wind energy facilities, “closed-loop” biomass facilities, open-loop biomass (including agricultural livestock waste nutrients) facilities, geothermal energy facilities, solar energy facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities. The base amount of the credit is 1.5 cents per kilowatt-hour (indexed for inflation) of electricity produced. The amount of the credit is 1.9 cents per kilowatt-hour for 2005. However, electricity produced at open-loop biomass, small irrigation power, and municipal solid waste facilities receives only 50 percent of the credit, or 0.9 cents per kilowatt-hour for 2005. Generally, wind and closed-loop biomass facilities may claim this credit for 10 years from the placed-in-service date of the facility. Other qualified facilities may claim the credit for only five years from the placed-in-service date.

Present law does not provide a credit for electricity produced at advanced nuclear power facilities.

House Bill

No provision.

Senate Amendment

The provision permits a taxpayer producing electricity at a qualifying advanced nuclear power facility to claim a credit equal to 1.8 cents per kilowatt-hour of electricity produced for the eight-year period starting when the facility is placed in service.[47] The aggregate amount of credit that a taxpayer may claim in any year during the eight-year period is subject to limitation based on allocated capacity and an annual limitation as described below.

A qualifying advanced nuclear facility is an advanced nuclear facility for which the taxpayer has received an allocation of megawatt capacity from the Secretary and is placed in service before January 1, 2021. The taxpayer may only claim credit for production of electricity equal to the ratio of the allocated capacity that the taxpayer receives from the Secretary to the rated nameplate capacity of the taxpayer's facility. For example, if the taxpayer receives an allocation of 750 megawatts of capacity from the Secretary and the taxpayer's facility has a rated nameplate capacity of 1,000 megawatts, then the taxpayer may claim three-quarters of the otherwise allowable credit, or 1.35 cents per kilowatt-hour, for each kilowatt-hour of electricity produced at the facility (subject to the annual limitation described below). The Secretary may allocate up to 6,000 megawatts of capacity.

A taxpayer operating a qualified facility may claim no more than $125 million in tax credits per 1,000 megawatts of allocated capacity in any one year of the eight-year credit period. If the taxpayer operates a 1,350 megawatt rated nameplate capacity system and has received an allocation from the Secretary for 1,350 megawatts of capacity eligible for the credit, the taxpayer's annual limitation on credits that may be claimed is equal to 1.35 times $125 million, or $168.75 million. If the taxpayer operates a facility with a nameplate rated capacity of 1,350 megawatts, but has received an allocation from the Secretary for 750 megawatts of credit eligible capacity, then the two limitations apply such that the taxpayer may claim a credit equal to 1.35 cents per kilowatt-hour of electricity produced (as described above) subject to an annual credit limitation of $93.75 million in credits (three-quarters of $125 million).

[47] The 1.8-cents credit amount is reduced, but not below zero, if the annual average contract price per kilowatt-hour of electricity generated from advanced nuclear power facilities in the preceding year exceeds eight cents per kilowatt-hour. The eight-cent price comparison level is indexed for inflation after 1992.

An advanced nuclear facility is any nuclear facility for the production of electricity, the reactor design for which was approved after 1993 by the Nuclear Regulatory Commission. For this purpose, a qualifying advanced nuclear facility does not include any facility for which a substantially similar design for a facility of comparable capacity was approved before 1994.

In addition, the credit allowable to the taxpayer is reduced by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits, but such reduction cannot exceed 50 percent of the otherwise allowable credit. The credit is treated as part of the general business credit.

Effective date.−The provision applies to electricity produced in taxable years beginning after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

14. Credit for investment in clean coal facilities (sec. 1508 of the Senate amendment, sec. 1307 of the conference agreement, and new secs. 48A and 48B of the Code)

Present Law

Present law does not provide an investment credit for electricity production facilities property that uses coal as a fuel or for the gasification of coal or other materials. However, a nonrefundable, 10-percent investment tax credit ("energy credit") is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) that is used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage (sec. 48). The energy credit is a component of the general business credit (sec. 38(b)(1)).

House Bill

No provision.

Senate Amendment

The provision creates two new 20-percent investment tax credits. Both credits are available only to projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. Certifications are issued using a competitive bidding process.

With respect to the first investment tax credit, the provision establishes a 10-year program to produce 7,500 megawatts of power generation capacity using integrated gasification combined cycle ("IGCC") and other advanced coal-based electricity generation technologies. Qualified projects must be economically feasible and use the appropriate clean coal technologies. The Secretary of Treasury, in consultation with the Secretary of Energy, must allocate up to 4,125 megawatts of power generation capacity to credit-eligible projects using IGCC technology.

The remaining 3,375 megawatts of power generation capacity must be allocated to credit-eligible projects that use other advanced coal-based technologies.

In determining which projects to certify that use IGCC technology, the Secretary must allocate power generation capacity in relatively equal amounts to projects that use bituminous coal, subbituminous coal, and lignite as primary feedstock. In addition, the Secretary must give high priority to projects which include greenhouse gas capture capability, increased by-product utilization, and other benefits.

With respect to the second investment tax credit, the provision authorizes the certification of certain gasification projects. Qualified gasification projects convert coal, petroleum residue, biomass, or other materials recovered for their energy or feedstock value into a synthesis gas composed primarily of carbon monoxide and hydrogen for direct use or subsequent chemical or physical conversion. Under the provision, certified gasification projects are eligible for the new 20 percent investment tax credit. The total qualified investment which may be certified as eligible for credit under the gasification program may not exceed $4 billion. In addition, the Secretary may certify a maximum of $1 billion in qualified investment as eligible for credit with respect to any single project.

Effective date.− The credits apply to periods after the date of enactment, under rules similar to the rules of section 48(m) (as in effect before its repeal).

Conference Agreement

The conference agreement follows the Senate amendment with modifications. Under the conference agreement, the Secretary may allocate investment credits for projects using IGCC and other advanced coal-based technologies based on the amount invested, rather than on megawatts of power generation capacity. The Secretary may allocate $800 million of credits to IGCC projects and $500 million of credits to projects using other advanced coal-based technologies.

Under the agreement, the credit available to IGCC projects remains 20 percent of qualified investments; however, the credit for other advanced coal-based projects is reduced to 15 percent of qualified investments. With respect to IGCC projects, the conference agreement narrows the definition of credit-eligible investments to include only investments in property associated with the gasification of coal, including any coal handling and gas separation equipment. Thus, investments in equipment that could operate by drawing fuel directly from a natural gas pipeline do not qualify for the credit.

The conference agreement retains the 20 percent investment credit for certified gasification projects. The agreement, however, reduces the total amount of gasification credits allocable by the Secretary to $350 million. A maximum of $650 million of credit-eligible investment may be allocated to any single gasification project. The conference agreement also clarifies that only property which is part of a qualifying gasification project and necessary for the gasification technology of such project is eligible for the gasification credit.

15. Clean energy coal bonds (sec. 1509 of the Senate amendment)

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. Subject to certain restrictions, activities that can be financed with these tax-exempt bonds include electric power facilities (i.e., generation, transmission, distribution, and retailing).

Generally, 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. 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 2005, the State volume cap is the greater of $80 per resident or $239 million. The Code imposes several additional restrictions on tax-exempt private activity bonds that do not apply to bonds for governmental activities.

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[48] 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.[49] 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 in order for a bond issue to be tax-exempt.[50] 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.

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

[49] Sec. 148.

[50] Sec. 149(e).

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments may issue "qualified zone academy bonds."[51] "Qualified zone academy bonds" are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds. A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community designated under the Code, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

Financial institutions that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate multiplied by the face amount of the bond. The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer. The credit is includable in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and AMT liability. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond.

There is an annual limitation of $400 million on the amount of qualified zone academy bonds that may be issued in calendar years 1998 through 2005. The $400 million aggregate bond cap is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

House Bill

No provision.

Senate Amendment

The provision creates a new category of tax credit bonds: Clean Energy Coal Bonds ("ClECos"). ClECos 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 "certified coal property."

[51] Sec. 1397E.

Certified coal property is defined as any property that is part of a qualifying advanced coal project certified by the Secretary.

Like qualified zone academy bonds, ClECos are not interest-bearing obligations. Rather, the taxpayer holding a ClECos on a credit allowance date would be 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 ClECos 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.

For purposes of the provision, "qualified issuers" include (1) governmental bodies; (2) the Tennessee Valley Authority; (3) 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 (4) clean energy bond lenders. A clean 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. The term "qualified borrower" includes a governmental body, the Tennessee Valley Authority, and a mutual or cooperative electric company.

Under the provision, ClECos are subject to the arbitrage requirements of section 148 that apply to traditional tax-exempt bonds. In addition, to qualify as ClECos, the qualified issuer must reasonably expect to and actually spend 95 percent or more of the proceeds of such bonds on certified coal property 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 ClECos if unspent proceeds are used within 90 days from the end of such five-year period to redeem any "nonqualified bonds." For these purposes, the amount of nonqualified bonds is to be determined in the same manner as Treasury regulations under section 142.[52] In addition, the provision provides that the five-year spending period may be extended by the Secretary upon the qualified issuer's request.

The provision also imposes a maximum maturity limitation on any ClECos. 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 ClECos being equal to 50 percent of the face amount of such bond. Moreover, the provision requires level amortization of ClECos during the period such bonds are outstanding.

Unlike qualified zone academy bonds, the provision requires issuers of ClECos to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds. Under the provision, there is a national limitation of $1 billion of ClECos that the Secretary may allocate, in the aggregate, to certified coal property projects. The authority to issue ClECos expires December 31, 2010.

[52] Treas. Reg. sec. 1.142-2(e).

Effective date.−The provision is effective for bonds issued after December 31, 2005.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

16. Credit for investment in clean coke/cogeneration manufacturing facilities (sec. 1511 of the Senate amendment)

Present Law

Present law does not provide a credit for investment in clean coke/cogeneration manufacturing facilities property.

House Bill

No provision.

Senate Amendment

The provision provides a 20-percent investment tax credit for qualified investments in clean coke/cogeneration facilities property. The provision defines clean coke/cogeneration manufacturing facilities property as depreciable real and tangible personal property located in the United States that meets certain emission standards and is used for the manufacture of metallurgical coke or for the production of steam or electricity from waste heat generated during the production of metallurgical coke.

The qualified investment for any taxable year is the basis of each coke/cogeneration facilities property placed in service by the taxpayer during such taxable year. The provision excludes the credit from the basis adjustment rules for investment credit property set out in section 50(c) of the Code. Under the basis adjustment rules, the basis in investment credit property is generally reduced by the amount of the investment credit.

Effective date.−The provision applies to periods after December 31, 2004, and before January 1, 2010, under rules similar to the rules of section 48(m) (as in effect before its repeal).

Conference Agreement

The conference agreement does not include the Senate amendment provision.

17. Temporary expensing for equipment used in the refining of liquid fuels (sec. 1512 of the Senate amendment, sec. 1323 of the conference agreement, and new sec. 179C of the Code)

Present Law

Depreciation of refinery assets

Under present law, depreciation allowances for property used in a trade or business generally are determined under the Modified Accelerated Cost Recovery System ("MACRS") of section 168 of the Internal Revenue Code. Under MACRS, petroleum refining assets are depreciated for regular tax purposes over a 10-year recovery period using the double declining balance method. Petroleum refining assets are assets used for distillation, fractionation, and catalytic cracking of crude petroleum into gasoline and its other components. Present law also provides a special expensing rule for small refiners for capital costs incurred in complying with Environmental Protection Agency sulfur regulations.

Taxation of cooperatives and their patrons

For Federal income tax purposes, a cooperative generally computes its income as if it were a taxable corporation, with one exception--the cooperative may exclude from its taxable income distributions of patronage dividends. Generally, cooperatives that are subject to the cooperative tax rules of subchapter T of the Code[53] are permitted a deduction for patronage dividends from their taxable income only to the extent of net income that is derived from transactions with patrons who are members of the cooperative.[54] The availability of such deductions from taxable income has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative.

House Bill

No provision.

Senate Amendment

The Senate amendment provision provides a temporary election to expense qualified refinery property.[55] Qualified refinery property includes assets, located in the United States, used in the refining of liquid fuels: (1) with respect to the construction of which there is a binding construction contract before January 1, 2008; (2) which are placed in service before January 1, 2012; (3) which increase the capacity of an existing refinery by at least five percent or increase the percentage of total throughput[56] attributable to qualified fuels (as defined in present

[53] Sec. 1381, et seq.

[54] Sec. 1382.

[55] For purposes of the provision, the term "refinery" refers to facilities the primary purpose of which is the processing of crude oil (whether or not previously refined) or qualified fuels (as defined in present law section 29(c), which is redesignated as section 45K(c) under section 1322(a)(1) of the Act). The limitation of present law section 29(d) (redesignated as section 45K(d) under the Act) requiring domestic production of qualified fuels is not applicable with respect to the definition of refinery under this provision; thus, otherwise qualifying refinery property will be eligible for the provision even if the primary purpose of the refinery is the processing of oil produced from shale and tar sands outside the United States. The term refinery would include a facility which processes coal via gas into liquid fuel.

[56] For purposes of the provision, the throughput of a refinery is measured on the basis of barrels per calendar day. Barrels per calendar day is the amount of fuels that a facility can process under usual

law section 29(c), which is redesignated as section 45K(c) by section 1322(a)(1) of the Act)[57] such that it equals or exceeds 25 percent; and (4) which meet all applicable environmental laws in effect when the property is placed in service.[58]

The expensing election is not available with respect to identifiable refinery property built solely to comply with Federally mandated projects or consent decrees. For example, a taxpayer may not elect to expense the cost of a scrubber, even if the scrubber is installed as part of a larger project, if the scrubber does not increase throughput or increased capacity to accommodate qualified fuels and is necessary for the refinery to comply with the Clean Air Act. This exclusion applies regardless of whether the mandate or consent decree addresses environmental concerns with respect to the refinery itself or the refined fuels.

The Senate amendment provision allows cooperative organizations to pass through to the owners of such organizations the expensing deduction for qualified refinery property. To the extent the deduction is passed through to owners, the cooperative is denied deductions it would otherwise be entitled with respect to qualified refinery property.

As a condition of eligibility for the expensing of equipment used in the refining of liquid fuels, the Senate amendment provision provides that a refinery must report to the IRS concerning its refinery operations (e.g. production and output).

Effective date.−The Senate amendment provision is effective for property placed in service after the date of enactment, the original use of which begins with the taxpayer, provided the property was not subject to a binding contract for construction on or before June 14, 2005.

Conference Agreement

The conference agreement follows the Senate amendment, with the following modifications. Under the conference agreement, the expensing election is limited to 50% of the taxpayer's qualifying expenditures. The remaining 50% is recovered as under present law.

Under the conference agreement, the five percent capacity requirement refers to the output capacity of the refinery, as measured by the volume of finished products other than asphalt and lube oil, rather than input capacity, as measured by rated capacity.

operating conditions, expressed in terms of capacity during a 24-hour period and reduced to account for down time and other limitations.

[57] The limitation of present law section 29(d) (redesignated as section 45K(d) under section 1322(a)(1) of the Act) regarding domestic production is not applicable with respect to the definition of qualified fuels under this provision.

[58] The requirement to meet all applicable environmental laws applies specifically to the refinery or portion of a refinery placed in service after the date of enactment. A refinery's failure to meet applicable environmental laws with respect to a portion of the refinery which was in service prior to the effective date will not disqualify the taxpayer from making the election under the provision with respect to otherwise qualifying refinery property.

The conference agreement includes a clarification that the expensing election is not available with respect to identifiable refinery property built solely to comply with consent decrees or projects mandated by Federal, State, or local governments.

Finally, an exception to the original use requirement is provided for property which would meet the requirement but for a sale-leaseback transaction within the first three months after the property is originally placed in service.

Under the conference agreement, a cooperative organization electing to pass the expensing deduction through to its owners must make such an election on the tax return for the taxable year to which the deduction relates. Once made, the election is irrevocable. Moreover, the organization making the election must provide cooperative owners receiving an allocation of the deduction written notice of the amount of such allocation.

18. Allow pass through to owners of deduction for capital costs incurred by small refiner cooperative in complying with Environmental Protection Agency sulfur regulations (sec. 1513 of the Senate amendment, sec. 1324 of the conference agreement, and sec. 179B of the Code)

Present Law

Expensing and credit for small refiners

Taxpayers generally may recover the costs of investments in refinery property through annual depreciation deductions. In addition, the Code permits small business refiners to immediately deduct as an expense up to 75 percent of the costs paid or incurred for the purpose of complying with the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency ("EPA"). Costs qualifying for the deduction are those costs paid or incurred with respect to any facility of a small business refiner during the period beginning on January 1, 2003 and ending on the earlier of the date that is one year after the date on which the taxpayer must comply with the applicable EPA regulations or December 31, 2009.

The Code also provides that a small business refiner may claim credit equal to five cents per gallon for each gallon of low sulfur diesel fuel produced during the taxable year that is in compliance with the Highway Diesel Fuel Sulfur Control Requirements. The total production credit claimed by the taxpayer is limited to 25 percent of the capital costs incurred to come into compliance with the EPA diesel fuel requirements. As with the deduction permitted under present law, costs qualifying for the credit are those costs paid or incurred with respect to any facility of a small business refiner during the period beginning on January 1, 2003 and ending on the earlier of the date that is one year after the date on which the taxpayer must comply with the applicable EPA regulations or December 31, 2009. The taxpayer's basis in property with respect to which the credit applies is reduced by the amount of production credit claimed.

For these purposes a small business refiner is a taxpayer who is within the business of refining petroleum products employs not more than 1,500 employees directly in refining and has less than 205,000 barrels per day (average) of total refinery capacity. The deduction is reduced, *pro rata*, for taxpayers with capacity in excess of 155,000 barrels per day.

In the case of a qualifying small business refiner that is owned by a cooperative, the cooperative is allowed to elect to pass any production credits to patrons of the organization. Present law does not permit cooperatives to pass through to members the deduction permitted for the costs paid or incurred for the purpose of complying with the Highway Diesel Fuel Sulfur Control Requirements.

Taxation of cooperatives and their patrons

For Federal income tax purposes, a cooperative generally computes its income as if it were a taxable corporation, with one exception--the cooperative may exclude from its taxable income distributions of patronage dividends. In general, patronage dividends are the profits of the cooperative that are rebated to its patrons pursuant to a pre-existing obligation of the cooperative to do so. The rebate must be made in some equitable fashion on the basis of the quantity or value of business done with the cooperative.

Except for tax-exempt farmers' cooperatives, cooperatives that are subject to the cooperative tax rules of subchapter T of the Code[59] are permitted a deduction for patronage dividends from their taxable income only to the extent of net income that is derived from transactions with patrons who are members of the cooperative.[60] The availability of such deductions from taxable income has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative.

Cooperatives that qualify as tax-exempt farmers' cooperatives are permitted to exclude patronage dividends from their taxable income to the extent of all net income, including net income that is derived from transactions with patrons who are not members of the cooperative, provided the value of transactions with patrons who are not members of the cooperative does not exceed the value of transactions with patrons who are members of the cooperative.[61]

House Bill

No provision.

Senate Amendment

The Senate amendment allows cooperatives to pass through to their owners the deduction permitted for costs paid or incurred for the purpose of complying with the Highway Diesel Fuel Sulfur Control Requirements. To the extent the deduction is passed through to owners, the cooperative is denied deductions it would otherwise be entitled with respect to costs attributable to complying with the Highway Diesel Fuel Sulfur Control Requirements.

[59] Sec. 1381, et seq.

[60] Sec. 1382.

[61] Sec. 521.

Effective date.−The provision is effective as if included in the amendments made by section 338(a) of the American Jobs Creation Act of 2004.[62]

Conference Agreement

The conference agreement follows the Senate amendment with modifications. The conference agreement clarifies the manner in which a cooperative organization may elect to pass through to cooperative owners the deduction for costs paid or incurred for the purpose of complying with the Highway Diesel Fuel Sulfur Control Requirements. Specifically, the election must be made on the tax return of the organization for the taxable year to which the deduction relates. Once made, the election is irrevocable. Moreover, the organization making such an election must provide cooperative owners receiving an allocation of the deduction written notice of the amount of such allocation. The written notice must be provided by the due date for the tax return on which the election is made.

19. Modification of enhanced oil recovery credit (sec. 1514 of the Senate amendment)

Present Law

Taxpayers may claim a credit equal to 15 percent of enhanced oil recovery ("EOR") costs (sec. 43). Qualified EOR costs include the following costs associated with an EOR project: (1) amounts paid for depreciable tangible property; (2) intangible drilling and development expenses; (3) tertiary injectant expenses; and (4) construction costs for certain Alaskan natural gas treatment facilities.

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). The reference price is determined based on the annual average price of domestic crude oil for the calendar year preceding the calendar year in which the taxable year begins (sec. 29(d)(2)(C)).[63]

House Bill

No provision.

Senate Amendment

The provision modifies the EOR credit to increase the credit rate to 20 percent with respect to any new EOR project or substantial expansion of an existing EOR project that occurs after December 31, 2005, and uses carbon dioxide flooding or injection as an oil recovery method. The increased credit is available only for qualified EOR projects that use carbon

[62] Pub. L. No. 108-357.

[63] The inflation adjustment factor for 2004 was 1.2952, so the EOR credit would have phased out in 2004 if the reference price had exceeded $36.27. However, the reference price for 2003 was only $27.56, so there was no phase out of the EOR credit for 2004.

dioxide that is (1) from an industrial source or (2) separated from natural gas and natural gas liquids at a natural gas processing plant.

The provision also expands the definition of a qualified EOR project to include qualified deep gas well projects. A qualified deep gas well project is defined as any project located in the United States which involves the production of natural gas from onshore formations deeper than 20,000 feet. Under the provision, the credit for qualified deep gas well projects phases out as crude oil prices increase using the same formula applicable to other EOR projects.

Effective date.−The provision applies to costs paid or incurred in taxable years ending after December 31, 2005, but terminates for costs paid or incurred after December 31, 2009.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

B. Miscellaneous Energy Tax Incentives

1. Credit for residential energy efficient property (sec. 1311 of the House bill, sec. 1527 of the Senate amendment, sec. 1335 of the conference agreement, and new sec. 25D of the Code)

Present Law

A taxpayer may exclude from income the value of any subsidy provided by a public utility for the purchase or installation of an energy conservation measure. An energy conservation measure means any installation or modification primarily designed to reduce consumption of electricity or natural gas or to improve the management of energy demand with respect to a dwelling unit (sec. 136).

There is no present-law credit for residential solar hot water, photovoltaic, or fuel cell property.

House Bill

The provision provides a personal tax credit for the purchase of qualified photovoltaic property and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs. The credit is equal to 15 percent of qualified investment up to a maximum credit of $2,000 for solar water heating property and $2,000 for rooftop photovoltaic property. The provision also provides a 15-percent personal tax credit for the purchase of qualified fuel cell power plants. The credit may not exceed $500 for each 0.5 kilowatt of capacity. The credit is nonrefundable.[64] The taxpayer's basis in the property is reduced by the amount of the credit.

Qualifying solar water heating property is property that heats water for use in a dwelling unit if at least half of the energy used by such property for such purpose is derived from the sun. Qualified photovoltaic property is property that uses solar energy to generate electricity for use in a dwelling unit. A qualified fuel cell power plant is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that converts a fuel into electricity using electrochemical means, and which has an electricity-only generation efficiency of greater than 30 percent.

To qualify for the credit, the property must be installed on or in connection with a dwelling unit located in the United States and used as a residence by the taxpayer. If less than 80 percent of the use of an item is for nonbusiness purposes, only that portion of the expenditures for such item which is properly allocable to use for nonbusines purposes shall be taken into account. Certain equipment safety requirements need to be met to qualify for the credit. Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations.

[64] Sec. 1321 of the House bill allows the credit to offset both the regular tax and the alternative minimum tax.

Effective date.−The credit applies to expenditures made after the date of enactment in taxable years ending before January 1, 2008.

Senate Amendment

The provision provides a personal tax credit for the purchase of qualified photovoltaic property and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs. The credit is equal to 30 percent of qualifying expenditures, with a maximum credit for each of these systems of property of $2,000. The provision also provides a 30 percent credit for the purchase of qualified fuel cell power plants. The credit for any fuel cell may not exceed $500 for each 0.5 kilowatt of capacity.

Qualifying solar water heating property means an expenditure for property to heat water for use in a dwelling unit located in the United States and used as a residence if at least half of the energy used by such property for such purpose is derived from the sun. Qualified photovoltaic property is property that uses solar energy to generate electricity for use in a dwelling unit. A qualified fuel cell power plant is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, (2) has an electricity-only generation efficiency of greater than 30 percent, and (3) generates at least 0.5 kilowatts of electricity. The qualified fuel cell power plant must be installed on or in connection with a dwelling unit located in the United States and used by the taxpayer as a principal residence.

The credit is nonrefundable, and the depreciable basis of the property is reduced by the amount of the credit. Expenditures for labor costs allocable to onsite preparation, assembly, or original installation of property eligible for the credit are eligible expenditures.

Certain equipment safety requirements need to be met to qualify for the credit. Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

Effective date.−The credit applies to property placed in service after December 31, 2005 and prior to January 1, 2010.

Conference Agreement

The conference agreement follows the Senate amendment, but only for property placed in service prior to January 1, 2008.

Effective date.−The credit applies to property placed in service after December 31, 2005 and prior to January 1, 2008.

2. Credit for business installation of qualified fuel cells and stationary microturbine power plants (sec. 1528 of the Senate amendment, sec. 1336 of the conference agreement, and sec. 48 of the Code)

Present Law

A 10-percent business energy investment tax credit is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage.

The business energy investment tax credit is a component of the general business credit. The general business credit generally may not exceed the excess of the taxpayer's net income tax over the greater of (1) the tentative minimum tax or (2) 25 percent of net regular tax liability in excess of $25,000. A general business credit in excess of the tax limitation generally may be carried back one year and carried forward up to 20 years.

There is no present-law credit for fuel cell or microturbine power plant property.

House Bill

The provision provides a 15-percent credit for the purchase of qualified fuel cell power plants for businesses. The credit is part of the business energy investment tax credit.[65] A qualified fuel cell power plant is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that converts a fuel into electricity using electrochemical means, and which has an electricity-only generation efficiency of greater than 30 percent. The credit may not exceed $500 for each 0.5 kilowatt of capacity. The taxpayer's basis in the property is reduced by the amount of the credit claimed.

Effective date.−The provision applies to property placed in service after April 11, 2005, and before January 1, 2008, under rules similar to rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990).

Senate Amendment

The provision provides a 30 percent business energy credit for the purchase of qualified fuel cell power plants for businesses. A qualified fuel cell power plant is an integrated system composed of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, (2) has an electricity-only

[65] Section 1322 of the House bill provides that the tentative minimum tax is treated as zero for purposes of applying the tax limitation to the portion of the investment tax credit attributable to the credit for fuel cells.

generation efficiency of greater than 30 percent, and (3) generates at least 0.5 kilowatts of electricity. The credit for any fuel cell may not exceed $500 for each 0.5 kilowatts of capacity.

Additionally, the provision provides a 10 percent credit for the purchase of qualifying stationary microturbine power plants. A qualified stationary microturbine power plant is an integrated system comprised of a gas turbine engine, a combustor, a recuperator or regenerator, a generator or alternator, and associated balance of plant components that converts a fuel into electricity and thermal energy. Such system also includes all secondary components located between the existing infrastructure for fuel delivery and the existing infrastructure for power distribution, including equipment and controls for meeting relevant power standards, such as voltage, frequency and power factors. Such system must have an electricity-only generation efficiency of not less that 26 percent at International Standard Organization conditions and a capacity of less than 2,000 kilowatts. The credit is limited to the lesser of 10 percent of the basis of the property or $200 for each kilowatt of capacity.

Additionally, for purposes of the fuel cell and microturbine credits, and only in the case of telecommunications companies, the provision removes the present-law section 48 restriction that would prevent telecommunication companies from claiming the new credit due to their status as public utilities.

The credit is nonrefundable. The taxpayer's basis in the property is reduced by the amount of the credit claimed.

Effective date.−The credit applies to periods after December 31, 2005 and before January 1, 2010 (January 1, 2009 in the case of micro turbines), for property placed in service in taxable years ending after December 31, 2005, under rules similar to rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990).

Conference Agreement

The conference agreement follows the Senate amendment, but only for periods before January 1, 2008.

Effective date.−The credit applies to periods after December 31, 2005 and before January 1, 2008, for property placed in service in taxable years ending after December 31, 2005, under rules similar to rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990).

3. Business solar investment tax credit (sec. 1529 of the Senate amendment, sec. 1337 of the conference agreement, and sec. 48 of the Code)

Present Law

A nonrefundable, 10-percent business energy credit is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage.

The business energy tax credits are components of the general business credit (sec. 38(b)(1)). The business energy tax credits, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of (1) 25 percent of so much of the net regular tax liability as exceeds $25,000 or (2) the tentative minimum tax. An unused general business credit generally may be carried back one year and carried forward 20 years (sec. 39).

House Bill

No provision.

Senate Amendment

The provision increases the 10-percent credit to 30 percent in the case of solar energy property. Additionally, the provision provides that equipment that uses fiber-optic distributed sunlight to illuminate the inside of a structure is solar energy property eligible for the 30-percent credit. The provision provides that property used to generate energy for the purposes of heating a swimming pool is not eligible solar energy property.

Effective date.−The provision applies to periods after December 31, 2005 and before January 1, 2012 for property placed in service in taxable years ending after December 31, 2005, under rules similar to rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990).

Conference Agreement

The conference agreement follows the Senate amendment, but only for periods before January 1, 2008 with respect to the 30 percent credit and the fiber-optic distributed sunlight. The conference agreement makes permanent the provision that provides that property used to generate energy for the purposes of heating a swimming pool is not eligible solar energy property.

Effective date.−The provision with respect to the heating of swimming pools applies to periods after December 31, 2005. The increase in the credit rate and the provision related to fiber-optic distributed sunlight applies to periods after December 31, 2005 and before January 1, 2008 for property placed in service in taxable years ending after December 31, 2005, under rules similar to rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990).

4. Diesel-water fuel emulsion (sec. 1313 of the House bill, sec. 1343 of the conference agreement, and sec. 4081 of the Code)

Present Law

A 24.3-cents-per-gallon excise tax is imposed on diesel fuel to finance the Highway Trust Fund.[66] Gasoline and most special motor fuels are subject to tax at 18.3 cents per gallon for the Trust Fund.[67]

The tax rate for certain special motor fuels is determined, on an energy equivalent basis, as follows:[68]

Liquefied petroleum gas (propane)	13.6 cents per gallon
Liquefied natural gas	11.9 cents per gallon
Methanol derived from natural gas	9.15 cents per gallon
Compressed natural gas	48.54 cents per MCF

No special tax rate is provided for diesel fuel blended with water to form a diesel-water fuel emulsion.

House Bill

A special tax rate of 19.7 cents per gallon is provided for diesel fuel blended with water into a diesel-water fuel emulsion to reflect the reduced Btu content per gallon resulting from the water. Emulsion fuels eligible for the special rate must consist of not more than 83.1 percent diesel (and other minor chemical additives to enhance combustion) and at least 16.9 percent water. The emulsion addition must be registered by a United States manufacturer with the Environmental Protection Agency pursuant to section 211 of the Clean Air Act (as in effect on March 31, 2003). A refund of the difference between the regular rate (24.3 cents per gallon) and the incentive rate (19.7 cents per gallon) is available to the extent tax-paid diesel is used to produce a qualifying emulsion diesel fuel. Anyone who separates the diesel fuel from the diesel-water fuel emulsion on which a reduced rate of tax was imposed is treated as a refiner of the fuel and is liable for the difference between the amount of tax on the latest removal of the separated fuel and the amount of tax that was imposed upon the pre-mixture removal.

[66] Sec. 4081(a)(2)(A)(iii).

[67] Secs. 4081(a)(2)(A)(i) and 4041(a)(2)(B)(i).

[68] See sec. 4041(a)(2)(B)(ii) and (iii), sec. 4041(a)(3) and sec. 4041(m)(1)(A).

Effective date.−The provision is effective on January 1, 2006.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill except the diesel-water emulsion fuels eligible for the special rate must consist of least 14 percent water. In addition, the person claiming entitlement to the special rate of tax must be registered with the Secretary. The conference agreement clarifies that claims for refund based on the incentive rate may be filed quarterly if such person can claim at least $750. If the person cannot claim at least $750 at the end of quarter, the amount can be carried over to the next quarter to determine if the person can claim at least $750. If the person cannot claim at least $750 at the end of the taxable year, the person must claim a credit on the person's income tax return.

5. Amortization of delay rental payments (sec. 1314 of the House bill)

Present Law

Present law generally requires costs associated with inventory and property held for resale to be capitalized rather than currently deducted as they are incurred (sec. 263). Oil and gas producers typically contract for mineral production in exchange for royalty payments. If mineral production is delayed, these contracts provide for "delay rental payments" as a condition of their extension. The Internal Revenue Service has taken the position that the uniform capitalization rules of section 263A require delay rental payments to be capitalized.

House Bill

The provision allows delay rental payments incurred in connection with the development of oil or gas within the United States to be amortized over two years. In the case of abandoned property, remaining basis may no longer be recovered in the year of abandonment of a property as all basis is recovered over the two-year amortization period.

Effective date.−The provision applies to amounts paid or incurred in taxable years beginning after the date of enactment. No inference is intended from the prospective effective date of this provision as to the proper treatment of pre-effective date delay rental payments.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House provision.

6. Amortization of geological and geophysical expenditures (sec. 1315 of the House bill, sec. 1329 of the conference agreement, and sec. 167 of the Code)

Present Law

In general

Geological and geophysical expenditures ("G&G costs") are costs incurred by a taxpayer for the purpose of obtaining and accumulating data that will serve as the basis for the acquisition and retention of mineral properties by taxpayers exploring for minerals. A key issue with respect to the tax treatment of such expenditures is whether or not they are capital in nature. Capital expenditures are not currently deductible as ordinary and necessary business expenses, but are allocated to the cost of the property.[69]

Courts have held that G&G costs are capital, and therefore are allocable to the cost of the property[70] acquired or retained.[71] The costs attributable to such exploration are allocable to the cost of the property acquired or retained. As described further below, IRS administrative rulings have provided further guidance regarding the definition and proper tax treatment of G&G costs.

Revenue Ruling 77-188

In Revenue Ruling 77-188[72] (hereinafter referred to as the "1977 ruling"), the IRS provided guidance regarding the proper tax treatment of G&G costs. The ruling describes a typical geological and geophysical exploration program as containing the following elements:

- It is customary in the search for mineral producing properties for a taxpayer to conduct an exploration program in one or more identifiable project areas. Each project area encompasses a territory that the taxpayer determines can be explored advantageously in a single integrated operation. This determination is made after

[69] Under section 263, capital expenditures are defined generally as any amount paid for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. Treasury regulations define capital expenditures to include amounts paid or incurred (1) to add to the value, or substantially prolong the useful life, of property owned by the taxpayer or (2) to adapt property to a new or different use. Treas. Reg. sec. 1.263(a)-1(b).

[70] "Property" means an interest in a property as defined in section 614 of the Code, and includes an economic interest in a tract or parcel of land notwithstanding that a mineral deposit has not been established or proved at the time the costs are incurred.

[71] See, *e.g., Schermerhorn Oil Corporation v. Commissioner,* 46 B.T.A. 151 (1942). By contrast, section 617 of the Code permits a taxpayer to elect to deduct certain expenditures incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (but not oil and gas). These deductions are subject to recapture if the mine with respect to which the expenditures were incurred reaches the producing stage.

[72] 1977-1 C.B. 76.

analyzing certain variables such as (1) the size and topography of the project area to be explored, (2) the existing information available with respect to the project area and nearby areas, and (3) the quantity of equipment, the number of personnel, and the amount of money available to conduct a reasonable exploration program over the project area.

- The taxpayer selects a specific project area from which geological and geophysical data are desired and conducts a reconnaissance-type survey utilizing various geological and geophysical exploration techniques. These techniques are designed to yield data that will afford a basis for identifying specific geological features with sufficient mineral potential to merit further exploration.

- Each separable, noncontiguous portion of the original project area in which such a specific geological feature is identified is a separate "area of interest." The original project area is subdivided into as many small projects as there are areas of interest located and identified within the original project area. If the circumstances permit a detailed exploratory survey to be conducted without an initial reconnaissance-type survey, the project area and the area of interest will be coextensive.

- The taxpayer seeks to further define the geological features identified by the prior reconnaissance-type surveys by additional, more detailed, exploratory surveys conducted with respect to each area of interest. For this purpose, the taxpayer engages in more intensive geological and geophysical exploration employing methods that are designed to yield sufficiently accurate sub-surface data to afford a basis for a decision to acquire or retain properties within or adjacent to a particular area of interest or to abandon the entire area of interest as unworthy of development by mine or well.

The 1977 ruling provides that if, on the basis of data obtained from the preliminary geological and geophysical exploration operations, only one area of interest is located and identified within the original project area, then the entire expenditure for those exploratory operations is to be allocated to that one area of interest and thus capitalized into the depletable basis of that area of interest. On the other hand, if two or more areas of interest are located and identified within the original project area, the entire expenditure for the exploratory operations is to be allocated equally among the various areas of interest.

If no areas of interest are located and identified by the taxpayer within the original project area, then the 1977 ruling states that the entire amount of the G&G costs related to the exploration is deductible as a loss under section 165. The loss is claimed in the taxable year in which that particular project area is abandoned as a potential source of mineral production.

A taxpayer may acquire or retain a property within or adjacent to an area of interest, based on data obtained from a detailed survey that does not relate exclusively to any discrete property within a particular area of interest. Generally, under the 1977 ruling, the taxpayer allocates the entire amount of G&G costs to the acquired or retained property as a capital cost under section 263(a). If more than one property is acquired, it is proper to determine the amount of the G&G costs allocable to each such property by allocating the entire amount of the costs among the properties on the basis of comparative acreage.

If, however, no property is acquired or retained within or adjacent to that area of interest, the entire amount of the G&G costs allocable to the area of interest is deductible as a loss under section 165 for the taxable year in which such area of interest is abandoned as a potential source of mineral production.

In 1983, the IRS issued Revenue Ruling 83-105,[73] which elaborates on the positions set forth in the 1977 ruling by setting forth seven factual situations and applying the principles of the 1977 ruling to those situations. In addition, Revenue Ruling 83-105 explains what constitutes "abandonment as a potential source of mineral production."

House Bill

The provision allows geological and geophysical amounts incurred in connection with oil and gas exploration in the United States to be amortized over two years. In the case of abandoned property, remaining basis may no longer be recovered in the year of abandonment of a property as all basis is recovered over the two-year amortization period.

Effective date.−The provision is effective for geological and geophysical costs paid or incurred in taxable years beginning after the date of enactment. No inference is intended from the prospective effective date of this provision as to the proper treatment of pre-effective date geological and geophysical costs.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

7. Alternative technology vehicle credits (sec. 1316 of the House bill, sec. 1553 of the Senate amendment, secs. 1341 and 1348 of the conference agreement, sec. 179A of the Code, and new sec. 30B of the Code)

Present Law

Certain costs of qualified clean-fuel vehicle may be expensed and deducted when such property is placed in service (sec. 179A). Qualified clean-fuel vehicle property includes motor vehicles that use certain clean-burning fuels (natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity and any other fuel at least 85 percent of which is methanol,

[73] 1983-2 C.B. 51.

ethanol, any other alcohol or ether).[74] The maximum amount of the deduction is $50,000 for a truck or van with a gross vehicle weight over 26,000 pounds or a bus with seating capacities of at least 20 adults; $5,000 in the case of a truck or van with a gross vehicle weight between 10,000 and 26,000 pounds; and $2,000 in the case of any other motor vehicle. Qualified electric vehicles do not qualify for the clean-fuel vehicle deduction. The deduction is reduced to 25 percent of the otherwise allowable deduction in 2006 and is unavailable for purchases after December 31, 2006.

House Bill

The House bill provides a credit for each new qualified advanced lean-burn technology motor vehicle placed in service by the taxpayer during the taxable year. The amount of the credit for any vehicle is the sum of an amount for fuel efficiency and an amount for conservation. The amount for fuel efficiency is based on a comparison of the fuel efficiency of the vehicle compared to the Environmental Protection Agency's 2000 model year city fuel economy for a vehicle in the same inertia weight class. The amount for conservation is based on the qualifying vehicle's estimated lifetime fuel savings compared to the same 2000 model year standard.

Table 2, below, shows the credit amount for fuel efficiency of a qualified advanced lean-burn technology motor vehicle.

Table 2.–Fuel Efficiency Credit Amount for Qualified Advanced Lean-Burn Technology Motor Vehicles

	If Fuel Economy of the Vehicle Is:	
Credit Amount	**at least**	**but less than**
$500	125% of base fuel economy	150% of base fuel economy
$1,000	150% of base fuel economy	175% of base fuel economy
$1,500	175% of base fuel economy	200% of base fuel economy
$2,000	200% of base fuel economy	225% of base fuel economy
$2,500	225% of base fuel economy	250% of base fuel economy
$3,000	250% of base fuel economy	

The credit amount for conservation of a qualified advanced lean burn technology vehicle is computed as follows. The vehicle is assumed to be driven 120,000 miles over its life. The 120,000 miles of lifetime mileage is divided by the fuel economy rating of the vehicle. The 120,000 miles of lifetime mileage also is divided by the 2000 model year city economy for a

[74] A hybrid-electric vehicle may qualify as a clean-fuel vehicle under present law. Seven different automobile makes (multiple model years for some makes of automobile) qualify for the present-law deduction.

vehicle in the same inertia weight class. The difference is the lifetime fuel savings. If the vehicle achieves a lifetime motor fuel savings between 1,500 and 2,500 gallons of fuel, the credit amount for the vehicle is $250. If the vehicle achieves a lifetime fuel savings of at least 2,500 gallons of motor fuel, the credit amount is $500.

The base fuel economy is the 2000 model year city fuel economy for vehicles by inertia weight class by vehicle type. The "vehicle inertia weight class" is that defined in regulations prescribed by the Environmental Protection Agency for purposes of Title II of the Clean Air Act. A qualifying advanced lean-burn technology motor vehicle means a motor vehicle the original use of which commences with the taxpayer, powered by an internal combustion engine that is designed to operate primarily using more air than is necessary for complete combustion of the fuel and incorporates direct injection, that uses only diesel fuel (as defined in section 4083(a)(3)), has sufficient fuel economy to qualify for the credit, and meets the Environmental Protection Agency's Tier II bin 8 emissions standards. In addition, in order to qualify for a credit, a vehicle must be in compliance with the applicable provisions of the Clean Air Act and the motor vehicle safety provisions.

In general, the credit is allowed to the vehicle owner, including the lessor of a vehicle subject to a lease. If the use of the vehicle is described in paragraph (3) or (4) of section 50(b) (relating to use by tax-exempts, governments, and foreign persons) and is not subject to a lease, the seller of the vehicle may claim the credit so long the seller clearly discloses to the user in a document the amount that is allowable as a credit. A vehicle must be used predominantly in the United States to qualify for the credit.

The provision permits the credit to offset both the regular tax and the alternative minimum tax. Credits in excess of this limitation may be carried forward for up to 20 years; credits may not be carried back to earlier years.

Effective date.−The provision is effective for property placed in service after the date of enactment and before January 1, 2008.

Senate Amendment

Alternative motor vehicle credits

The Senate amendment provides a credit for each new qualified fuel cell vehicle, each new qualified hybrid motor vehicle, and each new qualified alternative fuel motor vehicle placed in service by the taxpayer during the taxable year.

In general, the credit is allowed to the vehicle owner, including the lessor of a vehicle subject to a lease. If the use of the vehicle is described in paragraphs (3) or (4) of section 50(b) (relating to use by tax-exempts, governments, and foreign persons) and is not subject to a lease, the seller of the vehicle may claim the credit so long as the seller clearly discloses to the user in a document the amount that is allowable as a credit. A vehicle must be used predominantly in the United States to qualify for the credit.

Any deduction otherwise allowable under section 179A is reduced by the amount of the credit allowable.

The provision permits the credit to offset the excess of the regular tax (reduced by certain credits) over the alternative minimum tax. Credits in excess of this limitation may be carried back for up to three years and forward for up to 20 years; credits may not be carried back to taxable years beginning before the date of enactment and credits for vehicles used for personal use may not be carried back.

Fuel cell vehicles

A qualifying fuel cell vehicle is a motor vehicle that is propelled by power derived from one or more cells which convert chemical energy directly into electricity by combining oxygen with hydrogen fuel which is stored on board the vehicle and may or may not require reformation prior to use. The amount of credit for the purchase of a fuel cell vehicle is determined by a base credit amount that depends upon the weight class of the vehicle and, in the case of automobiles or light trucks, an additional credit amount that depends upon the rated fuel economy of the vehicle compared to a base fuel economy. For these purposes the base fuel economy is the 2002 model year city fuel economy rating for vehicles of various weight classes (see below). Table 3, below, shows the proposed base credit amounts.

Table 3.–Base Credit Amount for Fuel Cell Vehicles

Vehicle Gross Weight Rating in Pounds	Credit Amount
Vehicle ≤ 8,500	$8,000
8,500 < vehicle ≤ 14,000..................................	$10,000
14,000 < vehicle ≤ 26,000................................	$20,000
26,000 < vehicle	$40,000

In the case of a fuel cell vehicle weighing less than 8,500 pounds and placed in service after December 31, 2009, the $8,000 amount in Table 3, above is reduced to $4,000.

Table 4, below, shows the proposed additional credits for passenger automobiles or light trucks.

Table 4.–Credit for Qualifying Fuel Cell Vehicles

Credit	If Fuel Economy of the Fuel Cell Vehicle Is:	
	At least	but less than
$1,000	150% of base fuel economy	175% of base fuel economy
$1,500	175% of base fuel economy	200% of base fuel economy
$2,000	200% of base fuel economy	225% of base fuel economy
$2,500	225% of base fuel economy	250% of base fuel economy
$3,000	250% of base fuel economy	275% of base fuel economy
$3,500	275% of base fuel economy	300% of base fuel economy
$4,000	300% of base fuel economy	

Hybrid motor vehicles

A qualifying hybrid vehicle is a motor vehicle that draws propulsion energy from on-board sources of stored energy which include both an internal combustion engine or heat engine using combustible fuel and a rechargeable energy storage system (*e.g.*, batteries). A qualifying hybrid motor vehicle must be placed in service before January 1, 2010.

In the case of an automobile or light truck (vehicles weighing 8,500 pounds or less), the amount of credit for the purchase of a hybrid vehicle varies with the rated fuel economy of the vehicle compared to a 2002 model year. A qualifying hybrid automobile or light truck must have a maximum available power from the rechargeable energy storage system of at least five percent.[75] In addition, the vehicle must meet or exceed certain EPA emissions standards. For a vehicle with a gross vehicle weight rating of 8,500 pounds or less the applicable emissions standards are the Bin 5 Tier II emissions standards.

[75] For vehicles weighing 8,500 pounds or less, the percentage of maximum available power is computed by dividing the maximum power available from the rechargeable energy storage system during a standard 10-second pulse power test, divided by the sum of such maximum power and the SAE net power of the heat (*e.g.*, internal combustion or diesel) engine.

Table 5, below, shows the fuel economy credit available to a hybrid passenger automobile or light truck whose fuel economy (on a gasoline gallon equivalent basis) exceeds that of a base fuel economy.

Table 5.–Fuel Economy Credit

Credit	**If Fuel Economy of the Fuel Cell Vehicle Is:**	
	At least	but less than
$400	125% of base fuel economy	150% of base fuel economy
$800	150% of base fuel economy	175% of base fuel economy
$1,200	175% of base fuel economy	200% of base fuel economy
$1,600	200% of base fuel economy	225% of base fuel economy
$2,000	225% of base fuel economy	250% of base fuel economy
$2,400	250% of base fuel economy	

In the case of a qualifying hybrid motor vehicle weighing more than 8,500 pounds, the amount of credit is determined by the estimated increase in fuel economy and the incremental cost of the hybrid vehicle compared to a comparable vehicle powered solely by a gasoline or diesel internal combustion engine and that is comparable in weight, size, and use of the vehicle. For a vehicle that achieves a fuel economy increase of at least 30 percent but less than 40 percent, the credit is equal to 20 percent of the incremental cost of the hybrid vehicle. For a vehicle that achieves a fuel economy increase of at least 40 percent but less than 50 percent, the credit is equal to 30 percent of the incremental cost of the hybrid vehicle. For a vehicle that achieves a fuel economy increase of 50 percent or more, the credit is equal to 40 percent of the incremental cost of the hybrid vehicle.

The credit is subject to certain maximum applicable incremental cost amounts. For a qualifying hybrid motor vehicle weighing more than 8,500 pounds but not more than 14,000 pounds, the maximum allowable incremental cost amount is $7,500. For a qualifying hybrid motor vehicle weighing more than 14,000 pounds but not more than 26,000 pounds, the maximum allowable incremental cost amount is $15,000. For a qualifying hybrid motor vehicle weighing more than 26,000 pounds, the maximum allowable incremental cost amount is $30,000.

A qualifying hybrid motor vehicle weighing more than 8,500 pounds but not more than 14,000 pounds must have a maximum available power from the rechargeable energy storage system of at least 10 percent. A qualifying hybrid vehicle weighing more than 14,000 pounds must have a maximum available power from the rechargeable energy storage system of at least 15 percent.[76]

Alternative fuel vehicle

The credit for the purchase of a new alternative fuel vehicle would be 50 percent of the incremental cost of such vehicle, plus an additional 30 percent if the vehicle meets certain emissions standards, but not more than between $4,000 and $32,000 depending upon the weight of the vehicle. Table 8, below, shows the maximum permitted incremental cost for the purpose of calculating the credit for alternative fuel vehicles by vehicle weight class.

Table 6.–Maximum Allowable Incremental Cost for Calculation of Alternative Fuel Vehicle Credit

Vehicle Gross Weight Rating in Pounds	Maximum Allowable Incremental Cost
Vehicle ≤ 8,500	$5,000
8,500 < vehicle ≤ 14,000..................................	$10,000
14,000 < vehicle ≤ 26,000................................	$25,000
26,000 < vehicle...	$40,000

Alternative fuels comprise compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, and any liquid fuel that is at least 85 percent methanol. Qualifying alternative fuel motor vehicles are vehicles that operate only on qualifying alternative fuels and are incapable of operating on gasoline or diesel (except in the extent gasoline or diesel fuel is part of a qualified mixed fuel, described below).

Certain mixed fuel vehicles, that is vehicles that use a combination of an alternative fuel and a petroleum-based fuel, are eligible for a reduced credit. If the vehicle operates on a mixed fuel that is at least 75 percent alternative fuel, the vehicle is eligible for 70 percent of the otherwise allowable alternative fuel vehicle credit. If the vehicle operates on a mixed fuel that is

[76] In the case of such heavy-duty hybrid motor vehicles, the percentage of maximum available power is computed by dividing the maximum power available from the rechargeable energy storage system during a standard 10-second pulse power test, divided by the vehicle's total traction power. A vehicle's total traction power is the sum of the peak power from the rechargeable energy storage system and the heat (*e.g.*, internal combustion or diesel) engine's peak power. If the rechargeable energy storage system is the sole means by which the vehicle can be driven, then the total traction power is the peak power of the rechargeable energy storage system.

at least 90 percent alternative fuel, the vehicle is eligible for 90 percent of the otherwise allowable alternative fuel vehicle credit.

Base fuel economy

The base fuel economy is the 2002 model year city fuel economy for vehicles by inertia weight class by vehicle type. The "vehicle inertia weight class" is that defined in regulations prescribed by the Environmental Protection Agency for purposes of Title II of the Clean Air Act. Table 7, below, shows the 2002 model year city fuel economy for vehicles by type and by inertia weight class.

Table 7.–2002 Model Year City Fuel Economy

Vehicle Inertia Weight Class (Pounds)	Passenger Automobile (miles per gallon)	Light Truck (miles per gallon)
1,500	45.2	39.4
1,750	45.2	39.4
2,000	39.6	35.2
2,250	35.2	31.8
2,500	31.7	29.0
2,750	28.8	26.8
3,000	26.4	24.9
3,500	22.6	21.8
4,000	19.8	19.4
4,500	17.6	17.6
5,000	15.9	16.1
5,500	14.4	14.8
6,000	13.2	13.7
6,500	12.2	12.8

Vehicle Inertia Weight Class (Pounds)	**Passenger Automobile (miles per gallon)**	**Light Truck (miles per gallon)**
7,000	11.3	12.1
8,500	11.3	12.1

Effective date.−The provision applies to vehicles placed in service after the date of enactment and, in the case of qualified fuel cell motor vehicles, before January 1, 2015; in the case of qualified hybrid motor vehicles, before January 1, 2010; and in the case of qualified alternative fuel motor vehicles, before January 1, 2011.

Conference Agreement

The conference agreement follows both the House bill and the Senate amendment with modifications.

Fuel cell vehicles

The conference agreement follows the Senate amendment with respect to fuel cell vehicles.

Alternate fuel vehicles

The conference agreement follows the Senate amendment with respect to alternate fuel vehicles.

Hybrid vehicles and advanced lean-burn technology vehicles

Qualifying hybrid vehicle

A qualifying hybrid vehicle is a motor vehicle that draws propulsion energy from on-board sources of stored energy which include both an internal combustion engine or heat engine using combustible fuel and a rechargeable energy storage system (e.g., batteries). A qualifying hybrid motor vehicle must be placed in service before January 1, 2011 (January 1, 2010 in the case of a hybrid motor vehicle weighing more than 8,500 pounds).

Hybrid vehicles that are automobiles and light trucks

In the case of an automobile or light truck (vehicles weighing 8,500 pounds or less), the amount of credit for the purchase of a hybrid vehicle is the sum of two components: a fuel economy credit amount that varies with the rated fuel economy of the vehicle compared to a 2002 model year standard and a conservation credit based on the estimated lifetime fuel savings of a qualifying vehicle compared to a comparable 2002 model year vehicle. A qualifying hybrid automobile or light truck must have a maximum available power from the rechargeable energy storage system of at least four percent. In addition, the vehicle must meet or exceed certain EPA emissions standards. For a vehicle with a gross vehicle weight rating of 6,000 pounds or less the applicable emissions standards are the Bin 5 Tier II emissions standards. For a vehicle with a gross vehicle weight rating greater than 6,000 pounds and less than or equal to 8,500 pounds, the applicable emissions standards are the Bin 8 Tier II emissions standards.

Table 8, below, shows the fuel economy credit available to a hybrid passenger automobile or light truck whose fuel economy (on a gasoline gallon equivalent basis) exceeds that of a base fuel economy.

Table 8.–Fuel Economy Credit

Credit	If Fuel Economy of the Hybrid Vehicle Is:	
	at least	**but less than**
$400	125% of base fuel economy	150% of base fuel economy
$800	150% of base fuel economy	175% of base fuel economy
$1,200	175% of base fuel economy	200% of base fuel economy
$1,600	200% of base fuel economy	225% of base fuel economy
$2,000	225% of base fuel economy	250% of base fuel economy
$2,400	250% of base fuel economy	

Table 9, below, shows the conservation credit.

Table 9.–Conservation Credit

Estimated Lifetime Fuel Savings	Conservation Amount
At least 1,200 but less than 1,800	$250
At least 1,800 but less than 2,400	$500
At least 2,400 but less than 3,000	$750
At least 3,000	$1,000

Advanced lean-burn technology motor vehicles

The conference agreement a credit for the purchase of a new advanced lean burn technology motor vehicle. The amount of credit for the purchase of an advanced lean burn technology motor vehicle is the sum of two components: a fuel economy credit amount that varies with the rated fuel economy of the vehicle compared to a 2002 model year standard as described in Table 8, above and a conservation credit based on the estimated lifetime fuel savings of a qualifying vehicle compared to a comparable 2002 model year vehicle as described in Table 9 above.

A qualifying advanced lean burn technology motor vehicle that incorporates direct injection, achieves at least 125 percent of the 2002 model year city fuel economy, and 2004 and later model vehicles meets or exceeds certain Environmental Protection Agency emissions standards. For a vehicle with a gross vehicle weight rating of 6,000 pounds or less the applicable emissions standards are the Bin 5 Tier II emissions standards. For a vehicle with a gross vehicle weight rating greater than 6,000 pounds and less than or equal to 8,500 pounds, the applicable emissions standards are the Bin 8 Tier II emissions standards. A qualifying advanced lean burn technology motor vehicle must be placed in service before January 1, 2011.

Limitation on number of qualified hybrid and advanced lean-burn technology motor vehicles eligible for the credit

The conference agreement imposes a limitation on the number of qualified hybrid motor vehicles and advanced lean-burn technology motor vehicles sold by each manufacturer of such vehicles that are eligible for the credit. Taxpayers may claim the full amount of the allowable credit up to the end of the first calendar quarter after the quarter in which the manufacturer records its sale of the 60,000th hybrid and advanced lean-burn technology motor vehicle. Taxpayers may claim one half of the otherwise allowable credit during the two calendar quarters subsequent to the first quarter after the manufacturer has recorded its 60,000th such sale. In the third and fourth calendar quarters subsequent to the first quarter after the manufacturer has recorded its 60,000th such sale, the taxpayer may claim one quarter of the otherwise allowable credit.

Thus, summing the sales of qualifying hybrid motor vehicles of all weight classes and all sales of qualifying advanced lean-burn technology motor vehicles, if a manufacturer records the sale of its 60,000th in February of 2007, taxpayers purchasing such vehicles from the manufacturer may claim the full amount of the credit on their purchases of qualifying vehicles through June 30, 2007. For the period July 1, 2007, through December 31, 2007, taxpayers may claim one half of the otherwise allowable credit on purchases of qualifying vehicles of the manufacturer. For the period January 1, 2008, through June 30, 2008, taxpayers may claim one quarter of the otherwise allowable credit on the purchases of qualifying vehicles of the manufacturer. After June 30, 2008, no credit may be claimed for purchases of hybrid motor vehicles or advanced lean-burn technology motor vehicles sold by the manufacturer.

Hybrid vehicles that are medium and heavy trucks

In the case of a qualifying hybrid motor vehicle weighing more than 8,500 pounds, the conference agreement follows the Senate amendment.

Other rules

The portion of the credit attributable to vehicles of a character subject to an allowance for depreciation is treated as a portion of the general business credit; the remainder of the credit is allowable to the extent of the excess of the regular tax (reduced by certain other credits) over the alternative minimum tax for the taxable year.

Termination of Code section 179A

The conference agreement provides that section 179A sunsets after December 31, 2005.

Effective date.−The provision applies to vehicles placed in service after December 31, 2005, in the case of qualified fuel cell motor vehicles, before January 1, 2015; in the case of qualified hybrid motor vehicles that are automobiles and light trucks and in the case of advanced lean-burn technology vehicles, before January 1, 2011; in the case of qualified hybrid motor vehicles that medium and heavy trucks, before January 1, 2010; and in the case of qualified alternative fuel motor vehicles, before January 1, 2011.

8. Modification and extension of credit for electric vehicles (sec. 1532 of the Senate amendment)

Present Law

A 10-percent tax credit is provided for the cost of a qualified electric vehicle, up to a maximum credit of $4,000. A qualified electric vehicle generally is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electrical current. The full amount of the credit is available for purchases prior to 2006. The credit is reduced to 25 percent of the otherwise allowable amount for purchases in 2006, and is unavailable for purchases after December 31, 2006.

House Bill

No provision.

Senate Amendment

The provision repeals the phase out of the credit under present law. The provision also modifies present law to provide for a credit equal to the lesser of $1,500 or 10 percent of the manufacturer's suggested retail price of certain vehicles that conform to the Motor Vehicle Safety Standard 500. For all other electric vehicles, Table 10, below describes the credit.

Table 10.–Credit for Qualifying Battery Electric Vehicles

Vehicle Gross Weight Rating in Pounds	Credit Amount
Vehicle ≤ 8,500	$4,000
8,500 < vehicle ≤ 14,000	$10,000
14,000 < vehicle ≤ 26,000	$20,000
26,000 < vehicle	$40,000

If an electric vehicle weighing not more than 8,500 pounds has an estimated driving range of at least 100 miles on a single charge of the vehicle's batteries or if it is capable of a payload capacity of at least 1,000 pounds, then the credit amount in Table 10 is $6,000.

In general, the credit is allowed to the vehicle owner, including the lessor of a vehicle subject to a lease. If the use of the vehicle is described in paragraph (3) or (4) of section 50(b) (relating to use by tax-exempts, governments, and foreign persons) and is not subject to a lease, the seller of the vehicle may claim the credit so long the seller clearly discloses to the user in a document the amount that is allowable as a credit. A vehicle must be used predominantly in the United States to qualify for the credit.

The provision permits the credit to offset the excess of the regular tax (reduced by certain credits) over the alternative minimum tax. Credits in excess of this limitation may be carried back for up to three years and forward for up to 20 years; credits may not be carried back to taxable years beginning before the date of enactment and credits for vehicles used for personal use may not be carried back.

Effective date.−The provision is effective for property placed in service after the date of enactment and before January 1, 2010.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

9. Credit for installation of alternative fuel refueling property (sec. 1533 of the Senate amendment, sec. 1342 of the conference agreement, and new sec. 30C of the Code)

Present Law

Clean-fuel vehicle refueling property may be expensed and deducted when such property is placed in service (sec. 179A). Clean-fuel vehicle refueling property comprises property for the storage or dispensing of a clean-burning fuel, if the storage or dispensing is the point at which the fuel is delivered into the fuel tank of a motor vehicle. Clean-fuel vehicle refueling property also includes property for the recharging of electric vehicles, but only if the property is located at a point where the electric vehicle is recharged. Up to $100,000 of such property at each location owned by the taxpayer may be expensed with respect to that location. The deduction is unavailable for costs incurred after December 31, 2006.

For the purpose of sec. 179A clean fuels comprise natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity, and any other fuel at least 85 percent of which is methanol, ethanol, or any other alcohol or ether.

House Bill

No provision.

Senate Amendment

The provision permits taxpayers to claim a 50-percent credit for the cost of installing clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer. In the case of retail clean-fuel vehicle refueling property the allowable credit may not exceed $30,000. In the case of residential clean-fuel vehicle refueling property the allowable credit may not exceed $1,000.

Under the provision clean fuels are any fuel at least 85 percent of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, and hydrogen and any mixture of diesel fuel and biodiesel containing at least 20 percent biodiesel.

The taxpayer's basis in the property is reduced by the amount of the credit and the taxpayer may not claim deductions under section 179A with respect to property for which the credit is claimed. In the case of refueling property installed on property owned or used by a tax-exempt person, the taxpayer that installs the property may claim the credit. To be eligible for the credit, the property must be placed in service before January 1, 2010. The credit allowable in the taxable year cannot exceed the difference between the taxpayer's regular tax (reduced by certain other credits) and the taxpayer's tentative minimum tax. The taxpayer may carry forward unused credits for 20 years.

Effective date.−The provision is effective for property placed in service December 31, 2005.

Conference Agreement

The conference agreement follows the Senate amendment with modifications. The conference agreement provides that the credit rate is 30 percent rather than 50 percent.

The portion of the credit attributable to property of a character subject to an allowance for depreciation is treated as a portion of the general business credit; the remainder of the credit is allowable to the extent of the excess of the regular tax (reduced by certain other credits) over the alternative minimum tax for the taxable year.

The conference agreement provides that the credit may not be claimed for property placed in service after December 31, 2007.

Effective date.−The provision is effective for property placed in service December 31, 2005 and before January 1, 2008.

10. Volumetric excise tax credit for alternative fuels (sec. 1534 of the Senate amendment)

Present Law

A 24.3-cents-per-gallon excise tax is imposed on diesel fuel to finance the Highway Trust Fund. Gasoline and most special motor fuels are subject to tax at 18.3 cents per gallon for the Trust Fund.[77] The statutory rates for certain special motor fuels are determined on an energy equivalent basis, as follows:

Liquefied petroleum gas (propane)	13.6 cents per gallon
Liquefied natural gas	11.9 cents per gallon
Methanol derived from petroleum or natural gas	9.15 cents per gallon
Compressed natural gas	48.54 cents per MCF

Under section 4041, tax is imposed on special motor fuels (any liquid other than gas oil, fuel oil or any product taxable under section 4081) when there is a taxable sale by any person to an owner, lessee or other operator of a motor vehicle or motorboat, for use as fuel in the motor vehicle or motorboat or used by any person as a fuel in a motor vehicle or motorboat unless there was a prior taxable sale. No excise tax credit is provided for the sale or use of those fuels.

Liquid hydrogen is a special motor fuel for purposes of the tax on special motor fuels and is subject to a tax of 18.3 cents per gallon.[78] Compressed hydrogen gas used or sold as a fuel is not subject to tax.

Prior to the American Jobs Creation Act of 2004, gasohol and gasoline to be blended into gasohol was taxed at a reduced rate based on the amount of ethanol contained in the mixture (e.g., 10 percent, 7.7 percent or 5.5 percent alcohol in the mixture). The Act eliminated reduced

[77] Sec. 4041(a)(2)(A)(i). An additional 0.1 cent per gallon tax is imposed for the Leaking Underground Storage Tank Trust Fund on the sale or use of any liquid (other than liquefied petroleum gas and other than liquefied natural gas) if any tax was applicable under section 4041(a)(1) (relating to diesel fuel and kerosene) or 4041(a)(2) (relating to special motor fuels). See sec. 4041(d).

[78] An additional 0.1 cent per gallon is imposed by section 4041(d) for the Leaking Underground Storage Tank Trust Fund.

rates of excise tax for most alcohol-blended fuels. In place of the reduced rates, the Act amended the Code to create two new excise tax credits: the alcohol fuel mixture credit and the biodiesel mixture credit.[79] The sum of these credits may be taken against the tax imposed on taxable fuels (by section 4081). A person may also file a claim for payment equal to the amount of these credits for biodiesel or alcohol used to produce an eligible mixture.[80] The credits and payments are paid out of the General Fund. If the alcohol is ethanol with a proof of 190 or greater, the credit or payment amount is 51 cents per gallon. For agri-biodiesel, the credit or payment amount is $1.00 per gallon; for biodiesel other than agri-biodiesel, the credit or payment amount is 50 cents per gallon. Under the Code's coordination rules, a claim may be taken only once with respect to any particular gallon of alcohol or biodiesel.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, the liquefied petroleum gas, and P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)) are taxed at 18.3 cents per gallon under section 4041. Compressed natural gas is taxed at 18.3 cents per energy equivalent of a gallon of gasoline. Liquefied natural gas, any liquid fuel derived from coal (other than ethanol or methanol) and liquid hydrocarbons derived from biomass are taxed at 24.3 cents per gallon under section 4041. Under the provision, hydrogen (whether in liquid or gas form) is exempt from the tax imposed by section 4041; however, persons selling hydrogen as fuel are required to register with the Secretary. Collectively, these fuels (including hydrogen) are referred to as "alternative fuels."

In addition, the Senate amendment creates two new excise tax credits, the alternative fuel credit, and the alternative fuel mixture credit. The credits are allowed against section 4041 liability. The alternative fuel credit is 50 cents per gallon of alternative fuel or gasoline gallon equivalents of nonliquid alternative fuel sold by the taxpayer for use as a motor fuel in a highway vehicle. The alternative fuel mixture credit is 50 cents per gallon of alternative fuel used in producing an alternative fuel mixture for sale or use in a trade or business of the taxpayer. The mixture must be sold by the taxpayer for use as a fuel in a highway vehicle or used by the taxpayer for use as a fuel in a highway vehicle. Liquid fuel derived from coal would only qualify for the credits if derived from the Fisher-Tropsch process. The credits generally expire after September 30, 2009. The provision also allows persons to file a claim for payment equal to the amount of the alternative fuel credit and alternative fuel mixture credits. These payment provisions generally also expire after September 30, 2009. With respect to hydrogen, the credit and payment provisions expire after December 31, 2014. Both credits and payments are made

[79] Sec. 6426. The Act also created an income tax credit for biodiesel and biodiesel mixtures. Sec. 40A.

[80] Sec. 6427(e).

out of the General Fund. Under coordination rules, a claim for payment or credit may only be taken once with respect to any particular gallon or gasoline-gallon equivalent of alternative fuel.

Effective date.−The provision is effective for any sale, use or removal for any period after September 30, 2006.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

11. Extend excise tax provisions and income tax credit for biodiesel and create similar incentives for renewable diesel (sec. 1535 of the Senate amendment, secs. 1344 and 1346 of the conference agreement, and secs. 40A, 6426 and 6427 of the Code)

Present Law

Biodiesel income tax credit

Overview

The Code provides an income tax credit for biodiesel and qualified biodiesel mixtures, the biodiesel fuels credit.[81] The biodiesel fuels credit is the sum of the biodiesel mixture credit plus the biodiesel credit and is treated as a general business credit. The amount of the biodiesel fuels credit is includable in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the biodiesel excise tax credit and payment provisions discussed below. The credit may not be carried back to a taxable year ending before or on December 31, 2004. The provision does not apply to fuel sold or used after December 31, 2006.

Biodiesel is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the Environmental Protection Agency under section 211 of the Clean Air Act and (2) the requirements of the American Society of Testing and Materials D6751. Agri-biodiesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, or animal fats.

Biodiesel may be taken into account for purposes of the credit only if the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer or importer of the biodiesel which identifies the product produced and the percentage of the biodiesel and agri-biodiesel in the product.

Biodiesel mixture credit

The biodiesel mixture credit is 50 cents for each gallon of biodiesel used by the taxpayer in the production of a qualified biodiesel mixture. For agri-biodiesel, the credit is $1.00 per

[81] Sec. 40A.

gallon. A qualified biodiesel mixture is a mixture of biodiesel and diesel fuel that is (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) is used as a fuel by the taxpayer producing such mixture. The sale or use must be in the trade or business of the taxpayer and is to be taken into account for the taxable year in which such sale or use occurs. No credit is allowed with respect to any casual off-farm production of a qualified biodiesel mixture.

Biodiesel credit

The biodiesel credit is 50 cents for each gallon of biodiesel which is not in a mixture with diesel fuel (100 percent biodiesel or B-100) and which during the taxable year is (1) used by the taxpayer as a fuel in a trade or business or (2) sold by the taxpayer at retail to a person and placed in the fuel tank of such person's vehicle. For agri-biodiesel, the credit is $1.00 per gallon.

Biodiesel mixture excise tax credit

The Code also provides an excise tax credit for biodiesel mixtures.[82] The credit is 50 cents for each gallon of biodiesel used by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of the taxpayer. In the case of agri-biodiesel, the credit is $1.00 per gallon. A biodiesel mixture is a mixture of biodiesel and diesel fuel that (1) is sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) is used as a fuel by the taxpayer producing such mixture. No credit is allowed unless the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.[83]

The credit is not available for any sale or use for any period after December 31, 2006. This excise tax credit is coordinated with the income tax credit for biodiesel such that credit for the same biodiesel cannot be claimed for both income and excise tax purposes.

Payments with respect to biodiesel fuel mixtures

If any person produces a biodiesel fuel mixture in such person's trade or business, the Secretary is to pay such person an amount equal to the biodiesel mixture credit.[84] To the extent the biodiesel fuel mixture credit exceeds the section 4081 liability of a person, the Secretary is to pay such person an amount equal to the biodiesel fuel mixture credit with respect to such mixture.[85] Thus, if the person has no section 4081 liability, the credit is refundable. The

[82] Sec. 6426(c).

[83] Sec. 6426(c)(4).

[84] Sec. 6427(e).

[85] Sec. 6427(e)(1) and 6327(e)(2). See also, Internal Revenue Service, *Notice 2005-4*, 2005-2 I.R.B. (December 15, 2004).

payment provision does not apply with respect to biodiesel fuel mixtures sold or used after December 31, 2006.

House Bill

No provision.

Senate Amendment

The Senate amendment extends the income tax credit, excise tax credit, and payment provisions through December 31, 2010.

Effective date.−The provision is effective on the date of enactment.

Conference Agreement

The conference agreement extends the income tax credit, excise tax credit, and payment provisions through December 31, 2008. The conference agreement also creates a similar income tax credit, excise tax credit and payment system for renewable diesel; however, there is no credit for small producers of renewable diesel. Renewable diesel means diesel fuel derived from biomass (as defined in section 29(c)(3), thus excluding petroleum oil, natural gas, coal, or any product thereof) using a thermal depolymerization process.[86] Renewable diesel must meet the requirements of the American Society of Testing and Materials D975 or D396, and meet the registration requirements for fuels and fuel additives established by the Environmental Protection Agency under section 211 of the Clean Air Act (42 USC 7545). The amount of the credit for renewable diesel is $1.00 per gallon. In addition, all producers of renewable diesel must be registered with the Secretary.

Effective date.−The extension of incentives is effective on the date of enactment. The renewable diesel provisions are effective for fuel sold or used after December 31, 2005.

12. Credit for certain nonbusiness energy property (sec. 1317 of the House bill, sec. 1524 of the Senate amendment, sec. 1333 of the conference agreement, and new sec. 25C of the Code)

Present Law

A taxpayer may exclude from income the value of any subsidy provided by a public utility for the purchase or installation of an energy conservation measure. An energy conservation measure means any installation or modification primarily designed to reduce

[86] Thermal depolymerization is a process for the reduction of complex organic materials (such as turkey offal) into light crude oil. The process uses pressure and heat to decompose long chain polymers of hydrogen, oxygen, and carbon into short-chain petroleum hydrocarbons with a maximum length of around 18 carbons.

consumption of electricity or natural gas or to improve the management of energy demand with respect to a dwelling unit (sec. 136).

There is no present law credit for energy efficiency improvements to existing homes.

House Bill

The provision provides a 20-percent credit for the purchase of qualified energy efficiency improvements to existing homes. The maximum credit for a taxpayer with respect to the same dwelling for all taxable years is $2,000. A qualified energy efficiency improvement is any energy efficiency building envelope component that meets or exceeds the prescriptive criteria for such a component established by the 2000 International Energy Conservation Code as supplemented and as in effect on the date of enactment (or, in the case of metal roofs with appropriate pigmented coatings, meets the Energy Star program requirements), and (1) that is installed in or on a dwelling located in the United States; (2) owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) such component reasonably can be expected to remain in use for at least five years. The credit is nonrefundable.[87]

Building envelope components are: (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling; (2) exterior windows (including skylights) and doors; and (3) metal roofs with appropriate pigmented coatings which are specifically and primarily designed to reduce the heat loss or gain for a dwelling.

The taxpayer's basis in the property is reduced by the amount of the credit. Special rules apply in the case of condominiums and tenant-stockholders in cooperative housing corporations.

In the case of expenditures that exceed $1,000, certain certification requirements must be met in order to qualify for the credit.

Effective date.−The provision is effective for qualified energy efficiency improvements installed after the date of enactment and before January 1, 2008.

Senate Amendment

The provision provides a personal tax credit equal to the greater of (1) the total of the allowable credits for the purchase of certain property, or (2) the credit with respect to a highly energy-efficient principal residence.

The allowable credit for the purchase of certain property is (1) $50 for each advanced main air circulating fan, (2) $150 for each qualified natural gas, propane, or oil furnace or hot water boiler, and (3) $300 for each item of qualified energy efficient property.

[87] Sec. 1321 of the House bill allows the credit to offset both the regular tax and the alternative minimum tax.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace originally placed in service by the taxpayer during the taxable year, and which has an annual electricity use of no more than two percent of the total annual energy use of the furnace (as determined in the standard Department of Energy test procedures).

A qualified natural gas, propane, or oil furnace or hot water boiler is a natural gas, propane, or oil furnace or hot water boiler with an annual fuel utilization efficiency rate of at least 95.

Qualified energy-efficient property is: (1) an electric heat pump water heater which yields an energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which has a heating seasonal performance factor (HSPF) of at least 9, a seasonal energy efficiency ratio (SEER) of at least 15, and an energy efficiency ratio (EER) of at least 13, (3) a geothermal heat pump which (i) in the case of a closed loop product, has an energy efficiency ratio (EER) of at least 14.1 and a heating coefficient of performance (COP) of at least 3.3, (ii) in the case of an open loop product, has an energy efficiency ratio (EER) of at least 16.2 and a heating coefficient of performance (COP) of at least 3.6, and (iii) in the case of a direct expansion (DX) product, has an energy efficiency ratio (EER) of at least 15 and a heating coefficient of performance (COP) of at least 3.5, (4) a central air conditioner which has a seasonal energy efficiency ratio (SEER) of at least 15 and an energy efficiency ratio (EER) of at least 13, and (5) a natural gas, propane, or oil water heater which has an energy factor of at least 0.80.

The credit with respect to a highly energy-efficient principal residence is $2,000 if the principal residence achieves a 50 percent reduction in energy costs relative to the original condition of the building. In the case of a new home, the original condition of the building is deemed to be a home constructed in accordance with the standards of chapter 4 of the 2003 International Energy Conservation Code as in effect (including supplements) on the date of enactment, and for which and any applicable Federal minimum efficiency standards for equipment are met. In the case of a principal residence that achieves a reduction in energy costs between 20 and 50 percent, the allowable credit is $4,000 times the percentage reduction. No credit is allowed in the case of energy cost savings of less than 20 percent.

The residence must be located in the United States, and, in the case of a new residence, not be acquired from a contractor eligible for a credit for the production of a new energy efficient home under Code section 45K (as added by the bill).

If a credit is allowed under Code section 25D (as added by the bill) relating to residential solar, photovoltaic and fuel cell property, for the purpose of measuring energy efficiency improvements under this provision, the original condition of the home, or the comparable building in the case of a new home, is determined assuming the building contains the property for which the credit is allowed. Additionally, if a credit is allowed under this provision for any expenditure, the increase in the basis of the property that would result from such expenditure is reduced by the amount of the credit.

In order to be eligible for the credit, the residence's energy savings must be demonstrated by performance-based compliance and be certified according to regulations established by the

Secretary that follow various rules and procedures, including the use of computer software based on the 2005 California Residential Alternative Calculation Method Approval Manual. The determination of compliance may be provided by a local building regulatory authority, a utility, a manufactured home production inspection primary inspection agency (IPIA), or an accredited home energy rating system provider. All providers shall be accredited, or otherwise authorized to use approved energy performance measurement methods, by the Residential Energy Services Network (RESNET).

Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. Certain restrictions and limitations apply with respect to property financed by subsidized energy financing or obtained through grant programs. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account. If a credit is allowed under this provision with respect to any property, the basis of such property is reduced by the amount of the credit so allowed.

Effective date.−The credit applies to property placed in service after December 31, 2005 and prior to January 1, 2009.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with modifications. The conference agreement follows the House bill with respect to energy efficient improvements to the building envelope, but the credit rate is reduced to 10 percent. The conference agreement includes the Senate amendment provisions related to (1) advanced main air circulating fans, (2) natural gas, propane, or oil furnace or hot water boilers and (3) qualified energy-efficient property, The conference agreement does not include the Senate amendment provision related to highly energy-efficient principal residences. The credit allowed under the conference agreement may not exceed $500 in total across all taxable years, and no more than $200 dollars of such credit may be attributable to expenditures on windows. There is no requirement for certification of expenditures.

The conference agreement modifies the energy efficiency requirements for qualifying central air conditioners to be the highest efficiency tier established by the Consortium for Energy Efficiency as in effect on Jan. 1, 2006.

The conference agreement also modifies the effective date.

Effective date.− The credit applies to property placed in service after December 31, 2005 and prior to January 1, 2008.

13. Energy efficient commercial buildings deduction (sec. 1521 of the Senate amendment sec. 1331 of the conference agreement, and new sec. 179D of the Code)

Present Law

No special deduction is provided for expenses incurred for energy-efficient commercial building property.

House Bill

No provision.

Senate Amendment

In general

The provision provides a deduction equal to energy-efficient commercial building property expenditures made by the taxpayer. Energy-efficient commercial building property expenditures is defined as property (1) which is installed on or in any building located in the United States that is within the scope of Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America ("ASHRAE/IESNA"), (2) which is installed as part of (i) the interior lighting systems, (ii) the heating, cooling, ventilation, and hot water systems, or (iii) the building envelope, and (3) which is certified as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more in comparison to a reference building which meets the minimum requirements of Standard 90.1-2001 (as in effect on April 2, 2003). The deduction is limited to an amount equal to $2.25 per square foot of the property for which such expenditures are made. The deduction is allowed in the year in which the property is placed in service.

Certain certification requirements must be met in order to qualify for the deduction. The Secretary, in consultation with the Secretary of Energy, will promulgate regulations that describe methods of calculating and verifying energy and power costs using qualified computer software based on the provisions of the 2005 California Nonresidential Alternative Calculation Method Approval Manual or, in the case of residential property, the 2005 California Residential Alternative Calculation Method Approval Manual.

The Committee intends that the methods for calculation be fuel neutral, such that the same energy efficiency features qualify a building for the deduction under this provision regardless of whether the heating source is a gas or oil furnace or boiler or an electric heat pump. The Committee also intends that the calculation methods provide appropriate calculated energy savings for design methods and technologies not otherwise credited in either Standard 90.1-2001 or in the 2005 California Nonresidential Alternative Calculation Method Approval Manual, including the following: (i) Natural ventilation (ii) Evaporative cooling (iii) Automatic lighting controls such as occupancy sensors, photocells, and timeclocks(iv) Daylighting (v) Designs utilizing semi-conditioned spaces which maintain adequate comfort conditions without air conditioning or without heating (vi) Improved fan system efficiency, including reductions in static pressure (vii) Advanced unloading mechanisms for mechanical cooling, such as multiple or variable speed compressors (viii) On-site generation of electricity, including combined heat and power systems, fuel cells, and renewable energy generation such as solar energy (ix) Wiring with lower energy losses than wiring satisfying Standard 90.1-2001 requirements for building power distribution systems. The calculation methods may take into account the extent of commissioning in the building, and allow the taxpayer to take into account measured performance which exceeds typical performance

The Secretary shall prescribe procedures for the inspection and testing for compliance of buildings that are comparable, given the difference between commercial and residential buildings, to the requirements in the Mortgage Industry National Accreditation Procedures for Home Energy Rating Systems. Individuals qualified to determine compliance shall only be those recognized by one or more organizations certified by the Secretary for such purposes.

For energy-efficient commercial building property expenditures made by a public entity, such as public schools, the Secretary shall promulgate regulations that allow the deduction to be allocated to the person primarily responsible for designing the property in lieu of the public entity.

If a deduction is allowed under this section, the basis of the property shall be reduced by the amount of the deduction. Additionally, if a deduction is allowed for business energy property under section 1523 of the Senate amendment, or an individual credit for nonbusiness energy property or principal residence is allowed under section 1524 of the Senate amendment, then with respect to property for which a deduction under this provision may be claimed, the annual energy and power costs of the reference building is to be determined assuming the reference building contains the property for which the deduction or credit has been allowed, and any cost of such property taken into account under those other provisions of the bill cannot be taken into account under this provision.

Partial allowance of deduction

In the case of a building that does not meet the overall building requirement of a 50-percent energy savings, a partial deduction is allowed with respect to each separate building system that comprises energy efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system-specific savings targets established by the Secretary of the Treasury. The applicable system-specific savings targets to be established by the Secretary are those that would result in a total annual energy savings with respect to the whole building of 50 percent, if each of the separate systems met the system specific target. The separate building systems are (1) the interior lighting system, (2) the heating, cooling, ventilation and hot water systems, and (3) the building envelope. The maximum allowable deduction is $0.75 per square foot for each separate system.

In the case of system-specific partial deductions, in general no deduction is allowed until the Secretary establishes system-specific targets. However, in the case of lighting system retrofits, until such time as the Secretary issues final regulations, the system-specific energy savings target for the lighting system is deemed to be met by a reduction in Lighting Power Density of 40 percent (50 percent in the case of a warehouse) of the minimum requirements in Table 9.3.1.1 or Table 9.3.1.2 of ASHRAE/IESNA Standard 90.1-2001. Also, in the case of a lighting system that reduces lighting power density by 25 percent, a partial deduction of 37.5 cents per square foot is allowed. A pro-rated partial deduction is allowed in the case of a lighting system that reduces lighting power density between 25 percent and 40 percent. Certain lighting level and lighting control requirements must also be met in order to qualify for the partial lighting deductions.

Effective date.–The provision is effective for property placed in service after the date of enactment and prior to January 1, 2010.

Conference Agreement

The conference agreement follows the Senate amendment with modifications. The conference agreement provides that the deduction amount is reduced to $1.80 per square foot, and that the partial deduction for building subsystems is reduced to $0.60 per square foot. The conference agreement also modifies the effective date.

Effective date.–The provision is effective for property placed in service after December 31, 2005 and prior to January 1, 2008.

14. Deduction for business energy property (sec. 1523 of the Senate amendment)

Present Law

There is no special deduction provided for energy-efficient property.

House Bill

No provision.

Senate Amendment

The provision provides a deduction equal to the greater of (1) the total of the allowable deductions for the purchase of certain property, or (2) the allowable deduction with respect to energy-efficient residential rental building property.

The allowable deduction for the purchase of certain property is (1) $150 for each advanced main air circulating fan, (2) $450 for each qualified natural gas, propane, or oil furnace or hot water boiler, and (3) $900 for each item of qualified energy efficient property.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace originally placed in service by the taxpayer during the taxable year, and which has an annual electricity use of no more than two percent of the total annual energy use of the furnace (as determined in the standard Department of Energy test procedures).

A qualified natural gas, propane, or oil furnace or hot water boiler is a natural gas, propane, or oil furnace or hot water boiler with an annual fuel utilization efficiency rate of at least 95.

Qualified energy-efficient property is: (1) an electric heat pump water heater which yields an energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which has a heating seasonal performance factor (HSPF) of at least 9, a seasonal energy efficiency ratio (SEER) of at least 15, and an energy efficiency ratio (EER) of at least 13, (3) a geothermal heat pump which (i) in the case of a closed loop product, has an energy efficiency ratio (EER) of at least 14.1 and a heating coefficient of performance (COP) of at least

3.3, (ii) in the case of an open loop product, has an energy efficiency ratio (EER) of at least 16.2 and a heating coefficient of performance (COP) of at least 3.6, and (iii) in the case of a direct expansion (DX) product, has an energy efficiency ratio (EER) of at least 15 and a heating coefficient of performance (COP) of at least 3.5, (4) a central air conditioner which has a seasonal energy efficiency ratio (SEER) of at least 15 and an energy efficiency ratio (EER) of at least 13, and (5) a natural gas, propane, or oil water heater which has an energy factor of at least 0.80.

The allowable deduction with respect to energy-efficient residential rental building property is $6,000 if the building achieves a 50 percent reduction in energy costs relative to the original condition of the building (in the case of new construction, the original condition of the building is deemed to be a building built to the standards necessary for compliance with applicable local building construction codes). In the case of a building that achieves a reduction in energy costs between 20 and 50 percent, the allowable deduction is $12,000 times the percentage reduction. No deduction is allowed in the case of energy cost savings of less than 20 percent. In order to be eligible for the deduction, the building's energy savings must be certified according to regulations established by the Secretary that follow various rules and procedures. In the case of energy efficient residential rental building property which is public property, the Secretary shall promulgate a regulation to allow the allocation of the deduction to the person primarily responsible for designing the improvements to the property in lieu of the public entity which is the owner of such property.

In order to be eligible for the deduction, the rental building's energy savings must be demonstrated by performance-based compliance and be certified according to regulations established by the Secretary that follow various rules and procedures, including the use of computer software based on the 2005 California Residential Alternative Calculation Method Approval Manual. The determination of compliance may be provided by a local building regulatory authority, a utility, a manufactured home production inspection primary inspection agency (IPIA), or an accredited home energy rating system provider. All providers shall be accredited, or otherwise authorized to use approved energy performance measurement methods, by the Residential Energy Services Network (RESNET).

For energy-efficient residential rental building property owned by a Federal Sate or local government or political subdivision thereof, the Secretary shall promulgate regulations that allow the deduction to be allocated to the person primarily responsible for designing the property in lieu of the public entity.

No deduction for energy efficient residential rental property is allowed for any property for which a deduction is allowable under Code section 179D (as added by the bill), relating to the deduction for energy efficient commercial building property.

If a deduction is allowed under this provision with respect to any property, the basis of such property is reduced by the amount of the deduction so allowed.

Effective date.−The credit applies to property placed in service after the date of enactment and prior to January 1, 2009.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

15. Energy efficient new homes (sec. 1522 of the Senate amendment, sec. 1332 of the conference agreement, and new sec. 45L of the Code)

Present Law

There is no present-law credit for the construction of new energy-efficient homes.

House Bill

No provision.

Senate Amendment

The provision provides a credit to an eligible contractor for the construction of a qualified new energy-efficient home. To qualify as an energy-efficient new home, the home must be: (1) a dwelling located in the United States, (2) substantially completed after the date of enactment, and (3) certified in accordance with guidance prescribed by the Secretary to have a projected level of annual heating and cooling energy consumption that meets the standards for either a 30-percent or 50-percent reduction in energy usage, compared to a comparable dwelling constructed in accordance with the standards of chapter 4 of the 2003 International Energy Conservation Code as in effect (including supplements) on the date of enactment, and any applicable Federal minimum efficiency standards for equipment. With respect to homes that meet the 30-percent standard, one-third of such 30 percent savings must come from the building envelope, and with respect to homes that meet the 50-percent standard, one-fifth of such 50 percent savings must come from the building envelope.

The credit equals $1,000 in the case of a new home that meets the 30 percent standard and $2,000 in the case of a new home that meets the 50 percent standard.

The eligible contractor is the person who constructed the home, or in the case of a manufactured home, the producer of such home. The Committee intends that the building envelope component means insulation materials or system specifically and primarily designed to reduce heat loss or gain, exterior windows (including skylights), doors, and any duct sealing and infiltration reduction measures.

Manufactured homes that conform to federal manufactured home construction and safety standards are eligible for the credit provided all the criteria for the credit are met. Manufactured homes certified by a method prescribed by the Administrator of the Environmental Protection Agency under the Energy Star Labeled Homes program are eligible for the $1,000 credit provided criteria (1) and (2), above, are met.

The credit is part of the general business credit. No credits attributable to energy efficient homes can be carried back to any taxable year ending on or before the effective date of the credit.

Effective date.−The credit applies to homes whose construction is substantially completed after the date of enactment, and which are purchased during the period beginning on the date of enactment and ending on December 31, 2009 (December 31, 2007 in the case of the $1,000 credit).

Conference Agreement

The conference agreement follows the Senate amendment with modifications. The conference agreement provides that the credit related to homes meeting the 30-percent efficiency standard applies only to manufactured homes. The conference agreement also modifies the effective date.

Effective date.−The credit applies to homes whose construction is substantially completed after December 31, 2005, and which are purchased after December 31, 2005 and prior to January 1, 2008.

16. Energy credit for combined heat and power system property (sec. 1525 of the Senate amendment)

Present Law

A nonrefundable, 10-percent business energy credit is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage.

The business energy tax credits are components of the general business credit (sec. 38(b)(1)). The business energy tax credits, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of (1) 25 percent of net regular tax liability above $25,000 or (2) the tentative minimum tax. For credits arising in taxable years beginning after December 31, 1997, an unused general business credit generally may be carried back one year and carried forward 20 years (sec. 39).

A taxpayer may exclude from income the value of any subsidy provided by a public utility for the purchase or installation of an energy conservation measure. An energy conservation measure means any installation or modification primarily designed to reduce consumption of electricity or natural gas or to improve the management of energy demand with respect to a dwelling unit (sec. 136).

There is no present-law credit for combined heat and power (“CHP”) property.

House Bill

No provision.

Senate Amendment

The provision provides a 10-percent credit for the purchase of CHP property.

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 provision provides that systems whose fuel source is at least 90 percent bagasse 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).

Effective date.−The credit applies to periods after the date of enactment in taxable years ending after the date of enactment, for property placed in service before January 1, 2008, under rules similar to rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990).

Conference Agreement

The conference agreement does not include the Senate amendment provision.

17. Energy efficient appliances (sec. 1526 of the Senate amendment, sec. 1334 of the conference agreement, and new sec. 45M of the Code)

Present Law

There is no present-law credit for the manufacture of energy-efficient appliances.

House Bill

No provision.

Senate Amendment

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 the percentage by which the efficiency of the 2007 standards (not yet known) exceeds that of the 2005 standards. The credit may not exceed $100 per dishwasher.

The credit for clothes washers equals (1) $50 for clothes washers manufactured in 2005 that have a modified energy factor (MEF) of at least 1.42, (2) $100 for clothes washers manufactured in 2005-2007 that meet the requirements of the Energy Star program which are in effect for clothes washers in 2007, or (3) the minimum of (i) $200 or (ii) $10 multiplied by the average of the energy and water savings percentages of the 2010 Energy Star standards relative to the 2007 Energy Star standards, for clothes washers manufactured in 2008-2010 that meet the requirements of the Energy Star program which are in effect for clothes washers in 2010.

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 2005 or 2006 receive a $75 credit. Refrigerators that achieve a 20 to 25 percent energy saving receive a (i) $125 credit if manufactured in 2005-2007, or (ii) $100 credit if manufactured in 2008. Refrigerators that achieve at least a 25 percent energy saving receive a (i) $175 credit if manufactured in 2005-2007, or (ii) $150 credit if manufactured in 2008-2010.

Appliances eligible for the credit include only those that exceed the average amount of production from the 3 prior calendar years for each category of appliance. In the case of refrigerators, eligible production is production that exceeds 110 percent of the average amount of production from the 3 prior calendar years. Proration rules apply in the case of credits for 2005 production.

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.

Effective date.−The credit applies to appliances produced after the date of enactment and prior to January 1, 2011 (January 1, 2008, in the case of dishwashers).

Conference Agreement

The conference agreement follows the Senate amendment, but only with respect to the provisions that cover production after December 31, 2005 and prior to January 1, 2008.

Effective date.−The credit applies to appliances produced after December 31, 2005 and prior to January 1, 2008.

C. Alternative Minimum Tax Relief Provisions

1. Allow nonbusiness energy credits against the alternative minimum tax (sec. 1321 of the House bill)

Present Law

Present law imposes an alternative minimum tax on individuals in an amount equal to the excess of the tentative minimum tax over the regular tax liability. The tentative minimum tax is an amount equal to specified rates of tax imposed on the excess of the alternative minimum taxable income over an exemption amount.

Generally, for taxable years beginning after December 31, 2005, nonrefundable personal credits may not exceed the excess of the regular tax liability over the tentative minimum tax.

House Bill

The provision allows the personal energy credits added by the House bill to offset both the regular tax and the alternative minimum tax.

Effective date.−The provision applies to taxable years beginning after December 31, 2005.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not contain the House bill provision.

2. Allow certain business energy credits against the alternative minimum tax (sec. 1322 of the House bill and sec. 1548(c) of the Senate amendment)

Present Law

Present law imposes an alternative minimum tax on individuals and corporations in an amount equal to the excess of the tentative minimum tax over the regular tax liability. The tentative minimum tax is an amount equal to specified rates of tax imposed on the excess of the alternative minimum taxable income over an exemption amount.

Generally, the general business credit may not exceed the excess of the regular tax liability over the tentative minimum tax (or, if greater, 25 percent of so much of the regular tax liability as exceeds $25,000). Amounts in excess of this limitation generally may be carried back one year and forward 20 years. In applying the tax limitation to certain business energy credits, the tentative minimum tax is treated as being zero. These credits include the alcohol fuels credit and the section 45 credit for electricity produced from a facility (placed in service after October

22, 2004) during the first four years of production beginning on the date the facility is placed in service.

House Bill

The House bill expands the list of business energy credits for which the tentative minimum tax is treated as being zero to include (i) the low sulfur diesel fuel production credit, (ii) the marginal oil and gas well production credit, (iii) the portion of the investment credit attributable to qualified fuel cells, and (iv) for taxable years beginning after December 31, 2005, and before January 1, 2008, the enhanced oil recovery credit.

Effective date.−The provision generally applies to credits determined for taxable years beginning after December 31, 2005. In the case of the credit for qualified fuel cells, the provision applies for taxable years ending after April 11, 2005.

Senate Amendment

The Senate amendment expands the list of business energy credits for which the tentative minimum tax is treated as being zero to include the credit for production of coal owned by Indian tribes.

Effective date.−The provision is effective as if included in the provision allowing the credit.

Conference Agreement

The conference agreement does not expand the list of business energy credits for which the tentative minimum tax is treated as being zero.[88]

[88] However, see sec. 45(e)(10)(D) treating the credit for the production of Indian Coal as being on the list.

D. Additional Energy Tax Incentives

1. Ten-year recovery period for underground natural gas storage facilities and cushion gas (sec. 1541 of the Senate amendment)

Present Law

Under present law, depreciation allowances for property used in a trade or business generally are determined under the Modified Accelerated Cost Recovery System ("MACRS"). Under MACRS, natural gas storage facilities and related equipment have a class life of 22 years and a recovery period of 15 years.

Cushion gas is the minimum volume of natural gas necessary to provide the pressure to facilitate the flow of gas from a storage reservoir to a pipeline. Recoverable cushion gas will be available for sale or other use upon abandonment of the storage reservoir, while nonrecoverable cushion gas will become obsolete with that abandonment. Under present law, the tax treatment of cushion gas depends on whether such gas is recoverable. The quantity of cushion gas that is recoverable is not subject to depreciation because it is not subject to exhaustion, wear, tear, or obsolescence. Conversely, non-recoverable cushion gas is subject to obsolescence and is therefore subject to tax depreciation. The depreciable life of non-recoverable cushion gas is also 15 years.

House Bill

No provision.

Senate Amendment

The Senate amendment reclassifies underground natural gas storage facilities and nonrecoverable cushion gas as 10-year MACRS property. The present law treatment of recoverable cushion gas remains unchanged.

Effective date.−The Senate amendment provision applies to property placed in service after the date of enactment, the original use of which commences with the taxpayer.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

2. Modify research credit for research relating to energy (sec. 1542 of the Senate amendment, sec. 1351 of the conference agreement, and sec. 41 of the Code)

Present Law

General rule

Section 41 provides for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenses for a taxable year exceed its base amount for that year.

The research tax credit is scheduled to expire and generally will not apply to amounts paid or incurred after December 31, 2005.

A 20-percent research tax credit also applies to the excess of (1) 100 percent of corporate cash expenses (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the university basic research credit (see sec. 41(e)).

Alternative incremental research credit regime

Taxpayers are allowed to elect an alternative incremental research credit regime. If a taxpayer elects to be subject to this alternative regime, the taxpayer is assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise is reduced. Under the alternative credit regime, a credit rate of 2.65 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of one percent (i.e., the base amount equals one percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 3.2 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of two percent. A credit rate of 3.75 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of two percent. An election to be subject to this alternative incremental credit regime may be made for any taxable year beginning after June 30, 1996, and such an election applies to that taxable year and all subsequent years unless revoked with the consent of the Secretary of the Treasury.

Eligible expenses

Qualified research expenses eligible for the research tax credit consist of: (1) in-house expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid or incurred by the taxpayer to certain other persons for qualified research conducted on the taxpayer's behalf (so-called contract research expenses). In the case of amounts paid to a research consortium, 75 percent of amounts paid for qualified research is treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer.

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 for the deduction for research expenses, but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and substantially all of the activities of which must constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component.

House Bill

No provision.

Senate Amendment

The provision modifies the present-law research credit as it applies to qualified energy research. In particular, the provision provides that the taxpayer may claim a credit equal to 20 percent of the taxpayer's expenditures on qualified energy research undertaken by an energy research consortium. The amount of credit claimed is determined only by regard to such expenditures by the taxpayer within the taxable year. Unlike the general rule for the research credit, the 20-percent credit for research by an energy research consortium applies to all such expenditures, not only those in excess of a base amount however determined. An energy research consortium is a qualified research consortium as under present law that also is organized and operated primarily to conduct energy research and development in the public interest and to which at least five unrelated persons paid, or incurred amounts, to such organization within the calendar year. In addition, to be a qualified energy research consortium no single person shall pay or incur more than 50 percent of the total amounts received by the research consortium during the calendar year.

The provision also provides that 100 percent of amounts paid or incurred by the taxpayer to eligible small businesses, universities, and Federal for qualified energy research would constitute qualified research expenses as contract research expenses, rather than 65 percent of qualified research expenditures allowed under present law. An eligible small business for this purpose is a business in which the taxpayer does not own a 50 percent or greater interest and the business has employed, on average, 500 or fewer employees in the two preceding calendar years.

Qualified energy research expenditures are expenditures that would otherwise qualify for the research credit under present law and relate to the production, supply, and conservation of energy, including otherwise qualifying research expenditures related to alternative energy sources or the use of alternative energy sources. For example, research relating to hydrogen fuel cell vehicles would qualify under this provision, if the research expenditures otherwise satisfy the criteria of present-law sec. 41. Likewise, otherwise qualifying research undertaken to improve the energy-efficiency of lighting would qualify under this provision.

Effective date.−The provision is effective for amounts paid or incurred after the date of enactment in taxable years ending after such date.

Conference Agreement

The conference agreement follows the Senate amendment.

3. Small agri-biodiesel producer credit (sec. 1543 of the Senate amendment, sec. 1345 of the conference agreement, and sec. 40A of the Code)

Present Law

Biodiesel income tax credit

The Code provides an income tax credit for biodiesel and qualified biodiesel mixtures, the biodiesel fuels credit. The biodiesel fuels credit is the sum of the biodiesel mixture credit plus the biodiesel credit and is treated as a general business credit. The amount of the biodiesel fuels credit is includable in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the biodiesel excise tax credit and payment provisions created by the Act. The credit may not be carried back to a taxable year ending before or on December 31, 2004. The provision does not apply to fuel sold or used after December 31, 2006.

Biodiesel is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the Environmental Protection Agency under section 211 of the Clean Air Act and (2) the requirements of the American Society of Testing and Materials D6751. Agri-biodiesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, or animal fats.

Biodiesel may be taken into account for purposes of the credit only if the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer or importer of the biodiesel which identifies the product produced and the percentage of the biodiesel and agri-biodiesel in the product.

The biodiesel income tax credit does not contain any incentives for small producers.

Small ethanol producer credit

Present law provides several tax benefits for ethanol and methanol produced from renewable sources that are used as a motor fuel or that are blended with other fuels (e.g., gasoline) for such a use. In the case of ethanol, a separate 10-cents-per-gallon credit for up to 15 million gallons per year for small producers, defined generally as persons whose production does not exceed 15 million gallons per year and whose production capacity does not exceed 30 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 al 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 (a), (b), or (c). A cooperative may pass through the small ethanol producer credit to its patrons. The alcohol fuels tax credits are includible in income. This credit may be used to offset alternative minimum tax liability. The credit is a treated as a general business credit, subject to the ordering rules and carryforward/carryback rules that apply to business credits generally. The alcohol fuels tax credit is scheduled to expire after December 31, 2010.

House Bill

No provision.

Senate Amendment

The Senate amendment adds to the biodiesel fuels credit a small agri-biodiesel producer credit. The credit is a 10-cents-per-gallon credit for up to 15 million gallons of agri-biodiesel produced by small producers, defined generally as persons whose agri-biodiesel production capacity does not exceed 60 million gallons per year. The agri-biodiesel must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified biodiesel 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 agri-biodiesel 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 (a), (b), or (c).

Like the small ethanol producer credit, cooperatives may elect to pass through any portion of the small agri-biodiesel producer credits to its patrons. The credit is apportioned pro rata among patrons of the cooperative on the basis of the quantity or value of the business done with or for such patrons for the taxable year. An election to pass through the credit is made on a timely filed return for the taxable year and is irrevocable for such taxable year.

The amount of the credit not apportioned to patrons is included in the organization's credit for the taxable year of the organization. The amount of the credit apportioned to patrons is to be included in the patron's credit for the first taxable year of each patron ending on or after the last day of the payment period for the taxable year of the organization, or, if earlier, for the taxable year of each patron ending on or after the date on which the patron receives notice from the cooperative of the apportionment.

If the amount of the cooperative's credit for a taxable year is less than the amount of the credit shown on the organization's tax return for such taxable year, an amount equal to the excess of the reduction in the credit over the amount not apportioned to patrons for the taxable year is treated as an increase in the cooperative's tax. The increase is not treated as tax imposed for purposes of determining the amount of any tax credit or for purposes of the alternative minimum tax.

The credit sunsets after December 31, 2010, along with the other biodiesel incentives as extended under the Senate amendment.

Effective date.–The provision is effective for taxable years ending after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment except the credit sunsets after December 31, 2008.

4. Modifications to small ethanol producer credit (sec. 1544 of the Senate amendment, sec. 1347 of the conference agreement, and sec. 40 of the Code)

Present Law

Present law provides several tax benefits for ethanol and methanol that are used as a fuel or that are blended with other fuels (e.g., gasoline) for such a use. For example, the Code provides an income tax credit for alcohol and alcohol-blended fuels. In the case of ethanol, the Code provides an additional 10-cents-per-gallon credit for small producers, defined generally as persons whose production capacity does not exceed 30 million gallons per year.[89]

House Bill

No provision.

Senate Amendment

The Senate amendment increases the limit on production capacity for small ethanol producers from 30 million gallons to 60 million gallons per year.

The Senate amendment also provides that an election to pass the small ethanol producer credit through to cooperative patrons is not valid unless the cooperative provides patrons timely written notice of the apportionment of the credit. Under the Senate amendment, notice is timely if mailed to patrons during the payment period described in section 1382(d) of the Code.

Effective date.−The provision is effective for taxable years ending after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

5. Credit for equipment for processing or sorting materials gathered through recycling (sec. 1545 of the Senate amendment and sec. 1353 of the conference agreement)

Present Law

There is no present law credit for equipment for processing or sorting materials gathered through recycling.

House Bill

No provision.

[89] Sec. 40(b)(4) and (g)(1). The alcohol fuels tax credit (which is comprised of the small ethanol producer credit, the alcohol mixture credit, and the alcohol credit) is scheduled to expire after December 31, 2010 (sec. 40(e)(1)).

Senate Amendment

The provision provides a 15-percent business tax credit for the cost of qualified recycling equipment placed in service or leased by the taxpayer. Qualified recycling equipment is equipment, including connecting piping, (1) that is employed in sorting or processing residential and commercial qualified recyclable materials (any packaging or printed material which is glass, paper, plastic, steel, or aluminum generated by an individual or business) for the purpose of converting such materials for use in manufacturing tangible consumer products, including packaging, or (2) whose primary purpose is the shredding and processing of any electronic waste, including any cathode ray tube, flat panel screen, or similar video display device with a screen size greater than four inches measured diagonally, or a central processing unit.

Qualified recycling equipment does not include rolling stock or other equipment used to transport recyclable materials. Materials that are not packaging or printed material, such as tires or scrap metal from junked automobiles, are not qualified recyclable materials, and thus equipment used to process such materials are not qualified recycling equipment.

For the purposes of (1), qualified recycling equipment includes equipment that is utilized at commercial or public venues, including recycling collection centers, where the equipment is utilized to sort or process qualified recyclable materials for such purpose. For the purpose of (2), only the cost of each piece of equipment as exceeds $400,000 is eligible for the credit.

Effective date.−The credit applies to amounts paid or incurred during the taxable year for qualified recycling equipment placed in service or leased in taxable years beginning after December 31, 2005.

Conference Agreement

The conference agreement does not include the Senate amendment provision. The conference agreement directs the Secretary of the Treasury, in consultation with the Secretary of Energy, to conduct a study to determine and quantify the energy savings achieved through the recycling of glass, paper, plastic, steel, aluminum, and electronic devices, and to identify tax incentives that would encourage recycling of such material. The study is to be submitted to Congress within one year of the date of enactment.

Effective date.−The provision is effective on the date of enactment.

6. Five-year carryback of net operating losses for certain electric utility companies (sec. 1546 of the Senate amendment, sec. 1311 of the conference agreement, and sec. 172 of the Code)

Present Law

A net operating loss ("NOL") is, generally, the amount by which a taxpayer's allowable deductions exceed the taxpayer's gross income. A carryback of an NOL generally results in the refund of Federal income tax for the carryback year. A carryover of an NOL reduces Federal income tax for the carryover year.

In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[90] Under present-law ordering rules, NOLs generally are first applied to the earliest of the taxable years to which the loss may be carried.[91]

Different rules apply with respect to NOLs arising in certain circumstances. For example, a three-year carryback applies with respect to NOLs (1) arising from casualty or theft losses of individuals, or (2) attributable to Presidentially declared disasters for taxpayers engaged in a farming business or a small business. A five-year carryback period applies to NOLs from a farming loss (regardless of whether the loss was incurred in a Presidentially declared disaster area). Special rules also apply to real estate investment trusts (no carryback), specified liability losses (10-year carryback), and excess interest losses (no carryback to any year preceding a corporate equity reduction transaction).

Section 202 of the Job Creation and Worker Assistance Act of 2002[92] ("JCWAA") provided a temporary extension of the general NOL carryback period to five years (from two years) for NOLs arising in taxable years ending in 2001 and 2002. In addition, the five-year carryback period applies to NOLs from these years that qualify under present law for a three-year carryback period (i.e., NOLs arising from casualty or theft losses of individuals or attributable to certain Presidentially declared disaster areas).

A taxpayer can elect to forgo the five-year carryback period. The election to forgo the five-year carryback period is made in the manner prescribed by the Secretary of the Treasury and must be made by the due date of the return (including extensions) for the year of the loss. The election is irrevocable. If a taxpayer elects to forgo the five-year carryback period, then the losses are subject to the rules that otherwise would apply under section 172 absent the provision.

House Bill

No provision.

Senate Amendment

The Senate amendment provides a temporary extension of the NOL carryback period to five years for NOLs of certain electric utility companies arising in taxable years ending in 2003, 2004, and 2005 ("eligible NOLs"). Regardless of the taxable year in which an eligible NOL arose, refund claims resulting from the extended carryback period can be made during any taxable year ending after December 31, 2005, and before January 1, 2009. However, the amount of the refund claimed during any one taxable year may not exceed the amount of the electric utility company's investment in electric transmission property and pollution control facilities

[90] Sec. 172.

[91] Sec. 172(b)(2).

[92] Pub. Law No. 107-147.

("qualifying investment") in the preceding taxable year.[93] The present-law NOL carryover ordering rules apply. Taxpayers may elect to forgo the five-year carryback period provided under the provision if an election is filed before January 1, 2009.

Effective date.−The Senate amendment provision is effective for refund claims resulting from net operating losses generated in taxable years ending in 2003, 2004, and 2005.

Conference Agreement

The conference agreement follows the Senate amendment, with the following modifications. The conference agreement provides an election for certain electric utility companies to extend the carryback period to five years for a portion of NOLs arising in 2003, 2004, and 2005 ("loss years"). The election may be made during any taxable year ending after December 31, 2005, and before January 1, 2009 ("election years"). An electing taxpayer must specify to which loss year the election applies.

The portion of the loss year NOL to which the election may apply is limited to 20 percent of the amount of the taxpayer's qualifying investment in the taxable year prior to the year in which the election is made (the "qualifying investment limitation"). Rules similar to those applicable to specified liability losses apply, and any remaining portion of the loss year NOL remains subject to the present law NOL carryover rules. Only one election may be made in any election year, and elections may not be made for more than one election year beginning in the same calendar year. Thus, for example, a taxpayer with two short taxable years beginning in calendar year 2006 is eligible to make an election under this provision in only one of those two short taxable years. Once an election has been made with respect to a loss year, no subsequent election is available with respect to that loss year.

For purposes of calculating interest on overpayments, any overpayment resulting from a five-year NOL carryback elected under this provision is deemed not to have been made prior to the filing date for the taxable year in which the election is made. The statute of limitations for refund claims, and that for assessment of deficiencies, are also extended.

An election under this provision is made in such manner as the Secretary may prescribe. However, the conferees expect that the filing of a refund claim will be considered sufficient for making the election, provided that the taxpayer attaches to the refund claim a statement specifying the election year, the loss year, and the amount of qualifying investment in electric transmission property and pollution control facilities in the preceding taxable year.

Under the conference agreement, an investment in electric transmission property qualifies if it is a capital expenditure made by the taxpayer which is attributable to electric transmission

[93] In order to qualify, such investment must be in the form of capital expenditures; qualifying investment does not include currently deductible expenses. In addition, the property must be acquired for use by the taxpayer in the taxpayer's trade or business. There is no requirement that the transmission property or pollution control facilities be placed in service in the year in which the capital expenditures are incurred.

property used by the taxpayer in the transmission at 69 or more kilovolts of electricity for sale. An investment in pollution control equipment qualifies if it is a capital expenditure, made by an electric utility company (as defined in the Public Utility Holding Company Act as in effect on the day before the date of enactment of the provision), which is attributable to a facility which will qualify as a certified pollution control facility, generally as defined under section 169(d)(1) but without regard to the requirements therein that the facility be new or that it be used in connection with a plant or other property in operation before January 1, 1976.

The conferees recognize that a significant amount of time may be required between the date of a capital expenditure for electric transmission property or pollution control equipment and the date the property is placed in service. Accordingly, there is no requirement that the transmission property or pollution control facilities be placed in service in the year in which the capital expenditures are incurred. However, it is intended that qualifying investment under the provision includes only capital expenditures to which the taxpayer is committed and with respect to property which the taxpayer intends to ultimately place in service in the taxpayer's trade or business. Under the conference agreement, capital expenditures which, at the taxpayer's option, are refundable or subject to material modification in a manner which would not meet the requirements of the provision, may not be taken into account. For example, if a taxpayer makes a cash deposit with respect to a contract for the purchase of electric transmission property, and the contract contains an option (or there is otherwise an understanding) under which the taxpayer may subsequently apply the deposit to the purchase of equipment other than electric transmission property, the deposit is not included in the taxpayer's qualifying investment. This rule is intended as an anti-abuse rule and should be interpreted to prevent a taxpayer from taking into account capital expenditures to which the taxpayer is not permanently committed.

Effective date.−The conference agreement provision is effective for elections made in taxable years ending after December 31, 2005, and before January 1, 2009, with respect to net operating losses arising in taxable years ending in 2003, 2004, and 2005.

7. Qualifying pollution control equipment credit (sec. 1547 of the Senate amendment)

Present Law

There is no tax credit for investment in pollution control equipment. An investment credit is available for investment in certain energy property.

Senate Amendment

The Senate amendment provides an investment credit for qualifying pollution control equipment. The credit is an amount equal to 15 percent of the basis of qualifying pollution control equipment placed in service at a qualifying facility during the taxable year. Qualifying pollution control equipment means any technology that is installed in or on a qualifying facility to reduce air emissions of any pollutant regulated by the Environmental Protection Agency under the Clean Air Act, including thermal oxidizers, scrubber systems, vapor recovery systems, low nitric oxide burners, flair systems, bag houses, cyclones, and continuous emission monitoring systems. A qualifying facility is a facility that produces not less than 1,000,000 gallons of ethanol during the taxable year. For depreciation purposes, the basis of qualifying pollution control equipment is reduced by 50 percent of the amount of the credit.

In the case of property constructed over a period of two or more years, a taxpayer may elect to claim the credit on the basis of qualified progress expenditures made during the period of construction before the property is completed and placed in service.[94]

Effective date.−The credit applies to periods after the date of enactment in accordance with the transitional rules set forth in 48(m) (as in effect before its repeal).

Conference Agreement

The conference agreement does not include the Senate amendment provision.

8. Credit for production of coal owned by Indian tribes (sec. 1548 of the Senate amendment)

Present Law

Present law provides two income tax incentives for businesses operating within Indian reservations: (1) accelerated depreciation with respect to certain non-gaming property used in a trade or business within an Indian reservation (sec. 168(j)); and (2) a nonrefundable income tax credit to employers on the first $20,000 of qualified wages and health care costs paid to certain members of Indian tribes (or their spouses) who work on or near an Indian reservation and who earn less than $30,000 per year (adjusted for inflation beginning in 1993) (sec. 45A). Both credits expire after December 31, 2005.

Present law does not provide a credit for the production of coal from coal reserves owned by an Indian tribe.

House Bill

No provision.

Senate Amendment

The provision establishes a credit for “Indian coal” sold to an unrelated person. Indian coal is defined as coal produced from coal reserves that on June 14, 2005, were owned by a Federally recognized tribe of Indians or are held in trust by the United States for a tribe or its members.

[94] The rules applicable to qualified progress expenditures are the rules in effect under section 46(c)(4) and (d) (relating to the investment tax credit), as in effect before their repeal.

The amount of the credit equals $1.50 per ton for coal sold in 2006 through 2009 and $2.00 per ton for coal sold after 2009. The credit is indexed for inflation after 2006, is part of the general business credit (sec. 38), and is allowed against the alternative minimum tax.

Effective date.− The provision applies to Indian coal sold after December 31, 2005, and before January 1, 2013.

Conference Agreement

The conference agreement generally follows the Senate amendment with some modifications. Under the conference agreement, the credit for Indian coal is added by modifying Code section 45, rather than by amending Code section 38 and creating new Code section 45N. As a result, some technical aspects of the credit are changed. These technical aspects are described in section A.9. of this report along with descriptions of other modifications to Code section 45.

9. Replacement stoves meeting environmental standards in non-attainment areas (sec. 1549 of the Senate amendment)

Present Law

There is no present law tax credit relating to stoves.

House Bill

No provision.

Senate Amendment

The provision provides a $500 credit for the replacement of a non-compliant wood stove with a solid fuel burning stove that complies with the Environmental Protection Agency's ("EPA") emission performance standards. In general, a non-compliant wood stove is any wood stove purchased prior to June 30, 1992. Stoves produced after June 30, 1992 must comply with EPA's Standards of Performance for Residential Wood Heaters. The credit is only available for replacements that occur in areas designated by the EPA as nonattainment areas for particulate matter less than 2.5 micrometers in diameter or nonattainment areas for particulate matter less than 10 micrometers in diameter.

Effective date.−The credit applies to solid fuel burning stoves purchased after the date of enactment and before January 1, 2009.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

10. Exemption for bulk beds from excise tax on retail sale of heavy trucks and trailers (sec. 1550 of the Senate amendment)

Present Law

The Code imposes a 12-percent excise tax on the first retail sale of heavy trucks and trailers (chassis and bodies).[95] Under present law, the tax on the first retail sale of automobile truck bodies does not apply to any body primarily designed: (1) to process or prepare seed, feed, or fertilizer for use on farms; (2) to haul feed, seed, or fertilizer to and on farms; (3) to spread feed, seed, or fertilizer on farms; (4) to load or unload feed, seed, or fertilizer on farms; or (5) for any combination of the foregoing.[96]

The IRS has issued various rulings in this area. In Revenue Ruling 69-579, the IRS found that a truck body used primarily for hauling animal and poultry feed to and unloading it on farms qualified for exemption because the built-in equipment was elaborate and expensive. Thus, the IRS concluded that the nature of the unloading systems made it impractical to purchase the bodies for use other than in hauling feed, seed, or fertilizer to and unloading it on farms.

In 1975, the IRS ruled as not exempt a dump truck designed for and used primarily in hauling grain and sugar beets from the field to points on or off the farm but which may also be used to haul feed or fertilizer from a distribution point over the highway to the farm. The ruling concluded that bodies that are used for the general hauling of feed, seed, or fertilizer over the highway are subject to the tax unless they have specific features that indicate they are primarily designed to haul feed, seed, or fertilizer to and on farms. In this case, although feed and fertilizer were among the commodities that the dump truck could be used for, it did not have specific features to indicate that it was primarily designed to haul feed, seed, or fertilizer to and on farms.[97]

In 1990, the IRS issued a technical advice memorandum ("the 1990 TAM") that concluded that a type of truck bought by farmers to haul seed potatoes, sugar beets, grain, and other farm products qualified for exemption.[98] Each model had a full-length, powered conveyor belt that was designed to support and unload the cargo; a powered rear discharge door to control the discharge rate of the cargo; and a standard universal motor mount to which an electric drive could be mounted. In that ruling, the IRS noted the special unloading equipment was elaborate and expensive, added substantially to the cost and weight of each body, and limited its load-carrying capabilities.

[95] Sec. 4051(a).

[96] Sec. 4053(2).

[97] Rev. Rul. 75-462.

[98] Tech. Adv. Mem. 9126001, 1991 WL 778984 (1991).

In 1999, the IRS revoked the 1990 TAM prospectively, noting that the exemption was not intended to cover truck bodies designed for general use, even if capable of hauling feed, seed, or fertilizer to and on farms.[99] The IRS noted that the sales literature indicated that the body was designed to be versatile for hauling potatoes, beets, and small grains. The IRS also observed that unlike the bodies described in Rev. Rul. 69-579, which would not be purchased for use other than in hauling feed, seed, or fertilizer, the bodies at issue are designed for general hauling of farm cargo. Further, the IRS found that the presence of a conveyor belt was equally useful for unloading a crop at market as it is for unloading feed, etc. on a farm. Thus, the IRS concluded that the truck body was not primarily designed for an exempt purpose.

House Bill

No provision.

Senate Amendment

The Senate amendment exempts bulk beds used for transporting farm crops to and on farms from the excise tax on the retail sale of heavy trucks and trailers if sold to a person who certifies to the seller that such person is actively engaged in the trade or business of farming and the primary use of the bulk bed is to haul to and on farms farm crops grown in connection with such trade or business. The Senate amendment provides for the recapture of the tax from the purchaser upon resale of within two years of the first retail sale, or if such purchaser makes substantial nonexempt use of the article.

Effective date.−The provision is effective for sales after September 30, 2005.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

11. National Academy of Sciences study (sec. 1551 of the Senate amendment and sec. 1352 of the conference agreement)

Present Law

Present law does not provide for a study of the health, environmental, security, and infrastructure external costs that may be associated with the use and production of energy.

House Bill

No provision.

[99] Tech. Adv. Mem. 199904038, 1999 WL 36828 (1999).

Senate Amendment

The provision requires the Secretary of Treasury to enter into an agreement, within 60 days, with the National Academy of Sciences to conduct a study to define and evaluate the health, environmental, security, and infrastructure external costs and benefits associated with production and consumption of energy that are not or may not be fully incorporated into the price of such activities, or into the Federal tax or fee or other applicable revenue measure related to such activities. The results of the study are to be submitted to Congress within two years of the agreement.

Effective date.−The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

12. Income tax exclusion for certain fuel costs of rural carpoolers (sec. 1552 of the Senate amendment)

Present Law

Under present law, qualified transportation benefits are excludable from gross income and wages for employment tax purposes. Qualified transportation benefits are: (1) transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment ("van pooling"); (2) transit passes; and (3) qualified parking. For purposes of the exclusion for van pooling benefits, a commuter highway vehicle is any highway vehicle: (1) the seating capacity of which is at least six adults (excluding the driver); and (2) at least 80 percent of the mileage use of which can reasonably be expected to be (a) for purposes of transporting employees in connection with travel between their residences and their place of employment and (b) on trips during which the number of employees transported for such purposes is at least one-half of the adult seating capacity of such vehicle (not including the driver).

The maximum amount of qualified parking that is excludable from income and wages is $200 per month (for 2005). The maximum amount of transit passes and van pooling benefits that are excludable from income and wages per month is $105 (for 2005). These dollar amounts are indexed for inflation.

House Bill

No provision.

Senate Amendment

The Senate amendment establishes a new qualified transportation fringe benefit. Employer reimbursement for certain fuel costs (up to $50 per month) of employees who meet rural carpool requirements are excluded from a taxpayer's gross income (but not wages) as a qualified transportation fringe benefit. To be eligible for the benefit, the employee must: (1)

reside in a rural area; (2) not be eligible for transit or vanpooling benefits provided by the employer; (3) use the employee's vehicle when traveling between the employee's residence and place of employment; and (4) for at least 75 percent of the total mileage of such travel, be accompanied by one or more employees of the same employer. In addition, the premises of the employer must be located in an area that is not accessible by a transit system designed primarily to provide daily work trips within a local commuting area.

Effective date.−The Senate amendment is effective for expenses incurred on or after the date of enactment and before January 1, 2007.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

13. Three-year applicable recovery period for depreciation of qualified energy management devices (sec. 1553 of the Senate amendment)

Present Law

No special recovery period is provided for depreciation of energy management devices.

House Bill

No provision.

Senate Amendment

The provision provides a three-year recovery period for qualified new energy management devices placed in service by any taxpayer who is a supplier of electric energy or is a provider of electric energy services. A qualified energy management device is any meter or metering device which is used by the taxpayer (1) to measure and record electricity usage data on a time-differentiated basis in at least 4 separate time segments per day, and (2) to provide such data on at least a monthly basis to both consumers and the taxpayer. Additionally, the original use of the energy management device must commence with the taxpayer, and the purchase must be subject to a binding contract entered into after June 23, 2005, and only if there was no written binding contract entered into on or before such date.

Effective date.−The provision applies to taxable years ending after December 31, 2005, for property placed in service after the December 31, 2005 and prior to January 1, 2008.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

14. Exception from volume cap for certain cooling facilities (sec. 1554 of the Senate amendment)

Present law

Tax-exempt bonds

In general

Interest on bonds issued by State and local governments 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. Interest on State or local bonds to finance activities of private persons ("private activity bonds") is taxable unless a specific exception is contained in the Code (or in a 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.

Qualified private activity bonds

Private activity bonds are eligible for tax-exemption if issued for certain purposes permitted by the Code ("qualified private activity bonds"). The definition of a qualified private activity bond includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond.[100] The definition of exempt facility bond includes bonds issued to finance local district heating and cooling facilities.[101]

The issuance of most qualified private activity bonds is subject (in whole or in part) to annual State volume limitations ("State volume cap").[102] For calendar year 2005, the State volume cap is the greater of $80 per resident or $239 million. Exceptions are provided for bonds issued to finance certain governmentally owned facilities (airports, ports, high-speed intercity rail, and solid waste disposal) and bonds which are subject to separate local, State, or national volume limits (public/private educational facilities, enterprise zone facility bonds, and qualified green building/sustainable design projects).

House Bill

No provision.

Senate Amendment

The Senate amendment provides an exception from the State volume cap for certain qualified private activity bonds issued to finance certain local district heating or cooling

[100] Sec. 141(e).

[101] Sec. 142(a).

[102] Sec. 146.

facilities. Specifically, State volume cap does not apply to bonds issued to finance local district heating or cooling facilities that are designed to access deep water cooling sources for building air conditionings if the aggregate face amount of bonds issued with respect to such a facility is not more than $75 million.

Effective date.−The provision applies to projects placed in service after the date of enactment and before July 1, 2008.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

E. Revenue Raising Provisions

1. Treatment of kerosene for use in aviation (sec. 1561 of the Senate amendment)

Present Law

In general, aviation-grade kerosene is taxed at a rate of 21.8 cents per gallon upon removal of such fuel from a refinery or terminal (or entry into the United States) and on the sale of such fuel to any unregistered person unless there was a prior taxable removal or entry of such fuel.[103] Aviation-grade kerosene may be removed at a reduced rate, either 4.3 or zero cents per gallon, if the aviation fuel is removed directly into the fuel tank of an aircraft for use in commercial aviation[104] or for a use that is exempt from the tax imposed by section 4041(c) (other than by reason of a prior imposition of tax),[105] or is removed or entered as part of an exempt bulk transfer.[106] These taxes are credited to the Airport and Airway Trust Fund.[107] If taxed aviation-grade kerosene is used for a nontaxable use, a claim for credit or refund may be made.[108] Such claims are paid from the Airport and Airway Trust Fund to the general fund of the Treasury.[109] All other removals and entries of kerosene used for surface transportation are taxed at the diesel tax rate of 24.3 cents per gallon,[110] and these taxes are credited to the Highway Trust Fund.[111] If

[103] Sec. 4081(a)(2)(A)(iv). (An additional 0.1 cent is imposed on aviation-grade kerosene and credited to the Leaking Underground Storage Tank ("LUST" Trust Fund.) Sec. 4081(a)(2)(B). The LUST Trust Fund tax is set to expire after September 30, 2005. Sec. 4081(d)(3).

[104] Sec. 4081(a)(2)(C).

[105] Sec. 4082(e). Exempt uses include use in commercial aviation as supplies for vessels or aircraft, which includes use by certain foreign air carriers and for the international flights of domestic carriers, secs. 4082(e), 6427(l)(2), and 4221(d)(3).

[106] Sec. 4081(a)(1)(B).

[107] Sec. 9502(b)(1)(C).

[108] Sec. 6427(l)(1) and 6427(l)(4). Nontaxable uses include: (1) use other than as fuel in an aircraft (such as use in heating oil); (2) use on a farm for farming purposes; (3) use in a military aircraft owned by the United States or a foreign country; (4) use in a domestic air carrier engaged in foreign trade or trade between the United States and any of its possessions; (5) use in a foreign air carrier engaged in foreign trade or trade between the United States and any of its possessions (but only if the foreign carrier’s country of registration provides similar privileges to United States carriers); (6) exclusive use of a State or local government; (7) sales for export, or shipment to a United States possession; (8) exclusive use by a nonprofit educational organization; (9) use by an aircraft museum exclusively for the procurement, care, or exhibition of aircraft of the type used for combat or transport in World War II, and (10) use as a fuel in a helicopter or a fixed-wing aircraft for purposes of providing transportation with respect to which certain requirements are met. Secs. 4041(f)(2), 4041(g), 4041(h), 4041(l), and 6427(l)(2)(B)(i).

[109] Sec. 9502(d)(2).

[110] Sec. 4081(a)(2)(iii).

aviation-grade kerosene is taxed upon removal or entry but fraudulently diverted for surface transportation, the taxes remain in the Airport and Airway Trust Fund, and the Highway Trust Fund is not credited for the taxes on such fuel.

A special rule of present law addresses whether a removal from a refueler truck, tanker, or tank wagon may be treated as a removal from a terminal for purposes of determining whether aviation-grade kerosene is removed directly into the wing of an aircraft for use in commercial aviation, and so eligible for the 4.3 cents per gallon rate.[112] For the special rule to apply, a qualifying truck, tanker, or tank wagon must be loaded with aviation-grade kerosene from a terminal: (1) that is located within a secured area of an airport, and (2) from which no vehicle licensed for highway use is loaded with aviation fuel, except in exigent circumstances identified by the Secretary in regulations. In order to qualify for the special rule, a refueler truck, tanker, or tank wagon must: (1) be loaded with fuel for delivery only into aircraft at the airport where the terminal is located; (2) have storage tanks, hose, and coupling equipment designed and used for the purposes of fueling aircraft; (3) not be registered for highway use; and (4) be operated by the terminal operator (who operates the terminal rack from which the fuel is unloaded) or by a person that makes a daily accounting to such terminal operator of each delivery of fuel from such truck, tanker, or tank wagon.

House Bill

No provision.

Senate Amendment

The Senate amendment imposes the kerosene tax rate of 24.3 cents per gallon upon the entry or removal of aviation-grade kerosene and on the sale of such fuel to any unregistered person unless there was a prior taxable removal or entry of the fuel. In general, the present law reduced rates for removals of aviation-grade kerosene directly into the fuel tank of an aircraft apply.[113] In addition, under the provision, the rate of tax is 21.8 cents per gallon if kerosene is removed (1) directly into the fuel tank of an aircraft for use in aviation other than commercial aviation and (2) from refueler trucks, tankers, and tank wagons that are loaded with fuel from a terminal that is located in an airport, without regard to whether the terminal is located in a

[111] Sec. 9503(b)(1)(D).

[112] Sec. 4081(a)(3).

[113] For example, for kerosene removed directly into the fuel tank of an aircraft for use in commercial aviation by a person registered for such use, the rate of tax is 4.3 cents per gallon. Kerosene removed directly into the fuel tank of an aircraft for an exempt use is not taxed. For purposes of these reduced rates, the Committee intends that the following airports be included on the Secretary's list of airports that include a secured area in which a terminal is located. The airports are listed by airport name, and the terminal with respect to the airport is identified by terminal control number: Los Angeles International Airport (T-95-CA-4812) and Federal Express Corporation Memphis Airport (T-62-TN-2220).

secured area of the airport, as long as all the other requirements of the present law special rule related to such trucks, tankers, and wagons are met. The provision clarifies that the rate of tax upon removal of kerosene is zero if the removal is from a refueler truck, tanker, or tank wagon that meets all of the requirements of present law, including the security requirement, the kerosene is delivered directly into the fuel tank of an aircraft, and the kerosene is exempt from the tax imposed by section 4041(c) (other than by prior imposition of tax).

The Senate amendment provides that amounts may be claimed as credits or refunds for kerosene that is taxed at the 24.3 cents per gallon rate and used for aviation purposes. If kerosene is used for noncommercial aviation, the amount is 2.5 cents; if kerosene is used for commercial aviation, the amount is 20 cents; if kerosene is used for a use that is exempt from tax (as determined under present law), the amount is 24.3 cents. Present law rules with respect to claims apply, except for claims with respect to kerosene used in noncommercial aviation, which are payable to the ultimate vendor only. To be eligible to receive a payment, a vendor must be registered and must show either that the price of the fuel did not include the tax and the tax was not collected from the purchaser, the amount of tax was repaid to the ultimate purchaser, or the written consent of the purchaser to the making of the claim was filed with the Secretary.

Under the Senate amendment, all taxes collected at the 24.3 cents per gallon rate (under section 4081) initially are credited to the Highway Trust Fund. The provision requires the Secretary to transfer at least monthly from the Highway Trust Fund into the Airport and Airway Trust Fund amounts equivalent to 21.8 cents per gallon for claims made with respect to kerosene used for noncommercial aviation purposes and 4.3 cents per gallon for claims made with respect to kerosene used for commercial aviation purposes. The provision requires that transfers be made on the basis of estimates by the Secretary, with proper adjustments to be made subsequently to the extent prior estimates were in excess of or less than the amounts required to be transferred. Transfers are required to be made with respect to taxes received on or after October 1, 2005, and before October 1, 2011. The provision provides that the Airport and Airway Trust Fund does not make payments with respect to kerosene that is taxed at the 24.3 cents per gallon rate and used for aviation purposes.

Effective date.–The Senate amendment is effective for fuels or liquids removed, entered, or sold after September 30, 2005.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

2. Repeal of ultimate vendor refund claims with respect to farming (sec. 1562 of the Senate amendment)

Present Law

In general - ultimate purchaser refunds for nontaxable uses

In general, the Code provides that if diesel fuel or kerosene on which tax has been imposed is used by any person in a nontaxable use, the Secretary is to refund (without interest) to the ultimate purchaser the amount of tax imposed.[114] The refund is made to the ultimate purchaser of the taxed fuel by either income tax credit or refund payment.[115] Not more than one claim may be filed by any person with respect to fuel used during its taxable year. However, there are exceptions to this rule.

An ultimate purchaser may make a claim for a refund payment for any quarter of a taxable year for which the purchaser can claim at least $750.[116] If the purchaser cannot claim at least $750 at the end of quarter, the amount can be carried over to the next quarter to determine if the purchaser can claim at least $750. If the purchaser cannot claim at least $750 at the end of the taxable year, the purchaser must claim a credit on the person's income tax return.

As discussed below, these ultimate purchaser refund rules do not apply to diesel fuel or kerosene used on a farm. The Code precludes the ultimate purchaser from claiming a refund for such use. Instead, the refund claims are made by registered vendors as described below.

Special vendor rule for use on a farm for farming purposes

In the case of diesel fuel or kerosene used on a farm for farming purposes refund payments are paid to the ultimate, registered vendors ("registered ultimate vendor") of such fuels. Thus a registered ultimate vendor that sells undyed diesel fuel or undyed kerosene to any of the following may make a claim for refund: (1) the owner, tenant, operator of a farm for use by that person on a farm for farming purposes; and (2) a person other than the owner, tenant, or operator of a farm for use by that person on a farm in connection with cultivating, raising or harvesting. The registered ultimate vendor is the only person who may make the claim with respect to diesel fuel or kerosene used on a farm for farming purposes. The purchaser of the fuel cannot make the claim for refund.

[114] Sec. 6427(l)(1).

[115] Generally, refund payments are only made to governmental units and tax-exempt organizations. Sec. 6427(k). The quarterly payment claim rules for ultimate purchasers are an exception to this rule.

[116] Sec. 6427(i)(2).

Registered ultimate vendors may make weekly claims if the claim is at least $200 ($100 or more in the case of kerosene).[117] If not paid within 45 days (20 days for an electronic claim), the Secretary is to pay interest on the claim.

House Bill

No provision.

Senate Amendment

The Senate amendment repeals ultimate vendor refund claims in the case of diesel fuel or kerosene used on a farm for farming purposes. Thus, refunds for taxed diesel fuel or kerosene used on a farm for farming purposes would be paid to the ultimate purchaser under the rules applicable to nontaxable uses of diesel fuel or kerosene.

Effective date.−The provision is effective for sales after September 30, 2005.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

3. Refunds of excise taxes on exempt sales of taxable fuel by credit card (sec. 1563 of the Senate amendment)

Present Law

Under the rules in effect prior to 2005, in the case of gasoline on which tax had been paid and sold to a State or local government, to a nonprofit educational organization, for supplies for vessels or aircraft, for export, or for the production of special fuels, the wholesale distributor that sold such gasoline was treated as the only person who paid the tax and thereby was the proper claimant for a credit or refund of the tax paid. A "wholesale distributor" included any person, other than an importer or producer, who sold gasoline to producers, retailers, or to users who purchased in bulk quantities and accepted delivery into bulk storage tanks. A wholesale distributor also included any person who made retail sales of gasoline at 10 or more retail motor fuel outlets.

Under a special administrative exception to these rules, a sale of gasoline charged on an oil company credit card issued to an exempt person described above is not considered a direct sale by the person actually selling the gasoline to the ultimate purchaser if the seller receives a reimbursement of the tax from the oil company (or indirectly through an intermediate vendor). Thus, the person that actually paid the tax, in most cases the oil company, is treated as the only person eligible to make the refund claim.[118]

[117] Sec. 6427(i)(4)(A).

[118] Notice 89-29, 1989-1 C.B. 669.

The American Jobs Creation Act of 2004 ("AJCA")[119] modified the pre-existing statutory rules with respect to certain sales. Under AJCA, if a registered ultimate vendor purchases any gasoline on which tax has been paid and sells such gasoline to a State or local government or to a nonprofit educational organization, for its exclusive use, such ultimate vendor is treated as the only person who paid the tax and thereby is the proper claimant for a credit or refund of the tax paid.[120] However, AJCA did not change the special administrative oil company credit card rule described above.[121]

In addition, under AJCA, refund claims made by such an ultimate vendor may be filed for any period of at least one week for which $200 or more is payable. Any such claim must be filed on or before the last day of the first quarter following the earliest quarter included in the claim. The Secretary must pay interest on refunds unpaid after 45 days. If the refund claim was filed by electronic means, and the ultimate vendor has certified to the Secretary for the most recent quarter of the taxable year that all ultimate purchasers of the vendor are certified for highway exempt use as a State or local government or a nonprofit educational organization, refunds unpaid after 20 days must be paid with interest.[122]

In the case of diesel fuel or kerosene used in a nontaxable use, the ultimate purchaser is generally the only person entitled to claim a refund of excise tax.[123] However, in the case of diesel fuel or kerosene used on a farm for farming purposes or by a State or local government, aviation-grade kerosene, and certain nonaviation-grade kerosene, an ultimate vendor may claim the refund if the ultimate vendor is registered and bears the tax (or receives the written consent of the ultimate purchaser to claim the refund).[124]

House Bill

No provision.

[119] Pub. L. No. 108-357.

[120] AJCA, sec. 865(a), effective January 1, 2005. See Code sec. 6416(a)(4)(A).

[121] In Notice 2005-4, 2005-2 I.R.B. 289, the Treasury Department confirmed that it would continue to apply the oil company credit card rule until March 1, 2005. On February 28, 2005, the Treasury Department issued Notice 2005-24, 2005-12 I.R.B. 1, modifying Notice 2005-4. Notice 2005-24 stated that the oil company credit card rule will remain in effect until it is modified by a statutory change or by future guidance.

[122] Sec. 6146(a)(4)(B).

[123] Sec. 6427(l)(1).

[124] See sec. 6427(l)(4)(B), (l)(5)(B), and (l)(5)(C), and sec. 6416(a)(1)(A), (B), and (D).

Senate Amendment

The Senate amendment replaces the oil company credit card rule with a new set of rules applicable to certain credit card sales. The new rules apply to all taxable fuels. Under the Senate amendment, if a purchase of taxable fuel is made by means of a credit card issued to an ultimate purchaser that is either a State or local government or, in the case of gasoline, a nonprofit educational organization, for its exclusive use, a credit card issuer who is registered and who extends such credit to the ultimate purchaser with respect to such purchase shall be the only person entitled to apply for a credit or refund if the following two conditions are met: (1) such registered person has not collected the amount of the tax from the purchaser, or has obtained the written consent of the ultimate purchaser to the allowance of the credit or refund; and (2) such registered person has either repaid or agreed to repay the amount of the tax to the ultimate vendor, has obtained the written consent of the ultimate vendor to the allowance of the credit or refund, or has otherwise made arrangements that directly or indirectly provide the ultimate vendor with reimbursement of such tax. It is anticipated that such indirect arrangements may consist of the contractual undertaking of the relevant oil company to the credit card issuer that it will pay the amount of the tax to the ultimate vendor, and the corresponding contractual undertaking of the oil company to the ultimate vendor.

If a credit card issuer is not registered, or if either condition (1) or (2) described above is not met (or if the ultimate purchaser is not exempt), then the credit card issuer is required to collect an amount equal to the tax from the ultimate purchaser and only an (exempt) ultimate purchaser may claim a credit or payment from the IRS.[125] Thus, tax-paid fuel shall not be sold tax free to an exempt entity by means of a credit card unless the credit card issuer is registered. An unregistered credit card issuer that does not collect an amount equal to the tax from the exempt entity is liable for present-law penalties for failure to register.[126]

A credit card issuer entitled to claim a refund under the provision is responsible for collecting and supplying all the appropriate documentation currently required from ultimate vendors. The present-law refund amount and timing rules applicable to ultimate vendors, including the special rules for electronic claims, apply to refunds to credit card issuers under the provision.[127]

The Senate amendment also conforms present-law penalty provisions to the new rules.

The Senate amendment does not change the present-law rules applicable to non-credit card purchases.

[125] See sec. 6421(c).

[126] See secs. 6719, 7232, and 7272.

[127] See sec. 6416(a)(4)(B). Present law would continue to apply to the timing of ultimate purchaser claims. Under present law, claims by an ultimate purchaser are generally made on an annual basis. However, claims aggregating over $750 may be made quarterly. See secs. 6421(d) and 6427(i)(2).

Effective date.–The provision is effective for sales after December 31, 2005.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

4. Recertification of exempt status (sec. 1564 of the Senate amendment)

Present Law

If gasoline is sold to any person for an exempt use, an ultimate purchaser that has borne the tax is entitled to claim a refund.[128] However, a registered ultimate vendor is the appropriate person to claim a refund of Federal excise taxes on gasoline sold to a State or local government or to a nonprofit educational organization.[129]

In general, in order to claim a refund of Federal excise taxes on gasoline (and on other articles subject to manufacturers excise taxes under Chapter 32 of the Code) sold to a State or local government or to a nonprofit educational organization, for its exclusive use, a claimant must submit a statement indicating that it possesses evidence of the exempt use giving rise to the overpayment of tax.[130] Such evidence consists of a certificate executed and signed by the ultimate purchaser, and must identify the article, show the name and address of the ultimate purchaser, and state the exempt use made or to be made of the article. In the case where the certificate sets forth the use to be made of the article, rather than its actual use, it must show that the ultimate purchaser has agreed to notify the claimant if the article is not in fact used as specified in the certificate.[131]

However, if the article to which the claim relates has passed through a chain of sales from the claimant to the ultimate purchaser, a certificate executed and signed by the ultimate vendor is sufficient to document the exempt use. The ultimate vendor certificate must contain the exempt sales information, and a statement that it possesses the ultimate purchaser certificates and will forward them to the claimant within three years from the date of the statement. An ultimate vendor statement may be made covering no more than 12 consecutive calendar quarters.[132]

[128] Sec. 6421(c).

[129] Sec. 6416(a)(4)(A).

[130] Treas. Reg. sec. 48.6416(b)(2)-3(a)(5).

[131] Treas. Reg. sec. 48.6416(b)(2)-3(b)(1)(i) and (ii). The certificate must also contain a statement that the ultimate purchaser understands that it and any other party may, for fraudulent use of the certificate, be subject under section 7201 to a fine of not more than $10,000, or imprisonment for not more than 5 years, or both, together with the costs of prosecution.

[132] Treas. Reg. sec. 48.6416(b)(2)-3(b)(1)(i) and (iii).

In general, an ultimate purchaser is the proper party to claim a refund of Federal excise tax on diesel fuel or kerosene used by any person in a nontaxable use.[133] However, in the case of diesel or kerosene used by a State or local government, the ultimate vendor is the proper person if such vendor is registered and has borne the tax (or receives the written consent of the ultimate purchaser to claim the refund).[134] A registered ultimate vendor claiming a refund under this provision must provide a statement that it has in its possession an unexpired exemption certificate of the purchaser and that the claimant has no reason to believe any information in the certificate is false.[135]

A State or local government includes any political subdivision of a State, or the District of Columbia.[136] A nonprofit educational organization means an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on, and which either is exempt from income tax under section 501(a) or is a school operated as an activity of an organization described in section 501(c)(3) which is exempt from income tax under section 501(a).[137]

House Bill

No provision.

Senate Amendment

Under the Senate amendment, additional documentation requirements are imposed with respect to purchases of taxable fuel and certain other articles on a nontaxable basis by State or local governments and nonprofit educational organizations and with respect to refunds or credits by any person with respect to such purchases. The Senate amendment covers Federal excise taxes on sales of liquids for use as a fuel (including taxable fuels), compressed natural gas (except if sold for use on school buses or intracity buses), heavy trucks and trailers, recreational equipment (bows and arrows, sport fishing equipment and firearms), and tires (except for tires sold for use on qualified buses). The Senate amendment does not cover Federal excise taxes on sales of coal and vaccines.

[133] Sec. 6427(l)(1). In the case of diesel fuel or kerosene, a nontaxable use is any use which is exempt from the tax imposed by section 4041(a)(1) other than by reason of a prior imposition of tax. Sec. 6427(l)(2).

[134] Sec. 6427(l)(5)(C).

[135] Treas. Reg. sec. 48.6427-9(e)(1)(vi).

[136] Sec. 4221(d)(4); Treas. Reg. sec. 48.6416(b)(2)-2(d).

[137] Sec. 4221(d)(5); Treas. Reg. sec. 48.6416(b)(2)-2(e).

In addition to present-law documentation requirements, in order for a State or local governmental entity to claim exemption from tax on sales of such covered articles, or for any person to claim a credit or refund based upon the State or local governmental status of the purchaser of such articles, the State must certify that the article is sold to a State or local government for the exclusive use of a State or local government. In the case of articles sold to a qualified volunteer fire department, as defined in section 150(e)(2),[138] the State must so certify, and the article must be sold for the exclusive use of the qualified volunteer fire department.

In order for a nonprofit educational organization to claim exemption from tax on such articles, or for any person to claim a credit or refund of tax on such articles based upon the nonprofit educational status of an organization, the State in which such organization is providing educational services must certify that such organization is in good standing.

For purposes of this provision, an Indian tribal government is treated as a State.[139] Consequently, it is intended that the applicable Indian tribal government will provide the certifications under this provision.

It is intended that the certifications required under this provision will be provided by exempt purchasers to the refund claimants (in addition to documentation required under present law), and that the IRS may require that such certifications be submitted as part of the claims. The Secretary may prescribe forms for such certifications.

Effective date.–The provision is effective for all sales after December 31, 2005.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

5. Reregistration in event of change in ownership (sec. 1565 of the Senate amendment)

Present Law

Blenders, enterers, pipeline operators, position holders, refiners, terminal operators, and vessel operators are required to register with the Secretary with respect to fuels taxes imposed by sections 4041(a)(1) and 4081.[140] An assessable penalty for failure to register is $10,000 for each

[138] In general, as defined in section 150(e)(2), a qualified volunteer fire department is any organization organized and operated to provide firefighting or emergency medical services for persons in an area that is not provided with any other firefighting services, and which is required by written agreement with the political subdivision to furnish firefighting services in such area.

[139] See sec. 7871(a)(2). Section 7871(b) provides that in order for an excise tax exemption (with respect to chapter 31 or 32) to apply to an Indian tribal government, the transaction must involve the exercise of an essential governmental function of the Indian tribal government.

[140] Sec. 4101; Treas. Reg. sec. 48.4101-1(a) and (c)(1).

initial failure, plus $1,000 per day that the failure continues.[141] A non-assessable penalty for failure to register is $10,000.[142] A criminal penalty of $10,000, or imprisonment of not more than five years, or both, together with the costs of prosecution also applies to a failure to register and to certain false statements made in connection with a registration application.[143] Treasury regulations require that a registrant notify the Secretary of any change (such as a change in ownership) in the information a registrant submitted in connection with its application for registration within 10 days of the change.[144] The Secretary has the discretion to revoke the registration of a noncompliant registrant.

House Bill

No provision.

Senate Amendment

The Senate amendment requires that upon a change in ownership of a registrant, the registrant must reregister with the Secretary, as provided by the Secretary. A change in ownership means that after a transaction (or series of related transactions), more than 50 percent of the ownership interests in, or assets of, a registrant are held by persons other than persons (or persons related thereto) who held more than 50 percent of such interests or assets before the transaction (or series of related transactions). The provision does not apply to a company, the stock of which is regularly traded on an established securities market. The penalties for failure to reregister are the same as the present law penalties for failure to register. The provision applies to changes in ownership occurring prior to, on, or after the date of enactment.

Effective date.–The Senate amendment is effective for actions or failures to act after the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

6. Registration of operators of deep-draft vessels (sec. 1566 of the Senate amendment)

Present Law

Blenders, enterers, pipeline operators, position holders, refiners, terminal operators, and vessel operators are required to register with the Secretary with respect to fuels taxes imposed by

[141] Sec. 6719.

[142] Sec. 7272(a).

[143] Sec. 7232.

[144] Treas. Reg. sec. 48.4101-1(h)(1)(v).

sections 4041(a)(1) and 4081.[145] Treasury regulations define a vessel operator as any person that operates a vessel within the bulk transfer/terminal system, excluding deep-draft ocean-going vessels.[146] Accordingly, operators of deep-draft ocean-going vessels are not required to register. A deep-draft ocean-going vessel is a vessel that is designed primarily for use on the high seas that has a draft of more than 12 feet.[147]

An assessable penalty for failure to register is $10,000 for each initial failure, plus $1,000 per day that the failure continues.[148] A non-assessable penalty for failure to register is $10,000.[149] A criminal penalty of $10,000, or imprisonment of not more than five years, or both, together with the costs of prosecution also applies to a failure to register and to certain false statements made in connection with a registration application.[150]

In general, gasoline, diesel fuel, and kerosene ("taxable fuel") are taxed upon removal from a refinery or a terminal.[151] Tax also is imposed on the entry into the United States of any taxable fuel for consumption, use, or warehousing. The tax does not apply to any removal or entry of a taxable fuel transferred in bulk (a "bulk transfer") by pipeline or vessel to a terminal or refinery if the person removing or entering the taxable fuel, the operator of such pipeline or vessel, and the operator of such terminal or refinery are registered with the Secretary as required by section 4101.[152] Transfer to an unregistered party subjects the transfer to tax.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, an operator of deep-draft ocean-going vessel is required to register with the Secretary unless such operator uses such vessel exclusively for purposes of the entry of taxable fuel. If a deep-draft ocean-going vessel is used as part of a bulk transfer, the

[145] Sec. 4101; Treas. Reg. sec. 48.4101-1(a) and (c)(1).

[146] Treas. Reg. sec. 48.4101-1(b)(8).

[147] Sec. 4042(c)(1).

[148] Sec. 6719.

[149] Sec. 7272(a).

[150] Sec. 7232.

[151] Sec. 4081(a)(1)(A).

[152] Sec. 4081(a)(1)(B). The sale of a taxable fuel to an unregistered person prior to a taxable removal or entry of the fuel is subject to tax. Sec. 4081(a)(1)(A).

operator of such vessel must be registered in order for the bulk transfer exemption to apply, except with respect to the entry of taxable fuel, in which case, registration is not required.

Effective date.–The Senate amendment is effective on the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

7. Reconciliation of on-loaded cargo to entered cargo (sec. 1567 of the Senate amendment)

Present Law

The Trade Act of 2002 directed the Secretary to promulgate regulations pertaining to the electronic transmission to the Bureau of Customs and Border Patrol ("Customs") of information pertaining to cargo destined for importation into the United States or exportation from the United States, prior to such importation or exportation.[153] The Department of the Treasury issued final regulations on October 31, 2002. The regulations require the advance and accurate presentation of certain manifest information prior to lading at the foreign port and encourage the presentation of this information electronically. Customs must receive from the carrier the vessel's Cargo Declaration (Customs Form 1302) or the electronic equivalent within 24 hours before such cargo is laden aboard the vessel at the foreign port. [154]

Certain carriers of bulk cargo, however, are exempt from these filing requirements. Such bulk cargo includes that composed of free flowing articles such as oil, grain, coal, ore and the like, which can be pumped or run through a chute or handled by dumping.[155] Thus, taxable fuels are not required to file the Cargo Declaration within 24 hours before such cargo is laden aboard the vessel at the foreign port. Instead the Cargo Declaration must be filed within 24 hours prior arrival in the United States.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that not later than one year after the date of enactment of this paragraph, the Secretary of Homeland Security, together with the Secretary of the Treasury, is to establish an electronic data interchange system through which Customs shall transmit to the Internal Revenue Service information pertaining to cargoes of taxable fuels (as defined in section 4083) that Customs has obtained electronically under its regulations adopted

[153] Sec. 343(a) of Pub. L. No. 107-210 (2002).

[154] 19 CFR sec. 4.7(b)(2).

[155] 19 CFR sec. 4.7(b)(4)(i)(A).

to carry out the Trade Act of 2002 requirement. For this purpose, not later than one year after the date of enactment, all filers of required cargo information for such taxable fuels, as defined, must provide such information to Customs through its approved electronic data interchange system.

Effective date.−The provision is effective upon date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

8. Gasoline blend stocks and kerosene (sec. 1568 of the Senate amendment)

Present Law

In general

A "taxable fuel" is gasoline, diesel fuel (including any liquid, other than gasoline, which is suitable for use as a fuel in a diesel-powered highway vehicle or train), and kerosene.[156] An excise tax is imposed upon (1) the removal of any taxable fuel from a refinery or terminal, (2) the entry of any taxable fuel into the United States, or (3) the sale of any taxable fuel to any person who is not registered with the IRS to receive untaxed fuel, unless there was a prior taxable removal or entry.[157] The tax does not apply to any removal or entry of taxable fuel transferred in bulk to a terminal or refinery if the person removing or entering the taxable fuel, the operator of such pipeline or vessel, and the operator of such terminal or refinery are registered with the Secretary.[158]

Gasoline blend stocks

Definition

Under the regulations, "gasoline" includes all products commonly or commercially known or sold as gasoline and are suitable for use as a motor fuel, and that have an octane rating of 75 or more. Gasoline also includes, to the extent provided in regulations, gasoline blend stocks and products commonly used as additives in gasoline. By regulation, the Treasury has identified certain products as gasoline blend stocks, [159] however, the term "gasoline blend stocks"

[156] Sec. 4083(a).

[157] Sec. 4081(a)(1).

[158] Sec. 4081(a)(1)(B).

[159] Treas. Reg. sec. 48.4081-1(c)(3)(ii). The term "gasoline blend stocks" means alkylate; butane; catalytically cracked gasoline; coker gasoline; ethyl tertiary butyl ether (ETBE); hexane; hydrocrackate; isomerate; methyl tertiary butyl ether (MTBE); mixed xylene (not including any separated isomer of xylene); natural gasoline; pentane; pentane mixture; polymer gasoline; raffinate; reformate; straight-run gasoline; straight-run naphtha; tertiary amyl methyl ether (TAME); tertiary butyl alcohol

does not include any product that cannot be blended into gasoline without further processing or fractionation (“off-spec gasoline”).

Gasoline blend stock exemptions

If certain conditions are met, the removal, entry, or sale of gasoline blend stocks is not taxable. Generally, the exemption from tax applies if a gasoline blend stock (1) is not used to produce finished gasoline (2) is received at an approved terminal or refinery, or (3) in bulk transfer to an industrial user.[160]

Gasoline blend stocks not used to produce finished gasoline.–Pursuant to Treasury regulation, no tax is imposed on nonbulk removals from a terminal or refinery, or nonbulk entries into the United States of any gasoline blend stocks if (1) the person liable for the tax is a taxable fuel registrant, and (2) such person does not use the gasoline blend stocks to produce finished gasoline. In connection with a sale, no tax is imposed on the nonbulk removal or entry if (1) the person liable for the tax is a gasoline registrant and (2) at the time of sale such party has an unexpired certificate from the buyer, and has no reason to believe any information in the certificate is false.[161]

Any sale (or resale) of a gasoline blend stock that was not subject to tax on nonbulk removal or entry is taxable unless the seller has an unexpired certificate from the buyer and has no reason to believe that any information in the certificate is false.

The certificate to be provided by a buyer of gasoline blend stocks contains a statement that the gasoline blend stocks covered by the certificate will not be used to produce finished gasoline, identifies the type (or types of blend stocks) covered by the certificate and provides that the buyer will not claim a credit or refund for any gasoline covered by the certificate. The certificate is signed under penalties of perjury by a person with authority to bind the buyer. The certificate expires on the earliest of one year from the effective date of the certificate, the date a new certificate is provided to the seller or the date the seller is notified by the IRS or the buyer that the buyer’s right to provide a certificate has been withdrawn.

Gasoline blend stocks received at an approved terminal or refinery.–Treasury regulations provide that tax is not imposed on the removal or entry of gasoline blend stocks that are received at a terminal or refinery if the person liable for tax is a taxable fuel registrant, has an unexpired notification certificate from the operator of the terminal or refinery where the gasoline blend stocks are received; and has no reason to believe that any information in the certificate is false.[162]

(gasoline grade) (TBA); thermally cracked gasoline; and toluene. Treas. Reg. sec. 48.4081-1(c)(3)(i). Effective January 1, 2005, transmix containing gasoline was removed from the definition of gasoline blend stocks. Internal Revenue Service, Notice 2005-4 (December 15, 2004).

[160] Treas. Reg. sec. 48.4081-4.

[161] Treas. Reg. sec. 48.4081-4(b)(1) and 48.4081-4(b)(1)(2).

[162] Treas. Reg. sec. 48.4081-4(b)(1).

A notification certificate is used to notify another person of the taxable fuel registrant's registration status.

Bulk transfer to an industrial user.–Tax is not imposed if upon removal of the gasoline blend stocks from a pipeline or vessel, the gasoline blend stocks are received by a taxable fuel registrant that is an industrial user.[163] An industrial user means any person that receives gasoline blend stocks by bulk transfer for its own use in the manufacture of any product other than finished gasoline.

Refunds or credits for tax imposed on gasoline blend stocks not used for producing gasoline

If any gasoline blend stock or additive is not used by a person to produce gasoline and that person establishes that the ultimate use of the gasoline blend stock or additive is not used to produce gasoline, then the Secretary is to pay (without interest) to such person, an amount equal to the aggregate amount of tax imposed on such person with respect to such gasoline or blend stock.[164]

If gasoline is used in an off-highway business use, the ultimate purchaser of the gasoline is entitled to a credit or refund for the excise taxes imposed on the fuel. "Off-highway business use" means any use by a person in a trade or business of such person otherwise than as a fuel in a highway vehicle that meets certain requirements.[165] Gasoline for this purpose includes gasoline blend stocks.[166]

The Code also provides for a refund of tax for tax-paid fuel sold to a subsequent manufacturer or producer if the subsequent manufacturer or producer uses the fuel, for nonfuel purposes, as a material in the manufacture or production of any other article manufactured or produced by him.[167]

Kerosene

Definition of kerosene

By regulation, kerosene is defined as the kerosene described in ASTM Specification D 3699 (No. 1-K and No. 2-K), ASTM Specification D 1655 (kerosene-type jet fuel), and military

[163] Treas. Reg. sec. 48.4081-4(d).

[164] Sec. 6427(h)(1).

[165] Sec. 6421(a) and 6421(e).

[166] Sec. 6421(e)(1) and sec. 4083(a)(2)(B).

[167] Sec. 6416(b)(3)(B).

specifications MIL-DTL-5624T (Grade JP-5) and MIL-DTL-83133E (Grade JP-8). Kerosene does not include any liquid that is an excluded liquid.[168]

An "excluded liquid" is (1) any liquid that contains less than four percent normal paraffins, or (2) any liquid that has a distillation range of 125 degrees Fahrenheit or less, sulfur content of 10 ppm or less, and minimum color of +27 Saybolt. These liquids are commonly known as "mineral spirits" and are obtained by distillation of crude oil. Mineral spirits are used for a wide variety of purposes, such as in dry-cleaning fluids, paint thinners, varnishes, photocopy toners, inks, adhesives, and as general purpose cleaners and degreasers.

Exemptions

Diesel fuel and kerosene that is to be used for a nontaxable purpose will not be taxed upon removal from the terminal if it is dyed to indicate its nontaxable purpose. Kerosene received by pipeline or vessel to satisfy a feedstock purpose is exempt from the dyeing requirement.[169] Pursuant to Treasury regulations, nonbulk removals of kerosene for a feedstock purpose by a registered feedstock user also are exempt.[170] The person receiving the kerosene must be registered with the IRS and provide a certificate noting that the kerosene will be used for a feedstock purpose in order for the exemption to apply. Pursuant to the Treasury regulations, tax also does not apply upon the removal or entry of kerosene if the person otherwise liable for tax is a taxable fuel registrant and such person uses the kerosene for a feedstock purpose.[171]

"Feedstock purpose" means the use of kerosene for nonfuel purposes in the manufacture or production of any substance (other than gasoline, diesel fuel or special fuels subject to tax).[172] Thus, for example, kerosene is used for a feedstock purpose when it is used as an ingredient in the production of paint and is not used for a feedstock purpose when it is used to power machinery at a factory where paint is produced.

Refunds and payments for nontaxable uses of kerosene

If tax-paid kerosene is used by any person in a nontaxable use, the Secretary is required to pay (without interest) to the ultimate purchaser of such fuel an amount equal to the aggregate amount of tax imposed on such fuel. For this purpose, a nontaxable use is any use which is exempt from the tax imposed by section 4041(a)(1) other than by reason of prior imposition of tax. Claims relating to kerosene used on a farm for farming purposes and by a State are made by

[168] Treas. Reg. sec. 48.4081-1(b).

[169] Sec. 4082(d)(1).

[170] Treas. Reg. sec. 48.4082-7(c).

[171] Treas. Reg. sec. 48.4082-7(c).

[172] Treas. Reg. sec. 48.4082-7(b).

registered ultimate vendors. Claims relating to undyed kerosene sold from a blocked pump[173] or sold for blending with heating oil to be used during periods of extreme or unseasonable cold are also made by registered ultimate vendors. Special rules apply with respect to aviation-grade kerosene.

The Code also provides for a refund of tax for tax-paid fuel sold to a subsequent manufacturer or producer if the subsequent manufacturer or producer uses the fuel, for nonfuel purposes, as a material in the manufacture or production of any other article manufactured or produced by him.[174]

House Bill

No provision.

Senate Amendment

Gasoline blend stocks

The Senate amendment partially repeals exemptions provided in Treas. Reg. sec. 48.4081-4, which, under certain conditions, exempts from tax gasoline blend stocks that are not used to produce finished gasoline or that are received at an approved terminal or refinery. Under the Senate amendment, tax is imposed on all nonbulk entries and removals of gasoline blend stocks, regardless of whether they will be used to produce finished gasoline or received at an approved terminal or refinery. The Senate amendment does not change the exemption for bulk transfers to registered industrial users.

Kerosene and mineral spirits

The Senate amendment requires that with respect to fuel entered or removed after September 30, 2005, the Secretary shall not exclude mineral spirits from the definition of kerosene. Thus, for entries and removals after September 30, 2005, mineral spirits are taxed and exempt from tax in the same manner as kerosene.

Effective date.−The provision is effective for fuel removed or entered after September 30, 2005.

[173] A blocked pump is a fuel pump that is used to dispense undyed kerosene that is sold at retail for use by the buyer in any nontaxable use; is at a fixed location; is identified with a legible and conspicuous notice stating "Undyed Untaxed Kerosene, Nontaxable Use Only"; and cannot reasonably be used to dispense fuel directly into the fuel supply tank of a diesel-powered highway vehicle or diesel-powered train; or is locked by the vendor after each sale and unlocked only in response to a request by a buyer for undyed kerosene for use other than as a fuel in a diesel-powered highway vehicle or diesel-powered train.

[174] Sec. 6416(b)(3)(B).

Conference Agreement

The conference agreement does not include the Senate amendment provision.

9. Nonapplication of export exemption to delivery of fuel to motor vehicles removed from United States (sec. 1569 of the Senate amendment)

Present Law

A "taxable fuel" is gasoline, diesel fuel (including any liquid, other than gasoline, which is suitable for use as a fuel in a diesel-powered highway vehicle or train), and kerosene.[175] An excise tax is imposed upon (1) the removal of any taxable fuel from a refinery or terminal, (2) the entry of any taxable fuel into the United States, or (3) the sale of any taxable fuel to any person who is not registered with the IRS to receive untaxed fuel, unless there was a prior taxable removal or entry.[176] The tax does not apply to any removal or entry of taxable fuel transferred in bulk to a terminal or refinery if the person removing or entering the taxable fuel, the operator of such pipeline or vessel, and the operator of such terminal or refinery are registered with the Secretary.[177]

Special provisions under the Code provide for a refund of tax to any person who sells gasoline to another for exportation.[178] Section 6421(c) provides "If gasoline is sold to any person for any purpose described in paragraph (2), (3), (4), or (5) of section 4221(a), the Secretary shall pay (without interest) to such person an amount equal to the product of the number of gallons so sold multiplied by the rate at which tax was imposed on such gasoline by section 4081." Section 4221 provides, in pertinent part, "Under regulations prescribed by the Secretary, no tax shall be imposed under this chapter. . . on the sale by the manufacturer. . . of an article–. . . for export, or for resale by the purchaser to a second purchaser for export. . . but only if such exportation or use is to occur before any other use . . .."

It is the IRS administrative position that the exemption from manufacturers excise tax by reason of exportation does not apply to the sale of motor fuel pumped into a fuel tank of a vehicle that is to be driven, or shipped, directly out of the United States.[179]

A duty-free sales facility that meets certain conditions may sell and deliver for export from the customs territory of the United States duty-free merchandise. Duty-free merchandise is merchandise sold by a duty-free sales facility on which neither Federal duty nor Federal tax has

[175] Sec. 4083(a).

[176] Sec. 4081(a)(1).

[177] Sec. 4081(a)(1)(B).

[178] Secs. 6421(c) and 4221(a)(2).

[179] Rev. Rul. 69-150, 1969-1 C.B. 286.

been assessed pending exportation from the customs territory of the United States. The statutes covering duty-free facilities do not contain any limitation on what goods may qualify for duty-free treatment.

The issue of whether fuel sold from a duty-free facility and placed into the tank of an automobile that is then driven out of the country is exported fuel has been litigated in the courts.[180] The cases involved the same operator of a duty-free facility seeking a refund of excise tax. The facility is near the Canadian border and is configured in such a way that anyone leaving the facility must depart the United States and enter into Canada. Both the Federal Circuit and the Sixth Circuit Court of Appeals are in accord with the IRS position and ruled that the operator of the duty-free facility did not have standing to pursue a claim for refund.[181]

House Bill

No provision.

Senate Amendment

The Senate amendment reaffirms the long-standing IRS position taken in Rev. Rul. 69-150 and restates present law by amending the Code definition of export to exclude the delivery of a taxable fuel into a fuel tank of a motor vehicle that is shipped or driven out of the United States. It also imposes a tax on the sale of taxable fuel at a duty-free sales enterprise unless there was a prior taxable removal, or entry of such fuel.

Effective date.−The provision applies to sales or deliveries made after the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

[180] See *Ammex Inc. v. United States*, 52 Fed. Cl. 303 (2002) (on cross-motions for summary judgment, the court found that plaintiff established standing to proceed to trial pursuant to sec. 6421(c) respecting its gasoline purchases only); and *Ammex Inc. v. United States*, 2002 U.S. Dist. LEXIS 25771 (E.D. Mich. July 31, 2002) (granting defendant's motion for summary judgment), reconsideration denied, *Ammex, Inc. v. United States*, 2002 U.S. Dist. LEXIS 22893 (E.D. Mich. Oct. 22, 2002). Although the Claims Court ruled that Ammex had standing to challenge the excise tax on gasoline, it subsequently held that Ammex was not entitled to a payment pursuant to sec. 6421(c) because it failed to prove at trial that it did not pass the tax on to its customers. *Ammex Inc. v. United States*, 2003 U.S. Claims LEXIS 63 (Fed. Cl. Mar. 26, 2003). The Claims Court finding that the plaintiff had standing was reversed on appeal.

[181] See *Ammex Inc. v. United States*, 384 F.3d 1368 (Fed. Cir. 2004) *cert. denied* 125 S.Ct. 1697 (2005); and *Ammex Inc. v. United States*, 367 F.3d 530 (6th Cir. 2004) *cert. denied* 125 S.Ct. 1695 (2005).

10. Impose assessable penalty on dealers of adulterated fuel (sec. 1570 of the Senate amendment)

Present Law

Diesel fuel, gasoline, and kerosene are taxable fuels. Diesel fuel is defined as (1) any liquid (other than gasoline) which is suitable for use as a fuel in a diesel-powered highway vehicle or a diesel powered train, (2) transmix, and (3) diesel fuel blend stocks identified by the Secretary.[182] As a defense to Federal and State excise tax liability, some taxpayers have contended that certain diesel fuel mixtures or additives do not meet the requirements of (1) above because they are not approved as additives or mixtures by the EPA. In addition, under present law, untaxed fuel additives, including certain contaminants, may displace taxed diesel fuel in a mixture.

The Code provides that any person who, in connection with a sale or lease (or offer for sale or lease) of an article, knowingly makes any false statement ascribing a particular part of the price of the article to a tax imposed by the United States, or intended to lead any person to believe that any part of the price consists of such a tax, is guilty of a misdemeanor.[183] Another Code provision provides that any person who has in his custody or possession any article on which taxes are imposed by law, for the purpose of selling the article in fraud of the internal revenue laws or with design to avoid payment of the taxes thereon, is liable for "a penalty of $500 or not less than double the amount of taxes fraudulently attempted to be evaded."[184]

House Bill

No provision.

Senate Amendment

The Senate amendment adds a new assessable penalty. Any person other than a retailer who knowingly transfers for resale, sells for resale, or holds out for resale for use in a diesel-powered highway vehicle (or train) any liquid that does not meet applicable EPA regulations (as defined in section 45H(c)(3)[185]) is subject to a penalty of $10,000 for each such transfer, sale or holding out for resale, in addition to the tax on such liquid, if any. Any retailer who knowingly holds out for sale (other than for resale) any such liquid, is subject to a $10,000 penalty for each such holding out for sale, in addition to the tax on such liquid, if any.

[182] Sec. 4083(a)(3)(A).

[183] Sec. 7211. Such a violation is punishable by a fine not to exceed $1,000, or by imprisonment for not more than one year, or both.

[184] Sec. 7268.

[185] Sec. 45H(c)(3) refers to “the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency.”

The penalty is dedicated to the Highway Trust Fund.

Effective date.–The provision is effective for any transfer, sale, or holding out for sale or resale occurring after the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

11. Oil Spill Liability Trust Fund (sec. 1571 of the Senate amendment, sec. 1361 of the conference agreement, and sec. 4611 of the Code)

Present Law

Between December 31, 1989, and January 1, 1995, a five-cent-per-barrel tax was imposed on crude oil received at a United States refinery and imported petroleum products received for consumption, use, or warehousing, and any domestically produced crude oil that is exported from the United States if, before exportation, no taxes were imposed on the crude oil. The tax was effective only if the unobligated balance in the Fund was less than $1 billion. Taxes received were credited to the Oil Spill Liability Trust Fund. The Oil Spill Liability Trust Fund is used for several purposes, including the payment of costs for responding to and removing oil spills.[186]

House Bill

No provision.

Senate Amendment

The Senate amendment reinstates the Oil Spill Liability Trust Fund tax. The tax applies on April 1, 2006, or if later, the last day of any calendar quarter for which the Secretary estimates that, as of the close of that quarter, the unobligated balance in the Oil Spill Liability Trust Fund is less than $2 billion.

The tax will be suspended during a calendar quarter if the Secretary estimates that, as of the close of the preceding calendar quarter, the unobligated balance in the Oil Spill Liability Trust Fund exceeds $3 billion. The tax terminates after December 31, 2014.

Effective date.−The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment with the following modification. The tax will be suspended during a calendar quarter if the Secretary estimates that,

[186] Sec. 9509(c)(1).

as of the close of the preceding calendar quarter, the unobligated balance in the Oil Spill Liability Trust Fund exceeds $2.7 billion.

12. Leaking Underground Storage Tank Trust Fund (sec. 1562 of the Senate amendment, sec. 1362 of the conference agreement, secs. 4041, 4081(d), 4082, 9508, and new sec. 6430 of the Code)

Present Law

The Code imposes an excise tax, generally at a rate of 0.1 cents per gallon, on gasoline, diesel, kerosene, and special motor fuels (other than liquefied petroleum gas and liquefied natural gas).[187] The taxes are deposited in the Leaking Underground Storage Tank ("LUST") Trust Fund. The tax expires on October 1, 2005.

Diesel fuel and kerosene that is to be used for a nontaxable purpose will not be taxed upon removal from the terminal if it is dyed to indicate its nontaxable purpose.

The Code requires the LUST Trust Fund to reimburse the General Fund for certain refund and credit claims related to the nontaxable use of fuel (only to the extent attributable to the LUST Trust fund financing rate).[188]

House Bill

No provision.

Senate Amendment

Under the Senate amendment, the LUST Trust Fund tax is extended at the current rate through September 30, 2011. Further, all fuel, including dyed fuel, is subject to the LUST tax and no refund or claim for payment in the case of otherwise nontaxable use (other than exports) is permitted for such fuel. Under the provision, the LUST Trust Fund is no longer required to reimburse the General Fund for claims and credits related to the nontaxable use of fuel.

Effective date.−The provision is generally effective for fuel entered, removed or sold after September 30, 2005. The extension of the trust fund tax is effective October 1, 2005.

[187] For qualified methanol and ethanol fuel the rate is 0.05 cents per gallon (sec. 4041(b)(2)(A)(ii)). Qualified methanol or ethanol fuel is any liquid at least 85 percent of which consists of methanol, ethanol or other alcohol produced from coal (including peat) (sec. 4041(b)(2)(B)).

[188] Specifically, section 9508(c)(2) requires the LUST Trust Fund to reimburse the General Fund from time to time for claims paid pursuant to sections 6420 (relating to amounts paid in respect of gasoline used on farms), section 6421 (relating to amounts paid in respect of gasoline used for certain nonhighway purposes or by local transit systems), and section 6427 (relating to fuels not used for taxable purposes) and income tax credits allowed under section 34 for the purposes previously mentioned. No income tax credit is allowed for any amount payable under section 6421 or 6427 if a claim for such amount is timely filed and is payable under such section (sec. 34(b)).

Conference Agreement

The conference agreement follows the Senate amendment.

13. Clarification of tire excise tax (sec. 1573 of the Senate amendment, sec. 1364 of the conference agreement, and sec. 4072(e) of the Code)

Present Law

The Code imposes an excise tax on highway tires with a rated load capacity exceeding 3,500 pounds, generally at a rate of 9.45 cents per 10 pounds of excess. Biasply tires and super single tires are taxed at a rate of 4.725 cents for each 10 pounds of rated load capacity exceeding 3,500 pounds. A super single tire is a single tire greater than 13 inches in cross section width designed to replace two tires in a dual fitment.

House Bill

No provision.

Senate Amendment

The Senate amendment subjects super single tires to a tax of 8 cents per 10 pounds of excess rated load capacity over 3,500 pounds. It redefines super single tire to be a single tire greater than 17.5 inches in cross section width designed to replace two tires in a dual fitment.

Effective date.−The provision is effective for sales after September 30, 2005.

Conference Agreement

The conference agreement clarifies that the definition of super single tire does not include tires designed to serve as steering tires. It is understood that steering axles are not equipped with a dual fitment. Therefore, tires classified as steering tires are not "designed to replace two tires in a dual fitment." To the extent there is any perceived ambiguity in the present law definition, the conferees wish to clarify that steering tires are not included within the definition of super single tire eligible for the special rate of tax. Under the conference agreement, a “super single tire” is a single tire greater than 13 inches in cross section width designed to replace two tires in a dual fitment, but such term does not include any tire designed for steering.

With respect to the one-year period beginning on January 1, 2006, the IRS is required to report to the Congress on the amount of tax collected during such period for each class of taxable tire (e.g. biasply, super single, or other) and the number of tires in each such class on which tax is imposed during such period. The report must be submitted no later than July 1, 2007. The IRS is directed to revise the Form 720, Quarterly Federal Excise Tax Return, to collect the information necessary to prepare the report. The report is also to include total tire tax collections for an equivalent one-year period preceding the date of enactment of the American Jobs Creation Act of 2004.

Effective date.−The provision regarding the definition of a super single tire is effective as if included in section 869 of the American Jobs Creation Act of 2004. The study requirement is effective on the date of enactment.

14. Modify recapture of section 197 amortization (sec. 1363 of the conference agreement and sec. 1245 of the Code)

Present Law

Taxpayers are entitled to recover the cost of amortizable section 197 intangibles using the straight-line method of amortization over a uniform life of fifteen years.[189] With certain exceptions, amortizable section 197 intangibles generally are purchased intangibles held by a taxpayer in the conduct of a business.[190]

Gain on the sale of depreciable property must be recaptured as ordinary income to the extent of depreciation deductions previously claimed,[191] and the recapture amount is computed separately for each item of property. Section 197 intangibles, because they are treated as property of a character subject to the allowance for depreciation,[192] are subject to these recapture rules.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

Under the conference agreement, if multiple section 197 intangibles are sold (or otherwise disposed of) in a single transaction or series of transactions, the seller must calculate recapture as if all of the section 197 intangibles were a single asset. Thus, any gain on the sale (or other disposition) of the intangibles is recaptured as ordinary income to the extent of ordinary depreciation deductions previously claimed on any of the section 197 intangibles.

The following example illustrates present law and the conference agreement:

[189] Sec. 197(a)

[190] Sec. 197(c)

[191] Sec. 1245.

[192] Sec. 197(f)(7).

Example.–In year 1, a taxpayer acquires two section 197 intangible assets for a total of $45. Asset A is assigned a cost basis of $15 and asset B is assigned a cost basis of $30. The allocation is irrelevant for amortization purposes, as the taxpayer will be entitled to a total of $3 per year ($45 divided by 15 years).

In year 6, the basis of A is $10 and the basis of B is $20. Taxpayer sells the assets for an aggregate sale price of $45, resulting in gain of $15. The character of this gain depends on the recapture amount, which depends in turn on the relative sales prices of the individual assets. Taxpayer has claimed $5 of amortization, and therefore has $5 of recapture potential, with respect to A. Taxpayer has claimed $10 of amortization, and therefore has $10 of recapture potential, with respect to B.

Under present law, if the sale proceeds are allocated $15 to A and $30 to B, the gain on assets A and B will be $5 and $10, respectively. These amounts match the recapture potential for each asset, so the full amount of the gain will be recaptured as ordinary income. However, if the sale proceeds instead are allocated $25 to A and $20 to B, the full $15 gain will be recognized with respect to A, and only $5 (full recapture potential with respect to A) will be recaptured as ordinary income. The remaining $10 of gain attributable to A will be treated as capital gain. No gain (and thus no recapture) will be recognized with respect to Asset B, and only $5 of the $15 recapture potential is recognized.

Under the conference agreement, the taxpayer calculates recapture as if assets A and B were a single asset. For purposes of the calculation, the proceeds are $45 and the gain is $15. Because a total of $15 of amortization has been claimed with respect to assets A and B, the full $15 gain is recaptured as ordinary income.

Effective date.−The conference agreement is effective for dispositions of property after the date of enactment.

F. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code (the "Code") and has widespread applicability to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that have "widespread applicability" to individuals or small businesses.