[JOINT COMMITTEE PRINT]

GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 110TH CONGRESS

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation in consultation with the staffs of the House Committee on Ways and Means and the Senate Committee on Finance, provides an explanation of tax legislation enacted in the 110th Congress. The explanation follows the chronological order of the tax legislation as signed into law.

For each provision, the document includes a description of present law, explanation of the provision, and effective date. Present law describes the law in effect immediately prior to enactment. It does not reflect changes to the law made by the provision or subsequent to the enactment of the provision. For many provisions, the reasons for change are also included. In some instances, provisions included in legislation enacted in the 110th Congress were not reported out of committee before enactment. For example, in some cases, the provisions enacted were included in bills that went directly to the House and Senate floors. As a result, the legislative history of such provisions does not include the reasons for change normally included in a committee report. In the case of such provisions, no reasons for change are included with the explanation of the provision in this document.

In some cases, there is no legislative history for enacted provisions. For such provisions, this document includes a description of present law, explanation of the provision, and effective date, as prepared by the staff of the Joint Committee on Taxation. In some cases, contemporaneous technical explanations of certain bills were prepared and published by the staff of the Joint Committee. In those cases, this document follows the technical explanations. Section references are to the Internal Revenue Code unless otherwise indicated.

Part One of this document is an explanation of the provisions of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007 (Pub. L. No. 110–28) relating to tax relief for small business and revenue offsets.

Part Two is an explanation of the provisions of the Energy Independence and Security Act of 2007 (Pub. L. No. 110–140) relating to the extension of the FUTA surtax and the amortization of geological and geophysical expenditures.

Part Three is an explanation of the provisions of the Act to exclude from gross income payments from the Hokie Spirit Memorial Fund to the victims of the tragic event at Virginia Polytechnic Institute & State University (Pub. L. No. 110–141).

Part Four is an explanation of the provisions of the Mortgage Forgiveness Debt Relief Act of 2007 (Pub. L. No. 110–142) relating

[1] This document may be cited as follows: Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 110th Congress (JCS–1–09), March 2009.

to housing tax benefits, tax relief for volunteer firefighters and emergency medical responders, and revenue offsets.

Part Five is an explanation of the provisions relating to the extension of the Airport and Airway Trust Fund excise taxes and expenditure authority (Pub. L. Nos. 110–92, 110–161, 110–190, 110–253, and 110–330).

Part Six is an explanation of the provisions of the Tax Increase Prevention Act of 2007 (Pub. L. No. 110–166) relating to extension of alternative minimum tax relief.

Part Seven is an explanation of the provisions of the Tax Technical Corrections Act of 2007 (Pub. L. No. 110–172) relating to amendments to recently enacted tax legislation to make technical corrections.

Part Eight is an explanation of the provision of the Act to amend the Internal Revenue Code of 1986 to clarify the term of the Commissioner of Internal Revenue (Pub. L. No. 110–176).

Part Nine is an explanation of the provisions of the Economic Stimulus Act of 2008 (Pub. L. No. 110–185) relating to recovery rebates for individuals and incentives for business investment.

Part Ten is an explanation of the provisions of the Genetic Information Nondiscrimination Act of 2008 (Pub. L. No. 110–233) relating to genetic nondiscrimination in group health plans.

Part Eleven is an explanation of the provisions of the Food, Conservation, and Energy Act of 2008 (Pub. L. Nos. 110–234 and 110–246) relating to tax benefits for land and species conservation, cellulosic biofuel production, and certain agricultural activities, other tax benefits, and revenue offsets.

Part Twelve is an explanation of the provisions of the Heroes Earnings Assistance and Relief Tax Act of 2008 (Pub. L. No. 110–245) relating to tax benefits for military, revenue offsets, and parity in the application of certain limits to mental health benefits.

Part Thirteen is an explanation of the provisions of the Housing and Economic Recovery Act of 2008 (Pub. L. No. 110–289) relating to housing tax incentives, real estate investment trust reforms, and revenue offsets.

Part Fourteen is an explanation of the provision of the Hubbard Act (Pub. L. No. 110–317) relating to the repeal of the dollar limitation on contributions to funeral trusts.

Part Fifteen is an explanation of the provision of the Act to amend the Internal Revenue Code of 1986 to restore the Highway Trust Fund balance (Pub. L. No. 110–318).

Part Sixteen is an explanation of the provision of the SSI Extension for Elderly and Disabled Refugees Act (Pub. L. No. 110–328) relating to the collection of unemployment compensation debts resulting from fraud.

Part Seventeen is an explanation of the provisions of the Emergency Economic Stabilization Act of 2008, the Energy Improvement and Extension Act of 2008, and the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (Pub. L. No. 110–343) relating to the tax treatment of sales or exchanges of certain preferred stock by certain financial institutions, limitations on executive compensation of certain employers, energy production incentives, transportation and domestic fuel security, energy conservation and effi-

ciency, alternative minimum tax relief, extension of certain tax provisions, disaster relief, other tax benefits, and revenue offsets.

Part Eighteen is an explanation of the provision of the Fostering Connections to Success and Increasing Adoptions Act of 2008 (Pub. L. No. 110–351) relating to the clarification of the uniform definition of qualifying child.

Part Nineteen is an explanation of the provision of Michelle's Law (Pub. L. No. 110–381) relating to group health plan coverage of dependent students on medically necessary leaves of absence.

Part Twenty is an explanation of the provision of the Inmate Tax Fraud Prevention Act of 2008 (Pub. L. No. 110–428) relating to the disclosure of prisoner return information to the Federal Bureau of Prisons.

Part Twenty-One is an explanation of the provisions Worker, Retiree, and Employer Recovery Act of 2008 (Pub. L. No. 110–458) relating to technical corrections of the Pension Protection Act of 2006 (Pub. L. No. 109–280), modifications to the required minimum distribution rules and the minimum funding rules for defined benefit pension plans, and other tax benefits and offsets.

Part Twenty-Two is an explanation of the provisions relating to the extension of custom user fees and the modification of corporate estimated tax payments (Pub. L. Nos. 110–42, 110-52, 110–89, 110–138, 110–191, 110–287, and 110–436).

The Appendix provides the estimated budget effects of tax legislation enacted in the 110th Congress.

The first footnote in each Part gives the legislative history of each of the Acts of the 110th Congress discussed.

PART ONE: U.S. TROOP READINESS VETERANS' CARE, KATRINA RECOVERY, AND IRAQ ACCOUNTABILITY APPROPRIATIONS ACT, 2007 (PUBLIC LAW 110–28)[2]

TITLE I—SMALL BUSINESS TAX RELIEF PROVISIONS GENERAL PROVISIONS

A. General Provisions

1. Extension and modification of work opportunity tax credit (sec. 8211 of the Act and sec. 51 of the Code[3])

Present Law

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally an employer is eligible for the credit only for qualified wages paid to members of a targeted group.

(1) Families receiving TANF

An eligible recipient is an individual certified by a designated local employment agency (e.g., a State employment agency) as being a member of a family eligible to receive benefits under the Temporary Assistance for Needy Families Program ("TANF") for a period of at least nine months during the 18-month period ending on the hiring date. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for the TANF.

(2) Qualified veteran

A qualified veteran is a veteran who is certified by the designated local agency as a member of a family certified as receiving

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[2] H.R. 2206. The House Committee on Ways and Means reported H.R. 976 on February 15, 2007 (H.R. Rep. 110–14). H.R. 2206 passed the House on February 16, 2007. The Senate Committee on Finance reported S. 349 on January 22, 2007 (S. Rep. 110–1). The text of H.R. 976 was added to H.R. 1591 as chapter 2 of Title VII. The House passed H.R. 1591 on March 23, 2007. The Senate passed H.R. 1591 with an amendment on March 29, 2007. The conference report was filed on April 24, 2007 (H. Rep. 110–107) and was passed by the House on April 25, 2007, and the Senate on April 26, 2007. The President vetoed the bill on May 1, 2007, and the House failed to override the veto on May 2, 2007. H.R. 2206, which contained the tax provisions of H.R. 1591, was passed by the House on May 10, 2007, and was passed by the Senate on May 17, 2007. On May 24, the House agreed to the Senate amendment with an amendment, and on May 24, 2007, the Senate agreed to the House amendment. The President signed the bill on May 25, 2007. For a technical explanation of the bill prepared by the staff of the Joint Committee on Taxation, see *Technical Explanation of the "Small Business And Work Opportunity Tax Act of 2007" and Pension Related Provisions Contained in H.R. 2206 As Considered By The House of Representatives on May 24, 2007* (JCX 29–07, May 24, 2007).

[3] Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

assistance under a food stamp program under the Food Stamp Act of 1977 for a period of at least three months ending during the 12-month period ending on the hiring date. For these purposes, members of a family are defined to include only those individuals taken into account for purposes of determining eligibility for a food stamp program under the Food Stamp Act of 1977.

For these purposes, a veteran is an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not a qualified veteran if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

(3) Qualified ex-felon

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any State or Federal law, and (2) having a hiring date within one year of release from prison or date of conviction.

(4) High-risk youth

A high-risk youth is an individual certified as being at least age 18 but not yet age 25 on the hiring date and as having a principal place of abode within an empowerment zone, enterprise community, or renewal community (as defined under Subchapter X of Subtitle A, Chapter 1 of the Internal Revenue Code (the ("Code")). Qualified wages do not include wages paid or incurred for services performed after the individual moves outside an empowerment zone, enterprise community, or renewal community.

(5) Vocational rehabilitation referral

A vocational rehabilitation referral is an individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing: (a) vocational rehabilitation services under an individualized, written plan for employment under a State plan approved under the Rehabilitation Act of 1973; or (b) under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(6) Qualified summer youth employee

A qualified summer youth employee is an individual: (1) who performs services during any 90-day period between May 1 and September 15, (2) who is certified by the designated local agency as being 16 or 17 years of age on the hiring date, (3) who has not been

an employee of that employer before, and (4) who is certified by the designated local agency as having a principal place of abode within an empowerment zone, enterprise community, or renewal community (as defined under Subchapter X of Subtitle A, Chapter 1 of the Internal Revenue Code). As with high-risk youths, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone, enterprise community, or renewal community. If, after the end of the 90-day period, the employer continues to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first year wages will take into account wages paid to the youth while a qualified summer youth employee.

(7) Qualified food stamp recipient

A qualified food stamp recipient is an individual aged 18 but not yet 40 certified by a designated local employment agency as being a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for a period of at least six months ending on the hiring date. In the case of families that cease to be eligible for food stamps under section 6(o) of the Food Stamp Act of 1977, the six-month requirement is replaced with a requirement that the family has been receiving food stamps for at least three of the five months ending on the date of hire. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for a food stamp program under the Food Stamp Act of 1977.

(8) Qualified SSI recipient

A qualified SSI recipient is an individual designated by a local agency as receiving supplemental security income ("SSI") benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date.

(9) Long-term family assistance recipients

A qualified long-term family assistance recipient is an individual certified by a designated local agency as being: (1) a member of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) a member of a family that has received such family assistance for a total of at least 18 months (whether or not consecutive) after August 5, 1997 (the date of enactment of the welfare-to-work tax credit)[4] if the individual is hired within two years after the date that the 18-month total is reached; or (3) a member of a family who is no longer eligible for family assistance because of either Federal or State time limits, if the individual is hired within two years after the Federal or State time limits made the family ineligible for family assistance.

[4] The welfare-to-work tax credit was consolidated into the work opportunity tax credit in the Tax Relief and Health Care Act of 2006, for qualified individuals who begin to work for an employer after December 31, 2006.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in sec. 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

Certification rules

An individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

Minimum employment period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

The work opportunity tax credit is not available for individuals who begin work for an employer after December 31, 2007.

Reasons for Change

The Congress believes that the experience with the credit has been positive and wishes to extend and expand the credit. In particular, the Congress believes that the credit can be used to improve employment opportunities for broader classes of qualified veterans and designated community residents. Also, the Congress believes that the expansion of the vocational rehabilitation referral group appropriately conforms availability of the credit to a previous expansion of the vocational rehabilitation referral program.

Explanation of Provision

Extension

The Act extends the work opportunity tax credit for 44 months (for qualified individuals who begin work for an employer after December 31, 2007, and before September 1, 2011).

Qualified veterans targeted group

The Act expands the qualified veterans' targeted group to include an individual who is certified as entitled to compensation for a service-connected disability and: (1) having a hiring date which is not more than one year after having been discharged or released from active duty in the Armed Forces of the United States, or (2) having been unemployed for six months or more (whether or not consecutive) during the one-year period ending on the date of hiring. Being entitled to compensation for a service-connected disability is defined with reference to section 101 of Title 38, U.S.C., which means having a disability rating of 10-percent or higher for service connected injuries.

Qualified first-year wages

The Act expands the definition of qualified first-year wages from $6,000 to $12,000 in the case of individuals who qualify under either of the new expansions of the qualified veteran group, above. The expanded definition of qualified first-year wages does not apply to the veterans qualified with reference to a food stamp program, as defined under present law.

High-risk youth targeted group

The Act expands the definition of high-risk youths to include otherwise qualifying individuals age 18 but not yet age 40 on the hiring date. Also, the Act expands the definition of eligible individuals under this category to include otherwise qualifying individuals from rural renewal counties. For these purposes, a rural renewal county is a county outside a metropolitan statistical area (as defined the Office of Management and Budget) which had a net population loss during the five-year periods 1990–1994 and 1995–1999. Finally, the Act changes the name of the category to the "designated community residents" targeted group.

Vocational rehabilitation referral targeted group

The Act expands the definition of vocational rehabilitation referral to include any individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing, an individual work plan developed and implemented by an employment network pursuant to subsection (g) of section 1148 of the Social Security Act.

Certification

Under present law, designated local employment agencies may enter into information sharing agreements to facilitate certification for purposes of WOTC eligibility. Such agreements are subject to confidentiality requirements. The Congress expects that the Department of Defense, the Department of Veterans Affairs, and the Social Security Administration will work with the designated local agencies to facilitate certification of the expansions of the qualified veteran category and the SSI recipient category. Finally, the Congress expects that the Internal Revenue Service will develop procedures to allow (in addition to original documents) paper versions of electronically completed pre-screening notices and photographic copies of hand signed original pre-screening notices for purposes of the credit. This allowance of pre-screening notices which are not original documents should be allowed only to the extent it does not foster incorrect or fraudulent filings.

Effective Date

The provisions are effective for individuals who begin work for an employer after the date of enactment (May 25, 2007).

2. Increase and extension of expensing for small business (sec. 8212 of the Act and sec. 179 of the Code)

Present Law

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under section 179. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2003 through 2009, is $100,000 of the cost of qualifying property placed in service for the taxable year.[5] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2010 is treated as qualifying property. The $100,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $400,000. The $100,000 and $400,000 amounts are indexed for inflation for taxable years beginning after 2003 and before 2010. For taxable years beginning in 2007, the inflation-adjusted amounts are $112,000 and $450,000, respectively.[6]

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[7]

For taxable years beginning in 2010 and thereafter (or before 2003), the following rules apply. A taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner.[8]

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[5] Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)).

[6] Rev. Proc. 2006–53, sec. 2.19, 2006–2 C.B. 996.

[7] Sec. 179(c)(1). Under Treas. Reg. sec. 1.179–5, applicable to property placed in service in taxable years beginning after 2002 and before 2008, a taxpayer is permitted to make or revoke an election under section 179 without the consent of the Commissioner on an amended Federal tax return for that taxable year. This amended return must be filed within the time prescribed by law for filing an amended return for the taxable year. T.D. 9209, July 12, 2005.

[8] Sec. 179(c)(2).

Reasons for Change

The Congress believes that section 179 expensing provides two important benefits for small businesses. First, it lowers the cost of capital for property used in a trade or business. With a lower cost of capital, the Congress believes small businesses will invest in more equipment and employ more workers. Second, it eliminates depreciation recordkeeping requirements with respect to expensed property. In 2006, Congress acted to extend the increased value of these benefits and the increased number of taxpayers eligible for these benefits for taxable years through 2009. The Congress believes that the changes to section 179 expensing will continue to provide important benefits, if extended, and the Act therefore extends these changes for an additional year. Furthermore, the Congress believes that the dollar limits on expensing should be increased in order to further lower the cost of capital for small businesses, and to make this benefit available for a greater number of small businesses.

Explanation of Provision[9]

The Act increases the $100,000 and $400,000 amounts to $125,000 and $500,000, respectively, for taxable years beginning in 2007 through 2010. These amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.

In addition, the Act extends for one year the increased amount that a taxpayer may deduct and the other section 179 rules applicable in taxable years beginning before 2010. Thus, under the Act, these rules continue in effect for taxable years beginning after 2009 and before 2011.

Effective Date

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

3. Determination of credit for certain taxes paid with respect to employee cash tips (sec. 8213 of the Act and sec. 45B of the Code)

Present Law[10]

The Federal minimum wage under the Fair Labor Standards Act (the "FLSA") is $5.15 per hour. In the case of tipped employees, the FLSA provides that the minimum wage may be reduced to $2.13 per hour (that is, the employer is only required to pay cash equal to $2.13 per hour) if the combination of tips and cash income equals the Federal minimum wage.[11]

Under present law, employee tip income is treated as employer-provided wages for purposes of the Federal Insurance Contribu-

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[9] The provision was subsequently modified to increase the annual limitation on investment and the phase-out amounts for taxable years beginning in 2008. See Part Nine, B.

[10] A separate provision of Pub. L. No. 110–28 increases the Federal minimum wage (to $7.25 per hour over a transition period).

[11] Some States require the payment of cash wages to tipped employees in excess of the Federal minimum of $2.13 per hour. For a history of the tip provisions under the FLSA and a description of relevant State laws, see William G. Whittaker, Congressional Research Service, *The Tip Credit Provisions of the Fair Labor Standards Act* (Order Code RL33348), March 24, 2006.

tions Act ("FICA"). Employees are required to report the amount of tips received.

A business tax credit is provided equal to an employer's FICA taxes paid on tips in excess of those treated as wages for purposes of meeting the minimum wage requirements of the FLSA. The credit applies only with respect to FICA taxes paid on tips received from customers in connection with the providing, delivering, or serving of food or beverages for consumption if the tipping of employees delivering or serving food or beverages by customers is customary. The credit is available whether or not the employee reports the tips on which the employer FICA taxes were paid. No deduction is allowed for any amount taken into account in determining the tip credit. A taxpayer may elect not to have the credit apply for a taxable year.

Reasons for Change

Under present law, because the amount of tips eligible for the FICA tip credit is tied to the minimum wage under the FLSA, if the minimum wage increases above $5.15 per hour, the amount of the FICA tip credit will automatically be reduced. The Congress believes that the increase in the minimum wage should not result in an increase in taxes for employers in the restaurant industry. Thus, the Committee bill freezes the tip credit based on the current minimum wage so that, when the minimum wage is increased, the tip credit will not be affected.

Explanation of Provision

The Act provides that the amount of the tip credit is based on the amount of tips in excess of those treated as wages for purposes of the FLSA as in effect on January 1, 2007. That is, under the provision, the tip credit is determined based on a minimum wage of $5.15 per hour. Therefore, if the amount of the minimum wage increases, the amount of the FICA tip credit will not be reduced.

Effective Date

The provision applies with respect to tips received for services performed after December 31, 2006.

4. Waiver of individual and corporate alternative minimum tax limits on work opportunity credit and credit for taxes paid with respect to employee cash tips (sec. 8214 of the Act and sec. 38 of the Code)

Present Law

Under present law, business tax credits generally may not exceed the excess of the taxpayer's income tax liability over the tentative minimum tax (or, if greater, 25 percent of the regular tax liability in excess of $25,000). Credits in excess of the limitation may be carried back one year and carried over for up to 20 years.

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. To the extent the tentative min-

imum tax exceeds the regular tax, a taxpayer is subject to the alternative minimum tax.

Thus, business tax credits generally cannot offset the alternative minimum tax liability.

Reasons for Change

The alternative minimum tax limits the intended effects of the work opportunity tax credit and the credit for taxes paid with respect to cash tips for some taxpayers. The Congress believes that the incentive effects of work opportunity credit and credit for taxes paid with respect to employee cash tips should be available to taxpayers regardless of their alternative minimum tax status. Accordingly, the Act provides that these credits can be utilized by offsetting both the regular tax and the alternative minimum tax.

Explanation of Provision

The Act treats the tentative minimum tax as being zero for purposes of determining the tax liability limitation with respect to the work opportunity credit and the credit for taxes paid with respect to employee cash tips.

Thus, the work opportunity tax credit and the credit for taxes paid with respect to cash tips may offset the alternative minimum tax liability.

Effective Date

The provision applies to credits determined in taxable years beginning after December 31, 2006.

5. Family business tax simplification (sec. 8215 of the Act and sec. 761 of the Code)

Present Law

Under present law, a partnership is defined to include a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation or venture is carried on, and which is not a trust or estate or a corporation (sec. 7701(a)(2)). A partnership is treated as a pass-through entity, and income earned by the partnership, whether distributed or not, is taxed to the partners. The income of a partnership and its partners is determined under subchapter K of the Code. An election not to be subject to the rules of subchapter K is provided for certain partnerships that meet specified criteria (e.g., the partnership is for investment purposes only, is for the joint production, extraction or use of property but not for selling services or property produced or extracted, or is used by securities dealers for short periods to underwrite, sell or distribute securities). Otherwise, the rules of subchapter K apply to a venture that is treated as a partnership for Federal tax purposes.

In the case of an individual with self-employment income, the income subject to self-employment tax is the net earnings from self-employment (sec. 1402(a)). Net earnings from self-employment is the gross income derived by an individual from any trade or business carried on by the individual, less the deductions attributable

to the trade or business that are allowed under the self-employment tax rules. If the individual is a partner in a partnership, the net earnings from self-employment generally include his or her distributive share (whether or not distributed) of income or loss from any trade or business carried on by the partnership.

Reasons for Change

The Congress is concerned that certain business ventures whose sole members are a husband and wife filing a joint return may be subject to unnecessary complexity under present law.[12] In the situation in which the spouses share all items of income, gain, loss, deduction and credit from the venture, the venture should not be required to file a partnership return if each of the two spouses' income can be accurately recorded on Schedule C (or F, in the case of a farm) filed with the joint return. The reported income would be the same on the joint return, whether or not a partnership return is filed. Further, the Congress is concerned that if only one spouse is treated as having net earnings from self-employment from the venture, when in fact both spouses materially participate in it, only the spouse that is treated as having net earnings from self-employment from the venture will receive credit for purposes of Social Security benefits. The Congress believes that, therefore in this situation, both spouses, not just one, should be treated as having net earnings from self-employment from the venture in accordance with their respective interests, and should receive credit for the appropriate net earnings from self-employment for purposes of Social Security benefits.

Explanation of Provision

The Act generally permits a qualified joint venture whose only members are a husband and wife filing a joint return not to be treated as a partnership for Federal tax purposes. A qualified joint venture is a joint venture involving the conduct of a trade or business, if (1) the only members of the joint venture are a husband and wife, (2) both spouses materially participate in the trade or business, and (3) both spouses elect such treatment.

Under the Act, a qualified joint venture conducted by a husband and wife who file a joint return is not treated as a partnership for Federal tax purposes. All items of income, gain, loss, deduction and credit are divided between the spouses in accordance with their respective interests in the venture. Each spouse takes into account his or her respective share of these items as a sole proprietor. Thus, it is anticipated that each spouse would account for his or her respective share on the appropriate form, such as Schedule C. The Act is not intended to change the determination under present law of whether an entity is a partnership for Federal tax purposes (without regard to the election provided by the provision).

For purposes of determining net earnings from self-employment, each spouse's share of income or loss from a qualified joint venture

[12] See *National Taxpayer Advocate FY 2002 Annual Report to Congress*, "Married Couples as Business Co-owners," at 172, recommending a similar change for this reason as well as other reasons. This recommendation was also included in the *National Taxpayer Advocate FY 2004 Annual Report to Congress*.

is taken into account just as it is for Federal income tax purposes under the Act (i.e., in accordance with their respective interests in the venture). A corresponding change is made to the definition of net earnings from self-employment under the Social Security Act. The Act is not intended to prevent allocations or reallocations, to the extent permitted under present law, by courts or by the Social Security Administration of net earnings from self-employment for purposes of determining Social Security benefits of an individual.

Effective Date

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

B. Gulf Opportunity Zone Tax Incentives

1. Extension of increased expensing for qualified section 179 Gulf Opportunity Zone property (sec. 8221 of the Act and sec. 1400N(e) of the Code)

Present Law

In general

Present law provides that, in lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct ("or expense") such costs under section 179. The maximum amount a taxpayer may expense, for taxable years beginning in 2003 through 2009, is $100,000 of the cost of qualifying property placed in service for the taxable year.[13] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2010 is treated as qualifying property. The $100,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $400,000. The $100,000 and $400,000 amounts are indexed for inflation for taxable years beginning after 2003 and before 2010. For taxable years beginning in 2007, the inflation-adjusted amounts are $112,000 and $450,000, respectively.[14]

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[15]

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[13] Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), or a renewal community (sec. 1400J).

[14] Rev. Proc. 2006–53, sec. 2.19, 2006–2 C.B. 996.

[15] Sec. 179(c)(1). Under Treas. Reg. sec. 1.179–5, applicable to property placed in service in taxable years beginning after 2002 and before 2008, a taxpayer is permitted to make or revoke

Continued

For taxable years beginning in 2010 and thereafter (or before 2003), the following rules apply. A taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner.[16]

Increase for Gulf Opportunity Zone Property

Under section 1400N(e), the $100,000 maximum amount that a taxpayer may elect to deduct under section 179 is increased by the lesser of $100,000 or the cost of qualified section 179 Gulf Opportunity Zone property for the taxable year. The Act applies with respect to qualified section 179 Gulf Opportunity Zone property acquired on or after August 28, 2005, and placed in service on or before December 31, 2007. Thus, in addition to the $100,000 maximum cost of any section 179 property (including property that also meets the definition of qualified section 179 Gulf Opportunity Zone property) that may be deducted under present law, a taxpayer may elect to deduct a maximum $100,000 additional amount of the taxpayer's cost of qualified section 179 Gulf Opportunity Zone property, resulting in a maximum deductible amount of $200,000 of qualified section 179 Gulf Opportunity Zone property. (The $100,000 present-law portion of this amount is indexed for taxable years beginning after 2003 and before 2010, so the total may be higher than $200,000 after taking indexation of this portion into account.) The $100,000 additional amount for the cost of qualified section 179 Gulf Opportunity Zone property is not indexed.

There is a special rule for the reduction in the $200,000 maximum deduction for the cost of qualified section 179 Gulf Opportunity Zone property. Under this rule, the $200,000 amount is reduced (but not below zero) by the amount by which the cost of qualified section 179 Gulf Opportunity Zone property placed in service during the taxable year exceeds a dollar cap of up to $1 million. (The $400,000 present-law portion of this amount is indexed for taxable years beginning after 2003 and before 2010, so the total may be higher than $1 million after taking indexation of this portion into account.) The dollar cap is computed by increasing the $400,000 present-law amount by the lesser of (1) $600,000, or (2) the cost of qualified section 179 Gulf Opportunity Zone property placed in service during the taxable year. The $600,000 amount is not indexed.

Qualified section 179 Gulf Opportunity Zone property means section 179 property (as defined in section 179(d)) that also meets the requirements to qualify for Gulf Opportunity Zone bonus deprecia-

an election under section 179 without the consent of the Commissioner on an amended Federal tax return for that taxable year. This amended return must be filed within the time prescribed by law for filing an amended return for the taxable year. T.D. 9209, July 12, 2005.

[16] Sec. 179(c)(2).

tion. Specifically, for section 179 purposes, qualified Gulf Opportunity Zone property is property (1) described in section 168(k)(2)(A)(i), (2) substantially all of the use of which is in the Gulf Opportunity Zone and is in the active conduct of a trade or business by the taxpayer in that Zone, (3) the original use of which commences with the taxpayer on or after August 28, 2005, (4) which is acquired by the taxpayer by purchase on or after August 28, 2005, but only if no written binding contract for the acquisition was in effect before August 28, 2005, and (5) which is placed in service by the taxpayer on or before December 31, 2007. Such property does not include alternative depreciation property, tax-exempt bond-financed property, or qualified revitalization buildings.

These rules are coordinated with expensing rules with respect to enterprise zone businesses in empowerment zones and with respect to renewal communities. For purposes of those rules, qualified section 179 Gulf Opportunity Zone property is not treated as qualified zone property or qualified renewal property, unless the taxpayer elects not to take such property into account for purposes of the increased section 179 expensing. Thus, a taxpayer acquiring property that could qualify as either qualified section 179 Gulf Opportunity Zone property, or qualified zone property or qualified renewal property, may elect the additional expensing provided either under this provision, or under the empowerment zone or renewal community rules, but not both, with respect to the property.

Recapture rules apply to this property if recapture applies under section 179(d)(10) or if the property ceases to be qualified section 179 Gulf Opportunity Zone property.

Explanation of Provision

The Act extends the increased expensing amount for property substantially all of the use of which is in one or more specified portions of the GO Zone to property placed in service by the taxpayer on or before December 31, 2008. The specified portions of the Go Zone include the Louisiana parishes of Calcasieu, Cameron, Orleans, Plaquemines, St. Bernard, St. Tammany, and Washington, and the Mississippi counties of Hancock, Harrison, Jackson, Pearl River, and Stone.[17]

Effective Date

The provision is effective for taxable years beginning after the date of enactment (May 25, 2007).

2. Extension and expansion of low-income housing credit rules for buildings in the GO Zones (sec. 8222 of the Act and 1400N(c) of the Code)

Present Law

In general

The low-income housing credit may be claimed over a 10-year period for the cost of building rental housing occupied by tenants hav-

[17] The "specified portions of the Go Zone" as defined by section 1400N(d)(6) are identified by the Secretary in Notice 2007–36, 2007–17 I.R.B 1000.

ing incomes below specified levels. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The qualified basis of any qualified low-income building for any taxable year equals the applicable fraction of the eligible basis of the building.

The credit percentage for newly constructed or substantially rehabilitated housing that is not Federally subsidized is adjusted monthly by the Internal Revenue Service so that the 10 annual installments of the credit have a present value of 70 percent of the total qualified basis. The credit percentage for newly constructed or substantially rehabilitated housing that is Federally subsidized and for existing housing that is substantially rehabilitated is calculated to have a present value of 30 percent of qualified basis. These are referred to as the 70-percent credit and 30-percent credit, respectively.

Credit cap

A low-income housing credit is allowable only if the owner of a qualified building receives a housing credit allocation from the State or local housing credit agency. Credit cap is provided to the States annually. For 2006, the amount is $1.90 per resident with a minimum annual cap of $2,180,000 for certain small population States. These amounts are indexed for inflation. These limits do not apply in the case of projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit.

Under the Gulf Opportunity Zone Act of 2005, the otherwise applicable housing credit ceiling amount is increased for each of the States within the Gulf Opportunity Zone (Alabama, Louisiana, and Mississippi). The additional credit cap for each of the affected States equals $18.00 times the number of such State's residents within the Gulf Opportunity Zone. This increase applies to calendar years 2006, 2007, and 2008. This amount is not adjusted for inflation. For purposes of the additional credit cap amount, the determination of population for any calendar year is made on the basis of the most recent census estimate of the resident population of the State in the Gulf Opportunity Zone released by the Bureau of the Census before August 28, 2005. In addition, under the Gulf Opportunity Zone Act of 2005, the otherwise applicable housing credit ceiling amount is increased for Florida and Texas by $3,500,000 per State. This increase applies only to calendar year 2006.

Carryover allocation rule

A low-income housing credit is allowable only if the owner of a qualified building receives a housing credit allocation from the State or local housing credit agency. In general, the allocation must be made not later than the close of the calendar year in which the building is placed in service. One exception to this rule is a carryover allocation. In the case of a carryover allocation, an allocation may be made to a building that has not yet been placed in service, provided that: (1) more than ten percent of the taxpayer's reasonably expected basis in the project (as of the close of the second calendar year following the calendar year of the allocation) is incurred

as of the later of six months after the allocation is made or the end of the calendar year in which the allocation is made; and (2) the building is placed in service not later than the close of the second calendar year following the calendar year of the allocation.

Enhanced credit

Generally, buildings located in high cost areas (i.e., qualified census tracts and difficult development areas) are eligible for an enhanced credit. Under the enhanced credit, the 70-percent and 30-percent credit is increased to a 91-percent and 39-percent credit, respectively. The mechanism for this increase is an increase from 100 to 130 percent of the otherwise applicable eligible basis of a new building or the rehabilitation expenditures of an existing building. A further requirement for the enhanced credit is that no area having more than 20 percent of the population of each metropolitan statistical area or nonmetropolitan statistical area can be a difficult to develop area and therefore a high cost area eligible for this treatment.

Under the Gulf Opportunity Zone Act of 2005, the Gulf Opportunity Zone, the Rita GO Zone, and the Wilma GO Zone (the, "Go Zones") are treated as high-cost areas for purposes of the low income housing credit for property placed-in-service in calendar years 2006, 2007, and 2008. Therefore, buildings located in the GO Zones are eligible for the enhanced credit. Under the enhanced credit, the 70-percent and 30-percent credits are increased to 91-percent and 39-percent credits, respectively. The 20-percent of population restriction is waived for this purpose. This enhanced credit applies regardless of whether the building receives its credit allocation under the otherwise applicable low-income housing credit cap or the additional credit cap provided under the Gulf Opportunity Zone Act of 2005 The Act to treat the GO Zones as a high-cost area is generally effective for calendar years beginning after 2005 and before 2009, and for buildings placed-in-service during such period in the case of projects that also receive financing with the proceeds of tax-exempt bonds subject to the private activity bond volume limit which are issued after December 31, 2005.

Definition of Federally subsidized

In general, any newly constructed or substantially rehabilitated building is treated as Federally subsidized for any taxable year if, at any time during such taxable year or prior taxable year, there is or was outstanding any obligation the interest on which is exempt under section 103, or any below market Federal loan, the proceeds of which are or were used (directly or indirectly) with respect to such building or the operation thereof. Exceptions are provided from this general rule: (1) if the taxpayer elects to reduce eligible basis; and (2) for certain subsidized construction financing. For purposes of this rule, a below market Federal loan generally is defined as a loan funded, in whole or in part, with Federal funds if the interest payable on such loan is less than the applicable Federal rate in effect under section 1274(d)(1) (as of the date the loan was made). A loan is not treated as a below market Federal loan for these purposes, if it is below market solely by reason of assistance provided under section 106, 107, or 108 of the Housing and

Community Development Act of 1974, as in effect on December 19, 1989 (the date of enactment of the Omnibus Budget Reconciliation Act of 1989).

Rehabilitation expenditures

Rehabilitation expenditures paid or incurred by the taxpayer with respect to any building shall be treated as a separate new building for purposes of the credit. In general, rehabilitation expenditures are amounts chargeable to a capital account and incurred for property (or additions or improvements to property) of a character subject to depreciation in connection with the rehabilitation of a building. Such term does not include the cost of acquiring a building (or interest therein). Other rules, including a minimum expenditure requirement, apply.

Reasons for Change[18]

The Congress believes that it is appropriate to respond to the extended recovery period currently being experienced in the GO Zones. Further, the Congress believes that a temporary extension of certain tax incentives for housing construction is necessary to accommodate the recovery effort. The extension of the time period within which certain tax incentives must be utilized will help provide thousands of additional units of low income rental housing in the affected areas.

Explanation of Provision

Carryover allocation rule

The Act makes two modifications to the carryover allocation rule for otherwise qualifying buildings located in the GO Zones placed in service before January 1, 2011. First, it repeals the requirement that 10 percent of the taxpayer's reasonably expected basis in the project (as of the close of the second calendar year following the calendar year of the allocation) must be incurred as of the later of six months after the allocation is made or the end of the calendar year in which the allocation is made (the "10-percent rule"). Second, it repeals the requirement that such building be placed in service not later than the close of the second calendar year following the calendar year of the allocation (the "second-year placed in service rule"). These changes apply only to allocations made in 2006, 2007, or 2008 whether made out of the regular credit cap or the additional Gulf Opportunity Zone credit cap. Therefore, an otherwise qualifying building is treated as a qualifying for the credit regardless of whether the 10-percent rule or the second-year placed in service rule are satisfied if such building in one of the GO Zones: (1) receives an allocation in 2006, 2007, or 2008; and (2) is placed in service before January 1, 2011.

Enhanced credit

The Act extends the placed in service dates for buildings eligible for the enhanced credit available under the Gulf Opportunity Zone

[18] See H.R. 1562, the "Katrina Housing Tax Relief Act of 2009," which was reported by the House Committee on Ways and Means on March 23, 2007 (H.R. Rep. No. 110–66).

Act of 2005 for two additional years (2009 and 2010) for allocations made in 2006, 2007, or 2008. The Act to treat the GO Zones as a high-cost area is generally effective for calendar years beginning after December 31, 2008 and before January 1, 2011, and for buildings placed-in-service during such period in the case of projects that also receive financing with the proceeds of tax-exempt bonds subject to the private activity bond volume limit which are issued during that period. Therefore, otherwise qualifying buildings located in the GO Zones generally are eligible for the enhanced credit for allocations made in 2006, 2007, or 2008, if placed in service after December 31, 2005 and before January 1, 2011.

Definition of Federally subsidized

The Act modifies the definition of below market Federal loan for otherwise qualifying buildings located in the GO Zones that are placed in service during the period beginning on January 1, 2006 and ending on December 31, 2010. Under the Act, a loan is not treated as a below market Federal loan solely by reason of assistance provided under section 106, 107, or 108 of the Housing and Community Development Act of 1974 by reason of: (1) section 122 of that Act; (2) any provision of the Department of Defense Appropriations Act, 2006 (Pub. L. No. 109–141); or (3) the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006 (Pub. L. No. 109–234). Therefore, such assistance will not cause an otherwise qualifying building receiving such assistance to be treated as Federally subsidized for purposes of the low income housing credit.

Rehabilitation expenditures

The Congress expects that the present law rules treating rehabilitation expenses as a separate new building for purposes of the low-income housing credit will apply in the case of buildings in the GO Zones which have been destroyed and, therefore, must be rehabilitated. For example, if a building receiving the low-income housing credit (with an eligible basis of $100 for credit purposes) was destroyed and the cost of replacing the building is $150, then the Congress expects that present law rules may allow the expenditures that exceed $100 but do not exceed $150 to be treated as a separate building with separate credit and compliance periods, assuming the rehabilitation expenditure receives a credit allocation and meets the otherwise applicable low income housing tax credit requirements.

Effective Date

The provisions are effective upon enactment (May 25, 2007).

3. Special tax-exempt bond financing rule for repairs and reconstructions of residences in the GO Zones (sec. 8223 of the Act and secs. 143 and 1400N(a) of the Code)

Present Law

In general

Under present law, gross income does not include interest on State or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds"). The definition of a qualified private activity bond includes a qualified mortgage bond.

Qualified mortgage bonds

Qualified mortgage bonds are tax-exempt bonds issued to make mortgage loans to eligible mortgagors for the purchase, improvement, or rehabilitation of owner-occupied residences. The Code imposes several limitations on qualified mortgage bonds, including income limitations for eligible mortgagors, purchase price limitations on the home financed with bond proceeds, and a "first-time homebuyer" requirement. In addition, bond proceeds generally only can be used for new mortgages, i.e., proceeds cannot be used to acquire or replace existing mortgages.

Exceptions to the new mortgage requirement are provided for the replacement of construction period loans, bridge loans, and other similar temporary initial financing. In addition, qualified rehabilitation loans may be used, in part, to replace existing mortgages. A qualified rehabilitation loan means certain loans for the rehabilitation of a building if there is a period of at least 20 years between the date on which the building was first used (the "20 year rule") and the date on which the physical work on such rehabilitation begins and the existing walls and basis requirements are met. The existing walls requirement for a rehabilitated building is met if 50 percent or more of the existing external walls are retained in place as external walls, 75 percent or more of the existing external walls are retained in place as internal or external walls, and 75 percent or more of the existing internal structural framework is retained in place. The basis requirement is met if expenditures for rehabilitation are 25 percent or more of the mortgagor's adjusted basis in the residence, determined as of the later of the completion of the rehabilitation or the date on which the mortgagor acquires the residence.

Qualified mortgage bonds also may be used to finance qualified home-improvement loans. Qualified home-improvement loans are defined as loans to finance alterations, repairs, and improvements on an existing residence, but only if such alterations, repairs, and

improvements substantially protect or improve the basic livability or energy efficiency of the property. Qualified home-improvement loans may not exceed $15,000, and may not be used to refinance existing mortgages.

As with most qualified private activity bonds, issuance of qualified mortgage bonds is subject to annual State volume limitations (the "State volume cap"). For calendar year 2007, the State volume cap, which is indexed for inflation, equals the greater of $85 per resident of the State, or $256.24 million. Exceptions from the State volume cap are provided for bonds issued for 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, qualified green building/sustainable design projects, and qualified highway or surface freight transfer facility bonds).

Gulf Opportunity Zone Bonds

The Gulf Opportunity Zone Act of 2005 (the "Act") authorizes Alabama, Louisiana, and Mississippi (or any political subdivision of those States) to issue qualified private activity bonds to finance the construction and rehabilitation of residential and nonresidential property located in the Gulf Opportunity Zone ("Gulf Opportunity Zone Bonds"). Gulf Opportunity Zone Bonds are not subject to the State volume cap. Rather, the maximum aggregate amount of Gulf Opportunity Zone Bonds that may be issued in any eligible State is limited to $2,500 multiplied by the population of the respective State within the Gulf Opportunity Zone.

Gulf Opportunity Zone Bonds issued to finance residences located in the Gulf Opportunity Zone are treated as qualified mortgage bonds if the general requirements for qualified mortgage bonds are met. The Code also provides special rules for Gulf Opportunity Zone Bonds issued to finance residences located in the Gulf Opportunity Zone. For example, the first-time homebuyer rule is waived and the income and purchase price rules are relaxed for residences financed in the GO Zone, the Rita GO Zone, or the Wilma GO Zone. In addition, the Code increases from $15,000 to $150,000 the amount of a qualified home-improvement loan with respect to residences located in the specified disaster areas. Gulf Opportunity Zone Bonds must be issued before January 1, 2011.

Reasons for Change[19]

The Congress believes that it is appropriate to respond to the low recovery effort in the GO Zones. Further, the Congress believes that mortgage bond proceeds could be used to help expedite the rebuilding efforts. The Congress believes that these additional steps will assist the effort to reconstruct housing in the affected areas.

Explanation of Provision

Under the Act, a qualified GO Zone repair or reconstruction loan is treated as a qualified rehabilitation loan for purposes of the

[19] See H.R. 1562, the "Katrina Housing Tax Relief Act of 2009," which was reported by the House Committee on Ways and Means on March 23, 2007 (H.R. Rep. No. 110–66).

qualified mortgage bond rules. Thus, such loans financed with the proceeds of qualified mortgage bonds and Gulf Opportunity Zone Bonds may be used to acquire or replace existing mortgages, without regard to the existing walls or 20 year rule under present law. The Act defines a qualified GO Zone repair or reconstruction loan as any loan used to repair damage caused by Hurricane Katrina, Hurricane Rita, or Hurricane Wilma to a building located in the GO Zones (or reconstruction of such building in the case of damage constituting destruction) if the expenditures for such repair or reconstruction are 25 percent or more of the mortgagor's adjusted basis in the residence. For purposes of the Act, the mortgagor's adjusted basis is determined as of the later of (1) the completion of the repair or reconstruction or (2) the date on which the mortgagor acquires the residence.

Effective Date

The provision applies to owner-financing provided after the date of enactment and before January 1, 2011.

4. GAO study of practices employed by State and local governments in allocating and utilizing tax incentives provided pursuant to the Gulf Opportunity Zone Tax Act of 2005 (sec. 8224 of the Act)

Present Law

There is no requirement under present law that the Government Accountability Office ("GAO") study and report on the utilization of tax incentives in the GO Zones.

Reasons for Change[20]

The Congress believes it is appropriate to require oversight with respect to the tax incentives and other funds provided to assist rebuilding efforts in the GO Zones. To ensure that States and localities use best practices in regard to these incentives, the Congress has requested that an independent review be made by the GAO and a report on its findings be made to the House Ways and Means Committee and Senate Finance Committee.

Explanation of Provision

The Act requires the GAO to conduct a study of the practices employed by State and local governments, and subdivisions thereof, in allocating and utilizing tax incentives provided pursuant to the Gulf Opportunity Act of 2005 (Pub. L. No. 109–135) and this bill.

Not more than one year after the date of enactment of this Act, the GAO must submit a report to the House Committee on Ways and Means and the Senate Committee on Finance on the findings of its study and recommendations, if any, relating to such findings. If the GAO report includes findings of significant fraud, waste or abuse, then each of the two committees should hold public hearings

[20] See H.R. 1562, the "Katrina Housing Tax Relief Act of 2009," which was reported by the House Committee on Ways and Means on March 23, 2007 (H.R. Rep. No. 110–66).

to review such findings within 60 days of the submission of the report.

Effective Date

The provision is effective on the date of enactment (May 25, 2007).

C. Subchapter S Provisions (secs. 8231–8236 of the Act and secs. 641, 1361 and 1362 of the Code)

Overview

In general, an S corporation is not subject to corporate-level income tax on its items of income and loss. Instead, an S corporation passes through its items of income and loss to its shareholders. The shareholders take into account separately their shares of these items on their individual income tax returns. To prevent double taxation of these items when the stock is later disposed of, each shareholder's basis in the stock of the S corporation is increased by the amount included in income (including tax-exempt income) and is decreased by the amount of any losses (including nondeductible losses) taken into account. A shareholder's loss may be deducted only to the extent of his or her basis in the stock or debt of the S corporation. To the extent a loss is not allowed due to this limitation, the loss generally is carried forward with respect to the shareholder.

Reasons for Change

Many small businesses are organized as S corporations. The Act contains a number of provisions relating to these corporations. These provisions modernize the S corporation rules and eliminate undue restrictions on S corporations. The Congress believes that these changes will improve the operation of Subchapter S and therefore will benefit small businesses.

1. Capital gain not treated as passive investment income

Present Law

Passive investment income

An S corporation is subject to corporate-level tax, at the highest corporate tax rate, on its excess net passive income if the corporation has (1) accumulated earnings and profits at the close of the taxable year and (2) gross receipts more than 25 percent of which are passive investment income.

Excess net passive income is the net passive income for a taxable year multiplied by a fraction, the numerator of which is the amount of passive investment income in excess of 25 percent of gross receipts and the denominator of which is the passive investment income for the year. Net passive income is defined as passive investment income reduced by the allowable deductions that are directly connected with the production of that income. Passive investment income generally means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (to the extent of gains). Passive investment in-

come generally does not include interest on accounts receivable, gross receipts that are derived directly from the active and regular conduct of a lending or finance business, gross receipts from certain liquidations, gain or loss from any section 1256 contract (or related property) of an options or commodities dealer, or certain interest and dividend income of banks and depository institution of holding companies.

In addition, an S corporation election is terminated whenever the S corporation has accumulated earnings and profits at the close of each of three consecutive taxable years and has gross receipts for each of those years more than 25 percent of which are passive investment income.

Explanation of Provision

The Act eliminates gains from sales or exchanges of stock or securities as an item of passive investment income.

Effective Date

The provision applies to taxable years beginning after the date of enactment (May 25, 2007).

2. Treatment of bank director shares

Present Law

An S corporation may have no more than 100 shareholders and may have only one outstanding class of stock.

An S corporation has one class of stock if all outstanding shares of stock confer identical rights to distribution and liquidation proceeds. Differences in voting rights are disregarded.[21]

National banking law requires that a director of a national bank own stock in the bank and that a bank have at least five directors.[22] A number of States have similar requirements for State-chartered banks. In some cases, a bank director enters into an agreement under which the bank (or a holding company) will reacquire the stock upon the director's ceasing to hold the office of director, at the price paid by the director for the stock.[23]

Explanation of Provision

Under the Act, restricted bank director stock is not taken into account as outstanding stock in applying the provisions of subchapter S.[24] Thus, the stock is not treated as a second class of stock; a director is not treated as a shareholder of the S corporation by reason of the stock; the stock is disregarded in allocating items of in-

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[21] Sec. 1361(c)(4). Treasury regulations provide that buy-sell and redemption agreements are disregarded in determining whether a corporation's outstanding shares confer identical distribution and liquidation rights unless (1) a principal purpose of the agreement is to circumvent the one class of stock requirement and (2) the agreement establishes a purchase price that, at the time the agreement is entered into, is significantly in excess of, or below, the fair market value of the stock. Treas. Reg. sec. 1.1361–1(l).

[22] 12 U.S.C. secs. 71–72.

[23] See Private Letter Ruling 200217048 (January 24, 2002) describing such an agreement and holding that it creates a second class of stock. Nonetheless, the ruling concluded that the election to be an S corporation was inadvertently invalid and that an amended agreement did not create a second class of stock so that the corporation's election was validated.

[24] No inference is intended as to the proper income tax treatment of restricted bank director stock or other similar stock under present law.

come, loss, etc. among the shareholders; and the stock is not treated as outstanding for purposes of determining whether an S corporation holds 100 percent of the stock of a qualified subchapter S subsidiary.

Restricted bank director stock is stock in a bank (as defined in sec. 581), or a depository institution holding company (within the meaning of sec. 3(w)(1) of the Federal Deposit Insurance Act), if the stock is required to be held by an individual under applicable Federal or State law in order to permit the individual to serve as a director of the bank or holding company and which is subject to an agreement with the bank or holding company (or corporation in control of the bank or company) pursuant to which the holder is required to sell the stock back upon ceasing to be a director at the same price the individual acquired the stock.

A distribution (other than a payment in exchange for the stock) with respect to the restricted stock is includible in the gross income of the director and is deductible by the S corporation for the taxable year that includes the last day of the director's taxable year in which the distribution is included in income.

Effective Date

The provision applies to taxable years beginning after December 31, 2006.

The provision also provides that restricted bank director stock is not treated as a second class of stock for taxable years beginning after December 31, 1996.

3. Treatment of banks changing from reserve method of accounting

Present Law

A financial institution which uses the reserve method of accounting for bad debts may not elect to be an S corporation.[25] If a financial institution changes from the reserve method of accounting, there is taken into account for the taxable year of the change adjustments to taxable income necessary to prevent amounts from being duplicated or omitted by reason of the change.[26]

Positive adjustments (i.e., additions to taxable income) are generally spread over four taxable years beginning in the year of change.[27] Negative adjustments (i.e., reductions to taxable income) are generally taken into account entirely in the year of change.[28]

In the case of a financial institution that changes from the reserve method and elects to be an S corporation for the year of change, the adjustments are both included in the income of the shareholders and are taken into account in computing the tax on built-in gain under section 1374. If the change in accounting method is made for the last taxable year prior to becoming an S corporation, any adjustments for that year are taken into account in computing the corporation's taxable income, but not taken into account by the shareholders.

[25] Sec. 1361(b)(2)(A).
[26] Sec. 481.
[27] Rev. Proc. 2002–19, 2002–1 C.B. 696.
[28] Id.

Explanation of Provision

The Act allows a bank which changes from the reserve method of accounting for bad debts for its first taxable year for which it is an S corporation to elect to take into account all adjustments under section 481 by reason of the change in the last taxable year it was a C corporation.

Effective Date

The provision applies to taxable years beginning after December 31, 2006.

4. Treatment of sale of an interest in a qualified subchapter S subsidiary

Present Law

Under present law, an S corporation that owns all the stock of a corporation may elect to treat the subsidiary corporation as a qualified subchapter S subsidiary ("QSub"). A qualified subchapter S subsidiary is disregarded as a separate entity for Federal tax purposes and its items of income, deduction, loss, and credit are treated as items of the S corporation.

If the subsidiary corporation ceases to be a QSub (e.g., fails to meet the wholly-owned requirement) the subsidiary is treated as a new corporation acquiring all its assets (and assuming all of its liabilities) immediately before such cessation from the parent S corporation in exchange for its stock. Under Treasury regulations,[29] the tax treatment of the termination of the QSub election is determined under general principles of tax law, including the step transaction doctrine. The regulations set forth an example[30] in which an S corporation sells 21 percent of the stock of a QSub to an unrelated party. In the example, the deemed transfer of all the assets to the QSub is treated as a taxable sale because the S corporation was not in control of the QSub immediately after the transfer by reason of the sale, and thus the transfer did not qualify for nonrecognition treatment under section 351.

Explanation of Provision

The Act provides that where the sale of stock of a QSub results in the termination of the QSub election, the sale is treated as a sale of an undivided interest in the assets of the QSub (based on the percentage of the stock sold) followed by a deemed transfer to the QSub in a transaction to which section 351 applies.

Thus, in the above example, the S corporation will be treated as selling a 21-percent interest in all the assets of the QSub to the unrelated party, followed by a transfer of all the assets to a new corporation in a transaction to which section 351 applies. Thus, the S corporation will recognize 21 percent of the gain or loss in the assets of the QSub.

The Act is not intended to change the present-law treatment of the disposition of stock of a QSUB by an S corporation in connec-

[29] Treas. Reg. sec. 1.1361–5(b).
[30] Example (1) of Treas. Reg. sec. 1.1361–5(b)(3).

tion with an otherwise non-taxable transaction. For example, the transfer of stock of a QSUB by an S corporation pro rata to its shareholders can qualify as a distribution to which sections 368(a)(1)(D) and 355 apply if the transaction otherwise satisfies the requirements of those sections.[31]

Effective Date

The provision applies to taxable years beginning after December 31, 2006.

5. Elimination of earnings and profits attributable to pre-1983 years

Present Law

The Small Business Jobs Protection Act of 1996 provided that if a corporation was an S corporation for its first taxable year beginning after December 31, 1996, the accumulated earnings and profits of the corporation as of the beginning of that year were reduced by the accumulated earnings and profits (if any) accumulated in a taxable year beginning before January 1, 1983, for which the corporation was an electing small business corporation under subchapter S.

Explanation of Provision

The Act provides in the case of any corporation which was not an S corporation for its first taxable year beginning after December 31, 1996, the accumulated earnings and profits of the corporation as of the beginning of the first taxable year beginning after the date of the enactment of this provision is reduced by the accumulated earnings and profits (if any) accumulated in a taxable year beginning before January 1, 1983, for which the corporation was an electing small business corporation under subchapter S.

Effective Date

The provision applies to taxable years beginning after the date of enactment (May 25, 2007).

6. Deductibility of interest expense of an ESBT on indebtedness incurred to acquire S corporation stock

Present Law

Under present law, an electing small business trust ("ESBT") is subject to a tax at the highest individual income tax rate (currently 35 percent) on the portion of the trust which consists of stock in one or more S corporations ("S portion").[32] The income from the S portion of an ESBT is not included in the beneficiaries' income.

The only items of income, loss, or deduction taken into account in computing the taxable income of the S portion of an ESBT are: (1) the items of income, loss or deduction allocated to it as an S corporation shareholder under the rules of subchapter S, (2) gain

[31] See Example (4) of Treas. Reg. sec. 1.1361–5(b)(3).
[32] Sec. 641(c).

or loss from the sale of the S corporation stock, and (3) to the extent provided in regulations, any state or local income taxes and administrative expenses of the ESBT properly allocable to the S corporation stock. Under Treasury regulations,[33] interest paid by an ESBT to purchase stock in an S corporation is allocated to the S portion of the ESBT but is not a deductible administrative expense for purposes determining the taxable income of the S portion.

In determining the tax liability with regard to the remaining portion of the trust, the items taken into account by the subchapter S portion of the trust are disregarded.

Explanation of Provision

The Act provides that a deduction for interest paid or accrued on indebtedness to acquire stock in an S corporation may be taken into account in computing the taxable income of the S portion of an ESBT.

Effective Date

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

TITLE II—REVENUE PROVISIONS

A. Increase in Age of Children Whose Unearned Income is Taxed as if Parents' income (sec. 8241 of the Act and sec. 1(g) of the Code)

Present Law

Special rules (generally referred to as the "kiddie tax") apply to the net unearned income of certain children.[34] Generally, the kiddie tax applies to a child if: (1) the child has not reached the age of 18 by the close of the taxable year and either of the child's parents is alive at such time; (2) the child's unearned income exceeds $1,700 (for 2007); and (3) the child does not file a joint return. The kiddie tax applies regardless of whether the child may be claimed as a dependent by either or both parents.

Under these rules, the net unearned income of a child (for 2007, generally unearned income over $1,700) is taxed at the parents' tax rates if the parents' tax rates are higher than the tax rates of the child.[35] The remainder of a child's taxable income (i.e., earned income, plus unearned income up to $1,700 (for 2007), less the child's standard deduction) is taxed at the child's rates, regardless of whether the kiddie tax applies to the child. For these purposes, unearned income is income other than wages, salaries, professional fees, other amounts received as compensation for personal services actually rendered, and distributions from qualified disability trusts.[36] In general, a child is eligible to use the preferential tax rates for qualified dividends and capital gains.[37]

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[33] Treas. Reg. sec. 1.641(c)–1(d)(4)(ii).
[34] Sec. 1(g).
[35] Special rules apply for determining which parent's rates apply where a joint return is not filed.
[36] Sec. 1(g)(4) and sec. 911(d)(2).
[37] Sec. 1(h).

The kiddie tax is calculated by computing the "allocable parental tax." This involves adding the net unearned income of the child to the parent's income and then applying the parent's tax rate. A child's "net unearned income" is the child's unearned income less the sum of (1) the minimum standard deduction allowed to dependents ($850 for 2007), and (2) the greater of (a) such minimum standard deduction amount or (b) the amount of allowable itemized deductions that are directly connected with the production of the unearned income.[38] A child's net unearned income cannot exceed the child's taxable income.

The allocable parental tax equals the hypothetical increase in tax to the parent that results from adding the child's net unearned income to the parent's taxable income. If the child has net capital gains or qualified dividends, these items are allocated to the parent's hypothetical taxable income according to the ratio of net unearned income to the child's total unearned income. If a parent has more than one child subject to the kiddie tax, the net unearned income of all children is combined, and a single kiddie tax is calculated. Each child is then allocated a proportionate share of the hypothetical increase, based upon the child's net unearned income relative to the aggregate net unearned income of all of the parent's children subject to the tax.

Generally, a child must file a separate return to report his or her income.[39] In such case, items on the parents' return are not affected by the child's income, and the total tax due from the child is the greater of:

1. The sum of (a) the tax payable by the child on the child's earned income and unearned income up to $1,700 (for 2007), plus (b) the allocable parental tax on the child's unearned income, or
2. The tax on the child's income without regard to the kiddie tax provisions.

Under certain circumstances, a parent may elect to report a child's unearned income on the parent's return.

Explanation of Provision

The Act expands the kiddie tax to apply to children who are 18 years old or who are full-time students over age 18 but under age 24. The expanded provision applies only to children whose earned income does not exceed one-half of the amount of their support.

Effective Date

The provision is effective for taxable years beginning after the date of enactment (May 25, 2007).

B. Suspension of Penalties and Interest (sec. 8242 of the Act and sec. 6404(g) of the Code)

Present Law

In general, interest and penalties accrue during periods for which taxes were unpaid without regard to whether the taxpayer was

[38] Sec. 1(g)(4).

[39] In cases where the kiddie tax applies, the child must attach to the return Form 8615, Tax for Children Under Age 18 With Investment Income of More Than $1,700 (2006).

aware that there was tax due. The Code suspends the accrual of certain penalties and interest starting 18 months after the filing of the tax return if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability within the specified period. If the return is filed before the due date, for this purpose it is considered to have been filed on the due date. Interest and penalties resume 21 days after the IRS sends the required notice to the taxpayer. The provision is applied separately with respect to each item or adjustment. The provision does not apply where a taxpayer has self-assessed the tax. The suspension applies only to taxpayers who are individuals and who file a timely tax return. In addition, the provision does not apply to the failure-to-pay penalty, in the case of fraud, or with respect to criminal penalties. Generally, the provision also does not apply to interest accruing with respect to underpayments resulting from listed transactions or undisclosed reportable transactions.

Reasons for Change

The Congress believes it is appropriate to provide the IRS with additional time to provide taxpayers with notice that they failed to comply with their tax obligations before the IRS is required to suspend the imposition of interest and penalties on underpayments. The Congress believes this change is appropriate for effective administration of the tax system.

Explanation of Provision

The Act extends the period before which accrual of interest and certain penalties are suspended. Under the Act, the accrual of certain penalties and interest is suspended starting 36 months after the filing of the tax return if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability.

Effective Date

The provision is effective for IRS notices issued after the date that is six months after the date of enactment.

C. Modification of Collection Due Process Procedures for Employment Tax Liabilities (sec. 8243 of the Act and sec. 6330 of the Code)

Present Law

Levy is the IRS's administrative authority to seize a taxpayer's property to pay the taxpayer's tax liability. The IRS is entitled to seize a taxpayer's property by levy if a Federal tax lien has attached to such property. A Federal tax lien arises automatically when (1) a tax assessment has been made, (2) the taxpayer has been given notice of the assessment stating the amount and demanding payment, and (3) the taxpayer has failed to pay the amount assessed within 10 days after the notice and demand.

In general, the IRS is required to notify taxpayers that they have a right to a fair and impartial collection due process ("CDP") hear-

ing before levy may be made on any property or right to property.[40] Similar rules apply with respect to notices of tax liens, although the right to a hearing arises only on the filing of a notice.[41] The CDP hearing is held by an impartial officer from the IRS Office of Appeals, who is required to issue a determination with respect to the issues raised by the taxpayer at the hearing. The taxpayer is entitled to appeal that determination to a court. Under present law, taxpayers are not entitled to a pre-levy CDP hearing if a levy is issued to collect a Federal tax liability from a State tax refund or if collection of the Federal tax is in jeopardy. However, levies related to State tax refunds or jeopardy determinations are subject to post-levy review through the CDP hearing process.

Employment taxes generally consist of the taxes under the Federal Insurance Contributions Act ("FICA"), the tax under the Federal Unemployment Tax Act ("FUTA"), and the requirement that employers withhold income taxes from wages paid to employees ("income tax withholding").[42] Income tax withholding rates vary depending on the amount of wages paid, the length of the payroll period, and the number of withholding allowances claimed by the employee.

Reasons for Change[43]

Congress enacted the CDP hearing procedures to afford taxpayers adequate notice of collection activity and a meaningful hearing before the IRS deprives them of their property. However, the Congress understands that some taxpayers abuse the CDP procedures by raising frivolous arguments simply for the purpose of delaying or evading collection of tax. The opportunity to delay collection of employment tax liabilities presents a greater risk to the government than delay may present in other contexts because employment tax liabilities continue to increase as ongoing wage payments are made to employees. A Government Accountability Office study found that businesses with employment tax liabilities were delinquent on more than twice as many periods than individuals. On average, businesses requesting a CDP appeal for delinquent employment taxes had not paid for nearly 1½ years and had a median employment tax liability of $30,000.[44] Thus, the Congress believes it is appropriate to revise the CDP procedures in cases where taxpayers are liable for unpaid employment taxes.

Explanation of Provision

Under the Act, a levy issued to collect Federal employment taxes is excepted from the pre-levy CDP hearing requirement if the taxpayer subject to the levy requested a CDP hearing with respect to unpaid employment taxes arising in the two-year period before the

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[40] Sec. 6330(a).

[41] Sec. 6320.

[42] Secs. 3101–3128 (FICA), 3301–3311 (FUTA), and 3401–3404 (income tax withholding). FICA taxes consist of an employer share and an employee share, which the employer withholds from employees' wages.

[43] See S. 349, the "Small Business and Work Opportunity Act of 2007," which was reported by the Senate Finance Committee on January 22, 2007 (S. Rep. No. 110–1).

[44] Government Accountability Office, *Tax Administration: Little Evidence of Procedural Errors in Collection Due Process Appeals Cases, but Opportunities Exist to Improve the Program,* GAO–07–112, October 2006.

beginning of the taxable period with respect to which the employment tax levy is served. However, the taxpayer is provided an opportunity for a hearing within a reasonable period of time after the levy. As the Code provides for State tax refunds or jeopardy determinations, collection by levy of employment tax liabilities is permitted to continue during the CDP proceedings.

Effective Date

The provision is effective for levies issued on or after the date that is 120 days after the date of enactment.

D. Permanent Extension of IRS User Fees (sec. 8244 of the Act and sec. 7528 of the Code)

Present Law

The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination.[45] These user fees are authorized by statute through September 30, 2014.

Reasons for Change

The Congress believes that it is appropriate to provide an extension of these user fees.

Explanation of Provision

The Act permanently extends the statutory authorization for IRS user fees.

Effective Date

The provision is effective for requests made after the date of enactment (May 25, 2007).

E. Increase in Penalty for Bad Checks and Money Orders (sec. 8245 of the Act and sec. 6657 of the Code)

Present Law

The Code[46] imposes a penalty on a person who tenders a bad check or money orders. The penalty is two percent of the amount of the bad check or money order. For checks or money orders that are less than $750, the minimum penalty is $15 (or, if less, the amount of the check or money order).

Reasons for Change

The Congress believes that it is appropriate to increase the minimum amount of this penalty so that it is more consistent with amounts charged by the private sector for bad checks.

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[45] Sec. 8228.
[46] Sec. 6657.

Explanation of Provision

The Act increases the minimum penalty to $25 (or, if less, the amount of the check or money order), applicable to checks or money orders that are less than $1,250.

Effective Date

The provision is effective with respect to checks or money orders received after the date of enactment (May 25, 2007).

F. Understatement of Taxpayer's Liability by Tax Return Preparers (sec. 8246 of the Act and secs. 6694 and 7701 of the Code)

Present Law

An income tax return preparer is defined as any person who prepares for compensation, or who employs other people to prepare for compensation, all or a substantial portion of an income tax return or claim for refund.[47] Under present law, the definition of an income tax return preparer does not include a person preparing non-income tax returns, such as estate and gift, excise, or employment tax returns.

An income tax return preparer who prepares a return with respect to which there is an understatement of tax that is due to an undisclosed position for which there was not a realistic possibility of being sustained on its merits, or a frivolous position, is liable for a first-tier penalty of $250, provided the preparer knew or reasonably should have known of the position.[48] For purposes of the penalty, an understatement is generally defined as any understatement with respect to any tax imposed by subtitle A (i.e., income taxes). An income tax return preparer who prepares a return and engages in specified willful or reckless conduct with respect to preparing an income tax return is liable for a second-tier penalty of $1,000.

Explanation of Provision[49]

The Act broadens the scope of the present-law tax return preparer penalties to include preparers of estate and gift tax, employment tax, and excise tax returns, and returns of exempt organizations.

The Act also alters the standards of conduct that must be met to avoid imposition of the penalties for preparing a return with respect to which there is an understatement of tax. First, the Act replaces the realistic possibility standard for undisclosed positions with a requirement that there be a reasonable belief that the tax treatment of the position was more likely than not the proper treatment. The Act replaces the not-frivolous standard accompanied by disclosure with the requirement that there be a reason-

[47] Sec. 7701(a)(36)(A).
[48] Sec. 6694.
[49] Subsequent amendment to this provision is described in Part Seventeen, Division C, Title V, Subtitle A, section F.

able basis for the tax treatment of the position accompanied by disclosure.

The Act also increases the first-tier penalty from $250 to the greater of $1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer from the preparation of a return or claim with respect to which the penalty is imposed. The Act increases the second-tier penalty from $1,000 to the greater of $5,000 or 50 percent of the income derived (or to be derived) by the tax return preparer.

Effective Date

The provision is effective for tax returns prepared after the date of enactment (May 25, 2007).

G. Penalty for Filing Erroneous Refund Claims (sec. 8247 of the Act and new sec. 6676 of the Code)

Present Law

Present law imposes accuracy-related penalties on a taxpayer in cases involving a substantial valuation misstatement or gross valuation misstatement relating to an underpayment of income tax.[50] For this purpose, a substantial valuation misstatement generally means a value claimed that is at least twice (200 percent or more) the amount determined to be the correct value, and a gross valuation misstatement generally means a value claimed that is at least four times (400 percent or more) the amount determined to be the correct value.

The penalty is 20 percent of the underpayment of tax resulting from a substantial valuation misstatement and rises to 40 percent for a gross valuation misstatement. No penalty is imposed unless the portion of the underpayment attributable to the valuation misstatement exceeds $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Under present law, no penalty is imposed with respect to any portion of the understatement attributable to any item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return and there is a reasonable basis for the tax treatment. Special rules apply to tax shelters.

Explanation of Provision

The Act imposes a penalty on any taxpayer filing an erroneous claim for refund or credit. The penalty is equal to 20 percent of the disallowed portion of the claim for refund or credit for which there is no reasonable basis for the claimed tax treatment. The penalty does not apply to any portion of the disallowed portion of the claim for refund or credit relating to the earned income credit or any portion of the disallowed portion of the claim for refund or credit that is subject to accuracy-related or fraud penalties.

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[50] Sec. 6662(b)(3) and (h).

Effective Date

The provision is effective for claims for refund or credit filed after the date of enactment (May 25, 2007).

H. Time for Payment of Corporate Estimated Tax (sec. 8248 of the Act and sec. 6655 of the Code)

Present Law

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

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

Reasons for Change

The Congress believes it is appropriate to adjust the corporate estimated tax payments.

Explanation of Provision [51]

The Act increases the corporate estimated tax payments due in July, August, and September, 2012, from 106.25 percent to 114.25 percent of the payment otherwise due. As under present law, the next payment is reduced accordingly.

Effective Date

The provision is effective on the date of enactment (May 25, 2007).

TITLE III—PENSION RELATED PROVISIONS

A. Revocation of Election Relating to Treatment as Multiemployer Plan (sec. 6611 of the Act and sec. 414(f) of the Code)

Present Law

A multiemployer plan means a plan (1) to which more than one employer is required to contribute; (2) which is maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer; and (3) which satisfies such other requirements as the Secretary of Labor may prescribe.[52] Present law provides that within one year

[51] All the public laws enacted in the 110th Congress affecting this provision are described in Part Twenty-Two.

[52] Code sec. 414(f).

after the date of enactment of the Multiemployer Pension Plan Amendments Act of 1980, a multiemployer plan could irrevocably elect for the plan not to be treated as a multiemployer plan if certain requirements were satisfied.

Pursuant to the Pension Protection Act of 2006, certain multiemployer plans are permitted under the Code to revoke an existing election not to treat the plan as a multiemployer plan if, for each of the three plan years prior to the date of enactment, the plan would have been a multiemployer plan, but for the election in place.[53] The revocation must be pursuant to procedures prescribed by the Pension Benefit Guaranty Corporation ("PBGC"). In the case of a plan to which more than one employer is required to contribute and which is maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer (collectively the "criteria"), such plan may, pursuant to procedures prescribed by the PBGC, elect to be a multiemployer plan if (1) for each of the three plan years prior to the date of enactment, the plan has met the criteria; (2) substantially all of the plan's employer contributions for each of those plan years were made or required to be made by organizations that were tax-exempt; and (3) the plan was established prior to September 2, 1974. Such a revocation election is also available in the case of a plan that was established in Chicago, Illinois, on August 12, 1881, and is sponsored by an organization described in Code section 501(c)(5). An election made under the provision is effective beginning with the first plan year ending after the date of enactment of the Pension Protection Act of 2006 (i.e., August 17, 2006) and is irrevocable.

Explanation of Provision[54]

The Act modifies the effective date of the election provided under the Code. Under the Act, a plan may elect an effective date that is any plan year beginning on or after January 1, 1999, and ending before January 1, 2008. The Act also modifies the time period during which the plan must have satisfied the criteria for the election. Under the Act, the criteria must have been satisfied for each of the three plan years immediately preceding the first plan year for which the election is effective with respect to the plan. In addition, the Act provides that a plan making the election is treated as maintained pursuant to a collective bargaining agreement if a collective bargaining agreement, expressly or otherwise, provides for or permits employer contributions to the plan by one or more employers that are signatory to such agreement, or participation in the plan by one or more employees of an employer that is signatory to such agreement.

In addition, the Act makes a technical correction to the description of one of the plans that is eligible to make the election. Specifically, the technical correction provides that an election is available in the case of a plan sponsored by an organization which is described in Code section 501(c)(5) and exempt from tax under Code

[53] Code sec. 414(f)(6).

[54] Provisions similar to those in the Code are contained in section 3(37) of the Employee Retirement Income Security Act of 1974 ("ERISA"). The Act makes corresponding changes to ERISA.

section 501(a) and which was established in Chicago, Illinois, on August 12, 1881.

Effective Date

The provision takes effect as if included in section 1106 of the Pension Protection Act of 2006.

B. Modification of Requirements for Qualified Transfers (secs. 6612 and 6613 of the Act and sec. 420 of the Code)

Present Law

A pension plan may provide medical benefits to retired employees through a separate account that is part of such plan ("retiree medical accounts"). Generally, defined benefit plan assets may not revert to an employer prior to termination of the plan and satisfaction of all plan liabilities. However, section 420 of the Code provides that certain transfers of excess assets of a defined benefit plan to a retiree medical account within the plan may be made in order to fund retiree health benefits. A transfer that qualifies under section 420 does not result in plan disqualification, is not a prohibited transaction, and is not treated as a reversion. No transfer pursuant to section 420 may be made after December 31, 2013.

Prior to the amendment of section 420 by the Pension Protection Act of 2006, transferred assets (and any income thereon) were required to be used to pay qualified current retiree health liabilities for the taxable year of the transfer. Among the requirements for such a transfer to be qualified is the requirement that the employer generally must maintain retiree health benefits at the same level for the taxable year of the transfer and the following four years (referred to as the minimum cost requirement).

Pursuant to changes made by the Pension Protection Act of 2006, section 420 currently permits an employer to elect to make a "qualified future transfer" or a "collectively bargained transfer" rather than a "qualified transfer" (which generally is a transfer described in section 420, prior to amendment by the Pension Protection Act of 2006). A qualified future transfer permits transfers of excess pension assets under a single-employer plan to retiree medical accounts to fund the expected cost of retiree medical benefits for the current and future years. A collectively bargained transfer permits such transfers in the case of benefits provided under a collective bargaining agreement. Transfers must be made for at least a two-year period (referred to as the transfer period). In addition, a qualified future transfer or collectively bargained transfer must meet the requirements applicable to qualified transfers, with certain modifications to the requirements, one of which is the minimum cost requirement.

In the case of a qualified future transfer, the minimum cost requirement is satisfied if, during the transfer period and the four subsequent years, the annual average amount of employer costs is not less than applicable employer cost determined with respect to the transfer. An employer may elect to meet this minimum cost requirement by meeting the requirements as in effect before the amendments made by section 535 of the Tax Relief Extension Act

of 1999 for each year during the transfer period and the four subsequent years. In the case of a collectively bargained transfer, the minimum cost requirement is satisfied if each collectively bargained group health plan under which collectively bargained health benefits are provided provides that the collectively bargained employer cost for each taxable year during the collectively bargained cost maintenance period is not less than the amount specified by the collective bargaining agreement. The collectively bargained employer cost is the average cost per covered individual of providing collectively bargained retiree health benefits as determined in accordance with the applicable collective bargaining agreement. Thus, retiree medical benefits must be provided at the level determined under the collective bargaining agreement for the shorter of (1) the remaining lifetime of each covered retiree (and any covered spouse and dependent), or (2) the period of coverage provided under the collectively bargained health plan for such covered retiree (and any covered spouse and dependent).

Explanation of Provision

In the case of a qualified transfer, the Act permits the transfer to satisfy the minimum cost requirement by satisfying the minimum cost requirement applicable to a collectively bargained transfer. This alternate method of satisfying the minimum cost requirement is only available if the transfer involves a plan maintained by an employer, which in its taxable year ending in 2005, provided health benefits or coverage to retirees and their spouses and the aggregate cost of such benefits or coverage which would have been allowable as a deduction to the employer is at least five percent of the gross receipts of the employer for such taxable year (or is a plan maintained by a successor to such employer).

In addition, the Act makes technical corrections to section 420 to correct an internal cross-reference and to reflect the revisions made to the minimum funding requirements applicable to defined benefit plans under the Pension Protection Act of 2006.

Effective Date

The provision is generally effective for transfers after the date of enactment (May 25, 2007). The technical corrections are effective as if included in the Pension Protection Act of 2006.

C. Extension of Alternative Deficit Reduction Contribution Rules (sec. 6614 of the Act and sec. 402(i) of the Pension Protection Act of 2006)

Present Law

Single-employer defined benefit pension plans are subject to minimum funding requirements under the Code.[55] Prior to the enactment of the Pension Protection Act of 2006, the amount of contributions required for a plan year under the minimum funding rules was generally the amount needed to fund benefits earned during

[55] Code sec. 412. Similar rules apply to single-employer defined benefit pension plans under ERISA.

that year plus that year's portion of other liabilities that are amortized over a period of years, such as benefits resulting from a grant of past service credit. Additional contributions were required under the deficit reduction contribution rules in the case of certain underfunded plans.

Under the Pension Protection Act of 2006, these minimum funding rules were replaced by new funding rules. These new rules are generally effective for plan years beginning after December 31, 2007.

Prior to the enactment of the Pension Protection Act of 2006, certain employers ("applicable employers") were permitted to elect a reduced amount of additional required contribution under the deficit reduction contribution rules (an "alternative deficit reduction contribution") with respect to certain plans for applicable plan years. For purposes of the election, an applicable plan year was a plan year beginning after December 27, 2003, and before December 28, 2005, for which the employer elects a reduced contribution. If an employer made such an election, the amount of the additional deficit reduction contribution for an applicable plan year was the greater of: (1) 20 percent of the amount of the additional contribution that would otherwise be required; or (2) the additional contribution that would be required if the deficit reduction contribution for the plan year were determined as the expected increase in current liability due to benefits accruing during the plan year. An applicable employer included an employer that is a commercial passenger airline.

In the case of an employer which is a commercial passenger airline, the Pension Protection Act of 2006 extends the alternative deficit reduction contribution rules to plan years beginning before December 28, 2007.

Explanation of Provision

The Act extends the alternative deficit reduction contribution rules to plan years beginning before January 1, 2008.

Effective Date

The provision takes effect as if included in section 402 of the Pension Protection Act of 2006.

D. Modification of the Interest Rate for Pension Funding Rules (sec. 6615 of the Act and sec. 402(a) of the Pension Protection Act of 2006)

Present Law

Single-employer defined benefit pension plans are subject to minimum funding requirements under the Code.[56] The Pension Protection Act of 2006 provides for new minimum funding rules, which are generally effective for plan years beginning after December 31, 2007.

[56] Code sec. 412. Similar rules apply to single-employer defined benefit pension plans under ERISA.

Under the new minimum funding rules, the minimum required contribution to a single-employer defined benefit pension plan for a plan year generally depends on a comparison of the value of the plan's assets with the plan's funding target and target normal cost. The plan's funding target is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan's target normal cost for a plan year is the present value of benefits expected to accrue or be earned during the plan year. In general, a plan has a funding shortfall if the plan's funding target for the year exceeds the value of the plan's assets (reduced, if applicable, by any prefunding balance and funding standard carryover balance). If the value of a plan's assets (reduced by any funding standard carryover balance and prefunding balance) is less than the plan's funding target for a plan year, so that the plan has a funding shortfall, the minimum required contribution is generally increased by a shortfall amortization charge.

The shortfall amortization charge for a plan year is the aggregate total of the shortfall amortization installments for the plan year with respect to any shortfall amortization bases for that plan year and the six preceding plan years. A shortfall amortization base is generally required to be established for a plan year if the plan has a funding shortfall for a plan year. The shortfall amortization base for a plan year is (1) the plan's funding shortfall, minus (2) the present value, determined using the segment interest rates (discussed below), of the aggregate total of the shortfall amortization installments (and, if applicable, waiver amortization installments) that have been determined for the plan year and any succeeding plan year with respect to any shortfall amortization bases (and waiver amortization bases) for preceding plan years. The shortfall amortization installments with respect to a shortfall amortization base for a plan year are the amounts necessary to amortize the shortfall amortization base in level annual installments over the seven-plan-year period beginning with the plan year. The shortfall amortization installment with respect to a shortfall amortization base for any plan year in the seven-year period is the annual installment determined for that year for that shortfall amortization base. Shortfall amortization installments are determined using the appropriate segment interest rates.

The new minimum funding rules specify the interest rates and other actuarial assumptions that must be used in determining a plan's target normal cost and funding target. Under the rules, present value is determined using three interest rates ("segment" rates), each of which applies to benefit payments expected to be made from the plan during a certain period. The first segment rate applies to benefits reasonably determined to be payable during the five-year period beginning on the first day of the plan year; the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable the end of the 15-year period. Each segment rate is a single interest rate determined monthly by the Secretary of the Treasury on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period. In gen-

eral, the corporate bond yield curve used for this purpose is to be prescribed on a monthly basis by the Secretary of the Treasury and reflects the average, for the 24-month period ending with the preceding month, of yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. A special transition rule applies for plan years beginning in 2008 and 2009 (other than for plans first effective after December 31, 2007).

In addition to the new minimum funding rules described above, the Pension Protection Act of 2006 also provides for special funding rules to apply for certain eligible plans. An eligible plan is a single-employer defined benefit pension plan sponsored by an employer that is a commercial passenger airline or the principal business of which is providing catering services to a commercial passenger airline.

The plan sponsor of an eligible plan may make one of two alternative elections. In the case of a plan that meets certain benefit accrual and benefit increase restrictions, an election allowing a 17-year amortization of the plan's unfunded liability is available. In lieu of this election, a plan sponsor may alternatively elect, for the first taxable year beginning in 2008, to amortize the shortfall amortization base for such taxable year over a period of 10 plan years (rather than 7 plan years) beginning with such plan year. Under this alternative election, the benefit accrual and benefit increase restrictions do not apply. This 10-year amortization election must be made by December 31, 2007.

Explanation of Provision

The Act provides that, in the case of a plan sponsor that elects to amortize the shortfall amortization base over a period of 10 plan years, the plan is to use an interest rate of 8.25 percent for purposes of determining the funding target for each of the 10 plan years during such period (instead of the segment rates calculated on the basis of the corporate bond yield curve).

Effective Date

The provision takes effect as if included in section 402 of the Pension Protection Act of 2006.

PART TWO: REVENUE PROVISIONS OF ENERGY INDEPENDENCE AND SECURITY ACT OF 2007 (PUBLIC LAW 110–140)[57]

A. Extension of Additional 0.2 Percent FUTA Surtax (sec. 1501 of the Act)

Present Law

The Federal Unemployment Tax Act ("FUTA") imposes a 6.2 percent gross tax rate on the first $7,000 paid annually by covered employers to each employee (sec. 3301). Employers in States with programs approved by the Federal Government and with no delinquent Federal loans may credit 5.4 percentage points against the 6.2 percent tax rate, making the minimum, net Federal unemployment tax rate 0.8 percent (sec. 3302). Since all States have approved programs, the minimum Federal tax rate of 0.8 percent is the Federal tax rate that generally applies. This Federal revenue finances administration of the unemployment system, half of the Federal-State extended benefits program, and a Federal account for State loans. The States use the revenue from the 5.4 percent credit to finance their regular State programs and half of the Federal-State extended benefits program.

In 1976, Congress passed a temporary surtax of 0.2 percent of taxable wages to be added to the permanent FUTA tax rate. Thus, the current 0.8 percent FUTA tax rate has two components: a permanent tax rate of 0.6 percent, and a temporary surtax rate of 0.2 percent. The temporary surtax was subsequently extended through 2007.

Explanation of Provision[58]

The Act extends the temporary surtax rate (for one year) through December 31, 2008.

Effective Date

The provision is effective for wages paid after December 31, 2007.

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[57] H.R. 6. H.R. 6 passed the House on January 18, 2007, and passed the Senate on June 21, 2007. On December 6, 2007, the House agreed to the Senate amendment with an amendment, and on December 13, 2007, the Senate agreed to the House amendment with an amendment. On December 18, 2007, the House agreed to the Senate amendment. The President signed the bill on December 19, 2007.

[58] The provision was subsequently extended in Division C, sec. 404 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110–328, described in Part Seventeen.

B. 7-Year Amortization of Geological and Geophysical Expenditures for Certain Major Integrated Oil Companies (sec. 1502 of the Act and sec. 167(h) of the Code)

Present Law

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. G&G costs incurred by independent producers and smaller integrated oil[59] companies in connection with oil and gas exploration in the United States may generally be amortized over two years.[60] Major integrated oil companies are required to amortize all G&G costs over five years.[61] For purposes of this provision, a major integrated oil company, with respect to any taxable year, is a producer of crude oil which has an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, had gross receipts in excess of one billion dollars for its last taxable year ending during the calendar year 2005, and generally has an ownership interest in a crude oil refiner of 15 percent or more.[62]

In the case of abandoned property, remaining basis may not be recovered in the year of abandonment of a property because all basis is recovered over the applicable amortization period.

Reasons for Change[63]

The Congress believes that a seven year period for amortization of G&G costs for major integrated oil companies is a more appropriate period for the recovery of these costs.

Explanation of Provision

The Act extends from five years to seven years the amortization period for G&G costs for major integrated oil companies.

Effective Date

The provision is effective for amounts paid or incurred after the date of enactment (December 19, 2007).

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[59] Generally, an integrated oil company is a producer of crude oil that engages in the refining or retail sale of petroleum products in excess of certain threshold amounts.

[60] Sec. 167(h)(1).

[61] Sec. 167(h)(5).

[62] Id.

[63] See H.R. 2776, the "Renewable Energy and Energy Conservation Tax Act of 2007," which was reported by the House Committee on Ways and Means on June 27, 2007 (H.R. Rep. No. 110–214).

PART THREE: HOKIE SPIRIT MEMORIAL FUND (PUBLIC LAW 110–141)[64]

A. Exclusion from Income of Payments from the Hokie Spirit Memorial Fund (sec. 1 of the Act)

Present Law

Following the shooting event at Virginia Polytechnic Institute and State University ("Virginia Tech University") on April 16, 2007, a payment program for victims and survivors of the event was established. Under the program, survivors of the murder victims and surviving victims of the event are eligible to receive cash payments from the university. In lieu of receipt of a cash payment, claimants under the program may instead donate their payments to a section 501(c)(3) organization for the purpose of funding scholarships at the university.

Under section 61, gross income includes all income from whatever source derived. The Code includes a number of exceptions from this rule. These include exceptions for amounts received by gift (section 102), amounts of any damages received on account of personal physical injuries (section 104(a)(2)), and amounts received as qualified disaster relief payments (section 139). There is no specific exclusion from gross income for amounts received pursuant to the Virginia Tech University program described above.

Explanation of Provision

The Act excludes from gross income specified amounts that an individual receives from Virginia Tech University under the program described above. Under the Act, the exclusion applies to any amount received from Virginia Tech University out of amounts transferred from the Hokie Spirit Memorial Fund established by the Virginia Tech Foundation, an organization organized and operated as described in section 501(c)(3), if such amount is paid on account of the tragic event on April 16, 2007, at such university.

Effective Date

The provision is effective on the date of enactment (December 19, 2007).

[64] H.R. 4118. H.R. 4118 passed the House on the suspension calendar on December 4, 2007, and passed the Senate by unanimous consent on December 6, 2007. The President signed the bill on December 19, 2007.

B. Increase in Penalty for Failure to File Partnership Returns (sec. 2 of the Act and sec. 6698(b) of the Code)

Present Law

A partnership generally is treated as a pass-through entity. Income earned by a partnership, whether distributed or not, is taxed to the partners. Distributions from the partnership generally are tax-free. The items of income, gain, loss, deduction or credit of a partnership generally are taken into account by a partner as allocated under the terms of the partnership agreement. If the agreement does not provide for an allocation, or the agreed allocation does not have substantial economic effect, then the items are to be allocated in accordance with the partners' interests in the partnership. To prevent double taxation of these items, a partner's basis in its interest is increased by its share of partnership income (including tax-exempt income), and is decreased by its share of any losses (including nondeductible losses).

Under present law, a partnership is required to file a tax return for each taxable year. The partnership's tax return is required to include the names and addresses of the individuals who would be entitled to share in the taxable income if distributed and the amount of the distributive share of each individual. In addition to applicable criminal penalties, present law imposes a civil penalty for the failure to timely file a partnership return. The penalty is $50 per partner for each month (or fraction of a month) that the failure continues, up to a maximum of five months.

Explanation of Provision [65]

The Act increases the present-law failure to file penalty for partnership returns by $1 per month.

Effective Date

The provision is effective for partnership returns required to be filed for a taxable year beginning in 2008.

[65] This provision was subsequently amended to increase the amount of the penalty. See Part Four, G and Part Twenty-Two, B.

PART FOUR: MORTGAGE FORGIVENESS DEBT RELIEF ACT OF 2007 (PUBLIC LAW 110–142)[66]

A. Exclude Discharges of Acquisition Indebtedness on Principal Residences from Gross Income (sec. 2 of the Act and sec. 108 of the Code)

Present Law

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, and certain real property business indebtedness (secs. 61(a)(12) and 108).[67] In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally reduce certain tax attributes, including basis in property, by the amount of the discharge of indebtedness.

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities immediately after the discharge (sec. 1017).

For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

For example, assume a taxpayer who is not in bankruptcy and is not insolvent owns a principal residence subject to a $200,000 mortgage debt. If the creditor forecloses and the home is sold for $180,000 in satisfaction of the debt, the debtor has $20,000 income from the discharge of indebtedness which is includible in gross income. Likewise, if the creditor restructures the loan and reduces the principal amount to $180,000, the debtor has $20,000 includible in gross income.

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[66] H.R. 3648. The House Committee on Ways and Means reported H.R. 3648 on October 1, 2007 (H.R. Rep. 110–356). H.R. 3648 passed the House on October 4, 2007. The bill passed the Senate on December 14, 2007, by unanimous consent, with an amendment. The House agreed to the Senate amendment on December 18, 2007. The President signed the bill on December 20, 2007.

[67] A debt cancellation which constitutes a gift or bequest is not treated as income to the donee debtor (sec. 102).

Reasons for Change

The Congress believes that where taxpayers restructure their acquisition debt on a principal residence or lose their principal residence in a foreclosure, that it is inappropriate to treat discharges of acquisition indebtedness as income.

Explanation of Provision [68]

The Act excludes from the gross income of a taxpayer any discharge of indebtedness income by reason of a discharge (in whole or in part) of qualified principal residence indebtedness. Qualified principal residence indebtedness means acquisition indebtedness (within the meaning of section 163(h)(3)(B) except that the dollar limitation is $2,000,000) with respect to the taxpayer's principal residence. Acquisition indebtedness with respect to a principal residence generally means indebtedness which is incurred in the acquisition, construction, or substantial improvement of the principal residence of the individual and is secured by the residence. It also includes refinancing of such indebtedness to the extent the amount of the refinancing does not exceed the amount of the refinanced indebtedness. For these purposes the term "principal residence" has the same meaning as under section 121 of the Code.

If, immediately before the discharge, only a portion of a discharged indebtedness is qualified principal residence indebtedness, the exclusion applies only to so much of the amount discharged as exceeds the portion of the debt which is not qualified principal residence indebtedness. Thus, assume that a principal residence is secured by an indebtedness of $1 million, of which $800,000 is qualified principal residence indebtedness. If the residence is sold for $700,000 and $300,000 debt is discharged, then only $100,000 of the amount discharged may be excluded from gross income under this provision.

The basis of the individual's principal residence is reduced by the amount excluded from income under the Act.

Under the Act, the exclusion does not apply to a taxpayer in a Title 11 case; instead the present-law exclusion applies. In the case of an insolvent taxpayer not in a Title 11 case, the exclusion under the Act applies unless the taxpayer elects to have the present-law exclusion apply instead.

Under the Act, the exclusion does not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

Effective Date

The provision is effective for discharges of indebtedness on or after January 1, 2007, and before January 1, 2010.

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[68] The provision was subsequently amended in Division A, section 303 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110–343, described in Part Seventeen.

B. Extend the Deduction for Private Mortgage Insurance (sec. 3 of the Act and sec. 163 of the Code)

Present Law

In general

Present law provides that qualified residence interest is deductible notwithstanding the general rule that personal interest is nondeductible (sec. 163(h)).

Acquisition indebtedness and home equity indebtedness

Qualified residence interest is interest on acquisition indebtedness and home equity indebtedness with respect to a principal and a second residence of the taxpayer. The maximum amount of home equity indebtedness is $100,000. The maximum amount of acquisition indebtedness is $1 million. Acquisition indebtedness means debt that is incurred in acquiring constructing, or substantially improving a qualified residence of the taxpayer, and that is secured by the residence. Home equity indebtedness is debt (other than acquisition indebtedness) that is secured by the taxpayer's principal or second residence, to the extent the aggregate amount of such debt does not exceed the difference between the total acquisition indebtedness with respect to the residence, and the fair market value of the residence.

Private mortgage insurance

Certain premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The amount allowable as a deduction is phased out ratably by 10 percent for each $1,000 by which the taxpayer's adjusted gross income exceeds $100,000 ($500 and $50,000, respectively, in the case of a married individual filing a separate return). Thus, the deduction is not allowed if the taxpayer's adjusted gross income exceeds $110,000 ($55,000 in the case of married individual filing a separate return).

For this purpose, qualified mortgage insurance means mortgage insurance provided by the Veterans Administration, the Federal Housing Administration, or the Rural Housing Administration,[69] and private mortgage insurance (defined in section 2 of the Homeowners Protection Act of 1998 as in effect on the date of enactment of the provision).

Amounts paid for qualified mortgage insurance that are properly allocable to periods after the close of the taxable year are treated as paid in the period to which they are allocated. No deduction is allowed for the unamortized balance if the mortgage is paid before its term (except in the case of qualified mortgage insurance provided by the Department of Veterans Affairs or Rural Housing Service).

The Act does not apply with respect to any mortgage insurance contract issued before January 1, 2007. The provision terminates

[69] The Veterans Administration and the Rural Housing Administration have been succeeded by the Department of Veterans Affairs and the Rural Housing Service, respectively.

for any amount paid or accrued after December 31, 2007, or properly allocable to any period after that date.

Reporting rules apply under the Act.

Reasons for Change

The Congress believes it is appropriate to extend the present-law temporary provision. The Congress understands that the purpose of the provisions permitting deduction of home mortgage interest is to encourage home ownership while limiting significant disincentives to saving. The Congress believes that it would be consistent with the purpose of the provisions permitting deduction of home mortgage interest to permit the deduction of mortgage insurance premiums. While these premiums are not in the nature of interest, the Congress notes that purchase of such insurance is often demanded by lenders in order for home buyers to obtain financing (depending on the size of the buyer's down payment). The Congress believes that permitting deductibility of premiums for this type of insurance connected with home purchases will foster home ownership. In the case of higher income taxpayers who may not purchase mortgage insurance, however, the Congress believes the incentive of deductibility becomes unnecessary, and a phase-out is appropriate. It is not intended that prepayments be currently deductible, but rather, that they be deductible only in the period to which they relate. Reporting of payments is generally necessary to administer the provision.

Explanation of Provision

The Act extends the deduction for private mortgage insurance to amounts paid or accrued after December 31, 2007, but only with respect to contracts entered into after December 31, 2006, and prior to January 1, 2011.

Effective Date

The provision applies to contracts entered into after December 31, 2006, and before January 1, 2011, with respect to amounts paid or accrued after December 31, 2007.

C. Alternative Tests for Qualifying as Cooperative Housing Corporation (sec. 4 of the Act and sec. 216 of the Code)

Present Law

A tenant-stockholder in a cooperative housing corporation is entitled to deduct amounts paid or accrued to the cooperative to the extent those amounts represent the tenant-stockholder's proportionate share of (1) real estate taxes allowable as a deduction to the cooperative which are paid or incurred by the cooperative on the cooperative's land or buildings and (2) interest allowable as a deduction to the cooperative that is paid or incurred by the cooperative on its indebtedness contracted in the acquisition of the cooperative's land or in the acquisition, construction, alteration, rehabilitation, or maintenance of the cooperative's buildings.

A cooperative housing corporation generally is a corporation (1) that has one class of stock, (2) each of the stockholders of which

is entitled, solely by reason of ownership of stock in the corporation, to occupy a dwelling owned or leased by the cooperative, (3) no stockholder of which is entitled to receive any distribution not out of earnings and profits of the cooperative, except on complete or partial liquidation of the cooperative, and (4) 80 percent or more of the gross income of which for the taxable year in which the taxes and interest are paid or incurred is derived from tenant-stockholders.

Reasons for Change

Under present law, tenant-stockholders of a cooperative housing corporation are allowed to deduct their proportionate shares of the cooperative's deductible real estate taxes and mortgage interest only if the cooperative's nonmember income is no more than 20 percent of its total gross income. To satisfy this rule, some cooperative housing corporations have made rentals to commercial tenants at below-market rates. The Congress believes that the tax rules should not create an incentive to charge below-market-rate rents. Accordingly, the Act provides two non-income-based alternatives to the 80-percent requirement of present law.

Explanation of Provision

The Act amends the fourth requirement listed above to provide that the requirement is satisfied if, for the taxable year in which the taxes and interest are paid or incurred, the corporation meets one of the following three requirements: (1) 80 percent or more of the corporation's gross income for that taxable year is derived from tenant-stockholders (the present law requirement); (2) at all times during that table year 80 percent or more of the total square footage of the corporation's property is used or available for use by the tenant-stockholders for residential purposes or purposes ancillary to such residential use; or (3) 90 percent or more of the expenditures of the corporation paid or incurred during that taxable year are paid or incurred for the acquisition, construction, management, maintenance, or care of the corporation's property for the benefit of tenant-stockholders.

Effective Date

The provision is effective for taxable years ending after the date of enactment (December 20, 2007).

D. Exclusion of Income for Benefits Provided to Volunteer Firefighters and Emergency Medical Responders (sec. 5 of the Act and sec. 139B of the Code)

Present Law

In general

The Internal Revenue Service has concluded that a reduction in property tax by persons who "volunteer their services" as emer-

gency responders under a State law program is includible in the gross income.[70]

Itemized deductions

Under present law, individuals are allowed itemized deductions for (i) State and local income taxes, real property taxes, and personal property taxes, and (ii) subject to certain limitations, charitable contributions to organizations described in section 170(c).

Explanation of Provision [71]

In general

The Act provides an exclusion from gross income to members of qualified volunteer emergency response organizations for: (1) any qualified State or local tax benefit; and (2) any qualified reimbursement payment. A qualified State or local tax benefit is any reduction or rebate of certain taxes provided by State or local governments on account of services performed by individuals as members of a qualified volunteer emergency response organization. These taxes are limited to State or local income taxes, State or local real property taxes, and State or local personal property taxes. A qualified reimbursement payment is a payment provided by a State or political subdivision thereof on account of reimbursement for expenses incurred in connection with the performance of services as a member of a qualified volunteer emergency response organization. The amount of such qualified reimbursement payments is limited to $30 for each month during which the taxpayer performs such services.

A qualified volunteer emergency response organization is any volunteer organization: (1) which is organized and operated to provide firefighting or emergency medical services for persons in the State or its political subdivision; and (2) which is required (by written agreement) by the State or political subdivision to furnish firefighting or emergency medical services in such State or political subdivision.

Denial of double benefits

The Act provides that the amount of State or local taxes taken into account in determining the deduction for taxes is reduced by the amount of any qualified State or local tax benefit.

Also, the Act provides that expenses paid or incurred by the taxpayer in connection with the performance of services as a member of a qualified volunteer emergency response organization is taken into account for purposes of the charitable deduction only to the extent such expenses exceed the amount of any qualified reimbursement payment excluded from income under the Act.

Sunset

The rules related to certain tax reductions or tax rebates provided by a State or local government provided to volunteer fire-

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[70] IRS Chief Counsel Advice ("CCA") 200302045.

[71] See section 115 of Pub. L. 110–245, related to the employment tax treatment of these amounts, described in Part Twelve.

fighters and emergency medical responders do not apply to taxable years beginning after December 31, 2010.

Effective Date

The provision is effective on the date of enactment (December 20, 2007).

E. Clarification of Student Housing Eligible for Low-Income Housing Credit (sec. 6 of the Act and sec. 42(i) of the Code

Present Law

Generally the credit is not available for housing units occupied entirely by full-time students. Under one exception, an otherwise qualifying unit which is occupied entirely by full-time students could qualify if (1) all such students are single parents and their children; and (2) all the single parents and their children are not dependents of another individual.

Explanation of Provision

The Act clarifies that an otherwise qualifying unit which is occupied entirely by full-time students could qualify if (1) all such students are single parents and their children; (2) the single parents are not dependents of another individual; and (3) the children of the single parents are not dependents of another individual other than a parent of such children. This allows such housing units to qualify for the credit even though the children in the unit may be dependents of a parent not occupying the unit.

Effective Date

The provision is effective for (1) housing credit allocations under the State housing credit ceiling made before, on, or after the date of the enactment of this Act (December 20, 2007), and (2) buildings placed in service before, on, or after such date in the case of substantially tax-exempt bond-financed projects which do not require a housing credit allocation by reason of 42(h)(4).

F. Application of Joint Return Limitation for Capital Gains Exclusion to Certain Post-Marriage Sales of Principal Residences by Surviving Spouses (sec. 7 of the Act and sec. 121 of the Code)

Present Law

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is

equal to the fraction of the two years that the ownership and use requirements are met.

Explanation of Provision

The Act provides that if a married couple was otherwise eligible for the $500,000 maximum exclusion with respect to a principal residence immediately prior to the death of one of the spouses then the unmarried surviving spouse is eligible for a maximum exclusion of $500,000 on the sale of such residence if such sale occurs not later than two years after the date of death of such spouse.

Effective Date

The provision is effective for sales or exchanges after December 31, 2007.

G. Modification of Penalty for Failure to File Partnership Returns; Limitation on Disclosure (sec. 8 of the Act and secs. 6698 and 6103(e) of the Code)

Present Law

A partnership generally is treated as a pass-through entity. Income earned by a partnership, whether distributed or not, is taxed to the partners. Distributions from the partnership generally are tax-free. The items of income, gain, loss, deduction or credit of a partnership generally are taken into account by a partner as allocated under the terms of the partnership agreement. If the agreement does not provide for an allocation, or the agreed allocation does not have substantial economic effect, then the items are to be allocated in accordance with the partners' interests in the partnership. To prevent double taxation of these items, a partner's basis in its interest is increased by its share of partnership income (including tax-exempt income), and is decreased by its share of any losses (including nondeductible losses).

Under present law, a partnership is required to file a tax return for each taxable year. The partnership's tax return is required to include the names and addresses of the individuals who would be entitled to share in the taxable income if distributed and the amount of the distributive share of each individual. In addition to applicable criminal penalties, present law imposes a civil penalty for the failure to timely file a partnership return. The penalty is $50 per partner for each month (or fraction of a month) that the failure continues, up to a maximum of five months.

Under present law, return information may be disclosed to the entity making the return or to persons with a material interest.

Explanation of Provision

The Act increases the present-law failure to file penalty for partnership returns to $85 per month, up to a maximum of 12 months.

The Act also amended the exception that permits disclosure of the return information of a pass-through entity to a person with a material interest. The information that may be disclosed or inspected under that exception does not include any supporting schedule, attachment or list that would identify a taxpayer other

than the person requesting the disclosure or the entity that made the return.

Effective Date

The provision is effective for partnership returns required to be filed after the date of enactment (December 20, 2007).

H. Penalty for Failure to File S Corporation Returns (sec. 9 of the Act and new sec. 6699 of the Code)

Present Law

Certain small business corporations are entitled to elect to be taxed as S corporations, the effect of which is to be treated as a flow-through entity whose income is distributed to its shareholders.[72] The S corporation will generally not incur an entity level tax, other than with respect to capital gains or certain passive income. It is required to report all income on an annual income tax return.[73] That return must include information identifying all shareholders, their respective pro rata share of the corporation's income, as well as any distributions of money or property to shareholders. The S corporation provides each shareholder with a schedule K–1 that reflects that shareholder's pro rata share of the various S corporation items of income.

Each shareholder is in turn required to treat those items consistently with the position taken on the S corporation return. If the shareholder fails to comply with the requirement to treat S corporate items consistently, the shareholder is subject to an accuracy related penalty. Although a failure to file by an S corporation could be subject to criminal penalties under section 7203 in appropriate cases, it is not subject to a civil penalty. Returns required by section 6037 are not within the scope of the addition to tax imposed by section 6651 for failure to file or pay, nor are they information returns[74] subject to the penalties for failure to comply with information reporting requirements.

Explanation of Provision

An S corporation that delinquently files its return, fails to file a required return, or fails to supply all required information on its return, is subject to an assessable penalty unless it can establish reasonable cause for the failure or delinquency. The penalty is imposed for each month or part of the month, up to 12 months, that the failure continues. The amount for each month is $85 multiplied by the total number of shareholders in the corporation during the taxable year to which the return relates.

Effective Date

This provision is effective for returns required to be filed after date of enactment (December 20, 2007).

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[72] Section 1363.
[73] Section 6037.
[74] Section 6724(d)(1).

I. Modifications to Corporate Estimated Tax Payments (sec. 10 of the Act and sec. 6655 of the Code)

Present Law

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

Under present law, in the case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, shall be increased to 114.75 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Reasons for Change

The Congress believes it is appropriate to adjust the corporate estimated tax payments.

Explanation of Provision [75]

The Act increases the otherwise applicable percentage by 1.50 percentage points.

Effective Date

The provision is effective on the date of enactment (December 20, 2007).

[75] All the public laws enacted in the 110th Congress affecting this provision are described in Part Twenty-Two.

PART FIVE: AIRPORT AND AIRWAY TRUST FUND EXTENSIONS (PUBLIC LAWS 110–92,[76] 110–161,[77] 110–190,[78] 110–253,[79] AND 110–330[80])

Present Law

The Airport and Airway Trust Fund provides funding for capital improvements to the U.S. airport and airway system and funding for the Federal Aviation Administration ("FAA"), among other purposes. The excise taxes imposed to finance the Airport and Airway Trust Fund are:[81]

- ticket taxes imposed on commercial, domestic passenger transportation by air;
- a use of international air facilities tax;
- a cargo tax imposed on freight transportation by air;
- fuels taxes imposed on gasoline used in commercial aviation and noncommercial aviation; and
- fuels taxes imposed on jet fuel (kerosene) and other aviation fuels used in commercial aviation and noncommercial aviation.

In general, except for 4.3 cents of the fuel tax rates, the excise taxes dedicated to the Airport and Airway Trust Fund do not apply after September 30, 2007. Expenditure authority for the Airport and Airway Trust Fund also terminates after September 30, 2007.

Explanation of Provisions

Pub. L. No. 110–92, 110–116, 110–137, and 110–149 (making continuing appropriations for fiscal year 2008)

The provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through November 15, 2007 as part of continuing appropriations for fiscal year 2008. Public Law No. 110–116 extended this date through December 14, 2007. Public Law No. 110–137 made a further extension through Decem-

[76] H.J. Res. 52. The House passed H.J. Res. 52 on September 26, 2007. The Senate passed the resolution without an amendment on September 27, 2007. The President signed the resolution on September 29, 2007.

[77] H.R. 2764. The House passed H.R. 2764 on June 22, 2007. The bill passed the Senate with an amendment on September 6, 2007. The House agreed to the Senate amendment with two amendments on December 17, 2007. The Senate agreed to one House amendment and agreed to the second House amendment with an amendment on December 18, 2007. The House agreed to the Senate amendment on December 19, 2007. The President signed the bill on December 26, 2007.

[78] H.R. 5270. The House passed H.R. 5270 on February 12, 2008. The Senate passed the bill without amendment on February 13, 2008. The President signed the bill on February 28, 2008.

[79] H.R. 6327. The House passed H.R. 6327 on June 24, 2008. The Senate passed the bill without amendment on June 26, 2008. The President signed the bill on June 30, 2008.

[80] H.R. 6984. The House passed H.R. 6984 on September 23, 2008. The Senate passed the bill without amendment on September 23, 2008. The President signed the bill on September 30, 2008.

[81] Sec. 9502(b)(1). The Airport and Airway Trust Fund also is credited with interest under sec. 9602(b).

ber 21, 2007, and Pub. L. No. 110–149 provided an extension through December 31, 2007.

Pub. L. No. 110–161 ("Department of Transportation Appropriations Act, 2008")

This provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through February 29, 2008.

Pub. L. No. 110–190 (the "Airport and Airway Extension Act of 2008")

The provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through June 30, 2008.

Pub. L. No. 110–253 (the "Federal Aviation Administration Extension Act of 2008")

The provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through September 30, 2008.

Pub. L. No. 110–330 (the Federal Aviation Administration Extension Act of 2008, Part II")

The provision extended the Airport and Airway Trust Fund excise taxes and expenditure authority through March 31, 2009.

PART SIX: TAX INCREASE PREVENTION ACT OF 2007 (PUBLIC LAW 110–166)[82]

A. Extension of Alternative Minimum Relief for Nonrefundable Personal Credits and Extension of Increased Alternative Minimum Tax Exemption Amounts (secs. 101 and 102 of the Act and secs. 26 and 55 of the Code)

Present Law

Present law imposes an alternative minimum tax on individuals. The alternative minimum tax is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments.

The present exemption amount is: (1) $62,550 ($45,000 in taxable years beginning after 2006) in the case of married individuals filing a joint return and surviving spouses; (2) $42,500 ($33,750 in taxable years beginning after 2006) in the case of other unmarried individuals; (3) $31,275 ($22,500 in taxable years beginning after 2006) in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust. The exemption amount is phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Present law provides for certain nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child tax credit, the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, the credit for savers, the credit for certain nonbusiness energy property, the credit for residential energy efficient property, and the D.C. first-time homebuyer credit).

[82] H.R. 3996. The House Ways and Means Committee reported H.R. 3996 on November 6, 2007 (H.R. Rep. 110–431). H.R. 3996 passed the House on November 9, 2007. The bill passed the Senate on December 6, 2007, with an amendment. The House agreed to the Senate amendment on December 19, 2007. The President signed the bill on December 26, 2007.

For taxable years beginning before 2007, the nonrefundable personal credits are allowed to the extent of the full amount of the individual's regular tax and alternative minimum tax.

For taxable years beginning after 2006, the nonrefundable personal credits (other than the adoption credit, child credit and saver's credit) are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit. The adoption credit, child credit, and saver's credit are allowed to the full extent of the individual's regular tax and alternative minimum tax.[83]

Reasons for Change

The Congress is concerned about the projected increase in the number of individuals who will be affected by the individual alternative minimum tax for 2007. The provision will reduce the number of individuals who would otherwise be affected by the minimum tax.

Explanation of Provision[84]

The Act provides that the individual AMT exemption amount for taxable years beginning in 2007 is (1) $66,250, in the case of married individuals filing a joint return and surviving spouses; (2) $44,350 in the case of other unmarried individuals; and (3) $33,125 in the case of married individuals filing separate returns.

For taxable years beginning in 2007, the Act allows an individual to offset the entire regular tax liability and alternative minimum tax liability by the nonrefundable personal credits.

Effective Date

The provision is effective for taxable years beginning in 2007.

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[83] The rule applicable to the adoption credit and child credit is subject to the EGTRRA sunset.

[84] The provision was subsequently amended for taxable years beginning in 2008. See Part Seventeen, Division C, Title I.

PART SEVEN: TAX TECHNICAL CORRECTIONS ACT OF 2007 (PUBLIC LAW 110–172)[85]

The Act includes technical corrections to recently enacted tax legislation. Except as otherwise provided, the amendments made by the technical corrections contained in the Act take effect as if included in the original legislation to which each amendment relates.

Amendment related to the Tax Relief and Health Care Act of 2006

Individuals with long-term unused credits under the alternative minimum tax (Act sec. 402 of Division A).—Under present law, an individual's minimum tax credit allowable for any taxable year beginning after December 20, 2006, and before January 1, 2013, is not less than the "AMT refundable credit amount." The AMT refundable credit amount is the greater of (1) the lesser of $5,000 or the long-term unused minimum tax credit, or (2) 20 percent of the long-term unused minimum tax credit. The long-term unused minimum tax credit for any taxable year means the portion of the minimum tax credit attributable to the adjusted net minimum tax for taxable years before the 3rd taxable year immediately preceding the taxable year (assuming the credits are used on a first-in, first-out basis). In the case of an individual whose adjusted gross income for a taxable year exceeds the threshold amount (within the meaning of section 151(d)(3)(C)), the AMT refundable credit amount is reduced by the applicable percentage (within the meaning of section 151(d)(3)(B)). The additional credit allowable by reason of this provision is refundable.

The provision amends the definition of the AMT refundable credit amount. The provision provides that the AMT refundable credit amount (before any reduction by reason of adjusted gross income) is an amount (not in excess of the long-term unused minimum tax credit) equal to the greater of (1) $5,000, (2) 20 percent of the long-term unused minimum tax credit, or (3) the AMT refundable credit amount (if any) for the prior taxable year (before any reduction by reason of adjusted gross income).

The provision may be illustrated by the following example: Assume an individual, whose adjusted gross income for all taxable years is less than the threshold amount, has a long-term unused minimum tax credit for 2007 of $100,000 and has no other minimum tax credits. The individual's AMT refundable credit amount under present law is $20,000 in 2007, $16,000 in 2008, $10,240 in 2009, $8,192 in 2010, $6,554 in 2011, and $5,243 in 2012. Under

[85] H.R. 4839. H.R. 4839 passed the House on December 19, 2007 without objection. The Senate passed the bill by unanimous consent on December 19, 2007. The President signed the bill on December 29, 2007. For a technical explanation of the Act prepared by the staff of the Joint Committee on Taxation, see *Description of the Tax Technical Corrections Act of 2007, as Passed By The House of Representatives* (JCX 119–07, December 18, 2007).

the provision, the individual's AMT refundable credit amount is $20,000 for 2007 (as under present law), and in each of the taxable years 2008 thru 2011 the AMT refundable credit amount is also $20,000. The minimum tax credit in 2012 is zero.

Amendments related to Title XII of the Pension Protection Act of 2006 (Provisions Relating to Exempt Organizations)

Tax-free distributions from individual retirement plans for charitable purposes (Act sec. 1201).—Under the provision, when determining the portion of a distribution that would otherwise be includible in income, the otherwise includible amount is determined as if all amounts were distributed from all of the individual's IRAs.

Contributions of appreciated property by S corporations (Act sec. 1203).—Under present law (sec. 1366(d)), the amount of losses and deductions which a shareholder of an S corporation may take into account in any taxable year is limited to the shareholder's adjusted basis in his stock and indebtedness of the corporation. The provision provides that this basis limitation does not apply to a contribution of appreciated property to the extent the shareholder's pro rata share of the contribution exceeds the shareholder's pro rata share of the adjusted basis of the property. Thus, the basis limitation of section 1366(d) does not apply to the amount of deductible appreciation in the contributed property. The provision does not apply to contributions made in taxable years beginning after December 31, 2007.

For example, assume that in taxable year 2007, an S corporation with one shareholder makes a charitable contribution of a capital asset held more than one year with an adjusted basis of $200 and a fair market value of $500. Assume the shareholder's adjusted basis of the stock (as determined under section 1366(d)(1)(A)) is $300. For purposes of applying the limitation under section 1366(d) to the contribution, the limitation does not apply to the $300 of appreciation and since the $300 adjusted basis of the stock exceeds the $200 adjusted basis of the contributed property, the limitation does not apply at all to the contribution. Thus, the shareholder is treated as making a $500 charitable contribution. The shareholder reduces the basis of the S corporation stock by $200 to $100 (pursuant to section 1367(a)(2)).

Recapture of tax benefit for charitable contributions of exempt use property not used for an exempt use (Act sec. 1215).—The Act permits a charitable deduction in the amount of the fair market value (not the donor's basis) for tangible personal property if an officer of the donee organization certifies upon disposition of the donated property that the use of the property was related to the purpose or function constituting the basis of the donee's tax-exempt status. It was not intended that the donee's use, though so related, not also be substantial. The provision adds to the certification requirement that the officer certify that use of the property by the donee was substantial.

Contributions of fractional interests in tangible personal property (Act sec. 1218).—The Act added an income tax provision providing for treatment of contributions of fractional interests in tangible personal property. A special valuation rule is provided under this

rule that creates unintended consequences under the estate and gift tax. The provision therefore strikes the special valuation rule for estate and gift tax purposes.

Time for assessment of penalty relating to substantial and gross valuation misstatements attributable to incorrect appraisals (Act section 1219).—Section 1219 of the Act added a penalty for substantial and gross valuation misstatements attributable to incorrect appraisals (Code sec. 6695A). First, the Act omitted to apply the penalty with respect to substantial valuation misstatements for estate and gift tax purposes, and the provision clarifies that the penalty applies for such purposes. Second, in the cross references for the penalty, the language of Code section 6696(d)(1), relating to the time period for assessment of the penalty, was not properly described. The provision adds a cross reference to section 6695A in section 6696(d).

Expansion of the base of tax on private foundation net investment income (Act sec. 1221).—The Act expands the base of the tax on net investment income of private foundations. The provision clarifies that capital gains from appreciation are included in this tax base. This clarification conforms the statutory language to the technical explanation.

Public disclosure of information relating to unrelated business income tax returns (Act sec. 1225).—The Act added a provision requiring that section 501(c)(3) organizations make publicly available their unrelated business income tax returns. However, as drafted, the requirement that, with respect to a Form 990, an organization make publicly available only the last three years of returns (sec. 6104(d)(2)) does not apply to disclosure of Form 990–T, because Form 990–T is required by section 6011, not by section 6033. The provision clarifies that the 3-year limitation on making returns publicly available applies to Form 990–T. The provision clarifies that the IRS is required to make Form 990–T publicly available, subject to redaction procedures applicable to Form 990 under section 6104(b).

Donor advised funds (Act sec. 1231).—The Act imposed excise taxes in the event of certain taxable distributions (Code sec. 4966) and on the provision of certain prohibited benefits (sec. 4967), but does not cross refer to these provisions in the section 4962 definition of qualified first tier taxes for purposes of tax abatement (though a cross reference to them is included in section 4963). The provision adds a cross reference to them in Code section 4962 (relating to abatement).

Excess benefit transactions involving supporting organizations (Act sec. 1242).—New Code section 4958(c)(3) provides that certain transactions involving supporting organizations are treated as excess benefit transactions for purposes of the intermediate sanctions rules. Under the Code, certain organizations described in Code sections 501(c)(4), (5) or (6) are treated as supported organizations, although they are not public charities or safety organizations. The provision provides that the excess benefit transaction rules of the Act generally do not apply to transactions between a supporting organization and its supported organization that is described in section 501(c)(4), (5), or (6).

Amendments related to the Tax Increase Prevention and Reconciliation Act of 2005

Look-through treatment and regulatory authority (Act sec. 103(b)).—Under the Act, for taxable years beginning after 2005 and before 2009, dividends, interest (including factoring income which is treated as equivalent to interest under sec. 954(c)(1)(E)), rents, and royalties received by one controlled foreign corporation ("CFC") from a related CFC are not treated as foreign personal holding company income to the extent attributable or properly allocable to non-subpart F income of the payor (the "TIPRA look-through rule").

The provision clarifies the treatment of deficits in earnings and profits. Under the provision, the TIPRA look-through rule does not apply to any interest, rent, or royalty to the extent that such interest, rent, or royalty creates (or increases) a deficit which under section 952(c) may reduce the subpart F income of the payor or another CFC. The provision parallels the rule applicable to interest, rents, or royalties that would otherwise qualify for exclusion from foreign personal holding company income under the "same country" exception (sec. 954(c)(3)(B)). Thus interest, rents, and royalties will be treated as subpart F income, notwithstanding the general TIPRA look-through rule, if the payment creates or increases a deficit of the payor corporation and that deficit is from an activity that could reduce the payor's subpart F income under the accumulated deficit rule (sec. 952(c)(1)(B)), or could reduce the income of a qualified chain member under the chain deficit rule (sec. 952(c)(1)(C)). For example, under the provision, items that do not qualify for the "same country" exception because they meet the terms of section 954(c)(3)(B) will also not qualify under the TIPRA look-through rule.

Modification of active business definition under section 355 (Act sec. 202).—The provision revises Code sections 355(b)(2)(A) and 355(b)(3) to reflect that the provision modifying the active business definition that was enacted by section 202 of the Act was made permanent by section 410 of the Tax Relief and Health Care Act of 2006. Conforming amendments are made as a result of this change.

The provision clarifies that if a corporation became a member of a separate affiliated group as a result of one or more transactions in which gain or loss was recognized in whole or in part, any trade or business conducted by such corporation (at the time that such corporation became such a member) is treated for purposes of section 355(b)(2) as acquired in a transaction in which gain or loss was recognized in whole or in part. Accordingly, such an acquisition is subject to the provisions of section 355(b)(2)(C), and may qualify as an expansion of an existing active trade or business conducted by the distributing corporation or the controlled corporation, as the case may be.

The provision clarifies that the Treasury Department shall prescribe regulations that provide for the proper application of sections 355(b)(2)(B), (C), and (D) in the case of any corporation that is tested for active business under the separate affiliated group rule, and that modify the application of section 355(a)(3)(B) in the case of such a corporation in a manner consistent with the purposes of the provision.

The provision further clarifies that the rule regarding the application of the new rules to determine the continued qualification under section 355 of a distribution that occurred before the effective date of the new rules, shall apply only if such application results in continued qualification and is not intended to require application of the new rules in a manner that would disqualify any distribution that satisfied the active business requirements of section 355 under prior law that was applicable to the distribution.

Computation of tax for individuals with income excluded under the foreign earned income exclusion (Act sec. 515).—The provision clarifies that in computing the tentative minimum tax on non-excluded income, the computation of tax is made before reduction for the alternative minimum tax foreign tax credit. This conforms the computation of the tentative minimum tax to the computation of the regular tax, so that both computations are made before the application of the foreign tax credit.

The provision also corrects an error in present law in the case where a taxpayer has net capital gain in excess of taxable income. Under the provision, if a taxpayer's net capital gain (within the meaning of section 1(h)) exceeds taxable income, in computing the tax on the taxable income as increased by the excluded income, the amount of net capital gain which otherwise be taken into account is reduced by the amount of that excess. The excess first reduces the amount of net capital gain without regard to qualified dividend income, and then qualified dividend income. Also, in computing adjusted net capital gain, unrecaptured section 1250 gain, and 28-percent rate gain, the amount of the excess is treated in the same manner as an increase in the long-term capital loss carried to the taxable year.

Similar rules apply in computing the tentative minimum tax where a taxpayer's net capital gain exceeds the taxable excess.

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

The following examples illustrate the provision:

Example 1.—For taxable year 2007, an unmarried individual has $80,000 excluded from gross income under section 911(a), $30,000 gain from the sale of a capital asset held more than one year, and $20,000 deductions. The taxpayer's taxable income is $10,000. Under the provision, the regular tax is the excess of (i) the amount of tax computed under section 911(f)(1)(A)(i) on taxable income of $90,000 ($10,000 taxable income plus $80,000 excluded income), over (ii) the amount of tax computed under section 911(f)(1)(A)(ii) on taxable income of $80,000 (excluded income). In applying section 1(h) to determine the tax under section 911(f)(1)(A)(i), the net capital gain and the adjusted net capital gain are each $10,000. The regular tax is $1,500, which is equal to a tax at the rate of 15 percent on $10,000 of adjusted net capital gain.

Example 2.—For taxable year 2007, an unmarried individual has $90,000 excluded from gross income under section 911(a), $5,000 gain from the sale of a capital asset held more than one year, $25,000 unrecaptured section 1250 gain, and $20,000 deductions. The taxpayer's taxable income is $10,000. Under the provision, the regular tax is the excess of (i) the amount of tax computed under section 911(f)(1)(A)(i) on taxable income of $100,000 ($10,000 tax-

able income plus $90,000 excluded income), over (ii) the amount of tax computed under section 911(f)(1)(A)(ii) on taxable income of $90,000 (excluded income). In applying section 1(h) to determine the tax under section 911(f)(1)(A)(i), the net capital gain is $10,000. $5,000 is unrecaptured section 1250 gain ($25,000 less $20,000) and $5,000 is adjusted net capital gain. The regular tax is $2,000, which is equal to a tax at the rate of 15 percent on $5,000 of adjusted net capital gain and a tax at the rate of 25 percent on $5,000 of unrecaptured section 1250 gain.

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

Timing of claims for excess alternative fuel (not in a mixture) credit (Act sec. 11113).—Present law provides that the alternative fuel (not in a mixture) credit is refundable. Code section 6427(i)(3) permits claims to be filed on a weekly basis with respect to alcohol, biodiesel, and alternative fuel mixtures if certain requirements are met. This rule, however, does not refer to the alternative fuel credit (for alternative fuel not in a mixture). The provision clarifies that the same rules for filing claims with respect to fuel mixtures apply to the alternative fuel credit.

Definition of alternative fuel (Act sec. 11113).—Code section 6426(d)(2) defines alternative fuel to include "liquid hydrocarbons from biomass" for purposes of the alternative fuel excise tax credit and payment provisions under sections 6426 and 6427. The statute does not define liquid hydrocarbons, which has led to questions as to whether it is permissible for such a fuel to contain other elements, such as oxygen, or whether the fuel must consist exclusively of hydrogen and carbon. It was intended that biomass fuels such as fish oil, which is not exclusively made of hydrogen and carbon, qualify for the credit. The provision changes the reference in section 6426 from "liquid hydrocarbons" to "liquid fuel" for purposes of the alternative fuel excise tax credit and payment provisions.

Amendments related to the Energy Policy Act of 2005

Credit for production from advanced nuclear power facilities (Act sec. 1306).—The provision clarifies that the national capacity limitation of 6,000 megawatts represents the total number of megawatts that the Secretary has authority to allocate under section 45J.

Clarify limitation on the credit of installing alternative fuel refueling property (Act sec. 1342).—The present-law credit for qualified alternative fuel vehicle refueling property for a taxable year is limited to $30,000 per property subject to depreciation, and $1,000 for other property (sec. 30C(b)). The provision clarifies that the $30,000 and $1,000 limitations apply to all alternative fuel vehicle refueling property placed in service by the taxpayer at a location. The provision is consistent with similar deduction limitations imposed under section 179A(b)(2)(A) (relating to the deduction for clean-fuel vehicles and certain refueling property).

In addition, Code section 30C(c)(1) provides that qualified alternative fuel vehicle refueling property has the meaning given to the term by section 179A(d). However, section 179A(d) defines a dif-

ferent term. The provision modifies the language of section 30C(c)(1) to refer to the correct term.

Clarify that research eligible for the energy research credit is qualified research (Act sec. 1351).—The energy research credit is available with respect to certain amounts paid or incurred to an energy research consortium. The provision clarifies that the credit is available with respect to such amounts paid or incurred to an energy research consortium provided they are used for energy research that is qualified research.

Double taxation of rail and inland waterway fuel resulting from the use of dyed fuel on which the Leaking Underground Storage Tank Trust Fund tax has already been imposed; off-highway business use (Act sec. 1362).—Section 4081(a)(2)(B) of the Code imposes tax at the Leaking Underground Storage Tank Trust Fund financing tax rate of 0.1 cent per gallon on diesel fuel at the time it is removed from a terminal. Section 4082(a) provides that none of the generally applicable exemptions other than the exemption for export apply to this removal even if the fuel is dyed. When dyed fuel is used or sold for use in a diesel powered highway vehicle or train (sec. 4041), or such fuel is subject to the inland waterway tax (sec. 4042), the Code inadvertently imposes the Leaking Underground Storage Tank Trust Fund tax a second time. Section 6430 prohibits the refund of taxes imposed at the Leaking Underground Storage Tank Trust Fund financing rate, except in the case of fuel destined for export. The provision eliminates the imposition of the 0.1 cent tax a second time if the Leaking Underground Storage Tank Trust Fund financing tax rate previously was imposed under section 4081. The provision permits a refund in the amount of the Leaking Underground Storage Tank Trust Fund financing rate if such tax was imposed a second time under 4041 or 4042 from October 1, 2005 through the date of enactment. The provision also clarifies that off-highway business use is not exempt from the Leaking Underground Storage Tank Trust Fund Financing rate. For administrative reasons associated with collecting the tax, the off-highway business use clarification is effective for fuel sold for use or used after the date of enactment.

Exemption from the Leaking Underground Storage Tank Trust Fund financing rate for aircraft and vessels engaged in foreign trade (Act sec. 1362).—Fuel supplied in the United States for use in aircraft engaged in foreign trade is exempt from U.S. customs duties and internal revenue taxes, so long as, where the aircraft is registered in a foreign State, the State of registry provides substantially reciprocal privileges for U.S.-registered aircraft. However, the Energy Policy Act of 2005 imposed, without exemption, the Leaking Underground Storage Tank Trust Fund financing rate on all taxable fuels, except in the case of export. As a result, aviation fuel is no longer exempt from the Leaking Underground Storage Tank Trust Fund financing rate. According to the State Department, almost all of the United States bilateral air services agreements contain provisions exempting from taxation all fuel supplied in the territory of one party for use in the aircraft of the other party. The United States has interpreted these provisions to prohibit the taxation, in any form, of aviation fuel supplied in the United States to the aircraft of airlines of the foreign countries that are parties

to these air services agreements. The amendment provides that fuel for use in vessels (including civil aircraft) employed in foreign trade or trade between the United States and any of its possessions is exempt from the Leaking Underground Storage Tank Trust Fund financing rate.

Amendments related to the American Jobs Creation Act of 2004

Interaction of rules relating to credit for low sulfur diesel fuel (Act sec. 339).—Section 45H of the Code allows a credit at the rate of 5 cents per gallon for low sulfur diesel fuel produced at certain small business refineries. The aggregate credit with respect to any refinery is limited to 25 percent of the costs of the type deductible under section 179B of the Code. Section 179B allows a deduction for 75 percent of certain costs paid or incurred with respect to these refineries. The basis of the property is reduced by the amount of any credit determined with respect to any expenditure (sec. 45H(d)). Further, no deduction is allowed for the expenses otherwise allowable as a deduction in an amount equal to the amount of the credit under section 45H (sec. 280C(d)). The interaction of these provisions is unclear, and the basis reduction and deduction denial rules may have an unintentionally duplicative effect. Under the provision, deductions are denied in an amount equal to the amount of the credit under section 45H, and the provisions of present law reducing basis and denying a deduction are repealed.

Eliminate the open-loop biomass segregation requirement in section 45(c)(3)(A)(ii) (Act sec. 710).—For purposes of the credit for electricity produced from certain renewable resources, section 45(c)(3)(A)(ii) defines open-loop biomass to include any solid, nonhazardous, cellulosic waste material or any lignin material that is segregated from other waste materials, and that meets other requirements. The Act added municipal solid waste to the category of qualified energy resources giving rise to the credit. Thus, both open-loop biomass and municipal solid waste can be treated as qualified energy resources. The provision therefore strikes the requirement that open-loop biomass be segregated from other waste materials in order to be treated as qualified energy resources.

Clarification of proportionate limitation applicable to closed-loop biomass (Act sec. 710).—Section 45(d)(2)(B)(ii) provides that when closed-loop biomass is co-fired with other fuels, the credit is limited to the otherwise allowable credit multiplied by the ratio of the thermal content of the closed-loop biomass to the thermal content of all fuel used. This limitation duplicates a similar limitation in section 45(a), which provides that the credit is equal to 1.5 cents multiplied by the kilowatt hours of electricity produced by the taxpayer from qualified energy resources (and meeting other criteria). The present-law section 45(a) rule has the effect of limiting the credit (or duration of the credit) to the appropriate portion of the fuel that constitutes qualified energy resources, in the situations in which qualified energy resources are permitted to be co-fired with each other, or are permitted to be co-fired with other fuels. The provision clarifies that the limitation applies only once, not twice, to closed-loop biomass co-fired with other fuels, by striking the duplicate limitation in section 45(d)(2)(B)(ii).

Treatment of partnerships under the limitation on deductions allocable to property used by governments or other tax-exempt entities (Act sec. 848).—Code section 470 generally applies loss deferral rules in the case of property leased to tax-exempt entities. This rule applies with respect to tax-exempt use property, which for this purpose generally has the meaning given to the term by section 168(h) (with exceptions specified in section 470(c)(2)). The manner of application of section 470 in the case of property owned by a partnership in which a tax-exempt entity is a partner is unclear.

The provision provides that tax-exempt use property does not include any property that would be tax-exempt use property solely by reason of section 168(h)(6). The provision refers to section 7701(e) for circumstances in which a partnership is treated as a lease to which section 168(h) applies. Thus, if a partnership is recharacterized as a lease pursuant to section 7701(e), and a provision of section 168(h) (other than section 168(h)(6)) applies to cause the property characterized as leased to be treated as tax-exempt use property, then the loss deferral rules of section 470 apply.

Under section 7701(e)(2), a partnership may be treated as a lease, taking into account all relevant factors, including factors similar to those set forth in section 7701(e)(1) (relating to service contracts treated as leases). In the case of property of a partnership in which a tax-exempt entity is a partner, factors similar to those in section 7701(e)(1) (and in the legislative history of that section) that are relevant in determining whether a partnership is properly treated as a lease of property held by the partnership include (1) a tax-exempt partner maintains physical possession or control or holds the benefits and burdens of ownership with respect to such property, (2) there is insignificant equity investment by any taxable partner, (3) the transfer of such property to the partnership does not result in a change in use of such property, (4) such property is necessary for the provision of government services, (5) a disproportionately large portion of the deductions for depreciation with respect to such property are allocated to one or more taxable partners relative to such partner's risk of loss with respect to such property or to such partner's allocation of other partnership items, and (6) amounts payable on behalf of the tax-exempt partner relating to the property are defeased or funded by set-asides or expected set-asides. It is intended that Treasury regulations or guidance may provide additional factors that can be taken into account in determining whether a partnership with taxable and tax-exempt partners is an arrangement that resembles a lease of property under which section 470 defers the allowance of losses.

The provision is effective as if included in the provision of the American Jobs Creation Act of 2004 to which it relates. It is not intended that the provision supercede the rules set forth by the Treasury Department in Notice 2005–29, 2005–13 I.R.B. 796, Notice 2006–2, 2006–2 I.R.B. 1, and Notice 2007–4, 2007–1 I.R.B. 260, with respect to the application of section 470 in the case of partnerships for taxable years of partnerships beginning in 2004, 2005, and 2006. These notices state that the Internal Revenue Service will not apply section 470 to disallow losses associated with property that is treated as tax-exempt use property solely as a result of the application of section 168(h)(6), and that abusive trans-

actions involving partnerships an other pass-through entities remain subject to challenge by the Internal Revenue Service under other provisions of the tax law. Accordingly, for partnership taxable years beginning in 2004, 2005, and 2006, the Internal Revenue Service may apply section 470 to a partnership that would be treated as a lease under section 7701(e)(2).

Treatment of losses on positions in identified straddles (Act sec. 888).—Under Code section 1092, the term "straddle" means offsetting positions in actively traded personal property. Generally, a loss on a position in a straddle may be recognized only to the extent the amount of the loss exceeds the unrecognized gain (if any) in offsetting positions in the straddle (sec. 1092(a)(1)(A)). Special rules for identified straddles provide a different treatment of losses and also provide that any position that is not part of an identified straddle is not treated as offsetting with respect to any position that is part of the identified straddle. A taxpayer is permitted to treat a straddle as an identified straddle only if, among other requirements, the straddle is not part of a larger straddle.

Before the enactment of the Act, the rules for treating a straddle as an identified straddle required that all the positions of the straddle were acquired on the same day and either that all of the positions were disposed of on the same day in a taxable year or that none of the positions were disposed of as of the close of the taxable year. A loss on a position in an identified straddle was not subject to the loss deferral rule described above but instead was taken into account when all the positions making up the straddle were disposed of.

The Act changed the rules for identified straddles by providing, among other things, that if there is a loss on a position in an identified straddle, the loss is applied to increase the basis of the offsetting positions in that identified straddle. Under section 1092(a)(2)(A)(ii), the basis of each offsetting position in an identified straddle is increased by an amount that equals the product of the amount of the loss multiplied by the ratio of the amount of unrecognized straddle period gain in that offsetting position to the aggregate amount of unrecognized straddle period gain in all offsetting positions. The Act also provided that any loss described in section 1092(a)(2)(A)(ii) is not otherwise taken into account for Federal tax purposes.

The Act left unclear the treatment of a loss on a position in an identified straddle in at least two circumstances: first, when there are no offsetting positions in the identified straddle with unrecognized straddle period gain, and, second, when an offsetting position in the identified straddle is or has been a liability to the taxpayer.

The provision addresses the treatment of losses in these two circumstances. In general, the provision reaffirms that a loss on a position in an identified straddle is not permitted to be recognized currently and also is not permanently disallowed.

The provision provides that if the application of section 1092(a)(2)(A)(ii) does not result in a basis increase in any offsetting position in the identified straddle (because there is no unrecognized straddle period gain in any offsetting position), the basis of each offsetting position in the identified straddle must be increased in a manner that (1) is reasonable, is consistent with the purposes of

the identified straddle rules, and is consistently applied by the taxpayer, and (2) allocates to offsetting positions the full amount of the loss (but no more than the full amount of the loss). At the time a taxpayer adopts an allocation method under this rule, the taxpayer is expected to describe that method in its books and records.

Under the provision, unless the Secretary of the Treasury provides otherwise, similar rules apply for purposes of the identified straddle rules when there is a loss on a position in an identified straddle and an offsetting position in the identified straddle is or has been a liability or an obligation (including, for instance, a debt obligation issued by the taxpayer, a written option, or a notional principal contract entered into by the taxpayer). Under this rule, if a taxpayer, for example, receives $1 to enter into a five-year short forward contract and the next day $100 of loss is allocated to that position, the resulting basis of the contract is $99.

Under present law, a straddle is treated as an identified straddle only if, among other requirements, it is clearly identified on the taxpayer's records as an identified straddle before the earlier of (1) the close of the day on which the straddle is acquired, or (2) a time that the Secretary of the Treasury may prescribe by regulations. The provision clarifies that for purposes of this identification requirement, a straddle is clearly identified only if the identification includes an identification of the positions in the straddle that are offsetting with respect to other positions in the straddle. Consequently, taxpayers are required to identify not only the positions that make up an identified straddle but also which positions in that identified straddle are offsetting with respect to one another. The offsetting positions identification requirement added by the provision is effective for straddles acquired after the date of enactment.

The provision provides that regulations or other guidance prescribed by the Secretary for carrying out the purposes of the identified straddle rules may include the rules for the application of section 1092 to a position that is or has been a liability or an obligation. Regulations or other guidance also may include safe harbor basis allocation methods that satisfy the requirements that an allocation other than under section 1092(a)(2)(A)(ii) must be reasonable, consistent with the purposes of the identified straddle rules, and consistently applied by the taxpayer.

Amendments related to the Economic Growth Tax Relief Reconciliation Act of 2001

Application of special elective deferral limit to designated Roth contributions (Act sec. 617).—Code section 402(g)(7) provides a special rule allowing certain employees to make additional elective deferrals to a tax-sheltered annuity, subject to (1) an annual limit of $3,000, and (2) a cumulative limit of $15,000 minus the amount of additional elective deferrals made in previous years under the special rule. Present law provides a rule to coordinate the cumulative limit with the ability to make designated Roth contributions, but inadvertently reduces the $15,000 amount by all designated Roth contributions made in previous years. The provision clarifies that the $15,000 amount is reduced only by additional designated Roth contributions made under the special rule.

Application of FICA taxes to designated Roth contributions (Act sec. 617).—Under Code section 3121(v)(1)(A), elective deferrals are included in wages for purposes of social security and Medicare taxes. The provision clarifies that wage treatment applies also to elective deferrals that are designated as Roth contributions.

Amendments related to the Tax Relief Extension Act of 1999

Renewable electricity sold to utilities under certain contracts (Act sec. 507).—Code section 45(e)(7) provides that a wind energy facility placed in service by the taxpayer after June 30, 1999, does not qualify for the section 45 production tax credit if the electricity generated at the facility is sold to a utility pursuant to certain pre–1987 contracts. The provision clarifies that facilities placed in service prior to June 30, 1999, that sell electricity under applicable pre–1987 contracts are not denied the section 45 production tax credit solely by reason of a change in ownership after June 30, 1999.

Treatment of income and services provided by taxable REIT subsidiaries (Act sec. 542).—The provision clarifies that the transient basis language in the definition of a lodging facility applies only in determining whether an establishment other than a hotel or motel qualifies as a lodging facility.

Amendment related to the Internal Revenue Service Restructuring and Reform Act of 1998

Redactions for background documents related to Chief Counsel Advice documents (Act sec. 3509).—The Internal Revenue Service Restructuring and Reform Act of 1998 established a structured process by which the IRS makes certain work products, designated Chief Counsel advice ("CCA"), open to public inspection. To afford additional protection for certain governmental interests implicated by CCAs, section 6110(i)(3) governs redactions that may be made to CCAs, including the exemptions or exclusions available under the Freedom of Information Act, 5 U.S.C. § 552(b) and (c) (except that the provision for redaction under a Federal statute excludes Title 26), as well as the exemptions pertaining to taxpayer identity information described in section 6110(c)(1). Section 6110(i)(3) does not expressly address redactions to the "background file documents" related to a CCA. The provision clarifies that the CCA background file documents are governed by the same redactions as CCAs.

Clerical corrections

The Act includes a number of clerical and conforming amendments, including amendments correcting typographical errors.

PART EIGHT: TERM OF IRS COMMISSIONER (PUBLIC LAW 110–176)[86]

A. Clarify Term of IRS Commissioner (sec. 7803)

Present Law

Within the Treasury is a Commissioner of Internal Revenue, who is appointed by the President, with the advice and consent of the Senate. The Commissioner is appointed to a five-year term. An individual appointed to fill a vacancy in the position of Commissioner occurring before the expiration of the term for which such individual's predecessor was appointed shall be appointed only for the remainder of the predecessor's term.

Explanation of Provision

The Act clarifies that the term of the Commissioner of Internal Revenue is a five-year term, beginning with a term to commence on November 13, 1997. Each subsequent term shall begin on the day after the date on which the previous term expires. Thus, if the Commissioner whose term ended November 12, 2009, left office prior to such date, a successor could be appointed for the remainder of the term ending on such date. Moreover, the Commissioner's term is determined by reference to the five-year term beginning with the term commencing on November 13, 1997, even if the Commissioner is appointed after the term has started. Thus, the term of a Commissioner appointed on February 1, 2008, would run until November 12, 2012, five years after the term beginning November 13, 2007.

Effective Date

The provision is effective as if included in the amendment made by section 1102(a) of the Internal Revenue Service Restructuring and Reform Act of 1998.

[86] S. 2436. S. 2436 passed the Senate on December 19, 2007, by unanimous consent. The House passed the bill on December 19, 2007, without objection. The President signed the bill on January 4, 2008.

PART NINE: ECONOMIC STIMULUS ACT OF 2008 (PUBLIC LAW 110–185)[87]

A. Recovery Rebates for Individual Taxpayers (sec. 101 of the Act and sec. 6428 of the Code)

Present Law

In general

Under the Federal individual income tax system, an individual who is a citizen or a resident of the United States generally is subject to tax on worldwide taxable income. Taxable income is total gross income less certain exclusions, exemptions, and deductions. An individual may claim either a standard deduction or itemized deductions.

An individual's income tax liability is determined by computing his or her regular income tax liability and, if applicable, alternative minimum tax liability.

Income tax liability

Regular income tax liability is determined by applying the regular income tax rate schedules (or tax tables) to the individual's taxable income (sec. 1). This tax liability is then reduced by any applicable tax credits. The regular income tax rate schedules are divided into several ranges of income, known as income brackets, and the marginal tax rate increases as the individual's income increases. The income bracket amounts are adjusted annually for inflation. Separate rate schedules apply based on filing status: single individuals (other than heads of households and surviving spouses), heads of households, married individuals filing joint returns (including surviving spouses), married individuals filing separate returns, and estates and trusts. Lower rates may apply to capital gains.

A taxpayer may also be subject to an alternative minimum tax.

Child tax credit

An individual may claim a tax credit of $1,000 for each qualifying child under the age of 17 (sec. 24). Generally, a qualifying child must have the same principal place of abode as the taxpayer for more than one-half the taxable year and satisfy a relationship test. To satisfy the relationship test, the child must be the taxpayer's son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, or a descendant of any such individual. The

[87] H.R. 5140. H.R. 5140 passed the House on January 29, 2008. The Senate passed the bill on February 7, 2008 with an amendment. The House agreed to the Senate amendment on February 7, 2008. The President signed the bill on February 13, 2008. For a technical explanation of the bill prepared by the staff of the Joint Committee on Taxation, see *Technical Explanation of the Revenue Provisions of H.R. 5140, the "Economic Stimulus Act of 2008" as Passed By the House of Representatives and the Senate on February 7, 2008* JCX–16–08 (February 8, 2008).

credit is phased-out at higher-income levels. A child who is not a citizen, national, or resident of the United States may not be a qualifying child. No credit is allowed unless the individual includes the name and taxpayer identification number of each qualifying child on the income tax return.

Earned income credit

Low and moderate-income workers may be eligible for the refundable earned income credit (EIC). Eligibility for the EIC is based on earned income, adjusted gross income, investment income, filing status, and immigration and work status in the United States. The amount of the EIC is based on the presence and number of qualifying children in the worker's family, as well as on adjusted gross income and earned income. Earned income is defined as (1) wages, salaries, tips, and other employee compensation, but only if such amounts are includible in gross income, plus (2) the amount of the individual's net self-employment earnings.

Explanation of Provision

In general

The provision includes a recovery rebate credit for 2008 which is refundable. The credit mechanism (and the issuance of checks described below) is intended to deliver an expedited fiscal stimulus to the economy.

The credit is computed with two components in the following manner.

Basic credit

Eligible individuals receive a basic credit (for the first taxable year beginning) in 2008 equal to the greater of the following:

- Net income tax liability not to exceed $600 ($1,200 in the case of a joint return).
- $300 ($600 in the case of a joint return) if: (1) the eligible individual has qualifying income of at least $3,000; or (2) the eligible individual has a net income tax liability of at least $1 and gross income greater than the sum of the applicable basic standard deduction amount and one personal exemption (two personal exemptions for a joint return).

An eligible individual is any individual other than: (1) a nonresident alien; (2) an estate or trust; or (3) a dependent.

For these purposes, "net income tax liability" means the excess of the sum of the individual's regular tax liability and alternative minimum tax over the sum of all nonrefundable credits (other than the child credit). Net income tax liability as determined for these purposes is not reduced by the credit added by this provision or any credit which is refundable under present law.

Qualifying income is the sum of the eligible individual's: (a) earned income; (b) social security benefits (within the meaning of sec. 86(d)); and (c) veteran's payments (under Chapters 11, 13, or 15 of title 38 of the U. S. Code). The definition of earned income has the same meaning as used in the earned income credit except that it includes certain combat pay and does not include net earn-

ings from self-employment which are not taken into account in computing taxable income.

Qualifying child credit

If an individual is eligible for any amount of the basic credit the individual also may be eligible for a qualifying child credit. The qualifying child credit equals $300 for each qualifying child of such individual. For these purposes, the child credit definition of qualifying child applies.

Limitation based on adjusted gross income

The amount of the credit (i.e., the sum of the amounts of the basic credit and the qualifying child credit) is phased out at a rate of five percent of adjusted gross income above certain income levels. The beginning point of this phase-out range is $75,000 of adjusted gross income ($150,000 in the case of joint returns).

Valid identification numbers

No credit is allowed to an individual who does not include a valid identification number on the individual's income tax return. In the case of a joint return which does not include valid identification numbers for both spouses, no credit is allowed. In addition, a child shall not be taken into account in determining the amount of the credit if a valid identification number for the child is not included on the return. For this purpose, a valid identification number means a social security number issued to an individual by the Social Security Administration. A taxpayer identification number issued by the Internal Revenue Service is not a valid identification number for purposes of this credit (e.g., an ITIN).

If an individual fails to provide a valid identification number, the omission is treated as a mathematical or clerical error. As under present law, the Internal Revenue Service (the "IRS") may summarily assess additional tax due as a result of a mathematical or clerical error without sending the taxpayer a notice of deficiency and giving the taxpayer an opportunity to petition the Tax Court. Where the IRS uses the summary assessment procedure for mathematical or clerical errors, the taxpayer must be given an explanation of the asserted error and given 60 days to request that the IRS abate its assessment.

Rebate checks

Most taxpayers will receive this credit in the form of a check issued by the Department of the Treasury.[88] The amount of the payment will be computed in the same manner as the credit, except that it will be done on the basis of tax returns filed for 2007 (instead of 2008). It is anticipated that the Department of the Treasury will make every effort to issue all payments as rapidly as possible to taxpayers who timely file their 2007 tax returns. (Taxpayers who file late or pursuant to extensions will receive their payments later.)

[88] To the extent practicable, the Department of the Treasury is expected to utilize individuals' current direct deposit information in its possession to expedite delivery of these amounts rather than the mailing of rebate checks.

Taxpayers will reconcile the amount of the credit with the payment they receive in the following manner. They will complete a worksheet calculating the amount of the credit based on their 2008 income tax return. They will then subtract from the credit the amount of the payment they received in 2008. For many taxpayers, these two amounts will be the same. If, however, the result is a positive number (because, for example, the taxpayer paid no tax in 2007 but is paying tax in 2008), the taxpayer may claim that amount as a refundable credit against 2008 tax liability. If, however, the result is negative (because, for example, the taxpayer paid tax in 2007 but owes no tax for 2008), the taxpayer is not required to repay that amount to the Treasury. Otherwise, the checks have no effect on tax returns filed for 2008; the amount is not includible in gross income and it does not otherwise reduce the amount of withholding.

In no event may the Department of the Treasury issue checks after December 31, 2008. This is designed to prevent errors by taxpayers who might claim the full amount of the credit on their 2008 tax returns and file those returns early in 2009, at the same time the Treasury check might be mailed to them. Payment of the credit (or the check) is treated, for all purposes of the Code, as a payment of tax. Any resulting overpayment under this provision is subject to the refund offset provisions, such as those applicable to past-due child support under section 6402 of the Code.

Examples of rebate determination

The following examples show the rebate amounts as calculated from the taxpayer's 2007 tax return.

Example 1.—A single taxpayer has $14,000 in Social Security income, no qualifying children, and no net tax liability prior to the application of refundable credits and the child credit. The taxpayer will receive a rebate of $300 for meeting the qualifying income test.

Example 2.—A head of household taxpayer has $4,000 in earned income, one qualifying child, and no net tax liability prior to the application of refundable credits and the child credit. The taxpayer will receive a rebate of $600, comprising $300 for meeting the qualifying income test, and $300 per child.

Example 3.—A married taxpayer filing jointly has $4,000 in earned income, one qualifying child, and no net tax liability prior to the application of refundable credits and the child credit. The taxpayer will receive a rebate of $900, comprising $600 for meeting the qualifying income test, and $300 per child.

Example 4.—A married taxpayer filing jointly has $2,000 in earned income, one qualifying child, and $1,100 in net tax liability (resulting from other unearned income) prior to the application of refundable credits and the child credit (the taxpayer's actual liability after the child credit is $100). The qualifying income test is not met, but the taxpayer has net tax liability for purposes of determining the rebate of $1,100. The taxpayer will receive a rebate of $1,400, comprising $1,100 of net tax liability, and $300 per child.

Example 5.—A married taxpayer filing jointly has $40,000 in earned income, two qualifying children, and a net tax liability of $1,573 prior to the application of refundable credits and child credits (the taxpayer's actual tax liability after the child credit is

-$427). The taxpayer meets the qualifying income test and the net tax liability test. The taxpayer will receive a rebate of $1,800, comprising $1,200 (greater of $600 or net tax liability not to exceed $1,200), and $300 per child.

Example 6.—A married taxpayer filing jointly has $175,000 in earned income, two qualifying children, and a net tax liability of $31,189 (the taxpayer's actual liability after the child credit also is $31,189 as the joint income is too high to qualify). The taxpayer meets the qualifying income test and the net tax liability test. The taxpayer will, in the absence of the rebate phase-out provision, receive a rebate of $1,800, comprising $1,200 (greater of $600 or net tax liability not to exceed $1,200), and $300 per child. The phase-out provision reduces the total rebate amount by five percent of the amount by which the taxpayer's adjusted gross income exceeds $150,000. Five percent of $25,000 ($175,000 minus $150,000) equals $1,250. The taxpayer's rebate is thus $1,800 minus $1,250, or $550.

Treatment of the U.S. possessions

Mirror code possessions[89]

The U.S. Treasury will make a payment to each mirror code possession in an amount equal to the aggregate amount of the credits allowable by reason of the provision to that possession's residents against its income tax. This amount will be determined by the Treasury Secretary based on information provided by the government of the respective possession. For purposes of this payment, a possession is a mirror code possession if the income tax liability of residents of the possession under that possession's income tax system is determined by reference to the U.S. income tax laws as if the possession were the United States.

Non-mirror code possessions[90]

To each possession that does not have a mirror code tax system, the U.S. Treasury will make a payment in an amount estimated by the Secretary as being equal to the aggregate credits that would have been allowed to residents of that possession if a mirror code tax system had been in effect in that possession. Accordingly, the amount of each payment to a non-mirror Code possession will be an estimate of the aggregate amount of the credits that would be allowed to the possession's residents if the credit provided by the provision to U.S. residents were provided by the possession to its residents. This payment will not be made to any U.S. possession unless that possession has a plan that has been approved by the Secretary under which the possession will promptly distribute the payment to its residents.

General rules

No credit against U.S. income taxes is permitted under the provision for any person to whom a credit is allowed against possession income taxes as a result of the provision (for example, under that

[89] Possessions with mirror code tax systems are the United States Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands.

[90] Possessions that do not have mirror code tax systems are Puerto Rico and American Samoa.

possession's mirror income tax). Similarly, no credit against U.S. income taxes is permitted for any person who is eligible for a payment under a non-mirror code possession's plan for distributing to its residents the payment described above from the U.S. Treasury.

For purposes of the rebate credit payment, the Commonwealth of Puerto Rico and the Commonwealth of the Northern Mariana Islands are considered possessions of the United States.

For purposes of the rule permitting the Treasury Secretary to disburse appropriated amounts for refunds due from certain credit provisions of the Internal Revenue Code of 1986, the payments required to be made to possessions under the provision are treated in the same manner as a refund due from the recovery rebate credit.

Federal programs or Federally-assisted programs

Any credit or refund allowed or made to an individual under this provision (including to any resident of a U.S. possessions) is not taken into account as income and shall not be taken into account as resources for the month of receipt and the following two months for purposes of determining eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any Federal program or under any State or local program financed in whole or in part with Federal funds.

Effective Date

The provision applies to taxable years beginning after December 31, 2007.

B. Temporary Increase in Limitations on Expensing of Certain Depreciable Business Assets (sec. 102 of the Act and sec. 179 of the Code)

Present Law

A taxpayer that satisfies limitations on annual investment may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions.[91] For taxable years beginning in 2008, the maximum amount that a taxpayer may expense is $128,000 of the cost of qualifying property placed in service for the taxable year. The $128,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $510,000.[92] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf

[91] Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)).

[92] Amounts applicable for 2008 are set forth in Rev. Proc. 2007–66, 2007–45 I.R.B. 970. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2007 through 2010, is $125,000 of the cost of qualifying property placed in service for the taxable year. The $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000. The $125,000 and $500,000 amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.

computer software placed in service in taxable years beginning before 2011 is treated as qualifying property.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[93] For taxable years beginning in 2011 and thereafter, other rules apply.[94]

Explanation of Provision

The provision increases the $128,000 and $510,000 amounts under section 179 for taxable years beginning in 2008 to $250,000 and $800,000, respectively. The $250,000 and $800,000 amounts are not indexed for inflation.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

C. Special Depreciation Allowance for Certain Property (sec. 103 of the Act and sec. 168(k) of the Code)

Present Law

A taxpayer is allowed to recover through annual depreciation deductions the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS"). Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property range from three to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150–percent declining balance methods, switching to the straight-line method for the taxable year in which the taxpayer's depreciation deduction would be maximized.

Section 280F limits the annual depreciation deductions with respect to certain passenger automobiles to specified dollar amounts, indexed for inflation.

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[93] Sec. 179(c)(1).

[94] Under the rules in effect for taxable years beginning in 2011 and thereafter, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner (sec. 179(c)(2)).

Section 167(f)(1) provides that capitalized computer software costs, other than computer software to which section 197 applies, are recovered ratably over 36 months.

A taxpayer that satisfies limitations on annual investment may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions.[95] For taxable years beginning in 2008, the maximum amount that a taxpayer may expense is $128,000 of the cost of qualifying property placed in service for the taxable year. The $128,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $510,000.[96] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2011 is treated as qualifying property. For taxable years beginning in 2011 and thereafter, other rules apply.[97]

Explanation of Provision[98]

The provision allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified property.[99] The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.[100] The basis of the property and the depreciation allowances in the year the property is placed in service and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there are no adjustments to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. The amount of the additional first-year depreciation deduction is not affected by a short taxable year. The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.

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[95] Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)).

[96] Amounts applicable for 2008 are set forth in Rev. Proc. 2007–66, 2007–45 I.R.B. 970. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2007 through 2010, is $125,000 of the cost of qualifying property placed in service for the taxable year. The $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000. The $125,000 and $500,000 amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.

[97] Under the rules in effect for taxable years beginning in 2011 and thereafter, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner (sec. 179(c)(2)).

[98] The provision was subsequently modified to provide an election to accelerate AMT and research credits in lieu of bonus depreciation. See Part Thirteen, Title III, A.1.

[99] The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or instead is subject to capitalization under section 263 or section 263A.

[100] However, the additional first-year depreciation deduction is not allowed for purposes of computing earnings and profits.

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2008, a taxpayer purchases new depreciable property and places it in service.[101] The property's cost is $1,000, and it is five-year property subject to the half-year convention. The amount of additional first-year depreciation allowed under the provision is $500. The remaining $500 of the cost of the property is deductible under the rules applicable to five-year property. Thus, 20 percent, or $100, is also allowed as a depreciation deduction in 2008. The total depreciation deduction with respect to the property for 2008 is $600. The remaining $400 cost of the property is recovered under otherwise applicable rules for computing depreciation.

In order for property to qualify for the additional first-year depreciation deduction it must meet all of the following requirements. First, the property must be (1) property to which MACRS applies with an applicable recovery period of 20 years or less, (2) water utility property (as defined in section 168(e)(5)), (3) computer software other than computer software covered by section 197, or (4) qualified leasehold improvement property (as defined in section 168(k)(3)).[102] Second, the original use[103] of the property must commence with the taxpayer after December 31, 2007.[104] Third, the taxpayer must purchase the property within the applicable time period. Finally, the property must be placed in service after December 31, 2007, and before January 1, 2009. An extension of the placed in service date of one year (i.e., to January 1, 2010) is provided for certain property with a recovery period of 10 years or longer and certain transportation property.[105] Transportation property is defined as tangible personal property used in the trade or business of transporting persons or property. Special rules, including an extension of the placed-in-service date of one year (i.e., to January 1, 2010), also apply to certain aircraft.

The applicable time period for acquired property is (1) after December 31, 2007, and before January 1, 2009, but only if no binding written contract for the acquisition is in effect before January 1, 2008, or (2) pursuant to a binding written contract which was en-

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[101] Assume that the cost of the property is not eligible for expensing under section 179.

[102] A special rule precludes the additional first-year depreciation deduction for any property that is required to be depreciated under the alternative depreciation system of MACRS.

[103] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer.

If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (i.e., each fractional owner is considered the original user of its proportionate share of the property).

[104] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback.

If property is originally placed in service by a lessor (including by operation of section 168(k)(2)(D)(i)), such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale.

[105] In order for property to qualify for the extended placed in service date, the property is required to have an estimated production period exceeding one year and a cost exceeding $1 million.

tered into after December 31, 2007, and before January 1, 2009.[106] With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property after December 31, 2007, and before January 1, 2009. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer. For property eligible for the extended placed in service date, a special rule limits the amount of costs eligible for the additional first year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2009 ("progress expenditures") is eligible for the additional first-year depreciation.[107]

Property does not qualify for the additional first-year depreciation deduction when the user of such property (or a related party) would not have been eligible for the additional first-year depreciation deduction if the user (or a related party) were treated as the owner. For example, if a taxpayer sells to a related party property that was under construction prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. Similarly, if a taxpayer sells to a related party property that was subject to a binding written contract prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. As a further example, if a taxpayer (the lessee) sells property in a sale-leaseback arrangement, and the property otherwise would not have qualified for the additional first-year depreciation deduction if it were owned by the taxpayer-lessee, then the lessor is not entitled to the additional first-year depreciation deduction.

The limitation on the amount of depreciation deductions allowed with respect to certain passenger automobiles (sec. 280F) is increased in the first year by $8,000 for automobiles that qualify (and do not elect out of the increased first year deduction). The $8,000 increase is not indexed for inflation.

Effective Date

The provision is effective for property placed in service after December 31, 2007.

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[106] Property does not fail to qualify for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to January 1, 2008.

[107] For purposes of determining the amount of eligible progress expenditures, it is intended that rules similar to sec. 46(d)(3) as in effect prior to the Tax Reform Act of 1986 shall apply.

PART TEN: GENETIC INFORMATION NONDISCRIMINATION ACT OF 2008 (PUBLIC LAW 110–233)[108]

A. Prohibition of Discrimination Based on Genetic Testing (sec. 103 of the Act and sec. 9802 and 9832 of the Code)

Present Law

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") imposes a number of requirements with respect to group health coverage that are designed to provide protections to health plan participants. HIPAA includes similar provisions in the Code, ERISA, and the Public Health Service Act ("PHSA").

Under present law, HIPAA provides certain protections against genetic discrimination. Among other things, HIPAA provides that a group health plan may not establish rules for eligibility of any individual to enroll under the plan based on genetic information.[109] Under final regulations issued by the Department of Treasury pursuant to HIPAA, any restriction on benefits provided under a group health plan must apply uniformly to all similarly situated individuals and must not be directed at individual participants or beneficiaries based on genetic information of the participants or beneficiaries.[110] A group health plan also may not require an individual to pay a premium or contribution which is greater than such premium or contribution for a similarly situated individual enrolled in the plan on the basis of genetic information of the individual or of a dependent enrolled under the plan.[111]

In addition, HIPAA generally provides that a pre-existing condition exclusion may be imposed with respect to a participant or beneficiary only if: (1) the exclusion relates to a condition (whether physical or mental), regardless of the cause of the condition, for which medical advice, diagnosis, care, or treatment was recommended or received within the 6–month period ending on the enrollment date; (2) the exclusion extends for a period of not more than 12 months after the enrollment date; and (3) the period of any pre-existing condition exclusion is reduced by the length of the aggregate of the periods of creditable coverage (if any) applicable to the participant as of the enrollment date. Pre-existing condition exclusions based on genetic information cannot be applied absent a diagnosis of the condition related to the information.[112]

Under final regulations issued by the Department of Treasury, genetic information is defined as information about genes, gene

[108] H.R. 493. The House Committee on Ways and Means reported H.R. 493 on March 26, 2007 (H.R. Rep. 110–28, Part II). The bill passed the House on April 25, 2007. The Senate passed the bill on April 24, 2008, with an amendment. The House agreed to the Senate amendment on May 1, 2008. The President signed the bill on May 21, 2008.

[109] Code sec. 9802(a).

[110] Treas. Reg. sec. 54.9802–1(b)(2)(i)(B).

[111] Code sec. 9802(b).

[112] Code sec. 9801(b)(1)(B).

products, and inherited characteristics that may derive from the individual or a family member. This includes information regarding carrier status and information derived from laboratory tests that identify mutations in specific genes or chromosomes, physical medical examinations, family histories, and direct analysis of genes or chromosomes.[113]

The requirements do not apply to any governmental plan or any group health plan that has less than two participants who are current employees. A group health plan is defined as a plan (including a self-insured plan) of, or contributed to by, an employer (including a self-employed person) or employee organization to provide health care (directly or otherwise) to the employees, former employees, the employer, others associated or formerly associated with the employer in a business relationship, or their families.

The Code imposes an excise tax on group health plans which fail to meet these requirements.[114] The excise tax is equal to $100 per day during the period of noncompliance and is generally imposed on the employer sponsoring the plan if the plan fails to meet the requirements. The maximum tax that can be imposed during a taxable year cannot exceed the lesser of: (1) 10 percent of the employer's group health plan expenses for the prior year; or (2) $500,000. No tax is imposed if the Secretary of the Treasury determines that the employer did not know, and in exercising reasonable diligence would not have known, that the failure existed.

Reasons for Change

The advances in genetics open up many opportunities for medical progress with respect to the prevention, detection, and treatment of disease. However, this information also presents the possibility for misuse. The Congress is aware of examples of genetic discrimination in the workforce and with respect to insurance. In some cases, genetic conditions and disorders are associated with particular racial and ethnic groups and gender. Because some genetic traits are most prevalent in particular groups, members of a particular group may be stigmatized or discriminated against as a result of genetic information. The Congress is concerned that the possibility of discrimination on the basis of genetic information may prohibit individuals from taking full advantage of the information that may be available. Thus, some individuals may not be receiving the best possible medical care. The Act therefore adopts a uniform, national standard that prohibits discrimination based on genetic information. The Act assures that the full array of enforcement mechanisms applicable to group health plans under the Code is available with respect to the prohibition on genetic discrimination under this provision.

Explanation of Provision

The provision modifies the group health plan requirements under the Code.

Under the provision, a group health plan may not adjust premium or contribution amounts for the group covered under such

[113] Treas. Reg. sec. 54.9801–2.
[114] Code sec. 4980D.

plan on the basis of genetic information. In the case of family members who are covered under the same group health plan, the group health plan is permitted to adjust premium or contribution amounts for the group on the basis of the occurrence of diseases or disorders in family members in the group, provided that such information is taken into account only with respect to the individual in which the disease or disorder occurs and not as genetic information with respect to family members in which the disease or disorder has not occurred.

The provision also requires that a group health plan may not request or require an individual or family member of such individual to undergo a genetic test. The provision does not limit the authority of a health care professional who is providing health care services to an individual to request that such individual undergo a genetic test. The provision also does not limit the authority of a group health plan to provide information generally about the availability of genetic tests, for example, in the case of a summary plan description, or to provide information about genetic tests to a health care professional with respect to the treatment of an individual to whom such professional is providing health care services, for example, during a quality assurance review.

The provision contains two rules with respect to a group health plan's collection of genetic information. First, a group health plan is prohibited from requesting, requiring, or purchasing genetic information for purposes of underwriting. Second, a group health plan is prohibited from requesting, requiring, or purchasing genetic information with respect to any individual prior to such individual's enrollment under the plan or in connection with such enrollment. The second prohibition is not violated where the collection of genetic information is incidental to the requesting, requiring, or purchasing of other information concerning the individual provided that such request, requirement or purchase is not for purposes of underwriting.

The term underwriting, with respect to any group health plan, means: (1) Rules for determining eligibility for, or determination of, benefits under the plan; (2) the computation of premium or contribution amounts under the plan; (3) the application of any preexisting condition exclusion under the plan; and (4) other activities related to the creation, renewal, or replacement of a contract of health insurance or health benefits.

Under the provision, the current law requirement that a group health plan may not establish rules for eligibility based on genetic information is extended to governmental plans and group health plans with less than two participants who are current employees. The provisions requiring (1) that group premiums or contribution amounts may not be adjusted on the basis of genetic information of an individual in the group, (2) that a group health plan may not request or require an individual or family member of such individual undergo a genetic test, and (3) that group health plans not collect genetic information for purposes of underwriting or in connection with enrollment also apply to all group health plans.

Genetic information means, with respect to any individual, information about: (1) such individual's genetic tests; (2) the genetic tests of family members of such individual; and (3) the occurrence

of a disease or disorder in family members of such individual. The term genetic information also includes, with respect to any individual, any request for genetic services, receipt of genetic services, or participation in any clinical research, or any other program, which includes genetic services, by such individual or any family member of such individual. The term genetic information does not include the occurrence of a disease or disorder in family members of an individual to the extent that such information is taken into account only with respect to the individual in which such disease or disorder occurs and not as genetic information with respect to any other individual.

A genetic test is defined as an analysis of human DNA, RNA, chromosomes, proteins, or metabolites, that detects genotypes, mutations, or chromosomal changes. The term genetic test does not include (1) an analysis of proteins or metabolites that does not detect genotypes, mutations, or chromosomal changes, or (2) an analysis of proteins or metabolites that is directly related to a manifested disease, disorder, or pathological condition that could reasonably be detected by a health care professional with appropriate training and expertise in the field of medicine involved.

Genetic services are defined as a genetic test, genetic counseling (such as obtaining, interpreting, or assessing genetic information), and genetic education.

A family member means, with respect to an individual: (1) A dependent (as such term is used for purposes of section 9801(f)(2)) of such individual, and (2) any other individual who is a first-degree, 2nd degree, 3rd degree, or 4th degree relative of such individual or such individual's dependent. In general, it is intended that the term "family member" be interpreted broadly so as to provide the maximum protection against discrimination.

Under the provision, the Secretary of the Treasury is directed to issue regulations or other guidance to carry out the provision no later than one year after date of enactment. The Secretary of the Treasury is to coordinate administration and enforcement with the Secretary of Health and Human Services and the Secretary of Labor so that provisions over which two or more such Secretaries have jurisdiction are administered in the same manner and so as to avoid duplication of enforcement efforts.

Effective Date

The provision is effective with respect to group health plans for plan years beginning after the date that is one year after the date of enactment (i.e., plan years beginning after May 21, 2009).

PART ELEVEN: FOOD, CONSERVATION, AND ENERGY ACT OF 2008 (PUBLIC LAWS 110–234 AND 110–246)[115]

TITLE I—REVENUE PROVISIONS FOR AGRICULTURE PROGRAMS

A. Extension of Custom User Fees (sec. 15201 of the Act)

Present Law

Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c) ("COBRA") authorizes the Secretary of the Treasury to collect certain customs services fees. Section 412 of the Homeland Security Act of 2002 authorizes the Secretary of the Treasury to delegate such authority to the Secretary of Homeland Security. Customs user fees include passenger and conveyance processing fees (e.g., fees for processing air and sea passengers, commercial trucks, rail cars, private aircraft and vessels, commercial vessels, dutiable mail packages, barges and bulk carriers, cargo, and Customs broker permits) and merchandise processing fees. Congress has authorized collection of the passenger and conveyance processing fees through December 27, 2014. The current authorization for the collection of the merchandise processing fees is through December 27, 2014.

Explanation of Provision[116]

The Act amends Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 to extend the passenger and conveyance processing fees through September 30, 2017, and extend the merchandise processing fees through November 14, 2017. The conference agreement would require remittance, by no later than September 25, 2017, of passenger and conveyance fees for the period July 1, 2017 through September 20, 2017. It would also require an estimated prepayment of the merchandise processing fees no later than September 25, 2017 for merchandise entered on or after October 1, 2017 and before November 15, 2017. The estimated prepayment will be based on the amount paid in the equivalent period of the previous year, as determined by the Secretary of the

[115] H.R. 2419. H.R. 2419 passed the House on July 27, 2007. The Senate Committee on Finance reported S. 2242 on October 25, 2007 (S. Rep. 110–206). The Senate passed H.R. 2419 on December 14, 2007, with an amendment. The conference report was filed on May 13, 2008 (H.R. 110–627), was passed by the House on May 14, 2008, and passed by the Senate on May 15, 2008. The bill was vetoed by the President on May 21, 2008. The veto was overridden by the House on May 21, 2008, and by the Senate on May 22, 2008.

To correct an enrolling error in H.R. 2419, Pub. L. No. 110–246 (which contains the identical revenue provisions) was enacted on June 18, 2008. Section 4 of Pub. L. No. 110–246 provides that the amendments made by P.L. 110–234 are repealed and that the amendments made by Pub. L. No. 110–246 generally take effect on the date of enactment of the earlier of the two bills to be enacted (May 22, 2008).

[116] All the public laws enacted in the 110th Congress affecting this provision are described in Part Twenty-Two.

Treasury. The Act also holds service users harmless for overpayments or underpayments of merchandise processing fees by requiring the Secretary of Treasury to reconcile the fees paid with the actual fees incurred for services rendered. The Secretary of Treasury must then refund any overpayments with interest, and make adjustments for any underpayments of such merchandise processing fees.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

B. Modifications to Corporate Estimated Tax Payments (sec. 15202 of the Act)

Present Law

In general

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

Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA")

TIPRA provided the following special rules:

In case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, shall be increased to 106.25 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

In case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2013, shall be increased to 100.75 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Subsequent legislation

Several public laws have been enacted since TIPRA which further increase the percentage of payments due under each of the two special rules enacted by TIPRA described above.

Reasons for Change

The Congress believes it is appropriate to adjust the corporate estimated tax payments.

Explanation of Provision [117]

The provision makes a modification to the corporate estimated tax payment rules.

In case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, are increased by

[117] All the public laws enacted in the 110th Congress affecting this provision are described in Part Twenty-Two.

7¾ percentage points of the payment otherwise due and the next required payment shall be reduced accordingly.

Effective Date

The provision is effective on the date of enactment.

TITLE II—TAX PROVISIONS

A. Conservation Provisions

1. Exclusion of Conservation Reserve Program Payments from SECA tax for individuals receiving Social Security retirement or disability payments (sec. 15301 of the Act and sec. 1402(a) of the Code)

Present Law

Generally, the Self-Employment Contributions Act ("SECA") tax is imposed on an individual's net earnings from self-employment income within the Social Security wage base. Net earnings from self-employment generally mean gross income (including the individual's net distributive share of partnership income) derived by an individual from any trade or business carried on by the individual less applicable deductions.[118]

Reasons for Change

The Congress believes that the correct measurement of income for SECA purposes in the cases of retired or disabled individuals does not include conservation reserve program payments.

Explanation of Provision

The provision excludes conservation reserve program payments from self-employment income for purposes of the SECA tax in the case of individuals who are receiving Social Security retirement or disability benefits. The treatment of conservation reserve program payments received by other taxpayers is not changed.

Effective Date

The provision is effective for payments made after December 31, 2007.

2. Extend the special rule encouraging contributions of capital gain real property for conservation purposes (sec. 15302 of the Act and sec. 170 of the Code)

Present Law

Charitable contributions generally

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contrib-

[118] Sec. 1402.

uted property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.[119]

In general, in any taxable year, charitable contributions by a corporation are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating or capital loss carrybacks. For individuals, the amount deductible is a percentage of the taxpayer's contribution base, (i.e., taxpayer's adjusted gross income computed without regard to any net operating loss carryback). The applicable percentage of the contribution base varies depending on the type of donee organization and property contributed. Cash contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations may not exceed 50 percent of the taxpayer's contribution base. Cash contributions to private foundations and certain other organizations generally may be deducted up to 30 percent of the taxpayer's contribution base.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity while also either retaining an interest in that property or transferring an interest in that property to a noncharity for less than full and adequate consideration. Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property, and qualified conservation contributions.

Capital gain property

Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property to a qualified charity are deductible at fair market value within certain limitations. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of capital gain property for a taxable year within the 50–percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(B) (e.g., private non-operating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

For purposes of determining whether a taxpayer's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions. Contribu-

[119] Secs. 170, 2055, and 2522, respectively.

tions of capital gain property that exceed the percentage limitation may be carried forward for five years.

Qualified conservation contributions

Qualified conservation contributions are not subject to the "partial interest" rule, which generally bars deductions for charitable contributions of partial interests in property. A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) The entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property. Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) The preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

Qualified conservation contributions of capital gain property are subject to the same limitations and carryover rules of other charitable contributions of capital gain property.

Special rule regarding contributions of capital gain real property for conservation purposes

In general

Under a temporary provision that is effective for contributions made in taxable years beginning after December 31, 2005,[120] the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined under present law). Instead, individuals may deduct the fair market value of any qualified conservation contribution to an organization described in section 170(b)(1)(A) to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions.

Individuals are allowed to carry over any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years.

For example, assume an individual with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions subject to the 50-percent limitation of $60. The individual is allowed a deduction of $50 in the current taxable year for the non-conservation contributions (50 percent of the $100 contribution

[120] Sec. 170(b)(1)(E).

base) and is allowed to carry over the excess $10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire $80 qualified conservation contribution may be carried forward for up to 15 years.

Farmers and ranchers

In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

In the above example, if the individual is a qualified farmer or rancher, in addition to the $50 deduction for non-conservation contributions, an additional $50 for the qualified conservation contribution is allowed and $30 may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[121]

As an additional condition of eligibility for the 100 percent limitation, with respect to any contribution of property in agriculture or livestock production, or that is available for such production, by a qualified farmer or rancher, the qualified real property interest must include a restriction that the property remain generally available for such production. (There is no requirement as to any specific use in agriculture or farming, or necessarily that the property be used for such purposes, merely that the property remain available for such purposes.) Such additional condition does not apply to contributions made on or before August 17, 2006.

A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

Termination

The special rule regarding contributions of capital gain real property for conservation purposes does not apply to contributions made in taxable years beginning after December 31, 2007.

Reasons for Change

Gifts of conservation easements to organizations that are dedicated to maintaining natural habitats, open spaces, or traditional agriculture help protect our nation's heritage. The charitable tax deduction for such conservation easements has proven to be a valuable incentive for making such gifts. The Congress believes that the special rule that provides an increased incentive to make charitable contributions of partial interests in real property for con-

[121] Sec. 170(b)(2)(B).

servation purposes is an important way of encouraging conservation and preservation.

Explanation of Provision

The Act extends the special rule regarding contributions of capital gain real property for conservation purposes for two years for contributions made in taxable years beginning on or before December 31, 2009.

Effective Date

The provision is effective for contributions made in taxable years beginning after December 31, 2007.

3. Deduction for endangered species recovery expenditures (sec. 15303 of the Act and sec. 175 of the Code)

Present Law

Under present law, a taxpayer engaged in the business of farming may treat expenditures that are paid or incurred by him during the taxable year for the purpose of soil or water conservation in respect of land used in farming, or for the prevention of erosion of land used in farming, as expenses that are not chargeable to capital account. Such expenditures are allowed as a deduction, not to exceed 25 percent of the gross income derived from farming during the taxable year.[122] Any excess above such percentage is deductible for succeeding taxable years, not to exceed 25 percent of the gross income derived from farming during such succeeding taxable year.

Reasons for Change

The goal of the Endangered Species Act of 1973 is to recover listed species and the ecosystems on which they depend to levels where protection under such Act is no longer necessary. Recovery is the process by which the decline of an endangered species is arrested or reversed, and threats removed or reduced so that the species' long-term survival in the wild can be ensured. Section 4(f)(1) of such Act directs the appropriate Secretary to develop and implement recovery plans for the conservation and survival of endangered and threatened species, unless the appropriate Secretary finds that such a plan will not promote the conservation of the species. To the maximum extent practicable, the recovery plan must incorporate a description of management actions to achieve the plan's goals, objective and measurable criteria for determining the removal of species from the endangered species list, and estimate the time required and cost to carry out the recovery plan. The appropriate Secretary may procure the services of appropriate private and public agencies in developing and implementing a recovery plan.

According to an April 6, 2006, General Accountability Office report entitled *"Endangered Species: Time and Costs to Recover Species Are Largely Unknown"*, as of January 2006, the Fish and Wildlife Service and the National Marine Fisheries Service had final-

[122] Sec. 175.

ized and approved 558 recovery plans covering 1,049 species, or about 82 percent of the 1,272 endangered or threatened species protected in the United States at that time. Recovery plans contain management measures that landowners can adopt on their land that will aid in the recovery of endangered or threatened species, resulting in a public benefit. Such are similar to measures undertaken for soil and water conservation, which are entitled to a tax deduction. The Congress believes that certain expenses of farmers made pursuant to a recovery plan under the Endangered Species Act should be treated similarly to expenditures by farmers made for soil and water conservation.

Explanation of Provision

The Act provides that expenditures paid or incurred by a taxpayer engaged in the business of farming for the purpose of achieving site-specific management actions pursuant to the Endangered Species Act of 1973 [123] are to be treated the same as expenditures for the purpose of soil or water conservation in respect of land used in farming, or for the prevention of erosion of land used in farming, i.e., such expenditures are treated as not chargeable to capital account and are deductible subject to the limitation that the deduction may not exceed 25 percent of the farmer's gross income derived from farming during the taxable year.

Effective Date

The provision is effective for expenditures paid or incurred after December 31, 2008.

4. Temporary reduction in corporate tax rate for qualified timber gain; timber REIT provisions (secs. 15311–15315 of the Act and secs. 856, 857, and 1201 of the Code)

Present Law

Treatment of certain timber gain

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

Under present law, for taxable years beginning before January 1, 2011, the maximum rate of tax on long term capital gain ("net cap-

[123] 16 U.S.C. 1533(f)(B).

ital gain")[124] of an individual, estate, or trust is 15 percent. Any net capital gain that otherwise would be taxed at a 10- or 15-percent rate is taxed at a zero-percent rate. These rates apply for purposes of both the regular tax and the alternative minimum tax.[125]

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

The net capital gain of a corporation is taxed at the same rates as ordinary income, up to a maximum rate of 35 percent.[126]

Real estate investment trusts ("REITs") are subject to a special taxation regime. Under this regime, a REIT is allowed a deduction for dividends paid to its shareholders.[127] As a result, REITs generally do not pay tax on distributed income, but the income is taxed to the REIT shareholders. A REIT that has long-term capital gain can declare a dividend that shareholders are entitled to treat as long-term capital gain.

REITs generally are required to distribute 90 percent of their taxable income (other than net capital gain). A REIT generally must pay tax at regular corporate rates on any undistributed income. However, a REIT that has net capital gain can retain that gain without distributing it, and the shareholders can report the net capital gain as if it were distributed to them. In that case the REIT pays a C corporation tax on the retained gain, but the shareholders who report the income are entitled to a credit or refund for the difference between the tax that would be due if the income had been distributed and the 35-percent rate paid by the REIT.[128] In effect, net capital gain of a REIT (including but not limited to timber gain) can be taxed as net capital gain of the shareholders, whether or not the gain is distributed.

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[124] Net capital gain is defined as the excess of net long-term capital gain over net short-term capital loss for the taxable year. Sec. 1222(11).

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

[126] Secs. 11 and 1201.

[127] A distribution to a corporate shareholder out of current or accumulated earnings and profits of the corporation is a dividend, unless the distribution is a redemption that terminates the shareholder's stock interest or reduces the shareholder's interest in the distributing corporation to an extent considered to result in treatment as a sale or exchange of the shareholder's stock. Secs. 301 and 302. A distribution in excess of corporate earnings and profits is treated by shareholders as first a recovery of their stock basis and then, to the extent the distribution exceeds a shareholder's stock basis, as a sale or exchange of the stock. Sec. 301. These rules generally apply to REITs.

[128] Sec. 857(b)(3)(D). The shareholders also obtain a basis increase in their REIT stock for the gross amount of the deemed distribution that is included in their income less the amount of corporate tax deemed paid by them that was paid by the REIT on the retained gain. Sec. 857(b)(3)(D)(iii).

Other REIT provisions

A REIT is also subject to a four-percent excise tax to the extent it does not distribute specified percentages of its income within any calendar year. The required distributed percentage is 85 percent in the case of the REIT ordinary income, and 95 percent in the case of the REIT capital gain net income (as defined).[129] The amount of the excess of the required distribution over the actual distribution is subject to the 4-percent tax.

A REIT generally is restricted to earning certain types of passive income. Among other requirements, at least 75 percent of the gross income of a REIT in a taxable year must consist of certain types of real estate related income, including rents from real property, income from the sale or exchange of real property (including interests in real property) that is not stock in trade, inventory, or held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, and interest on mortgages secured by real property or interests in real property.[130] Interests in real property are specifically defined to exclude mineral, oil, or gas royalty interests.[131] A REIT will not qualify as a REIT, and will be taxable as a C corporation, for any taxable year if it does not meet this income test.

Some REITs have been formed to hold land on which trees are grown. Upon maturity of the trees, the standing trees are sold by the REIT. The Internal Revenue Service has issued private letter rulings in particular instances stating that the income from the sale of the trees under section 631(b) can qualify as REIT real property income because the uncut timber and the timberland on which the timber grew is considered real property and the sale of uncut trees can qualify as capital gain derived from the sale of real property.[132]

A REIT is subject to a 100-percent excise tax on gain from any sale that is a "prohibited transaction," defined as a sale of property that is stock in trade, inventory, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.[133] This determination is based on facts and circumstances. However, a safe-harbor provides that no excise tax is imposed if certain requirements are met. In the case of timber property, the safe harbor is met, regardless of the number of sales that occur during the taxable year, if (i) the REIT has held the property for not less than four years in connection with the trade or business of producing timber; (ii) the aggregate adjusted bases of the property sold (other than foreclosure property) during the taxable year does not exceed 10 percent of the aggregate bases of all the assets of the REIT as of the beginning of the taxable year, and if certain other requirements are met. These include require-

[129] Section 4981. The definition is the excess of gains from sales or exchanges of capital assets over losses from such sales or exchanges for the calendar year, reduced by any net ordinary loss.

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

[131] Section 856(c)(5)(C).

[132] Timber income under section 631(b) has also been held to be qualified real estate income even if the one year holding period is not met. See, e.g., PLR 200052021, see also PLR 199945055, PLR 199927021, PLR 8838016. A private letter ruling may be relied upon only by the taxpayer to which the ruling is issued. However, such rulings provide an indication of administrative practice.

[133] Sections 857(b)(6) and 1221(a)(1). There is an exception for certain foreclosure property.

ments that limit the amount of expenditures the REIT can make during the 4-year period prior to the sale that are includible in the adjusted basis of the property,[134] that require marketing to be done by an independent contractor, and that forbid a sales price that is based on the income or profits of any person.[135] There is a similar but separate safe harbor for sales of non-timber property, with similar rules, including a 4-year holding period requirement and a limit on the percentage of the aggregate adjusted basis of property that can be sold in one taxable year.[136]

A REIT is not generally permitted to hold securities representing more than 10 percent of the voting power or value of the securities of any one issuer; nor may more than 5 percent of the fair market value of REIT assets be securities of any one issuer.[137] However, under an exception, a REIT may hold any amount of securities of one or more "taxable REIT subsidiary" (TRS) corporations, provided that such TRS securities do not represent more than 20 percent of the fair market value of REIT assets at the end of any quarter. A TRS is a C corporation that is subject to regular corporate tax on its income and that meets certain other requirements. A taxable REIT subsidiary may conduct activities that would produce disqualified non-passive or non-real estate income that could disqualify the REIT if conducted by a REIT itself. Such business could include business relating to processing timber, or holding timber products or other assets for sale to customers in the ordinary course of business. Such income would be subject to regular corporate rates of tax as income of the TRS.[138]

Reasons for Change

The Congress believes it is desirable to provide greater equivalence to the capital gain tax treatment of timber gain, regardless of whether the gain is recognized by a C corporation or a REIT. The Congress also believes it is desirable to provide changes to the statutory rules governing REITs, in order to clarify and facilitate timber REIT operations.

Explanation of Provision

Corporate rate reduction for qualified timber gain

The Act provides a 15-percent alternative tax rate for corporations on the portion of a corporation's taxable income that consists of qualified timber gain (or, if less, the net capital gain) for a taxable year.

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[134] Aggregate expenditures (other than timberland acquisition expenditures) during such period made by the REIT or a partner of the REIT, which are includible in basis, may not exceed 30 percent of the net selling price in the case of expenditures that are directly related to operation of the property for the production of timber or the preservation of the property for use as timberland, and may not exceed 5 percent of the net selling price in the case of expenditures that are not directly related to those purposes.

[135] Section 857(b)(6)(D).

[136] Section 857(b)(6)(C).

[137] Section 856(c)(4)(B)(ii) and (iii). Certain interests are not treated as "securities" for purposes of the rule forbidding the REIT to hold securities representing more than 10 percent of the value of securities of any one issuer. Sec. 856(m).

[138] A 100-percent excise tax is imposed on the amount of certain transactions involving a TRS and a REIT, to the extent such amount would exceed an arm's length amount under section 482. Sec. 857(b)(7).

The alternative 15-percent tax rate applies to both the regular tax and the alternative minimum tax.

Qualified timber gain means the net gain described in section 631(a) and (b) for the taxable year, determined by taking into account only trees held more than 15 years.

Additional REIT provisions

Timber gain qualified REIT income without regard to 1 year holding period

The Act specifically includes timber gain under section 631(a) as a category of statutorily recognized qualified real estate income of a REIT if the cutting is provided by a taxable REIT subsidiary, and also includes gain recognized under section 631(b). For purposes of such qualified income treatment under those provisions, the requirement of a one-year holding period is removed. Thus, for example, a REIT can acquire timber property and harvest the timber on the property within one year of the acquisition, with the resulting income being qualified real estate income for REIT qualification purposes, even though such income is not eligible for long-term capital gain treatment under sections 631(a) or (b). The provision specifically provides, however, that for all purposes of the Code, such income shall not be considered to be gain described in section 1221(a)(1), that is, it shall not be treated as income from the sale of stock in trade, inventory, or property held by the REIT primarily for sale to customers in the ordinary course of the REITs trade or business.

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

REIT prohibited transaction safe harbor for timber property

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

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

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

Special rules for Timber REITs

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

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

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

Effective Date

The capital gain provision applies to taxable years ending after the date of enactment (May 22, 2008) and beginning on or before the date which is one year after the date of enactment. In the case of a taxable year that includes the date of enactment, qualified timber gain may not exceed the qualified timber gain properly taken into account for the portion of the year after that date. In the case of a taxable year that includes the date that is one year after the date of enactment, qualified timber gain may not exceed the qualified timber gain properly taken into account for the portion of the year on or before that date.

The additional REIT provisions apply only for the first taxable year of the REIT that begins after the date of enactment and before the date that is one year after the date of enactment. The provisions terminate after that time.

5. Qualified forestry conservation bonds (sec. 15316 of the Act and new secs. 54A and 54B of the Code)

Present Law

Tax-exempt bonds

In general

Subject to certain Code restrictions, interest on bonds issued by State and local government generally is excluded from gross income for Federal income tax purposes. Bonds issued by State and local governments 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 which are repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons. For this purpose, the term "nongovernmental person" generally includes the Federal Government and all other individuals and entities other than States or local governments. The exclusion from income for interest on State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") and other Code requirements are met.

Private activity bond tests

Present law provides two tests for determining whether a State or local bond is in substance a private activity bond, the private business test and the private loan test.[139]

Private business tests

Private business use and private payments result in State and local bonds being private activity bonds if both parts of the two-part private business test are satisfied—

1. More than 10 percent of the bond proceeds is to be used (directly or indirectly) by a private business (the "private business use test"); and

2. More than 10 percent of the debt service on the bonds is secured by an interest in property to be used in a private business use or to be derived from payments in respect of such property (the "private payment test").[140]

Private business use generally includes any use by a business entity (including the Federal government), which occurs pursuant to terms not generally available to the general public. For example, if bond-financed property is leased to a private business (other than pursuant to certain short-term leases for which safe harbors are provided under Treasury regulations), bond proceeds used to finance the property are treated as used in a private business use, and rental payments are treated as securing the payment of the bonds. Private business use also can arise when a governmental entity contracts for the operation of a governmental facility by a private business under a management contract that does not satisfy Treasury regulatory safe harbors regarding the types of payments made to the private operator and the length of the contract.[141]

Private loan test

The second standard for determining whether a State or local bond is a private activity bond is whether an amount exceeding the lesser of (1) five percent of the bond proceeds or (2) $5 million is used (directly or indirectly) to finance loans to private persons. Private loans include both business and other (e.g., personal) uses and payments by private persons; however, in the case of business uses and payments, all private loans also constitute private business uses and payments subject to the private business test. Present law provides that the substance of a transaction governs in determining whether the transaction gives rise to a private loan. In general, any transaction which transfers tax ownership of property to a private person is treated as a loan.

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[139] Sec. 141(b) and (c).

[140] The 10-percent private business use and payment threshold is reduced to five percent for private business uses that are unrelated to a governmental purpose also being financed with proceeds of the bond issue. In addition, as described more fully below, the 10-percent private business use and private payment thresholds are phased-down for larger bond issues for the financing of certain "output" facilities. The term output facility includes electric generation, transmission, and distribution facilities.

[141] See Treas. Reg. sec. 1.141–3(b)(4) and Rev. Proc. 97–13, 1997–1 C.B. 632.

Qualified private activity bonds

As stated, interest on private activity bonds is taxable unless the bonds meet the requirements for qualified private activity bonds. Qualified private activity bonds permit States or local governments to act as conduits providing tax-exempt financing for certain private activities. The definition of qualified private activity bonds includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond (sec. 141(e)). The definition of exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities (sec. 142(a)).

In most cases, the aggregate volume of these tax-exempt private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2007, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $256.24 million, if greater.

Arbitrage restrictions

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[142] 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.[143] 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.

Indian tribal governments

Indian tribal governments are provided with a tax status similar to State and local governments for specified purposes under the Code.[144] Among the purposes for which a tribal government is treated as a State is the issuance of tax-exempt bonds. However, bonds issued by tribal governments are subject to limitations not imposed on State and local government issuers. Tribal governments are authorized to issue tax-exempt bonds only if substantially all of the proceeds are used for essential governmental functions or certain manufacturing facilities.[145]

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[142] Sec. 103(a) and (b)(2).
[143] Sec. 148.
[144] Sec. 7871.
[145] Sec. 7871(c).

Clean renewable energy bonds

As an alternative to traditional tax-exempt bonds, States and local governments may issue clean renewable energy bonds ("CREBs"). CREBs are defined as any bond issued by a qualified issuer if, in addition to the requirements discussed below, 95 percent or more of the proceeds of such bonds are used to finance capital expenditures incurred by qualified borrowers for qualified projects. "Qualified projects" are facilities that qualify for the tax credit under section 45 (other than Indian coal production facilities), without regard to the placed-in-service date requirements of that section.[146] The term "qualified issuers" includes (1) governmental bodies (including Indian tribal governments); (2) mutual or cooperative electric companies (described in section 501(c)(12) or section 1381(a)(2)(C), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act); and (3) clean renewable energy bond lenders. The term "qualified borrower" includes a governmental body (including an Indian tribal government) and a mutual or cooperative electric company. A clean renewable energy bond lender means a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002.

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

CREBs are subject to a maximum maturity limitation. The maximum maturity is the term which the Secretary estimates will result in the present value of the obligation to repay the principal on a CREBs being equal to 50 percent of the face amount of such bond. In addition, the Code requires level amortization of CREBs during the period such bonds are outstanding.

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

In addition to the above requirements, at least 95 percent of the proceeds of CREBs must be spent on qualified projects within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified projects during the five-year spending period, bonds will continue to qualify as CREBs if unspent proceeds are used within 90 days from the end of such five-year period to redeem any "nonqualified bonds." The five-year spending period may be extended by the Sec-

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

retary upon the qualified issuer's request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

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

Reasons for Change

The Congress believes it is appropriate to provide certain tax incentives to further the goal of permanently setting aside working forests for conservation purposes. The Congress believes that providing tax-exempt financing to nonprofit organizations for the purpose of acquiring forests and forest lands to be dedicated to certain conservation purposes will increase their ability to purchase such properties from commercial owners and operators, and that providing limited exclusions from income tax to such nonprofit organizations will enable them to conduct charitable and conservation activities as they make debt service payments on the bonds.

Explanation of Provision

The Act creates a new category of tax-credit bonds, qualified forestry conservation bonds. Qualified forestry conservation bonds are bonds issued by qualified issuers to finance qualified forestry conservation projects. The term "qualified issuer" means a State or a section 501(c)(3) organization. The term "qualified forestry conservation project" means the acquisition by a State or section 501(c)(3) organization from an unrelated person of forest and forest land that meets the following qualifications: (1) some portion of the land acquired must be adjacent to United States Forest Service Land; (2) at least half of the land acquired must be transferred to the United States Forest Service at no net cost and not more than half of the land acquired may either remain with or be donated to a State; (3) all of the land must be subject to a habitat conservation plan for native fish approved by the United States Fish and Wildlife Service; and (4) the amount of acreage acquired must be at least 40,000 acres.

There is a national limitation on qualified forestry conservation bonds of $500 million. Allocations of qualified forestry conservation bonds are among qualified forestry conservation projects in the manner the Secretary determines appropriate so as to ensure that all of such limitation is allocated before the date that is 24 months after the date of enactment. The Act also requires the Secretary to solicit applications for allocations of qualified forestry conservation bonds no later than 90 days after the date of enactment.

The Act requires 100 percent of the available project proceeds of qualified forestry conservation bonds to be used within the three-year period that begins on the date of issuance. The Act defines available project proceeds as proceeds from the sale of the issue less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds. To the extent less than 100 percent

of the available project proceeds are used to finance qualified forestry conservation purposes during the three-year spending period, bonds will continue to qualify as qualified forestry conservation bonds if unspent proceeds are used within 90 days from the end of such three-year period to redeem bonds. The three-year spending period may be extended by the Secretary upon the issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Qualified forestry conservation bonds generally are subject to the arbitrage requirements of section 148. However, available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (2) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified forestry conservation bonds are issued.

The maturity of qualified forestry conservation bonds is the term that the Secretary estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified forestry conservation bonds are issued.

As with present-law tax credit bonds, the taxpayer holding qualified forestry conservation bonds on a credit allowance date is entitled to a tax credit. The credit rate is set by the Secretary at a rate that would permit issuance of qualified forestry conservation bonds without discount and interest cost to the qualified issuer. The amount of the tax credit to the holder is determined by multiplying the bond's credit rate by the face amount on the holder's bond. The credit accrues quarterly, 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. Unused credits in one year may be carried forward to succeeding taxable years. In addition, credits may be separated from the ownership of the underlying bond similar to how interest coupons can be stripped for interest-bearing bonds.

Issuers of qualified forestry conservation bonds are required to certify that the financial disclosure requirements that apply to State and local bonds offered for sale to the general public are satisfied with respect to any Federal, State, or local government official directly involved with the issuance of such bonds. The Act authorizes the Secretary to impose additional financial reporting requirements by regulation.

The Act also provides that a qualified issuer receiving an allocation to issue qualified forestry conservation bonds may, in lieu of issuing bonds, elect to treat such allocation as a deemed payment of tax (regardless of whether the issuer is subject to tax under chapter 1 of the Code) that is equal to 50 percent of the amount

of such allocation. An election to treat an allocation of qualified forestry conservation bonds as a deemed payment is not valid unless the qualified issuer certifies to the Secretary that any payment of tax refunded to the issuer will be used exclusively for one or more qualified forestry conservation purposes. The deemed tax payment may not be used as an offset or credit against any other tax and shall not accrue interest. In addition, if the qualified issuer fails to use any portion of the overpayment for qualified forestry conservation purposes, the issuer shall be liable to the United States in an amount equal to such portion, plus interest, for the period from the date such portion was refunded to the date such amount is paid.

Effective Date

The provision is effective for bonds issued after the date of enactment (May 22, 2008).

B. Energy Provisions

1. Credit for production of cellulosic biofuel (sec. 15321 of the Act and sec. 40 of the Code)

Present Law

In the case of ethanol, the Code provides a separate 10–cents-per-gallon credit for up to 15 million gallons per year for small producers, defined generally as persons whose production capacity does not exceed 60 million gallons per year. The ethanol must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified alcohol fuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such ethanol at retail to another person and places such ethanol in the fuel tank of 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 credit is includible in income and is treated as a general business credit, subject to the ordering rules and carryforward/carryback rules that apply to business credits generally. The alcohol fuels tax credit, of which the small producer credit is a part, is scheduled to expire after December 31, 2010.

Under the Renewable Fuels Standard Program all renewable fuel produced or imported on or after September 1, 2007, must have a renewable identification number (RIN) associated with it. Producers and importers must generate RINs to represent all the renewable fuel they produce or import and provide those RINs to the EPA. For cellulosic ethanol, 2.5 RINs are generated for every gallon produced.

Reasons for Change

The Congress believes that the development of fuels from cellulosic materials, such as corn stover, switchgrass, and other organic materials that can be grown anywhere, is a significant component in establishing the nation's energy independence. Tax incentives are an important part of taking this industry from the level of dem-

onstration projects into a practical and competitive fuel source. To encourage new production capacity for this fuel, the provision provides a new per-gallon incentive for cellulosic fuel producers.

Explanation of Provision

The provision adds a new component to section 40 of the Code, the "cellulosic biofuel producer credit." This credit is a nonrefundable income tax credit for each gallon of qualified cellulosic fuel production of the producer for the taxable year. The amount of the credit per gallon is $1.01, except in the case of cellulosic biofuel that is alcohol. In the case of cellulosic biofuel that is alcohol, the $1.01 credit amount is reduced by (1) the credit amount applicable for such alcohol under the alcohol mixture credit as in effect at the time cellulosic biofuel is produced and (2) in the case of cellulosic biofuel that is ethanol, the credit amount for small ethanol producers as in effect at the time the cellulosic biofuel fuel is produced. The reduction applies regardless of whether the producer claims the alcohol mixture credit or small ethanol producer credit with respect to the cellulosic alcohol. When the alcohol mixture credit and small ethanol producer credit expire after December 31, 2010, cellulosic biofuel will receive the $1.01 without reduction.

"Qualified cellulosic biofuel production" is any cellulosic biofuel which is produced by the taxpayer and which is (1) sold by the taxpayer to another person (a) for use by such other person in the production of a qualified biofuel 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 biofuel at retail to another person and places such biofuel in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c).

"Cellulosic biofuel" means any liquid fuel that (1) is produced in the United States and used as fuel in the United States,[147] (2) is derived from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis and (3) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency under section 211 of the Clean Air Act. Thus, to qualify for the credit the fuel must be approved by the Environmental Protection Agency. Cellulosic biofuel does not include any alcohol with a proof of less than 150. Examples of lignocellulosic or hemicellulosic matter that is available of a renewable or recurring basis include dedicated energy crops and trees, wood and wood residues, plants, grasses, agricultural residues, fibers, animal wastes and other waste materials, and municipal solid waste.

A "qualified cellulosic biofuel mixture" is a mixture of cellulosic biofuel and a special fuel or of cellulosic biofuel and gasoline, which is sold by the person producing such mixture to any person for use as a fuel, or is used as a fuel by the person producing such mixture. The term "special fuel" includes any liquid fuel (other than gasoline) which is suitable for use in an internal combustion engine.

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[147] For this purpose, "United States" includes any possession of the United States.

The cellulosic biofuel producer credit terminates on December 31, 2012. The provision requires cellulosic biofuel producers to be registered with the IRS. The cellulosic biofuel producer credit cannot be claimed unless the taxpayer is registered with the IRS as a producer of cellulosic biofuel.

With respect to the small ethanol producer credit, the provision also waives the 15 million gallon limitation for cellulosic biofuel that is ethanol. Thus the small ethanol producer credit may be claimed for cellulosic ethanol in excess of 15 million gallons. The other requirements for the small ethanol producer credit continue to apply for ethanol other than cellulosic ethanol, including the 15 million gallon limitation.

Under the provision, cellulosic biofuel and alcohols cannot qualify as biodiesel, renewable diesel, or alternative fuel for purposes of the credit and payment provisions relating to those fuels.

Effective Date

The provision is effective for fuel produced after December 31, 2008.

2. Comprehensive study of biofuels (sec. 15322 of the Act)

Present Law

The National Academy of Sciences serves to investigate, examine, experiment and report upon any subject of science whenever called upon to do so by any department of the government. The National Research Council is part of the National Academies. The National Research Council was organized by the National Academy of Sciences in 1916 and is its principal operating agency for conducting science policy and technical work.

Explanation of Provision

The Act requires the Secretary, in consultation with the Department of Energy and the Department of Agriculture and the Environmental Protection Agency, to enter into an agreement with the National Academy of Sciences to produce an analysis of current scientific findings to determine:

1. Current biofuels production, as well as projections for future production;

2. The maximum amount of biofuels production capable on U.S. forests and farmlands, including the current quantities and character of the feedstocks and including such information as regional forest inventories that are commercially available, used in the production of biofuels;

3. The domestic effects of a increase in biofuels production on, for example, (a) the price of fuel, (b) the price of land in rural and suburban communities, (c) crop acreage and other land use, (d) the environment, due to changes in crop acreage, fertilizer use, runoff, water use, emissions from vehicles utilizing biofuels, and other factors, (e) the price of feed, (f) the selling price of grain crops, and forest products, (g) exports and imports of grains and forest products, (h) taxpayers, through cost or savings to commodity crop payments, and (i) the expansion of refinery capacity;

4. The ability to convert corn ethanol plants for other uses, such as cellulosic ethanol or biodiesel;

5. A comparative analysis of corn ethanol versus other biofuels and renewable energy sources, considering cost, energy output, and ease of implementation;

6. The impact of the credit for production of cellulosic biofuel (as established by the Act) on the regional agricultural and silvicultural capabilities of commercially available forest inventories; and

7. The need for additional scientific inquiry, and specific areas of interest for future research.

The Secretary shall submit an initial report of the findings to the Congress not later than six months after the date of enactment, and a final report not later than 12 months after the date of enactment. In the case of information relating to the impact of the tax credits established by the Act on the regional agricultural and silvicultural capabilities of commercially available forest inventories, the initial report is due 36 months after the date of enactment and the final report is due 42 months after the date of enactment.

Effective date.—The provision is effective on the date of enactment (May 22, 2008).

3. Modification of alcohol credit (sec. 15331 of the Act and secs. 40 and 6426 of the Code)

Present Law

Income tax credit

The alcohol fuels credit is the sum of three credits: the alcohol mixture credit, the alcohol credit, and the small ethanol producer credit. Generally, the alcohol fuels credit expires after December 31, 2010.[148]

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

Taxpayers may reduce their income taxes by 51 cents for each gallon of ethanol, which is not in a mixture with gasoline or other special fuel, that they sell at the retail level as vehicle fuel or use themselves as a fuel in their trade or business ("the alcohol credit"). For alcohol other than ethanol, the rate is 60 cents per gallon.[149]

In the case of ethanol, the Code provides an additional 10-cents-per-gallon credit for up to 15 million gallons per year for small producers. Small producer is defined generally as persons whose production capacity does not exceed 60 million gallons per year. The

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

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

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

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

Excise tax credit and payment provision for alcohol fuel mixtures

The Code also provides an excise tax credit and payment provision for alcohol fuel mixtures. Like the income tax credit, the amount of the credit is 60 cents per gallon of alcohol used as part of a qualified mixture (51 cents in the case of ethanol). For purposes of the excise tax credit and payment provisions, alcohol includes methanol and ethanol but does not include (1) alcohol produced from petroleum, natural gas, or coal (including peat), or (2) alcohol with a proof of less than 190. Such term also includes an alcohol gallon equivalent of ethyl tertiary butyl either or other ethers produced from alcohol. In lieu of a tax credit, a person making a qualified mixture eligible for the credit may seek a payment from the Secretary in the amount of the credit. The payment provisions and credits are coordinated such that the incentive is not claimed more than once for each gallon of alcohol used as part of qualified mixture.

Renewable Fuels Standard Program

Under the Renewable Fuels Standard Program all renewable fuel produced or imported on or after September 1, 2007 must have a renewable identification number (RIN) associated with it. Producers and importers must generate RINs to represent all the renewable fuel they produce or import and provide those RINs to the Environmental Protection Agency. For cellulosic ethanol, 2.5 RINs are generated for every gallon produced.

Reasons for Change

As the ethanol industry further matures, the Congress believes it is appropriate to reduce the amount of the tax incentive.

Explanation of Provision

Under the Act, the 51-cent-per-gallon incentive for ethanol is adjusted to 45 cents per gallon for the calendar year 2009 and thereafter.[150] If the Secretary makes a determination, in consultation with the Administrator of the Environmental Protection Agency,

[150] The low-proof blender amount is adjusted accordingly to 33.33 cents.

that 7,500,000,000 gallons of ethanol (including cellulosic ethanol) were not produced in or imported into the United States in 2008, the reduction in the credit amount will be delayed. If the threshold was not reached in 2008, the reduction for 2010 also will be delayed if the Secretary determines 7,500,000,000 gallons were not produced or imported in 2009. In the absence of a determination, the reduction remains in effect. In the event the determination is made subsequent to the start of a calendar year, those persons claiming the reduced amount prior to the Secretary's determination will be entitled to the difference between the correct credit amount for that year and the credit amount claimed, e.g. between 51 cents per gallon and 45 cents per gallon.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

4. Calculation of volume of alcohol for fuel credits (sec. 15332 of the Act and sec. 40 of the Code)

Present Law

The Code provides a per-gallon credit for the volume of alcohol used as a fuel or in a qualified mixture. For purposes of determining the number of gallons of alcohol with respect to which the credit is allowable, the volume of alcohol includes any denaturant, including gasoline.[151] The denaturant must be added under a formula approved by the Secretary and the denaturant cannot exceed five percent of the volume of such alcohol (including denaturants).

Reasons for Change

Gasoline can be used as a denaturant of alcohol. The Congress believes it is inappropriate to allow a credit that is intended to be for alcohol to be claimed on liquids that do not constitute alcohol.

Explanation of Provision

The Act reduces the amount of allowable denaturants to two percent of the volume of the alcohol.

Effective Date

The provision is effective for fuel sold or used after December 31, 2007.

5. Ethanol tariff extension (sec. 15333 of the Act)

Present Law

Heading 9901.00.50 of the Harmonized Tariff Schedule of the United States imposes a cumulative general duty of 14.27 cents per liter (approximately 54 cents per gallon) to imports of ethyl alcohol, and any mixture containing ethyl alcohol, if used as a fuel or in producing a mixture to be used as a fuel, that are entered into the

[151] Sec. 40(d)(4).

United States prior to January 1, 2009. Taxpayers who blend ethanol with gasoline are eligible to claim an alcohol fuels tax credit of 51 cents per gallon, irrespective of whether the ethanol used is produced domestically or imported. Heading 9901.00.50 applies a temporary duty to ethanol imports that offsets the benefit of the alcohol fuels tax credit to imported ethanol.

Heading 9901.00.52 of the Harmonized Tariff Schedule of the United States imposes a general duty of 5.99 cents per liter to imports of ethyl tertiary-butyl ether, and any mixture containing ethyl tertiary-butyl ether, that are entered into the United States prior to January 1, 2009.

Reasons for Change

The Congress believes it is appropriate to extend the tariff through the end of calendar year 2010.

Explanation of Provision

The Act modifies the existing effective period for ethyl alcohol as classified under heading 9901.00.50 and 9901.00.52 of the Harmonized Tariff Schedule of the United States from before January 1, 2009 to before January 1, 2011.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

6. Limitations on duty drawback on certain imported ethanol (sec. 15334 of the Act)

Present Law

Subheading 9901.00.50 of the Harmonized Tariff Schedule of the United States ("HTSUS"), imposes an additional duty on ethanol that is used as fuel or used to make fuel. Subsection (b) of Section 313 of the Tariff Act of 1930 permits the refund of duty if the duty-paid good, or a substitute good, is used to make an article that is exported. Subsection (j)(2) of Section 313 permits the refund of duty if the duty-paid good, or a substitute good, is exported. Subsection (p) of section 313 permits the substitution on exportation for drawback eligibility of one motor fuel for another motor fuel. A person who manufactures or acquires gasoline with ethanol subject to the duty imposed by subheading 9901.00.50, HTSUS, can export jet fuel (which does not involve the use of ethanol) and obtain a refund of the duty paid under subheading 9901.00.50, HTSUS.

Reasons for Change

The Congress believes it is appropriate to eliminate the ability to claim duty drawback on the substitution of jet fuel for ethyl alcohol (ethanol), or an ethyl alcohol mixture, used as a fuel. In addition, the Congress believes that it is appropriate to eliminate the ability to claim duty drawback on the substitution of a low-value ethyl alcohol for ethyl alcohol (ethanol) subject to the duty under HTSUS subheading 9901.00.50.

Explanation of Provision

Under the provision, any duty paid under subheading 9901.00.50, HTSUS, on imports of ethyl alcohol or a mixture of ethyl alcohol may not be refunded if the exported article upon which a drawback claim is based does not contain ethyl alcohol or a mixture of ethyl alcohol. In particular, the provision eliminates the ability to export jet fuel as a substitute for imports of ethyl alcohol or a mixture of ethyl alcohol, and then receive duty drawback based upon the import duty paid on the ethyl alcohol or the mixture of ethyl alcohol under subheading 9901.00.50, HTSUS.

Effective Date

The provision applies to imports of ethyl alcohol or a mixture of ethyl alcohol entered for consumption, or withdrawn from warehouse for consumption, on or after October 1, 2008. With respect to claims for substitution duty drawback that are based upon imports of ethyl alcohol or a mixture of ethyl alcohol entered for consumption, or withdrawn from warehouse for consumption, before October 1, 2008, such claims must be filed not later than September 30, 2010; otherwise, such claims are disallowed.

C. Agricultural Provisions

1. Qualified small issue bonds for farming (sec. 15341 of the Act and sec. 144 of the Code)

Present Law

Qualified small issue bonds are tax-exempt bonds issued by State and local governments to finance private business manufacturing facilities (including certain directly related and ancillary facilities) or the acquisition of land and equipment by certain first-time farmers. A first-time farmer means any individual who has not at any time had any direct ownership interest in substantial farmland in the operation of which such individual materially participated. In addition, an individual does not qualify as a first-time farmer if such individual has received more than $250,000 in qualified small issue bond financing. Substantial farmland means any parcel of land unless (1) such parcel is smaller than 30 percent of the median size of a farm in the county in which such parcel is located and (2) the fair market value of the land does not at any time while held by the individual exceed $125,000.

Reasons for Change

The Congress notes that the loan limits for first-time farmers have not been increased in more than two decades. Similarly, the rules relating to the definition of substantial farmland have not been increased in many years and, as a result, have not kept pace with increases in land prices. Thus, the Congress believes the tax-exempt bond rules for first-time farmers should be updated.

Explanation of Provision

The Act increases the maximum amount of qualified small issue bond proceeds available to first-time farmers to $450,000 and indexes this amount for inflation. The provision also eliminates the fair market value test from the definition of substantial farmland.

Effective Date

The provision is effective for bonds issued after the date of enactment (May 22, 2008).

2. Allowance of section 1031 for exchanges involving certain mutual ditch, reservoir, or irrigation company stock (sec. 15342 of the Act and sec. 1031 of the Code)

Present Law

An exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like-kind" which is to be held for productive use in a trade or business or for investment.[152] If section 1031 applies to an exchange of properties, the basis of the property received in the exchange is equal to the basis of the property transferred, decreased by any money received by the taxpayer, and further adjusted for any gain or loss recognized on the exchange. In general, section 1031 does not apply to any exchange of stock in trade or other property held primarily for sale; stocks, bonds or notes; other securities or evidences of indebtedness or interest; interests in a partnership; certificates of trust or beneficial interests; or choses in action.[153]

Reasons for Change

The Congress believes that section 1031 should be clarified to remove any doubt that an exchange of shares in mutual ditch, reservoir, and irrigation company stock qualifies for tax deferral treatment under section 1031. The Congress intends this clarification would be for cases in which the highest court or statute of the State in which the company is organized recognize such shares as constituting or representing real property or an interest in real property.

Explanation of Provision

The Act provides that the general exclusion from section 1031 treatment for stocks shall not apply to shares in a mutual ditch, reservoir, or irrigation company, if at the time of the exchange: (1) the company is an organization described in section 501(c)(12)(A) (determined without regard to the percentage of its income that is collected from its members for the purpose of meeting losses and expenses); and (2) the shares in the company have been recognized by the highest court of the State in which such company was orga-

[152] Sec. 1031(a)(1).
[153] Sec. 1031(a)(2).

nized or by applicable State statute as constituting or representing real property or an interest in real property.

Effective Date

The provision is effective for transfers after the date of enactment (May 22, 2008).

3. Agricultural chemicals security tax credit (sec. 15343 of the Act and new sec. 45O of the Code)

Present Law

Present law does not provide a credit for agricultural chemicals security.

Reasons for Change

The Congress believes that a security tax credit would help the agricultural industry to properly safeguard agricultural pesticides and fertilizers from the threat of terrorists, drug dealers and other criminals. These safeguards are necessary to help alleviate a heightened concern as to the vulnerability of chemical storage facilities. This credit will help ease the substantial increase in production costs faced by agriculture related to installing improved security measures that will better protect the American public from the potential threat of terrorism or other illegal activities.

Explanation of Provision

The Act establishes a 30 percent credit for qualified chemical security expenditures for the taxable year with respect to eligible agricultural businesses. The credit is a component of the general business credit.[154]

The credit is limited to $100,000 per facility, this amount is reduced by the aggregate amount of the credits allowed for the facility in the prior five years. In addition, each taxpayer's annual credit is limited to $2,000,000.[155] The credit only applies to expenditures paid or incurred before December 31, 2012. The taxpayer's deductible expense is reduced by the amount of the credit claimed.

Qualified chemical security expenditures are amounts paid for: 1) employee security training and background checks; (2) limitation and prevention of access to controls of specific agricultural chemicals stored at a facility; (3) tagging, locking tank valves, and chemical additives to prevent the theft of specific agricultural chemicals or to render such chemicals unfit for illegal use; (4) protection of the perimeter of areas where specified agricultural chemicals are stored; (5) installation of security lighting, cameras, recording equipment and intrusion detection sensors (6) implementation of measures to increase computer or computer network security; (7) conducting security vulnerability assessments; (8) implementing a site security plan; and (9) other measures provided for by regulation. Amounts described in the preceding sentence are only eligible

[154] Sec. 38(b)(1).

[155] The term taxpayer includes controlled groups under rules similar to the rules set out in section 41(f)(1) and (2).

to the extent they are incurred by an eligible agricultural business for protecting specified agricultural chemicals.

Eligible agricultural businesses are businesses that: (1) sell agricultural products, including specified agricultural chemicals, at retail predominantly to farmers and ranchers; or (2) manufacture, formulate, distribute, or aerially apply specified agricultural chemicals.

Specified agricultural chemicals means: (1) fertilizer commonly used in agricultural operations which is listed under section 302(a)(2) of the Emergency Planning and Community Right-to-know Act of 1986, section 101 or part 172 of title 49, Code of Federal Regulations, or part 126, 127 or 154 of title 33, Code of Federal Regulations; and (2) any pesticide (as defined in section 2(u) of the Federal Insecticide, Fungicide, and Rodenticide Act) including all active and inert ingredients which are used on crops grown for food, feed or fiber.

Effective Date

The provision is effective for expenses paid or incurred after date of enactment (May 22, 2008).

4. Three-year depreciation for all race horses (sec. 15344 of the Act and sec. 168 of the Code)

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[156] The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87–56.[157] Any race horse that is more than two years old at the time it is placed in service is assigned a three-year recovery period.[158] A seven year recovery period is assigned to any race horse that is two years old or younger at the time it is placed in service.[159]

Explanation of Provision

The Act provides a three year recovery period for any race horse that is two years old or younger at the time that it is placed in service.

Effective Date

The provision applies to property placed in service on or after December 31, 2008 and before January 1, 2014.

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[156] Sec. 168.
[157] 1987–2 C.B. 674 (as clarified and modified by Rev. Proc. 88–22, 1988–1 C.B. 785).
[158] Sec. 168(e)(3)(A)(i).
[159] Rev. Proc. 87–56, 1987–2 C.B. 674, asset class 01.225.

5. Temporary relief for Kiowa County, Kansas and surrounding area[160]

(a) Suspension of certain limitations on personal casualty losses (sec. 15345 of the Act and sec. 1400S(b) of the Code)

Present Law

Under present law, a taxpayer may generally claim a deduction for any loss sustained during the taxable year and not compensated by insurance or otherwise (sec. 165). For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Personal casualty or theft losses are deductible only if they exceed $100 per casualty or theft (the "$100 limitation") (sec. 165(h)). In addition, aggregate net casualty and theft losses are deductible only to the extent they exceed 10 percent of an individual taxpayer's adjusted gross income (the "AGI limitation") (sec. 165(h)).

Explanation of Provision

The Act removes two limitations on personal casualty or theft losses to the extent those losses arose from such events in the Kansas disaster area after May 4, 2007, and are attributable to the disaster occurring at that time. For purposes of the provisions of this Act, the term "Kansas disaster area" means an area with respect to which a major disaster has been declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (FEMA–1699–DR, as in effect on the date of enactment of this Act) by reason of severe storms and tornados beginning on May 4, 2007, and determined by the President to warrant individual or individual and public assistance from the Federal Government under such Act with respect to damages attributable to storms and tornados. These personal casualty or theft losses are deductible without regard to either the $100 limitation or the AGI limitation. For purposes of applying the AGI limitation to other personal casualty or theft losses, losses deductible under this provision are disregarded. Thus, the provision has the effect of treating personal casualty or theft losses from the disaster separate from all other casualty losses.

Effective Date

The provision is effective for losses arising on or after May 4, 2007.

(b) Extension of replacement period for nonrecognition of gain (sec. 15345 of the Act)

Present Law

Generally, a taxpayer realizes gain to the extent the sales price (and any other consideration received) exceeds the taxpayer's basis

[160] The provisions of this Act generally provide tax relief similar to certain other disaster areas.

in the property. The realized gain is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

Under section 1033, gain realized by a taxpayer from an involuntary conversion of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within the applicable period. The taxpayer's basis in the replacement property generally is the cost of such property, reduced by the amount of gain not recognized.

The applicable period for the taxpayer to replace the converted property begins with the date of the disposition of the converted property (or if earlier, the earliest date of the threat or imminence of requisition or condemnation of the converted property) and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized (the "replacement period").

Special rules extend the replacement period for certain real property[161] and principal residences damaged by a Presidentially declared disaster[162] to three years and four years, respectively, after the close of the first taxable year in which gain is realized. Similarly, the replacement period for livestock sold on account of drought, flood, or other weather-related conditions is extended from two years to four years after the close of the first taxable year in which any part of the gain on conversion is realized.[163]

Explanation of Provision

The Act extends from two to five years the replacement period in which a taxpayer may replace converted property, in the case of property that is in the Kansas disaster area and that is compulsorily or involuntarily converted on or after May 4, 2007, by reason of the May 4, 2007, storms and tornados. Substantially all of the use of the replacement property must be in this area.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

(c) Employee retention credit (sec. 15345 of the Act and sec. 1400R(a) of the Code)

Present Law

For employers affected by Hurricanes Katrina, Rita, or Wilma, section 1400R provides a credit of 40 percent of the qualified wages (up to a maximum of $6,000 in qualified wages per employee) paid by an eligible employer to an eligible employee.

Hurricane Katrina

An eligible employer is any employer (1) that conducted an active trade or business on August 28, 2005, in the GO Zone and (2) with respect to which the trade or business described in (1) is inoperable

[161] Sec. 1033(g)(4).
[162] Sec. 1033(h)(1)(B).
[163] Sec. 1033(e)(2).

on any day after August 28, 2005, and before January 1, 2006, as a result of damage sustained by reason of Hurricane Katrina.

An eligible employee is, with respect to an eligible employer, an employee whose principal place of employment on August 28, 2005, with such eligible employer was in the GO Zone. An employee may not be treated as an eligible employee for any period with respect to an employer if such employer is allowed a credit under section 51 with respect to the employee for the period.

Qualified wages are wages (as defined in section 51(c)(1) of the Code, but without regard to section 3306(b)(2)(B) of the Code) paid or incurred by an eligible employer with respect to an eligible employee on any day after August 28, 2005, and before January 1, 2006, during the period (1) beginning on the date on which the trade or business first became inoperable at the principal place of employment of the employee immediately before Hurricane Katrina, and (2) ending on the date on which such trade or business has resumed significant operations at such principal place of employment. Qualified wages include wages paid without regard to whether the employee performs no services, performs services at a different place of employment than such principal place of employment, or performs services at such principal place of employment before significant operations have resumed.

The credit is a part of the current year business credit under section 38(b) and therefore is subject to the tax liability limitations of section 38(c). Rules similar to sections 51(i)(1) and 52 apply to the credit.

Hurricane Rita and Wilma

The credit for employers affected by Hurricanes Rita and Wilma is subject to the same rules as Katrina, except the reference dates for affected employers, comparable to the August 28, 2005 date for Katrina, are September 23, 2005, and October 23, 2005, respectively.

Explanation of Provision

The Act extends the retention credit, as modified to include an employer size limitation, for employers affected by the Kansas storms and tornados. The reference dates for these employers, comparable to the August 28, 2005 and January 1, 2006 dates of present law for employers affected by Hurricane Katrina, are May 4, 2007, and January 1, 2008, respectively.

The retention credit for employers affected by the Kansas storms and tornados includes an employer size limitation. The credit only applies to eligible employers who employed an average of not more than 200 employees on business days during the taxable year before May 4, 2007.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

(d) Special depreciation allowance (sec. 15345 of the Act and sec. 1400N(d) of the Code)

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[164] Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

For qualified Gulf Opportunity Zone property, the Code provides an additional first-year depreciation deduction equal to 50 percent of the adjusted basis.[165] In order to qualify, property generally must be placed in service on or before December 31, 2007 (December 31, 2008 in the case of nonresidential real property and residential rental property).

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service. The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or subject to capitalization under section 263 or section 263A. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, the provision provides that there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

In order for property to qualify for the additional first-year depreciation deduction, it must meet all of the following requirements. First, the property must be property to which the general rules of the Modified Accelerated Cost Recovery System ("MACRS") apply with (1) an applicable recovery period of 20 years or less, (2) computer software other than computer software covered by section 197, (3) water utility property (as defined in section 168(e)(5)), (4) certain leasehold improvement property, or (5) certain nonresidential real property and residential rental property. Second, substantially all of the use of such property must be in the Gulf Opportunity Zone and in the active conduct of a trade or business by the taxpayer in the Gulf Opportunity Zone. Third, the original use of

[164] Sec. 168.
[165] Sec. 1400N(d).

the property in the Gulf Opportunity Zone must commence with the taxpayer on or after August 28, 2005.[166] Finally, the property must be acquired by purchase (as defined under section 179(d)) by the taxpayer on or after August 28, 2005 and placed in service on or before December 31, 2007 (December 31, 2008, for qualifying nonresidential real property and residential rental property). Property does not qualify if a binding written contract for the acquisition of such property was in effect before August 28, 2005. However, property is not precluded from qualifying for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to August 28, 2005.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after August 27, 2005, and before January 1, 2008, and the property is placed in service on or before December 31, 2007 (and all other requirements are met). In the case of qualified nonresidential real property and residential rental property, the property must be placed in service on or before December 31, 2008. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

The special allowance for Gulf Opportunity Zone property was extended for certain nonresidential real property and residential rental property, and certain personal property if substantially all of the use of such property is in such building,[167] placed in service in specified portions of the GO Zone by the taxpayer on or before December 31, 2010.[168] The extension only applies to nonresidential real property and residential rental property to the extent of the adjusted basis attributable to manufacture, construction, or production before January 1, 2010.[169]

Explanation of Provision

The Act provides an additional first-year depreciation deduction equal to 50 percent of the adjusted basis for qualified Recovery Assistance property. In order for property to qualify for the additional first-year depreciation deduction, it must meet all of the following requirements: (1) The property must be a property to which the general rules of the MACRS apply with (a) an applicable recovery period of 20 years or less, (b) computer software other than computer software covered by section 197, (c) water utility property (as defined in section 168(e)(5)), (d) certain leasehold improvement property, or (e) certain nonresidential real property and residential rental property; (2) substantially all of the use of such property

[166] Used property may constitute qualified property so long as it has not previously been used within the Gulf Opportunity Zone. In addition, it is intended that additional capital expenditures incurred to recondition or rebuild property the original use of which in the Gulf Opportunity Zone began with the taxpayer would satisfy the "original use" requirement. See Treasury Regulation sec. 1.48–2, Example 5.

[167] Such personal property must be placed in service by the taxpayer not later than 90 days after such building is placed in service.

[168] Sec. 1400N(d)(6).

[169] Sec. 1400N(d)(6)(D).

must be in the Kansas Disaster Zone and in the active conduct of a trade or business by the taxpayer in the Kansas Disaster Zone. Third, the original use of the property in the Kansas Disaster Zone must commence with the taxpayer on or after May 5, 2007.[170] Finally, the property must be acquired by purchase (as defined under section 179(d)) by the taxpayer on or after May 5, 2007 and placed in service on or before December 31, 2008 (December 31, 2009, for qualifying nonresidential real property and residential rental property). Property does not qualify if a binding written contract for the acquisition of such property was in effect before May 5, 2007. However, property is not precluded from qualifying for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to May 5, 2007.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after May 4, 2007, and before January 1, 2009, and the property is placed in service on or before December 31, 2008 (and all other requirements are met). In the case of qualified nonresidential real property and residential rental property, the property must be placed in service on or before December 31, 2009. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

(e) Increase in expensing under section 179 (sec. 15345 of the Act and sec. 1400N(e) of the Code)

Present Law

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under section 179. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2007 through 2010, is $125,000 of the cost of qualifying property placed in service for the taxable year.[171] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2010 is treated as qualifying property. The $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the

[170] Used property may constitute qualified property so long as it has not previously been used within the Kansas Disaster Zone. In addition, it is intended that additional capital expenditures incurred to recondition or rebuild property the original use of which in the Kansas Disaster Zone began with the taxpayer would satisfy the "original use" requirement. See Treasury Regulation sec. 1.48–2, Example 5.

[171] Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)).

taxable year exceeds $500,000. The $125,000 and $500,000 amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[172]

For taxable years beginning in 2011 and thereafter (or before 2003), the following rules apply. A taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner.[173]

For qualified section 179 Gulf Opportunity Zone property, the maximum amount that a taxpayer may elect to deduct is increased by the lesser of $100,000 or the cost of qualified section 179 Gulf Opportunity Zone property for the taxable year.[174] The provision applies with respect to qualified section 179 Gulf Opportunity Zone property acquired on or after August 28, 2005, and placed in service on or before December 31, 2007. This placed in service date was extended to December 31, 2008 for property substantially all of the use of which is in one or more specified portions of the GO Zone. The threshold for reducing the amount expensed is computed by increasing the $500,000 present-law amount by the lesser of (1) $600,000, or (2) the cost of qualified section 179 Gulf Opportunity Zone property placed in service during the taxable year. Neither the $100,000 nor $600,000 amounts are indexed for inflation.

Qualified section 179 Gulf Opportunity Zone property means section 179 property (as defined in section 179(d)) that also meets the following requirements: (1) The property must be property to which the general rules of the MACRS apply with (a) an applicable recovery period of 20 years or less, (b) computer software other than computer software covered by section 197, (c) water utility property (as defined in section 168(e)(5)), (d) certain leasehold improvement property; (2) substantially all of the use of which is in the Gulf Opportunity Zone and is in the active conduct of a trade or business

[172] Sec. 179(c)(1). Under Treas. Reg. sec. 1.179–5, applicable to property placed in service in taxable years beginning after 2002 and before 2008, a taxpayer is permitted to make or revoke an election under section 179 without the consent of the Commissioner on an amended Federal tax return for that taxable year. This amended return must be filed within the time prescribed by law for filing an amended return for the taxable year. T.D. 9209, July 12, 2005.

[173] Sec. 179(c)(2).

[174] Sec. 1400N(e).

by the taxpayer in that Zone; (3) the original use of which commences with the taxpayer on or after August 28, 2005; (4) which is acquired by the taxpayer by purchase on or after August 28, 2005, but only if no written binding contract for the acquisition was in effect before August 28, 2005; and (5) which is placed in service by the taxpayer on or before December 31, 2007.

Explanation of Provision

The Act increases the amount that a taxpayer may elect for qualified section 179 Recovery Assistance property. The maximum amount that a taxpayer may elect to deduct under section 179 is increased by the lesser of $100,000 or the cost of qualified section 179 Recovery Assistance property for the taxable year. The provision applies with respect to qualified section 179 Recovery Assistance property acquired on or after May 5, 2007, and placed in service on or before December 31, 2008. The threshold for reducing the amount expensed is computed by increasing the $500,000 present-law amount by the lesser of (1) $600,000, or (2) the cost of qualified section 179 Recovery Assistance property placed in service during the taxable year. Neither the $100,000 nor $600,000 amounts are indexed for inflation.

Qualified section 179 Recovery Assistance property means section 179 property (as defined in section 179(d)) that also meets the following requirements: (1) The property must be (a) property to which the general rules of the MACRS apply with an applicable recovery period of 20 years or less, (b) computer software other than computer software covered by section 197, (c) water utility property (as defined in section 168(e)(5)), or (d) certain leasehold improvement property; (2) substantially all of the use of which is in the Kansas Disaster Zone and is in the active conduct of a trade or business by the taxpayer in that Zone; (3) the original use of which commences with the taxpayer on or after May 5, 2007; (4) which is acquired by the taxpayer by purchase on or after May 5, 2007, but only if no written binding contract for the acquisition was in effect before May 5, 2007; and (5) which is placed in service by the taxpayer on or before December 31, 2008.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

(f) Expensing for certain demolition and clean-up costs (sec. 15345 of the Act and sec. 1400N(f) of the Code)

Present Law

Under present law, the cost of demolition of a structure is capitalized into the taxpayer's basis in the land on which the structure is located.[175] Land is not subject to an allowance for depreciation or amortization.

The treatment of the cost of debris removal depends on the nature of the costs incurred. For example, the cost of debris removal

[175] Sec. 280B.

after a storm may in some cases constitute an ordinary and necessary business expense which is deductible in the year paid or incurred. In other cases, debris removal costs may be in the nature of replacement of part of the property that was damaged. In such cases, the costs are capitalized and added to the taxpayer's basis in the property. For example, Revenue Ruling 71–161[176] permits the use of clean-up costs as a measure of casualty loss but requires that such costs be added to the post-casualty basis of the property.

Under section 1400N(f), a taxpayer is permitted a deduction for 50 percent of any qualified Gulf Opportunity Zone clean-up cost paid or incurred during the period beginning on August 28, 2005, and ending on December 31, 2007. The remaining 50 percent is capitalized and treated as described above. A qualified Gulf Opportunity Zone clean-up cost is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the Gulf Opportunity Zone to the extent that the amount would otherwise be capitalized. In order to qualify, the property must be held for use in a trade or business, for the production of income, or as inventory.

Explanation of Provision

Under the Act, a taxpayer is permitted a deduction for 50 percent of any qualified Recovery Assistance clean-up cost paid or incurred during the period beginning on May 4, 2007, and ending on December 31, 2009. The remaining 50 percent is treated as under present law. A qualified Recovery Assistance clean-up cost is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the Kansas disaster area to the extent that the amount would otherwise be capitalized. In order to qualify, the property must be held for use in a trade or business, for the production of income, or as inventory.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

(g) Treatment of public utility property disaster losses (sec. 15345 of the Act and sec. 1400N(o) of the Code)

Present Law

Under section 165(i), certain losses attributable to a disaster occurring in a Presidentially declared disaster area may, at the election of the taxpayer, be taken into account for the taxable year immediately preceding the taxable year in which the disaster occurred.

Section 6411 provides a procedure under which taxpayers may apply for tentative carryback and refund adjustments with respect to net operating losses, net capital losses, and unused business credits.

Section 1400N(o) provides an election for taxpayers who incurred casualty losses attributable to Hurricane Katrina with respect to

[176] 1971–1 C.B. 76.

public utility property located in the Gulf Opportunity Zone. Under the election, such losses may be taken into account in the fifth taxable year (rather than the 1st taxable year) immediately preceding the taxable year in which the loss occurred. If the application of this provision results in the creation or increase of a net operating loss for the year in which the casualty loss is taken into account, the net operating loss may be carried back or carried over as under present law applicable to net operating losses for such year.

For purposes of section 1400N(o), public utility property is property used predominantly in the trade or business of the furnishing or sale of electrical energy, water, or sewage disposal services; gas or steam through a local distribution system; telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962; or transportation of gas or steam by pipeline. Such property is eligible regardless of whether the taxpayer's rates are established or approved by any regulatory body.

A taxpayer making the election under the provision is eligible to file an application for a tentative carryback adjustment of the tax for any prior taxable year affected by the election. As under present law with respect to tentative carryback and refund adjustments, the IRS generally has 90 days to act on the refund claim. Under the provision, the statute of limitations with respect to such a claim can not expire earlier than one year after the date of enactment. Also, a taxpayer making the election with respect to a loss is not entitled to interest with respect to any overpayment attributable to the loss.

Explanation of Provision

The Act provides an election for taxpayers who incurred casualty losses attributable to the Kansas storms and tornados with respect to public utility property located in the Kansas Disaster Zone. Under the election, such losses may be taken into account in the fifth taxable year (rather than the 1st taxable year) immediately preceding the taxable year in which the loss occurred. If the application of this provision results in the creation or increase of a net operating loss for the year in which the casualty loss is taken into account, the net operating loss may be carried back or carried over as under present law applicable to net operating losses for such year. The other definitions and rules that apply under section 1400N(o) shall apply to the losses claimed in the Kansas Disaster Zone.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

(h) Treatment of net operating losses attributable to storm losses (sec. 15345 of the Act and sec. 1400N(k) of the Code)

Present Law

Under present law, a net operating loss ("NOL") is, generally, the amount by which a taxpayer's business deductions exceed its gross

income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[177] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[178]

Different rules apply with respect to NOLs arising in certain circumstances. 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 applies to NOLs (1) arising from a farming loss regardless of whether the loss was incurred in a Presidentially declared disaster area), or (2) certain amounts related to Hurricane Katrina and the Gulf Opportunity Zone. 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). Additionally, a special rule applies to certain electric utility companies.

Explanation of Provision

The Act provides rules in connection with certain net operating losses similar to the rules provided for Gulf Opportunity Zone losses under section 1400N(k). The rules, as applied to qualified Recovery Assistance losses, are as follows:

In general

The provision provides a special five-year carryback period for NOLs to the extent of certain specified amounts related to the Kansas storms and tornados. The amount of the NOL which is eligible for the five year carryback ("eligible NOL") is limited to the aggregate amount of the following deductions: (i) qualified Recovery Assistance casualty losses; (ii) certain moving expenses; (iii) certain temporary housing expenses; (iv) depreciation deductions with respect to qualified Recovery Assistance property for the taxable year the property is placed in service; and (v) deductions for certain repair expenses resulting from the Kansas storms and tornados. The provision applies for losses paid or incurred after May 3, 2007, and before January 1, 2010; however, an irrevocable election not to apply the five-year carryback under the provision may be made with respect to any taxable year.

Qualified Recovery Assistance casualty losses

The amount of qualified Recovery Assistance casualty losses which may be included in the eligible NOL is the amount of the taxpayer's casualty losses with respect to (1) property used in a trade or business, and (2) capital assets held for more than one year in connection with either a trade or business or a transaction entered into for profit. In order for a casualty loss to qualify, the property must be located in the Kansas Disaster Zone and the loss must be attributable to Kansas storms or tornados. As under present law, the amount of any casualty loss includes only the amount not compensated for by insurance or otherwise. In addition,

[177] Sec. 172(b)(1)(A).
[178] Sec. 172(b)(2).

the total amount of the casualty loss which may be included in the eligible NOL is reduced by the amount of any gain recognized by the taxpayer from involuntary conversions of property located in the Kansas Disaster Zone caused by the Kansas storms or tornados.

To the extent that a casualty loss is included in the eligible NOL and carried back under the provision, the taxpayer is not eligible to also treat the loss as having occurred in the prior taxable year under section 165(i). Similarly, the five year carryback under the provision does not apply to any loss taken into account for purposes of the ten-year carryback of public utility casualty losses which is provided under another provision in the Act.

Moving expenses

Certain employee moving expenses of an employer may be included in the eligible NOL. In order to qualify, an amount must be paid or incurred after May 3, 2007, and before January 1, 2010 with respect to an employee who (i) lived in the Kansas Disaster Zone before May 4, 2007, (ii) was displaced from their home either temporarily or permanently as a result of the Kansas storms or tornados, and (iii) is employed in the Kansas Disaster Zone by the taxpayer after the expense is paid or incurred.

For this purpose, moving expenses are defined as under present law to include only the reasonable expenses of moving household goods and personal effects from the former residence to the new residence, and of traveling (including lodging) from the former residence to the new place of residence. However, for purposes of the provision, the former residence and the new residence may be the same residence if the employee initially vacated the residence as a result of the Kansas storms or tornados. It is not necessary for the individual with respect to whom the moving expenses are incurred to have been an employee of the taxpayer at the time the expenses were incurred. Thus, assuming the other requirements are met, a taxpayer who pays the moving expenses of a prospective employee and subsequently employs the individual in the Kansas Disaster Zone may include such expenses in the eligible NOL.

Temporary housing expenses

Any deduction for expenses of an employer to temporarily house employees who are employed in the Kansas Disaster Zone may be included in the eligible NOL. It is not necessary for the temporary housing to be located in the Kansas Disaster Zone in order for such expenses to be included in the eligible NOL; however, the employee's principal place of employment with the taxpayer must be in the Kansas Disaster Zone. So, for example, if a taxpayer temporarily houses an employee at a location outside of the Kansas Disaster Zone, and the employee commutes into the Kansas Disaster Zone to the employee's principal place of employment, such temporary housing costs will be included in the eligible NOL (assuming all other requirements are met).

Depreciation of qualified Recovery Assistance property

The eligible NOL includes the depreciation deduction (or amortization deduction in lieu of depreciation) with respect to qualified

Recovery Assistance property placed in service during the year. The special carryback period applies to the entire allowable depreciation deduction for such property for the year in which it is placed in service, including both the regular depreciation deduction and the additional first-year depreciation deduction, if any. An election out of the additional first-year depreciation deduction for qualified Recovery Assistance property does not preclude eligibility for the five-year carryback.

Repair expenses

The eligible NOL includes deductions for repair expenses (including the cost of removal of debris) with respect to damage caused by the Kansas storms or tornados. In order to qualify, the amount must be paid or incurred after May 3, 2007 and before January 1, 2010, and the property must be located in the Kansas Disaster Zone.

Other rules

The amount of the NOL to which the five-year carryback period applies is limited to the amount of the corporation's overall NOL for the taxable year. Any remaining portion of the taxpayer's NOL is subject to the general two-year carryback period. Ordering rules similar to those for specified liability losses apply to losses carried back under the provision.

In addition, the general rule which limits a taxpayer's NOL deduction to 90 percent of AMTI does not apply to any NOL to which the five-year carryback period applies under the provision. Instead, a taxpayer may apply such NOL carrybacks to offset up to 100 percent of AMTI.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

(i) Representations Regarding Income Eligibility for Purposes of Qualified Residential Rental Project Requirements (sec. 15345 of the Act and sec. 1400N(n) of the Code)

Present Law

In general

Under present law, gross income does not include interest on State or local bonds (sec. 103). State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds").

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. The definition of exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities.

Subject to certain requirements, qualified private activity bonds may be issued to finance residential rental property or owner-occupied housing. Residential rental property may be financed with exempt facility bonds if the financed project is a "qualified residential rental project." A project is a qualified residential rental project if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income (the "20–50 test"). Alternatively, a project is a qualified residential rental project if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income (the "40–60 test"). The issuer must elect to apply either the 20–50 test or the 40–60 test. Operators of qualified residential rental projects must annually certify that such project meets the requirements for qualification, including meeting the 20–50 test or the 40–60 test.

Explanation of Provision

Under the provision, the operator of a qualified residential rental project may rely on the representations of prospective tenants displaced by reason of the severe storms and tornados in the Kansas disaster area beginning on May 4, 2007 for purposes of determining whether such individual satisfies the income limitations for qualified residential rental projects and, thus, the project is in compliance with the 20–50 test or the 40–60 test. This rule only applies if the individual's tenancy begins during the six-month period beginning on the date when such individual was displaced.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

(j) Use of retirement funds from retirement plans relating to the Kansas Disaster Zone (sec. 15345 of the Act and sec. 4100Q of the Code)

Present Law

In general

Withdrawals from retirement plans

Under present law, a distribution from a qualified retirement plan under section 401(a), a qualified annuity plan under section 403(a), a tax-sheltered annuity under section 403(b) (a "403(b) annuity"), an eligible deferred compensation plan maintained by a State or local government under section 457 (a "governmental 457 plan"), or an individual retirement arrangement under section 408 (an "IRA") generally is included in income for the year distributed.[179] (These plans are referred to collectively as "eligible retirement plans".) In addition, a distribution from a qualified retirement or annuity plan, a 403(b) annuity, or an IRA received before age 59½, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount includible in income, unless an exception applies.[180]

An eligible rollover distribution from a qualified retirement or annuity plan, a 403(b) annuity, or a governmental 457 plan, or a distribution from an IRA, generally can be rolled over within 60 days to another plan, annuity, or IRA. The IRS has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual. Any amount rolled over is not includible in income (and thus also not subject to the 10-percent early withdrawal tax).

Distributions from a qualified retirement or annuity plan, 403(b) annuity, a governmental 457 plan, or an IRA are generally subject to income tax withholding unless the recipient elects otherwise. An eligible rollover distribution from a qualified retirement or annuity plan, 403(b) annuity, or governmental 457 plan is subject to income tax withholding at a 20-percent rate unless the distribution is rolled over to another plan, annuity or IRA by means of a direct transfer. Any distribution is an eligible rollover distribution unless specifically excepted. Exceptions include a distribution that is part of a series of substantially equal periodic payments made at least annually for the life of the employee.

Certain amounts held in a qualified retirement plan that includes a qualified cash-or-deferred arrangement (a "401(k) plan") or in a 403(b) annuity may not be distributed before severance from employment, age 59½, death, disability, or financial hardship of the employee. Amounts deferred under a governmental 457 plan may not be distributed before severance from employment, age 70½, or an unforeseeable emergency of the employee.

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[179] Secs. 402(a), 403(a), 403(b), 408(d), and 457(a).
[180] Sec. 72(t).

Loans from retirement plans

An individual is permitted to borrow from a qualified plan in which the individual participates (and to use his or her accrued benefit as security for the loan) provided the loan bears a reasonable rate of interest, is adequately secured, provides a reasonable repayment schedule, and is not made available on a basis that discriminates in favor of employees who are officers, shareholders, or highly compensated.

Subject to certain exceptions, a loan from a qualified employer plan to a plan participant is treated as a taxable distribution of plan benefits. A qualified employer plan includes a qualified retirement plan under section 401(a), a qualified annuity plan under section 403(a), a tax-deferred annuity under section 403(b), and any plan that was (or was determined to be) a qualified employer plan or a governmental plan.

An exception to this general rule of income inclusion is provided to the extent that the loan (when added to the outstanding balance of all other loans to the participant from all plans maintained by the employer) does not exceed the lesser of (1) $50,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or (2) the greater of $10,000 or one half of the participant's accrued benefit under the plan.[181] This exception applies only if the loan is required, by its terms, to be repaid within five years. An extended repayment period is permitted for the purchase of the principal residence of the participant. Plan loan repayments (principal and interest) must be amortized in level payments and made not less frequently than quarterly, over the term of the loan.

Plan amendments

Present law provides a remedial amendment period during which, under certain circumstances, a plan may be amended retroactively in order to comply with the qualification requirements.[182] In general, plan amendments required to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs. The Secretary of the Treasury may extend the time by which plan amendments need to be made.

Use of retirement funds related to disaster relief for Hurricanes Katrina, Rita, and Wilma

In general

Section 1400Q provides exceptions to certain rules regarding distributions from retirement plans, for loans from retirement plans, and for plan amendments to retirement plans.[183]

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[181] Sec. 72(p).

[182] Sec. 401(b).

[183] The relief with respect to Hurricane Katrina was initially provided in the Katrina Emergency Relief Act of 2005 (Pub. L. 109–73). The IRS provided guidance on those relief provisions in Notice 2005–92, 2005–2 C.B. 1165. The relief was codified in section 1400Q and was expanded to the Hurricanes Rita and Wilma Disaster areas in the Gulf Opportunity Zone Act of 2005 (Pub. L. 109–135).

Tax favored withdrawals from retirement plans

Section 1400Q(a) provides an exception to the 10-percent early withdrawal tax in the case of a qualified hurricane distribution from a qualified retirement or annuity plan, a 403(b) annuity, or an IRA. In addition, as discussed more fully below, income attributable to a qualified hurricane distribution may be included in income ratably over three years, and the amount of a qualified hurricane distribution may be recontributed to an eligible retirement plan within three years.

A qualified hurricane distribution includes certain distributions from an eligible retirement plan related to Hurricanes Katrina, Wilma, and Rita. Specifically, qualified hurricane distributions include the following distributions from an eligible retirement plan: any distribution made on or after August 25, 2005, and before January 1, 2007, to an individual whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss by reason of Hurricane Katrina; any distribution made on or after September 23, 2005, and before January 1, 2007, to an individual whose principal place of abode on September 23, 2005, is located in the Hurricane Rita disaster area and who has sustained an economic loss by reason of Hurricane Rita; and any distribution made on or after October 23, 2005, and before January 1, 2007, to an individual whose principal place of abode on October 23, 2005, is located in the Hurricane Wilma disaster area and who has sustained an economic loss by reason of Hurricane Wilma.

The total amount of qualified hurricane distributions that an individual can receive from all plans, annuities, or IRAs is $100,000. Thus, any distributions in excess of $100,000 during the applicable periods are not qualified hurricane distributions.

Any amount required to be included in income as a result of a qualified hurricane distribution is included in income ratably over the three-year period beginning with the year of distribution unless the individual elects not to have ratable inclusion apply.

Any portion of a qualified hurricane distribution may, at any time during the three-year period beginning the day after the date on which the distribution was received, be recontributed to an eligible retirement plan to which a rollover can be made. Any amount recontributed within the three-year period is treated as a rollover and thus is not includible in income. For example, if an individual receives a qualified hurricane distribution in 2005, that amount is included in income, generally ratably over the year of the distribution and the following two years, but is not subject to the 10-percent early withdrawal tax. If, in 2007, the amount of the qualified hurricane distribution is recontributed to an eligible retirement plan, the individual may file an amended return (or returns) to claim a refund of the tax attributable to the amount previously included in income. In addition, if, under the ratable inclusion provision, a portion of the distribution has not yet been included in income at the time of the contribution, the remaining amount is not includible in income.

A qualified hurricane distribution is a permissible distribution from a 401(k) plan, 403(b) annuity, or governmental 457 plan, regardless of whether a distribution would otherwise be permissible.

A plan is not treated as violating any Code requirement merely because it treats a distribution as a qualified hurricane distribution, provided that the aggregate amount of such distributions from plans maintained by the employer and members of the employer's controlled group does not exceed $100,000. A plan is not treated as violating any Code requirement merely because an individual might receive total distributions in excess of $100,000, taking into account distributions from plans of other employers or IRAs.

Qualified hurricane distributions are subject to the income tax withholding rules applicable to distributions other than eligible rollover distributions. Thus, 20-percent mandatory withholding does not apply.

Recontributions of withdrawals for home purchases

Section 1400Q(b) generally provides that a distribution received from a 401(k) plan, 403(b) annuity, or IRA in order to purchase a home in the Hurricane Katrina, Rita, or Wilma disaster areas may be recontributed to such a plan, annuity, or IRA in certain circumstances.

The ability to recontribute applies to an individual who receives a qualified distribution. A qualified distribution is a hardship distribution from a 401(k) plan or 403(b) annuity, or a qualified first-time homebuyer distribution from an IRA, that is a qualified Katrina distribution, a qualified Rita distribution, or a qualified Wilma distribution.

A qualified Katrina distribution is a distribution: (1) that is received after February 28, 2005, and before August 29, 2005; and (2) that was to be used to purchase or construct a principal residence in the Hurricane Katrina disaster area, but the residence is not purchased or constructed on account of Hurricane Katrina. Any portion of a qualified Katrina distribution may, during the period beginning on August 25, 2005, and ending on February 28, 2006, be recontributed to a plan, annuity or IRA to which a rollover is permitted.

A qualified Hurricane Rita distribution is a distribution: (1) that is received after February 28, 2005, and before September 24, 2005; and (2) that was to be used to purchase or construct a principal residence in the Hurricane Rita disaster area, but the residence is not purchased or constructed on account of Hurricane Rita. Any portion of a qualified Hurricane Rita distribution may, during the period beginning on September 23, 2005, and ending on February 28, 2006, be recontributed to a plan, annuity or IRA to which a rollover is permitted.

A qualified Hurricane Wilma distribution is a distribution: (1) that is received after February 28, 2005, and before October 24, 2005; and (2) that was to be used to purchase or construct a principal residence in the Hurricane Wilma disaster area, but the residence is not purchased or constructed on account of Hurricane Wilma. Any portion of a qualified Hurricane Wilma distribution may, during the period beginning on October 23, 2005, and ending on February 28, 2006, be recontributed to a plan, annuity or IRA to which a rollover is permitted.

Any amount recontributed is treated as a rollover. Thus, that portion of the qualified distribution is not includible in income (and also is not subject to the 10-percent early withdrawal tax).

Loans from qualified plans to individuals sustaining an economic loss

Section 1400Q(c) provides an exception to the income inclusion rule for loans from a qualified employer plan related to Hurricanes Katrina, Rita, and Wilma made to a qualified individual during an applicable period and provides a repayment delay for loans that are outstanding on or after a qualified beginning date if the due date for any repayment with respect to such loan occurs after the qualified beginning date and December 31, 2006.

The exception to the general rule of income inclusion is provided to the extent that the loan (when added to the outstanding balance of all other loans to the participant from all plans maintained by the employer) does not exceed the lesser of (1) $100,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or (2) the greater of $10,000 or the participant's accrued benefit under the plan.

In the case of a qualified individual with an outstanding loan on or after the qualified beginning date from a qualified employer plan, if the due date for any repayment with respect to such loan occurs during the period beginning on the qualified beginning date, and ending on December 31, 2006, such due date is delayed for one year. Any subsequent repayments with respect to such loan shall be appropriately adjusted to reflect the delay in the due date and any interest accruing during such delay. The period during which required repayment is delayed is disregarded in complying with the requirements that the loan be repaid within five years and that level amortization payments be made.

A qualified individual entitled to this plan loan relief includes a qualified Katrina individual, a qualified Rita individual, or a qualified Wilma individual. A qualified Hurricane Katrina individual is an individual whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss by reason of Hurricane Katrina. The qualified beginning date for a qualified Katrina individual is August 25, 2005 and the applicable period is the period beginning on September 24, 2005, and ending December 31, 2006.

A qualified Hurricane Rita individual is an individual whose principal place of abode on September 23, 2005, is located in a Hurricane Rita disaster area and who has sustained an economic loss by reason of Hurricane Rita. The qualified beginning date for a qualified Hurricane Rita individual is September 23, 2005, and the applicable period is the period beginning on September 23, 2005, and ending on December 31, 2006.

A qualified Hurricane Wilma individual is an individual whose principal place of abode on October 23, 2005, is located in a Hurricane Wilma disaster area and who has sustained an economic loss by reason of Hurricane Wilma. The qualified beginning date for a qualified Hurricane Wilma individual is October 23, 2005, and the

applicable period is the period beginning on October 23, 2005, and ending on December 31, 2006.

An individual cannot be a qualified individual with respect to more than one hurricane.

Plan amendments relating to Hurricanes Katrina, Rita, and Wilma

Section 1400Q(d) permits certain plan amendments made pursuant to any provision in section 1400Q, or regulations issued thereunder, to be retroactively effective. If the plan amendment meets the requirements of section 1400Q, then the plan will be treated as being operated in accordance with its terms. In order for this treatment to apply, the plan amendment is required to be made on or before the last day of the first plan year beginning on or after January 1, 2007, or such later date as provided by the Secretary of the Treasury. Governmental plans are given an additional two years in which to make required plan amendments. If the amendment is required to be made to retain qualified status as a result of the changes made by section 1400Q (or regulations promulgated thereunder), the amendment is required to be made retroactively effective as of the date on which the change became effective with respect to the plan, and the plan is required to be operated in compliance until the amendment is made. Amendments that are not required to retain qualified status but that are made pursuant to section 1400Q may be made retroactively effective as of the first day the plan is operated in accordance with the amendment. A plan amendment will not be considered to be pursuant to section 1400Q (or regulations) if it has an effective date before the effective date of the provision (or regulations) to which it relates.

Explanation of Provision

The Act provides relief similar to the relief provided in section 1400Q with respect to use of retirement funds in connection with the tornadoes and storms that occurred in the Kansas disaster area.

Effective Date

The provision is effective on the date of enactment (May 22, 2008).

6. Modification of the advanced coal project credit and the gasification project credit (sec. 15346 of the Act and secs. 48A and 48B of the Code)

Present Law

Advanced coal project credit

An investment tax credit is available for power generation projects that use integrated gasification combined cycle ("IGCC") or other advanced coal-based electricity generation technologies.[184] The credit amount is 20 percent for investments in qualifying IGCC projects and 15 percent for investments in qualifying projects

[184] Sec. 48A.

that use other advanced coal-based electricity generation technologies.

To qualify, an advanced coal project must be located in the United States and use an advanced coal-based generation technology to power a new electric generation unit or to retrofit or repower an existing unit. Generally, an electric generation unit using an advanced coal-based technology must be designed to achieve a 99 percent reduction in sulfur dioxide and a 90 percent reduction in mercury, as well as to limit emissions of nitrous oxide and particulate matter.[185]

The fuel input for a qualifying project, when completed, must use at least 75 percent coal. The project, consisting of one or more electric generation units at one site, must have a nameplate generating capacity of at least 400 megawatts, and the taxpayer must provide evidence that a majority of the output of the project is reasonably expected to be acquired or utilized.

Credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. Certifications are issued using a competitive bidding process. The Secretary of Treasury must establish a certification program no later than 180 days after August 8, 2005,[186] and each project application must be submitted during the three-year period beginning on the date such certification program is established. An applicant for certification has two years from the date the Secretary accepts the application to provide the Secretary with evidence that the requirements for certification have been met. Upon certification, the applicant has five years from the date of issuance of the certification to place the project in service.

The Secretary of Treasury may allocate $800 million of credits to IGCC projects and $500 million to projects using other advanced coal-based electricity generation technologies. Qualified projects must be economically feasible and use the appropriate clean coal technologies. With respect to IGCC projects, credit-eligible investments 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.

In determining which projects to certify, 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.

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[185] For advanced coal project certification applications submitted after October 2, 2006, an electric generation unit using advanced coal-based generation technology designed to use subbituminous coal can meet the performance requirement relating to the removal of sulfur dioxide if it is designed either to remove 99 percent of the sulfur dioxide or to achieve an emission limit of 0.04 pounds of sulfur dioxide per million British thermal unis on a 30-day average.

[186] The Secretary issued guidance establishing the certification program on February 21, 2006 (IRS Notice 2006–24).

Gasification project credit

A 20-percent investment tax credit is also available for investments in certain qualifying coal gasification projects.[187] 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.

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. Qualified projects must be carried out by an eligible entity, defined as any person whose application for certification is principally intended for use in a domestic project which employs domestic gasification applications related to (1) chemicals, (2) fertilizers, (3) glass, (4) steel, (5) petroleum residues, (6) forest products, and (7) agriculture, including feedlots and dairy operations.

Credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. Certifications are issued using a competitive bidding process. The Secretary of Treasury must establish a certification program no later than 180 days after August 8, 2005,[188] and each project application must be submitted during the three-year period beginning on the date such certification program is established. The Secretary of Treasury may not allocate more than $350 million in credits. In addition, the Secretary may certify a maximum of $650 million in qualified investment as eligible for credit with respect to any single project.

Explanation of Provision

In implementing either section 48A (relating to the credit described above) or section 48B (relating to the coal gasification credit), the provision directs the Secretary to modify the terms of any competitive certification award and any associated closing agreements in certain cases. Specifically, modification is required when it (1) is consistent with the objectives of such section, (2) is requested by the recipient of the award, and (3) involves moving the project site to improve the potential to capture and sequester carbon dioxide emissions, reduce costs of transporting feedstock, and serve a broader customer base. However, no modification is required if the Secretary determines that the dollar amount of tax credits available to the taxpayer under the applicable section would increase as a result of the modification or such modification would result in such project not being originally certified. In considering any such modification, the Secretary must consult with other relevant Federal agencies, including the Department of Energy.

Effective Date

The provision is effective for credit allocation awards issued before, on, or after the date of enactment (May 22, 2008).

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[187] Sec. 48B.

[188] The Secretary issued guidance establishing the certification program on February 21, 2006 (IRS Notice 2006–25).

D. Other Revenue Provisions

1. Limitation on farming losses of certain taxpayers (sec. 15351 of the Act and sec. 461 of the Code)

Present Law

For taxpayers who materially participate (as defined in section 469(h)) in a farming activity, net farming losses are reported in full as a reduction to income from both passive and nonpassive sources. For taxpayers who do not materially participate in a farming activity, the passive activity rules of section 469 limit the ability to use such losses to reduce income from nonpassive sources.

Farming income generally includes sales of livestock, produce, grains, and other products; cooperative distributions; Agricultural Program Payments; certain Commodity Credit Corporation ("CCC") loans (if an election is made to include loan proceeds in income in the year received); certain crop insurance proceeds and federal crop disaster payments; and other income. Farm expenses generally include feed, fertilizers, gasoline, fuel, and oil; insurance; interest; hired labor; rent and lease payments; repairs and maintenance; taxes; utilities; depreciation; and other business-related expenses. Living expenses and other personal expenses are not deductible farming expenses.

Present law (section 263A(e)(4))[189] defines a farming business as the trade or business of farming, including the trade or business of operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees (excluding evergreen trees that are more than six years old at the time severed from the roots). Treasury regulation section 1.263A–4(a)(4) further provides that a farming business generally means a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity. The raising, shearing, feeding, caring for, training, and management of animals are included in this definition. For example, the raising of cattle for sale is considered a farming business. However, the mere buying and reselling of plants or animals grown or raised entirely by another is not considered to be raising an agricultural or horticultural commodity. While a farming business does include processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products (e.g., harvesting, washing, inspecting, and packing fruits and vegetables for sale), it does not include the processing of commodities or products beyond those activities that are normally incident to the growing, raising, or harvesting of such products.

Reasons for Change

The Congress believes that taxpayers receiving government assistance through payment programs and loan programs should not be allowed to claim unlimited amounts of losses from farming activities.

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[189] This is the same definition of "farming business" used for averaging of farm income under section 1301.

Explanation of Provision

The Act limits the farming loss of a taxpayer, other than a C corporation, for any taxable year in which any applicable subsidies are received to the greater of (1) $300,000 ($150,000 in the case of a married person filing a separate return), or (2) the taxpayer's total net farm income for the prior five taxable years. For purposes of the provision, applicable subsidies are (1) any direct or counter-cyclical payments under title I of the Food, Conservation, and Energy Act of 2008 (or any payment elected in lieu of any such payment), or (2) any CCC loan. Total net farm income is an aggregation of all income and loss from farming businesses for the prior five taxable years.

The following examples illustrate the operation of this provision:

Example 1.—Assume an individual taxpayer has $1 million of net income from a farming business in each taxable year 2010 to 2014, and incurs a $5 million farming loss in 2015. For purposes of this provision, the farming loss in 2015 is limited to the greater of (1) $300,000 or (2) $5 million (total net farm income for the prior five taxable years). Thus, the farming loss is allowable in full in 2015. Assuming the taxpayer had no other income or deductions in any of the taxable years 2010 to 2015, the $5 million net operating loss for 2015 is carried back to the prior five taxable years under the present-law net operating loss carryback rules and reduces the taxpayer's taxable income in each of those years to zero.[190]

Example 2.—Assume an individual taxpayer has $300,000 of net farm income and $700,000 of non-farm income in 2010, and $1 million of net farm income in each taxable year 2011 to 2014. In 2015, the taxpayer incurs a $7 million farming loss. For purposes of this provision, the farming loss in 2015 is limited to the greater of (1) $300,000 or (2) $4.3 million (total net farm income for the prior five taxable years). Thus, $2.7 million of the farming loss is disallowed under the provision and will be treated as a deduction attributable to a farming business in 2016. The $4.3 million farming loss allowed for 2015 is carried back to the prior five taxable years and allowed as a deduction under present-law rules. The taxpayer's taxable income in each of the years 2010[191] to 2013 is reduced to zero and taxable income in 2014 is reduced by the remaining farm loss of $300,000 to $700,000.

For purposes of calculating total net farm income for the prior five years, losses that are limited under the provision are taken into account in the year in which they are allowed as a deduction. For example, if a taxpayer has a $500,000 excess farm loss in 2010 that is not allowed as a deduction until 2012, the calculation in 2011 of total net farm income for the prior five years does not take into account the $500,000 as a farm loss. Instead, the $500,000 loss would be included in the calculation of prior year's total net farm income for taxable years 2013 through 2017. In the case where the filing status of the taxpayer is not the same for the taxable year and each of the taxable years in the five-year period, the Treasury

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[190] Under section 172(b)(1)(G), farming losses may be carried back to each of the five taxable years preceding the taxable year of the loss.

[191] The loss carryback to 2010 reduces both the $300,000 of net farm income and $700,000 of non-farm income to zero.

Department is authorized to provide guidance for the computation of total net farm income.

In the case of a partnership or S corporation, the limit is applied at the partner or shareholder level.[192] Therefore, each partner or shareholder takes into account its proportionate share of income, gain, or deduction from farming businesses of a partnership or S corporation, and any applicable subsidies received by a partnership or S corporation during the taxable year (regardless of whether such items are treated as income for Federal tax purposes).

For purposes of the provision, the term "farming business" has the meaning provided in present-law section 263A(e)(4), with a modification for certain processing activities. Thus, for purposes of this provision, the conference agreement broadens the definition of "farming business" to include the processing of commodities, without regard to whether such activity is incidental, by a taxpayer otherwise engaged in a farming business with respect to such commodities. The farming activities of a cooperative are attributed to each member for purposes of this rule. Thus, a member of a cooperative who raises a commodity and sells it to the cooperative for processing is considered to be the processor of such commodity. In this case, patronage dividends received from a cooperative that is engaged in a farming business are considered to be income from a farming business for purposes of this provision.

Any loss that is disallowed under the provision in a particular year is carried forward to the next taxable year and treated as a deduction attributable to farming businesses in that year.

Farming losses arising by reason of fire, storm, or other casualty, or by reason of disease or drought, are disregarded for purposes of calculating the limitation.

Treasury regulatory authority is provided to prescribe such additional reporting requirements as appropriate to carry out the purposes of this provision.

Effective Date

The provision is effective for taxable years beginning after December 31, 2009.

2. Increase and index dollar thresholds for farm optional method and nonfarm optional method for computing net earnings from self-employment (sec. 15352 of the Act and sec. 1402(a) of the Code)

Present Law

In general

Generally, tax under the Self-Employment Contributions Act (SECA) is imposed on the self-employment income of an individual. SECA tax has two components. Under the old-age, survivors, and disability insurance component, the rate of tax is 12.40 percent on self-employment income up to the Social Security wage base

[192] The Treasury Department may provide guidance for the application of this provision to any other pass-thru entity to the extent necessary to carry out the purposes of this provision. In the case of tiered partnership or pass-thru entity structures, the Treasury Department may provide guidance as necessary to carry out the purposes of this provision.

($97,500 for 2007). Under the hospital insurance component, the rate is 2.90 percent of all self-employment income (without regard to the Social Security wage base).

Self-employment income subject to the SECA tax is determined as the net earnings from self-employment. An individual may use one of three methods to calculate net earnings from self-employment. Under the generally applicable rule, net earnings from self-employment means gross income (including the individual's net distributive share of partnership income) derived by an individual from any trade or business carried on by the individual, less the deductions attributable to the trade or business that are allowed under the SECA tax rules. Alternatively, an individual may elect to use one of two optional methods for calculating net earnings from self-employment. These methods are: (1) the farm optional method; and (2) the nonfarm optional method. The farm optional method allows individuals to pay SECA taxes (and secure Social Security benefit coverage) when they have low net income or losses from farming. The nonfarm optional method is similar to the farm optional method.

Farm optional method

If an individual is engaged in a farming trade or business, either as a sole proprietor or as a partner, the individual may elect to use the farm optional method in one of two instances. The first instance is an individual engaged in a farming business who has gross farm income of $2,400 or less for the taxable year. In this instance, the individual may elect to report two-thirds of gross farm income as net earnings from self-employment. In the second instance, an individual engaged in a farming business may elect the farm optional method even though gross farm income exceeds $2,400 for the taxable year but only if the net farm income is less than $1,733 for the taxable year. In this second instance, the individual may elect to report $1,600 as net earnings from self-employment for the taxable year. In all other instances (i.e., more than $2,400 of gross farm income and net farm income of at least $1,733) a person engaged in a farming business must compute net earnings from self-employment under the generally applicable rule. There is no limit on the number of years that an individual may elect the farm optional method during such individual's lifetime.

The dollar limits in the farm optional method are not indexed for inflation.

Nonfarm optional method

The nonfarm optional method is available only to individuals who have been self-employed for at least two of the three years before the year in which they seek to elect the nonfarm optional method and who meet certain other requirements. Specifically, an individual may elect the nonfarm optional method if the individual's: (1) net nonfarm income for the taxable year is less than $1,733; and (2) net nonfarm income for the taxable year is less than 72.189 percent of gross nonfarm income. If a qualified individual engaged in a nonfarming business who elects the nonfarm optional method has gross nonfarm income of $2,400 or less for the taxable year, then the individual may elect to report two-thirds of

gross nonfarm income as net earnings from self-employment. If the electing individual engaged in a nonfarming business has gross nonfarm income of at least $2,400 for the taxable year, then the individual may elect to report $1,600 as net earnings from self-employment for the taxable year. In all other instances, a person engaged in a nonfarming business must compute net earnings from self-employment under the generally applicable rule. An individual may elect to use the nonfarm optional method for no more than five years in the course of the individual's lifetime.

The dollar limits in the nonfarm optional method are not indexed for inflation.

Other rules applicable to farm optional and nonfarm optional methods

In the case of a cash method trade or business, gross income is defined as the gross receipts from such trade or business less the cost or other basis of property sold in carrying out such trade or business with certain adjustments. In the case of an accrual method trade or business, gross income is defined as the gross income from the trade or business with certain adjustments. If an individual (including a member of a partnership) derives gross income from more than one trade or business then such gross income (including the individual's distributive share of the gross income of any partnership) is treated as derived from a single trade or business.

Social Security benefit eligibility

Generally, Social Security benefits can be paid to an individual (and dependents or survivors) only if that individual has worked long enough in covered employment to be insured. Insured status is measured in terms of "credits," previously called "quarters of coverage." For this purpose, Social Security uses the lifetime record of earnings reported for that individual. In the case of a self-employed individual, net earnings from self-employment is used to calculate Social Security benefit eligibility.

Up to four quarters of coverage can be earned for a year, depending on covered wages for the year and the amount needed to earn each quarter of coverage. For 2007, credit for a quarter of coverage is provided for each $1,000 of wages.

Reasons for Change

The Congress believes that taxpayers should have the ability to earn four quarters of coverage for Social Security benefits annually under either the farm optional method or nonfarm optional method. Because the present-law dollar amounts are not updated or indexed for inflation otherwise eligible taxpayers have lost that ability. The Act makes needed changes to those methods and ensures that they are indexed so the problem will not reoccur in the future.

Explanation of Provision

The Act modifies the farm optional method so that electing taxpayers may be eligible to secure four credits of Social Security benefit coverage each taxable year by increasing and indexing the

thresholds. The provision makes a similar modification to the non-farm optional method.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

3. Information reporting for commodity credit corporation transactions (sec. 15353 of the Act and new sec. 6039J of the Code)

Present Law

The Farm Security and Rural Investment Act of 2002[193] authorizes a marketing assistance loan program through the Commodity Credit Corporation ("CCC"). Under such program, the CCC may make loans for eligible commodities at a specified rate per unit of commodity (the original loan rate). The repayment amount for such a loan secured by an eligible commodity generally is based on the lower of the original loan rate or the alternative repayment rate, as determined by the CCC, as of the date of repayment. The alternative repayment rate may be adjusted to reflect quality and location for each type of commodity. A taxpayer receiving a CCC loan can use cash to repay such a loan, purchase CCC certificates for use in repayment of the loan, or deliver the pledged collateral as full payment for the loan at maturity.

If a taxpayer uses cash or CCC certificates to repay a CCC loan, and the loan is repaid at a time when the repayment rate is less than the original loan rate, the difference between the original loan amount and the lesser repayment amount is market gain. Regardless of whether a taxpayer repays a CCC loan in cash or uses CCC certificates in repayment of the loan, the market gain is taken into account either as income or as an adjustment to the basis of the commodity (if the taxpayer has made an election under section 77).

If a farmer uses cash instead of certificates, the farmer will receive a Form CCC–1099–G Information Return showing the market gain realized. For transactions prior to January 1, 2007, however, if a farmer uses CCC certificates to facilitate repayment of a CCC loan, the farmer will not receive an information return. For loans repaid on or after January 1, 2007, IRS Notice 2007–63 provides that the CCC reports market gain associated with the repayment of a CCC loan whether the taxpayer repays the loan with cash or uses CCC certificates in repayment of the loan.[194] The CCC reports the market gain on Form 1099–G, Certain Government Payments.

Reasons for Change

Income that is subject to information reporting is less likely to be underreported. In contrast, the absence of information reporting on many types of payments results in underreporting and contributes to the tax gap.[195] Thus, the Congress believes it is important

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[193] Pub. L. No. 107–171.

[194] 2007–33 IRB.

[195] The tax gap is the amount of tax that is imposed by law for a given tax year but is not paid voluntarily and timely.

to ensure that information reporting rules are applied consistently to payments that may differ in form, but are economically equivalent. For this reason, the Congress believes it is appropriate to codify the IRS's administrative determination regarding information reporting for the repayment of CCC loans.

Explanation of Provision

The Act codifies the requirements of IRS Notice 2007–63 providing that the CCC reports market gain associated with the repayment of a CCC loan, regardless of whether the taxpayer repays the loan with cash or uses CCC certificates in repayment of the loan.

Effective Date

The provision is effective for loans repaid on or after January 1, 2007.

PART TWELVE: HEROES EARNINGS ASSISTANCE AND RELIEF TAX ACT OF 2008 (PUBLIC LAW 110–245)[196]

TITLE I—BENEFITS FOR MILITARY

A. Recovery Rebate Provided for Military Families (sec. 101 of the Act and sec. 6428 of the Code)

Present Law

In general

Present law includes a recovery rebate credit for 2008 which is refundable. The credit mechanism (and the issuance of checks described below) is intended to deliver an expedited fiscal stimulus to the economy.

The credit is computed with two components in the following manner.

Basic credit

Eligible individuals receive a basic credit (for the first taxable year beginning) in 2008 equal to the greater of the following:

- Net income tax liability not to exceed $600 ($1,200 in the case of a joint return).
- $300 ($600 in the case of a joint return) if: (1) the eligible individual has qualifying income of at least $3,000; or (2) the eligible individual has a net income tax liability of at least $1 and gross income greater than the sum of the applicable basic standard deduction amount and one personal exemption (two personal exemptions for a joint return).

An eligible individual is any individual other than: (1) a nonresident alien; (2) an estate or trust; or (3) a dependent.

For these purposes, "net income tax liability" means the excess of the sum of the individual's regular tax liability and alternative minimum tax over the sum of all nonrefundable credits (other than the child credit). Net income tax liability as determined for these purposes is not reduced by the credit added by this provision or any credit which is refundable under present law.

Qualifying income is the sum of the eligible individual's: (a) earned income; (b) Social Security benefits (within the meaning of sec. 86(d)); and (c) veteran's payments (under Chapters 11, 13, or

[196] H.R. 6081. The House Committee on Ways and Means reported H.R. 3997 on November 5, 2007 (H.R. Rep. 110–426). H.R. 6081 passed the House on November 6, 2007. The bill passed the Senate on December 12, 2008, with an amendment, by unanimous consent. The House on December 18, 2007, agreed to the Senate amendment with an amendment. On December 19, 2007, the Senate concurred in the House amendment with an amendment. H.R. 6081, which contains many of the provisions of H.R. 3997, passed the House on May 20, 2008. The bill passed the Senate by unanimous consent on May 22, 2008. The President signed the bill on June 17, 2008. *Technical Explanation of H.R. 6081, the "Heroes Earnings Assistance and Relief Tax Act of 2008," as Scheduled For Consideration by the House of Representatives on May 20, 2008* (JCX–44–08 (May 20, 2008).

15 of title 38 of the U. S. Code). The definition of earned income has the same meaning as when used in the earned income credit except that it includes certain combat pay and does not include net earnings from self-employment which are not taken into account in computing taxable income.

Qualifying child credit

If an individual is eligible for any amount of the basic credit the individual also may be eligible for a qualifying child credit. The qualifying child credit equals $300 for each qualifying child of such individual. For these purposes, the child credit definition of qualifying child applies.

Limitation based on adjusted gross income

The amount of the credit (i.e., the sum of the amounts of the basic credit and the qualifying child credit) is phased out at a rate of five percent of adjusted gross income above certain income levels. The beginning point of this phase-out range is $75,000 of adjusted gross income ($150,000 in the case of joint returns).

Rebate checks

Most taxpayers will receive this credit in the form of a check issued by the Department of the Treasury. The amount of the payment is computed in the same manner as the credit, except that it is done on the basis of tax returns filed for 2007 (instead of 2008).

In no event may the Department of the Treasury issue checks after December 31, 2008. Payment of the credit (or the check) is treated, for all purposes of the Code, as a payment of tax. Any resulting overpayment under this provision is subject to the refund offset provisions, such as those applicable to past-due child support under section 6402 of the Code.

Valid identification numbers

No credit is allowed to an individual who does not include a valid identification number on the individual's income tax return. In the case of a joint return which does not include valid identification numbers for both spouses, no credit is allowed. In addition, a child shall not be taken into account in determining the amount of the credit if a valid identification number for the child is not included on the return. For this purpose, a valid identification number means a Social Security number issued to an individual by the Social Security Administration. A taxpayer identification number issued by the Internal Revenue Service (the "IRS") is not a valid identification number for purposes of this credit (e.g., an ITIN).

If an individual fails to provide a valid identification number, the omission is treated as a mathematical or clerical error. As under present law, the IRS may summarily assess additional tax due as a result of a mathematical or clerical error without sending the taxpayer a notice of deficiency and giving the taxpayer an opportunity to petition the Tax Court. Where the IRS uses the summary assessment procedure for mathematical or clerical errors, the taxpayer must be given an explanation of the asserted error and given 60 days to request that the IRS abate its assessment.

Explanation of Provision

The Act makes a modification to the rules relating to valid identification numbers in the case of the recovery rebate credit.

The Act provides that the identification number requirement does not apply in the case of a joint return where at least one spouse is a member of the Armed Forces of the United States[197] at any time during the taxable year.

Effective Date

The provision is effective as if included in the amendments made by section 101 of the Economic Stimulus Act of 2008 (Pub. L. No. 110–185).

B. Make Permanent the Election to Treat Combat Pay as Earned Income for Purposes of the Earned Income Tax Credit (sec. 102 of the Act and secs. 32 and 112 of the Code)

Present Law

In general

Subject to certain limitations, military compensation earned by members of the Armed Forces while serving in a combat zone may be excluded from gross income. In addition, for up to two years following service in a combat zone, military personnel may also exclude compensation earned while hospitalized from wounds, disease, or injuries incurred while serving in the combat zone.

Child credit

Combat pay that is otherwise excluded from gross income under section 112 is treated as earned income which is taken into account in computing taxable income for purposes of calculating the refundable portion of the child credit.

Earned income tax credit

Any taxpayer may elect to treat combat pay that is otherwise excluded from gross income under section 112 as earned income for purposes of the earned income tax credit. This election is available with respect to any taxable year ending after the date of enactment and before January 1, 2008.

Reasons for Change

The Congress believes that members of the armed forces serving in combat should have full availability of the earned income tax credit, notwithstanding the exclusion of combat pay from gross income for purposes of determining federal tax liability. The Congress believes a permanent extension of the election to treat combat pay as earnings for purposes of the earned income tax credit is necessary to achieve this result.

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[197] The term includes all regular and reserve components of the uniformed services. See section 7701(a)(15).

Explanation of Proposal

The Act permanently extends the availability of the election to treat combat pay that is otherwise excluded from gross income under section 112 as earned income for purposes of the earned income tax credit.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

C. Modification of Qualified Mortgage Bond Program Rules for Veterans (sec. 103 of the Act and sec. 143 of the Code)

Present Law

In general

Private activity bonds are bonds that are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such private person. The exclusion from income for interest paid on State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds"). The definition of qualified private activity bonds includes both qualified mortgage bonds and qualified veterans' mortgage bonds.

Qualified mortgage bonds

Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for owner-occupied residences. The Code imposes several limitations on qualified mortgage bonds, including income limitations for homebuyers and purchase price limitations for the home financed with bond proceeds. In addition, qualified mortgage bonds generally cannot be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the three years preceding the execution of the mortgage (the "first-time homebuyer" requirement).

Under a special rule, qualified mortgage bonds may be issued to finance mortgages for veterans who served in the active military without regard to the first-time homebuyer requirement. Present-law income and purchase price limitations apply to loans to veterans financed with the proceeds of qualified mortgage bonds. Veterans are eligible for the exception from the first-time homebuyer requirement without regard to the date they last served on active duty or the date they applied for a loan after leaving active duty. However, veterans may only use the exception one time and the exception only applies to financing provided from bonds issued before January 1, 2008.

Qualified veterans' mortgage bonds

Qualified veterans' mortgage bonds are private activity bonds the proceeds of which are used to make mortgage loans to certain veterans. Authority to issue qualified veterans' mortgage bonds is limited to States that had issued such bonds before June 22, 1984.

Qualified veterans' mortgage bonds are not subject to the State volume limitations generally applicable to private activity bonds. Instead, annual issuance in each State is subject to a separate State volume limitation. The five States eligible to issue these bonds are Alaska, California, Oregon, Texas, and Wisconsin.

In the case of qualified veterans' mortgage bonds issued by California or Texas, mortgage loans only can be made to veterans who served on active duty before 1977 and who applied for the financing before the date 30 years after the last date on which such veteran left active service. In the case of qualified veterans' mortgage bonds issued by the States of Alaska, Oregon, and Wisconsin, mortgage loans can be made to veterans who apply for financing before the date 25 years after the last date on which such veteran left active service, without regard to the calendar year the veteran served on active duty.

The annual volume of qualified veterans' mortgage bonds that can be issued in California or Texas is based on the average amount of bonds issued in the respective State between 1979 and 1984. In Alaska, Oregon, and Wisconsin, the annual limit on qualified veterans' mortgage bonds that can be issued in years after 2009 is $25 million. This $25 million per-State limit is phased in from 2006 through 2009 by allowing the applicable percentage of the $25 million limit. The following table provides those percentages.

Calendar year:	Applicable percentage is:
2006	20 percent
2007	40 percent
2008	60 percent
2009	80 percent

Unused allocation cannot be carried forward to subsequent years.

Reasons for Change

The Congress believes that the eligibility requirements for qualified veterans' mortgage bonds should be consistent. Thus, the Congress believes the programs in California and Texas should be expanded to permit financing for veterans without regard to the date they served on active duty, as is the case for financing provided in Alaska, Oregon, and Wisconsin under present law. The Congress also believes that the volume limits for qualified veterans' mortgage bonds should be modified so that more veterans are able to benefit from the program. Similarly, the Congress believes that the present-law exception to the first-time homebuyer rule for qualified mortgage bonds should be made permanent. The Congress believes this will allow a broader class of veterans to achieve homeownership under the program.

Explanation of Provision

Qualified mortgage bonds

The Act permanently extends the limited exception from the first-time homebuyer rule for veterans under the qualified mortgage bond program.

Qualified veterans' mortgage bonds

The Act increases the annual limit on qualified veterans' mortgage bonds that can be issued in Alaska, Oregon, and Wisconsin in years after 2009 to $100 million. For 2008 and 2009, the $100 million limit is phased in by applying the present-law applicable percentages for those years (i.e., 60 percent in 2008 and 80 percent in 2009).

With respect to qualified veterans' mortgage bonds issued in California or Texas, the provision repeals the requirement that veterans receiving loans financed with qualified veterans' mortgage bonds must have served before 1977 and reduces the eligibility period to 25 years (rather than 30 years) following release from military service.

Effective Date

The provision generally applies to bonds issued after December 31, 2007. In the case of any bond issued after December 31, 2007, and before the date of enactment, the eligibility period for a loan financed with qualified veterans' mortgage bonds is 30 years following release from military service.

D. Survivor and Disability Payments with Respect to Qualified Military Service (sec. 104 of the Act and secs. 401(a), 414(u), 403(b), and 457(g) of the Code)

Present Law

Under the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA"),[198] which revised and restated the Federal law protecting veterans' reemployment rights, an employee who leaves a civilian job for qualified military service generally is entitled to be reemployed by the civilian employer if the individual returns to employment within a specified time period. In addition to reemployment rights, a returning veteran also is entitled to the restoration of certain pension, profit sharing and similar benefits that would have accrued, but for the employee's absence due to the qualified military service. The protections provided under USERRA do not apply if the veteran is not reemployed by the veteran's civilian employer.

USERRA generally provides that for a reemployed veteran, service in the uniformed services is considered service with the employer for retirement plan vesting and benefit accrual purposes. The employer that reemploys the returning veteran is liable for funding any resulting obligation. USERRA also provides that the reemployed veteran is entitled to any accrued benefits that are contingent on the making of, or derived from, employee contributions or elective deferrals only to the extent the reemployed veteran makes payment to the plan with respect to such contributions or deferrals. No such payment may exceed the amount the reemployed veteran would have been permitted or required to contribute had the person remained continuously employed by the employer throughout the period of uniformed service. Under USERRA, any

[198] Pub. L. No. 103–353.

such payment to the plan must be made during the period beginning with the date of reemployment and whose duration is three times the reemployed veteran's period of uniform service, not to exceed five years.

The Small Business Job Protection Act of 1996[199] added section 414(u) to the Code to provide rules regarding the interaction of the USERRA protections with generally applicable rules that govern tax qualified retirement plans. For example, section 414(u) provides that if any make-up contribution is made by an employer or employee with respect to a reemployed veteran, then such contribution is not subject to the otherwise applicable plan contribution and deduction limits for the year in which the contribution is made (such as the section 402(g) annual limit on elective deferrals, which is generally $15,500 in 2008). Such limits are instead applied for the year to which the contribution relates had the individual continued to be employed by the employer during the period of uniformed service.

Under section 414(u), a plan to which a make-up contribution is made on account of a reemployed veteran is not treated as failing to meet the qualified plan nondiscrimination, coverage, minimum participation, and top heavy rules[200] by reason of the making of such contribution. Consequently, for purposes of applying the requirements and tests associated with these rules, make-up contributions are not taken into account either for the year in which they are made or for the year to which they relate.

In addition, section 414(u) provides for a special rule in the case of make-up contributions of salary reduction, employer matching, and after-tax employee amounts. A plan that provides for elective deferrals or employee contributions is treated as meeting the requirements of USERRA if the employer permits reemployed veterans to make additional elective deferrals or employee contributions under the plan during the period which begins on the date of reemployment and has the same length as the lesser of (1) the period of the individual's absence due to uniformed service multiplied by three or (2) five years. The employer is required to match any additional elective deferrals or employee contributions at the same rate that would have been required had the deferrals or contributions actually been made during the period of uniformed service. Additional elective deferrals, employer matching contributions, and employee contributions are treated as make-up contributions for purposes of the rule exempting such contributions from qualified plan nondiscrimination, coverage, minimum participation, and top heavy rules described above.

Reasons for Change

Present law provides certain retirement plan protections for reservists who are called to active duty and who are able to return to their civilian employers after serving our country. The Congress is concerned that there is a gap in this protection for those who are called to serve our country, but who are unable to return to their

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[199] Pub. L. No. 104–188.

[200] These include Code sections 401(a)(4), 401(a)(26), 401(k)(3), 401(k)(11), 401(k)(12), 401(m), 403(b)(12), 408(k)(3), 408(k)(6), 408(p), 410(b), and 416.

civilian employers because they have given their lives in service, or have suffered a disability that makes reemployment impossible. The Congress believes that certain retirement plan protections should be extended to the survivors of reservists who have sacrificed their lives, and that other protections should be permitted to be made available under employer-sponsored qualified pension plans in the case of reservists who do not survive, or who are disabled while serving our country.

Explanation of Provision

The Act adds a new tax qualification requirement for retirement plans that are qualified under section 401(a) of the Code (a "tax-qualified plan"). Under the new requirement, a tax-qualified plan must provide that, in the case of a participant who dies while performing qualified military service, the survivors of the participant must be entitled to any additional benefits (other than benefit accruals relating to the period of qualified military service) that would be provided under the plan had the participant resumed employment with the employer maintaining the plan and then terminated employment on account of death. Thus, if a plan provides for accelerated vesting, ancillary life insurance benefits, or other survivor benefits that are contingent upon a participant's termination of employment on account of death, the plan must provide such benefits to the beneficiary of a participant who dies during qualified military service.

Under the provision, conforming amendments apply the new tax qualification requirement to section 403(b) tax-deferred annuities and eligible deferred compensation plans (described in section 457(b)) maintained by State and local governments. The provision also conditions the deduction timing rule of section 404(a)(2) (permitting contributions for the purchase of employee retirement annuities that meet certain requirements applicable to tax-qualified retirement plans to be deducted in the year of payment) on satisfaction of the new qualification requirement.

In addition, for benefit accrual purposes, the provision permits a retirement plan to treat an individual who leaves service with the plan's sponsoring employer for qualified military service, and who cannot be reemployed on account of death or disability, as if the individual had been rehired as of the day before death or disability (a "deemed rehired employee") and then had terminated employment on the date of death or disability. In the case of a deemed rehired employee, the plan is permitted to comply fully or partially with the benefit accrual restoration provisions that would be required under section 414(u) had the individual actually been rehired.

Subject to several conditions, if a plan complies fully or partially with the benefit accrual requirements of section 414(u), the special section 414(u) rules regarding the interaction of USERRA with the otherwise applicable benefit limitation and nondiscrimination rules apply. The first condition is that all employees performing qualified military service of the employer maintaining the plan who die or become disabled must be credited with benefits on a reasonably equivalent basis. Thus, differences in credited benefits on account of different compensation levels are permissible, but complying

fully with the section 414(u) benefit accrual requirements with respect to highly compensated employees and complying partially with respect to nonhighly compensated employees is not permissible. The second condition is that if the plan credits deemed rehired employees with benefits that are contingent on employee contributions or elective contributions, the plan must determine the rate of employee contributions or elective deferrals on the basis of the actual average contributions or deferrals made by the employee during the 12-month period prior to military service (or if less, the average for the actual period of service).

The provision provides rules regarding the date by which a plan must be amended to comply with the provision. In general, a plan must be amended on or before the last day of the plan year beginning on or after January 1, 2010.

Effective Date

The provision applies in the case of deaths and disabilities occurring on or after January 1, 2007.

E. Treatment of Differential Military Pay as Wages (sec. 105 of the Act and secs. 3401 and 414(u) of the Code)

Present Law

In general

In the case of an employee who is called to active duty with the United States uniformed services, some employers voluntarily agree to continue paying the level of compensation that the service member would otherwise have received from the employer during the service member's period of active duty. Such compensation is commonly referred to as "differential pay."

Wage withholding

Differential pay is not treated as wages for purposes of the Federal income tax withholding rules that apply to an employer's payment of wages. This is because the service member is treated as terminating the employment relationship with the employer that pays the differential pay upon being called for active duty.[201]

Retirement plans

Section 415 imposes limitations on the benefits that may be provided under a retirement plan that is qualified under section 401(a) (a "qualified plan"). For a defined contribution plan, section 415 limits the annual additions to a participant's account under the plan to the lesser of a dollar amount ($46,000 in 2008) or 100 percent of the participant's compensation. In the case of a defined benefit plan, section 415 generally limits the annual benefit payable under the plan to the lesser of a dollar amount ($185,000 in 2008) or 100 percent of the participant's average compensation for the participant's high three years.

Final regulations issued in 2007 generally permit a plan to treat differential pay as compensation for purposes of section 415.[202] The

[201] See Rev. Rul. 69–136, 1969–1 C.B. 252.
[202] Treas. Reg. sec. 1.415(c)–2(e)(4), 72 Fed. Reg. 16,878 (Apr. 5, 2007).

section 415 limitations also apply to tax deferred annuities[203] and simplified employee pensions[204] ("SEPs"). The definition of compensation in section 415 is used in limiting the amount that may be deferred under an eligible deferred compensation plan (described in section 457(b)).

Limitation on in-service distributions

Under present law, certain types of contributions to a retirement plan are subject to restrictions that generally limit distributions to a participant prior to the participant severing employment with the employer that sponsors the plan. This limitation on in-service distributions applies to: (1) elective deferrals under a qualified cash or deferred compensation arrangement (a "section 401(k) plan"); (2) amounts attributable to a salary reduction agreement under a section 403(b) tax-sheltered annuity; (3) amounts contributed to a custodial account described in section 403(b)(7); and (4) amounts deferred under an eligible deferred compensation plan (described in section 457(b)).

USERRA

Under USERRA, which revised and restated the Federal law protecting veterans' reemployment rights, an employee who leaves a civilian job for qualified military service generally is entitled to be reemployed by the civilian employer if the individual returns to employment within a specified time period. In addition to reemployment rights, a returning veteran also is entitled to the restoration of certain pension, profit sharing and similar benefits that would have accrued, but for the employee's absence due to the qualified military service. Section 414(u) provides special rules that permit defined benefit plans and individual account plans to satisfy the requirements of USERRA. An individual account plan for this purpose is any defined contribution plan (such as a section 401(k) plan), and includes a section 403(b) tax sheltered annuity, a SEP, a qualified salary reduction arrangement under section 408(p) ("SIMPLE"), and an eligible deferred compensation plan (described in section 457(b)). Section 414(u) does not apply to a plan to which Chapter 43 of Title 38 of the United States Code does not apply.

IRA contributions

There are two general types of individual retirement arrangements ("IRAs"): traditional IRAs and Roth IRAs.[205] Under section 219, the total amount that an individual may contribute to one or more IRAs for a year is generally limited to the lesser of: (1) a dollar amount ($5,000 for 2008); or (2) the amount of the individual's compensation that is includible in gross income for the year. In the case of a married couple, contributions can be made up to the dollar limit for each spouse if the combined compensation of the spouses that is includible in gross income is at least equal to the contributed amount. For purposes of the IRA contribution limita-

[203] Sec. 403(b).
[204] Sec. 408(k).
[205] Secs. 408 and 408A.

tions, compensation includes an individual's net earnings from self employment.

Reasons for Change

The Congress is concerned that the current law treatment of differential pay for purposes of the Federal wage withholding rules creates a possible trap for unwary reservists who are called to active duty. This is because differential pay is paid by the reservist's former civilian employer and thus reservists may assume that such payments are subject to the wage withholding rules as other compensation paid when not on qualified military service. Thus, the reservist would not anticipate that there is an estimated tax payment obligation with respect to such payments. The Congress also believes that differential pay should be treated as employer-paid compensation for purposes of tax-favored retirement savings programs.

The Congress believes that a reservist called to active duty is properly treated as having terminated employment for purposes of rules that limit an individual's ability to access certain contributions to tax-favored retirement savings plans. This rule allows reservists access to amounts in their retirement savings plans. However, the Congress believes that such contributions should not be accessed if reservists have other means of satisfying their financial obligations. Thus, if such contributions are accessed by a reservist, no additional contributions may be made to the plan by the reservist for the six-month period following the distribution.

Explanation of Provision

Wage withholding

The provision amends the definition of wages for purposes of the Federal income tax withholding rules applicable to an employer's payment of wages. The provision includes as wages the employer's payment of any differential wage payment to the employee. Differential wage payment is defined as any payment which: (1) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services while on active duty for a period of more than 30 days; and (2) represents all or a portion of the wages that the individual would have received from the employer if the individual were performing services for the employer.

Retirement plans

The provision also provides rules relating to differential wage payments (as defined for purposes of wage withholding) for purposes of a retirement plan that is subject to section 414(u). Specifically, an individual receiving a differential wage payment is required to be treated as an employee of the employer making the payment, and the differential wage payment is required to be treated as compensation. In addition, a retirement plan that is subject to section 414(u) is not treated as failing to meet certain requirements relating to minimum participation and nondiscrimination

standards[206] by reason of any contribution or benefit that is based on the differential wage payment if all of the sponsoring employer's employees: (1) are entitled to differential wage payments on reasonably equivalent terms; and (2) if all employees eligible to participate in a retirement plan maintained by the employer are entitled to make contributions based on such differential payments on reasonably equivalent terms.

Under the provision, an individual is treated as having been severed from employment during any period the individual is performing service in the uniformed services while on active duty for a period of more than 30 days for purposes of the limitation on in-service distributions with respect to: (1) elective deferrals under a section 401(k) plan; (2) amounts attributable to a salary reduction agreement under a section 403(b) tax-sheltered annuity; (3) amounts contributed to a custodial account described in section 403(b)(7); and (4) amounts deferred under an eligible deferred compensation plan (described in section 457(b)). Thus, such individuals are not prohibited from receiving distributions on account of not severing employment. However, if any amounts are distributed on account of the foregoing rule, the individual is not permitted to make elective deferrals or employee contributions to the plan during the six-month period beginning on the date of distribution.

IRAs

For purposes of the limitation on contributions to an IRA, the provision amends the term "compensation" to include differential wage payments (as defined for purposes of wage withholding).

Plan amendment timing

In general, the provision permits a plan or annuity contract to be retroactively amended to comply with the provision provided that the amendment is made no later than the last day of the first plan year beginning on or after January 1, 2010. Subject to certain conditions, a plan or annuity contract is treated as being operated in accordance with its terms during the period prior to amendment and, except as provided by the Secretary of the Treasury, the plan or annuity contract does not fail to meet the requirements of the Code or ERISA by reason of the amendment.

Effective Date

For purposes of the wage withholding rules, the provision is effective with respect to remuneration paid after December 31, 2008. Otherwise, the provision is effective with respect to years beginning after December 31, 2008.

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[206] These standards include the following: section 401(a)(4) (prohibiting discrimination in contributions or benefits provided under qualified plans); section 401(a)(26) (providing minimum participation rules for qualified defined benefit plans); section 401(k)(3), (11), and (12) (providing non-discrimination rules for elective deferrals under qualified cash or deferred arrangements); section 401(m) (providing non-discrimination rules for employee contributions and employer matching contributions to qualified plans); 403(b)(12) (providing non-discrimination rules for section 403(b) tax sheltered annuities); section 408(k)(3), (k)(6), and (p) (providing non-discrimination rules for SEPs and SIMPLEs); section 410(b) (providing minimum coverage rules for qualified plans); and section 416 (requiring minimum benefits in the case of top heavy qualified plans).

F. Extension of the Statute of Limitations To File Claims for Refunds Relating to Disability Determinations by the Department of Veterans Affairs (sec. 106 of the Act and sec. 6511(d) of the Code)

Present Law

In general, a taxpayer must file a claim for credit or refund within three years of the filing of the tax return or within two years of the payment of the tax, whichever expires later (if no tax return is filed, the two-year limit applies). A claim for credit or refund that is not filed within these time periods is rejected as untimely.

Generally, military retirement benefits based on length of service are included in income, whereas veterans' benefits based on a service-connected disability are excluded from income. If an individual receives includible retirement benefits and is later retroactively determined to be eligible for service-connected disability benefits, the portion of the retirement benefits attributable to the disability is retroactively excluded from income. In that case, the individual may claim a refund of the tax paid on the retroactively excluded benefits, subject to the statute of limitations on filing a refund claim.

Reasons for Change

Because of the lapse of time between retirement and the determination of, or the onset and determination of, a service connected disability, the Congress believes it is appropriate to extend the statute of limitations to permit retired military personnel to file claims for refunds when a determination of a service-connected disability is made.

Explanation of Provision

The Act extends the time period for filing claims for credits or refunds for retired military personnel who receive disability determinations from the Department of Veterans Affairs (e.g., determinations after the tax return is filed). Specifically, in the case of a determination after the date of enactment, the provision extends the period for filing such a refund claim until one year after the date of the disability determination (if later than the time periods allowed under present law). The provision applies to any taxable year which begins five years before the date of the determination or thereafter. In the case of a determination after December 31, 2000, and on or before the date of enactment, the period for filing a claim for credit or refund is extended until one year after the date of enactment (if later than the time periods allowed under present law).

Effective Date

The provision is effective for claims for credits or refunds filed after the date of enactment (June 17, 2008).

G. Treatment of Distributions to Individuals Called to Active Duty for at Least 180 Days (sec. 107 of the Act and sec. 72(t) of the Code)

Present Law

Under present law, a taxpayer who receives a distribution from a qualified retirement plan prior to age 59½, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount includible in income, unless an exception to the tax applies. Among other exceptions, the early distribution tax does not apply to distributions made to an employee who separates from service after age 55, or to distributions that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the employee or the joint lives (or life expectancies) of the employee and his or her beneficiary.

Certain amounts held in a qualified cash or deferred arrangement (a "section 401(k) plan") or in a tax-sheltered annuity (a "section 403(b) annuity") may not be distributed before severance from employment, age 59½, death, disability, or financial hardship of the employee.

Pursuant to amendments to section 72(t) made by the Pension Protection Act of 2006,[207] the 10-percent early withdrawal tax does not apply to a qualified reservist distribution. A qualified reservist distribution is a distribution (1) from an IRA or attributable to elective deferrals under a section 401(k) plan, section 403(b) annuity, or certain similar arrangements, (2) made to an individual who (by reason of being a member of a reserve component as defined in section 101 of title 37 of the United States Code) was ordered or called to active duty for a period in excess of 179 days or for an indefinite period, and (3) that is made during the period beginning on the date of such order or call to duty and ending at the close of the active duty period. A section 401(k) plan or section 403(b) annuity does not violate the distribution restrictions applicable to such plans by reason of making a qualified reservist distribution.

An individual who receives a qualified reservist distribution may, at any time during the two-year period beginning on the day after the end of the active duty period, make one or more contributions to an IRA of such individual in an aggregate amount not to exceed the amount of such distribution. The dollar limitations otherwise applicable to contributions to IRAs do not apply to any contribution made pursuant to this special repayment rule. No deduction is allowed for any contribution made under the special repayment rule.

The special rules applicable to a qualified reservist distribution apply to individuals ordered or called to active duty after September 11, 2001, and before December 31, 2007.

Reasons for Change

The Congress believes that the exception to the 10-percent early withdrawal tax is an important tax relief provision for reservists called to active duty. Reservists called to active duty may need access to amounts that they have contributed to tax-favored retire-

[207] Pub. L. No. 109–280.

ment savings programs in order to meet their personal financial obligations while serving our country. Given the continuing need for activation of reservists, the Congress believes that this tax relief provision should be made permanent so that it applies to reservists called to active duty on or after December 31, 2007.

Explanation of Provision

The provision makes permanent the rules applicable to qualified reservist distributions to individuals ordered or called to active duty on or after December 31, 2007.

Effective Date

The provision is effective upon enactment (June 17, 2008).

H. Authority To Disclose Return Information for Certain Veterans Programs Made Permanent (sec. 108 of the Act and sec. 6103 of the Code)

Present Law

The Code prohibits disclosure of returns and return information, except to the extent specifically authorized by the Code (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431). No tax information may be furnished by the IRS to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

Among the disclosures permitted under the Code is disclosure of certain tax information to the Department of Veterans Affairs. Disclosure is permitted to assist the Department of Veterans Affairs in determining eligibility for, and establishing correct benefit amounts under, certain of its needs-based pension, health care, and other programs (sec. 6103(1)(7)(D)(viii)). The Department of Veterans Affairs disclosure provisions do not apply after September 30, 2008.

Reasons for Change

The temporary provision permitting the disclosure of otherwise confidential return information to the Department of Veterans Affairs to ensure the correctness of government benefit payments has been in existence since 1990. The Congress believes it is appropriate to make permanent this long-standing temporary provision.

Explanation of Provision

The Act makes permanent the authority to make disclosures to the Department of Veterans Affairs. The provision also corrects the cross-references to Title 38.

Effective Date

The provision is effective for requests made after September 30, 2008.

I. Contributions of Military Death Gratuities to Certain Tax-Favored Accounts (sec. 109 of the Act and secs. 408A and 530 of the Code)

Present Law

Military death gratuities and SGLI

Section 1477 of Title 10 of the United States Code provides for the payment of a military death gratuity to an eligible survivor of a service member. Under Code section 134, as amended by the Military Family Tax Relief Act of 2003, the full amount of the military death gratuity is excludable from gross income. Pursuant to section 1967 of Title 38 of the United States Code, certain members of the uniformed services are automatically insured against death under the Servicemembers' Group Life Insurance ("SGLI") program. In general, life insurance proceeds are excludable from gross income under Code section 101.

Roth IRAs

There are two general types of individual retirement arrangements ("IRAs"): traditional IRAs and Roth IRAs.[208] In general, contributions (other than a rollover contribution) to a traditional IRA may be deductible, and distributions from a traditional IRA are includible in gross income to the extent not attributable to a return of nondeductible contributions. Contributions to a Roth IRA are not deductible, and qualified distributions from a Roth IRA are excludable from gross income. Distributions from a Roth IRA that are not qualified distributions are includible in gross income to the extent attributable to earnings. In general, a qualified distribution is a distribution that is made on or after the individual attains age 59½, death, or disability or which is a qualified special purpose distribution. A distribution is not a qualified distribution if it is made within the five-taxable year period beginning with the taxable year for which an individual first made a contribution to a Roth IRA.

The total amount that an individual may contribute to one or more IRAs for a year is generally limited to the lesser of: (1) a dollar amount ($5,000 for 2008); or (2) the amount of the individual's compensation that is includible in gross income for the year. IRA contributions in excess of the applicable limit are generally subject to an excise tax of six percent per year until withdrawn. The contribution limit is reduced to the extent an individual makes contributions to any other IRA for the same taxable year.

As under the rules relating to traditional IRAs, a contribution of up to the dollar limit for each spouse may be made to a Roth IRA provided the combined compensation of the spouses is at least equal to the contributed amount. The maximum annual contribution that can be made to a Roth IRA is phased out for taxpayers with adjusted gross income for the taxable year over certain indexed levels. The adjusted gross income phase-out ranges for 2008 are: (1) for single taxpayers, $101,000 to $116,000; (2) for married

[208] Traditional IRAs are described in Code section 408, and Roth IRAs in Code section 408A.

taxpayers filing joint returns, $159,000 to $169,000; and (3) for married taxpayers filing separate returns, $0 to $10,000.

The foregoing contribution limitations generally do not apply in the case of a rollover contribution to an IRA. If certain requirements are satisfied, a participant in a tax-qualified retirement plan, a tax-sheltered annuity,[209] or a governmental section 457 plan may roll over distributions from the plan or annuity into a traditional IRA. For distributions after December 31, 2007, certain taxpayers are permitted to make qualified rollover contributions from such plans or annuities into a Roth IRA (subject to inclusion in gross income of any amount that would be includible were it not part of the qualified rollover contribution).

Coverdell Education Savings Accounts

Annual contributions to a Coverdell education savings account[210] may not exceed $2,000 (except in cases involving certain tax-free rollovers) and may not be made after the designated beneficiary reaches age 18. The maximum annual contribution that can be made to a Coverdell education savings account is phased out for taxpayers with adjusted gross income for the taxable year over certain indexed levels. Contributions to a Coverdell education savings account are not deductible. In general, a rollover is permitted between Coverdell education savings accounts for the benefit of the same beneficiary or member of such beneficiary's family.

In general, a distribution from a Coverdell education savings account is includible in the gross income of the distributee. However, distributions from an account are excludable from the distributee's gross income to the extent that the total distribution does not exceed the qualified education expenses incurred by the beneficiary during the year the distribution is made. Contributions to a Coverdell education savings account are treated as nontaxable investment in the contract. Thus, earnings on contributions are subject to tax if amounts withdrawn from the account exceed qualified education expenses. The portion of a distribution from a Coverdell education savings account that is includible in income (i.e., the portion allocable to earnings on contributions when a distribution exceeds qualified education expenses) is generally subject to an additional 10-percent tax.

Reasons for Change

The survivor of a service member who dies while serving our country is eligible to receive certain death benefits. In some cases, these benefit proceeds may not be needed by the survivor for immediate living expenses. Instead, the benefit proceeds may be needed for future expenses, such as retirement or education expenses. Under present law, contributions to tax-favored accounts for retirement and education savings are subject to annual limits. As a result, immediate contribution of death benefit proceeds to such accounts is prohibited. The Congress believes survivors of service members should be able to contribute death benefit proceeds to such accounts to save for future retirement and education needs.

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[209] Sec. 403(b).

[210] Coverdell education savings accounts are described in sec. 530.

Explanation of Provision

In the case of an individual who receives a military death gratuity or SGLI payment, the provision permits the individual to contribute an amount no greater than the sum of the gratuity and SGLI payments received by the individual to a Roth IRA, notwithstanding the contributions limits that otherwise apply to contributions to Roth IRAs (e.g., the annual contribution limit and the income phase-out of the contribution dollar limit). The provision also permits such an individual to contribute the gratuity and SGLI payments that the individual receives to one or more Coverdell education savings accounts, notwithstanding the $2,000 annual contribution limit and the income phase-out of the limit that would otherwise apply. The maximum amount that can be contributed to a Roth IRA or one or more Coverdell education savings accounts in the aggregate under the provision is limited to the sum of the gratuity and SGLI payments that the individual receives.

The contribution of a military death gratuity or SGLI payment to a Roth IRA is treated as a qualified rollover contribution to the Roth IRA. Similarly, the contribution of a military death gratuity or SGLI payment to a Coverdell education savings account is treated as a permissible rollover to such an account. The contribution of a military death gratuity or SGLI payment to a Roth IRA or Coverdell education savings account cannot be made later than one year after the date on which the gratuity or SGLI payment is received by the individual.

In the event of a subsequent distribution from a Roth IRA that is not a qualified distribution or a distribution from a Coverdell education savings account that is not a qualified education distribution, the amount of the distribution attributable to the contribution of the military death gratuity or SGLI payment is treated as nontaxable investment in the contract.

Effective Date

The provision is generally effective with respect to payments made on account of deaths from injuries occurring on or after the date of enactment (June 17, 2008). In addition, the provision permits the contribution to a Roth IRA or a Coverdell education savings account of a military death gratuity or SGLI payment received by an individual with respect to a death from injury occurring on or after October 7, 2001, and before the date of enactment of the provision (June 17, 2008) if the individual makes the contribution to the account no later than one year after the date of enactment of the provision (June 17, 2009).

J. Suspension of Five-year Period for the Exclusion of Gain on Sale of a Principal Residence by Certain Peace Corps Volunteers (sec. 110 of the Act and sec. 121(d) of the Code)

Present Law

In general

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized

on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met.

Uniformed services and Foreign Service

Present law also contains special rules relating to members of the uniformed services or the Foreign Service of the United States. An individual may elect to suspend for a maximum of 10 years the five-year test period for ownership and use during certain absences due to service in the uniformed services or the Foreign Service of the United States. The uniformed services include: (1) the Armed Forces (the Army, Navy, Air Force, Marine Corps, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service. If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to 10 years during which the taxpayer or the taxpayer's spouse is on qualified official extended duty as a member of the uniformed services or in the Foreign Service of the United States. For these purposes, qualified official extended duty is any period of extended duty while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in government furnished quarters. Extended duty is defined as any period of duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period. The election may be made with respect to only one property for a suspension period.

Intelligence community

Specified employees of the intelligence community may elect to suspend the running of the five-year test period during any period in which they are serving on extended duty. The term "employee of the intelligence community" means an employee of the Office of the Director of National Intelligence, the Central Intelligence Agency, the National Security Agency, the Defense Intelligence Agency, the National Geospatial-Intelligence Agency, or the National Reconnaissance Office. The term also includes employment with: (1) any other office within the Department of Defense for the collection of specialized national intelligence through reconnaissance programs; (2) any of the intelligence elements of the Army, the Navy, the Air Force, the Marine Corps, the Federal Bureau of Investigation, the Department of the Treasury, the Department of Energy, and the Coast Guard; (3) the Bureau of Intelligence and Research of the Department of State; and (4) the elements of the Department of Homeland Security concerned with the analyses of foreign intelligence information. To qualify, a specified employee must move from one duty station to another and the new duty station must

be located outside of the United States. The five-year period may not be extended more than 10 years.

The provision relating to employees of the intelligence community is effective for sales and exchanges before January 1, 2011.

Reasons for Change

For purposes of determining the excludability of gain on the sale of a principal residence, the Congress believes it is appropriate to treat Peace Corps volunteers in a manner similar to members of the uniformed services, the Foreign Service, and the intelligence community. Specifically, the Congress recognizes that Peace Corps volunteers face the same requirements to serve abroad, and thus should receive treatment similar to that provided members of the uniformed services, the Foreign Service and the intelligence community with respect to determining whether the necessary residency tests have been met to qualify for exclusion of gain.

Explanation of Provision

The provision creates a new rule for Peace Corps volunteers similar to the rules applicable to the uniformed services and Foreign Service and the intelligence community. Under this new rule, an individual may elect to suspend for a maximum of 10 years the five-year test period for ownership and use during certain absences due to volunteer service in the Peace Corps. If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to 10 years during which the taxpayer or the taxpayer's spouse is serving as a Peace Corps volunteer.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

K. Employer Wage Credit for Activated Military Reservists (sec. 111 of the Act and new sec. 45P of the Code)

Present Law

In general, compensation paid by an employer to an employee is deductible by the employer under section 162(a)(1), unless the expense must be capitalized. In the case of an employee who is called to active duty with respect to the armed forces of the United States, some employers voluntarily pay the employee the difference between the compensation that the employer would have paid to the employee during the period of military service less the amount of pay received by the employee from the military. This payment of the difference is often referred to as "differential pay."

Explanation of Provision

If a taxpayer qualifies as an eligible small business employer, the provision allows the taxpayer to take a credit against the taxpayer's income tax liability for a taxable year in an amount equal

to 20 percent of the sum of the eligible differential wage payments for each of the taxpayer's qualified employees for the taxable year.

A qualified employee of a taxpayer is a person who has been an employee for the 91-day period immediately preceding the period for which any differential wage payment is made. Differential wage payments means any payment which: (1) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services of the United States while on active duty for a period of more than 30 days; and (2) represents all or a portion of the wages that the individual would have received from the employer if the individual were performing services for the employer. The term eligible differential wage payments means so much of the differential wage payments paid to a qualified employee does not exceed $20,000.

An eligible small business employer means, with respect to a taxable year, any taxpayer which: (1) employed on average less than 50 employees on business days during the taxable year; and (2) under a written plan of the taxpayer, provides eligible differential wage payments to every qualified employee of the taxpayer. Taxpayers under common control are aggregated for purposes of determining whether a taxpayer is an eligible small business employer. The credit is not available with respect to a taxpayer who has failed to comply with the employment and reemployment rights of members of the uniformed services (as provided under Chapter 43 of Title 38 of the United States Code).

Under the provision, no deduction may be taken for that portion of compensation which is equal to the credit. In addition, the amount of any other credit otherwise allowable under Chapter 1 (Normal Taxes and Surtaxes) of Subtitle A (Income Taxes) of the Code with respect to compensation paid to an employee must be reduced by the differential wage payment credit allowed with respect to such employee.

Under the provision, the differential wage payment credit is part of the general business credit, and thus this credit is subject to the rules applicable to business credits. For example, an unused credit generally may be carried back to the taxable year that precedes an unused credit year or carried forward to each of the 20 taxable years following the unused credit year. The credit is not allowable against a taxpayer's alternative minimum tax liability.

Effective Date

The provision is effective with respect to amounts paid after the date of enactment (June 17, 2008) and before January 1, 2010.

L. Exclusion of Certain State Payments to Military Personnel (sec. 112 of the Act and sec. 134 of the Code)

Present Law

Subject to certain limitations, military compensation earned by members of the Armed Forces while serving in a combat zone is excludable from gross income.[211] Military personnel may also exclude, for up to two years following service in a combat zone, com-

[211] Sec. 112.

pensation earned while hospitalized from wounds, disease, or injuries incurred while serving in the zone. In addition, certain qualified military benefits, including certain death gratuities and other payments, are excludable from gross income.[212] Finally, the IRS has ruled that certain bonuses paid by States to military personnel are gifts that are not includible in gross income.[213]

Explanation of Provision

The Act provides that gross income does not include State or local payments of bonuses to active or former military personnel or their dependents by reason of such personnel's service in a combat zone.

Effective Date

The provision is effective for payments made before, on, or after the date of enactment (June 17, 2008).

M. Exclusion of Gain on Sale of a Principal Residence by Certain Employees of the Intelligence Community (sec. 113 of the Act and sec. 121 of the Code)

Present Law

In general

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met.

Uniformed services and Foreign Service

Present law also contains special rules relating to members of the uniformed services or the Foreign Service of the United States. An individual may elect to suspend for a maximum of 10 years the five-year test period for ownership and use during certain absences due to service in the uniformed services or the Foreign Service of the United States. The uniformed services include: (1) the Armed Forces (the Army, Navy, Air Force, Marine Corps, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service. If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to 10 years during which the taxpayer or the taxpayer's spouse is on qualified official extended duty

[212] Sec. 134.
[213] Rev. Rul. 68–158, 1968–1 C.B. 47; Chief Counsel Advice 200708003 (Feb. 23, 2007).

as a member of the uniformed services or in the Foreign Service of the United States. For these purposes, qualified official extended duty is any period of extended duty while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in government furnished quarters. Extended duty is defined as any period of duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period. The election may be made with respect to only one property for a suspension period.

Intelligence community

Specified employees of the intelligence community may elect to suspend the running of the five-year test period during any period in which they are serving on extended duty. The term "employee of the intelligence community" means an employee of the Office of the Director of National Intelligence, the Central Intelligence Agency, the National Security Agency, the Defense Intelligence Agency, the National Geospatial-Intelligence Agency, or the National Reconnaissance Office. The term also includes employment with: (1) any other office within the Department of Defense for the collection of specialized national intelligence through reconnaissance programs; (2) any of the intelligence elements of the Army, the Navy, the Air Force, the Marine Corps, the Federal Bureau of Investigation, the Department of the Treasury, the Department of Energy, and the Coast Guard; (3) the Bureau of Intelligence and Research of the Department of State; and (4) the elements of the Department of Homeland Security concerned with the analyses of foreign intelligence information. To qualify, a specified employee must move from one duty station to another and the new duty station must be located outside of the United States. The five-year period may not be extended more than 10 years.

The provision relating to employees of the intelligence community is effective for sales and exchanges before January 1, 2011.

Explanation of Provision

The provision permanently extends the provision relating to employees of the intelligence community.

The provision repeals the requirement that members of the intelligence community must move to a duty station outside of the United States to qualify for the exclusion.

Effective Date

The provision is effective for sales and exchanges after the date of enactment (June 17, 2008).

N. Disposition of Unused Health Benefits in Flexible Spending Arrangements (sec. 114 of the Act and sec. 125 of the Code)

Present Law

A flexible spending arrangement ("FSA") is a reimbursement account or other arrangement under which an employee is reimbursed for medical expenses or other nontaxable employer-provided

benefits, such as dependent care. Typically, FSAs are part of a cafeteria plan and may be funded through salary reduction. FSAs may also be provided by an employer outside of a cafeteria plan. FSAs are commonly used, for example, to reimburse employees for medical expenses not covered by insurance (referred to as a "health FSA").

There is no special exclusion for benefits provided under an FSA. Thus, benefits provided under an FSA are excludable from income only if there is a specific exclusion for the benefits in the Code (e.g., the exclusion for employer-provided health care (other than long-term care) or dependant care assistance coverage). If certain requirements are satisfied, contributions to a health FSA and all distributions to pay medical expenses are excludable from income and from wages for FICA tax purposes.

FSAs that are part of a cafeteria plan must comply with the rules applicable to cafeteria plans generally. One of these rules is that a cafeteria plan may not offer deferred compensation except through a qualified cash or deferred arrangement.[214] Under proposed Treasury regulations, a cafeteria plan is considered to permit the deferral of compensation if it includes a health FSA which reimburses participants for medical expenses incurred beyond the end of the plan year.[215] Thus, amounts in an employee's account that are not used for medical expenses incurred before the end of a plan year must be forfeited. This rule is often referred to as the "use it or lose it" rule. In 2005, the IRS issued guidance allowing a grace period immediately following the end of a plan year during which unused benefits or contributions remaining at the end of the plan year may be paid or reimbursed to plan participants for qualified benefit expenses incurred during a grace period.[216] A plan may allow benefits not used during the plan year to be used to reimburse qualified expenses incurred during the period, not to exceed two and one-half months, immediately following the end of the plan year. Additionally, if health FSAs provide any benefit other than medical reimbursements, all payments by the plan become taxable.

Proposed Treasury regulations contain additional requirements with which health FSAs must comply in order for the coverage and benefits provided under the FSA to be excludable from income.[217] These rules apply with respect to a health FSA without regard to whether the health FSA is provided through a cafeteria plan (i.e., without regard to whether an employee has an election to take cash or benefits).

Explanation of Provision

Under the provision, a plan does not fail to be treated as a cafeteria plan or health FSA merely because the plan provides for qualified reservist distributions. A qualified reservist distribution means a distribution to a participant in a health FSA of all or a portion of the participant's FSA balance if (1) the participant is a reservist called to active duty for a period of at least 180 days (or is called for an indefinite period) and (2) the distribution is made

[214] Sec. 125(d).
[215] Prop. Treas. Reg. 1.125–5(c).
[216] Notice 2005–42, 2005–1 C.B. 1204; see also Prop. Treas. Reg. 1.125–1(e).
[217] Prop. Treas. Reg. 1.125–5.

during the period beginning with the call to active duty and ending on the date that reimbursements would otherwise be made under the FSA for the plan year.

Effective Date

The provision is effective for distributions made after date of enactment (June 17, 2008).

O. Clarification Related to the Exclusion of Certain Benefits Provided to Volunteer Firefighters and Emergency Medical Responders (sec. 115 of the Act and secs. 3121, 3306, and 3401 of the Code)

Present Law

Deduction for certain State or local taxes

For purposes of determining regular tax liability, an itemized deduction is permitted for certain State and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. The itemized deduction is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. For taxable years beginning before January 1, 2008, at the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction provided under present law for State and local income taxes.

The otherwise allowable itemized deduction for these State or local taxes is not reduced by the amount of any reduction or rebate on account of services performed as a member of a qualified volunteer emergency response organization.

Charitable deduction for certain expenses

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and the fair market value of property contributed to an organization described in section 501(c)(3), to a Federal, State, or local governmental entity, or to certain other organizations.[218] The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced or limited depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer. Within certain limitations, donors also are entitled to deduct their contributions to section 501(c)(3) organizations for Federal estate and gift tax purposes.

Certain tax reductions or tax rebates provided by a State or local government

In general

Present law provides an exclusion from gross income to members of qualified volunteer emergency response organizations for: (1) any qualified State or local tax benefit; and (2) any qualified reimbursement payment. A qualified State or local tax benefit is any reduction or rebate of certain taxes provided by State or local govern-

[218] Sec. 170(a), (c), and (e).

ments on account of services performed by individuals as members of a qualified volunteer emergency response organization. These taxes are limited to State or local income taxes, State or local real property taxes, and State or local personal property taxes. A qualified reimbursement payment is a payment provided by a State or political subdivision thereof on account of reimbursement for expenses incurred in connection with the performance of services as a member of a qualified volunteer emergency response organization. The amount of such qualified reimbursement payments is limited to $30 for each month during which the taxpayer performs such services.

A qualified volunteer emergency response organization is any volunteer organization: (1) which is organized and operated to provide firefighting or emergency medical services for persons in the State or its political subdivision; and (2) which is required (by written agreement) by the State or political subdivision to furnish firefighting or emergency medical services in such State or political subdivision.

Denial of double benefits

Present law provides that the amount of State or local taxes taken into account in determining the deduction for taxes is reduced by the amount of any qualified State or local tax benefit.

Also, present law provides that expenses paid or incurred by the taxpayer in connection with the performance of services as a member of a qualified volunteer emergency response organization is taken into account for purposes of the charitable deduction only to the extent such expenses exceed the amount of any qualified reimbursement payment excluded from income under the Act.

Sunset

The rules related to certain tax reductions or tax rebates provided by a State or local government provided to volunteer firefighters and emergency medical responders do not apply to taxable years beginning after December 31, 2010.

Explanation of Provision

The provision clarifies that any qualified State or local tax benefit and any qualified reimbursement payment excluded from gross income is not subject to social security tax or unemployment tax.

Effective Date

The provision is effective as if included in section 5 of the Mortgage Forgiveness Debt Relief Act of 2007 (Pub. L. 110–142).

TITLE III—REVENUE PROVISIONS

A. Revision of Tax Rules on Expatriation of Individuals (sec. 301 of the Act and new secs. 877A and 2801 of the Code)

Present Law

In general

Income tax

U.S. citizens and residents generally are subject to U.S. income taxation on their worldwide income. The U.S. tax may be reduced or offset by a credit allowed for foreign income taxes paid with respect to foreign source income. Nonresident aliens are taxed at a flat rate of 30 percent (or a lower treaty rate) on certain types of passive income derived from U.S. sources, and at regular graduated rates on net profits derived from a U.S. trade or business.

Certain special rules (sections 671–679) apply to certain trust interests deemed to be owned by the grantor or other person (a "grantor trust"). In that case, the deemed owner must include in income the items of income and deduction (and credits against tax) of the portion of such trust deemed to be owned by such person.

Except to the extent a trust is a grantor trust, a transfer of property by a U.S. person to a foreign estate or trust is treated (under section 684) by the transferor as if the property had been sold to such estate or trust. The same rule applies if a domestic trust becomes a foreign trust.

Estate tax

The estates of U.S. citizens and residents are subject to estate tax on all property, wherever located. The estates of nonresident aliens generally are subject to estate tax on U.S.-situated property (e.g., real estate and tangible property located within the United States and stock in a U.S. corporation).

Gift tax

U.S. citizens and residents generally are subject to gift tax on transfers by gift of any property, wherever situated. Nonresident aliens generally are subject to gift tax on transfers by gift of U.S.-situated property (e.g., real estate and tangible property located within the United States), but excluding intangibles, such as stock, regardless of where they are located.

Income tax rules with respect to expatriates

For the 10 taxable years after an individual relinquishes his or her U.S. citizenship or terminates his or her U.S. long-term residency, unless certain conditions are met, the individual is subject to an alternative method of income taxation than that generally ap-

plicable to nonresident aliens (the "alternative tax regime"). Generally, the individual is subject to income tax for the 10-year period at the rates applicable to U.S. citizens, but only on U.S.-source income.[219]

A "long-term resident" is a noncitizen who is a lawful permanent resident of the United States for at least eight taxable years during the period of 15 taxable years ending with the taxable year during which the individual either ceases to be a lawful permanent resident of the United States or commences to be treated as a resident of a foreign country under a tax treaty between such foreign country and the United States (and does not waive such benefits).

A former citizen or former long-term resident is subject to the alternative tax regime for a 10-year period following citizenship relinquishment or residency termination, unless the former citizen or former long-term resident: (1) establishes that his or her average annual net income tax liability for the five preceding years does not exceed $124,000 (adjusted for inflation after 2004) and his or her net worth is less than $2 million, or alternatively satisfies limited, objective exceptions for certain dual citizens and minors who have had no substantial contacts with the United States; and (2) certifies under penalties of perjury that he or she has complied with all U.S. Federal tax obligations for the preceding five years and provides such evidence of compliance as the Secretary may require.

Anti-abuse rules are provided to prevent the circumvention of the alternative tax regime.

Estate tax rules with respect to expatriates

Special estate tax rules apply to individuals who die during a taxable year in which they are subject to the alternative tax regime. Under these special rules, certain closely-held foreign stock owned by the former citizen or former long-term resident is includible in his or her gross estate to the extent that the foreign corporation owns U.S.-situated assets. The special rules apply if, at the time of death, the former citizen or former long-term resident: (1) owns, directly or indirectly, 10 percent or more of the total combined voting power of all classes of stock of the foreign corporation entitled to vote; and (2) is considered to own, directly or indirectly, more than 50 percent of (a) the total combined voting power of all classes of stock of the foreign corporation entitled to vote, or (b) the total value of the stock of such corporation. If this stock ownership test is met, then the gross estate of the former citizen or former long-term resident includes that proportion of the fair market value of the foreign stock owned by the individual at the time of death, which the fair market value of any assets owned by such foreign corporation and situated in the United States (at the time of death) bears to the total fair market value of all assets owned by such foreign corporation (at the time of death).

Gift tax rules with respect to expatriates

Special gift tax rules apply to individuals who make gifts during a taxable year in which they are subject to the alternative tax re-

[219] For this purpose, however, U.S.-source income has a broader scope than it does typically in the Code.

gime. The individual is subject to gift tax on gifts of U.S.-situated intangibles made during the 10 years following citizenship relinquishment or residency termination. In addition, gifts of stock of certain closely-held foreign corporations by a former citizen or former long-term resident are subject to gift tax, if the gift is made during the time that such person is subject to the alternative tax regime. The operative rules with respect to these gifts of closely-held foreign stock are the same as described above relating to the estate tax, except that the relevant testing and valuation date is the date of gift rather than the date of death.

Termination of U.S. citizenship or long-term resident status for U.S. Federal income tax purposes

An individual continues to be treated as a U.S. citizen or long-term resident for U.S. Federal tax purposes, including for purposes of section 7701(b)(10), until the individual: (1) gives notice of an expatriating act or termination of residency (with the requisite intent to relinquish citizenship or terminate residency) to the Secretary of State or the Secretary of Homeland Security, respectively; and (2) provides a statement to the Secretary of the Treasury in accordance with section 6039G.

Sanction for individuals subject to the individual tax regime who return to the United States for extended periods

The alternative tax regime does not apply to any individual for any taxable year during the 10-year period following citizenship relinquishment or residency termination if such individual is present in the United States for more than 30 days in the calendar year ending in such taxable year. Such individual is treated as a U.S. citizen or resident for such taxable year and, therefore, is taxed on his or her worldwide income.

Similarly, if an individual subject to the alternative tax regime is present in the United States for more than 30 days in any calendar year ending during the 10-year period following citizenship relinquishment or residency termination, and the individual dies during that year, he or she is treated as a U.S. resident, and the individual's worldwide estate is subject to U.S. estate tax. Likewise, if an individual subject to the alternative tax regime is present in the United States for more than 30 days in any year during the 10-year period following citizenship relinquishment or residency termination, the individual is subject to U.S. gift tax on any transfer of his or her worldwide assets by gift during that taxable year.

For purposes of these rules, an individual is treated as present in the United States on any day if such individual is physically present in the United States at any time during that day. The present-law exceptions to the U.S. presence rules for residency purposes[220] generally do not apply. However, for individuals with certain ties to countries other than the United States[221] and individ-

[220] Secs. 7701(b)(3)(D), 7701(b)(5), and 7701(b)(7)(B)–(D).

[221] An individual has such a relationship to a foreign country if (1) the individual becomes a citizen or resident of the country in which the individual was born, such individual's spouse was born, or either of the individual's parents was born, and (2) the individual becomes fully liable for income tax in such country.

uals with minimal prior physical presence in the United States,[222] a day of physical presence in the United States is disregarded if the individual is performing services in the United States on such day for an unrelated employer (within the meaning of sections 267 and 707(b)), that meets such requirements as the Secretary may prescribe in regulations. No more than 30 days may be disregarded during any calendar year under this rule.

Annual return

Former citizens and former long-term residents are required to file an annual return for each year in which they are subject to the alternative tax regime. The annual return is required even if no U.S. Federal income tax is due. The annual return requires certain information, including information on the permanent home of the individual, the individual's country of residence, the number of days the individual was present in the United States for the year, and detailed information about the individual's income and assets that are subject to the alternative tax regime. This requirement includes information relating to foreign stock potentially subject to the special estate and gift tax rules.

If the individual fails to file the statement in a timely manner or fails correctly to include all the required information, the individual is required to pay a penalty of $10,000. The $10,000 penalty does not apply if it is shown that the failure is due to reasonable cause and not to willful neglect.

Reasons for Change[223]

The Congress is aware that some individuals each year relinquish their U.S. citizenship or terminate their U.S. residency for the purpose of avoiding U.S. income, estate, and gift taxes. By so doing, such individuals reduce their annual U.S. income tax liability and reduce or eliminate their U.S. estate and gift tax liability.

The Congress recognizes that citizens and residents of the United States have a right not only physically to leave the United States to live elsewhere, but also to relinquish their citizenship or terminate their residency. The Congress does not believe that the Internal Revenue Code should be used to stop U.S. citizens and residents from relinquishing citizenship or terminating residency; however, the Congress also does not believe that the Code should provide a tax incentive for doing so. In other words, to the extent possible, an individual's decision to relinquish citizenship or terminate residency should be tax-neutral.

The Congress recognizes that the American Jobs Creation Act of 2004 altered prior law regarding expatriation in a number of respects, including the replacement of the subjective "principal purpose of tax avoidance test" with objective rules. Notwithstanding these changes, the Congress remains concerned that the present-

[222] An individual has a minimal prior physical presence in the United States if the individual was physically present for no more than 30 days during each year in the ten-year period ending on the date of loss of United States citizenship or termination of residency. However, for purposes of this test, an individual is not treated as being present in the United States on a day if the individual remained in the United States because of a medical condition that arose while the individual was in the United States. Sec. 7701(b)(3)(D)(ii).

[223] See. S. 349, the Small Business and Work Opportunity Act of 2007, which was reported by the Senate Committee on Finance on January 22, 2007 (S. Rep. No. 110–1).

law expatriation tax rules (as modified in 2004) are difficult to administer and could be made more effective. In addition, the Congress is concerned that the alternative method of taxation under section 877 can be avoided by postponing the realization of U.S.-source income for 10 years.

Consequently, the Congress believes that the present-law expatriation tax rules should be replaced with a new tax regime applicable to former citizens and residents. Because U.S. citizens and residents who retain their citizenship or residency generally are subject to income tax on accrued appreciation when they dispose of their assets, as well as estate tax on the full value of assets that are held until death, the Congress believes it fair to tax individuals on the appreciation in their assets when they relinquish their citizenship or terminate their residency. The Congress believes that an exception from such a tax should be provided for individuals with a relatively modest amount of appreciated assets. The Congress also believes that, where U.S. estate or gift taxes are avoided with respect to a transfer of property to a U.S. person by reason of the expatriation of the donor, it is appropriate for the recipient to be subject to an income tax based on the value of the property.

The Congress also believes that the present-law immigration rules applicable to former citizens are ineffective. The Congress believes that the rules should be modified to eliminate the requirement of proof of a tax avoidance purpose, and to coordinate the application of those rules with the tax rules provided under the new regime.

Explanation of Provision

In general

In general, the provision imposes tax on certain U.S. citizens who relinquish their U.S. citizenship and certain long-term U.S. residents who terminate their U.S. residency. Such individuals are subject to income tax on the net unrealized gain in their property as if the property had been sold for its fair market value on the day before the expatriation or residency termination ("mark-to-market tax"). Gain from the deemed sale is taken into account at that time without regard to other Code provisions. Any loss from the deemed sale generally is taken into account to the extent otherwise provided in the Code, except that the wash sale rules of section 1091 do not apply. Any net gain on the deemed sale is recognized to the extent it exceeds $600,000. The $600,000 amount is increased by a cost of living adjustment factor for calendar years after 2008. Any gains or losses subsequently realized are to be adjusted for gains and losses taken into account under the deemed sale rules, without regard to the $600,000 exemption.

The mark-to-market tax described above applies to most types of property interests held by the individual on the date of relinquishment of citizenship or termination of residency, with certain exceptions. Deferred compensation items, interests in nongrantor trusts, and specified tax deferred accounts are excepted from the mark-to-market tax but are subject to the special rules described below.

In addition, the provision imposes a transfer tax on certain transfers to U.S. persons from certain U.S. citizens who relin-

quished their U.S. citizenship and certain long-term U.S. residents who terminated their U.S. residency, or from their estates.

Individuals covered

The provision applies to any U.S. citizen who relinquishes citizenship and any long-term resident who terminates U.S. residency, if such individual ("covered expatriate") (1) has an average annual net income tax liability for the five preceding years ending before the date of the loss of U.S. citizenship or residency termination that exceeds $124,000 (as adjusted for inflation after 2004—$139,000 in 2008);[224] (2) has a net worth of $2 million or more on such date; or (3) fails to certify under penalties of perjury that he or she has complied with all U.S. Federal tax obligations for the preceding five years or fails to submit such evidence of compliance as the Secretary may require.

Exceptions to an individual's classification as a covered expatriate due to (1) or (2) above (but not (3)) are provided in two situations. The first exception applies to an individual who was born with citizenship both in the United States and in another country; provided that (1) as of the expatriation date the individual continues to be a citizen of, and is taxed as a resident of, such other country, and (2) the individual has been a resident of the United States (under the substantial presence test of section 7701(b)(1)(A)(ii)) for not more than 10 taxable years during the 15-year taxable year period ending with the taxable year of expatriation. The second exception applies to a U.S. citizen who relinquishes U.S. citizenship before reaching age 18½, provided that the individual was a resident of the United States (under the substantial presence test of section 7701(b)(1)(A)(ii)) for no more than 10 taxable years before such relinquishment.

The definition of "long-term resident" under the provision is generally the same as that under present law. As under present law, an individual is considered to terminate long-term U.S. residency when the individual ceases to be a lawful permanent resident of the United States (i.e., loses his or her green card status through revocation or has been administratively or judicially determined to have abandoned such status). Under the provision, however, an individual ceases to be treated as a lawful permanent resident of the United States for all tax purposes if such individual commences to be treated as a resident of a foreign country under a tax treaty between the United States and such foreign country, does not waive the benefits of the treaty applicable to residents of such foreign country, and notifies the Secretary of the commencement of such treatment.

The provision provides that, for all tax purposes, a U.S. citizen continues to be treated as a U.S. citizen for tax purposes until that individual's citizenship is treated as relinquished under the following rules. An individual is treated as having relinquished U.S. citizenship on the earliest of four possible dates: (1) the date that the individual renounces U.S. nationality before a diplomatic or consular officer of the United States (provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of

[224] Rev. Proc. 2007–66, sec. 3.29, 2007–45 I.R.B. 970.

loss of nationality); (2) the date that the individual furnishes to the State Department a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act (again, provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (3) the date that the State Department issues a certificate of loss of nationality; or (4) the date that a U.S. court cancels a naturalized citizen's certificate of naturalization. Notwithstanding the two immediately preceding sentences, relinquishment may occur earlier under Treasury regulations with respect to an individual who became at birth a citizen of the United States and of another country.

In the case of a long-term resident, the date that long-term residency is terminated is the "expatriation date." In the case of a citizen, the date that the individual relinquishes citizenship is the "expatriation date."

The foregoing rules replace the present-law rules that provide that an individual continues to be treated as a U.S. citizen or long-term resident for U.S. Federal tax purposes until the individual gives notice of an expatriating act or termination of residency.

If an individual who is a covered expatriate becomes subject to tax as a citizen or resident of the United States for any period beginning after the expatriation date, the individual is not treated as a covered expatriate during that period for purposes of applying the withholding rules relating to deferred compensation items, the rules relating to interests in nongrantor trusts, and the rules relating to gifts and bequests from covered expatriates. If the individual again relinquishes citizenship or terminates long-term residency (after meeting anew the requirements to become a long-term resident), the mark-to-market tax and other provisions are re-triggered with the new expatriation date.

Deferral of payment of mark-to-market tax

Under the provision, an individual may elect to defer payment of the mark-to-market tax imposed on the deemed sale of property. Interest is charged for the period the tax is deferred at the rate normally applicable to individual underpayments. The election is irrevocable and is made on a property-by-property basis. Under the election, the deferred tax attributable to a particular property is due when the return is due for the taxable year in which the property is disposed (or, if the property is disposed of in a transaction in which gain is not recognized in whole or in part, at such other time as the Secretary may prescribe). The deferred tax attributable to a particular property is an amount which bears the same ratio to the total mark-to-market tax as the gain taken into account with respect to such property bears to the total gain taken into account for the mark-to-market tax. The deferral of the mark-to-market tax may not be extended beyond the due date of the return for the taxable year which includes the individual's death.

In order to elect deferral of the mark-to-market tax, the individual is required to furnish a bond to the Secretary. The bond must be conditioned upon payment of the amount of tax due, plus interest thereon, and must be in accordance with such requirements relating to terms, conditions, form of the bond, and sureties, as may be specified by regulations. The bond must be accepted by

the Secretary. Other security mechanisms, including letters of credit, are permitted provided that they meet such requirements as the Secretary may prescribe. In the event that the security provided with respect to a particular property subsequently fails to meet the requirements of these rules and the individual fails to correct such failure, the deferred tax and the interest with respect to such property will become due. As a further condition to making the election, the individual is required to consent to the waiver of any treaty rights that would preclude the assessment or collection of the tax.

Deferred compensation items

The provision contains special rules for interests in deferred compensation items. For purposes of the provision, a "deferred compensation item" means any interest in a plan or arrangement described in section 219(g)(5), any interest in a foreign pension plan or similar retirement arrangement or program, any item of deferred compensation, and any property, or right to property, which the individual is entitled to receive in connection with the performance of services to the extent not previously taken into account under section 83 or in accordance with section 83.

The plans and arrangements described in section 219(g)(5) are (i) a plan described in section 401(a), which includes a trust exempt from tax under section 501(a); (ii) an annuity plan described in section 403(a); (iii) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, but excluding an eligible deferred compensation plan (within the meaning of section 457(b)); (iv) an annuity contract described in section 403(b); (v) a simplified employee pension (within the meaning of section 408(k)); (vi) a simplified retirement account (within the meaning of section 408(p)); and (vii) a trust described in section 501(c)(18).

If a deferred compensation item is an eligible deferred compensation item, the payor must deduct and withhold from a "taxable payment" to the covered expatriate a tax equal to 30 percent of such taxable payment. This withholding requirement is in lieu of any withholding requirement under present law. A taxable payment is subject to withholding to the extent it would be included in gross income of the covered expatriate if such person were subject to tax as a citizen or resident of the United States. A deferred compensation item is taken into account as a payment when such item would be so includible. A deferred compensation item that is subject to the 30 percent withholding requirement is subject to tax under section 871.

If a deferred compensation item is not an eligible deferred compensation item (and is not subject to section 83), an amount equal to the present value of the covered expatriate's deferred compensation item is treated as having been received on the day before the expatriation date. In the case of a deferred compensation item that is subject to section 83, the item is treated as becoming transferable and no longer subject to a substantial risk of forfeiture on the day before the expatriation date. Appropriate adjustments shall be made to subsequent distributions to take into account the foregoing treatment. In addition, these deemed distributions are not subject to early distribution tax. For this purpose, "early distribution tax"

means any increase in tax imposed under section 72(t), 220(e)(4), 223(f)(4), 409A(a)(1)(B), 529(c)(6), or 530(d)(4).

An "eligible deferred compensation item" means any deferred compensation item with respect to which (i) the payor is either a U.S. person or a non-U.S. person who elects to be treated as a U.S. person for purposes of withholding and who meet the requirements prescribed by the Secretary to ensure compliance with the withholding requirements, and (ii) the covered expatriate notifies the payor of his status as a covered expatriate and irrevocably waives any claim of withholding reduction under any treaty with the United States.

The foregoing taxing rules regarding eligible deferred compensation items and items that are not eligible deferred compensation items do not apply to deferred compensation items to the extent attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States.

Specified tax deferred accounts

There are special rules for interests in specified tax deferred accounts. If a covered expatriate holds any interest in a specified tax deferred account on the day before the expatriation date, such covered expatriate is treated as receiving a distribution of his entire interest in such account on the day before the expatriation date. Appropriate adjustments are made for subsequent distributions to take into account this treatment. As with deferred compensation items, these deemed distributions are not subject to early distribution tax.

The term "specified tax deferred account" means an individual retirement plan (as defined in section 7701(a)(37)), a qualified tuition plan (as defined in section 529), a Coverdell education savings account (as defined in section 530), a health savings account (as defined in section 223), and an Archer MSA (as defined in section 220). However, simplified employee pensions (within the meaning of section 408(k)) and simplified retirement accounts (within the meaning of section 408(p)) of a covered expatriate are treated as deferred compensation items and not as specified tax deferred accounts.

Interests in trusts

Grantor trusts

In the case of the portion of any trust for which the covered expatriate is treated as the owner under the grantor trust provisions of the Code, as determined immediately before the expatriation date, the assets held by that portion of the trust are subject to the mark-to-market tax.

If a trust that is a grantor trust immediately before the expatriation date subsequently becomes a nongrantor trust, such trust remains a grantor trust for purposes of the provision.

Nongrantor trusts

Special rules apply to trusts with respect to which the covered expatriate is a beneficiary on the day before the expatriation date.

The mark-to-market tax does not apply with respect to the portion of any such trust not treated (under the grantor trust provisions of the Code) as owned by a covered expatriate immediately before the expatriation date. Instead, in the case of any direct or indirect distribution from such a portion of a trust ("nongrantor trust") to a covered expatriate, the trustee must deduct and withhold from the distribution an amount equal to 30 percent of the portion of the distribution which would be includible in the gross income of the covered expatriate if the covered expatriate continued to be subject to tax as a citizen or resident of the United States. Such portion of such distribution (that is subject to the 30 percent withholding requirement) is subject to tax under section 871. The covered expatriate is treated as having waived any right to claim any reduction in withholding under any treaty with the United States unless the covered expatriate agrees to such other treatment as the Secretary deems appropriate.

In addition, if the nongrantor trust distributes appreciated property to a covered expatriate, the trust must recognize gain as if the property were sold to the covered expatriate at its fair market value.

If a trust that is a nongrantor trust immediately before the expatriation date subsequently becomes a grantor trust of which a covered expatriate is treated as the owner, directly or indirectly, such conversion is treated under the provision as a distribution to such covered expatriate to the extent of the portion of the trust of which the covered expatriate is treated as the owner.

Special rules

Notwithstanding any other provision of the Code, any period for acquiring property which results in the reduction of gain recognized with respect to property disposed of by the taxpayer terminates on the day before the expatriation date. This rule applies to certain incomplete transactions such as deferred like-kind exchanges and involuntary conversions. In addition, notwithstanding any other provision of the Code, any extension of time for payment of tax ceases to apply on the day before relinquishment of citizenship or termination of residency, and the unpaid portion of such tax becomes due and payable at the time and in the manner prescribed by the Secretary.

For purposes of determining the tax imposed under the mark-to-market tax, property that was held by an individual on the date that such individual first became a resident of the United States (within the meaning of section 7701(b)) is treated as having a basis on such date of not less than the fair market value of such property on such date. An individual may make an irrevocable election not to have this rule apply.

In the case of a domestic trust that becomes a foreign trust due to the expatriation of an individual, the general income tax rules pertaining to transfers by U.S. persons to foreign trusts (i.e., section 684) apply before the rules of the provision.

Regulatory authority

The provision authorizes the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the income tax rules of the provision.

Treatment of gifts and bequests from a former citizen or former long-term resident

Under the provision, a special transfer tax applies to certain "covered gifts or bequests" received by a U.S. citizen or resident. A covered gift or bequest is any property acquired (i) by gift directly or indirectly from an individual who is a covered expatriate at the time of such acquisition, or (ii) directly or indirectly by reason of the death of an individual who was a covered expatriate immediately before death. A covered gift or bequest, however, does not include (i) any property shown as a taxable gift on a timely filed gift tax return by the covered expatriate, (ii) any property included in the gross estate of the covered expatriate for estate tax purposes and shown on a timely filed estate tax return of the estate of the covered expatriate, and (iii) any property with respect to which a deduction would be allowed under section 2055, 2056, 2522 or 2523, whichever is appropriate (these sections allow deductions for transfers for charitable purposes or to spouses, for purposes of determining estate and gift taxes).

The tax is calculated as the product of (i) the highest marginal rate of tax specified in the table applicable to estate tax (i.e., section 2001(c)) or, if greater, the highest marginal rate of tax specified in the table applicable to gift tax (i.e., section 2502(a)), both as in effect on the date of receipt of the covered gift or bequest; and (ii) the value of the covered gift or bequest.

The tax is imposed upon the recipient of the covered gift or bequest and is imposed on a calendar-year basis. The tax applies to a recipient of a covered gift or bequest only to the extent that the total value of covered gifts and bequests received by such recipient during a calendar year exceeds the amount in effect under section 2503(b) for that calendar year ($12,000 for 2008).[225] The tax on covered gifts and bequests is reduced by the amount of any gift or estate tax paid to a foreign country with respect to such covered gift or bequest.

Special rules apply to the tax on covered gifts or bequests made to domestic or foreign trusts. In the case of a covered gift or bequest made to a domestic trust, the tax applies as if the trust is a U.S. citizen, and the trust is required to pay the tax. In the case of a covered gift or bequest made to a foreign trust, the tax applies to any distribution from such trust (whether from income or corpus) attributable to such covered gift or bequest to a recipient that is a U.S. citizen or resident, in the same manner as if such distribution were a covered gift or bequest. Such a recipient is entitled to deduct the amount of such tax for income tax purposes to the extent such tax is imposed on the portion of such distribution that is included in the gross income of the recipient. For purposes of these rules, a foreign trust may elect to be treated as a domestic

[225] Rev. Proc. 2007–66, sec. 3.32(1), 2007–45 I.R.B. 970.

trust. The election may not be revoked without the Secretary's consent.

Coordination with present-law alternative tax regime

Under the provision, the present-law expatriation income tax rules under section 877 do not apply with respect to a covered expatriate whose expatriation or residency termination occurs on or after the date of enactment.

Information reporting

Certain information reporting requirements under the law presently applicable to former citizens and former long-term residents (sec. 6039G) also apply for purposes of the provision.

Effective Date

The provision generally is effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after the date of enactment (June 17, 2008). The portion of the provision relating to covered gifts and bequests is effective for gifts and bequests received on or after the date of enactment (June 17, 2008) from former citizens or former long-term residents (or the estates of such persons) whose expatriation date is on or after the date of enactment (June 17, 2008).

B. Certain Domestically Controlled Foreign Persons Performing Services Under Contract with United States Government Treated as American Employers (sec. 302 of the Act and sec. 3121 of the Code)

Present Law

In general

Under the Federal Insurance Contributions Act ("FICA"), separate taxes are imposed on every employer and employee with respect to wages paid to such employer's employees.[226] These two taxes are commonly referred to as the employer's and the employee's share of FICA. The employee's share of FICA is collected by means of payroll withholding by the employee's employer.

For both the employer and the employee's share of FICA, the tax consists of two parts: (1) old age, survivor, and disability insurance ("OASDI"), which correlates to the Social Security program that provides monthly benefits after retirement, disability, or death; and (2) Medicare hospital insurance ("HI"). The OASDI tax rate is 6.2 percent on both the employee and employer (for a total rate of 12.4 percent). The OASDI tax rate applies to wages up to the OASDI wage base ($102,000 for 2008). The HI tax rate is 1.45 percent on both the employee and the employer (for a total rate of 2.9 percent). Unlike the OASDI tax, the HI tax is not limited to a specific amount of wages, but applies to all wages.

For purposes of the employer's and employee's share of FICA, wages generally means all remuneration for employment including the cash value of all remuneration paid in a medium other than

[226] Secs. 3101–3128 (FICA). Sections 3501–3510 provide additional rules..

cash. However, the general definition of wages is subject to a number of special rules and exceptions.[227]

Employment for FICA purposes generally means any service of whatever nature performed by an employee for the employer (irrespective of the citizenship or residence of either) within the United States. In the case of service outside the United States, employment also includes service performed by a United States citizen or resident as an employee for an American employer. As in the case of the definition of wages, the definition of employment is also subject to a number of exceptions and special rules.[228] An American employer is defined as an employer which is: (1) the United States or any instrumentality thereof; (2) an individual who is a resident of the United States; (3) a partnership, if at least two-thirds of the partners are United States residents; (4) a trust, if all of the trustees are United States residents; or (5) a corporation organized under the laws of the United States or any of the States.[229]

Section 3121(l) agreements

An American employer may enter into a voluntary agreement with the Secretary of the Treasury to extend coverage of the insurance system of Title II of the Social Security Act to service performed outside the United States in the case of certain employees. Specifically, such an agreement may be entered into with respect to employees of a foreign affiliate of the American employer who are United States citizens or residents.[230] Such an agreement is commonly referred to as a "section 3121(l) agreement," and is entered into by completing Internal Revenue Service Form 2032. A foreign affiliate for purposes of the section 3121(l) agreement is any foreign entity in which the American employer has at least a 10-percent interest.[231]

If a section 3121(l) agreement is entered into, the American employer agrees to pay the Secretary of the Treasury amounts equivalent to the employer and employee's share of FICA (including amounts equivalent to interest, additional taxes, and penalties which would be applicable) with respect to the remuneration which would be wages if the services covered by the agreement constituted employment for purposes of FICA. In addition, the American employer agrees to comply with such regulations relating to payments and reports as the Secretary of the Treasury may prescribe.[232] A section 3121(l) agreement may not be terminated with respect to a foreign affiliate after June 15, 1989.[233]

In the case of a domestic corporation, a deduction is allowed for amounts paid or incurred pursuant to a section 3121(l) agreement with respect to services performed by United States citizens employed by foreign subsidiary corporations.[234] Any reimbursement of

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[227] Sec. 3121(a).

[228] Sec. 3121(b). For example, employment for FICA purposes includes certain service with respect to American vessels or aircrafts and also includes service that is designated as employment under an agreement entered into under section 233 of the Social Security Act.

[229] Sec. 3121(h).

[230] Sec. 3121(l).

[231] Sec. 3121(l)(6).

[232] Sec. 3121(l)(1).

[233] Sec. 3121(l)(3).

[234] Sec. 176.

any amount previously allowed as a deduction is included in gross income in the year received.

Totalization agreements

Under section 233 of the Social Security Act, the President of the United States is authorized to enter into agreements establishing totalization arrangements between the social security system of the United States and the social security system of a foreign country (referred to as a "totalization agreement").[235] The purposes of a totalization agreement are (1) to establish entitlement to and the amount of old-age, survivors, disability, or derivative benefits based on a combination of an individual's periods of coverage under the United States social security system and the social security system of a foreign country, and (2) to prevent imposition of employment taxes by two countries on the same wages.

For purposes of FICA, during any period in which a totalization agreement is in effect, wages paid to an individual are exempt from the employer's and employee's share of FICA to the extent such wages are subject under the agreement exclusively to the laws applicable to the foreign country's social security system.[236]

Explanation of Provision

Under the provision, a foreign person is treated as an American employer with respect to certain employees for purposes of determining whether their employment is subject to the employer's and employee's share of FICA. Specifically, a foreign person is treated as an American employer with respect to an employee of the foreign person who is performing services in connection with a contract between the United States government (or any instrumentality thereof) and any member of any domestically controlled group of entities which includes such foreign person. Thus, under the provision, service performed as an employee for such an employer outside of the United States by a United States citizen or resident in connection with such a contract is employment that is subject to FICA. A domestically controlled group of entities is a controlled group of entities the common parent of which is a domestic corporation. For this purpose, a controlled group of entities is as defined in section 1563(a)(1) except that the ownership threshold is 50 percent rather than 80 percent and certain other changes are made, including that certain partnerships may be considered members of a controlled group.

The sections 3101(c) and 3111(c) exceptions for wages not subject to FICA as a result of a totalization agreement apply under the provision. Also, this provision does not apply to any services covered by an agreement under section 3121(l). In addition, the provision does not apply to services if the employer establishes to the satisfaction of the Secretary that the remuneration paid by such employer for such services is subject to a tax imposed by a foreign country which is substantially equivalent to FICA. It is intended that a tax is substantially equivalent to FICA only if the tax is imposed on wages at a rate equivalent to at least 80 percent of the

[235] 42 U.S.C. sec. 433.
[236] Secs. 3101(c) and 3111(c).

combined employer and employee rates under FICA (i.e., 15.3 percent).

The provision provides that the common parent of the domestically controlled group of entities is jointly and severally liable for the FICA taxes for which the foreign person is liable as a result of the provision. In addition, the common parent is liable for any penalty imposed on the foreign person with respect to any failure to pay the FICA taxes or any failure to file any return or statement with respect to such tax or wages subject to such tax. No deduction is allowed for any liability imposed on the common parent as a result of these joint and several liability rules.

Effective Date

The provision is effective for services performed in calendar months beginning more than 30 days after the date of enactment of the provision.

C. Minimum Failure to File Penalty (sec. 303 of the Act and sec. 6651 of the Code)

Present Law

Under present law, a taxpayer who fails to file a tax return on a timely basis is subject to a penalty equal to five percent of the net amount of tax due for each month that the return is not filed, up to a maximum of five months or 25 percent.[237] An exception from the penalty applies if the failure is due to reasonable cause. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax.[238]

In the case of a failure to file a tax return within 60 days of the due date, present law imposes a minimum penalty equal to the lesser of $100 or 100 percent of the amount of tax required to be shown on the return.

Reasons for Change

The minimum penalty for an extended failure to file (i.e., a return not filed within 60 days of the due date) has not been modified since 1982. The Congress believes that inflation has eroded the deterrent effect of the present law penalty. Thus, the Congress believes that the minimum penalty for an extended failure to file should be increased to a level that effectively discourages noncompliance.

Explanation of Provision

The provision increases the minimum penalty for a failure to file a tax return within 60 days of the due date to the lesser of $135 or 100 percent of the amount of tax required to be shown on the return.

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[237] Sec. 6651(a)(1).
[238] Sec. 6651(b)(1).

Effective Date

The provision is effective for tax returns required to be filed after December 31, 2008.

TITLE IV—PARITY IN THE APPLICATION OF CERTAIN LIMITS TO MENTAL HEALTH BENEFITS

A. Extension of Parity in the Application of Certain Limits to Mental Health Benefits (sec. 401 of the Act and sec. 9812(f) of the Code)

Present Law

The Code, ERISA, and PHSA contain provisions under which group health plans that provide both medical and surgical benefits and mental health benefits cannot impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits ("mental health parity requirements"). In the case of a group health plan which provides benefits for mental health, the mental health parity requirements do not affect the terms and conditions (including cost sharing, limits on numbers of visits or days of coverage, and requirements relating to medical necessity) relating to the amount, duration, or scope of mental health benefits under the plan, except as specifically provided in regard to parity in the imposition of aggregate lifetime limits and annual limits.

The Code imposes an excise tax on group health plans which fail to meet the mental health parity requirements. The excise tax is equal to $100 per day during the period of noncompliance and is generally imposed on the employer sponsoring the plan if the plan fails to meet the requirements. The maximum tax that can be imposed during a taxable year cannot exceed the lesser of 10 percent of the employer's group health plan expenses for the prior year or $500,000. No tax is imposed if the Secretary determines that the employer did not know, and in exercising reasonable diligence would not have known, that the failure existed.

The mental health parity requirements do not apply to group health plans of small employers nor do they apply if their application results in an increase in the cost under a group health plan of at least one percent. Further, the mental health parity requirements do not require group health plans to provide mental health benefits.

The Code, ERISA and PHSA mental health parity requirements expired with respect to benefits for services furnished after December 31, 2007.

Reasons for Change[239]

The Congress recognizes that the provisions relating to mental health parity are important to carrying out the purposes of the

[239] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H.R. Rep. No. 110–658).

Mental Health Parity Act. Thus, the Congress believes that extending the provisions relating to mental health parity is warranted.

Explanation of Provision[240]

The provision extends the present-law Code excise tax for failure to comply with the mental health parity requirements for benefits for services furnished on or after the date of enactment through December 31, 2008. It also extends the ERISA and PHSA requirements through December 31, 2008.

Effective Date

The provision is effective upon the date of enactment (June 17, 2008).

[240] The provision was subsequently extended and modified. See Part 17, Division C, Title IV, Subtitle B.

PART THIRTEEN: HOUSING AND ECONOMIC RECOVERY ACT OF 2008 (PUBLIC LAW 110–289)[241]

TITLE I—BENEFITS FOR MULTI-FAMILY LOW-INCOME HOUSING

Overview

Low-income housing credit

The low-income housing credit may be claimed over a 10-year period for the cost of building rental housing occupied by tenants having incomes below specified levels. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The qualified basis of any qualified low-income building for any taxable year equals the applicable fraction of the eligible basis of the building.

The credit percentage for newly constructed or substantially rehabilitated housing that is not Federally subsidized is adjusted monthly by the Internal Revenue Service so that the 10 annual installments of the credit have a present value of 70 percent of the total qualified basis. The credit percentage for newly constructed or substantially rehabilitated housing that is Federally subsidized and for existing housing that is substantially rehabilitated is calculated to have a present value of 30 percent of qualified basis. These are referred to as the 70-percent credit and 30-percent credit, respectively.

Tax-exempt bonds for housing

Private activity bonds are bonds that nominally are issued by State or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such private person. The exclusion from income for interest paid on State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds"). The definition of a qualified private activity bond includes, but is not limited to, qualified mortgage bonds, qualified veterans' mortgage bonds, and bonds for qualified residential rental projects.

Residential rental property may be financed with qualified private activity bonds if the financed project is a "qualified residential

[241] H.R. 3221. The House Committee on Ways and Means reported H.R. 5720 on April 24, 2008 (H.R. Rep. 110–606). The Senate passed H.R. 3221 (a bill unrelated to housing as passed by the House) on April 10, 2008 with an amendment. The House passed H.R. 3221 on May 8, 2008 with amendments to the Senate amendment. The Senate passed H.R. 3221 on July 11, 2008, with an amendment to the House amendments. The House passed H.R. 3221 on July 23, 2008 with an amendment to the Senate amendment. The Senate agreed to the House amendment on July 26, 2008. The President signed the bill on July 30, 2008. For a technical explanation of the bill prepared by the staff of the Joint Committee on Taxation, see *Technical Explanation of Division C of H.R. 3221, the "Housing Assistance Tax Act of 2008" as Scheduled For Consideration By the House of Representatives on July 23, 2008* (JCX–63–08 (July 23, 2008)).

rental project." A project is a qualified residential rental project if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income (the "20–50 test"). Alternatively, a project is a qualified residential rental project if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income (the "40-60 test"). The issuer must elect to apply either the 20–50 test or the 40–60 test. Operators of qualified residential rental projects must annually certify that such project meets the requirements for qualification, including meeting the 20–50 test or the 40-60 test.

Reasons for Change

Safe, affordable housing is a major priority to all individual Americans. The temporary increase in the volume limit for the low income housing credit is intended to augment the supply of rental housing for low-income individuals. The various improvements to the low-income housing credit and tax-exempt bond rules are designed to create new opportunities for such housing in situations and geographical areas which have not previously benefited from the low-income housing credit and tax-exempt bond financing. In the first comprehensive effort to improve the technical operation of the credit in over a decade, the Congress intends to eliminate outdated requirements, unnecessary restrictions, and needless complexity in the development and operation of low-income credit projects. The Congress also believes that a change to the refunding rules for multi-family housing bonds will allow more efficient combinations of the credit and tax-exempt bonds in certain circumstances. The Congress believes that all the modifications described in this title of the Act are necessary improvements to the vitally important system of housing tax incentives in the Code. In the future, the Congress will continue to monitor the operation of the low-income credit and tax-exempt housing bonds to ensure that these subsidies for affordable housing continue to serve low-income individuals efficiently.

A. Low-Income Housing Credit

1. Temporary increase in the low-income housing credit volume limits (sec. 3001 of the Act and sec. 42 of the Code)

Present Law

In general

The low-income housing credit may be claimed over a 10-year period by owners of certain residential rental property for the cost of rental housing occupied by tenants having incomes below specified levels (sec. 42). The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The qualified basis of any qualified low-income building for any taxable year equals the applicable fraction of the eligible basis of the building.

Volume limits

A low-income housing credit is allowable only if the owner of a qualified building receives a housing credit allocation from the State or local housing credit agency. Generally, the aggregate credit authority provided annually to each State for calendar year 2008 is $2.00 per resident, with a minimum annual cap of $2,325,000 for certain small population States (Rev. Proc. 2007–66). These amounts are indexed for inflation. Projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit do not require an allocation of the low-income housing credit.

Explanation of Provision

The provision increases from $2.00 per resident to $2.20 per resident the allocation authority provided annually to each State for calendar years 2008 and 2009. Also, the provision increases the minimum annual cap for certain small population States by ten percent of the otherwise available amounts in 2008 and 2009, respectively. In 2010, the volume limits will return to the prescribed levels had this provision not been enacted.

Effective Date

The provision is effective for low-income credit allocations made for calendar years after 2007.

2. Determination of credit rate (sec. 3002 of the Act and sec. 42 of the Code)

(a) Modifications to the applicable percentage

Present Law

In general

The low-income housing credit may be claimed over a 10-year credit period after each low-income building is placed-in-service. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building.

Present value credit

The calculation of the applicable percentage is designed to produce a credit equal to: (1) 70 percent of the present value of the building's qualified basis in the case of newly constructed or substantially rehabilitated housing that is not Federally subsidized (the "70-percent credit"); or (2) 30 percent of the present value of the building's qualified basis in the case of newly constructed or substantially rehabilitated housing that is Federally subsidized and existing housing that is substantially rehabilitated (the "30-percent credit"). Where existing housing is substantially rehabilitated, the existing housing is eligible for the 30-percent credit and the qualified rehabilitation expenses (if not Federally subsidized) are eligible for the 70-percent credit.

Calculation of the applicable percentage

The credit percentage for a low-income building is set for the earlier of: (1) the month the building is placed in service; or (2) at the election of the taxpayer, (a) the month the taxpayer and the housing credit agency enter into a binding agreement with respect to such building for a credit allocation, or (b) in the case of a tax-exempt bond-financed project for which no credit allocation is required, the month in which the tax-exempt bonds are issued.

These credit percentages (used for the 70-percent credit and 30-percent credit) are adjusted monthly by the IRS on a discounted after-tax basis (assuming a 28-percent tax rate) based on the average of the Applicable Federal Rates for mid-term and long-term obligations for the month the building is placed in service. The discounting formula assumes that each credit is received on the last day of each year and that the present value is computed on the last day of the first year. In a project consisting of two or more buildings placed in service in different months, a separate credit percentage may apply to each building.

Explanation of Provision

The provision provides a temporary applicable percentage of 9 percent for newly constructed non-Federally subsidized buildings placed in service after the date of enactment and before December 31, 2013.

Effective Date

The provision is effective for buildings placed in service after the date of enactment (July 30, 2008).

(b) Modification to the definition of a Federally subsidized building

Present Law

If any portion of the eligible basis of a building is Federally subsidized, then the building is ineligible for the 70-percent credit. A Federal subsidy is defined as: (1) any obligation the interest of which is tax exempt from tax under section 103; (2) a direct or indirect Federal loan if the interest rate is less than the applicable Federal rate; or (3) assistance provided under the HOME Investments Partnership Act or the Native American Housing Assistance and Self Determination Act of 1996 if certain requirements are not met.

Explanation of Provision

The provision limits the definition of a Federal subsidy for these purposes to any obligation the interest on which is exempt from tax under section 103. Therefore, additional buildings may become eligible for the 70-percent credit.

Effective Date

The provision is effective for buildings placed in service after the date of enactment (July 30, 2008).

3. Modifications to definition of eligible basis (sec. 3003 of the Act and sec. 42 of the Code)

(a) Modification to the enhanced credit for buildings in high-cost areas

Present Law

Generally, buildings located in two types of high-cost areas (i.e., qualified census tracts and difficult development areas) are eligible for an enhanced credit. Under the enhanced credit, the 70-percent and 30-percent credits are increased to a 91-percent and 39-percent credit, respectively. The mechanism for this increase is through an increase from 100 to 130 percent of the otherwise applicable eligible basis of a new building or the rehabilitation expenditures of an existing building. A further requirement for the enhanced credit is that the portions of each metropolitan statistical area or nonmetropolitan statistical area designated as difficult to develop areas cannot exceed an aggregate area having 20 percent of the population of such statistical area.

Explanation of Provision

The provision adds a third type of high-cost area eligible for an enhanced credit. The third type is defined as any building designated by the State housing credit agency as requiring the enhanced credit in order for such building to be financially feasible. This new type of high-cost area is not subject to the present-law limitation limiting high cost areas to 20 percent of the population of each metropolitan statistical area or nonmetropolitan statistical area.

It is expected that the State allocating agencies shall set standards for determining which areas shall be designated difficult development areas and which projects shall be allocated additional credits in such areas in the State allocating agency's allocation plan. It is also expected that the State allocating agency shall publicly express its reasons for such area designations and the basis for allocating additional credits to a project.

Effective Date

The provision is effective for buildings placed in service after the date of enactment (July 30, 2008).

(b) Modification to the substantial rehabilitation requirement

Present Law

Rehabilitation expenditures[242] paid or incurred by a taxpayer with respect to a low-income building are treated as a separate building and may be eligible for the 70-percent credit if they satisfy

[242] Rehabilitation expenditures are amounts chargeable to a capital account and incurred for property (or additions or improvements to property) of a character subject to the allowance for depreciation in connection with the rehabilitation of a building. Such term does not include the cost of acquiring the building (or any interest therein). Other rules apply.

the otherwise applicable credit rules.[243] To qualify for the credit, the rehabilitation expenditures must equal the greater of an amount that is (1) at least 10 percent of the adjusted basis of the building being rehabbed; or (2) at least $3,000 per low-income unit in the building being rehabbed.

At the election of the taxpayer, a special rule applies allowing the 30 percent credit to both existing buildings and rehabilitation expenditures if the second prong (i.e., at least $3,000 of rehabilitation expenditures per low-income unit) of the rehabilitation expenditures test is satisfied. This special rule applies only in the case where the taxpayer acquired the building and immediately prior to that acquisition the building was owned by or on behalf of a government unit.

Explanation of Provision

The provision increases the minimum expenditure requirements. Under the provision, the rehabilitation expenditures must equal the greater of an amount that is (1) at least 20 percent of the adjusted basis of the building being rehabbed; or (2) at least $6,000 per low-income unit in the building being rehabbed. The provision also indexes the $6,000 amount for inflation. The other present-law rules apply.[244]

The provision retains the taxpayer election allowing the 30-percent credit to both existing building and the rehabilitation expenditures if the second prong (i.e., at least $6,000 of rehabilitation expenditures per low-income unit) of the rehabilitation expenditures test is satisfied.

Effective Date

The provision is effective for buildings which receive credit allocations after the date of enactment (July 30, 2008) and substantially tax-exempt bond financed buildings (which satisfy the requirements of section 42(h)(4) and therefore do not require a credit allocation) which receive a tax-exempt bond allocation after the date of enactment.

(c) Community service facility eligibility for the credit

Present Law

In general, the qualified basis of a low-income building is limited to that portion of the building dedicated to qualified low-income use (either living space or certain common areas). However certain "community service facilities" used by non-tenants of the low-income building may be included in the qualified basis of the low-income building if certain requirements are satisfied. For this purpose, a community service facility: (1) means any facility to serve

[243] The credit period for an existing building does not begin before the credit period for the rehabilitation expenditures.

[244] A present-law rule reduces the $3,000 amount to $2,000 for any building substantially assisted, financed, or operated under Housing and Urban Development ("HUD") section 8, section 221(d)(3), or section 236 programs, or under the USDA Rural Development section 515 program where an assignment of the mortgage secured by the property in the project to HUD or the USDA Rural Development otherwise would occur or when a claim against a Federal mortgage insurance fund would occur. A conforming change is made by the provision so that that the $2,000 amount will be increased to two-thirds of the $6,000 amount as indexed.

primarily individuals whose income is 60 percent or less of area median income; and (2) may not exceed 10 percent of the eligible basis of the qualified low-income housing credit project of which it is a part.

Explanation of Provision

The provision expands the size of the community service facility with respect to which the low-income housing credit may be claimed. Under the provision the size of the community service facility may not exceed the sum of: (1) 25 percent of so much of the eligible basis of the qualified low-income housing credit project of which it is a part as does not exceed $15,000,000; and (2) 10 percent of any excess over $15,000,000 of the eligible basis of the qualified low-income housing credit project of which it is a part.

Effective Date

The provision is effective for buildings placed in service after the date of enactment (July 30, 2008).

(d) Clarification of the treatment of Federal grants

Present Law

The compliance period for any low-income credit building is the period of fifteen taxable years beginning with the taxable year in which the building is placed in service, or at the election of the taxpayer the succeeding taxable year. If during any year of the compliance period, a grant is made with respect to any building or the operation thereof and any portion of the grant is funded with Federal funds, the eligible basis of the building must be reduced by the portion of the grant that is Federally-funded. This basis reduction must be made for the taxable year in which the grant is made and all succeeding taxable years.

Explanation of Provision

The provision clarifies the basis reduction rule to apply to Federally-funded grants received before the compliance period. It also provides that no basis reduction is required for Federally-funded grants to enable the property to be rented to low-income tenants received during the compliance period if those grants do not otherwise increase the taxpayer's eligible basis in the building.

The provision also directs the modification of section 1.42–16(b) of the Treasury regulations to provide that none of the following shall be considered a grant made with respect to a building or its operation for purposes of section 42(d)(5)(A) of the Internal Revenue Code of 1986: (1) rental assistance under section 521 of the Housing Act of 1949 (42 U.S.C. 1490a); (2) assistance under section 538(f)(5) of the Housing Act of 1949 (42 U.S.C. 1490p–2(f)(5)); (3) interest reduction payments under section 236 of the National Housing Act (12 U.S.C. 1715z–1); (4) rental assistance under section 202 of the Housing Act of 1959 (12 U.S.C. 1701q); (5) rental assistance under section 811 of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 8013); (6) modernization, operating, and rental assistance pursuant to section 202 of the Native

American Housing Assistance and Self-Determination Act of 1996 (25 U.S.C. 4132); (7) assistance under title IV of the Stewart B. McKinney Homeless Assistance Act (42 U.S.C. 11361 et seq.); (8) tenant-based rental assistance under section 212 of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12742); (9) assistance under the AIDS Housing Opportunity Act (42 U.S.C. 12901 et seq.); (10) per diem payments under section 2012 of title 38, United States Code; (11) rent supplements under section 101 of the Housing and Urban Development Act of 1965 (12 U.S.C. 1701s); (12) assistance under section 542 of the Housing Act of 1949 (42 U.S.C. 1490r); and (13) any other ongoing payment used to enable the property to be rented to low-income tenants. Further, no basis reduction is required for loans (regardless of interest rate) made to owners of qualified low-income housing projects from the proceeds of Federally-funded grants. Nothing contained in this direction to modify the regulations is intended to create any inference with respect to the consideration of any program specified under subsection (a) of a grant made with respect to a building or its operation for purposes of section 42(d)(5)(A) of the Internal Revenue Code of 1986 as in effect on the day before such date of enactment.

Effective Date

The provision is effective for buildings placed in service after the date of enactment (July 30, 2008).

(e) Modification to the definition of related persons

Present Law

With certain exceptions,[245] the eligible basis of an existing building is zero for low-income housing credit purposes unless: (1) the building was acquired by purchase; (2) there has been a period of at least 10 years between the acquisition by purchase and the later of the date the building was last placed in service or the date of the most recent nonqualified substantial improvement of the building (e.g., improvements equaling at least 25 percent of the adjusted basis of the building before such improvements); and (3) the building was not previously placed-in-service by the taxpayer or a related person (sec. 42(d)(2)(B)). In order for a building to be acquired by purchase, it may not be acquired from a related party.

The definition of related persons for purposes of these rules is the same as the definition used in sections 267(b) and 707(b)(1) (relating to the disallowance of losses) with one modification.[246] Under the modification, in determining whether two persons are related, "10 percent" is substituted for "50 percent" in determining the threshold level of ownership in certain partnerships and corporations. For example, under the low-income credit provision, two

[245] The Internal Revenue Service may waive the 10-year requirement for any building substantially assisted, financed, or operated under Housing and Urban Development ("HUD") section 8, section 221(d)(3), or section 236 programs, or under the Farmers' Home Administration section 515 program where an assignment of the mortgage secured by the property in the project to HUD or the Farmers' Home Administration otherwise would occur or when a claim against a Federal mortgage insurance fund would occur.

[246] In addition, certain businesses under common control are related persons for purposes of these rules.

partnerships are related if the same persons own more than ten percent of the capital interests or profits interest in each partnership.

Explanation of Provision

The provision repeals the ten-percent attribution rule used to determine whether parties are related for purposes of determining whether an existing building qualifies for the low-income housing credit. Under the provision, two persons are related for this purpose if they bear a relationship to each other specified in sections 267(b) or 707(b)(1).

Effective Date

The provision is effective for buildings placed in service after the date of enactment (July 30, 2008).

(f) Exception to 10-year period rule related to prior placement in service of certain buildings

Present Law

In general the low-income housing credit is not allowed with respect to existing buildings unless there was a period of at least ten years between the date of its acquisition by the taxpayer and the later of the date the building was last placed-in-service or the date of the most recent nonqualified substantial improvement of the buildings (the "ten-year" rule").

Under one exception from this general rule, the Secretary of the Treasury (after consultation with the appropriate Federal official) may waive the ten-year rule with respect to any Federally-assisted building if such waiver is necessary: (1) to avert an assignment of the mortgage secured by property in the project (of which the building is a part) to the Department of Housing and Urban Development or the Farmers Home Administration, or (2) to avert a claim against a Federal mortgage insurance fund (or such department or Administration) with respect to a mortgage which is so secured. For these purposes a Federally-assisted building is any building which is substantially assisted, financed, or operated under: (1) section 8 of the United States Housing Act of 1937; (2) section 221(d)(3) or 236 of the National Housing Act; or (3) section 515 of the Housing Act of 1949, as such Acts are in effect on the date of the enactment of the Tax Reform Act of 1986.

Also, a waiver may be granted with respect to certain Federally-assisted building if; (1) the mortgage on such building is eligible for prepayment under subtitle B of the Emergency Low Income Housing Preservation Act of 1987 or under section 502(c) of the Housing Act of 1949 at any time within one year after the date of the application for such waiver; (2) the appropriate Federal official certifies to the Secretary of the Treasury that it is reasonable to expect that, if the waiver is not granted, such building will cease complying with its low-income occupancy requirements; and (3) the eligibility to prepay such mortgage without the approval of the appropriate Federal official is waived by all persons who are so eligible and such waiver is binding on all successors of such persons. For

purposes of this rule a Federally-assisted building is a building which is substantially assisted, financed, or operated under: (1) section 221(d)(3) or 236 of the National Housing Act; or (2) section 515 of the Housing Act of 1949, as such Acts are in effect on the date of the enactment of the Tax Reform Act of 1986). An appropriate Federal official means, for these purposes, the Secretary of Housing and Urban Development (in certain instances) and the Secretary of Agriculture (in certain instances).

Finally, a waiver may be granted with respect to any building acquired from an insured depository institution in default (as defined in section 3 of the Federal Deposit Insurance Act) or from a receiver or conservator of such an institution.

Explanation of Provision

The provision replaces the first two exceptions to the ten-year rule under present law with one new exception. The new exception waives the ten-year rule in the case of any Federally- or State-assisted building. For these purposes, the definition of Federally-assisted building is expanded to include any building which is substantially assisted, financed, or operated under section 8 of the United States Housing Act of 1937, section 221(d)(3), 221(d)(4) or 236 of the National Housing Act, section 515 of the Housing Act of 1949, or any other housing program administered by the Department of Housing and Urban Development or the Rural Housing Service of the Department of Agriculture. The term State-assisted building means any building which is substantially assisted, financed, or operated under any State law similar in purposes to those of the Federal laws used in the definition of a Federally-assisted building. The present-law exception related to certain depository institutions in default is retained.

Effective Date

The provision is effective for buildings placed in service after the date of enactment (July 30, 2008).

4. Other simplification and reform of low-income housing tax incentives (sec. 3004 of the Act and sec. 42 of the Code)

(a) Repeal prohibition of the credit for buildings receiving HUD moderate rehabilitation assistance

Present Law

Generally, the low-income housing credit is available to otherwise qualifying buildings which also receive direct assistance under HUD Section 8 programs. No credit is allowed to any building with respect to which moderate rehabilitation assistance is provided at any time during the compliance period, under section 8(e)(2) of the United States Housing Act of 1937 (other than assistance under the Stewart B. McKinney Homeless Assistance Act).

Explanation of Provision

The provision eliminates the present-law prohibition against providing the low-income housing credit to buildings receiving mod-

erate rehabilitation assistance under section 8(e)(2) of the United States Housing Act of 1937.

Effective Date

The provision is effective for buildings placed in service after the date of enactment (July 30, 2008).

(b) Carryover allocation rule

Present Law

In general, the allocation of the low-income housing credit must be made not later than the close of the calendar year in which the building is placed in service. One exception to this rule is a carryover allocation. In a carryover allocation, an allocation may be made to a building that has not yet been placed in service, provided that: (1) more than 10 percent of the taxpayer's reasonably expected basis in the project (as of the close of the second calendar year following the calendar year of the allocation) is incurred as of the later of six months after the allocation is made or the end of the calendar year in which the allocation is made; and (2) the building is placed in service not later than the close of the second calendar year following the calendar year of the allocation.

Explanation of Provision

The provision modifies the first prong of the carryover allocation rule. Under this modification such an allocation will satisfy the first prong provided that more than 10 percent of the taxpayer's reasonably expected basis in the project (as of the close of the second calendar year following the calendar year of the allocation) is incurred as of 12 months after the allocation is made. The second prong of the carryover allocation rules is unchanged.

Effective Date

The provision is effective for buildings placed in service after the date of enactment (July 30, 2008).

(c) Repeal of bond posting requirement

Present Law

The compliance period for any building is the period beginning on the first day of the first taxable year of the credit period of such building and ending 15 years from such date.

The penalty for any building subject to the 15-year compliance period failing to remain part of a qualified low-income project (due, for example, to noncompliance with the minimum set aside requirement, or the gross rent requirement, or other requirements with respect to the units comprising the set aside) is recapture of the accelerated portion of the credit, with interest, for all prior years.

Generally, any change in ownership by a taxpayer of a building subject to the compliance period is also a recapture event. An exception is provided if the seller satisfies certain bond posting requirements (in an amount and manner prescribed by Treasury), and if it can reasonably be expected that such building will con-

tinue to be operated as a qualified low-income building for the remainder of the compliance period.

Explanation of Provision

The provision eliminates the bond posting requirement. In its place the provision extends the otherwise applicable statute of limitation until three years after the Secretary of the Treasury is notified of noncompliance with the low-income housing credit rules.

Also, at the election of the taxpayer, the provision applies with respect to dispositions of interests in a building on or before the date of enactment if it is reasonably expected that such building will continue to be a qualified low-income building for the remaining compliance period.

Effective Date

The provision applies with respect to dispositions of interests in buildings after the date of enactment (July 30, 2008).

(d) Additions of energy efficiency and historic nature criteria to housing credit agency allocation plan criteria

Present Law

Each State must develop a plan for allocating credits, and such plan must include certain allocation criteria including: (1) project location; (2) housing needs characteristics; (3) project characteristics (including whether the project uses existing housing as part of a community revitalization plan; (4) sponsor characteristics; (5) tenant populations with special needs; (6) tenant populations of individuals with children; and (7) projects intended for eventual tenant ownership.

The State allocation plan must also give preference to housing projects: (1) that serve the lowest-income tenants; (2) that are obligated to serve qualified tenants for the longest periods; and (3) that are located in qualified census tracts and the development of which contributes to a concerted community revitalization plan. For this purpose, a qualified census tract is defined as a census tract: (1) designated by the Secretary of HUD; and (2) for the most recent year for which census data is available for such tract, either 50 percent or more of the households have a income that is less than 60 percent of the area median income for that year or which has a poverty rate of at least 25 percent.

Present law also requires that housing credit agencies perform a comprehensive market study of the housing needs of the low-income individuals in the area to be served by the project and a written explanation, available to the general public, for any allocation not made in accordance with the established priorities and selection criteria of the housing credit agency. It also requires that the housing credit agency conduct site visits to monitor for compliance with habitability standards.

Explanation of Provision

The provision adds two additional criteria which States must use in its allocation of credits among potential low-income housing

projects. The additional criteria are: (1) the energy efficiency of the project; (2) the historic nature of the project (e.g., encouraging rehabilitation of certified historic structures (sec. 47(c)(3))).

Effective Date

The provision is effective for allocations made after December 31, 2008.

(e) Treatment of individuals who previously received foster care assistance

Present Law

In general, student housing does not qualify for the low-income housing credit. Two exceptions are provided from this general rule.[247] These two exceptions are units occupied by an individual: (1) who is a student and receiving assistance under title IV of the Social Security Act (Temporary Assistance for Needy Families); or (2) enrolled in a job training program receiving assistance under the Job Training Partnership Act or under other similar Federal, State, or local laws.

Explanation of Provision

The provision adds a third exception to the general rule that student housing is not eligible for the low-income housing credit. This new exception applies in the case of a student who was previously under the care and placement responsibility of a foster care program (under part B or E of title IV of the Social Security Act).

Effective Date

The provision is effective for determinations made after the date of enactment (July 30, 2008).

(f) Measurement of area median gross income for certain projects located in certain nonmetropolitan areas

Present Law

In order to be eligible for the low-income housing credit, a qualified low-income building must be part of a qualified low-income housing project. In general, a qualified low-income housing project is defined as a project which satisfies one of two tests at the election of the taxpayer. The first test is met if 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income (the "20–50 test"). The second test is met if 40 percent or more of the residential units in such project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income (the "40–60 test").

In the case of property placed in service during 2006, 2007, and 2008 in a nonmetropolitan area within the Gulf Opportunity Zone, the income targeting rules of the low-income housing credit are applied by replacing the area median gross income standard with a

[247] See also the discussion of the full-time student rule in item I.A.7., below.

national nonmetropolitan median gross income standard. These new income targeting rules apply to all such buildings in the Gulf Opportunity Zone regardless of whether the building receives its credit allocation under the otherwise applicable low-income housing credit cap or the additional credit cap (described above). The income targeting rules are not changed for buildings in metropolitan areas in the Gulf Opportunity Zone.

Explanation of Provision

The measurement of area median gross income applied for residential rental property located in certain rural areas is modified in the case of projects subject to the low-income housing credit volume limits. In the case of such properties located in rural areas (as defined in section 520 of the Housing Act of 1949), the income targeting rules of the low-income housing credit are applied by reference to the greater of the otherwise applicable area median gross income standard, or the national nonmetropolitan median gross income. This new income targeting rule applies to all such buildings if the building receives a low-income housing credit allocation under the otherwise applicable low-income housing credit volume limit. It does not apply in the case of buildings which do not require a low-income housing credit allocation because they are substantially bond-financed. The area median gross income rules are not changed for buildings in metropolitan areas.

Effective Date

The provision is effective for determinations after the date of enactment (July 30, 2008).

(g) Clarification of general public use rule

Present Law

In order to be eligible for the low-income housing credit, the residential units in a qualified low-income housing project must be available for use by the general public. A project is available for general public use if: (1) the project complies with housing non-discrimination policies including those set forth in the Fair Housing Act (42 U.S.C. 3601), and (2) the project does not restrict occupancy based on membership in a social organization or employment by specific employers.[248] In addition, any residential unit that is part of a hospital, nursing home, sanitarium, lifecare facility, trailer park, or intermediate care facility for the mentally or physically handicapped is not available for use by the general public.

Explanation of Provision

The provision clarifies that a project which otherwise meets the general public use requirements above shall not fail to meet the general public use requirement solely because of occupancy restrictions or preferences that favor tenants: (1) with special needs; or (2) who are members of specified group under a Federal program

[248] See Treas. Reg. 1.42–9.

or State program or policy that supports housing for such a specified group; or (3) who are involved in artistic and literary activities.

Effective Date

The provision applies to buildings placed in service before, on, or after the date of enactment (July 30, 2008).

(h) GAO study

Present Law

There are no current GAO studies planned of the low-income credit.

Explanation of Provision

The Comptroller General of the United States is directed to analyze the changes to the low-income credit made by this Act. The report shall be submitted to Congress not later than December 31, 2012.

Effective Date

The provision is effective on the date of enactment (July 30, 2008).

5. Treatment of basic housing allowances for purposes of income eligibility rules (sec. 3005 of the Act and sec. 42 of the Code)

Present Law

In order to be eligible for the low-income housing credit, a qualified low-income building must be part of a qualified low-income housing project. In general, a qualified low-income housing project is defined as a project that satisfies one of two tests at the election of the taxpayer. The first test is met if 20 percent or more of the residential units in the project are both rent-restricted, and occupied by individuals whose income is 50 percent or less of area median gross income (the "20–50 test"). The second test is met if 40 percent or more of the residential units in such project are both rent-restricted, and occupied by individuals whose income is 60 percent or less of area median gross income (the "40–60 test"). These income figures are adjusted for family size.

The military provides the basic housing allowance. The recipients of the military basic housing allowance must include these amounts for purposes of low-income credit eligibility.

Explanation of Provision

In general

Under the provision the basic housing allowance (i.e., payments under 37 U.S.C. sec. 403) is not included in income for the low-income credit income eligibility rule. The provision is limited in application to qualified buildings. A qualified building is defined as any building located:

1. any county which contains a qualified military installation to which the number of members of the Armed Forces assigned to units based out of such qualified military installation has increased by 20 percent or more as of June 1, 2008 over the personnel level on December 31, 2005; and

2. any counties adjacent to county described in (1), above.

For these purposes, a qualified military installation is any military installation or facility with at least 1000 members of the Armed Forces assigned to it.

Applicability

The provision applies to income determinations: (1) made after the date of enactment and before January 1, 2012 in the case of qualified buildings which received credit allocations on or before the date of enactment or qualified buildings placed in service on or before the date of enactment to the extent a credit allocation was not required with respect to such building by reason of 42(h)(4) (i.e. such qualified building was at least 50% tax bond financed with bonds subject to the private activity bonds volume cap) but only with respect to bonds issued before such date of enactment; and (2) made after the date of enactment in the case of qualified buildings which received credit allocations after the date of enactment and before January 1, 2012 or qualified buildings placed in service after the date of enactment and before January 1, 2012, to the extent a credit allocation was not required with respect to such qualified building by reason of 42(h)(4) (i.e. such qualified building was at least 50% tax bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued after such date of enactment and before January 1, 2012.

Effective Date

The provision is effective for income determinations after the date of enactment (July 30, 2008).

6. Refunding treatment for certain multi-family housing bonds (sec. 3007 of the Act and sec. 146 of the Code)

Present Law

In general

Private activity bonds are bonds that nominally are issued by State or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such private person. The exclusion from income for interest paid on State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds"). The definition of a qualified private activity bond includes, but is not limited to, qualified mortgage bonds, qualified veterans' mortgage bonds, and bonds for qualified residential rental projects.

Qualified residential rental projects

Residential rental property may be financed with qualified private activity bonds if the financed project is a "qualified residential

rental project." A project is a qualified residential rental project if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income (the "20–50 test"). Alternatively, a project is a qualified residential rental project if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income (the "40–60 test"). The issuer must elect to apply either the 20–50 test or the 40–60 test. Operators of qualified residential rental projects must annually certify that such project meets the requirements for qualification, including meeting the 20–50 test or the 40–60 test.

As with most qualified private activity bonds, bonds for qualified residential rental projects are subject to annual State volume limitations (the "State volume cap"). For calendar year 2008, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $262.09 million, if greater.

Bonds issued to finance qualified residential rental projects are subject to a term to maturity rule which limits the period of time such bonds may remain outstanding. Generally, this rule provides that the average maturity of a qualified private activity bond cannot exceed 120 percent of the economic life of the property being financed.[249]

Explanation of Provision

Under the provision, if within six months after receipt of a repayment of a conduit loan used to finance a qualified residential rental project, such repayment is used to finance a second qualified residential rental project, any bond issued to refinance the first issue of bonds (i.e., the bond financing the original conduit loan) shall be treated as a refunding issue. A loan to a person other than the governmental entity from the proceeds of a bond issue to carry out the defined qualified purpose of the issue is a conduit loan. Thus, under the provision, the refinancing bond is treated as a refunding notwithstanding a change in obligors under the first and second conduit loans. The provision only applies to the first refunding of the refunded bond and only if such refunding bond is issued within four years of the date of issue of the refunded bond. In addition, the final maturity date for the refunding bonds cannot be later than 34 years after the date of issuance of the refunded bond.

Effective Date

The provision applies to repayments of loans received after the date of enactment (July 30, 2008).

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[249] Sec. 147(b).

7. Coordination of certain rules applicable to the low-income housing credit and qualified residential rental project exempt facility bonds (sec. 3008 of the Act and sec. 142 of the Code)

(a) Next available unit rule

Present Law

In order to be eligible for the low-income housing credit, each of the residential units with respect to which the credit is claimed must be: (1) occupied by low-income tenants; and (2) rent-restricted. If the incomes of any such tenants rise above certain levels, then the credit with respect to that unit is denied unless the next available unit in the low-income building (of a size comparable or smaller than such unit) is rented to a new tenant who satisfies the income and rent-restriction requirements (the "next-available-unit rule").[250]

Subject to certain requirements, tax-exempt bonds may be issued to finance qualified residential rental projects. The tax-exempt bond rules for qualified residential projects have similar tenant income limitations as the low-income credit, but apply the next available unit rule on a project basis rather than a building-by-building basis.[251] Therefore, to avoid noncompliance when the income of a tenant rises above certain levels, the next available unit (of a size comparable or smaller than such unit) in the entire project (rather than just the same building) must be rented to a new tenant who satisfies the income and rent-restriction requirements.

Explanation of Provision

In the case of a low-income building which is tax-exempt bond financed and eligible for the low-income housing credit, the provision provides that both the bond and credit restrictions will be satisfied if the next available unit in the building is rented to a new tenant who satisfies the income and rent-restriction requirements. It therefore conforms the tax-exempt bond rule to the low-income housing credit rule.

Effective Date

The provision applies to determinations of the status of qualified residential rental projects for periods beginning after the date of enactment (July 30, 2008) with respect to bonds issued before, on, or after such date.

(b) Students

Present Law

In general

The low-income housing credit is not available for any residential unit unless it is available for use by the general public. For these purposes, a residential unit generally is available for use by the

[250] Sec. 42(g)(2)(D)(ii).
[251] Sec. 142(d)(3)(B).

general public if the unit is rented in a manner consistent with housing policy governing nondiscrimination as evidenced by the rules and regulations of the Department of Housing and Urban Development ("HUD"). Notwithstanding compliance with the HUD rules and regulations, a residential rental unit is not available for use by the general public if such unit is: (1) provided only for a member of a social organization; or (2) provided by an employer for its employees. Other rules may apply.

Rules for full-time students

For purposes of the low-income housing credit, no credit is allowed with respect to a otherwise eligible unit occupied entirely by full-time students: (1) unless those students are comprised entirely of single parents and their children; or (2) are married and file a joint return. Further, the single parents may not be dependents of another individual and the children may not be dependents of another individual other than of their parents. For purposes of the tax-exempt bond rules, a slightly different full-time student rule applies. The tax-exempt bond rule provides that a residential unit will not satisfy the income tests if all the occupants are students (as defined in section 152(f)(2)) and are not entitled to file a joint tax return.

Explanation of Provision

The provision conforms the tax-exempt bond rule with respect to students to the low-income housing credit rule.

Effective Date

The full-time student provision applies to determinations of the status of qualified residential rental projects for periods beginning after the date of enactment with respect to bonds issued before, on, or after such date.

(c) Single-room occupancy units

Present Law

Unlike the requirements for projects financed with tax-exempt bonds, certain single-room occupancy housing used on a nontransient basis may qualify for the low-income credit, even though such housing may provide eating, cooking, and sanitation facilities on a shared basis. An example of housing that may qualify for the credit is a residential hotel used on a nontransient basis that is available to all members of the public.

Among other requirements, qualified residential rental projects financed with tax-exempt bonds generally cannot be used on a transient basis. Treasury regulations clarify that a residential unit will not be treated as used on a transient basis if the unit contains complete facilities for living, including living, sleeping, eating, cooking, and sanitation.[252]

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[252] Treas. Reg. sec. 1.103–8(b)(10)(ii).

Explanation of Provision

The provision conforms the tax-exempt bond rule to the low-income housing credit rule.

Effective Date

The provision applies to determinations of the status of qualified residential rental projects for periods beginning after the date of enactment with respect to bonds issued before, on, or after such date (July 30, 2008).

8. Hold harmless for reductions in area median gross income (sec. 3009 of the Act and sec. 42 of the Code)

Present Law

Tax rules

Tax-exempt bonds

Residential rental property may be financed with exempt facility bonds if the financed project is a "qualified residential rental project." A project is a qualified residential rental project if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income (the "20–50 test"). Alternatively, a project is a qualified residential rental project if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income (the "40–60 test"). The issuer must elect to apply either the 20–50 test or the 40–60 test (sec. 142).

Low-income housing tax credit

In order to be eligible for the low-income housing credit, a qualified low-income building must be part of a qualified low-income housing project. In general, a qualified low-income housing project is defined as a project that satisfies one of two tests at the election of the taxpayer (sec. 42(g)). The first test is met if 20 percent or more of the residential units in the project are both rent-restricted, and occupied by individuals whose income is 50 percent or less of area median gross income (the "20-50 test"). The second test is met if 40 percent or more of the residential units in such project are both rent-restricted, and occupied by individuals whose income is 60 percent or less of area median gross income (the "40-60 test"). These income figures are adjusted for family size.

Determination of income and area median gross income

The income of individuals and area median gross income are determined by the Secretary of the Treasury in a manner consistent with determinations of lower-income families and area median gross income under section 8 of the Housing Act of 1937 (sec. 142(d)). These determinations under section 8 are made by HUD. These determinations also include adjustments for family size.

Therefore such determinations (individual and area median gross income) are applicable for purposes of tax-exempt bonds and the low-income housing credit.

HUD hold harmless policy

Generally HUD releases its calculation of area median gross income for a calendar year early in that year. Historically HUD has used the most recent decennial census data and updated it with other data on income, employment and earnings.

Recently HUD modified its methodology to include additional data in its calculation of area median gross income. In some instances this change in methodology resulted in significantly lower numbers for area median gross income in some areas. In response to this result, HUD provided that such areas are not treated as having a lower area median gross income for purposes of HUD housing programs.

Explanation of Provision

In general

The provision makes two modifications to the determination of area median gross income for purposes of tax-exempt bonds and the low-income housing credit.

Determination of income and area median gross income

The provision provides that any determination of area median gross income with respect to a project may not be less than the determination of area median gross income with respect to that project for the preceding calendar year. This modification applies to all projects and is not limited to projects benefiting from the HUD hold harmless policy.

HUD hold harmless policy

In the case of a HUD hold harmless impacted project, the determination of area median gross income for the project is the greater of (i) the amount determined without regard to the special rule for HUD hold harmless impacted projects or (ii) the sum of the area median gross income determined under the HUD hold harmless policy with respect to the project for 2008 plus any increase in area median gross income after 2008.

Effective Date

The provision applies to determinations of area median gross income for calendar years after 2008.

9. Exception from the annual recertification requirement for projects which are entirely low-income use (sec. 3010 of the Act and sec. 142 of the Code)

Present Law

Tax rules

In general

Tax-exempt bonds

Residential rental property may be financed with exempt facility bonds if the financed project is a "qualified residential rental project." A project is a qualified residential rental project if 20 per-

cent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income (the "20-50 test"). Alternatively, a project is a qualified residential rental project if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income (the "40-60 test"). The issuer must elect to apply either the 20-50 test or the 40-60 test (sec. 142).

Low-income housing tax credits

In order to be eligible for the low-income housing credit, a qualified low-income building must be part of a qualified low-income housing project. In general, a qualified low-income housing project is defined as a project that satisfies one of two tests at the election of the taxpayer (sec. 42(g)). The first test is met if 20 percent or more of the residential units in the project are both rent-restricted, and occupied by individuals whose income is 50 percent or less of area median gross income (the "20-50 test"). The second test is met if 40 percent or more of the residential units in such project are both rent-restricted, and occupied by individuals whose income is 60 percent or less of area median gross income (the "40-60 test"). These income figures are adjusted for family size.

Determination of income and area median gross income

The income of individuals and area median gross income are determined by the Secretary of the Treasury in a manner consistent with determinations of lower-income families and area median gross income under section 8 of the Housing Act of 1937 (sec. 142(d)). These determinations also include adjustments for family size.

Certification

The Code provides that the operator of any qualified residential rental project must submit to the Secretary of the Treasury (at such time and in such manner as the Secretary prescribes) an annual certification that the project continues to satisfy the requirements of a qualified residential rental project. Any failure to comply with the annual certification to the Secretary of the Treasury will subject the operator to penalties but will not affect the tax-exempt status of the underlying bonds (sec. 142(d)(7)).

Similar rules apply for the low-income housing credit regarding tenant incomes (sec. 42(g)(4)). IRS Revenue Procedure 1994–64 allows a taxpayer to request a waiver of this certification under certain circumstances with the consent of the State agency responsible for monitoring the low-income credit project.

Treatment of tenants whose incomes rise above the income limits

Generally a low-income unit will continue to be treated as such even when the tenant's income rises above the income limits provided that the next available unit (of a size comparable to or smaller than such unit) in the project is occupied by a new resident who satisfies the income limits.

HUD rules

A family's eligibility for various types of HUD housing assistance is based on its income and family composition. The HUD Handbook 4350.3 contains the certification and annual recertification rules to be followed by project operators. Under the HUD program requirements tenants have the responsibility to provide timely information to the project operators. Operators have the responsibility to review and verify the tenant information and to make changes to assistance payment and tenant rent to satisfy program requirements.

Explanation of Provision

The provision waives the annual recertification requirements under the low-income credit (sec. 42) and tax-exempt bonds (sec. 142) for any project as long as no residential unit in the project is occupied by tenants who fail to satisfy the otherwise applicable income limits. The provision does not modify the HUD rules; therefore some projects must continue annual certification notwithstanding this provision.

Effective Date

The provision is effective for years ending after the date of enactment (July 30, 2008).

B. Single Family Housing

1. First-time homebuyer credit (sec. 3011 of the Act and sec. 36 of the Code)

Present Law

Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for owner-occupied residences. The subsidy provided for qualified mortgage bonds allows issuers to finance mortgages for homebuyers at reduced interest rates. The Code imposes several limitations on qualified mortgage bonds, including a "first-time homebuyer" requirement. The first-time homebuyer requirement provides that qualified mortgage bonds generally cannot be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the three years preceding the execution of the mortgage. In addition, bond proceeds generally only can be used for new mortgages, i.e., proceeds cannot be used to acquire or refinance existing mortgages.

In addition, first-time homebuyers of a principal residence in the District of Columbia are eligible for a nonrefundable tax credit of up to $5,000 of the amount of the purchase price. The $5,000 maximum credit applies both to individuals and married couples filing a joint return. A married individual filing separately can claim a maximum credit of $2,500. The instructions to IRS Form 8859 (District of Columbia First-Time Homebuyer Credit) state that if "two or more unmarried individuals buy a main home, they can allocate the credit among the individual owners in any manner they choose." The credit phases out for individual taxpayers with modified adjusted gross income between $70,000 and $90,000 ($110,000–$130,000 for joint filers). For purposes of eligibility,

"first-time homebuyer" means any individual if such individual did not have a present ownership interest in a principal residence in the District of Columbia in the one-year period ending on the date of the purchase of the residence to which the credit applies. The credit expires for residences purchased after December 31, 2009.[253]

Reasons for Change

The Congress wishes to provide temporary alternatives to assist first-time homebuyers. The provision is intended to provide first-time homebuyers with the equivalent of an interest-free loan, effectively reducing the cost incurred by first-time homebuyers in borrowing to acquire a home.

Explanation of Provision

Under the proposal, a taxpayer who is a first-time homebuyer is allowed a refundable tax credit equal to the lesser of $7,500 ($3,750 for a married individual filing separately) or 10 percent of the purchase price of a principal residence. The credit is allowed for the tax year in which the taxpayer purchases the home.

The credit phases out for individual taxpayers with modified adjusted gross income between $75,000 and $95,000 ($150,000–$170,000 for joint filers) for the year of purchase.

A taxpayer is considered a first-time homebuyer if such individual had no ownership interest in a principal residence in the United States during the three-year period prior to the purchase of the home to which the credit applies.

No credit is allowed if the D.C. homebuyer credit is allowable for the taxable year the residence is purchased or a prior taxable year. A taxpayer is not permitted to claim the credit if the taxpayer's financing is from tax-exempt mortgage revenue bonds, if the taxpayer is a nonresident alien, or if the taxpayer disposes of the residence (or it ceases to be a principal residence) before the close of a taxable year for which a credit otherwise would be allowable.

The credit is recaptured ratably over fifteen years with no interest charge beginning in the second taxable year after the taxable year in which the home is purchased. For example, if the taxpayer purchases a home in 2008, the credit is allowed on the 2008 tax return, and repayments commence with the 2010 tax return. If the taxpayer sells the home (or the home ceases to be used as the principal residence of the taxpayer or the taxpayer's spouse) prior to complete repayment of the credit, any remaining credit repayment amount is due on the tax return for the year in which the home is sold (or ceases to be used as the principal residence). However, the credit repayment amount may not exceed the amount of gain from the sale of the residence to an unrelated person. For this purpose, gain is determined by reducing the basis of the residence by the amount of the credit to the extent not previously recaptured. No amount is recaptured after the death of a taxpayer. In the case of an involuntary conversion of the home, recapture is not accelerated if a new principal residence is acquired within a two year pe-

[253] Sec. 1400C. The credit was enacted as part of the Taxpayer Relief Act of 1997 and was originally scheduled to expire on December 31, 2000. It has been extended several times, the last extension through December 31, 2009.

riod. In the case of a transfer of the residence to a spouse or to a former spouse incident to divorce, the transferee spouse (and not the transferor spouse) will be responsible for any future recapture.

An election is provided to treat a home purchased in the eligible period in 2009 as if purchased on December 31, 2008 for purposes of claiming the credit on the 2008 tax return and for establishing the beginning of the recapture period. Taxpayers may amend their returns for this purpose.

Effective Date

The provision is effective for qualifying home purchases on or after April 9, 2008 and before July 1, 2009 (without regard to whether or not there was a binding contract to purchase prior to April 9, 2008).

2. Additional standard deduction for state and local real property taxes (sec. 3012 of the Act and sec. 63 of the Code)

Present Law

An individual taxpayer's taxable income is computed by reducing adjusted gross income either by a standard deduction or, if the taxpayer elects, by the taxpayer's itemized deductions. Unless an individual taxpayer elects, no itemized deduction is allowed for the taxable year. The deduction for certain taxes, including income taxes, real property taxes, and personal property taxes, generally is an itemized deduction.[254]

Reasons for Change

The Congress believes an additional standard deduction for real property taxes is appropriate in order to help lessen the impact of rising State and local property tax bills on those individual taxpayers with insufficient total itemized deductions to elect not to take the standard deduction.

Explanation of Provision[255]

The provision increases an individual taxpayer's standard deduction for a taxable year beginning in 2008 by the lesser of (1) the amount allowable[256] to the taxpayer as a deduction for State and local taxes described in section 164(a)(1) (relating to real property taxes), or (2) $500 ($1,000 in the case of a married individual filing jointly). The increased standard deduction is determined by taking into account real estate taxes for which a deduction is allowable to the taxpayer under section 164 and, in the case of a tenant-stockholder in a cooperative housing corporation, real estate taxes for which a deduction is allowable to the taxpayer under section 216.

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[254] If the deduction for State and local taxes is attributable to business or rental income, the deduction is allowed in computing adjusted gross income and therefore is not an itemized deduction.

[255] This provision was subsequently extended through December 31, 2009. See Part Seventeen, Division C. Title II. D.

[256] In the case of an individual taxpayer who does not elect to itemize deductions, although no itemized deductions are allowed to the taxpayer, itemized deductions are nevertheless treated as "allowable." See section 63(e).

No taxes deductible in computing adjusted gross income are taken into account in computing the increased standard deduction.

Effective Date

The provision applies to taxable years beginning in 2008.

C. General Provisions

1. Modifications to qualified private activity bond rules for housing (sec. 3021 of the Act and secs. 142, 143, and 146 of the Code)

Present Law

In general

Private activity bonds are bonds that nominally are issued by State or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such private person. The exclusion from income for interest paid on State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds"). The definition of a qualified private activity bond includes, but is not limited to, qualified mortgage bonds, qualified veterans' mortgage bonds, and bonds for qualified residential rental projects.

Qualified private activity bond rules for housing

Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for owner-occupied residences. The Code imposes several limitations on qualified mortgage bonds, including income limitations for homebuyers, purchase price limitations for the home financed with bond proceeds, and a "first-time homebuyer" requirement. The income limitations are satisfied if all financing provided by an issue is provided for mortgagors whose family income does not exceed 115 percent of the median family income for the metropolitan area or State, whichever is greater, in which the financed residences are located. The purchase price limitations provide that a residence financed with qualified mortgage bonds may not have a purchase price in excess of 90 percent of the average area purchase price for that residence. The first-time homebuyer requirement provides that qualified mortgage bonds generally cannot be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the three years preceding the execution of the mortgage. In addition, bond proceeds generally only can be used for new mortgages, i.e., proceeds cannot be used to acquire or refinance existing mortgages. Under present law, the proceeds of qualified mortgage bonds generally must be used to finance mortgages within 42 months from the date of issuance of the bonds.

Residential rental property may be financed with qualified private activity bonds if the financed project is a "qualified residential rental project." A project is a qualified residential rental project if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area me-

dian gross income (the "20-50 test"). Alternatively, a project is a qualified residential rental project if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income (the "40-60 test").

As with most qualified private activity bonds, qualified mortgage bonds and bonds for qualified residential rental projects are subject to annual State volume limitations (the "State volume cap"). For calendar year 2008, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $262.09 million, if greater. The interest income from qualified mortgage bonds and bonds for qualified residential rental projects is a preference item for purposes of calculating the alternative minimum tax ("AMT").

Reasons for Change

The Congress is concerned that the general deterioration in the credit markets and decline in housing prices is making it difficult for many homeowners to refinance high interest rate mortgages. The Congress believes that additional tools are needed to alleviate the financial burdens faced by homeowners with subprime, adjustable-rate mortgages that are due to reset over the next several years. The Congress also believes that tax-exempt bonds are an effective way to provide these homeowners with lower-cost refinancing options than are otherwise available under current market conditions. Thus, the Congress believes it is appropriate to temporarily expand the purposes for which qualified mortgage bonds may be issued and to temporarily increase the volume cap available for housing projects.

Explanation of Provision

Temporary volume cap increase

The provision authorizes an additional $11 billion of volume cap for 2008 for the purpose of issuing qualified mortgage bonds or private activity bonds for qualified residential rental projects. The additional volume cap is allocated to each State in the same proportion as the total State volume is allocated to each of the States. Qualified mortgage bonds issued with respect to the additional volume cap may be used to finance either mortgages permitted under present law (e.g., new mortgages) or qualified subprime loans as defined under the Act. However, all proceeds of qualified mortgage bonds issued with respect to the additional volume cap must be used within 12 months of the date of issuance of such bonds. Additional volume cap that remains unused at the end of 2008 may be carried forward to 2009 and 2010, but solely for the purpose of issuing qualified mortgage bonds or private activity bonds for qualified residential rental projects.

Qualified mortgage bonds for certain refinancings

The provision creates an exception to the new mortgage requirement for qualified mortgage bonds by authorizing the use of such bonds to refinance a qualified subprime loan. The provision defines a qualified subprime loan as an adjustable rate residential mortgage loan originated after December 31, 2001, and before January

1, 2008, that the issuer determines would be reasonably likely to cause financial hardship to the borrower if not refinanced. Under the provision, proceeds of qualified mortgage bonds used to refinance qualified subprime loans must be so used within 12 months from the date of issuance of the bond. In addition, the provision also provides that qualified subprime loans cannot be refinanced by bonds issued after December 31, 2010.

Effective Date

The provision applies to bonds issued after the date of enactment (July 30, 2008).

2. Alternative minimum tax treatment of interest on certain bonds, the low-income housing credit, and the rehabilitation credit (sec. 3022 of the Act and secs. 38, 56 and 57 of the Code)

Present Law

In general

Present law imposes an alternative minimum tax ("AMT") on individuals and corporations. AMT is the amount by which the tentative minimum tax exceeds the regular income tax. The tentative minimum tax is computed based upon a taxpayer's alternative minimum taxable income ("AMTI"). AMTI is the taxpayer's taxable income modified to take into account certain preferences and adjustments.

Tax-exempt bonds

One of the preference items is tax-exempt interest on certain tax-exempt bonds issued for private activities (sec. 57(a)(5)). Also, in the case of a corporation, an adjustment based on current earnings is determined, in part, by taking into account 75 percent of items, including tax-exempt interest, that are excluded from taxable income but included in the corporation's earnings and profits (sec. 56(g)(4)(B)).

Low-income housing and rehabilitation credits

Business tax credits generally may not exceed the excess of the taxpayer's income tax liability over the tentative minimum tax (or, if greater, 25 percent of the regular tax liability in excess of $25,000). Thus, business tax credits generally cannot offset the alternative minimum tax liability.[257]

Credits in excess of the limitation may be carried back one year and carried forward for up to 20 years.

Reasons for Change

The alternative minimum tax limits the intended benefits of tax-exempt housing bonds for some taxpayers who invest in these bonds. Also, the alternative minimum tax limits the intended ef-

[257] A special rule treats the tentative minimum tax as being zero for purposes of determining the tax liability limitation with respect to certain energy credits, the work opportunity credit and the credit for taxes paid with respect to employee cash tips (sec. 38(c)(4)). Thus, the credits listed in the preceding sentence may offset the alternative minimum tax liability.

fects of the low-income housing tax credit and the rehabilitation credit for some taxpayers. The Congress believes that the tax exemption for interest on these housing bonds, the low-income housing tax credit and the rehabilitation credit should be available to taxpayers regardless of their alternative minimum tax status. Accordingly, the Act eliminates the treatment of this interest as a tax preference under the alternative minimum tax and provides that these credits can be utilized to offset both the regular tax and the alternative minimum tax.

Explanation of Provision

Tax-exempt bonds

The Act provides that tax-exempt interest on (i) exempt facility bonds issued as part of an issue 95 percent or more of the net proceeds of which are used to provide qualified residential rental projects (as defined in section 142(d)), (ii) qualified mortgage bonds (as defined in section 143(a)), and (iii) qualified veterans' mortgage bonds (as defined in section 143(b)) is not an item of tax preference for purposes of the alternative minimum tax. Also, this interest is not included in the corporate adjustment based on current earnings. The provision does not apply to interest on any refunding bond unless interest on the refunded bond (or in the case of a series of refundings, the original bond) was not an item of tax preference.

Low-income housing and rehabilitation credits

The Act treats the tentative minimum tax as being zero for purposes of determining the tax liability limitation with respect to the low-income housing credit and the rehabilitation credit.

Thus, the low-income housing tax credit and the rehabilitation credit may offset the alternative minimum tax liability.

Effective Date

The provision applies to interest on bonds issued after the date of enactment (July 30, 2008).

The provision applies to low-income housing credits determined under section 42 attributable to buildings placed in service after December 31, 2007 (including any carryback of the credits).

The provision applies to rehabilitation credits determined under section 47 attributable to qualified rehabilitation expenses properly taken into account for periods after December 31, 2007 (including any carryback of the credits).

3. Bonds guaranteed by Federal Home Loan Banks eligible for treatment as tax-exempt bonds (sec. 3023 of the Act and sec. 149 of the Code)

Present Law

Interest paid on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes. However, the exclusion generally does not apply to State and local bonds that are Federally guaranteed. Under present law, a bond is Federally guaranteed if: (1) the payment of principal or

interest with respect to such bond is guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof); (2) such bond is issued as part of an issue and five percent or more of the proceeds of such issue is to be (a) used in making loans the payment of principal or interest with respect to which is guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof), or (b) invested directly or indirectly in Federally insured deposits or accounts; or (3) the payment of principal or interest on such bond is otherwise indirectly guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof).

The Federal guarantee restriction was enacted in 1984 with certain exceptions for certain guarantee programs in existence at that time. The exceptions include guarantees by: the Federal Housing Administration; the Department of Veterans' Affairs; the Federal National Mortgage Association; the Federal Home Loan Mortgage Association; the Government National Mortgage Association; the Student Loan Marketing Association; and the Bonneville Power Authority. The exception also includes guarantees for certain housing programs. These are: (a) private activity bonds for a qualified residential rental project or a housing program obligation under section 11(b) of the United States Housing Act of 1937; (b) a qualified mortgage bond; or (c) a qualified veterans' mortgage bond.

Reasons for Change

The Congress is concerned that the recent deterioration in the credit markets is increasing the borrowing costs of State and local governments for essential governmental projects. The Congress believes that additional tools are needed to allow State and local governments easier access to the credit markets. Thus, the Congress believes it is appropriate to provide a temporary exception to the Federal guarantee prohibition to reduce the borrowing costs of State and local governments.

Explanation of Provision

Under the provision, bonds issued by State and local governments are not treated as Federally guaranteed by reason of any guarantee provided by any Federal Home Loan Bank of a bond issued after the date of enactment and before January 1, 2011, if such bank made a guarantee of such bond in connection with such issuance.

The exception to the Federal guarantee prohibition does not apply to any guarantee by a Federal home loan bank unless such bank meets safety and soundness collateral requirements for such guarantees which are at least as stringent as the regulatory requirements for guarantees by Federal home loan banks as in effect on April 9, 2008.

Effective Date

The provision applies to guarantees made after the date of enactment (July 30, 2008).

4. Modification of rules pertaining to FIRPTA nonforeign affidavits (sec. 3024 of the Act and sec. 1445 of the Code)

Present Law

In general, nonresident aliens and foreign corporations are not taxed on capital gains.[258] However, such foreign persons must take into account gains and losses from the disposition of an interest in United States real property ("USRPI") as if such persons were engaged in a trade or business in the United States during the taxable year and such gains or losses were effectively connected with such trade or business.[259]

Although tax is imposed upon such dispositions on a net basis, in the case of any disposition of a USRPI by a foreign person, the transferee is generally required to deduct and withhold a tax equal to ten percent of the amount realized.[260] The transferee is exempt from this withholding requirement if:

In general, the transferred interest is not a USRPI;

The transferee receives a "qualifying statement" from the Secretary of the Treasury (or his delegate) that states that the transferor is exempt from the tax on the disposition of the USRPI or has reached agreement with the Secretary for payment of such tax, and that any withholding tax has been satisfied or secured;

The USRPI is acquired by the transferee for use by him as a residence and the amount realized does not exceed $300,000; or

The transferor furnishes to the transferee an affidavit by the transferor stating, under penalties of perjury, the transferor's United States taxpayer identification number and that the transferor is not a foreign person. However, this rule does not apply if the transferee has actual knowledge that such affidavit is false or if the transferee receives a notice from a transferor's agent or a transferee's agent that such affidavit is false, or if the transferee fails to meet the Secretary's requirement that the transferee furnish a copy of such affidavit to the Secretary.[261] Regulations require the transferee to retain the transferor's affidavit until the end of the fifth taxable year following the taxable year in which the transfer takes place.[262]

In certain circumstances, agents may be liable for some or all of the withholding tax. In general, if the transferor's agent or the transferee's agent has actual knowledge that the affidavit is false, then such agent is required to notify the transferee pursuant to regulations.[263] An agent that is required to notify the transferee pursuant to regulations yet fails to do so is under the same duty to deduct and withhold that the transferee would have been under if such agent had properly given such notice.[264] However, an

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[258] Nonresident aliens present in the United States for a period or period aggregating 183 days or more during a taxable year are taxed at a flat 30 percent on their net U.S. source capital gains. Sec. 871(a)(2).

[259] Sec. 897(a)(1).

[260] Sec. 1445(a).

[261] Sec. 1445(b).

[262] Treas. Reg. sec. 1.1445–2(b)(3).

[263] Sec. 1445(d)(1).

[264] Sec. 1445(d)(2)(A).

agent's liability under these circumstances is limited to the amount of the agent's compensation from the transaction.[265]

In the case of a real estate transaction, a "real estate reporting person" is required to file an information return and to furnish certain written statements to customers.[266] A real estate reporting person means the person (including any attorney or title company) responsible for closing the transaction, if there is such a person.[267]

Reasons for Change

The Congress believes that U.S. persons generally are hesitant to provide their social security numbers to persons with whom they do not have an ongoing business relationship. The Congress believes that offering transferors of USRPIs the option of providing nonforeign affidavits solely to the person responsible for closing the transaction should better protect the social security numbers of transferors and provide assurance to transferors that their private information will be secure.

Explanation of Provision

The provision provides an alternate procedure with respect to the nonforeign affidavit. Under this procedure, in lieu of furnishing a nonforeign affidavit to the transferee, a transferor may furnish such affidavit to a "qualified substitute." Such qualified substitute is then required to furnish a statement to the transferee stating, under penalties of perjury, that the qualified substitute has such affidavit in his or her possession. With respect to a disposition of a USRPI, the term "qualified substitute" means (1) the person, including any attorney or title company, responsible for closing the transaction, other than the transferor's agent, and (2) the transferee's agent.

This exemption does not apply if the transferee or qualified substitute has actual knowledge that such affidavit or statement is false, if the transferee or qualified substitute receives a notice from a transferor's agent, transferee's agent, or qualified substitute that such affidavit or statement is false, or if the transferee or qualified substitute fails to meet a regulatory requirement that the transferee or qualified substitute furnish a copy of such affidavit or statement to the Secretary.

Moreover, if the transferor's agent, the transferee's agent, or the qualified substitute has actual knowledge that the affidavit or statement is false, then such agent or qualified substitute is required to notify the transferee. As under present law, the time and manner of such notice is to be specified by regulations. An agent or qualified substitute that is required to notify the transferee pursuant to regulations yet fails to do so has the same duty to deduct and withhold that the transferee would have had if such agent or qualified substitute had properly given such notice. An agent's or

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[265] Sec. 1445(d)(2)(B).

[266] Sec. 6045(e)(1). There is an exception to this requirement for a sale or exchange of a residence for $250,000 or less ($500,000 if the seller is married), if certain conditions are met. Sec. 6045(e)(5).

[267] If there is no such person, then the real estate reporting person with respect to that transaction is either the mortgage lender, seller's broker, buyer's broker, or other person designated under regulations, in that order. Sec. 6045(e)(2).

qualified substitute's liability under these circumstances is limited to the amount of the compensation that such agent or qualified substitute derives from the transaction.

The Secretary of the Treasury is required to prescribe such regulations as may be necessary or appropriate to carry out this provision. It is intended that such rules will require the qualified substitute and transferee to retain the documentation for a period commensurate with the period required under the present-law regulations.

Effective Date

The provision is effective for dispositions after the date of enactment (July 30, 2008).

5. Modify rehabilitation credit tax-exempt use safe harbor and definition of disqualified lease (sec. 3025 of the House Act and sec. 47 of the Code)

Present Law

A 10-percent credit is provided for rehabilitation expenditures with respect to buildings first placed in service before 1936. A 20-percent credit is provided for rehabilitation expenditures with respect to a certified historic structure.

Rehabilitation expenditures eligible for the credit do not include any expenditure in connection with the rehabilitation of a building that is allocable to the portion of the property that is (or may reasonably be expected to be) tax-exempt use property. In the case of nonresidential real property, tax-exempt use property generally means the portion of the property leased in a disqualified lease to tax-exempt entities (sec. 168(h)(1)). For this purpose, a tax-exempt entity means (1) the United States, a State or political subdivision, a U.S. possession, or an agency or instrumentality thereof, (2) a tax-exempt organization, (3) a foreign person or entity, or (4) an Indian tribal government.

A safe harbor provides, however, that in the case of nonresidential real property, the property is treated as tax-exempt use property only if the portion of the property leased to tax-exempt entities in disqualified leases is more than 35 percent of the property.

A disqualified lease for this purpose is a lease to a tax-exempt entity in specified circumstances. These are: (1) part or all of the property was financed, directly or indirectly, by tax-exempt bond financing and the entity (or a related entity) participated in the financing; (2) under the lease there is a fixed or determinable price purchase or sale involving the entity or a related entity (or the equivalent of such an option); (3) the term of the lease exceeds 20 years; or (4) there has been a sale and leaseback of the property and the entity (or a related entity) used the property before the sale, transfer, or lease (sec. 168(h)(1)(B)).

Reasons for Change

The Congress is concerned that the rehabilitation tax credit may not be providing an incentive to rehabilitate buildings when a tax-exempt entity leases a portion of the building in some cir-

cumstances. For example, when a governmental entity such as a post office uses a portion of the building exceeding 35 percent, the amount of the tax credit for rehabilitating the building is reduced. The Congress believes that increasing the present-law percentage of permitted tax-exempt use somewhat, from 35 percent to 50 percent, will encourage the rehabilitation of more buildings.

Explanation of Provision

The provision increases from 35 percent to 50 percent the percentage of the property that may be leased to a tax-exempt entity in a disqualified lease without requiring allocation of rehabilitation expenditures under the rehabilitation credit. Under the provision, for determining rehabilitation expenditures eligible for the credit, nonresidential real property is treated as "tax-exempt use" property only if the portion of the property leased to tax-exempt entities in disqualified leases is more than 50 percent of the property. For this purpose, a tax-exempt entity continues to have the same meaning provided by present law.

Effective Date

The provision is effective for expenditures properly taken into account for periods after December 31, 2007.

6. Special rules for mortgage revenue bonds in Presidentially declared disaster areas (sec. 3026 of the Act and sec. 143 of the Code)

Present Law

In general

Under present law, gross income does not include interest on State or local bonds (sec. 103). State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") (secs. 103(b)(1) and 141).

Qualified mortgage bonds

The definition of a qualified private activity bond includes a qualified mortgage bond (sec. 143). Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for the purchase, improvement, or rehabilitation of owner-occupied residences. The Code imposes several limitations on qualified mortgage bonds, including income limitations for homebuyers and purchase price limitations for the home financed with bond proceeds. In addition to these limitations, qualified mortgage bonds generally cannot be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the three years preceding the

execution of the mortgage (the "first-time homebuyer" requirement). The first-time homebuyer requirement does not apply to targeted area residences. A targeted area residence is one located in either (1) a census tract in which at least 70 percent of the families have an income which is 80 percent or less of the state-wide median income or (2) an area of chronic economic distress.

A temporary provision waived the first-time homebuyer requirement for residences located in certain Presidentially declared disaster areas (sec. 143(k)(11)). In addition, residences located in such areas were treated as targeted area residences for purposes of the income and purchase price limitations. The special rule for residences located in Presidentially declared disaster areas does not apply to bonds issued after December 31, 1998.

Explanation of Provision[268]

The provision waives the first-time homebuyer requirement for residences located in Presidentially declared disaster areas. In addition, residences located in such areas were treated as targeted area residences for purposes of the income and purchase price limitations. The provision applies to bonds issued after May 1, 2008 and before January 1, 2010.

Effective Date

The provision is effective on the date of enactment (July 30, 2008).

7. Transfer of funds appropriated to carry out 2008 recovery rebates to individuals (sec. 3027 of the Act)

Present Law

The Economic Stimulus Act of 2008 (Pub. L. No. 110–185) appropriated the following sums, for the fiscal year ending September 30, 2008 to the Department of the Treasury: (1) an additional amount for the Financial Management Service—Salaries and Expenses", $64,175,000, to remain available until September 30, 2009; (2) an additional amount for the Internal Revenue Service—Taxpayer Services", $50,720,000, to remain available until September 30, 2009; and (3) an additional amount for Internal Revenue Service—Operations Support", $151,415,000, to remain available until September 30, 2009. The Economic Stimulus Act also appropriated an additional amount for the "Social Security Administration—Limitation on Administrative Expenses", $31,000,000, to remain available until September 30, 2008.

Explanation of Provision

The Act provides that the Secretary of the Treasury may transfer funds among the three accounts specified for the Department of Treasury to carry out the purposes of the Economic Stimulus Act.

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[268] The provision related to mortgage revenue bonds in Presidentially declared disaster areas was subsequently amended. See Part Seventeen, Division C. Title VI. Subtitle B. D.

Effective Date

The provision is effective on the date of enactment (July 30, 2008).

TITLE II—REFORMS RELATED TO REAL ESTATE INVESTMENT TRUSTS ("REITS")

(secs. 3031–3071 of the Act and secs. 856 and 857 of the Code)

Present Law

In general

A real estate investment trust ("REIT") is an entity that otherwise would be taxed as a U.S. corporation but elects to be taxed under a special REIT tax regime. In order to qualify as a REIT, an entity must meet a number of requirements. At least 90 percent of REIT income (other than net capital gain) must be distributed annually;[269] the REIT must derive most of its income from passive, generally real-estate-related investments; and REIT assets must be primarily real-estate related. In addition, a REIT must have transferable interests and at least 100 shareholders, and no more than 50 percent of the REIT interests may be owned by 5 or fewer individual shareholders (as determined using specified attribution rules). Other requirements also apply.[270]

If an electing entity meets the requirements for REIT status, the portion of its income that is distributed to its shareholders each year as a dividend is deductible by the REIT (unlike the case of a regular subchapter C corporation, which cannot deduct dividends). As a result, the distributed income of the REIT is not taxed at the entity level; instead, it is taxed only at the investor level.[271]

Income tests

In general

A REIT is restricted to earning certain types of generally passive income. Among other requirements, at least 75 percent of the gross income of a REIT in each taxable year must consist of real-estate-related income. Such income includes: rents from real property; income from the sale or exchange of real property (including interests in real property) that is not stock in trade, inventory, or held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business; interest on mortgages secured by real property or interests in real property; and certain income from foreclosure property (the "75-percent income test").[272] Amounts attrib-

[269] Even if a REIT meets the 90-percent income distribution requirement for REIT qualification, more stringent distribution requirements must be met in order to avoid an excise tax under section 4981.

[270] Secs. 856 and 857.

[271] A REIT that has net capital gain can either distribute that gain as a "capital gain" dividend or retain that gain without distributing it but cause the shareholders to be treated as if they had received and reinvested a capital gain dividend. In either case, the gain in effect is taxed only as net capital gain of the shareholders. Sec. 857(b)(3).

[272] Secs. 856(c)(3) and 1221(a)(1). Income from sales that are not prohibited transactions solely by virtue of section 857(b)(6) also is qualified REIT income.

utable to most types of services provided to tenants (other than certain "customary services"), or to more than specified amounts of personal property, are not qualifying rents.[273] In addition, rents received from any entity in which the REIT owns more than 10 percent of the vote or value also generally are not qualifying income. However, there is an exception for certain rents received from taxable REIT subsidiaries (described further below), in which a REIT may own more than 10 percent of the vote or value.

In addition, 95 percent of the gross income of a REIT for each taxable year must be from the 75-percent income sources and a second permitted category of other, generally passive investments such as dividends, capital gains, and interest income (the "95-percent income test").[274]

Income from certain hedging transactions

Except as provided by Treasury regulations, income from a hedging transaction that is clearly identified,[275] including gain from the sale or disposition of such a transaction, is not included as gross income under the 95-percent income test, to the extent the transaction hedges any indebtedness incurred or to be incurred by the REIT to acquire or carry real estate assets.[276]

Foreign currency exchange gain

A REIT must be a U.S. domestic entity, but it is permitted to hold foreign real estate or other foreign-based assets, provided the 75-percent and 95-percent income tests and the other requirements for REIT qualification are met.[277] A REIT that holds foreign real estate or other foreign-based assets may have foreign currency exchange gain under the foreign currency transaction rules of the Code (described below). Foreign currency exchange gain is not explicitly included in the statutory definitions of qualifying income for purposes of the 75-percent and 95-percent income tests, though the IRS has issued guidance that allows foreign currency gain to be treated as qualified income in certain circumstances.

The foreign currency transaction rules of sections 985 through 989 apply whenever a taxpayer engages in a business or investment activity using a currency other than the taxpayer's functional currency (a "nonfunctional currency"). Section 985 provides in general that all determinations for Federal income tax purposes are made in the taxpayer's functional currency. A taxpayer's functional currency is the dollar except in the case of a qualified business unit ("QBU"), in which case the functional currency is "the currency of the economic environment in which a significant part of such unit's activities are conducted and which is used by such unit in keeping its books and records."[278] A QBU is any separate and clearly iden-

[273] Sec. 856(d). Amounts attributable to the provision of certain services by an independent contractor or by a taxable REIT subsidiary can be qualified rents. Sec. 856(d)(7).

[274] Sec. 856(c)(3).

[275] A hedging transaction for this purpose is one defined in clause (ii) or (iii) of section 1221(b)(2)(A). The identification requirement is defined in section 1221(a)(7).

[276] Sec. 856(c)(5)(G).

[277] *See* Rev. Rul. 74–191, 1974–1 C.B. 170.

[278] Sec. 985(b)(1).

tified unit of a trade or business of a taxpayer if the unit maintains separate books and records.[279]

A taxpayer that engages in a business or investment activity using a currency other than the U.S. dollar may have gain or loss under section 987 or 988, depending on the nature of the activity and type of entity (if any) through which the activity is conducted.

A U.S. taxpayer becomes subject to section 988 when it enters into a "section 988 transaction." Among other things, a "section 988 transaction" includes the acquisition of a debt instrument, becoming an obligor under a debt instrument, the accrual of items of expense or gross income, or the disposition of any nonfunctional currency.[280]

When a REIT holds a mortgage (or other instrument or arrangement described in section 988)[281] denominated in a nonfunctional currency or determined by reference to the value of a nonfunctional currency and the applicable foreign currency exchange rate changes between the time interest on an obligation to (or an obligation of) the REIT accrues and the time it is paid, the REIT may have foreign currency gain or loss under the rules of section 988. Foreign currency exchange gain under section 988 also can result when a REIT receives payment of principal on a debt instrument denominated in a nonfunctional currency or sells such a debt instrument, or when a REIT incurs a debt obligation denominated in a nonfunctional currency and pays interest or principal in that currency.

In May 2007, the IRS ruled in Rev. Rul. 2007–33 that if section 988 currency gain is recognized by a REIT with respect to an item of income, the section 988 gain will be qualifying income for purposes of the 95-percent and 75-percent income tests of section 856(c)(2) and (3), respectively, to the extent the underlying income so qualifies. Analogous relief was not provided for section 988 gain with respect to any items other than income items.[282]

Section 987 applies when there is a remittance from a foreign business or investment activity conducted through a QBU that is a branch that keeps its books and records in a functional currency other than the dollar. If a REIT has a QBU that keeps its books and records in a foreign currency, the REIT could have foreign cur-

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[279] Sec. 989(a).

[280] Sec. 988(c)(1)(B) and (C).

[281] Section 988 applies to (i) the acquisition of a debt instrument or becoming the obligor under a debt instrument; (ii) accruing (or otherwise taking into account) any item of expense or gross income or receipts which is to be paid after the date on which so accrued or taken into account, and (iii) entering into or acquiring any forward contract, futures contract, option, or similar financial instrument (except for any regulated futures contract or nonequity option which would be marked to market under section 1256 if held on the last day of the taxable year). Section 988 also applies to the disposition of any nonfunctional currency. Nonfunctional currency includes "coin or currency, and nonfunctional currency denominated demand or time deposits or similar instruments issued by a bank or other financial institution." Sec. 988(c)(1).

[282] Rev. Rul. 2007–33, 2007–1 C.B. 1281. This ruling does not address the treatment of currency gain that might arise with respect to the payment of principal on an obligation that would produce qualified income. The ruling also does not address the treatment of foreign currency gain that might arise in connection with indebtedness denominated in a foreign currency that is incurred to acquire assets that produce qualifying income. A private letter ruling concluded that section 988 currency gain attributable to fluctuation in the exchange rates of currency used to make payments on non-dollar debt obligations incurred to acquire investments that produced qualifying non-dollar income would be treated as qualifying income, where the borrowings were to be used to finance the acquisition of the investments on a cost-effective basis, and not to speculate in foreign currency. PLR 200808024. A private letter ruling may be relied upon only by the taxpayer to which the ruling is issued.

rency exchange gain or loss under section 987 with respect to remittances.[283]

The IRS has ruled in several private rulings that a REIT may establish a REIT subsidiary that itself qualifies as a separate REIT (and thus would not be treated as a branch) to conduct qualified REIT activity with respect to foreign investments in a particular foreign currency, and that subsidiary can itself be treated as a QBU whose functional currency is that particular foreign currency, if that subsidiary keeps its books and records in that particular foreign currency.[284] This structure provides a method for a REIT to conduct activities abroad and minimize any concerns regarding the treatment of foreign currency gain for purposes of the 75-percent and 95-percent income tests. However, this structure effectively requires a separate REIT subsidiary that itself qualifies as a REIT, for each different currency in which the REIT may conduct activities.[285]

At the same time that it issued Rev. Rul. 2007–33, the IRS also issued a notice regarding the application of section 987 to a QBU of a REIT. The notice states that until further guidance is issued, a REIT that has a QBU that uses a functional currency other than the U.S. dollar may apply the principles of proposed regulations issued on September 7, 2006, to determine whether section 987 currency gain is derived from income described in sections 856(c)(2) or (3).[286]

Certain other items

Certain private letter rulings issued to particular taxpayers have permitted various other types of income to be ignored for purposes of the 75-percent or 95-percent income tests, due to the relationship of the income to REIT qualifying assets or income. A few examples include a settlement payment received by a REIT with respect to construction of a mall or a payment received as a "breakup" fee in a proposed merger.[287]

Asset tests

At least 75 percent of the value of a REIT's assets must be real estate assets, cash and cash items (including receivables), and Government securities (the "75-percent asset test"). Real estate assets are real property (including interests in real property and mortgages on real property) and shares (or transferable certificates of

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[283] Recent proposed regulations under section 987 would replace previously proposed rules in an attempt to limit the ability of taxpayers to recognize non-economic foreign currency losses that could reduce otherwise taxable income, as well as to prevent non-economic currency gains that could arise. The 2006 proposed regulations would provide certain tracing-type rules. See REG–208270–86 (Sept. 7, 2006). See also, Notice 2000–20 (March 22, 2000), discussing concerns regarding earlier proposed regulations issued in 1991. The 2006 proposed regulations when originally issued did not by their terms apply to REITs, RICs, or certain other types of entities. Prop. Reg. Sec. 1.987–1(b)(iii). But see Notice 2007–42, 2007–1 C.B. 1288, *infra*.

[284] *See, e.g.,* PLR 200625019 and PLR 200550025. A private letter ruling may be relied upon only by the taxpayer to which the ruling was issued.

[285] In this structure, the parent REIT treats the dividends paid by the subsidiary REIT as a qualified REIT dividend, minimizing any currency gains by exchanging the foreign currency into dollars at the time of the dividend distribution.

[286] Notice 2007–42, 2007–1 C.B. 1288. Compare REG–208270–86 (Sept. 7, 2006), which by its terms did not apply to REITs.

[287] PLR 200039027 and PLR 200127024. A private letter ruling may relied upon only by the taxpayer to which the ruling was issued.

beneficial interest) in other REITs.[288] No more than 25 percent of a REIT's assets may be securities other than such real estate assets.[289]

Except with respect to a taxable REIT subsidiary (described further below), not more than 5 percent of the value of a REIT's assets may be securities of any one issuer, and the REIT may not possess securities representing more than 10 percent of the outstanding value or voting power of any one issuer.[290] In addition, (except in the case of certain timber REITs for a limited time period), not more than 20 percent of the value of a REIT's assets may be securities of one or more taxable REIT subsidiaries.[291]

The asset tests must be met as of the close of each quarter of a REIT's taxable year. However, a REIT that has met the asset tests as of the close of any quarter does not lose its REIT status solely because of a discrepancy during a subsequent quarter between the value of the REIT's investments and such requirements, unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition.[292]

Taxable REIT subsidiaries

A REIT generally cannot own more than 10 percent of the vote or value of a single entity; however, there is an exception for ownership of a taxable REIT subsidiary ("TRS") that is taxed as a corporation, provided that securities of one or more TRSs do not represent more than 20 percent[293] of the value of REIT assets.

A TRS generally can engage in any kind of business activity except that it is not permitted directly or indirectly to operate either a lodging facility or a health care facility. However, a TRS is permitted to rent hotel, motel, or other transient lodging facilities from its parent REIT and is permitted to hire an independent contractor to operate such facilities.[294]

Furthermore, rent paid to the parent REIT by the TRS with respect to hotel, motel, or other transient lodging facilities operated by an independent contractor is qualified rent for purposes of the REIT's 75-percent and 95-percent income tests. This lodging facility rental rule is an exception to the general rule that rent paid to a REIT by any corporation (including a TRS) in which the REIT owns 10 percent or more of the vote or value is not qualified rental income for purposes of the 75-percent or 95-percent REIT income

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[288] Sec. 856(c)(4)(A). Temporary investments in certain stock or debt instruments also can qualify if they are temporary investments of new capital, but only for the one-year period beginning on the date the REIT receives such capital. Sec. 856(c)(5)(B).

[289] Sec. 856(c)(4)(B)(i).

[290] Sec. 856(c)(4)(B)(iii).

[291] Sec. 856(c)(4)(B)(ii). In the case of a "timber REIT" defined as a REIT more than 50 percent of the value of whose assets consists of real property held in connection with the trade or business or producing timber, up to 25 percent of the value of the REITs assets may be securities of one or more taxable REIT subsidiaries. This special rule is in place only for taxable years beginning after the date of enactment of the Food, Conservation, and Energy Act of 2008 (H.R. 2419, Pub. L. No. 110–234, enacted on May 22, 2008) and before the date that is one year after such date of enactment.

[292] Sec. 856(c)(4). In the case of such an acquisition, the REIT also has a grace period of 30 days after the close of the quarter to eliminate the discrepancy.

[293] 25 percent for certain timber REITs for a one-year period. See "Asset tests," *supra*.

[294] An independent contractor will not fail to be treated as such for this purpose because the TRS bears the expenses of operation of the facility under the contract, or because the TRS receives the revenues from the operation of the facility, net of expenses for such operation and fees payable to the operator pursuant to the contract, or both. Sec. 856(d)(9)(B).

tests. An exception to the general rule exists in the case of a TRS that rents space in a building owned by its parent REIT if at least 90 percent of the space in the building is rented to unrelated parties and the rent paid by the TRS to the REIT is comparable to the rent paid by the unrelated parties.[295]

Prohibited transactions tax

REITs are subject to a prohibited transaction tax ("PTT") of 100 percent of the net income derived from prohibited transactions. For this purpose, a prohibited transaction is a sale or other disposition of property by the REIT that is "stock in trade of a taxpayer or other property which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held for sale to customers by the taxpayer in the ordinary course of his trade or business" (sec. 1221(a)(1))[296] and is not foreclosure property. The PTT for a REIT does not apply to a sale if the REIT satisfies certain safe harbor requirements in sections 857(b)(6)(C) or (D), including an asset holding period of at least four years (2 years in the case of certain sales of timber property for a limited time period).[297] If the conditions are met, a REIT may either i) make no more than 7 sales within a taxable year (other than sales of foreclosure property or involuntary conversions under section 1033), or ii) sell no more than 10 percent of the aggregate bases of all its assets as of the beginning of the taxable year (computed without regard to sales of foreclosure property or involuntary conversions under section 1033), without being subject to the PTT tax.

Reasons for Change

The Congress believes that present law contains undesirable uncertainty and complexity in determining the effect of foreign currency gain on REIT qualification when a REIT invests in otherwise qualified foreign assets that produce otherwise qualified foreign income. If foreign currency gain is attributable to otherwise qualifying REIT income from foreign investments, such currency gain should not cause disqualification of a REIT. The Treasury Department has issued some guidance to that effect in the case of certain income items.[298] The Congress wishes to assure that the same re-

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

[296] This definition is the same as the definition of certain property the sale or other disposition of which would produce ordinary income rather than capital gain under section 1221(a)(1).

[297] Additional requirements for the safe harbor limit the amount of expenditures the REIT can make during the four year period prior to the sale that are includible in the adjusted basis of the property, require marketing to be done by an independent contractor, and forbid a sales price that is based on the income or profits of any person. Under the Food, Conservation, and Energy Act of 2008 (H.R. 2419, Pub. L. No. 110–234, enacted on May 22, 2008), the four-year holding period is reduced to two years in the case of a sale of timber property under section 857(b)(6)(D), provided the sale is to a qualified organization (as defined in section 170(h)(3)), exclusively for conservation purposes (as defined in section 170(h)(1)(C). The rule is in place only for taxable years beginning after the date of enactment of that Act and before one year following such date of enactment. In addition, for the same one year period, any sale that is exempt from the prohibited transactions provision by virtue of section 857(b)(6)(D) is treated for all purposes of subtitle A of the Code as a sale of property held for investment or use in a trade or business, and not property described in section 1221(a)(1) of the Code.

[298] Rev. Rul. 2007–33, 2007–21 I.R.B. 1281.

sult will occur with respect to foreign currency gain on a REIT's receipt of payments of principal (rather than income) on an asset that would produce qualified REIT income (for example, the receipt of principal payments on a mortgage that is secured by real property and denominated in foreign currency). If a REIT borrows in a foreign currency to facilitate the acquisition of qualified assets denominated in a foreign currency, the Congress wishes to assure that the same result will occur with respect to payments of interest and principal on such a borrowing.

Similarly, although the Treasury Department has indicated that a REIT may operate in a foreign country with a qualified business unit that uses a nonfunctional currency and that the REIT may rely on the principles of the 2006 proposed Treasury regulations to determine whether currency gain on remittances is qualified REIT income,[299] the Congress wishes to provide a simpler method to determine that foreign currency gain on remittances from a qualified business unit will not adversely affect REIT qualification. The Congress therefore has adopted rules that are intended both to assure that appropriate foreign currency gain will not disqualify a REIT and to preclude the treatment of income from foreign currency speculation as qualified income.

The Congress also believes it is desirable to grant regulatory authority to the Treasury Department to permit other types of income that are not statutorily designated as qualified income to be disregarded for purposes of the REIT gross income tests in appropriate cases. Under present law, the Internal Revenue Service has issued private rulings that have reached this result in cases involving income related to the conduct of permitted REIT activities, for example, income relating to settlement of a lawsuit over construction of a mall in which a REIT was investing,[300] and income from a "breakup" fee related to the termination of a proposed acquisition of another REIT.[301] However, a private ruling may be relied upon only by the taxpayer to whom the ruling is issued. The Congress believes it is desirable for the Treasury Department to be permitted to issue generally applicable guidance in appropriate cases.

With respect to taxable REIT subsidiaries ("TRSs"), the Congress believes it is appropriate to allow a greater percentage of a REIT's assets to consist of stock of such subsidiaries. The Congress believes that a 25 percent limitation is consistent with the present law rule that at least 75 percent of REIT assets must be real estate assets, cash, cash items, and Government securities.

The Congress also believes it is desirable to extend to health care facilities the rules that permit a TRS to bear the costs and receive the revenues of a qualified lodging facility, and to pay qualified arm's length rent to the REIT for such a facility, provided the facility is operated by an independent contractor and the TRS pays an arm's length fee to the independent contractor for such operation. Also, the Congress desires to provide that a taxable REIT subsidiary is not considered to be directly or indirectly operating a lodging or health care facility (i.e., without the required use of an

[299] Notice 2007–42, 2007–21 I.R.B. 1288.
[300] PLR 200039027.
[301] PLR 200127024.

independent contractor) merely because it possesses a license to do so.

Finally, the Congress is concerned that the four-year holding period for the safe harbor from prohibited transactions tax may inappropriately deter REITs from selling their properties, and that the present law rule requiring use of basis for purposes of the 10-percent safe harbor limitation may unfairly affect a REIT that sells more recently acquired, higher-basis assets instead of longer-held assets with greater appreciation. The Congress thus desires to shorten the required holding period for REIT asset sales that can qualify for the safe harbor from the prohibited transactions tax ("PTT"), and to allow a REIT that makes more than 7 sales in a taxable year to make sales under the alternative safe harbor equal to 10 percent of the aggregate fair market value of the REIT assets, where the basis of property sold during the year exceeds the amount permitted under the present law rule (10 percent of aggregate basis of REIT assets). The Congress believes these changes will enable REITs to sell properties more readily and thus capture asset values for shareholders with more flexibility.

Explanation of Provision

Foreign currency gain

Exclusion of certain foreign currency gain for certain income tests

The provision excludes certain foreign currency gain recognized under section 987 or section 988 from the computation of qualifying income for purposes of the 75-percent income test or the 95-percent income test, respectively.[302] The exclusion is solely for purposes of the computations under these tests.

The provision defines two new categories of income for purposes of the exclusion rules: "real estate foreign exchange gain" and "passive foreign exchange gain." Real estate foreign exchange gain is excluded from gross income for purposes of both the 75-percent and 95-percent income tests. Passive foreign exchange gain is excluded for purposes of the 95-percent income test but is included in gross income and treated as non-qualifying income to the extent that it is not real estate foreign exchange gain, for purposes of the 75-percent income test.

Real estate foreign exchange gain is foreign currency gain (as defined in section 988(b)(1)) which is attributable to (i) any item of income or gain described in section 856(c)(3) (i.e., described in the 75-percent income test), (ii) the acquisition or ownership of obligations secured by mortgages on real property or interests in real property; or (iii) becoming or being the obligor under obligations secured by mortgages on real property or on interests in real property. Real estate foreign exchange gain also includes section 987 gain attributable to a qualified business unit ("QBU") of the REIT if the QBU itself meets the 75-percent income test for the taxable year, and meets the 75-percent asset test at the close of each quarter of the REIT that has directly or indirectly held the QBU. The

[302] The excluded amounts are excluded from both the numerator and the denominator in the relevant computations.

QBU is not required to meet the 95–percent income test in order for this 987 gain exclusion to apply. Real estate foreign exchange gain also includes any other foreign currency gain as determined by the Secretary of the Treasury.

Passive foreign exchange gain includes all real estate foreign exchange gain, and in addition includes foreign currency gain which is attributable to (i) any item of income or gain described in section 856(c)(2) (i.e., described in the 95-percent income test), (ii) the acquisition or ownership of obligations, (iii) becoming or being the obligor under obligations, and (iv) any other foreign currency gain as determined by the Secretary of the Treasury.

Notwithstanding the foregoing rules, except in the case of certain income that is excluded under the hedging rules of section 856(c)(5)(G) (as amended by the provision), any section 988 gain derived from engaging in dealing, or substantial and regular trading, in securities (as defined in section 475(c)(2)) shall constitute gross income that does not qualify under either the 75-percent or 95-percent income test.

The effect of these rules is to change the result of Rev. Rul. 2007–33 in the case of foreign currency gain attributable to an item of REIT income that qualifies under sections 856(c)(2) or 856(c)(3), respectively, because the provision excludes such gain (solely for purposes of the relevant income test) rather than treating such gain as qualified income for purposes of that test. The provision in addition excludes foreign currency gain attributable to principal payments received on certain REIT assets, or to principal or interest payments with respect to certain liabilities of a REIT, situations not addressed in the revenue ruling.

The rules of the provision also supersede Notice 2007–42 in the case of remittances from a QBU that uses a functional currency other than the dollar. The provision excludes section 987 gain on a remittance from such a QBU to the REIT from the computation of both the 75-percent and the 95-percent income tests of the REIT, provided the QBU itself both meets the 75-percent income test for the taxable year and meets the 75-percent asset test at the close of each quarter of the taxable year. If the QBU meets these requirements, the section 987 gain is excluded entirely for purposes of the REIT gross income tests, and no tracing-type rules with respect to section 987 gain are imposed, as would have been the case under Notice 2007–42. For this purpose, the QBU is tested as if it were a separate entity that is independently required to meet the 75-percent income test and the 75-percent asset test applicable to REIT qualification. However, the QBU need not meet any of the other REIT requirements, nor itself be treated as a REIT. It is expected that the Treasury Department will use its regulatory authority[303] to provide appropriate rules with respect to the treatment of section 987 currency gain for purposes of the REIT gross income tests if a QBU does not meet the requirements of the provision.

In the case of a section 988 transaction, it is intended that the provision only apply to foreign currency gain that is directly attributable to income items that otherwise are treated as qualifying in-

[303] *See, e.g.* Sec. 989(c).

come for purposes of the 75-percent and 95-percent income tests, respectively, (or directly attributable to the acquisition or ownership of, or to becoming the obligor under, obligations secured by mortgages on real property or on interests on real property). As one example, foreign currency gain attributable to exchange rate fluctuations between the time of the accrual of interest income on a foreign-currency denominated obligation secured by a mortgage on real property and the time of payment, would constitute excluded income for purposes of both the 75-percent and 95-percent income tests. However, any additional foreign currency gain arising from subsequent disposition of the foreign currency received upon payment of the accrued interest would be attributable to holding the foreign currency after its receipt and would not constitute excluded income under either test; rather it would be non-qualifying income.

Similarly, in the case of section 987 foreign currency gain on remittances, only section 987 gain as of the time of, and resulting from, the remittance is attributable to the QBU and is excluded income. Any currency gain arising from holding currency after remittance is not attributable to the QBU. Such gain is not excluded income for purposes of the 75-percent or 95-percent income tests and is not qualifying income for purposes of those tests.

The following examples demonstrate the operation of the distinction between "real estate foreign exchange gain", which is excluded for purposes of both the 75-percent and 95-percent income tests, and "passive foreign exchange gain," which is excluded only for purposes of the 95-percent income test and which is non-qualifying income for purposes of the 75-percent income test.

Example 1.—Assume that a REIT whose functional currency is the dollar holds an obligation that is secured by a mortgage on real property, which instrument pays interest at a date later than the date the interest is accrued by the REIT. The obligation is denominated in a foreign currency. Under sections 856(c)(3) and 856(c)(2), the REIT's interest income accrued on such a mortgage obligation is qualified income for purposes of the 75-percent and 95-percent income tests. Under the provision, any section 988 gain attributable to currency fluctuations between the time the interest is accrued by the REIT and the time the interest is paid to the REIT is real estate foreign exchange gain because it is directly attributable to the qualified interest income, and thus the section 988 gain is excluded for purposes of the 75-percent and 95-percent income tests.

Example 2.—Assume the same facts as in Example 1, except that the instrument held by the REIT is a debt instrument that is not an obligation secured by a mortgage on real property or an interest in real property. Under sections 856(c)(3) and 856(c)(2), interest income accrued by the REIT is qualified income for purposes of the 95-percent income test but is not qualified income for purposes of the 75-percent income test. Under the provision, any section 988 gain attributable to currency fluctuations between the time the interest is accrued and the time the interest is paid is passive foreign exchange gain because it is directly attributable to the interest income that is qualified for purposes of the 95-percent income test. Such passive foreign exchange gain is excluded for purposes of the

95-percent income test but is not excluded (and is not qualified income) for purposes of the 75-percent income test.

Example 3.—Assume the same facts as in Example 1, and further assume that the REIT receives a repayment of the principal on the obligation. Under the provision, any section 988 gain attributable to the receipt of principal is real estate foreign exchange gain because it is attributable to the acquisition or ownership of an obligation secured by a mortgage on real property. Such section 988 gain is excluded for purposes of both the 75-percent and 95-percent income tests.

Example 4.—Assume the same facts as in Example 2, and further assume that the REIT receives a repayment of the principal on the obligation. Under the provision, any section 988 gain attributable to the receipt of principal is passive foreign exchange gain because it is attributable to the acquisition or ownership of an obligation not secured by a mortgage on real property or an interest in real property. Such section 988 gain is excluded for purposes of the 95-percent income test but is not excluded, and is not qualified income, for purposes of the 75-percent income test.

Other rules

The provision makes several changes to other REIT provisions.

First, the provision extends the present law rule of section 856(c)(5)(G), which excludes certain hedging income from the computation of the 95-percent income test, to exclude such hedging income from the computation of the 75-percent income test as well. As under present law, except to the extent determined by the Secretary of the Treasury, such income is income of a REIT from a hedging transaction (as defined in clause (ii) or (iii) of section 1221(b)(2)(A)), which is clearly identified pursuant to section 1221(a)(7), including gain from the sale or disposition of such a transaction, to the extent that the transaction hedges any indebtedness incurred or to be incurred by the REIT to acquire or carry real estate assets.

Second, the provision extends section 856(c)(5)(G) to encompass, (except to the extent determined by the Secretary of the Treasury), income of a REIT from a transaction entered into by the REIT primarily to manage risk of currency fluctuations with respect to any item of income or gain that would be qualified income under the 75-percent or 95-percent income tests, (or any property which generates such income or gain) provided the transaction is clearly identified as such before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may prescribe). Such income is excluded from gross income for purposes of both the 75-percent and 95-percent income tests.

Third, the rule that if a REIT has met the asset tests as of the close of any quarter it will not fail them solely because of a discrepancy due to variations in value that are not attributable to the acquisition of investments is clarified to include a discrepancy caused solely by the change in the foreign currency exchange rate used to value a foreign asset.[304]

[304] For example, suppose a REIT meets the 75-percent asset test as of the close of a quarter, but as of the close of the following quarter, a change in the foreign currency exchange rate has increased the value of certain foreign currency-denominated securities that are not qualifying

Fourth, the term "cash" for purposes of the REIT asset qualification rules is defined to include foreign currency[305] if the REIT[306] or its QBU uses such currency as its functional currency, but only to the extent such foreign currency is held for use in the normal course of the activities of the REIT or the QBU giving rise to income or gain described in sections 856(c)(2) or (3), or directly related to acquiring or holding assets described in section 856(c)(4), and is not held in connection with a trade or business of trading or dealing in securities (as defined in section 475(c)(2)).[307]

Fifth, permitted foreclosure property income also includes foreign currency gain that is attributable to otherwise permitted income from foreclosure property.[308]

Finally, foreign currency gain under section 988(b)(1), or loss under section 988(b)(2), that is attributable to any prohibited transaction is taken into account in determining the amount of prohibited transaction net income subject to the 100-percent tax.

Treasury authority regarding other items of income

The provision authorizes the Treasury Department to issue guidance that would allow other items of income to be excluded for purposes of the computation of qualifying gross income under either the 75 percent or the 95 percent test, respectively, or to be included as qualifying income for either of such tests, respectively, in appropriate cases consistent with the purposes of the REIT provisions.[309]

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assets for purposes of that test, such that the value of those securities exceeds the 25 percent permitted amount. If the REIT does not acquire any other asset during that next quarter, the REIT will not lose its status by reason of failure to meet the 75-percent asset test. However, if in that next quarter the REIT acquires another foreign-currency denominated (or any other) asset that is not a qualifying asset, and immediately after that acquisition the total value of non-qualifying assets, including the new acquisition, fails the test, then the REIT has until 30 days after the end of that quarter to adjust its asset value so that it satisfies the test.

[305] Although foreign currency thus may be considered a qualified asset for purposes of the 75-percent asset test of section 856(c)(4), foreign currency gain with respect to such currency is excluded income for purposes of the 75-percent or 95-percent income tests only to the extent such gain is attributable to the income items or other specific 988 transactions described in the rules of the provision that govern such income exclusions.

[306] Because a REIT must be a U.S. entity, it is normally required to use the dollar as its functional currency. However, under private rulings, the IRS has permitted REITs to use a functional currency other than the dollar where the operations and record-keeping requirements for treatment as a QBU that uses a functional currency other than the dollar are met. See, e.g., PLR 200625019 and PLR 200550025. A private letter ruling may be relied upon only by the taxpayer to which the ruling was issued.

[307] This test applies to a REIT in determining whether it meets the 75-percent asset test. This test also independently applies to any QBU of a REIT in determining whether such QBU meets the 75-percent asset requirement. If that 75 percent asset requirement (along with the 75 percent income test) is met, then section 987 gain of the REIT attributable to that QBU is excluded from the REIT's gross income for the 75-percent and 95-percent income tests. In applying the 75-percent asset test to the REIT or a QBU, respectively, it is intended that currency held by such REIT or QBU, respectively, is treated as cash only to the extent used in the normal course of the activities of such REIT or QBU giving rise to income or gain described in sections 856(c)(2) or (3) or directly related to acquiring or holding assets described in section 856(c)(4) (other than such cash), and not held in connection with a trade or business of trading or dealing in securities (as defined in section 475(c)(2)).

[308] Such foreign currency gain is also included as foreclosure property income for purposes of any tax on such income under section 857(b)(4)(B)(i).

[309] Income that is statutorily excluded from gross income computations under the provision is not intended to be within the authority to include as qualifying income. In all cases, the Treasury regulatory authority applies solely for purposes of applying the relevant percentage tests for REIT qualification, and does not affect the substantive characterization of an item as income for purposes of computing the REIT's taxable income.

Taxable REIT subsidiary limit increase

The provision increases the percentage of the value of REIT assets that can be held in securities of a taxable REIT subsidiary to 25 percent from the present 20 percent.[310]

Holding period under safe harbor for prohibited transactions

The provision shortens from four years to two years the minimum holding period under the prohibited transactions tax safe harbors of 857(b)(6)(C) and 857(b)(6)(D). The requirement that timber property under section 857(b)(6)(D) be sold to a qualified organization (as defined in section 170(h)(3)) exclusively for conservation purposes (as defined in section 170(h)(1)(C)) in order for the 2-year holding period to apply under the safe harbor, and the one-year limited application of the 2-year holding period rule under 857(b)(6)(D), are generally removed. The provision makes clear that the safe harbor is an exception from the prohibited transactions tax only, and does not cause a gain on a sale that otherwise does not qualify for capital gains treatment (i.e., because it was a sale of property held for sale to customers in the ordinary course of business under section 1221(a)(1)) to become a capital gain transaction.[311] Consequently, treatment of gain or loss as ordinary or capital in character continues to be determined based on all the facts and circumstances as under present law, without regard to the prohibited transactions tax safe harbor. However, in the case of timber property under section 857(b)(6)(D), the provision retains for the one-year period prescribed in the Food, Energy and Conservation Act of 2008 the rule that qualification of the sale under the safe harbor also means that the sale is considered to be a sale of property held for investment or use in a trade or business, and not of property described in section 1221(a)(1), for all purposes of subtitle A of the Code, but only if the sale would have qualified under section 857(b)(6)(D) as in effect prior to the enactment of the provision.

Permitted extent of sales under safe harbor for prohibited transactions

The provision changes the prohibited transactions tax safe harbor provisions concerning maximum amount of sales within a taxable year that are consistent with the alternative prohibited transactions tax safe harbor (that is an alternative to the test for no more than 7 sales). Instead of the present alternative limit of 10-percent of the aggregate bases of all the assets of the REIT as of the beginning of the taxable year, the limit under the provision is either 10-percent of such aggregate basis or 10-percent of the aggregate fair market value of all the assets of the REIT as of such time.

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[310] The special 25 percent rule for timber REITs is made permanent under the provision, since timber REITs are treated in the same manner as other REITs for this purpose.

[311] In the case of a sale of timber property that qualifies for the safe harbor under section 857(b)(1)(D), for the one-year period prescribed in the Food, Conservation and Energy Act of 2008, such a sale is considered to be a sale of property held for investment or use in a trade or business, and not of property described in section 1221(a)(1), for all purposes of subtitle A of the Code, for such one-year period.

Health care facilities held by a taxable REIT subsidiary

The provision expands the taxable REIT subsidiary exception for hotel, motel, and other transient facilities so that it also applies to health care facilities. Thus, a taxable REIT subsidiary is permitted to rent a health care facility from its parent REIT and hire an independent contractor to operate such a facility; the rents paid to the parent REIT are qualifying rental income for purposes of the 75-percent and 95-percent income tests.

Rules regarding operating a health care or lodging facility through an independent contractor

Under the provision, a taxable REIT subsidiary is not to be considered to be operating or managing a qualified health care property or a qualified lodging facility other than through an independent contractor solely because the taxable REIT subsidiary directly or indirectly possesses a license, permit, or similar instrument enabling it to do so.

Under the provision, a taxable REIT subsidiary is not to be considered to be operating or managing a qualified health care property or qualified lodging facility solely because it employs individuals working at such property or facility located outside the United States, but only if an eligible independent contractor is responsible for the daily supervision and direction of such individuals on behalf of the taxable REIT subsidiary pursuant to a management agreement or similar service contract.

Effective Date

The provision generally is effective for taxable years beginning after the date of enactment (July 30, 2008). However, the rules treating certain foreign currency gain as excluded income for purposes of the income tests apply to gain and items of income recognized after the date of enactment. The new rules of section 856(c)(5)(G), relating to hedging and managing risk, are effective for transactions entered into after such date of enactment. The Treasury authority to exclude items from income or to add items of qualifying income for purposes of the income qualification tests applies to gains and items of income recognized after the date of enactment. The foreign currency amendment relating to gain from foreclosure property applies to gain recognized after the date of enactment, and the provision relating to net prohibited transactions income applies to gain and deductions recognized after the date of enactment. The provisions relating to the prohibited transactions tax safe harbor apply to sales made after the date of enactment.

TITLE III—REVENUE PROVISIONS

A. General Provisions

1. Election to accelerate AMT and research credits in lieu of bonus depreciation (sec. 3081 of the Act and sec. 168(k) of the Code)

Present Law

Bonus depreciation

Taxpayers are permitted an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified property generally placed in service in 2008.[312] The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service. The basis of the property and the depreciation allowances in the year the property is placed in service and later years are appropriately adjusted to reflect the additional first-year depreciation deduction.

In order for property to qualify for the additional first-year depreciation deduction it must meet all of the following requirements: (1) the property must be (a) property to which MACRS applies with an applicable recovery period of 20 years or less, (b) water utility property (as defined in section 168(e)(5)), (c) computer software other than computer software covered by section 197, or (d) qualified leasehold improvement property (as defined in section 168(k)(3)); (2) the original use of the property must commence with the taxpayer after December 31, 2007; (3) the taxpayer must purchase the property either (a) after December 31, 2007, and before January 1, 2009, but only if no binding written contract for the acquisition is in effect before January 1, 2008, or (b) pursuant to a binding written contract which was entered into after December 31, 2007, and before January 1, 2009;[313] and (4) the property must be placed in service after December 31, 2007, and before January 1, 2009. An extension of the placed in service date of one year (i.e., to January 1, 2010) is provided for certain property with a recovery period of 10 years or longer and certain transportation property.

Corporate AMT credit

If a corporation is subject to the alternative minimum tax ("AMT") in any year, the amount of AMT paid is allowed as a credit in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds its tentative minimum tax.

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[312] This provision was added by section 103 of the Economic Stimulus Act of 2008.

[313] Special rules apply to property manufactured, constructed, or produced by the taxpayer for use by the taxpayer.

Research credit

As part of the general business credit, section 38 limits credits for increasing research activities ("research credit") generally to the amount of regular tax in excess of tentative minimum tax.

Explanation of Provision

Corporations otherwise eligible for additional first year depreciation under section 168(k) may elect to claim additional research or minimum tax credits in lieu of claiming depreciation under section 168(k) for "eligible qualified property" placed in service after March 31, 2008.[314] A corporation making the election forgoes the depreciation deductions allowable under section 168(k) and instead increases the limitation under section 38(c) on the use of research credits or section 53(c) on the use of minimum tax credits. The increases in the allowable credits are treated as refundable for purposes of this provision. The depreciation for qualified property is calculated for both regular tax and AMT purposes using the straight-line method in place of the method that would otherwise be used absent the election under this provision.

The research credit or minimum tax credit limitation is increased by the bonus depreciation amount, which is equal to 20 percent of bonus depreciation[315] for certain eligible qualified property that could be claimed absent an election under this provision. Generally, eligible qualified property included in the calculation is bonus depreciation property that meets the following requirements: (1) the original use of the property must commence with the taxpayer after March 31, 2008; (2) the taxpayer must purchase the property either (a) after March 31, 2008, and before January 1, 2009, but only if no binding written contract for the acquisition is in effect before April 1, 2008,[316] or (b) pursuant to a binding written contract which was entered into after March 31, 2008, and before January 1, 2009;[317] and (3) the property must be placed in service after March 31, 2008, and before January 1, 2009 (January 1, 2010 for certain longer-lived and transportation property).

The bonus depreciation amount is limited to the lesser of: (1) $30 million, or (2) six percent of the sum of research credit carryforwards from taxable years beginning before January 1, 2006 and minimum tax credits allocable to the adjusted minimum tax imposed for taxable years beginning before January 1, 2006. All corporations treated as a single employer under section 52(a) shall be treated as one taxpayer for purposes of the limitation, as well as for electing the application of this provision.

The provision also provides that an applicable partnership may elect to be treated as making a deemed payment of tax for any ap-

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[314] In the case of an electing corporation that is a partner in a partnership, the corporate partner's distributive share of partnership items is determined as if 168(k) does not apply to any eligible qualified property and the straight line is used to calculate depreciation of such property.

[315] For this purpose, bonus depreciation is the difference between (i) the aggregate amount of depreciation for all eligible qualified property determined if section 168(k)(l) applied using the most accelerated depreciation method (determined without regard to this provision), and shortest life allowable for each property, and (ii) the amount of depreciation that would be determined if section 168(k)(1) did not apply using the same method and life for each property.

[316] In the case of passenger aircraft, the written binding contract limitation does not apply.

[317] Special rules apply to property manufactured, constructed, or produced by the taxpayer for use by the taxpayer.

plicable taxable year in the amount of the least of the following: (1) the bonus depreciation amount that would be determined if an election under this provision were in effect for the partnership; (2) the amount of the partnership's research credit for the taxable year; or (3) $30 million (reduced by any deemed payment for any preceding taxable year). The deemed payment may not be used as an offset or credit against any tax liability of the partnership or any partner, but is instead refunded to the partnership. For purposes of this provision, an applicable partnership is a domestic partnership that was formed on August 3, 2007, and will produce in excess of 675,000 automobiles during the period beginning on January 1, 2008, and ending on June 30, 2008. An applicable taxable year is any taxable year during which eligible qualified property is placed in service. If an applicable partnership makes this election, the amount of the deduction allowable to the partnership or any partner for any eligible qualified property is computed without applying section 168(k), the straight line method must be used by the partnership and any partner for such property, the election to increase minimum tax credits and research credits under this provision is not available, and the research credit amount for any applicable taxable year with respect to the partnership is reduced by the amount of the deemed payment.

Effective Date

The provision is effective for taxable years ending after March 31, 2008.

2. Certain GO Zones incentives

(a) Election to amend returns for hurricane-related casualty losses (sec. 3082(a) of the Act)

Present Law

Under present law, a taxpayer may generally claim a deduction for any loss sustained during the taxable year and not compensated by insurance or otherwise.[318] For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft.[319] Generally, personal casualty or theft losses are deductible only if they exceed $100 per casualty or theft and net casualty and theft losses are deductible only to the extent it exceeds 10 percent of adjusted gross income.[320] However, for hurricane-related casualty losses, these two casualty loss limitations are removed.[321]

Casualty losses are generally allowed for the taxable year of the loss. However, in the case of a disaster loss arising in an area determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, the taxpayer may elect

[318] Sec. 165.
[319] Sec. 165(c)(3).
[320] Sec. 165(h).
[321] Sec. 1400S(b).

to take the loss into account for the taxable year immediately before the taxable year in which the disaster occurred.[322]

When a taxpayer receives reimbursement for such loss in a subsequent taxable year, the deductible loss is not recomputed for the taxable year in which the deduction was taken, the reimbursement amount is taken into income in the taxable year received.[323]

Reasons for Change

The Congress believes that homeowners who sustained hurricane related casualty losses on a principal residence should receive additional relief. Taxpayers may elect to include grant reimbursements into income in the year the casualty loss was taken to avoid being subject to higher marginal tax rate brackets in the year of receipt. This provides tax relief that allows homeowners to put more funds into rebuilding their principal residences.

Explanation of Provision

The provision allows a taxpayer who claimed a casualty loss to a principal residence (within the meaning of section 121) resulting from Hurricane Katrina, Hurricane Rita, or Hurricane Wilma and in a subsequent year receives a grant as reimbursement of such loss to elect to file an amended return for the taxable year in which such deduction was allowed.[324] The casualty loss deduction is reduced, but not below zero, by the amount of such reimbursement. The time for filing such amended return is the later of one year from the date of enactment of this Act or the due date for the tax return for the year in which the grant was received. The provision further provides that interest and penalties are waived with respect to the resulting underpayment to the extent of payments, whether full or partial, actually paid within one year after filing of the amended return.

Effective Date

The provision is effective on the date of enactment (July 30, 2008).

(b) Waiver of deadline on construction of GO Zone property eligible for bonus depreciation (sec. 3082(b) of the Act)

Present Law

In general

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS"). Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property

[322] Sec. 165(i).
[323] Treas. Reg. sec. 165–1(d)(2)(iii).
[324] To qualify the grant must be received under Public Law 109–148, 109–234, or 110–116.

(other than residential rental property and nonresidential real property) range from three to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

Gulf Opportunity Zone

The "Gulf Opportunity Zone" or "GO Zone" is defined as that portion of the Hurricane Katrina Disaster Area determined by the President to warrant individual or individual and public assistance from the Federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of Hurricane Katrina. The term "Hurricane Katrina disaster area" means an area with respect to which a major disaster has been declared by the President before September 14, 2005, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of Hurricane Katrina.

Gulf Opportunity Zone property

Present law provides an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified Gulf Opportunity Zone property. In order to qualify, property generally must be placed in service on or before December 31, 2007 (December 31, 2008 in the case of nonresidential real property and residential rental property).

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service. The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or subject to capitalization under section 263 or section 263A. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, the provision provides that there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

In order for property to qualify for the additional first-year depreciation deduction, it must meet all of the following requirements. First, the property must be property (1) to which the general rules of the Modified Accelerated Cost Recovery System ("MACRS") apply with an applicable recovery period of 20 years or less, (2) computer software other than computer software covered by section 197, (3) water utility property (as defined in section 168(e)(5)), (4) certain leasehold improvement property, or (5) certain nonresidential real property and residential rental property. Second, substantially all of the use of such property must be in the Gulf Opportunity Zone and in the active conduct of a trade or business by the taxpayer in the Gulf Opportunity Zone. Third, the original use of the property in the Gulf Opportunity Zone must

commence with the taxpayer on or after August 28, 2005. (Thus, used property may constitute qualified property so long as it has not previously been used within the Gulf Opportunity Zone. In addition, it is intended that additional capital expenditures incurred to recondition or rebuild property the original use of which in the Gulf Opportunity Zone began with the taxpayer would satisfy the "original use" requirement. See Treasury Regulation 1.48–2 Example 5.) Finally, the property must be acquired by purchase (as defined under section 179(d)) by the taxpayer on or after August 28, 2005 and placed in service on or before December 31, 2007. For qualifying nonresidential real property and residential rental property, the property must be placed in service on or before December 31, 2008, in lieu of December 31, 2007. Property does not qualify if a binding written contract for the acquisition of such property was in effect before August 28, 2005. However, property is not precluded from qualifying for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to August 28, 2005.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property on or after August 28, 2005 and before January 1, 2008, and the property is placed in service on or before December 31, 2007 (and all other requirements are met). In the case of qualified nonresidential real property and residential rental property, the property must be placed in service on or before December 31, 2008. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

Under a special rule, property any portion of which is financed with the proceeds of a tax-exempt obligation under section 103 is not eligible for the additional first-year depreciation deduction. Recapture rules apply under the provision if the property ceases to be qualified Gulf Opportunity Zone property.

Gulf Opportunity Zone extension property

The placed-in-service deadline is extended for specified Gulf Opportunity Zone extension property to qualify for the additional first-year depreciation deduction. Specified Gulf Opportunity Zone extension property is defined as property substantially all the use of which is in one or more specified portions of the Gulf Opportunity Zone and which is either: (1) nonresidential real property or residential rental property which is placed in service by the taxpayer on or before December 31, 2010, or (2) in the case of a taxpayer who places in service a building described in (1), property described in section 168(k)(2)(A)(i)[325] placed in service on or before December 31, 2010, if substantially all the use of such property is in such building and such property is placed in service within 90

[325] Property described in section 168(k)(2)(A)(i) includes (1) property to which the general rules of the Modified Accelerated Cost Recovery System ("MACRS") apply with an applicable recovery period of 20 years or less, (2) computer software other than computer software covered by section 197, (3) water utility property (as defined in section 168(e)(5)), and (4) certain leasehold improvement property.

days of the date the building is placed in service. However, in the case of nonresidential real property or residential rental property, only the adjusted basis of such property attributable to manufacture, construction, or production before January 1, 2010 ("progress expenditures") is eligible for the additional first-year depreciation.

The specified portions of the Gulf Opportunity Zone are defined as those portions of the Gulf Opportunity Zone which are in a county or parish which is identified by the Secretary of the Treasury (or his delegate) as being a county or parish in which hurricanes occurring in 2005 damaged (in the aggregate) more than 60 percent of the housing units in such county or parish which were occupied (determined according to the 2000 Census). These areas include the Louisiana parishes of Calcasieu, Cameron, Orleans, Plaquemines, St. Bernard, St. Tammany, and Washington, and the Mississippi counties of Hancock, Harrison, Jackson, Pearl River, and Stone.[326]

Reasons for Change

Many taxpayers have been unable to begin the construction of property in the Gulf Opportunity Zone due to the lack of electricity, clean water, and other circumstances beyond their control. Therefore, the Congress believes the commencement date for beginning the construction of self-constructed property should be removed so that these taxpayers may qualify for the additional first-year depreciation deduction to the extent the other requirements are met.

Description of Proposal

The Act removes the commencement date of January 1, 2008, for self-constructed Gulf Opportunity Zone extension property. The placed in service date of December 31, 2010 and the progress expenditure date of January 1, 2010 are not modified.

Effective Date

The provision applies to property placed in service after December 31, 2007.

(c) Inclusion of certain counties in GO Zone for purposes of tax-exempt bond financing (sec. 3082(c) of the Act and sec. 1400N(a) of the Code)

Present Law

The Gulf Opportunity Zone Act of 2005 established certain tax benefits for areas affected by Hurricanes Katrina, Wilma and Rita.[327] Under present law, the "Gulf Opportunity Zone" or "GO Zone" means that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the "Stafford Act") by reason of Hurricane Katrina.[328] The "Hurricane Katrina disaster area" is the area with respect to which a major

[326] Notice 2007–36, 2007–17 I.R.B. 1000.
[327] Pub. L. No. 109–135.
[328] Sec. 1400M(1).

disaster has been declared by the President before September 14, 2005, under section 401 of the Stafford Act by reason of Hurricane Katrina.[329] The Code authorizes the States of Alabama, Louisiana and Mississippi to issue certain exempt facility bonds and qualified mortgage bonds for property located in the GO Zone ("GO Zone bonds").[330] In Alabama, the following counties have been identified as warranting individual or individual and public assistance: Baldwin, Chocktaw, Clarke, Greene, Hale, Marengo, Mobile, Pickens, Sumter, Tuscaloosa and Washington.[331]

Reasons for Change

The Congress believes that areas affected by Hurricane Katrina need additional recovery tools. The Congress believes that the Gulf Opportunity Zone bonds are a valuable resource for promoting recovery in the affected areas. The Congress believes that the Gulf Opportunity Zone bonds should be expanded so that this resource may be utilized by those areas that were not originally designated as part of the Gulf Opportunity Zone, but were severely impacted by the hurricane.

Explanation of Provision

For purposes of GO Zone bonds only, the provision includes the following counties for purposes of defining the GO Zone: Colbert County, Alabama and Dallas County, Alabama.

Effective Date

The provision is effective as if included in the Gulf Opportunity Zone Act of 2005 to which it relates.

B. Revenue Offsets

1. Require information reporting on payment card and third party payment transactions (sec. 3091 of the Act and new sec. 6050W of the Code)

Present Law

Present law imposes a variety of information reporting requirements on participants in certain transactions. These requirements

[329] Sec. 1400M(2).

[330] Sec. 1400N(a). For purposes of these bonds, qualified project costs are the cost of any qualified residential rental project (as defined in section 142(d)) located in the GO Zone, the cost of acquisition, construction, reconstruction and renovation of nonresidential real property (including fixed improvements associated with such property) located in the GO Zone, and the cost of acquisition, construction, reconstruction and renovation of public utility property (as defined in section 168(i)(10) located in the GO Zone (sec. 1400N(a)(4)). GO Zone bonds cannot be used for movable fixtures or equipment (sec. 1400N(a)(3)(B)). Nor can GO Zone bonds be used to provide any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling or any store the principal businesses of which is the sale of alcoholic beverages for consumption off premises (sec. 1400N(a)(2)(E) and sec. 144(c)(6)(B)). GO Zone bonds are treated as qualified mortgage bonds if the issue meets the general requirements of a qualified mortgage issue and the residences financed with such bonds are located in the GO Zone. For these residences, the first-time homebuyer rule is waived and purchase and income rules for targeted area residences apply. In addition, 100 percent of the mortgages must be made to mortgagors whose family income is 140 percent or less of the applicable median family income.

[331] Internal Revenue Service, Notice 2006–21, GO Zone Resident Population Estimates (March 20, 2006).

are intended to assist taxpayers in preparing their income tax returns and to help the Internal Revenue Service ("IRS") determine whether such returns are correct and complete. For example, every person engaged in a trade or business generally is required to file information returns for each calendar year for payments of $600 or more made in the course of the payor's trade or business.[332] Payments to corporations generally are excepted from this requirement. Certain payments subject to information reporting also are subject to backup withholding if the payee has not provided a valid taxpayer identification number ("TIN").

Under present law, any person required to file a correct information return who fails to do so on or before the prescribed filing date is subject to a penalty that varies based on when, if at all, the correct information return is filed.

Explanation of Provision

The provision requires any payment settlement entity making payment to a participating payee in settlement of reportable payment transactions to report annually to the IRS and to the participating payee the gross amount of such reportable payment transactions, as well as the name, address, and TIN of the participating payees. A "reportable payment transaction" means any payment card transaction and any third party network transaction.

Under the provision, a "payment settlement entity" means, in the case of a payment card transaction, a merchant acquiring entity and, in the case of a third party network transaction, a third party settlement organization. A "participating payee" means, in the case of a payment card transaction, any person who accepts a payment card as payment and, in the case of a third party network transaction, any person who accepts payment from a third party settlement organization in settlement of such transaction.

For purposes of the reporting requirement, the term "merchant acquiring entity" means the bank or other organization with the contractual obligation to make payment to participating payees in settlement of payment card transactions. A "payment card transaction" means any transaction in which a payment card is accepted as payment.[333] A "payment card" is defined as any card (e.g., a credit card or debit card) which is issued pursuant to an agreement or arrangement which provides for: (1) one or more issuers of such cards; (2) a network of persons unrelated to each other, and to the issuer, who agree to accept such cards as payment; and (3) standards and mechanisms for settling the transactions between the merchant acquiring entities and the persons who agree to accept such cards as payment. Thus, under the provision, a bank that enrolls a business to accept credit cards and contracts with the business to make payment on credit card transactions is required to report to the IRS the business's gross credit card transactions for each calendar year. The bank also is required to provide a copy of the information report to the business.

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[332] Sec. 6041(a).

[333] For this purpose, the acceptance as payment of any account number or other indicia associated with a payment card also qualifies a payment card transaction.

The provision also requires reporting on a third party network transaction. The term "third party network transaction" means any transaction which is settled through a third party payment network. A "third party payment network" is defined as any agreement or arrangement which (1) involves the establishment of accounts with a central organization by a substantial number of persons (e.g., more than 50) who are unrelated to such organization, provide goods or services, and have agreed to settle transactions for the provision of such goods or services pursuant to such agreement or arrangement; (2) which provides for standards and mechanisms for settling such transactions; and (3) which guarantees persons providing goods or services pursuant to such agreement or arrangement that such persons will be paid for providing such goods or services. In the case of a third party network transaction, the payment settlement entity is the third party settlement organization, which is defined as the central organization which has the contractual obligation to make payment to participating payees of third party network transactions. Thus, an organization generally is required to report if it provides a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payment through the network. However, an organization operating a network which merely processes electronic payments (such as wire transfers, electronic checks, and direct deposit payments) between buyers and sellers, but does not have contractual agreements with sellers to use such network, is not required to report under the provision. Similarly, an agreement to transfer funds between two demand deposit accounts will not, by itself, constitute a third party network transaction.

A third party payment network does not include any agreement or arrangement which provides for the issuance of payment cards as defined by the provision. In addition, a third party settlement organization is not required to report unless the aggregate value of third party network transactions for the year exceeds $20,000 and the aggregate number of such transactions exceeds 200. For the avoidance of doubt, if a payment of funds is made to a third party settlement organization by means of a payment card (i.e., as part of a transaction that is a payment card transaction), the $20,000 and 200 transaction *de minimis* rule continues to apply to any reporting obligation with respect to payment of such funds to a participating payee by the third party settlement organization made as part of a third party network transaction.

The provision also imposes reporting requirements on intermediaries who receive payments from a payment settlement entity and distribute such payments to one or more participating payees. The provision treats such intermediaries as participating payees with respect to the payment settlement entity and as payment settlement entities with respect to the participating payees to whom the intermediary distributes payments. Thus, for example, in the case of a corporation that receives payment from a bank for credit card sales effectuated at the corporation's independently-owned franchise stores, the bank is required to report the gross amount of reportable payment transactions settled through the corporation (notwithstanding the fact that the corporation does not accept pay-

ment cards and would not otherwise be treated as a participating payee). In turn, the corporation, as an intermediary, would be required to report the gross amount of reportable payment transactions allocable to each franchise store. The bank would have no reporting obligation with respect to payments made by the corporation to its franchise stores.

If a payment settlement entity contracts with a third party to settle reportable payment transactions on behalf of the payment settlement entity, the provision requires the third party to file the annual information return in lieu of the payment settlement entity.

The provision grants authority to the Secretary to issue guidance to implement the reporting requirement, including rules to prevent the reporting of the same transaction more than once.

Under the provision, reportable payment transactions subject to information reporting generally are subject to backup withholding requirements. Finally, present law penalties relating to the failure to file correct information returns would apply to the new information reporting requirements required under the provision.

Effective Date

The provision generally is effective for information returns for reportable payment transactions for calendar years beginning after December 31, 2010. The amendments to the backup withholding requirements apply to amounts paid after December 31, 2011.

2. Exclusion of gain on sale of a principal residence not to apply to nonqualified use (sec. 3092 of the Act and sec. 121 of the Code)

Present Law

In general

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met.

Present law also contains an election relating to members of the uniformed services, the Foreign Service, and certain employees of the intelligence community. If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period up to 10 years during which the taxpayer or the taxpayer's spouse is on qualified official extended duty. For these purposes, qualified official extended duty is any period of extended duty while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in government furnished quarters. The elec-

tion may be made with respect to only one property for a suspension period.

The exclusion does not apply to gain to the extent the gain is attributable to depreciation allowable with respect to the rental or business use of a principal residence for periods after May 6, 1997.

Reasons for Change

The present-law exclusion of gain on principal residences has many beneficial effects by encouraging home ownership. The Congress believes that the application of present law to exclude gain attributable to periods of use prior to a home's use as a principal residence is not consistent with the purpose of the present-law exclusion and inappropriate. The Congress believes that the provision limits the application of the exclusion to use as a principal residence without imposing undue computational and record-keeping burdens on the taxpayer or the Internal Revenue Service.

Explanation of Provision

Under the Act, gain from the sale or exchange of a principal residence allocated to periods of nonqualified use is not excluded from gross income. The amount of gain allocated to periods of nonqualified use is the amount of gain multiplied by a fraction the numerator of which is the aggregate periods of nonqualified use during the period the property was owned by the taxpayer and the denominator of which is the period the taxpayer owned the property.

A period of nonqualified use means any period (not including any period before January 1, 2009) during which the property is not used by the taxpayer or the taxpayer's spouse or former spouse as a principal residence. For purposes of determining periods of nonqualified use, (i) any period after the last date the property is used as the principal residence of the taxpayer or spouse (regardless of use during that period), and (ii) any period (not to exceed two years) that the taxpayer is temporarily absent by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances, are not taken into account. The present-law election for the uniformed services, Foreign Service and employees of the intelligence community is unchanged.

If any gain is attributable to post-May 6, 1997, depreciation, the exclusion does not apply to that amount of gain, as under present law, and that gain is not taken into account in determining the amount of gain allocated to nonqualified use.

These provisions may be illustrated by the following examples:

Example 1.—Assume that an individual buys a property on January 1, 2009, for $400,000, and uses it as rental property for two years claiming $20,000 of depreciation deductions. On January 1, 2011, the taxpayer converts the property to his principal residence. On January 1, 2013, the taxpayer moves out, and the taxpayer sells the property for $700,000 on January 1, 2014. As under present law, $20,000 gain attributable to the depreciation deductions is included in income. Of the remaining $300,000 gain, 40% of the gain (2 years divided by 5 years), or $120,000, is allocated to nonqualified use and is not eligible for the exclusion. Since the remaining gain of $180,000 is less than the maximum gain of

$250,000 that may be excluded, gain of $180,000 is excluded from gross income.

Example 2.—Assume that an individual buys a principal residence on January 1, 2009, for $400,000, moves out on January 1, 2019, and on December 1, 2021 sells the property for $600,000. The entire $200,000 gain is excluded from gross income, as under present law, because periods after the last qualified use do not constitute nonqualified use.

Effective Date

The provision is effective for sales and exchanges after December 31, 2008.

3. Delay implementation of worldwide interest allocation (sec. 3093 of the Act and sec. 864(f) of the Code)

Present Law

In general

In order to compute the foreign tax credit limitation, a taxpayer must determine the amount of its taxable income from foreign sources. Thus, the taxpayer must allocate and apportion deductions between items of U.S.-source gross income, on the one hand, and items of foreign-source gross income, on the other.

In the case of interest expense, the rules generally are based on the approach that money is fungible and that interest expense is properly attributable to all business activities and property of a taxpayer, regardless of any specific purpose for incurring an obligation on which interest is paid.[334] For interest allocation purposes, all members of an affiliated group of corporations generally are treated as a single corporation (the so-called "one-taxpayer rule") and allocation must be made on the basis of assets rather than gross income. The term "affiliated group" in this context generally is defined by reference to the rules for determining whether corporations are eligible to file consolidated returns.

For consolidation purposes, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if: (1) the common parent owns directly stock possessing at least 80 percent of the total voting power and at least 80 percent of the total value of at least one other includible corporation; and (2) stock meeting the same voting power and value standards with respect to each includible corporation (excluding the common parent) is directly owned by one or more other includible corporations.

Generally, the term "includible corporation" means any domestic corporation except certain corporations exempt from tax under section 501 (for example, corporations organized and operated exclusively for charitable or educational purposes), certain life insurance companies, corporations electing application of the possession tax credit, regulated investment companies, real estate investment

[334] However, exceptions to the fungibility are provided in particular cases, some of which are described below.

trusts, and domestic international sales corporations. A foreign corporation generally is not an includible corporation.

Subject to exceptions, the consolidated return and interest allocation definitions of affiliation generally are consistent with each other.[335] For example, both definitions generally exclude all foreign corporations from the affiliated group. Thus, while debt generally is considered fungible among the assets of a group of domestic affiliated corporations, the same rules do not apply as between the domestic and foreign members of a group with the same degree of common control as the domestic affiliated group.

Banks, savings institutions, and other financial affiliates

The affiliated group for interest allocation purposes generally excludes what are referred to in the Treasury regulations as "financial corporations."[336] These include any corporation, otherwise a member of the affiliated group for consolidation purposes, that is a financial institution (described in section 581 or section 591), the business of which is predominantly with persons other than related persons or their customers, and which is required by State or Federal law to be operated separately from any other entity which is not a financial institution.[337] The category of financial corporations also includes, to the extent provided in regulations, bank holding companies (including financial holding companies), subsidiaries of banks and bank holding companies (including financial holding companies), and savings institutions predominantly engaged in the active conduct of a banking, financing, or similar business.[338]

A financial corporation is not treated as a member of the regular affiliated group for purposes of applying the one-taxpayer rule to other non-financial members of that group. Instead, all such financial corporations that would be so affiliated are treated as a separate single corporation for interest allocation purposes.

Worldwide interest allocation

In general

The American Jobs Creation Act of 2004 ("AJCA")[339] modifies the interest expense allocation rules described above (which generally apply for purposes of computing the foreign tax credit limitation) by providing a one-time election (the "worldwide affiliated group election") under which the taxable income of the domestic members of an affiliated group from sources outside the United States generally is determined by allocating and apportioning interest expense of the domestic members of a worldwide affiliated group on a worldwide-group basis (i.e., as if all members of the worldwide group were a single corporation). If a group makes this election, the taxable income of the domestic members of a worldwide affiliated group from sources outside the United States is determined by allocating and apportioning the third-party interest expense of those domestic members to foreign-source income in an

[335] One such exception is that the affiliated group for interest allocation purposes includes section 936 corporations that are excluded from the consolidated group.
[336] Treas. Reg. sec. 1.861–11T(d)(4).
[337] Sec. 864(e)(5)(C).
[338] Sec. 864(e)(5)(D).
[339] Pub. L. No. 108–357, sec. 401 (2004).

amount equal to the excess (if any) of (1) the worldwide affiliated group's worldwide third-party interest expense multiplied by the ratio which the foreign assets of the worldwide affiliated group bears to the total assets of the worldwide affiliated group,[340] over (2) the third-party interest expense incurred by foreign members of the group to the extent such interest would be allocated to foreign sources if the principles of worldwide interest allocation were applied separately to the foreign members of the group.[341]

For purposes of the new elective rules based on worldwide fungibility, the worldwide affiliated group means all corporations in an affiliated group as well as all controlled foreign corporations that, in the aggregate, either directly or indirectly,[342] would be members of such an affiliated group if section 1504(b)(3) did not apply (i.e., in which at least 80 percent of the vote and value of the stock of such corporations is owned by one or more other corporations included in the affiliated group). Thus, if an affiliated group makes this election, the taxable income from sources outside the United States of domestic group members generally is determined by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group as if all of the interest expense and assets of 80-percent or greater owned domestic corporations (i.e., corporations that are part of the affiliated group, as modified to include insurance companies) and certain controlled foreign corporations were attributable to a single corporation.

The common parent of the domestic affiliated group must make the worldwide affiliated group election. It must be made for the first taxable year beginning after December 31, 2008, in which a worldwide affiliated group exists that includes at least one foreign corporation that meets the requirements for inclusion in a worldwide affiliated group. Once made, the election applies to the common parent and all other members of the worldwide affiliated group for the taxable year for which the election was made and all subsequent taxable years, unless revoked with the consent of the Secretary of the Treasury.

Financial institution group election

Taxpayers are allowed to apply the bank group rules to exclude certain financial institutions from the affiliated group for interest allocation purposes under the worldwide fungibility approach. The rules also provide a one-time "financial institution group" election that expands the bank group. At the election of the common parent of the pre-election worldwide affiliated group, the interest expense allocation rules are applied separately to a subgroup of the worldwide affiliated group that consists of (1) all corporations that are part of the bank group, and (2) all "financial corporations." For this purpose, a corporation is a financial corporation if at least 80 per-

[340] For purposes of determining the assets of the worldwide affiliated group, neither stock in corporations within the group nor indebtedness (including receivables) between members of the group is taken into account.

[341] Although the interest expense of a foreign subsidiary is taken into account for purposes of allocating the interest expense of the domestic members of the electing worldwide affiliated group for foreign tax credit limitation purposes, the interest expense incurred by a foreign subsidiary is not deductible on a U.S. return.

[342] Indirect ownership is determined under the rules of section 958(a)(2) or through applying rules similar to those of section 958(a)(2) to stock owned directly or indirectly by domestic partnerships, trusts, or estates.

cent of its gross income is financial services income (as described in section 904(d)(2)(C)(i) and the regulations thereunder) that is derived from transactions with unrelated persons.[343] For these purposes, items of income or gain from a transaction or series of transactions are disregarded if a principal purpose for the transaction or transactions is to qualify any corporation as a financial corporation.

The common parent of the pre-election worldwide affiliated group must make the election for the first taxable year beginning after December 31, 2008, in which a worldwide affiliated group includes a financial corporation. Once made, the election applies to the financial institution group for the taxable year and all subsequent taxable years. In addition, anti-abuse rules are provided under which certain transfers from one member of a financial institution group to a member of the worldwide affiliated group outside of the financial institution group are treated as reducing the amount of indebtedness of the separate financial institution group. Regulatory authority is provided with respect to the election to provide for the direct allocation of interest expense in circumstances in which such allocation is appropriate to carry out the purposes of these rules, to prevent assets or interest expense from being taken into account more than once, or to address changes in members of any group (through acquisitions or otherwise) treated as affiliated under these rules.

Effective date of worldwide interest allocation under AJCA

The worldwide interest allocation rules under AJCA are effective for taxable years beginning after December 31, 2008.

Reasons for Change

The Congress believes that it is appropriate to delay implementation of the worldwide interest allocation rules.

Explanation of Provision

The provision delays the effective date of worldwide interest allocation rules for two years, until taxable years beginning after December 31, 2010. The required dates for making the worldwide affiliated group election and the financial institution group election are changed accordingly.

The provision also provides a special phase-in rule in the case of the first taxable year to which the worldwide interest allocation rules apply. For that year, the amount of the taxpayer's taxable income from foreign sources is reduced by 70 percent of the excess of (i) the amount of its taxable income from foreign sources as calculated using the worldwide interest allocation rules over (ii) the amount of its taxable income from foreign sources as calculated using the present-law interest allocation rules. Any foreign tax credits disallowed by virtue of this reduction in foreign-source taxable income may be carried back or forward under the normal rules for carrybacks and carryforwards of excess foreign tax credits.

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[343] See Treas. Reg. sec. 1.904–4(e)(2).

Effective Date

The provision is effective on the date of enactment (July 30, 2008).

4. Modifications to corporate estimated tax payments (sec. 3094 of the Act)

Present Law

In general

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

Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA")

TIPRA provided the following special rules:

In case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, shall be increased to 106.25 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

In case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2013, shall be increased to 100.75 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Subsequent legislation

Several public laws have been enacted since TIPRA which further increase the percentage of payments due under each of the two special rules enacted by TIPRA described above.

Reasons for Change

The Congress believes it is appropriate to adjust the corporate estimated tax payments.

Explanation of Provision[344]

The provision makes two modifications to the corporate estimated tax payment rules.

First, in case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2013, are increased by 16.75 percent points of the payment otherwise due and the next required payment shall be reduced accordingly.

Second, in case of a corporation with assets of at least $1 billion, the increased payments due in July, August, and September, 2012 under the special rules in TIPRA and subsequent legislation are repealed. In effect the general rule is applied (i.e., such corporations are required to make quarterly estimated tax payments based on their income tax liability.)

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[344] All the public laws enacted in the 110th Congress affecting this provision are described in Part Twenty-Two.

Effective Date

The provision is effective on the date of enactment (July 30, 2008).

PART FOURTEEN: REVENUE PROVISION RELATING TO FUNERAL TRUSTS (PUBLIC LAW 110–317)[345]

Present Law

A qualified funeral trust is a taxable trust that arises as a result of a contract with a person engaged in the trade or business of providing funeral or burial services or property necessary to provide such services, and which meets certain other requirements.[346] A qualified funeral trust must have as its sole purpose holding, investing, and reinvesting funds in the trust, and using such funds solely to make payments for the above-described services or property for the benefit of the beneficiaries of the trust. A qualified funeral trust may have as beneficiaries only individuals with respect to whom the above-described services or property are to be provided at death, and the trust may only accept contributions by or for the benefit of such beneficiaries. In addition, to qualify, the trust must be one that, but for the making of a required election, would be treated under the grantor trust rules as owned by the purchaser of the funeral or burial contract. Because a qualified funeral trust is not treated as a grantor trust, the trust (rather than the purchaser of the contract) is taxed on income from the trust.

A trust is not a qualified funeral trust if it accepts aggregate contributions by or for the benefit of an individual in excess of a statutory dollar limit, which is $9,000 for 2008[347] (and which periodically is adjusted for inflation).

Explanation of Provision

The provision repeals the dollar limit on contributions to qualified funeral trusts.

Effective Date

The provision is effective for taxable years beginning after the date of enactment (August 29, 2008).

[345] H.R. 6580. H.R. 6580 passed the House on July 29, 2008, and passed the Senate without amendment on August 1, 2008. The President signed the bill on August 29, 2008.
[346] Sec. 685(b).
[347] Rev. Proc. 2007–66, I.R.B. 2007–45 (Oct. 18, 2007).

PART FIFTEEN: HIGHWAY TRUST FUND RESTORATION (PUBLIC LAW 110–318)[348]

Present Law

Section 9004 of the Surface Transportation Revenue Act of 1998 (Title IX of the Transportation Equity Act for the 21st Century) provided that the Highway Trust Fund will not earn interest on unspent balances after September 30, 1998. Further. the balance in excess of $8 billion in the Highway Account of the Highway Trust Fund was cancelled on October 1, 1998 and transferred to the General Fund.[349]

Explanation of Provision

The Act provides that out of money in the Treasury not otherwise appropriated, $8,017,000,000 is appropriated to the Highway Trust Fund.

Effective Date

The provision is effective on the date of enactment (September 15, 2008).

[348] H.R. 6532. H.R. 6532 passed the House on July 23, 2008. The Senate passed the bill on September 10, 2008, with an amendment. The House agreed to the Senate amendment on September 11, 2008. The President signed the bill on September 15, 2008.

[349] Sec. 9502(f).

PART SIXTEEN: SSI EXTENSION FOR ELDERLY AND DISABLED REFUGEES ACT (PUBLIC LAW 110–328)[350]

A. Collection of Unemployment Compensation Debts Resulting From Fraud (sec. 3 of the Act and sec. 6402 and 6103 of the Code)

Present Law

Under present law, the IRS has the authority to credit any overpayment against any other federal tax liability owed by the person who made the overpayment. The balance of the overpayment will generally be refunded, unless a claim has been made for payment of certain non-tax debts of that person. Such non-tax debts include past-due support within the meaning of the Social Security Act,[351] debts owed to federal agencies[352] and state income tax obligations.[353]

If such a debt is claimed by the creditor agency to which the debt is owed, the IRS will notify the person who overpaid that the overpayment has been reduced by the amount of the debt and that such amount will be paid to the creditor agency. The statute establishes priorities of the various categories of debt. It requires that any offsets for non-tax debts occur only after satisfaction of federal tax debts but before any amount is credited to estimated tax for a future tax liability; past-due support is paid before federal agencies, which are in turn paid before states that are owed state income tax.[354] In the case of state income tax debts, only overpayments by residents of the requesting state are subject to offset.[355] In addition, if a payment to a State is determined to have been erroneously made by the IRS in its exercise of this authority, the State is required to promptly repay upon notice from the IRS. The actions of the IRS in reducing the overpayment to satisfy non-tax debts are not subject to judicial review.[356]

The IRS is generally barred from disclosing return information for reasons other than tax administration. Certain information may be disclosed to agencies requesting a reduction of an overpayment under section 6402.[357]

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[350] H.R. 2608. H.R. 2608 passed the House on July 11, 2007. The bill passed the Senate on August 1, 2008, with an amendment. The House agreed to the Senate amendment on September 17, 2008. The President signed the bill on September 30, 2008.

[351] Sec. 6402(c).

[352] Sec. 6402(d).

[353] Sec. 6403(e).

[354] Sec. 6402(c), 6402(d)(1)(C) and 6402(e)(1)(C).

[355] Sec. 6402(e)(2).

[356] Sec. 6402(f).

[357] Sec. 6103(l)(10).

Explanation of Provision

The Act adds a new category of non-tax debt that may be satisfied by offset against an overpayment of income tax. Under new subsection 6402(f), upon receipt of notice from a State, the IRS is authorized to offset an overpayment against a covered unemployment compensation debt. The definition of covered unemployment compensation debts includes debts that arise from either uncollected contributions due to the State's unemployment fund that remain unpaid due to fraud and erroneous payments of unemployment compensation obtained by fraud on the part of the taxpayer who made the overpayment of tax. In addition, the penalty and interest attributable to these debts constitute covered unemployment compensation debts. If the debt is for an erroneous payment, the State must establish that the debt has become final and certified by the Secretary of Labor.[358]

The provision includes safeguards and establishes priorities that generally parallel those applicable to state income tax debts. Before submitting its claim to the IRS, the State must provide notice by certified mail with return receipt of its intent to the person owing the debt. The notice must allow at least 60 days for the person to submit a response, with any supporting evidence, which the State will then consider. If more than one debt is owed by the same resident to his state, the debts will be satisfied by the overpayment in the order in which the debts accrued, without regard to whether they arise from income tax or unemployment compensation. Other conditions may be prescribed by the Secretary to ensure that the State has made reasonable efforts to obtain payment of the covered debt and that the State determination with respect to fraud is valid.

The provision also amends section 6103 to permit the IRS to disclose information about the covered unemployment compensation debts and related offsets to the Department of Labor.

Effective Date

The provision is effective for refunds paid within the 10-year period following the date of enactment (September 30, 2008).

[358] Sec. 3304.

PART SEVENTEEN: EMERGENCY ECONOMIC STABILIZATION ACT OF 2008, ENERGY IMPROVEMENT AND EXTENSION ACT OF 2008, AND TAX EXTENDERS AND THE ALTERNATIVE MINIMUM TAX RELIEF ACT OF 2008 (110–343)[359]

DIVISION A

EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

A. Treat Gain or Loss From Sale or Exchange of Certain Preferred Stock by Applicable Financial Institutions as Ordinary Income or Loss (sec. 301 of the Act)

Present Law

Under section 582(c)(1), the sale or exchange of a bond, debenture, note, or certificate or other evidence of indebtedness by a financial institution described in section 582(c)(2) is not considered a sale or exchange of a capital asset. The financial institutions described in section 582(c)(2) are (i) any bank (including any corporation which would be a bank except for the fact that it is a foreign corporation), (ii) any financial institution referred to in section 591, which includes mutual savings banks, cooperative banks, domestic building and loan associations, and other savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, (iii) any small business investment company operating under the Small Business Investment Act of 1958, and (iv) any business development corporation, defined as a corporation which was created by or pursuant to an act of a State legislature for purposes of promoting, maintaining, and assisting the economy and industry within such State on a regional or statewide basis by making loans to be used in trades and businesses which would generally not be made by banks within such region or State in the ordinary course of their business (except on the basis of a partial participation) and which is operated primarily for such purposes. In the case of a foreign corporation, section 582(c)(1) applies only with respect to gains or losses that are effectively connected with the conduct of a banking business in the United States.

Preferred stock issued by the Federal National Mortgage Corporation ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac") is not treated as indebtedness for Federal income tax purposes, and therefore is not treated as an asset to which section 582(c)(1) applies. Accordingly, a financial institution

[359] H.R. 1424. The House Committee on Ways and Means reported H.R. 6049 on May 20, 2008 (H. Rept. 110–658). H.R. 6049 passed the House on May 21, 2008. The Senate passed H.R. 6049 with an amendment on September 23, 2008. The Senate passed H.R. 1424, with an amendment including the text of the Senate amendment to H.R 6049, on October 1, 2008. The House agreed to the Senate amendment on October 3, 2008. The President signed the bill on October 3, 2008.

described in section 582(c)(2) that holds Fannie Mae or Freddie Mac preferred stock as a capital asset generally will recognize capital gain or loss upon the sale or taxable exchange of that stock. Section 1211 provides that, in the case of a corporation, losses from sales or exchanges of capital assets are allowed only to the extent of gains from such sales or exchanges.[360] Thus, in taxable years in which a corporation does not recognize gain from the sale of capital assets, its capital losses do not reduce its income.

Explanation of Provision

Under the provision, gain or loss recognized by an "applicable financial institution" from the sale or exchange of "applicable preferred stock" is treated as ordinary income or loss. An applicable financial institution is a financial institution referred to in section 582(c)(2) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1)). Applicable preferred stock is preferred stock of Fannie Mae or Freddie Mac that was (i) held by the applicable financial institution on September 6, 2008, or (ii) was sold or exchanged by the applicable financial institution on or after January 1, 2008, and before September 7, 2008.[361]

In the case of a sale or exchange of applicable preferred stock on or after January 1, 2008, and before September 7, 2008, the provision applies only to taxpayers that were applicable financial institutions at the time of such sale or exchange. In the case of a sale or exchange of applicable preferred stock after September 6, 2008, by a taxpayer that held such preferred stock on September 6, 2008, the provision applies only where the taxpayer was an applicable financial institution at all times during the period beginning on September 6, 2008, and ending on the date of the sale or exchange of the applicable preferred stock. Thus, the provision is generally in-

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[360] In general, corporations (other than S corporations) may carry capital losses back to each of the three taxable years preceding the loss year and forward to each of the five taxable years succeeding the loss year. Sec. 1212(a). In the case of an S corporation, net capital losses flow through to the corporation's shareholders. Banks hold a wide range of financial assets in the ordinary course of their banking business. For convenience, those assets often are described as "loans" or "investments," but both serve the same overall purpose (to earn a return on the bank's capital and borrowings consistent with prudent banking practices). A bank's investments are subject to the same regulatory capital adequacy supervision as are its loans, and a bank may acquire only certain types of financial assets as permitted investments. Banks determine how much of their assets to hold as loans or as investments based on the exercise of their commercial and financial judgment, taking into account such factors as return on the asset, relative liquidity, and diversification objectives. As a result, for Federal income tax purposes, gains and losses on a bank's investment portfolio ordinarily would be considered an integral part of the business operations of the bank, and ordinary losses that pass through to the shareholder of a bank that is an S corporation therefore could comprise part of such shareholder's net operating loss for the year attributable to that banking business.

Section 1366(d) provides that losses that flow through to an S corporation shareholder are limited to the sum of (i) the shareholder's adjusted basis in his S corporation stock and (ii) the shareholder's adjusted basis in any indebtedness of the S corporation to the shareholder; losses in excess of basis are suspended (and allowed to the extent of basis in subsequent years). An S corporation shareholder's ability to utilize any flow-through capital loss is subject to all limitations otherwise imposed by the Code on such shareholder. In general, under section 1211, an individual (including an individual S corporation shareholder) may deduct capital losses only against capital gains plus up to $3,000 of ordinary income; in addition, an individual may carry excess capital losses forward but not back.

[361] On September 7, 2008, the Federal Housing Finance Agency ("FHFA") placed both Fannie Mae and Freddie Mac in a conservatorship. Also on September 7, 2008, FHFA and the Treasury Department entered into Preferred Stock Purchase Agreements, contractual agreements between the Treasury and the conserved entities. Under these agreements, the Treasury Department received senior preferred stock in the two companies and warrants to buy 79.9% of the common stock of such companies.

applicable to any Fannie Mae or Freddie Mac preferred stock held by a taxpayer that was not an applicable financial institution on September 6, 2008 (even if such taxpayer subsequently became an applicable financial institution).

The provision grants the Secretary authority to extend the provision to cases in which gain or loss is recognized on the sale or exchange of applicable preferred stock acquired in a carryover basis transaction by an applicable financial institution after September 6, 2008. For example, if after September 6, 2008, Bank A, an entity that was an applicable financial institution at all times during the period beginning on September 6, 2008, acquired assets of Bank T, an entity that also was an applicable financial institution at all times during the period beginning on September 6, 2008, in a transaction in which no gain or loss was recognized under section 368(a)(1), regulations could provide that Fannie Mae and Freddie Mac stock that was applicable preferred stock in the hands of Bank T will continue to be applicable preferred stock in the hands of Bank A.

In addition, the Secretary may, through regulations, extend the provision to cases in which the applicable financial institution is a partner in a partnership that (i) held preferred stock of Fannie Mae or Freddie Mac on September 6, 2008, and later sold or exchanged such stock, or (ii) sold or exchanged such preferred stock on or after January 1, 2008, and before September 7, 2008. It is intended that Treasury guidance will provide that loss (or gain) attributable to Fannie Mae or Freddie Mac preferred stock of a partnership is characterized as ordinary in the hands of a partner only if the partner is an applicable financial institution, and only if the institution would have been eligible for ordinary treatment under section 301 of the Act had the institution held the underlying preferred stock directly for the time period during which both (i) the partnership holds the preferred stock and (ii) the institution holds substantially the same partnership interest.

In particular, substantial amounts of the preferred stock of Fannie Mae and Freddie Mac are held through "pass-through trusts" analyzed as partnerships for Federal income tax purposes. Substantially all the assets of such a pass-through trust comprise Fannie Mae or Freddie Mac preferred stock, and the trust in turn passes through dividends received on such stock to its two outstanding classes of certificates (partnership interests): an auction-rate class, where the share of the underlying preferred stock dividend is determined by periodic auctions, and a residual class, which receives the remainder of any dividends received on the underlying stock. The Act's delegation of authority to the Secretary anticipates that regulations will promptly be issued confirming in general that losses recognized by such a trust on or after January 1, 2008, in respect of the preferred stock of Fannie Mae or Freddie Mac that it acquired before September 6, 2008, will be characterized as ordinary loss in the hands of a certificate holder that is an applicable financial institution and that would be eligible for the relief contemplated by this provision if the applicable financial institution had held the underlying preferred stock directly for the same period that it held the pass-through certificate. In light of the substantial amount of such pass-through certificates in the market-

place, and the importance of the prompt resolution of the character of any resulting losses allocated to certificate holders that are applicable financial institutions for purposes of their regulatory and investor financial statement filings, unnecessary disruptions to the marketplace could best be avoided if the Secretary were to exercise the regulatory authority granted under the provision to address this case as soon as possible and, in any event, by October 31, 2008.

The provision was the subject of a colloquy on the House floor between Mr. Frank of Massachusetts and Mr. Neal of Massachusetts.[362]

Effective Date

This provision applies to sales or exchanges occurring after December 31, 2007, in taxable years ending after such date.

B. Special Rules for Tax Treatment of Executive Compensation of Employers Participating in the Troubled Assets Relief Program (sec. 302 of the Act and secs. 162(m) and 280G of the Code)

Present Law

In general

An employer generally may deduct reasonable compensation for personal services as an ordinary and necessary business expense. Sections 162(m) and 280G provide explicit limitations on the deductibility of compensation expenses in the case of corporate employers.

Section 162(m)

In general

The otherwise allowable deduction for compensation paid or accrued with respect to a covered employee of a publicly held corporation[363] is limited to no more than $1 million per year.[364] The deduction limitation applies when the deduction would otherwise be taken. Thus, for example, in the case of compensation resulting from a transfer of property in connection with the performance of services, such compensation is taken into account in applying the deduction limitation for the year for which the compensation is deductible under section 83 (i.e., generally the year in which the employee's right to the property is no longer subject to a substantial risk of forfeiture).

Covered employees

Section 162(m) defines a covered employee as (1) the chief executive officer of the corporation (or an individual acting in such capacity) as of the close of the taxable year and (2) the four most highly compensated officers for the taxable year (other than the

[362] 154 Cong. Rec. H10769 (daily ed. Oct. 3, 2008).

[363] A corporation is treated as publicly held if it has a class of common equity securities that is required to be registered under section 12 of the Securities Exchange Act of 1934.

[364] Sec. 162(m). This deduction limitation applies for purposes of the regular income tax and the alternative minimum tax.

chief executive officer). Treasury regulations under section 162(m) provide that whether an employee is the chief executive officer or among the four most highly compensated officers should be determined pursuant to the executive compensation disclosure rules promulgated under the Securities Exchange Act of 1934 ("Exchange Act").

In 2006, the Securities and Exchange Commission amended certain rules relating to executive compensation, including which executive officers' compensation must be disclosed under the Exchange Act. Under the new rules, such officers consist of (1) the principal executive officer (or an individual acting in such capacity), (2) the principal financial officer (or an individual acting in such capacity), and (3) the three most highly compensated executive officers, other than the principal executive officer or financial officer.

In response to the Securities and Exchange Commission's new disclosure rules, the Internal Revenue Service issued updated guidance on identifying which employees are covered by section 162(m).[365] The new guidance provides that "covered employee" means any employee who is (1) the principal executive officer (or an individual acting in such capacity) defined in reference to the Exchange Act, or (2) among the three most highly compensated officers for the taxable year (other than the principal executive officer), again defined by reference to the Exchange Act. Thus, under current guidance, only four employees are covered under section 162(m) for any taxable year. Under Treasury regulations, the requirement that the individual meet the criteria as of the last day of the taxable year applies to both the principal executive officer and the three highest compensated officers.[366]

Compensation subject to the deduction limitation

In general.—Unless specifically excluded, the deduction limitation applies to all remuneration for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash. If an individual is a covered employee for a taxable year, the deduction limitation applies to all compensation not explicitly excluded from the deduction limitation, regardless of whether the compensation is for services as a covered employee and regardless of when the compensation was earned. The $1 million cap is reduced by excess parachute payments (as defined in sec. 280G, discussed below) that are not deductible by the corporation.

Certain types of compensation are not subject to the deduction limit and are not taken into account in determining whether other compensation exceeds $1 million. The following types of compensation are not taken into account: (1) remuneration payable on a commission basis; (2) remuneration payable solely on account of the attainment of one or more performance goals if certain outside director and shareholder approval requirements are met ("performance-based compensation"); (3) payments to a tax-qualified retirement plan (including salary reduction contributions); (4) amounts that are excludable from the executive's gross income (such as employer-

[365] Notice 2007–49, 2007–25 I.R.B. 1429.
[366] Treas. Reg. sec. 1.162–27(c)(2).

provided health benefits and miscellaneous fringe benefits (sec. 132)); and (5) any remuneration payable under a written binding contract which was in effect on February 17, 1993. In addition, remuneration does not include compensation for which a deduction is allowable after a covered employee ceases to be a covered employee. Thus, the deduction limitation often does not apply to deferred compensation that is otherwise subject to the deduction limitation (e.g., is not performance-based compensation) because the payment of compensation is deferred until after termination of employment.

Performance-based compensation.—Compensation qualifies for the exception for performance-based compensation only if (1) it is paid solely on account of the attainment of one or more performance goals, (2) the performance goals are established by a compensation committee consisting solely of two or more outside directors,[367] (3) the material terms under which the compensation is to be paid, including the performance goals, are disclosed to and approved by the shareholders in a separate vote prior to payment, and (4) prior to payment, the compensation committee certifies that the performance goals and any other material terms were in fact satisfied.

Compensation (other than stock options or other stock appreciation rights) is not treated as paid solely on account of the attainment of one or more performance goals unless the compensation is paid to the particular executive pursuant to a pre-established objective performance formula or standard that precludes discretion. Stock options or other stock appreciation rights generally are treated as meeting the exception for performance-based compensation, provided that the requirements for outside director and shareholder approval are met (without the need for certification that the performance standards have been met), because the amount of compensation attributable to the options or other rights received by the executive would be based solely on an increase in the corporation's stock price. Stock-based compensation is not treated as performance-based if it is dependent on factors other than corporate performance. For example, if a stock option is granted to an executive with an exercise price that is less than the current fair market value of the stock at the time of grant, then the executive would have the right to receive compensation on the exercise of the option even if the stock price decreases or stays the same. In contrast to options or other stock appreciation rights, grants of restricted stock are not inherently performance-based because the executive may receive compensation even if the stock price decreases or stays the same. Thus, a grant of restricted stock does not satisfy the definition of performance-based compensation unless the grant or vesting of the restricted stock is based upon the attainment of a performance goal and otherwise satisfies the standards for performance-based compensation.

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[367] A director is considered an outside director if he or she is not a current employee of the corporation (or related entities), is not a former employee of the corporation (or related entities) who is receiving compensation for prior services (other than benefits under a tax-qualified retirement plan), was not an officer of the corporation (or related entities) at any time, and is not currently receiving compensation for personal services in any capacity (e.g., for services as a consultant) other than as a director.

Section 280G

In general

In some cases, a compensation agreement for a corporate executive may provide for payments to be made if there is a change in control of the executive's employer, even if the executive does not lose his or her job as part of the change in control. Such payments are sometimes referred to as "golden parachute payments." The Code contains limits on the amount of certain types of such payments, referred to as "excess parachute payments." Excess parachute payments are not deductible by a corporation.[368] In addition, an excise tax is imposed on the recipient of any excess parachute payment equal to 20 percent of the amount of such payment.[369]

Definition of parachute payment

A "parachute payment" is any payment in the nature of compensation to (or for the benefit of) a disqualified individual which is contingent on a change in the ownership or effective control of a corporation or on a change in the ownership of a substantial portion of the assets of a corporation ("acquired corporation"), if the aggregate present value of all such payments made or to be made to the disqualified individual equals or exceeds three times the individual's "base amount."

The individual's base amount is the average annual compensation payable by the acquired corporation and includible in the individual's gross income over the five-taxable years of such individual preceding the individual's taxable year in which the change in ownership or control occurs.

The term parachute payment also includes any payment in the nature of compensation to a disqualified individual if the payment is made pursuant to an agreement which violates any generally enforced securities laws or regulations.

Certain amounts are not considered parachute payments, including payments under a qualified retirement plan, and payments that are reasonable compensation for services rendered on or after the date of the change in control. In addition, the term parachute payment does not include any payment to a disqualified individual with respect to a small business corporation or a corporation no stock of which was readily tradable, if certain shareholder approval requirements are satisfied.

Disqualified individual

A disqualified individual is any individual who is an employee, independent contractor, or other person specified in Treasury regulations who performs personal services for the corporation and who is an officer, shareholder, or highly compensated individual of the corporation. Personal service corporations and similar entities generally are treated as individuals for this purpose. A highly compensated individual is defined for this purpose as an employee (or a former employee) who is among the highest-paid one percent of individuals performing services for the corporation (or an affiliated

[368] Sec. 280G.
[369] Sec. 4999.

corporation) or the 250 highest paid individuals who perform services for a corporation (or affiliated group).

Excess parachute payments

In general, excess parachute payments are any parachute payments in excess of the base amount allocated to the payment. The amount treated as an excess parachute payment is reduced by the portion of the payment that the taxpayer establishes by clear and convincing evidence is reasonable compensation for personal services actually rendered before the change in control.

Explanation of Provision

Section 162(m)

In general

Under the provision, the section 162(m) limit is reduced to $500,000 in the case of otherwise deductible compensation of a covered executive for any applicable taxable year of an applicable employer.

An applicable employer means any employer from which one or more troubled assets are acquired under the "troubled assets relief program" ("TARP") established by the Act if the aggregate amount of the assets so acquired for all taxable years (including assets acquired through a direct purchase by the Treasury Department, within the meaning of section 113(c) of Title I of the Act) exceeds $300,000,000. However, such term does not include any employer from which troubled assets are acquired by the Treasury Department solely through direct purchases (within the meaning of section 113(c) of Title I of the Act). For example, if a firm sells $250,000,000 in assets through an auction system managed by the Treasury Department, and $100,000,000 to the Treasury Department in direct purchases, then the firm is an applicable employer. Conversely, if all $350,000,000 in sales take the form of direct purchases, then the firm would not be an applicable employer.

Unlike section 162(m), an applicable employer under this provision is not limited to publicly held corporations (or even limited to corporations). For example, an applicable employer could be a partnership if the partnership is an employer from which a troubled asset is acquired. The aggregation rules of Code section 414(b) and (c) apply in determining whether an employer is an applicable employer. However, these rules are applied disregarding the rules for brother-sister controlled groups and combined groups in sections 1563(a)(2) and (3). Thus, this aggregation rule only applies to parent-subsidiary controlled groups. A similar controlled group rule applies for trades and businesses under common control.

The result of this aggregation rule is that all corporations in the same controlled group are treated as a single employer for purposes of identifying the covered executives of that employer and all compensation from all members of the controlled group are taken into account for purposes of applying the $500,000 deduction limit. Further, all sales of assets under the TARP from all members of the controlled group are considered in determining whether such sales exceed $300,000,000.

An applicable taxable year with respect to an applicable employer means the first taxable year which includes any portion of the period during which the authorities for the TARP established under the Act are in effect (the "authorities period") if the aggregate amount of troubled assets acquired from the employer under that authority during the taxable year (when added to the aggregate amount so acquired for all preceding taxable years) exceeds $300,000,000, and includes any subsequent taxable year which includes any portion of the authorities period.

A special rule applies in the case of compensation that relates to services that a covered executive performs during an applicable taxable year but that is not deductible until a later year ("deferred deduction executive remuneration"), such as nonqualified deferred compensation. Under the special rule, the unused portion (if any) of the $500,000 limit for the applicable tax year is carried forward until the year in which the compensation is otherwise deductible, and the remaining unused limit is then applied to the compensation.

For example, assume a covered executive is paid $400,000 in cash salary by an applicable employer in 2008 (assuming 2008 is an applicable taxable year) and the covered executive earns $100,000 in nonqualified deferred compensation (along with the right to future earnings credits) payable in 2020. Assume further that the $100,000 has grown to $300,000 in 2020. The full $400,000 in cash salary is deductible under the $500,000 limit in 2008. In 2020, the applicable employer's deduction with respect to the $300,000 will be limited to $100,000 (the lesser of the $300,000 in deductible compensation before considering the special limitation, and $500,000 less $400,000, which represents the unused portion of the $500,000 limit from 2008).

Deferred deduction executive remuneration that is properly deductible in an applicable taxable year (before application of the limitation under the provision) but is attributable to services performed in a prior applicable taxable year is subject to the special rule described above and is not double-counted. For example, assume the same facts as above, except that the nonqualified deferred compensation is deferred until 2009 and that 2009 is an applicable taxable year. The employer's deduction for the nonqualified deferred compensation for 2009 would be limited to $100,000 (as in the example above). The limit that would apply under the provision for executive remuneration that is in a form other than deferred deduction executive remuneration and that is otherwise deductible for 2009 is $500,000. For example, if the covered executive is paid $500,000 in cash compensation for 2009, all $500,000 of that cash compensation would be deductible in 2009 under the provision.

Covered executive

The term covered executive means any individual who is the chief executive officer or the chief financial officer of an applicable employer, or an individual acting in that capacity, at any time during a portion of the taxable year that includes the authorities period. It also includes any employee who is one of the three highest compensated officers of the applicable employer for the applicable taxable year (other than the chief executive officer or the chief fi-

nancial officer and only taking into account employees employed during any portion of the taxable year that includes the authorities period).

The determination of the three highest compensated officers is made on the basis of the shareholder disclosure rules for compensation under the Exchange Act, except to the extent that the shareholder disclosure rules are inconsistent with the provision.[370] Such shareholder disclosure rules are applied without regard to whether those rules actually apply to the employer under the Exchange Act. If an employee is a covered executive with respect to an applicable employer for any applicable taxable year, the employee will be treated as a covered executive for all subsequent applicable taxable years (and will be treated as a covered executive for purposes of any subsequent taxable year for purposes of the special rule for deferred deduction executive remuneration).

Executive remuneration

The provision generally incorporates the present law definition of applicable employee remuneration. However, the present law exceptions for remuneration payable on commission and performance-based compensation do not apply for purposes of the new $500,000 limit. In addition, the new $500,000 limit only applies to executive remuneration which is attributable to services performed by a covered executive during an applicable taxable year. For example, assume the same facts as in the example above, except that the covered executive also receives in 2008 a payment of $300,000 in nonqualified deferred compensation that was attributable to services performed in 2006. Such payment is not treated as executive remuneration for purposes of the new $500,000 limit.

Other rules

The modification to section 162(m) provides the same coordination rules with disallowed parachute payment and stock compensation of insiders in expatriated corporations as exist under present law section 162(m). Thus, the $500,000 deduction limit under this section is reduced (but not below zero) by any parachute payments (including parachute payments under the expanded definition under this provision) paid during the authorities period and any payment of the excise tax under section 4985 for stock compensation of insiders in expatriated corporations.

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[370] For example, the shareholder disclosure rules require the reporting of the compensation of the three most highly compensated executive officers (other than the principal executive officer and the principal financial officer) who were serving as executive officers at the end of the last completed fiscal year and up to two additional individuals from whom disclosure would have been provided but for the fact that the individual was not serving as an executive officer at the end of the last completed fiscal year. 17 C.F.R. sec. 229.402(a)(3)(iii), (iv). For purposes of the provision, the term "officer" is intended to mean those "executive officers" whose compensation is subject to reporting under the Exchange Act. Under the provision, however, an individual's status as one of the three most highly compensated officers takes into account only executive officers employed during the authorities period, regardless of whether the individual serves as an executive officer at year end. Additionally, the shareholder disclosure rules measure compensation for purposes of determining "high three" status by reference to total compensation for the last completed fiscal year, and compensation is measured without regard to whether the compensation is includible in an executive officer's gross income. It is intended that this broad measurement of compensation apply for purposes of the provision; however, the measurement period for purposes of the provision is the applicable taxable year for which "high three" status is being determined.

The modification authorizes the Secretary of the Treasury to prescribe such guidance, rules, or regulations as are necessary to carry out the purposes of the $500,000 deduction limit, including the application of the limit in the case of any acquisition, merger, or reorganization of an applicable employer.

Section 280G

The provision also modifies section 280G by expanding the definition of parachute payment in the case of a covered executive of an applicable employer. For this purpose, the terms "covered executive," "applicable taxable year," and "applicable employer" have the same meaning as under the modifications to section 162(m) (described above).

Under the modification, a parachute payment means any payments in the nature of compensation to (or for the benefit of) a covered executive made during an applicable taxable year on account of an applicable severance from employment during the authorities period if the aggregate present value of such payments equals or exceeds an amount equal to three times the covered executive's base amount. An applicable severance from employment is any severance from employment of a covered executive (1) by reason of an involuntary termination of the executive by the employer or (2) in connection with a bankruptcy, liquidation, or receivership of the employer.

Whether a payment is on account of the employee's severance from employment is generally determined in the same manner as under present law. Thus, a payment is on account of the employee's severance from employment if the payment would not have been made at that time if the severance from employment had not occurred. Such payments include amounts that are payable upon severance from employment (or separation from service), vest or are no longer subject to a substantial risk of forfeiture on account of such a separation, or are accelerated on account of severance from employment. As under present law, the modified definition of parachute payment does not include amounts paid to a covered executive from certain tax qualified retirement plans.

A parachute payment during an applicable taxable year that is paid on account of a covered executive's applicable severance from employment is nondeductible on the part of the employer (and the covered executive is subject to the section 4999 excise tax) to the extent of the amount of the payment that is equal to the excess over the employee's base amount that is allocable to such payment. For example, assume that a covered executive's annualized includible compensation is $1 million and the covered executive's only parachute payment under the provision is a lump sum payment of $5 million. The covered executive's base amount is $1 million and the excess parachute payment is $4 million.

The modifications to section 280G do not apply in the case of a payment that is treated as a parachute payment under present law. The modifications further authorize the Secretary of Treasury to issue regulations to carry out the purposes of the provision, including the application of the provision in the case of a covered executive who receives payments some of which are treated as parachute payments under present law section 280G and others of

which are treated as parachute payments on account of this provision, and the application of the provision in the event of any acquisition, merger, or reorganization of an applicable employer. The regulations shall also prevent the avoidance of the application of the provision through the mischaracterization of a severance from employment as other than an applicable severance from employment. It is intended that the regulations prevent the avoidance of the provision through the acceleration, delay, or other modification of payment dates with respect to existing compensation arrangements.

Effective Date

The provision is effective for taxable years ending on or after date of enactment (October 3, 2008), except that the modifications to section 280G are effective for payments with respect to severances occurring during the authorities period.

C. Exclude Discharges of Acquisition Indebtedness on Principal Residences From Gross Income (sec. 303 of the Act and sec. 108 of the Code)

Present Law

In general

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, and certain real property business indebtedness (secs. 61(a)(12) and 108).[371] In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally reduce certain tax attributes, including basis in property, by the amount of the discharge of indebtedness.

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge (sec. 1017).

For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

Qualified principal residence indebtedness

An exclusion from gross income is provided for any discharge of indebtedness income by reason of a discharge (in whole or in part)

[371] A debt cancellation which constitutes a gift or bequest is not treated as income to the donee debtor (sec. 102).

of qualified principal residence indebtedness. Qualified principal residence indebtedness means acquisition indebtedness (within the meaning of section 163(h)(3)(B), except that the dollar limitation is $2,000,000) with respect to the taxpayer's principal residence. Acquisition indebtedness with respect to a principal residence generally means indebtedness which is incurred in the acquisition, construction, or substantial improvement of the principal residence of the individual and is secured by the residence. It also includes refinancing of such indebtedness to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness. For these purposes, the term "principal residence" has the same meaning as under section 121 of the Code.

If, immediately before the discharge, only a portion of a discharged indebtedness is qualified principal residence indebtedness, the exclusion applies only to so much of the amount discharged as exceeds the portion of the debt which is not qualified principal residence indebtedness. Thus, assume that a principal residence is secured by an indebtedness of $1 million, of which $800,000 is qualified principal residence indebtedness. If the residence is sold for $700,000 and $300,000 debt is discharged, then only $100,000 of the amount discharged may be excluded from gross income under the qualified principal residence indebtedness exclusion.

The basis of the individual's principal residence is reduced by the amount excluded from income under the provision.

The qualified principal residence indebtedness exclusion does not apply to a taxpayer in a Title 11 case; instead the general exclusion rules apply. In the case of an insolvent taxpayer not in a Title 11 case, the qualified principal residence indebtedness exclusion applies unless the taxpayer elects to have the general exclusion rules apply instead.

The exclusion does not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

The exclusion for qualified principal residence indebtedness is effective for discharges of indebtedness before January 1, 2010.

Explanation of Provision

The provision extends for three additional years the exclusion from gross income for discharges of qualified principal residence indebtedness.

Effective Date

The provision is effective for discharges of indebtedness on or after January 1, 2010, and before January 1, 2013.

DIVISION B

ENERGY IMPROVEMENT AND EXTENSION ACT OF 2008

TITLE I—ENERGY PRODUCTION INCENTIVES

A. Renewable Energy Incentives

1. Extension and modification of the renewable electricity and coal production credits (secs. 101, 102, and 108 of the Act and sec. 45 of the Code)

Present Law

In general

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities (the "electricity production credit").[372] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, and qualified hydropower production. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person. In addition to the electricity production credit, an income tax credit is allowed for the production of refined coal (the "refined coal credit") and Indian coal (the "Indian coal credit") at qualified facilities. The electricity production credit, the refined coal credit, and the Indian coal credit are referred to collectively as the "section 45 credit."

Credit amounts and credit periods

Electricity production credit rate and period

The base amount of the electricity production credit is 1.5 cents per kilowatt-hour (indexed annually for inflation) of electricity produced. The amount of the credit was 2.1 cents per kilowatt-hour for 2008. A taxpayer may generally claim a credit during 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.

Credit phaseout

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 credit) exceeds certain threshold levels. The electricity production credit is reduced over a three-cent phaseout range to the extent the annual average contract price per kilowatt-hour of electricity sold in the prior year from the same qualified energy resource exceeds eight cents (adjusted for inflation; 11.8 cents for 2008). The refined coal credit is reduced over an $8.75 phaseout range as the reference price of the fuel used as feedstock for the refined coal exceeds the reference price for such fuel in 2002 (adjusted for inflation).

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[372] Sec. 45.

Reduced credit periods and credit amounts for certain facilities

Generally, 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 placed in service before August 8, 2005, the 10-year credit period is reduced to five years commencing on the date the facility was originally placed in service. However, for qualified open-loop biomass facilities (other than a facility described in sec. 45(d)(3)(A)(i) that uses agricultural livestock waste nutrients) placed in service before October 22, 2004, the five-year 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, trash combustion facilities, and qualified hydropower facilities, the otherwise allowable credit rate is one half of the generally applicable amount, indexed for inflation (one cent per kilowatt-hour for 2008).

Refined coal credit rate

The amount of the credit for refined coal is $4.375 per ton (also indexed for inflation after 1992 and equaling $6.061 per ton for 2008).

Indian coal credit period and rate

A credit is available for the sale of Indian coal to an unrelated party from a qualified facility for a seven-year period beginning on January 1, 2006, and before January 1, 2013. The amount of the credit for Indian coal 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. Beginning in calendar years after 2006, the credit amounts are indexed annually for inflation using 2005 as the base year; for 2008 the Indian coal credit is $1.589 per ton.

Other limitations on section 45 credit claimants and credit amounts

In general, in order to claim the credit, a taxpayer must own the qualified facility and sell the electricity, refined coal or Indian coal produced by the facility 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 and 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. 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 the amount of 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.[373] 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 25 percent of so much of the net regular tax liability as exceeds $25,000. However, this limitation does not apply to section 45 credits for electricity or refined coal 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.[374] Excess credits may be carried back one year and forward up to 20 years.

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, 2009.

Closed-loop biomass facility

A closed-loop biomass facility is a facility that uses any organic material from a plant that 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, 2009. 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, 2009.

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

An open-loop biomass facility is a facility that uses open-loop biomass to produce electricity. For purposes of the section 45 credit, open-loop biomass is defined as (1) any agricultural livestock waste nutrients or (2) any solid, nonhazardous, cellulosic waste material or any lignin material that is segregated from other waste materials and which is derived from:

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[373] Sec. 38(b)(8).
[374] Sec. 38(c)(4)(B)(ii).

- forest-related resources, including mill and harvesting residues, precommercial thinnings, slash, and brush;
- solid wood waste materials, including waste pallets, crates, dunnage, manufacturing and construction wood wastes, and landscape or right-of-way tree trimmings; or
- agricultural sources, including orchard tree crops, vineyard, grain, legumes, sugar, and other crop by-products or residues.

Agricultural livestock waste nutrients are defined as agricultural livestock manure and litter, including bedding material for the disposition of manure. Wood waste materials do not qualify as open-loop biomass to the extent they are pressure treated, chemically treated, or painted. In addition, municipal solid waste, gas derived from the biodegradation of solid waste, and paper that is commonly recycled do not qualify as open-loop biomass. 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.

In the case of an open-loop biomass facility that uses agricultural livestock waste nutrients, a qualified facility is one that was originally placed in service after October 22, 2004, and before January 1, 2009, and has a nameplate capacity rating which is not less than 150 kilowatts. In the case of any other open-loop biomass facility, a qualified facility is one that was originally placed in service before January 1, 2009.

Geothermal facility

A geothermal facility is a facility that uses geothermal energy to produce electricity. Geothermal energy is energy derived from a geothermal deposit that is a geothermal reservoir consisting of natural heat that 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, 2009.

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 power 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 at least 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, 2009.

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, 2009.

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, 2009. A qualified 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.

Hydropower facility

A qualifying hydropower facility is (1) a facility that produced hydroelectric power (a hydroelectric dam) prior to August 8, 2005, at which efficiency improvements or additions to capacity have been made after such date and before January 1, 2009, that enable the taxpayer to produce incremental hydropower or (2) a facility placed in service before August 8, 2005, that did not produce hydroelectric power (a nonhydroelectric dam) on such date, and to which turbines or other electricity generating equipment have been added after such date and before January 1, 2009.

At an existing hydroelectric facility, the taxpayer may claim credit only 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 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. In addition, there must not be any enlargement of the diversion structure, construction or enlargement of a bypass channel, or the impoundment or any withholding of additional water from the natural stream channel.

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 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 at least 20 percent less nitrogen oxide and 20 percent less sulfur dioxide or mercury than the feedstock coal or comparable coal predominantly available in the marketplace as of January 1, 2003, and that sells at prices at least 50 percent greater than the prices of the feedstock 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.

Indian coal facility

A qualified Indian coal facility is a facility placed in service before January 1, 2009, 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.

Summary of credit rate and credit period by facility type

TABLE 1.—SUMMARY OF SECTION 45 CREDIT RATES AND PERIODS

Eligible electricity production or coal production activity	Credit amount for 2008 (cents per kilowatt-hour; dollars per ton)	Credit period for facilities placed in service on or before August 8, 2005 (years from placed-in-service date)	Credit period facilities placed in service after August 8, 2005 (years from placed-in-service date)
Wind	2.1	10	10
Closed-loop biomass	2.1	101	10
Open-loop biomass (including agricultural livestock waste nutrient facilities)	1.0	52	10
Geothermal	2.1	5	10
Solar (pre-2006 facilities only)	2.1	5	10
Small irrigation power	1.0	5	10
Municipal solid waste (including landfill gas facilities and trash combustion facilities)	1.0	5	10
Qualified hydropower	1.0	N/A	10
Refined Coal	6.061	10	10
Indian Coal	1.589	73	73

[1] In the case of certain co-firing closed-loop facilities, the credit period begins no earlier than October 22, 2004.
[2] For certain facilities placed in service before October 22, 2004, the five-year credit period commences on January 1, 2005.
[3] For Indian coal, the credit period begins for coal sold after January 1, 2006.

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, a cooperative that is subject to the cooperative tax rules of subchapter T of the Code[375] is permitted a deduction for patronage dividends paid only to the extent of net income that is derived from transactions with patrons who are members of the cooperative.[376] 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.

Eligible cooperatives may elect to pass any portion of the section 45 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. 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.

Reasons for Change[377]

The Congress believes that additional incentives for the production of electricity from renewable resources will help limit the environmental consequences of continued reliance on power generated using fossil fuels. The Congress also believes that it is important to modify the existing incentives to make them operate more effectively and to take advantage of new renewable energy technologies.

Explanation of Provision

The provision extends and modifies the section 45 credit.

Extension of placed-in-service date for qualifying facilities

The provision extends for two years (through 2010) the period during which qualified facilities producing electricity from closed-loop biomass, open-loop biomass, geothermal energy, small irrigation power, municipal solid waste, and qualified hydropower may be placed in service for purposes of the electricity production credit. The provision extends for one year (through 2009) the placed-in-service period for qualified wind and refined coal facilities.

Addition of marine and hydrokinetic renewable energy as a qualified resource

The provision adds marine and hydrokinetic renewable energy as a qualified energy resource and marine and hydrokinetic renewable energy facilities as qualified facilities. Marine and hydrokinetic renewable energy is defined as energy derived from (1) waves, tides, and currents in oceans, estuaries, and tidal areas; (2) free flowing

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[375] Secs. 1381–1383.
[376] Sec. 1382.
[377] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

water in rivers, lakes, and streams; (3) free flowing water in an irrigation system, canal, or other man-made channel, including projects that utilize nonmechanical structures to accelerate the flow of water for electric power production purposes; or (4) differentials in ocean temperature (ocean thermal energy conversion). The term does not include energy derived from any source that uses a dam, diversionary structure (except for irrigation systems, canals, and other man-made channels), or impoundment for electric power production. A qualified marine and hydrokinetic renewable energy facility is any facility owned by the taxpayer and placed in service after the date of enactment and before 2011, that produces electric power from marine and hydrokinetic renewable energy and that has a nameplate capacity rating of at least 150 kilowatts.

Under the provision, marine and hydrokinetic renewable energy facilities subsume small irrigation power facilities. The provision, therefore, terminates as a separate category of qualified facility small irrigation power facilities placed in service on or after the date of enactment. Such facilities qualify for the electricity production credit as marine and hydrokinetic renewable energy facilities.

Clarification of the definition of trash combustion facility

The provision modifies the definition of qualified trash combustion facility to permit facilities that use municipal solid waste as part of an electricity generation process to qualify for the electricity production credit, whether or not such facilities utilize a process that involves burning the waste.

Modification of the definitions of open-loop biomass facility and closed-loop biomass facility to include new units added to existing qualified facilities

The definitions of qualified open-loop biomass facility and qualified closed-loop biomass facility are modified to include new power generation units placed in service at existing qualified facilities, but only to the extent of the increased amount of electricity produced at such facilities by reason of such new units.

Modification to definition of nonhydroelectric dam for purposes of qualified hydropower production

The provision modifies the definition of nonhydroelectric dam for purposes of qualified hydropower production. Under the new definition, the nonhydroelectric dam must have been operated for flood control, navigation, or water supply purposes.

The provision replaces the requirement that any hydroelectric project installed on a nonhydroelectric dam not enlarge the diversion structure or bypass channel, or impound additional water from the natural stream channel, with a requirement that such project be operated so that the water surface elevation at any given location and time be the same as would occur in absence of the project, subject to any license requirements aimed at improving the environmental quality of the affected waterway.

A hydroelectric project installed on a nonhydroelectric dam must still be licensed by the Federal Energy Regulatory Commission and meet all other applicable environmental, licensing, and regulatory requirements, including applicable fish passage requirements.

Modification to definition of refined coal

The provision modifies the definition of refined coal by eliminating the requirement that the qualified refined coal fuel sell at a price at least 50 percent greater than the price of the feedstock coal. It also increases to 40 percent the amount by which refined coal must reduce, when burned, emissions of either sulfur dioxide or mercury compared to the emissions released by the feedstock coal or comparable coal predominantly available in the marketplace as of January 1, 2003.

Steel industry fuel

The provision adds to the section 45 credit a new production credit for steel industry fuel. The provision defines steel industry fuel as a fuel produced through a process of liquefying coal waste sludge, distributing the liquefied product on coal, and using the resulting mixture as a feedstock for the manufacture of coke. Coal waste sludge includes tar decanter sludge and related byproducts of the coking process.

Under the provision, each barrel-of-oil equivalent (defined as 5.8 million British thermal units) of steel industry fuel produced at a qualified facility during the credit period receives a $2 credit (adjusted for inflation using 1992 as the base year). A qualified facility is any facility capable of producing steel industry fuel (or any modification to a facility making it so capable) that is placed in service before January 1, 2010. For facilities capable of producing steel industry fuel on or before October 1, 2008, the credit is available for fuel produced and sold on or after such date and before January 1, 2010. For facilities placed in service or modified to produce steel industry fuel after October 1, 2008, the credit period begins on the placed-in-service or modification date and ends one year after such date or December 31, 2009, whichever is later.

Coke produced using fuel qualifying for a credit under this provision is not eligible for credit under present-law section 45K(g).[378]

Effective Date

The extension of the section 45 credit is effective for facilities originally placed in service after 2008. The addition of marine and hydrokinetic renewable energy as a qualified energy resource is effective for electricity produced at qualified facilities and sold after the date of enactment in taxable years ending after such date. The clarification of the definition of trash combustion facility is effective for electricity produced and sold after the date of enactment. The modifications to the definitions of open-loop biomass facility, closed-loop biomass facility, and nonhydroelectric dam are effective for property placed in service after the date of enactment. The modification to the definition of refined coal is effective for coal produced and sold from facilities placed in service after 2008. The new credit for steel industry fuel is effective for fuel produced and sold after September 30, 2008.

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[378] A technical correction may be necessary so that the statute reflects this intent.

2. Extension and modification of energy credit (secs. 103, 104 and 105 of the Act and sec. 48 of the Code)

Present Law

In general

A nonrefundable, 10-percent business energy credit[379] is allowed for the cost of new property that is equipment that either (1) uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) 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. Property used to generate energy for the purpose of heating a swimming pool is not eligible solar energy property.

The energy credit is a component of the general business credit[380] and as such is subject to the alternative minimum tax. An unused general business credit generally may be carried back one year and carried forward 20 years.[381] The taxpayer's basis in the property is reduced by one-half of the amount of the credit claimed. For projects whose construction time is expected to equal or exceed two years, the credit may be claimed as progress expenditures are made on the project, rather than during the year the property is placed in service. The credit only applies to expenditures made after the effective date of the provision.

In general, property that is public utility property is not eligible for the credit. Public utility property is property that is used predominantly in the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas through a local distribution system, or (3) telephone service, domestic telegraph services, or other communication services (other than international telegraph services), if the rates for such furnishing or sale have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission.

Special rules for solar energy property

The credit for solar energy property is increased to 30 percent in the case of periods after December 31, 2005, and prior to January 1, 2009. Additionally, equipment that uses fiber-optic distributed sunlight to illuminate the inside of a structure is solar energy property eligible for the 30-percent credit.

Fuel cells and microturbines

The business energy credit also applies for the purchase of qualified fuel cell power plants, but only for periods after December 31, 2005, and prior to January 1, 2009. The credit rate is 30 percent.

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, and (2) has an electricity-only generation effi-

[379] Sec. 48.
[380] Sec. 38(b)(1).
[381] Sec. 39.

ciency of greater than 30 percent and a capacity of at least one-half kilowatt. The credit may not exceed $500 for each 0.5 kilowatt of capacity.

The business energy credit also applies for the purchase of qualifying stationary microturbine power plants, but only for periods after December 31, 2005, and prior to January 1, 2009. The credit is limited to the lesser of 10 percent of the basis of the property or $200 for each kilowatt of capacity.

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.

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

Reasons for Change[382]

The Congress believes that alternative sources of energy are necessary to meet growing energy needs, reduce reliance on imports, and reduce green-house gas emissions. Toward that end, the Congress believes a long-term extension of the business credit for solar and fuel cell property is warranted to ensure the continued development of alternative energy resources. The Congress further believes that provision of the credit for combined heat and power property will help to stimulate more efficient use of fossil fuels used to generate electrical or mechanical power.

The Congress believes that all sectors of the economy should be encouraged to invest in alternative energy technologies, and therefore removes the rule that prohibits public utilities from claiming the energy credit and also allows the credit against the alternative minimum tax for all taxpayers. The Congress also believes that increasing the cap on the fuel cell credit is necessary to promote further development of fuel cell technology.

Explanation of Provision

In general

The provision extends the otherwise expiring credits and credit rates for eight years, through December 31, 2016. The provision raises the $500 per half kilowatt of capacity credit cap with respect to fuel cells to $1500 per half kilowatt of capacity. Also, the restric-

[382] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

tions on public utility property being eligible for the credit are repealed. The provision makes the energy credit allowable against the alternative minimum tax.

Geothermal heat pump property

The provision provides a 10 percent credit for qualified geothermal heat pump property placed in service, through December 31, 2016. Geothermal heat pump property is equipment that uses the ground or ground water as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure.

Small wind property

The provision provides a credit of 30 percent of the basis of qualified small wind energy property placed in service, through December 31, 2016. The credit is limited to $4,000 per year with respect to all wind energy property of any taxpayer. Qualified small wind energy property is property that uses a qualified wind turbine to generate electricity. A qualifying wind turbine means a wind turbine of 100 kilowatts of rated capacity or less.

Combined heat and power property

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

CHP property is property: (1) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) that has an electrical capacity of not more than 50 megawatts or a mechanical energy capacity of no more than 67,000 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.

The otherwise allowable credit with respect to CHP property is reduced to the extent the property has an electrical capacity or mechanical capacity in excess of any applicable limits. Property in excess of the applicable limit (15 megawatts or a mechanical energy capacity of more than 20,000 horsepower or an equivalent combination of electrical and mechanical energy capacities) is permitted to claim a fraction of the otherwise allowable credit. The fraction is equal to the applicable limit divided by the capacity of the property. For example, a 45 megawatt property would be eligible to claim 15/45ths, or one third, of the otherwise allowable credit. Again, no credit is allowed if the property exceeds the 50 megawatt or 67,000 horsepower limitations described above.

Additionally, the provision provides that systems whose fuel source is at least 90 percent open-loop biomass and that would

qualify for the credit but for the failure to meet the efficiency standard are eligible for a credit that is reduced in proportion to the degree to which the system fails to meet the efficiency standard. For example, a system that would otherwise be required to meet the 60-percent efficiency standard, but which only achieves 30-percent efficiency, would be permitted a credit equal to one-half of the otherwise allowable credit (i.e., a five-percent credit).

Effective Date

The provision is generally effective on the date of enactment (October 3, 2008).

The provisions relating to geothermal heat pump property, small wind property, and combined heat and power property apply to periods after the date of enactment, in taxable years ending after such date, under rules similar to the rules of section 48(m) of the Code (as in effect on the day before the enactment of the Revenue Reconciliation Act of 1990).

The provision relating to the restrictions on public utility property applies to periods after February 13, 2008, in taxable years ending after such date, under rules similar to the rules of section 48(m) of the Code (as in effect on the day before the enactment of the Revenue Reconciliation Act of 1990).

The allowance of the credit against the alternative minimum tax is effective for credits determined in taxable years beginning after the date of enactment (October 3, 2008).

3. Credit for residential energy efficient property (sec. 106 of the Act and sec. 25D of the Code)

Present Law

Code section 25D provides a personal tax credit for the purchase of qualified solar electric 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. Section 25D 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.

Qualified solar water heating property is property that heats 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 solar electric property is property that uses solar energy to generate electricity for use in such 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) has a nameplate capacity of at least 0.5 kilowatts. 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.

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.

The credit applies to property placed in service prior to January 1, 2009.

Reasons for Change[383]

The Congress believes the cap on the amount of the available credit for solar electric and fuel cell property should be removed in order to provide additional incentive to invest in such property for those who would otherwise have been restricted by the cap. The Congress also believes that it is proper to provide an incentive for residential wind and geothermal property to encourage investments in such property to reduce fossil fuel consumption. Finally, the Congress believes that it is appropriate to allow the credit against the alternative minimum tax in order to make sure the incentive is available to all taxpayers.

Explanation of Provision

The provision extends the credit for eight years (through December 31, 2016) and allows the credit to be claimed against the alternative minimum tax. Additionally, the credit cap (currently $2,000) for solar electric property is eliminated.

The provision provides a new 30 percent credit for qualified small wind energy property expenses made by the taxpayer during the taxable year. The credit is limited to $500 with respect to each half kilowatt of capacity, not to exceed $4,000. The credit for qualified small wind energy property is allowed for expenditures in taxable years beginning after December 31, 2007, for property placed in service prior to January 1, 2017.

Qualified small wind energy property expenditures are expenditures for property that uses a wind turbine to generate electricity for use in a dwelling unit located in the United States and used as a residence by the taxpayer.

The provision also provides a 30 percent credit for qualified geothermal heat pump property expenditures, not to exceed $2,000. The term "qualified geothermal heat pump property expenditure" means an expenditure for qualified geothermal heat pump property installed on or in connection with a dwelling unit located in the United States and used as a residence by the taxpayer. Qualified geothermal heat pump property means any equipment which (1) uses the ground or ground water as a thermal energy source to heat the dwelling unit or as a thermal energy sink to cool such dwelling unit, and (2) meets the requirements of the Energy Star

[383] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

program which are in effect at the time that the expenditure for such equipment is made. The credit for qualified geothermal heat pump property is allowed for expenditures in taxable years beginning after December 31, 2007, for property placed in service prior to January 1, 2017.

Effective Date

Generally, the provision is effective for taxable years beginning after December 31, 2007, for property placed in service prior to January 1, 2017. The removal of the solar electric credit cap applies to taxable years beginning after December 31, 2008.

4. New clean renewable energy bonds (sec. 107 of the Act and new sec. 54C of the Code)

Present Law

Tax-exempt bonds

Subject to certain Code restrictions, interest paid on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes. Bonds issued by State and local governments 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 which are repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons. For this purpose, the term "nongovernmental person" generally includes the Federal Government and all other individuals and entities other than States or local governments. The exclusion from income for interest on State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") and other Code requirements are met.

In most cases, the aggregate volume of tax-exempt qualified private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2008, the State volume limit, which is indexed for inflation, equals $85 per resident of the State, or $262.09 million, if greater.

The exclusion from income for interest on State and local bonds also does not apply to any arbitrage bond.[384] 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.[385] 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

[384] See 103(a) and (b)(2).
[385] See 148.

or on such investments must be rebated to the Federal Government.

An issuer must file with the IRS certain information about the bonds issued by it in order for that bond issue to be tax exempt.[386] Generally, this information return is required to be filed no later than the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

Clean renewable energy bonds

As an alternative to traditional tax-exempt bonds, States and local governments may issue clean renewable energy bonds ("CREBs"). CREBs are defined as any bond issued by a qualified issuer if, in addition to the requirements discussed below, 95 percent or more of the proceeds of such bonds are used to finance capital expenditures incurred by qualified borrowers for qualified projects. "Qualified projects" are facilities that qualify for the tax credit under section 45 (other than Indian coal production facilities), without regard to the placed-in-service date requirements of that section.[387] The term "qualified issuers" includes (1) governmental bodies (including Indian tribal governments); (2) mutual or cooperative electric companies (described in section 501(c)(12) or section 1381(a)(2)(C), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act); and (3) clean renewable energy bond lenders. The term "qualified borrower" includes a governmental body (including an Indian tribal government) and a mutual or cooperative electric company. A clean renewable energy bond lender means a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002.

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

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

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[386] See 149(e).

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

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

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

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

Qualified tax credit bonds

Section 54A of the Code sets forth general rules applicable to qualified tax credit bonds (defined as qualified forestry conservation bonds meeting certain requirements specified in section 54A). Section 54A sets forth requirements regarding the expenditure of available project proceeds, reporting, arbitrage, maturity limitations, and financial conflicts of interest, among other special rules.

Reasons for Change[388]

The Congress believes that incentives for the development of facilities that produce electricity from renewable resources will help limit the environmental consequences of continued reliance on power generated using fossil fuels. Because certain taxpayers themselves are unable to benefit from tax credits, tax-credit bonds provide an alternative means of assisting such taxpayers with the costs of installing facilities that produce electricity from renewable resources. As a result, the Congress feels that it is appropriate to authorize the issuance of new clean renewable energy bonds.

Explanation of Provision

New Clean Renewable Energy Bonds

The provision creates a new category of clean renewable energy bonds ("New CREBs") that may be issued by qualified issuers to finance qualified renewable energy facilities. Qualified renewable energy facilities are facilities: (1) that qualify for the tax credit under section 45 (other than Indian coal and refined coal production facilities), without regard to the placed-in-service date requirements

[388] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

of that section; and (2) that are owned by a public power provider, governmental body, or cooperative electric company.

The term "qualified issuers" includes: (1) public power providers; (2) a governmental body; (3) cooperative electric companies; (4) a not-for-profit electric utility that has received a loan or guarantee under the Rural Electrification Act; and (5) clean renewable energy bond lenders. The term "public power provider" means a State utility with a service obligation, as such terms are defined in section 217 of the Federal Power Act (as in effect on the date of the enactment of this paragraph). A "governmental body" means any State or Indian tribal government, or any political subdivision thereof. The term "cooperative electric company" means a mutual or cooperative electric company (described in section 501(c)(12) or section 1381(a)(2)(C)). A clean renewable energy bond lender means a cooperative that is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002 (including any affiliated entity which is controlled by such lender).

There is a national limitation for New CREBs of $800 million. Under the provision, no more than one third of the national limit may be allocated to projects of public power providers, governmental bodies, or cooperative electric companies. Allocations to governmental bodies and cooperative electric companies may be made in the manner the Secretary determines appropriate. Allocations to projects of public power providers shall be made, to the extent practicable, in such manner that the amount allocated to each such project bears the same ratio to the cost of such project as the maximum allocation limitation to projects of public power providers bears to the cost of all such projects.

The provision makes New CREBs a type of qualified tax credit bond for purposes of section 54A of the Code. As such, 100 percent of the available project proceeds of New CREBs must be used within the three-year period that begins on the date of issuance. Available project proceeds are proceeds from the sale of the bond issue less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds. To the extent less than 100 percent of the available project proceeds are used to finance qualified projects during the three-year spending period, bonds will continue to qualify as New CREBs if unspent proceeds are used within 90 days from the end of such three-year period to redeem bonds. The three-year spending period may be extended by the Secretary upon the qualified issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

New CREBs generally are subject to the arbitrage requirements of section 148. However, available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest

rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the New CREBs are issued.

The maturity of New CREBs is the term that the Secretary estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the New CREBs are issued.

As with present-law CREBs, a taxpayer holding New CREBs on a credit allowance date is entitled to a tax credit. Unlike present-law CREBs, however, the credit rate on New CREBs is set by the Secretary at a rate that is 70 percent of the rate that would permit issuance of such bonds without discount and interest cost to the issuer. The amount of the tax credit is determined by multiplying the bond's credit rate by the face amount on the holder's bond. The credit accrues quarterly, 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. Unused credits may be carried forward to succeeding taxable years. In addition, credits may be separated from the ownership of the underlying bond similar to how interest coupons can be stripped for interest-bearing bonds.

An issuer of New CREBs is treated as meeting the "prohibition on financial conflicts of interest" requirement in section 54A(d)(6) if it certifies that it satisfies (i) applicable State and local law requirements governing conflicts of interest and (ii) any additional conflict of interest rules prescribed by the Secretary with respect to any Federal, State, or local government official directly involved with the issuance of New CREBs.

Extension of time to issue CREBS

The provision extends the period to issue CREBs for one additional year. Under the provision, CREBs must be issued by December 31, 2009.

Effective Date

The provision is effective for bonds issued after the date of enactment (October 3, 2008).

5. Special rule to implement FERC and State electric restructuring policy (sec. 109 of the Act and sec. 451(i) 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[389] (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 an entity providing such services, to an independent transmission company prior to January 1, 2008. In general, an independent transmission company is defined as: (1) an independent transmission provider[390] approved by the Federal Energy Regulatory Commission ("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, but not later than December 31, 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).

Reasons for Change[391]

The Congress believes that the "unbundling" of electric transmission assets held by vertically integrated utilities, with the transmission assets ultimately placed under the ownership or control of independent transmission providers (or other similarly-approved operators), continues to be an important policy. To facilitate the implementation of this policy, the Congress believes it is appropriate to assist taxpayers in moving forward with industry restructuring by providing a tax deferral for gain associated with certain dispositions of electric transmission assets.

The Congress believes that the exempt utility property purchased by the taxpayer with the proceeds from the qualifying electric

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[389] 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.

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

[391] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

transmission transaction should be located in the United States in order to qualify for tax-deferral treatment.

Explanation of Provision

The provision extends the treatment under the present-law deferral provision to sales or dispositions by a qualified electric utility prior to January 1, 2010. A qualified electric utility is defined as an electric utility, which as of the date of the qualifying electric transmission transaction, is vertically integrated in that it is both (1) a transmitting utility (as defined in the Federal Power Act)[392] with respect to the transmission facilities to which the election applies, and (2) an electric utility (as defined in the Federal Power Act).[393]

The definition of an independent transmission company is modified for taxpayers whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider, which under the provision must take place no later than four years after the close of the taxable year in which the transaction occurs.

The provision also changes the definition of exempt utility property to exclude property that is located outside the United States.

Effective Date

The extension provision applies transactions after December 31, 2007. The change in the definition of an independent transmission company is effective as if included in section 909 of the American Jobs Creation Act of 2004. The exclusion for property located outside the United States applies to transactions after the date of enactment (October 3, 2008).

B. Carbon Mitigation and Coal Provisions

1. Expansion and modification of the advanced coal project credit (sec. 111 of the Act and sec. 48A of the Code)

Present Law

An investment tax credit is available for power generation projects that use integrated gasification combined cycle ("IGCC") or other advanced coal-based electricity generation technologies. The credit amount is 20 percent for investments in qualifying IGCC projects and 15 percent for investments in qualifying projects that use other advanced coal-based electricity generation technologies.

To qualify, an advanced coal project must be located in the United States and use an advanced coal-based generation technology to power a new electric generation unit or to retrofit or repower an existing unit. Generally, an electric generation unit using an advanced coal-based technology must be designed to

[392] Sec. 3(23), 16 U.S.C. 796, defines "transmitting utility" as any electric utility, qualifying cogeneration facility, qualifying small power production facility, or Federal power marketing agency which owns or operates electric power transmission facilities which are used for the sale of electric energy at wholesale.

[393] Sec. 3(22), 16 U.S.C. 796, defines "electric utility" as any person or State agency (including any municipality) which sells electric energy; such term includes the Tennessee Valley Authority, but does not include any Federal power marketing agency.

achieve a 99-percent reduction in sulfur dioxide and a 90-percent reduction in mercury, as well as to limit emissions of nitrous oxide and particulate matter.[394]

The fuel input for a qualifying project, when completed, must use at least 75 percent coal. The project, consisting of one or more electric generation units at one site, must have a nameplate generating capacity of at least 400 megawatts, and the taxpayer must provide evidence that a majority of the output of the project is reasonably expected to be acquired or utilized.

Credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. Certifications are issued using a competitive bidding process. The Secretary of Treasury must establish a certification program no later than 180 days after August 8, 2005,[395] and each project application must be submitted during the three-year period beginning on the date such certification program is established. An applicant for certification has two years from the date the Secretary accepts the application to provide the Secretary with evidence that the requirements for certification have been met. Upon certification, the applicant has five years from the date of issuance of the certification to place the project in service.

The Secretary of Treasury may allocate $800 million of credits to IGCC projects and $500 million to projects using other advanced coal-based electricity generation technologies. Qualified projects must be economically feasible and use the appropriate clean coal technologies. With respect to IGCC projects, credit-eligible investments 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.

In determining which projects to certify, 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.

Reasons for Change[396]

The Congress believes that to the extent electricity will continue to be produced from coal, it must be done in as clean and efficient a manner as possible. To this end, the Congress believes that additional investment incentives will encourage the construction of advanced coal facilities that both capture and sequester carbon dioxide and reduce the emissions of other pollutants.

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[394] For advanced coal project certification applications submitted after October 2, 2006, an electric generation unit using advanced coal-based generation technology designed to use subbituminous coal can meet the performance requirement relating to the removal of sulfur dioxide if it is designed either to remove 99 percent of the sulfur dioxide or to achieve an emission limit of 0.04 pounds of sulfur dioxide per million British thermal units on a 30-day average.

[395] The Secretary issued guidance establishing the certification program on February 21, 2006 (IRS Notice 2006–24).

[396] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

Explanation of Provision

The provision increases to 30 percent the credit rate for new IGCC and other advanced coal projects. In addition, the provision permits the Secretary to allocate an additional $1.25 billion of credits to qualifying projects.

The provision modifies the definition of qualifying projects to require that projects include equipment which separates and sequesters at least 65 percent of the project's total carbon dioxide emissions. This percentage increases to 70 percent if the credits are later reallocated by the Secretary. The Secretary is required to recapture the benefit of any allocated credit if a project fails to attain or maintain these carbon dioxide separation and sequestration requirements.

In selecting projects, the provision requires the Secretary to give high priority to applicants who have a research partnership with an eligible educational institution. In addition, the Secretary must give the highest priority to projects with the greatest separation and sequestration percentage of total carbon dioxide emissions. The provision also requires that the Secretary disclose which projects receive credit allocations, including the identity of the taxpayer and the amount of the credit awarded.

Effective Date

The provision authorizing the Secretary to allocate additional credits is effective on the date of enactment (October 3, 2008). The increased credit rate along with the carbon dioxide sequestration and other rules are effective with respect to these additional credit allocations.

2. Expansion and modification of the coal gasification investment credit (sec. 112 of the Act and sec. 48B of the Code)

Present Law

A 20-percent investment tax credit is available for investments in certain qualifying coal gasification projects. 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.

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. Qualified projects must be carried out by an eligible entity, defined as any person whose application for certification is principally intended for use in a domestic project which employs domestic gasification applications related to (1) chemicals, (2) fertilizers, (3) glass, (4) steel, (5) petroleum residues, (6) forest products, and (7) agriculture, including feedlots and dairy operations.

Credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. Certifications are issued using a competitive bidding process. The Secretary of Treasury must establish a certification program no later

than 180 days after August 8, 2005,[397] and each project application must be submitted during the 3-year period beginning on the date such certification program is established. The Secretary of Treasury may not allocate more than $350 million in credits. In addition, the Secretary may certify a maximum of $650 million in qualified investment as eligible for credit with respect to any single project.

Reasons for Change[398]

The Congress believes that facilities that gasify coal and other resources for use in industrial applications should be operated in an environmentally responsible manner. To this end, the Congress believes these incentives will reduce pollution and encourage the capture and sequestration of carbon dioxide emissions.

Explanation of Provision

The provision expands and modifies the coal gasification investment credit. The provision increases the gasification project credit rate to 30 percent and permits the Secretary to allocate an additional $250 million of credits to qualified projects that separate and sequester at least 75 percent of total carbon dioxide emissions. The provision also expands the definition of credit-eligible entities to include entities whose gasification projects are related to the production of transportation grade liquid fuels. The Secretary is required to recapture the benefit of any allocated credit if a project fails to attain or maintain these carbon dioxide separation and sequestration requirements.

In selecting projects, the provision requires the Secretary to give high priority to applicants who have a research partnership with an eligible educational institution. In addition, the Secretary must give the highest priority to projects with the greatest separation and sequestration percentage of total carbon dioxide emissions. The provision also requires that the Secretary disclose which projects receive credit allocations, including the identity of the taxpayer and the amount of the credit awarded.

Effective Date

The provision authorizing the Secretary to allocate additional credits is effective on the date of enactment (October 3, 2008). The increased credit rate along with the carbon dioxide sequestration and other rules are effective with respect to these additional credit allocations.

3. Extend excise tax on coal at current rates (sec. 113 of the Act and sec. 4121 of the Code)

Present Law

A $1.10 per ton excise tax is imposed on coal sold by the producer from underground mines in the United States. The rate is 55 cents per ton on coal sold by the producer from surface mining op-

[397] The Secretary issued guidance establishing the certification program on February 21, 2006 (IRS Notice 2006–25).

[398] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H.R. Rep. No. 110–658).

erations. In either case, the tax cannot exceed 4.4 percent of the coal producer's selling price. No tax is imposed on lignite.

Gross receipts from the excise tax are dedicated to the Black Lung Disability Trust Fund ("Trust Fund") to finance benefits under the Federal Black Lung Benefits Act. Currently, the Trust Fund is in a deficit position because previous spending was financed with interest-bearing advances from the General Fund.

The coal excise tax rates are scheduled to decline to 50 cents per ton for underground-mined coal and 25 cents per ton for surface-mined coal (and the cap is scheduled to decline to two percent of the selling price) for sales after January 1, 2014, or after any earlier January 1 on which there is no balance of repayable advances from the Trust Fund to the General Fund and no unpaid interest on such advances.

Reasons for Change[399]

Trust fund financing of benefits under the Federal Black Lung Benefits Act was established in 1977 to reduce reliance on the Treasury and to recover costs from the mining industry. The expenses of the program covered by the Trust Fund (benefits, administration, and interest) have exceeded revenues, with advances from the General Fund making up the difference. It appears that the Trust Fund will not be able to pay off its debt to the Treasury Department by December 31, 2013. Therefore, the Congress believes that it is appropriate to continue the tax on coal at the increased rates beyond the expiration date.

Explanation of Provision

The provision retains the excise tax on coal at the current rates until the earlier of the following dates: (1) January 1, 2019; and (2) the day after the first December 31 after 2007 on which the Trust Fund has repaid, with interest, all amounts borrowed from the General Fund. On and after that date, the reduced rates of $.50 per ton for coal from underground mines and $.25 per ton for coal from surface mines will apply and the tax per ton of coal will be capped at two percent of the amount for which it is sold by the producer.

The provision also provides for the financial restructuring of the Trust Fund, as follows. On the refinancing date, the Trust Fund shall repay the market value of the outstanding repayable advances, plus accrued interest, by transferring into the General Fund of the Treasury the following sums:

1. The proceeds from obligations that the Trust Fund shall issue to the Secretary of the Treasury in such amounts as the Secretaries of Labor and the Treasury shall determine and bearing interest at the Treasury rate, and that shall be in such forms and denominations and be subject to such other terms and conditions, including maturity, as the Secretary of the Treasury shall prescribe; and

2. All, or that portion, of the one-time appropriation, made to the Trust Fund that is needed to cover the difference between:

[399] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

a. the market value of the outstanding repayable advances, plus accrued interest; and

b. the proceeds from the obligations issued by the Trust Fund to the Secretary of the Treasury under paragraph one above.

In the event that the Trust Fund is unable to repay the obligations that it has issued to the Secretary of the Treasury under paragraph one above and under this paragraph, or is unable to make benefit payments and other authorized expenditures, the Trust Fund shall issue obligations to the Secretary of the Treasury in such amounts as may be necessary to make such repayments, payments, and expenditures, with a maturity of one year, and bearing interest at the Treasury one-year rate. These obligations shall be in such forms and denominations and be subject to such other terms and conditions as the Secretary of the Treasury shall prescribe.

The provision also authorizes the Trust Fund to issue obligations to the Secretary of the Treasury under paragraph one above and under the paragraph immediately preceding this paragraph. The Secretary of the Treasury is authorized to purchase such obligations of the Trust Fund. For the purposes of making such purchases, the Secretary of the Treasury may use as a public debt transaction the proceeds from the sale of any securities issued under chapter 31 of title 31, United States Code, and the purposes for which securities may be issued under such chapter are extended under the provision to include any purchase of such Trust Fund obligations under this paragraph.

The Trust Fund is also authorized to repay any obligation issued to the Secretary of the Treasury under the provision prior to its maturity date by paying a prepayment price that would, if the obligation being prepaid (including all unpaid interest accrued thereon through the date of prepayment) were purchased by a third party and held to the maturity date of such obligation, produce a yield to the third-party purchaser for the period from the date of purchase to the maturity date of such obligation substantially equal to the Treasury yield on outstanding marketable obligations of the United States having a comparable maturity to this period.

The following definitions apply for purposes of the provision. The term "market value of the outstanding repayable advances, plus accrued interest" means the present value (determined by the Secretary of the Treasury as of the refinancing date and using the Treasury rate as the discount rate) of the stream of principal and interest payments derived assuming that each repayable advance that is outstanding on the refinancing date is due on the 30th anniversary of the end of the fiscal year in which the advance was made to the Trust Fund, and that all such principal and interest payments are made on September 30 of the applicable fiscal year.

The term "refinancing date" means the date occurring two days after the enactment of the provision.

The term "repayable advance" means an amount that has been appropriated to the Trust.

Fund in order to make benefit payments and other expenditures that are authorized under section 9501 and are required to be re-

paid when the Secretary of the Treasury determines that monies are available in the Trust Fund for such purpose.

The term "Treasury rate" means a rate determined by the Secretary of the Treasury, taking into consideration current market yields on outstanding marketable obligations of the United States of comparable maturities.

The term "Treasury one-year rate" means a rate determined by the Secretary of the Treasury, taking into consideration current market yields on outstanding marketable obligations of the United States with remaining periods to maturity of approximately one year, to have been in effect as of the close of business one business day prior to the date on which the Trust Fund issues obligations to the Secretary of the Treasury under this provision.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

4. Temporary procedures for excise tax refunds on exported coal (sec. 114 of the Act)

Present Law

In general

Excise tax is imposed on coal, except lignite, produced from mines located in the United States.[400] The producer of the coal is liable for paying the tax to the IRS. Producers generally recover the tax from their purchasers.

The Export Clause of the U.S. Constitution provides that "no Tax or Duty shall be laid on Articles exported from any State."[401] Courts have determined that the Export Clause applies to excise tax on exported coal, and therefore such taxes are subject to a claim for refund.[402] The Supreme Court has ruled that taxpayers seeking a refund of such taxes must proceed under the rules of the Internal Revenue Code.[403]

Claims under the Code

In order to obtain a refund of taxes on exported coal, a claimant must satisfy the following requirements of the Code and case law:

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

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

[402] See *Ranger Fuel Corp.* v. *United States*, 33 F. Supp. 2d 466 (E.D. Va. 1998). The IRS subsequently provided guidance regarding how taxpayers may assure that exported coal would not be subject to excise tax. Notice 2000–28, 2000–1 C.B. 1116.

[403] *United States* v. *Clintwood Elkhorn Mining Co.*, 128 S. Ct. 1511 (April 15, 2008). Prior to the Supreme Court's decision, some courts had allowed taxpayers to bring claims under the Tucker Act, 28 U.S.C. sec. 1491(a), which confers jurisdiction upon the Court of Federal Claims "to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department ...." Lower courts had held that such a Tucker Act claim was subject to the Tucker Act's six-year statute of limitations and was not subject to the requirements of the Code. *Venture Coal Sales Co.* v. *U.S.*, 93 AFTR 2d 2004–2495 (Fed. Cir. 2004); *Cyprus Amax Coal Co.* v. *U.S.*, 205 F.3d 1369 (Fed. Cir. 2000). The Supreme Court held that the stricter rules of the Code apply to these refund claims.

1. A claim for refund must be filed within three years from the time the return was filed, or within two years from the time the tax was paid, whichever period expires later;[404]

2. The person must establish that the goods were in the stream of export when the excise tax was imposed;[405]

3. The claimant must establish that it has borne the tax. More specifically, the claimant must establish that the tax was neither included in the price of the article nor collected from the purchaser (or if so, that the claimant has repaid the amount of tax to the ultimate purchaser), that the claimant has repaid or agreed to repay the tax to the ultimate vendor or has obtained the written consent of such ultimate vendor to the allowance of the claim, or that the claimant has filed the written consent of the ultimate purchaser to the allowance of the claim;[406]

4. In the case of an exporter or shipper of an article exported to a foreign country or shipped to a possession, the amount of tax may be refunded to the exporter or shipper if the person who paid the tax waives its claim to such amount;[407] and

5. A civil action for refund must not be begun before the expiration of six months from the date of filing the claim (unless the claim has been disallowed during that time), nor after the expiration of two years from the date of mailing the notice of claim disallowance.[408]

In 2000, the IRS issued Notice 2000–28,[409] which summarizes its position regarding claims for credits or refunds of excise taxes on exported coal and sets forth procedural rules relating to such claims. Under Notice 2000–28, a coal producer or exporter must provide the following information as part of its claim:

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

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

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

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

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

6. A statement that the claimant:

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

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

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[404] Sec. 6511(a).

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

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

[407] Sec. 6416(c).

[408] Sec. 6532(a).

[409] Notice 2000–28, 2001–1 C.B. 1116.

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

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

With respect to claims under the Code allowed by the IRS or by a court, prejudgment interest is generally allowed.[410]

Reasons for Change[411]

Courts have determined, and the IRS has agreed, that the Federal excise taxes imposed on exported coal was unconstitutionally collected. However, present law does not offer a complete remedy to affected coal producers and exporters, to whom the producers generally passed on the excise tax (in those transactions in which exporters were involved). The recent Supreme Court case of *United States* v. *Clintwood Elkhorn Mining Co.* further limits the available remedies by clarifying that the claims of the coal producers and exporters are subject to the three-year statute of limitations of the Code. The Congress believes that it is appropriate to provide a fair, equitable, and more complete remedy to both the affected coal producers and exporters that permits refunds for these unconstitutionally collected taxes that would otherwise be barred by the applicable statute of limitations.

Explanation of Provision

The provision creates a new procedure under which certain coal producers and exporters may claim a refund of excise taxes imposed on coal exported from the United States. Coal producers or exporters that exported coal during the period beginning on or after October 1, 1990, and ending on or before the date of enactment of the provision, with respect to which a return was filed on or after October 1, 1990, and on or before the date of enactment, and that file a claim for refund not later than the close of the 30-day period beginning on the day of enactment, may obtain a refund from the Secretary of the Treasury of excise taxes paid on such exported coal and any interest accrued from the date of overpayment. Interest on such claims is computed under the Code.[412] The Secretary of the Treasury is required to determine whether to approve the claim within 180 days after such claim is filed, and to pay such claim not later than 180 days after making such determination.

In order to qualify for a refund under the provision, a coal producer must establish that it, or a party related to such coal producer, exported coal produced by such coal producer to a foreign country or shipped coal produced by such coal producer to a U.S.

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[410] See sec. 6611; 28 U.S.C. sec. 2411.

[411] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

[412] See sec. 6621.

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

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

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

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

son, regardless of whether such credit or refund occurs prior to, or after, the date of enactment.

The provision does not confer standing upon an exporter to commence, or intervene in, any judicial or administrative proceeding concerning a claim for refund by a coal producer of any Federal or State tax, fee, or royalty paid by the coal producer. The provision does not confer standing upon a coal producer to commence, or intervene in, any judicial or administrative proceeding concerning a claim for refund by an exporter of any Federal or State tax, fee, or royalty paid by the producer and alleged to have been passed on to an exporter.

Effective Date

The provision applies to claims on coal exported on or after October 1, 1990, through the date of enactment (October 3, 2008), with respect to amounts of tax for which a return was filed on or after October 1, 1990, and on or before the date of enactment (October 3, 2008), and for which a claim for refund is filed not later than the close of the 30-day period beginning on the date of enactment (October 3, 2008).

5. Credit for carbon dioxide sequestration (sec. 115 of the Act and new sec. 45Q of the Code)

Present Law

Taxpayers engaged in petroleum extraction activities may generally deduct qualified tertiary injectant expenses paid or incurred while applying a tertiary recovery method, including carbon dioxide augmented waterflooding and immiscible carbon dioxide displacement.[413] In addition, taxpayers may claim a credit equal to 15 percent of their qualified enhanced oil recovery ("EOR") costs, which include tertiary injectant expenses associated with an EOR project.[414] 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) and is currently phased out.

Explanation of Provision

The provision allows a credit of $20 per metric ton of qualified carbon dioxide that is captured by the taxpayer at a qualified facility and disposed of by such taxpayer in secure geological storage (including storage at deep saline formations and unminable coal seams under such conditions as the Secretary may determine). In addition, the provision allows a credit of $10 per metric ton of qualified carbon dioxide that is captured by the taxpayer at a qualified facility and used by such taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project. Both credit amounts are adjusted for inflation after 2009.

Qualified carbon dioxide is defined under the provision as carbon dioxide captured from an industrial source that (1) would otherwise be released into the atmosphere as an industrial emission of green-

[413] Sec. 193.
[414] Sec. 43.

house gas, and (2) is measured at the source of capture and verified at the point or points of injection. Qualified carbon dioxide includes the initial deposit of captured carbon dioxide used as a tertiary injectant but does not include carbon dioxide that is recaptured, recycled, and re-injected as part of an enhanced oil or natural gas recovery project process. A qualified enhanced oil or natural gas recovery project is a project that would otherwise meet the definition of an EOR project under section 43, if natural gas projects were included within that definition.

Under the provision, a qualified facility means any industrial facility (1) which is owned by the taxpayer, (2) at which carbon capture equipment is placed in service, and (3) which captures not less than 500,000 metric tons of carbon dioxide during the taxable year. The credit applies only with respect to qualified carbon dioxide captured and sequestered or injected in the United States[415] or one of its possessions.[416]

Except as provided in regulations, any credit under the provision is attributable to the person that captures and physically or contractually ensures the disposal, or use as a tertiary injectant, of the qualified carbon dioxide. Any credit allowable under the provision will be recaptured, as provided by regulation, with respect to any qualified carbon dioxide which ceases to be recaptured, disposed of, or used as a tertiary injectant in a manner consistent with the rules of the provision.

The credit is part of the general business credit. The credit sunsets at the end of the calendar year in which the Secretary, in consultation with the Administrator of the Environmental Protection Agency, certifies that 75 million metric tons of qualified carbon dioxide have been captured and disposed of or used as a tertiary injectant.

Effective Date

The provision is effective for carbon dioxide captured after the date of enactment (October 3, 2008).

6. Certain income and gains relating to industrial source carbon dioxide and to alcohol fuels and mixtures, biodiesel fuels and mixtures, and alternative fuels and mixtures treated as qualifying income for purposes of the exception from treatment of publicly traded partnerships as corporations (secs. 116 and 208 of the Act and sec. 7704 of the Code)

Present Law

Partnerships in general

A partnership generally is not treated as a taxable entity (except for certain publicly traded partnerships), but rather, is treated as a pass-through entity. Income earned by a partnership, whether distributed or not, is taxed to the partners.[417] The character of

[415] Sec. 638(1).
[416] Sec. 638(2).
[417] Sec. 701.

partnership items passes through to the partners, as if the items were realized directly by the partners.[418] For example, a partner's share of the partnership's dividend income is generally treated as dividend income in the hands of the partner.

Publicly traded partnerships

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes (sec. 7704(a)). For this purpose, a publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market, or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income.[419] However, this exception does not apply to any partnership that would be described in section 851(a) if it were a domestic corporation, which includes a corporation registered under the Investment Company Act of 1940 as a management company or unit investment trust.

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

Explanation of Provision

The Act provides that qualifying income of a publicly traded partnership includes income or gains from specified activities with respect to industrial source carbon dioxide, including transportation or marketing of industrial source carbon dioxide.

The Act provides that qualifying income of a publicly traded partnership includes income or gains from the transportation or storage of specified fuels. Specifically, the fuels are: (1) Any fuel described in subsection (b), (c), (d) or (e) of section 6426, namely, alcohol fuel mixtures, biodiesel mixtures, alternative fuels (which include liquefied petroleum gas, P Series Fuels, compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process, and liquid fuel derived from biomass), and alternative fuel mixtures; (2) neat alcohol other than alcohol derived from petroleum, natural gas, or coal, or having a

[418] Sec. 702.
[419] Sec. 7704(c)(2).

proof of less than 190 (as defined in section 6426(b)(4)(A)), and (3) neat biodiesel (as defined in section 40A(d)(1)).

Effective Date

The provisions apply to taxable years ending after the date of enactment (October 3, 2008).

7. Carbon audit of provisions of the Internal Revenue Code of 1986 (sec. 117 of the Act)

Present Law

Present law does not require a review of the Code for provisions that affect carbon emissions and climate. The National Research Council is part of the National Academies. The National Academy of Sciences serves to investigate, examine, experiment, and report upon any subject of science whenever called upon to do so by any department of the government. The National Research Council was organized by the National Academy of Sciences in 1916 and is its principal operating agency for conducting science policy and technical work.

Reasons for Change[420]

The Congress believes it is important to identify provisions in the Code which affect carbon dioxide and other greenhouse emissions. This study will provide scientifically-based information to aid decision makers in the formulation of tax policies aimed at reducing emissions and mitigating climate change.

Explanation of Provision

The provision directs the Secretary to request that the National Academy of Sciences undertake a comprehensive review of the Code to identify the types of and specific tax provisions that have the largest effects on carbon dioxide and other greenhouse gas emissions and to generally estimate the magnitude of those effects.[421] The report should identify the provisions of the Code that are most likely to have significant effects on carbon dioxide emissions and discuss the importance of controlling carbon dioxide and greenhouse gas emissions as part of a comprehensive national strategy for reducing U.S. contributions to global climate change.[422] The report will describe the processes by which the tax provisions affect emissions (both directly and indirectly), assess the relative influence of the identified provisions, and evaluate the potential for changes in the Code to reduce carbon dioxide emissions. The report also will identify other provisions of the Code that may have significant influence on other factors affecting climate change.

The Secretary is to submit to Congress a report containing the results of the National Academy of Sciences review within two

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[420] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

[421] A detailed quantitative analysis is not required. It is envisioned that the review will catalogue and provide a general analysis of the effect of each identified provision.

[422] "Greenhouse gas emissions" include, but are not limited to, methane, nitrous oxide, ozone, and fluorinated hydrocarbons.

years of the date of enactment. The provision authorizes the appropriation of $1,500,000 to carry out the review.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

TITLE II—TRANSPORTATION AND DOMESTIC FUEL SECURITY PROVISIONS

A. Inclusion of Cellulosic Biofuel in Bonus Depreciation for Biomass Ethanol Plant Property (sec. 201 of the Act and sec. 168(l) of the Code)

Present Law

Section 168(l) allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified cellulosic biomass ethanol plant property. In order to qualify, the property generally must be placed in service before January 1, 2013.

Qualified cellulosic biomass ethanol plant property means property used in the U.S. solely to produce cellulosic biomass ethanol. For this purpose, cellulosic biomass ethanol means ethanol derived from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis. For example, lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis includes bagasse (from sugar cane), corn stalks, and switchgrass.

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service. The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or subject to capitalization under section 263 or section 263A. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

In order for property to qualify for the additional first-year depreciation deduction, it must meet the following requirements. The original use of the property must commence with the taxpayer on or after December 20, 2006. The property must be acquired by purchase (as defined under section 179(d)) by the taxpayer after December 20, 2006, and placed in service before January 1, 2013. Property does not qualify if a binding written contract for the acquisition of such property was in effect on or before December 20, 2006.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after December 20, 2006, and the property is placed in service before

January 1, 2013 (and all other requirements are met). Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

Property any portion of which is financed with the proceeds of a tax-exempt obligation under section 103 is not eligible for the additional first-year depreciation deduction. Recapture rules apply if the property ceases to be qualified cellulosic biomass ethanol plant property.

Property with respect to which the taxpayer has elected 50 percent expensing under section 179C is not eligible for the additional first-year depreciation deduction.

Reasons for Change[423]

The Congress believes that the expensing provision should include any cellulosic biofuel and not be limited to ethanol. Additionally, the Congress believes that the provision should not be limited to certain processes.

Explanation of Provision

The provision changes the definition of qualified property. Under the provision, qualified property includes cellulosic biofuel, which is defined as any liquid fuel which is produced from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis.

Effective Date

The provision is effective for property placed in service after the date of enactment (October 3, 2008), in taxable years ending after such date.

B. Credits for Biodiesel and Renewable Diesel (sec. 202 of the Act and secs. 40A, 6426, and 6427 of the Code)

Present Law

Income tax credit

Overview

The Code provides an income tax credit for biodiesel fuels (the "biodiesel fuels credit").[424] The biodiesel fuels credit is the sum of three credits: (1) the biodiesel mixture credit, (2) the biodiesel credit, and (3) the small agri-biodiesel producer credit. The biodiesel fuels credit 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 does not apply to fuel sold or used after December 31, 2008.

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[423] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

[424] Sec. 40A.

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 ("ASTM") 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 that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.

Biodiesel mixture credit

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

Small agri-biodiesel producer credit

The Code provides a small agri-biodiesel producer income tax credit, in addition to the biodiesel and biodiesel fuel mixture credits. 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 agri-biodiesel in the fuel tank of such other person; or (2) be used by the producer for any purpose described in (a), (b), or (c).

Biodiesel mixture excise tax credit

The Code also provides an excise tax credit for biodiesel mixtures.[425] 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.[426]

The credit is not available for any sale or use for any period after December 31, 2008. 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.[427] Such a payment is required only to the extent the biodiesel fuel mixture credit exceeds the person's section 4081 liability. Thus, the credit is refundable to the extent it exceeds the person's section 4081 liability. The Secretary is not required to make payments with respect to biodiesel fuel mixtures sold or used after December 31, 2008.

Renewable diesel

"Renewable diesel" is diesel fuel that (1) is derived from biomass (as defined in section 45K(c)(3)) using a thermal depolymerization process; (2) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency ("EPA") under section 211 of the Clean Air Act (42 U.S.C. sec. 7545); and (3) meets the requirements of the ASTM D975 or D396. ASTM D975 provides standards for diesel fuel suitable for use in diesel engines. ASTM D396 provides standards for fuel oil intended for use in fuel-oil burning equipment, such as furnaces.

For purposes of the Code, renewable diesel is generally treated the same as biodiesel. Like biodiesel, the incentive may be taken as an income tax credit, an excise tax credit, or as a payment from the Secretary.[428] The incentive for renewable diesel is $1.00 per gallon. There is no small producer credit for renewable diesel. The incentives for renewable diesel expire after December 31, 2008.

Pursuant to IRS Notice 2007–37, the Secretary provided that fuel produced as a result of co-processing biomass and petroleum feedstock ("co-produced fuel") qualifies for the renewable diesel incentives to the extent of the fuel attributable to the biomass in the mixture. In co-produced fuel, the fuel attributable to the biomass does not exist as a distinct separate quantity prior to mixing.

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[425] Sec. 6426(c).
[426] Sec. 6426(c)(4).
[427] Sec. 6427(e).
[428] Secs. 40A(f), 6426(c), and 6427(e).

Reasons for Change[429]

The Congress believes it is appropriate to extend the biodiesel and renewable diesel incentives for an additional year to further encourage the development and use of these fuels. With respect to renewable diesel, the Congress believes that the incentive should be technology neutral, and therefore, the Congress deletes the requirement that the fuel be made through a thermal depolymerization process. While the Congress is unaware of an appropriate standard in addition to ASTM D975 and ASTM D396 for renewable diesel, the Congress recognizes that as technology evolves, other appropriate standards may arise for such fuel and therefore, the provision permits the Secretary to identify other equivalent or improved standards for renewable diesel.

Explanation of Provision

The provision extends an additional year (through December 31, 2009) the income tax credit, excise tax credit, and payment provisions for biodiesel (including agri-biodiesel) and renewable diesel. The provision provides that both biodiesel and agri-biodiesel are entitled to a credit of $1.00 per gallon.

The provision modifies the definition of renewable diesel. The provision eliminates the requirement that the fuel be made using a thermal depolymerization process. The provision also permits the Secretary to identify standards equivalent to ASTM D975 and ASTM D396 for renewable diesel. Thus, under the provision, renewable diesel is liquid fuel derived from biomass which meets (a) the registration requirements for fuels and fuel additives established by the EPA under section 211 of the Clean Air Act, and (b) the requirements of the ASTM D975, ASTM D396, or other equivalent standard approved by the Secretary. The provision also provides that renewable diesel includes biomass fuel that meets a Department of Defense military specification for jet fuel or an ASTM for aviation turbine fuel.

The provision also overrides IRS Notice 2007–37 with respect to co-produced fuel, providing that renewable diesel does not include any fuel derived from co-processing biomass with a feedstock that is not biomass. The de minimis use of catalysts, such as hydrogen, is permitted under the provision.

Effective Date

The provision is generally effective for fuel produced, and sold or used, after December 31, 2008. The provision making co-produced fuel ineligible for the renewable diesel incentives is effective for fuel produced, and sold or used, after the date of enactment (October 3, 2008).

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[429] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

C. Clarification That Credits for Fuel Are Designed To Provide an Incentive for United States Production (sec. 203 of the Act and secs. 40, 40A, 6426 and 6427 of the Code)

Present Law

The Code provides per-gallon incentives relating to the following qualified fuels: alcohol (including ethanol), biodiesel (including agri-biodiesel), renewable diesel, and certain alternative fuels.[430] The incentives may be taken as an income tax credit, excise tax credit or payment. The provisions are coordinated so that a gallon of qualified fuel is only taken into account once. If the qualified fuel is part of a qualified fuel mixture, the incentives apply only to the amount of qualified fuel in the mixture.

For alcohol, other than ethanol, the amount of the credit is 60 cents per gallon. For ethanol, the credit is generally 51 cents per gallon, an extra 10 cents per gallon available for small ethanol producers. The alcohol incentives expire after December 31, 2010. The amount of the credit for biodiesel is 50 cents. For agri-biodiesel and renewable diesel, the credit amount is $1.00 per gallon. An extra 10 cents per gallon is available for small producers of agri-biodiesel. The biodiesel, agri-biodiesel and renewable diesel incentives expire after December 31, 2008. The credit amount for alternative fuels is 50 cents per gallon. The incentives for alternative fuels expire after September 30, 2009 (after September 30, 2014, in the case of liquefied hydrogen).

The Code is silent as to the geographic limitations on where the fuel must be produced, used, or sold.

Reasons for Change[431]

Alternative fuels are a significant component of establishing the nation's independence from foreign oil. The fuel incentives were not intended to subsidize fuels with no nexus to the United States. The Congress is aware of situations in which foreign-produced fuel is imported into the United States, mixed with a small amount of diesel fuel, in order to qualify for the credit for qualified biodiesel fuel mixtures, and then the fuel is exported. This practice does not contribute to establishing the country's fuel independence, therefore the provision denies the fuel credits and payments to such fuel.

Explanation of Provision

The provision provides that fuel that is produced outside the United States for use as a fuel outside the United States is ineligible for the per-gallon tax incentives relating to alcohol, biodiesel, renewable diesel, and alternative fuel. For example, fuel in the following situations is ineligible for incentives: (1) biodiesel, which is not in a mixture, that is both produced and used outside the United States, (2) foreign-produced biodiesel that is used to make a qualified mixture outside of the United States for foreign use, and (3) foreign-produced biodiesel that is used to make a qualified mixture in the United States that is then exported for foreign use.

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[430] See secs. 40, 40A, 6426, and 6427(e).

[431] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

Effective Date

The provision is effective for claims for credit or payment made on or after May 15, 2008.

D. Extension and Modification of Alternative Fuel Credit (sec. 204 of the Act and secs. 6426 and 6427 of the Code)

Present Law

The Code provides two per-gallon excise tax credits with respect to alternative fuel, the alternative fuel credit, and the alternative fuel mixture credit. For this purpose, the term "alternative fuel" means liquefied petroleum gas, P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)), compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process, or liquid hydrocarbons derived from biomass. Such term does not include ethanol, methanol, or biodiesel.

The alternative fuel credit is allowed against section 4041 liability and the alternative fuel mixture credit is allowed against section 4081 liability. Neither credit is allowed unless the taxpayer is registered with the Secretary. The alternative fuel credit is 50 cents per gallon of alternative fuel or gasoline gallon equivalents[432] of nonliquid alternative fuel sold by the taxpayer for use as a motor fuel in a motor vehicle or motorboat, or so used by the taxpayer.

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 producing such mixture to any person for use as a fuel or used by the taxpayer for use as a fuel. The credits generally expire after September 30, 2009.

A person may 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 liquefied hydrogen, the credit and payment provisions expire after September 30, 2014. 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.

Explanation of Provision

The provision extends the alternative fuel excise tax credit, alternative fuel mixture excise tax credit and related payment provisions an additional three months (through December 31, 2009) for all fuels other than hydrogen. The incentives for hydrogen are unchanged by the provision and will expire as provided under present law. The provision provides that liquefied or compressed biomass gas qualifies for the credit. The provision also provides that alter-

[432] "Gasoline gallon equivalent" means, with respect to any nonliquid alternative fuel, the amount of such fuel having a Btu content of 124,800 (higher heating value).

native fuel that is not in a mixture may be used, or sold for use, as a fuel in aviation for purposes of the credit.

For fuel produced after September 30, 2009, to qualify as an alternative fuel, liquid fuel from coal derived through the Fischer-Tropsch process must be certified as having been derived from coal produced at a gasification facility that separates and sequesters at least 50 percent of such facility's total carbon dioxide emissions. The sequestration requirement increases to 75 percent on December 31, 2009.

Effective Date

The provision is effective for fuel sold or used after the date of enactment (October 3, 2008).

E. Alternative Motor Vehicle Credit and Plug-In Electric Vehicle Credit (sec. 205 of the Act and sec. 30B and new sec. 30D of the Code)

Present Law

In general

A credit is available for each new qualified fuel cell vehicle, hybrid vehicle, advanced lean burn technology vehicle, and alternative fuel vehicle placed in service by the taxpayer during the taxable year.[433] In general, the credit amount varies depending upon the type of technology used, the weight class of the vehicle, the amount by which the vehicle exceeds certain fuel economy standards, and, for some vehicles, the estimated lifetime fuel savings. The credit generally is available for vehicles purchased after 2005. The credit terminates after 2009, 2010, or 2014, depending on the type of vehicle.

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-exempt organizations, 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.

Fuel cell vehicles

A qualified fuel cell vehicle is a motor vehicle that is propelled by power derived from one or more cells that convert chemical energy directly into electricity by combining oxygen with hydrogen fuel that is stored on board the vehicle and may or may not require reformation prior to use. A qualified fuel cell vehicle must be purchased before January 1, 2015. 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

[433] Sec. 30B.

2002 model year city fuel economy rating for vehicles of various weight classes.[434] Table 2, below, shows the base credit amounts.

TABLE 2.—BASE CREDIT AMOUNT FOR FUEL CELL VEHICLES

Vehicle gross weight rating (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 2, above, is reduced to $4,000.

Table 3, below, shows the additional credits for passenger automobiles or light trucks.

TABLE 3.—CREDIT FOR QUALIFIED 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 vehicles and advanced lean burn technology vehicles

Qualified hybrid vehicles

A qualified hybrid vehicle is a motor vehicle that draws propulsion energy from on-board sources of stored energy that include both an internal combustion engine or heat engine using combustible fuel and a rechargeable energy storage system (e.g., batteries). A qualified hybrid vehicle must be placed in service before January 1, 2011 (January 1, 2010 in the case of a hybrid 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: (1) a fuel economy credit amount that varies with the rated fuel economy of the vehicle compared to a 2002 model year standard and (2) a conservation credit based on the estimated lifetime fuel savings of the qualified vehicle compared to a comparable 2002 model year vehicle that is powered solely by a gasoline or diesel internal combustion engine. A qualified hybrid automobile or light truck must have a maximum available power 1A[435] from the rechargeable energy storage system

[434] See discussion surrounding Table 7, below.

[435] For hybrid passenger vehicles and light trucks, the term "maximum available power" means the maximum power available from the rechargeable energy storage system, during a

Continued

of at least four percent. In addition, the vehicle must meet or exceed certain Environmental Protection Agency ("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 4, 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 4.—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 5, below, shows the conservation credit.

TABLE 5.—CONSERVATION CREDIT

Estimated lifetime fuel savings (gallons of gasoline)	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 vehicles

The amount of credit for the purchase of an advanced lean burn technology vehicle is the sum of two components: (1) 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 4, above, and (2) a conservation credit based on the estimated lifetime fuel savings of a qualified vehicle compared to a comparable 2002 model year vehicle as described in Table 5, above. The amounts of the credits are determined after an adjustment is made to account for the different BTU content of gasoline and the fuel utilized by the lean burn technology vehicle.

A qualified advanced lean burn technology vehicle is a passenger automobile or a light truck that incorporates direct injection, achieves at least 125 percent of the 2002 model year city fuel economy, and for 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

standard 10 second pulse power or equivalent test, divided by such maximum power and the SAE net power of the heat engine. Sec. 30B(d)(3)(C)(i).

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 qualified advanced lean burn technology vehicle must be placed in service before January 1, 2011.

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

There is a limitation on the number of passenger and light truck qualified hybrid vehicles and advanced lean burn technology 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 the 60,000th hybrid and advanced lean burn technology vehicle sale occurring after December 31, 2005. 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, for example, summing the sales of qualified hybrid vehicles that are passenger vehicles or light trucks and all sales of qualified advanced lean burn technology vehicles, if a manufacturer records the sale of its 60,000th qualified vehicle in February of 2007, taxpayers purchasing such vehicles from the manufacturer may claim the full amount of the credit on their purchases of qualified 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 qualified 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 qualified vehicles of the manufacturer. After June 30, 2008, no credit may be claimed for purchases of such hybrid vehicles or advanced lean burn technology vehicles sold by the manufacturer.

Hybrid vehicles that are medium and heavy trucks

In the case of a qualified hybrid 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 qualified hybrid 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 qualified hybrid 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 qualified hybrid vehicle weighing more than 26,000 pounds, the maximum allowable incremental cost amount is $30,000.

A qualified hybrid 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 qualified 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.[436]

Alternative fuel vehicle

The credit for the purchase of a new alternative fuel vehicle is 50 percent of the incremental cost of such vehicle, plus an additional 30 percent if the vehicle meets certain emissions standards. The incremental cost of any new qualified alternative fuel vehicle is the excess of the manufacturer's suggested retail price for such vehicle over the price for a gasoline or diesel fuel vehicle of the same model. To be eligible for the credit, a qualified alternative fuel vehicle must be purchased before January 1, 2011.

The amount of the credit varies depending on the weight of the qualified vehicle. The credit is subject to certain maximum applicable incremental cost amounts. Table 6, below, shows the maximum permitted incremental cost for the purpose of calculating the credit for alternative fuel vehicles by vehicle weight class as well as the maximum credit amount for such vehicles.

TABLE 6.—MAXIMUM ALLOWABLE INCREMENTAL COST FOR CALCULATION OF ALTERNATIVE FUEL VEHICLE CREDIT

Vehicle gross weight rating (pounds)	Maximum allowable incremental cost	Maximum allowable credit
Vehicle ≤ 8,500	$5,000	$4,000
8,500 < vehicle ≤ 14,000	10,000	8,000
14,000 < vehicle ≤ 26,000	25,000	20,000
26,000 < vehicle	40,000	32,000

Alternative fuels comprise compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, and any liquid fuel that is at least 85 percent methanol. Qualified alternative fuel vehicles are vehicles that operate only on qualified alternative fuels and are incapable of operating on gasoline or diesel (except to 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

[436] 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.

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 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 by vehicle type and vehicle inertia weight class. For this purpose, "vehicle inertia weight class" has the same meaning as when defined in regulations prescribed by the EPA 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
7,000	11.3	12.1
8,500	11.3	12.1

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.

Reasons for Change[437]

The Congress believes that further investments in advanced technology vehicles are necessary to transform automotive transportation in the United States to be cleaner, more fuel efficient, and less reliant on petroleum fuels. Tax benefits provided directly to the consumer to lower the cost of new technology and alternative-fuel vehicles can help lower consumer resistance to these technologies by making the vehicles more price competitive with purely petroleum-based fuel vehicles and creating increased demand for manufacturers to produce the technologies. The even-

[437] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

tual goal is mass production and mass-market acceptance of new technology vehicles. To this end, the Congress believes the present-law incentives for alternative fuel vehicles should be expanded to include benefits for plug-in electric drive vehicles, which the Congress believes are the next generation of alternative-fuel vehicles.

Explanation of Provision

The provision allows a credit for each qualified plug-in electric drive motor vehicle placed in service. A qualified plug-in electric drive motor vehicle is a motor vehicle that meets certain emissions standards (except for certain heavy vehicles), draws propulsion using a traction battery with at least four kilowatt-hours of capacity, and is capable of being recharged from an external source of electricity.

The base amount of the plug-in electric drive motor vehicle credit is $2,500, plus another $417 for each kilowatt-hour of battery capacity in excess of four kilowatt-hours. The maximum credit for qualified vehicles weighing 10,000 pounds or less is $7,500. This maximum amount increases to $10,000 for vehicles weighing more than 10,000 pounds but not more than 14,000 pounds, to $12,500 for vehicles weighing more than 14,000 pounds but not more than 26,000 pounds, and to $15,000 for vehicle weighing more than 26,000 pounds.

In general, the credit is available to the vehicle owner, including the lessor of a vehicle subject to lease. If the qualified vehicle is used by certain tax-exempt organizations, governments, or 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.

Once a total of 250,000 credit-eligible vehicles have been sold for use in the United States, the credit phases out over four calendar quarters. The phaseout period begins in the second calendar quarter following the quarter during which the vehicle cap has been reached. Taxpayers may claim one-half of the otherwise allowable credit during the first two calendar quarters of the phaseout period and twenty-five percent of the otherwise allowable credit during the next two quarters. After this, no credit is available.

The basis of any qualified vehicle is reduced by the amount of the credit. To the extent a vehicle is eligible for credit as a qualified plug-in electric drive motor vehicle, it is not eligible for credit as a qualified hybrid vehicle under section 30B. The portion of the credit attributable to vehicles of a character subject to an allowance for depreciation is treated as part of the general business credit; the nonbusiness portion of the credit is allowable to the extent of the excess of the regular tax and the alternative minimum tax (reduced by certain other credits) for the taxable year.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

F. Exclusion From Heavy Vehicle Excise Tax for Idling Reduction Units and Advanced Insulation (sec. 206 of the Act and sec. 4053 of the Code)

Present Law

A 12 percent excise tax (the "heavy vehicle excise tax") is imposed on the first retail sale of automobile truck chassis and bodies, truck trailer and semitrailer chassis and bodies, and tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.[438] The heavy vehicle excise tax does not apply to automobile truck chassis and bodies suitable for use with a vehicle which has a gross vehicle weight of 33,000 pounds or less. The tax also does not apply to truck trailer and semitrailer chassis and bodies suitable for use with a trailer or semitrailer which has a gross vehicle weight of 26,000 pounds or less, or to tractors having a gross vehicle weight of 19,500 pounds or less if such tractor in combination with a trailer or semitrailer has a gross combined weight of 33,000 pounds or less.

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

Reasons for Change[439]

Idling of the main drive engine of heavy trucks consumes significant amounts of fuel. For example, truckers may continue to engage the main drive engines during rest periods to continue running air conditioning, heat, or electric appliances during rest stops. The Congress believes it is appropriate to provide an exemption from the heavy vehicle excise tax for qualified idling reduction devices, as such devices could lower fuel consumption, as well as reduce emissions.

Explanation of Provision

The provision provides an exemption from the heavy vehicle excise tax for the cost of qualifying idling reduction devices. A qualifying idling reduction device means any device or system of devices that (1) is designed to provide to a vehicle those services (such as heat, air conditioning, or electricity), which would otherwise require the operation of the main drive engine while the vehicle is temporarily parked or remains stationary, by using one or more devices affixed to a tractor, and (2) is determined by the Administrator of the Environmental Protection Agency, in consultation with the Secretary of Energy and the Secretary of Transportation, to reduce idling of such vehicle at a motor vehicle rest stop or other location where such vehicles are temporarily parked or remain stationary.

The provision also provides an exemption for the installation of "advanced insulation" in a commercial refrigerated truck or trailer that is subject to the heavy vehicle excise tax. Advanced insulation

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[438] Sec. 4051.

[439] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

means insulation that has an R value of not less than R35 per inch.

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

Effective Date

The provision is effective for retail sales or installations made after the date of enactment (October 3, 2008).

G. Extension and Modification of Alternative Fuel Vehicle Refueling Property Credit (sec. 207 of the Act and sec. 30C of the Code)

Present Law

Taxpayers may claim a 30-percent credit for the cost of installing qualified 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.[440] The credit may not exceed $30,000 per taxable year per location, in the case of qualified refueling property used in a trade or business and $1,000 per taxable year per location, in the case of qualified refueling property installed on property which is used as a principal residence.

Qualified refueling property is property (not including a building or its structural components) for the storage or dispensing of a clean-burning fuel into the fuel tank of a motor vehicle propelled by such fuel, but only if the storage or dispensing of the fuel is at the point where such fuel is delivered into the fuel tank of the motor vehicle. The use of such property must begin with the taxpayer.

Clean-burning 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, or hydrogen. In addition, any mixture of biodiesel and diesel fuel, determined without regard to any use of kerosene and containing at least 20 percent biodiesel, qualifies as a clean fuel.

Credits for qualified refueling property used in a trade or business are part of the general business credit and may be carried back for one year and forward for 20 years. Credits for residential qualified refueling property cannot exceed for any taxable year the difference between the taxpayer's regular tax (reduced by certain other credits) and the taxpayer's tentative minimum tax. Generally, in the case of qualified refueling property sold to a tax-exempt entity, the taxpayer selling the property may claim the credit.

A taxpayer's basis in qualified refueling property is reduced by the amount of the credit. In addition, no credit is available for property used outside the United States or for which an election to expense has been made under section 179.

The credit is available for property placed in service after December 31, 2005, and (except in the case of hydrogen refueling property) before January 1, 2010. In the case of hydrogen refueling

[440] Sec. 30C.

property, the property must be placed in service before January 1, 2015.

Reasons for Change[441]

The Congress believes that widespread adoption of advanced technology and alternative-fuel vehicles is necessary to transform automotive transportation in the United States to be cleaner, more fuel efficient, and less reliant on petroleum fuels. The Congress further believes that one important method to encourage this trend is to provide additional tax incentives for the development and installation of the infrastructure necessary to deliver clean fuels to drivers of clean-fuel vehicles.

Explanation of Provision

The provision extends and modifies the credit for installing alternative fuel refueling property. The provision extends for one year (through 2010) the credit for installing non-hydrogen alternative fuel refueling property. The provision also expands the definition of credit-eligible property to include property designed to recharge an electrically propelled vehicle with electricity.

Effective Date

The provision is effective for property placed in service after the date of enactment (October 3, 2008), in taxable years ending after such date.

H. Extension and Modification of Election To Expense Certain Refineries (sec. 209 of the Act and sec. 179C of the Code)

Present Law

In general

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[442] 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.

A small business refiner (as defined by sec. 45H(c)(1)) may elect to expense 75 percent of qualified capital costs (as defined by sec. 45H(c)(2)) related to compliance with the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency

[441] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).
[442] Sec. 168.

("EPA") which are paid or incurred by the taxpayer during the taxable year.[443]

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[444] 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.[445] 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.

Election to expense certain refineries

Section 179C provides a temporary election to expense 50 percent of qualified refinery property.[446] The remaining 50 percent is recovered as under present law. 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;[447] (2) which are placed in service before January 1, 2012; (3) which increase the capacity of an existing refinery by at least five percent[448] or increase the percentage of total throughput[449] attributable to qualified fuels (as defined in section 45K(c)) 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.[450]

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. 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

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[443] Sec. 179B.

[444] Sec. 1381, et seq.

[445] Sec. 1382.

[446] 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 section 45(c)). The limitation of section 45K(d) 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 includes a facility which processes coal via gas into liquid fuel.

[447] This requirement also may be met by placing the property in service before January 1, 2008 or, in the case of self-constructed property, by beginning construction after June 14, 2005 and before January 1, 2008.

[448] 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.

[449] For purposes of the provision, the throughput of a refinery is measured on the basis of barrels per calendar day. Barrels per calender day is the amount of fuels that a facility can process under usual operating conditions, expressed in terms of capacity during a 24-hour period and reduced to account for down time and other limitations.

[450] 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.

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 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. Under the provision, 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.

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

Explanation of Provision

The provision extends the qualified refinery property placed in service requirement to January 1, 2014, and the binding construction contract requirement to January 1, 2010.

The provision also expands the primary purpose test in the definition of qualified refinery to include the processing of shale or tar sands. The production capacity test for processing qualified fuels is also expanded to include the processing of shale or tar sands.

Effective Date

The provision is effective for property placed in service after the date of enactment (October 3, 2008).

I. Extension of Suspension of Taxable Income Limit on Percentage Depletion for Oil and Natural Gas Produced from Marginal Properties (sec. 210 of the Act and sec. 613A of the Code)

Present Law

The Code permits taxpayers to recover their investments in oil and gas wells through depletion deductions. Two methods of depletion are currently allowable under the Code: (1) the cost depletion method, and (2) the percentage depletion method. Under the cost depletion method, the taxpayer deducts that portion of the adjusted basis of the depletable property which is equal to the ratio of units sold from that property during the taxable year to the number of units remaining as of the end of taxable year plus the number of units sold during the taxable year. Thus, the amount recovered under cost depletion may never exceed the taxpayer's basis in the property.

The Code generally limits the percentage depletion method for oil and gas properties to independent producers and royalty owners. Generally, under the percentage depletion method, 15 percent of

the taxpayer's gross income from an oil- or gas-producing property is allowed as a deduction in each taxable year. The amount deducted generally may not exceed 100 percent of the taxable income from that property in any year. For marginal production, the 100-percent taxable income limitation has been suspended for taxable years beginning after December 31, 1997, and before January 1, 2008.

Marginal production is defined as domestic crude oil and natural gas production from stripper well property or from property substantially all of the production from which during the calendar year is heavy oil. Stripper well property is property from which the average daily production is 15 barrel equivalents or less, determined by dividing the average daily production of domestic crude oil and domestic natural gas from producing wells on the property for the calendar year by the number of wells. Heavy oil is domestic crude oil with a weighted average gravity of 20 degrees API or less (corrected to 60 degrees Fahrenheit).

Explanation of Provision

The provision provides the present law taxable income limitation suspension provision for marginal production for taxable years beginning after December 31, 2008, and before January 1, 2010.

Effective Date

The provision applies to taxable years beginning after December 31, 2008.

J. Extension of Transportation Fringe Benefit to Bicycle Commuters (sec. 211 of the Act and sec. 132(f) of the Code)

Present Law

Qualified transportation fringe benefits provided by an employer are excluded from an employee's gross income.[451] Qualified transportation fringe benefits include parking, transit passes, and vanpool benefits. In addition, no amount is includible in income of an employee merely because the employer offers the employee a choice between cash and qualified transportation fringe benefits. Up to $220 (for 2008) per month of employer-provided parking is excludable from income. Up to $115 (for 2008) per month of employer-provided transit and vanpool benefits are excludable from gross income. These amounts are indexed annually for inflation, rounded to the nearest multiple of $5.

Under present law, qualified transportation fringe benefits include a cash reimbursement by an employer to an employee. However, in the case of transit passes, a cash reimbursement is considered a qualified transportation fringe benefit only if a voucher or similar item which may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee.

[451] Sec. 132(f).

Reasons for Change[452]

As part of a package of alternatives to reduce the nation's reliance on fossil fuels and to encourage conservation of energy resources, the exclusion from gross income for qualified transportation fringe benefits should be extended to cover expenses incurred by an employee in commuting to work by bicycle. Bicycle commuting achieves both goals of reducing fossil fuel reliance and encouraging conservation. Such commuting involves recurring expenses and incentives should be provided to encourage this nonmotorized form of commuting.

Explanation of Provision

The provision adds a qualified bicycle commuting reimbursement fringe benefit as a qualified transportation fringe benefit. A qualified bicycle commuting reimbursement fringe benefit means, with respect to a calendar year, any employer reimbursement during the 15-month period beginning with the first day of such calendar year of an employee for reasonable expenses incurred by the employee during the calendar year for the purchase and repair of a bicycle, bicycle improvements, and bicycle storage, provided that the bicycle is regularly used for travel between the employee's residence and place of employment.

The maximum amount that can be excluded from an employee's gross income for a calendar year on account of a bicycle commuting reimbursement fringe benefit is the applicable annual limitation for the employee for that calendar year. The applicable annual limitation for an employee for a calendar year is equal to the product of $20 multiplied by the number of the employee's qualified bicycle commuting months for the year. The $20 amount is not indexed for inflation. A qualified bicycle commuting month means with respect to an employee any month for which the employee does not receive any other qualified transportation fringe benefit and during which the employee regularly uses a bicycle for a substantial portion of travel between the employee's residence and place of employment. Thus, no amount is credited towards an employee's applicable annual limitation for any month in which an employee's usage of a bicycle is infrequent or constitutes an insubstantial portion of the employee's commute.

A bicycle commuting reimbursement fringe benefit cannot be funded by an elective salary contribution on the part of an employee.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

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[452] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

TITLE III—ENERGY CONSERVATION AND EFFICIENCY PROVISIONS

A. Qualified Energy Conservation Bonds (sec. 301 of the Act and new sec. 54D of the Code)

Present Law

Tax-exempt bonds

In general

Subject to certain Code restrictions, interest paid on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes. Bonds issued by State and local governments 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 which are repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons. For this purpose, the term "nongovernmental person" generally includes the Federal Government and all other individuals and entities other than States or local governments. The exclusion from income for interest on State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") and other Code requirements are met.

Private activity bond tests

Present law provides two tests for determining whether a State or local bond is in substance a private activity bond, the private business test and the private loan test.[453]

Private business tests

Private business use and private payments result in State and local bonds being private activity bonds if both parts of the two-part private business test are satisfied—

- More than 10 percent of the bond proceeds is to be used (directly or indirectly) by a private business (the "private business use test"); and
- More than 10 percent of the debt service on the bonds is secured by an interest in property to be used in a private business use or to be derived from payments in respect of such property (the "private payment test").[454]

[453] Sec. 141(b) and (c).

[454] The 10-percent private business use and payment threshold is reduced to five percent for private business uses that are unrelated to a governmental purpose also being financed with proceeds of the bond issue. In addition, as described more fully below, the 10-percent private business use and private payment thresholds are phased-down for larger bond issues for the fi-

Private business use generally includes any use by a business entity (including the Federal Government), which occurs pursuant to terms not generally available to the general public. For example, if bond-financed property is leased to a private business (other than pursuant to certain short-term leases for which safe harbors are provided under Treasury regulations), bond proceeds used to finance the property are treated as used in a private business use, and rental payments are treated as securing the payment of the bonds. Private business use also can arise when a governmental entity contracts for the operation of a governmental facility by a private business under a management contract that does not satisfy Treasury regulatory safe harbors regarding the types of payments made to the private operator and the length of the contract.[455]

Private loan test

The second standard for determining whether a State or local bond is a private activity bond is whether an amount exceeding the lesser of (1) five percent of the bond proceeds or (2) $5 million is used (directly or indirectly) to finance loans to private persons. Private loans include both business and other (e.g., personal) uses and payments by private persons; however, in the case of business uses and payments, all private loans also constitute private business uses and payments subject to the private business test. Present law provides that the substance of a transaction governs in determining whether the transaction gives rise to a private loan. In general, any transaction which transfers tax ownership of property to a private person is treated as a loan.

Qualified private activity bonds

As stated, interest on private activity bonds is taxable unless the bonds meet the requirements for qualified private activity bonds. Qualified private activity bonds permit States or local governments to act as conduits providing tax-exempt financing for certain private activities. Qualified private activity bonds include exempt facility, qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), and student loan bonds.[456] The definition of exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities.[457]

In most cases, the aggregate volume of tax-exempt qualified private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar

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nancing of certain "output" facilities. The term output facility includes electric generation, transmission, and distribution facilities.

[455] See Treas. Reg. sec. 1.141–3(b)(4) and Rev. Proc. 97–13, 1997–1 C.B. 632.

[456] Sec. 141(e).

[457] Sec. 142(a).

year 2008, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $262.09 million, if greater.

Arbitrage restrictions

The exclusion from income for interest on State and local bonds does not apply to any arbitrage bond.[458] 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.[459] 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.

Indian tribal governments

Indian tribal governments are provided with a tax status similar to State and local governments for specified purposes under the Code.[460] Among the purposes for which a tribal government is treated as a State is the issuance of tax-exempt bonds. However, bonds issued by tribal governments are subject to limitations not imposed on State and local government issuers. Tribal governments are authorized to issue tax-exempt bonds only if substantially all of the proceeds are used for essential governmental functions or certain manufacturing facilities.[461]

Clean renewable energy bonds

As an alternative to traditional tax-exempt bonds, States and local governments may issue clean renewable energy bonds ("CREBs"). CREBs are defined as any bond issued by a qualified issuer if, in addition to the requirements discussed below, 95 percent or more of the proceeds of such bonds are used to finance capital expenditures incurred by qualified borrowers for qualified projects. "Qualified projects" are facilities that qualify for the tax credit under section 45 (other than Indian coal production facilities), without regard to the placed-in-service date requirements of that section.[462] The term "qualified issuers" includes (1) governmental bodies (including Indian tribal governments); (2) mutual or cooperative electric companies (described in section 501(c)(12) or section 1381(a)(2)(C), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act); and (3) clean renewable energy bond lenders. The term "qualified borrower" includes a governmental body (including an Indian tribal government) and a mutual or cooperative electric company. A clean renewable energy bond lender means a cooperative which is owned

[458] Sec. 103(a) and (b)(2).
[459] Sec. 148.
[460] Sec. 7871.
[461] Sec. 7871(c).
[462] In addition, Notice 2006–7 provides that qualified projects include any facility owned by a qualified borrower that is functionally related and subordinate to any facility described in section 45(d)(1) through (d)(9) and owned by such qualified borrower.

by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002.

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

CREBs are subject to a maximum maturity limitation. The maximum maturity is the term which the Secretary estimates will result in the present value of the obligation to repay the principal on a CREBs being equal to 50 percent of the face amount of such bond. In addition, the Code requires level amortization of CREBs during the period such bonds are outstanding.

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

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

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

Qualified tax credit bonds

Section 54A of the Code sets forth general rules applicable to qualified tax credit bonds, (defined as qualified forestry conservation bonds meeting certain requirements specified in section 54A). Section 54A sets forth requirements regarding the expenditure of available project proceeds, reporting, arbitrage, maturity limitations, and financial conflicts of interest, among other special rules.

Reasons for Change[463]

The Congress believes that it is important to encourage energy conservation. The Congress believes that State and local governments often are in the best position to assess community needs and recognizes there are a number of approaches to energy conservation that State and local governments may wish to encourage. For example, the Congress recognizes that State and local governments may wish to encourage the development of combined heat and power systems, facilities that use thermal energy produced from renewable resources, smart electrical grids, the use of solar panels, mass transit, bicycle paths, or residential property that reduces peak-use of energy. In addition to these approaches, the Congress believes that State and local governments will develop numerous other approaches to energy conservation. Furthermore, the Congress recognizes that there is great potential for energy conservation in urban areas and the Congress believes that local officials should have the flexibility to develop their own approaches to energy conservation. Therefore, the Congress believes that it is appropriate to empower State and local governments by providing them with access to subsidized financing to help promote energy-efficient policies tailored to the needs of local communities.

Explanation of Provision

The provision creates a new category of tax-credit bonds, qualified energy conservation bonds. Qualified energy conservation bonds may be used to finance qualified conservation purposes.

The term "qualified conservation purpose" means:

1. Capital expenditures incurred for purposes of reducing energy consumption in publicly owned buildings by at least 20 percent; implementing green community programs; rural development involving the production of electricity from renewable energy resources; or any facility eligible for the production tax credit under section 45 (other than Indian coal and refined coal production facilities);

2. Expenditures with respect to facilities or grants that support research in: (A) development of cellulosic ethanol or other nonfossil fuels; (B) technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels; (C) increasing the efficiency of existing technologies for producing nonfossil fuels; (D) automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation; and (E) technologies to reduce energy use in buildings;

3. Mass commuting facilities and related facilities that reduce the consumption of energy, including expenditures to reduce pollution from vehicles used for mass commuting;

4. Demonstration projects designed to promote the commercialization of: (A) green building technology; (B) conversion of agricultural waste for use in the production of fuel or otherwise; (C) advanced battery manufacturing technologies; (D) technologies to reduce peak-use of electricity; and (D) technologies for the capture

[463] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

and sequestration of carbon dioxide emitted from combusting fossil fuels in order to produce electricity; and

5. Public education campaigns to promote energy efficiency (other than movies, concerts, and other events held primarily for entertainment purposes).

There is a national limitation on qualified energy conservation bonds of $800 million. Allocations of qualified energy conservation bonds are made to the States with sub-allocations to large local governments. Allocations are made to the States according to their respective populations, reduced by any sub-allocations to large local governments (defined below) within the States. Sub-allocations to large local governments shall be an amount of the national qualified energy conservation bond limitation that bears the same ratio to the amount of such limitation that otherwise would be allocated to the State in which such large local government is located as the population of such large local government bears to the population of such State. The term large local government means: any municipality or county if such municipality or county has a population of 100,000 or more. Indian tribal governments also are treated as large local governments for these purposes (without regard to population).

Each State or large local government receiving an allocation of qualified energy conservation bonds may further allocate issuance authority to issuers within such State or large local government. However, any allocations to issuers within the State or large local government shall be made in a manner that results in not less than 70 percent of the allocation of qualified energy conservation bonds to such State or large local government being used to designate bonds that are not private activity bonds (i.e., the bond cannot meet the private business tests or the private loan test of section 141).

The provision makes qualified energy conservations bonds a type of qualified tax credit bond for purposes of section 54A of the Code. As a result, 100 percent of the available project proceeds of qualified energy conservation bonds must be used for qualified conservation purposes. In the case of qualified conservation bonds issued as private activity bonds, 100 percent of the available project proceeds must be used for capital expenditures. In addition, qualified energy conservation bonds only may be issued by Indian tribal governments to the extent such bonds are issued for purposes that satisfy the present law requirements for tax-exempt bonds issued by Indian tribal governments (i.e., essential governmental functions and certain manufacturing purposes).

The provision requires 100 percent of the available project proceeds of qualified energy conservation bonds to be used within the three-year period that begins on the date of issuance. Available project proceeds are proceeds from the sale of the issue less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds. To the extent less than 100 percent of the available project proceeds are used to finance qualified conservation purposes during the three-year spending period, bonds will continue to qualify as qualified energy conservation bonds if unspent proceeds are used within 90 days from the end of such three-year period to redeem bonds. The three-year spending period

may be extended by the Secretary upon the issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Qualified energy conservation bonds generally are subject to the arbitrage requirements of section 148. However, available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) Such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified energy conservation bonds are issued.

The maturity of qualified energy conservation bonds is the term that the Secretary estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified energy conservation bonds are issued.

As with present-law tax credit bonds, the taxpayer holding qualified energy conservation bonds on a credit allowance date is entitled to a tax credit. The credit rate on the bonds is set by the Secretary at a rate that is 70 percent of the rate that would permit issuance of such bonds without discount and interest cost to the issuer. The amount of the tax credit is determined by multiplying the bond's credit rate by the face amount on the holder's bond. The credit accrues quarterly, 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. Unused credits may be carried forward to succeeding taxable years. In addition, credits may be separated from the ownership of the underlying bond similar to how interest coupons can be stripped for interest-bearing bonds.

Issuers of qualified energy conservation bonds are required to certify that the financial disclosure requirements that applicable State and local law requirements governing conflicts of interest are satisfied with respect to such issue, as well as any other additional conflict of interest rules prescribed by the Secretary with respect to any Federal, State, or local government official directly involved with the issuance of qualified energy conservation bonds.

Effective Date

The provision is effective for bonds issued after the date of enactment (October 3, 2008).

B. Extension and Modification of Credit for Nonbusiness Energy Property (sec. 302 of the Act and sec. 25C of the Code)

Present Law

With respect to property placed in service prior to January 1, 2008, Code section 25C provides a 10-percent credit for qualified energy efficiency improvements to existing homes. A qualified energy efficiency improvement is any energy efficiency building envelope component (1) 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 August 8, 2005 (or, in the case of metal roofs with appropriate pigmented coatings, meets the Energy Star program requirements); (2) that is installed in or on a dwelling located in the United States and owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) that reasonably can be expected to remain in use for at least five years. The credit is nonrefundable.

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.

Additionally, code section 25C provides specified credits for specific energy efficient property. The allowable credit 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.

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 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 EER of at least 16.2 and a heating COP of at least 3.6, and (iii) in the case of a direct expansion (DX) product, has an EER of at least 15 and a COP of at least 3.5, (4) a central air conditioner with energy efficiency of at least the highest efficiency tier established by the Consortium for Energy Efficiency as in effect on Jan. 1, 2006, and

(5) a natural gas, propane, or oil water heater which has an energy factor of at least 0.80.

Under section 25C, the maximum credit for a taxpayer with respect to the same dwelling for all taxable years is $500, and no more than $200 of such credit may be attributable to expenditures on windows.

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.

Reasons for Change[464]

Because residential energy consumption represents a large fraction of national energy use, the Congress believes that energy savings in this sector of the economy have the potential to significantly reduce national energy consumption, which in turn will decrease reliance on foreign suppliers of oil and reduce pollution in general. The Congress believes that tax credits for certain energy efficiency improvements will help to spur savings in this sector of the economy.

Because section 25D includes a new credit for geothermal heat pumps the credit for geothermal heat pumps in section 25C is eliminated.

Explanation of Provision

The section 25C credit is expired for 2008. The provision reestablishes the credit for one year, for property placed in service after December 31, 2008 and before January 1, 2010. The provision modifies the energy efficiency requirement for a natural gas, propane, or oil water heater to include heaters with a thermal efficiency of at least 90 percent. The provision modifies the criteria for qualifying roofs to include asphalt roofs with appropriate cooling granules.

Additionally, the provision adds biomass fuel property to the qualified energy efficient building property eligible for a $300 credit. Biomass fuel property is a stove that burns biomass fuel to heat a dwelling unit located in the United States and used as a principal residence by the taxpayer, or to heat water for such dwelling unit, and that has a thermal efficiency rating of at least 75 percent. Biomass fuel is any plant-derived fuel available on a renewable or recurring basis, including agricultural crops and trees, wood and wood waste and residues (including wood pellets), plants (including aquatic plants), grasses, residues, and fibers.

The credit for geothermal heat pumps is eliminated to conform with the establishment by this Act of a residential geothermal heat pump credit under Code section 25D.

Effective Date

The provision is effective for expenditures after December 31, 2008, for property placed in service after December 31, 2008 and prior to January 1, 2010.

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[464] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

C. Energy Efficient Commercial Buildings Deduction (sec. 303 of the Act and sec. 179D of the Code)

Present Law

In general

Code section 179D provides a deduction equal to energy-efficient commercial building property expenditures made by the taxpayer. Energy-efficient commercial building property 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 $1.80 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 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.

The deduction is effective for property placed in service after December 31, 2005, and prior to January 1, 2009.

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 com-

prises 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 $0.60 per square foot for each separate system.

Interim rules for lighting systems

In the case of system-specific partial deductions, in general no deduction is allowed until the Secretary establishes system-specific targets.[465] 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 30 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 under the interim rule.

Reasons for Change[466]

The Congress recognizes that a substantial portion of U.S. energy consumption is attributable to commercial buildings, and that the design and construction of commercial buildings is a multi-year process. Hence, the Congress believes that a long-term extension of the deduction for energy efficient commercial buildings is necessary to ensure that buildings currently in the design phase will be able to claim the deduction.

Explanation of Provision

The provision extends the energy efficient commercial buildings deduction for five years, through December 31, 2013.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

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[465] IRS Notice 2008–40 has set a target of a 10 percent reduction in total energy and power costs with respect to the building envelope, and 20 percent each with respect to the interior lighting system and the heating, cooling, ventilation and hot water systems.

[466] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

D. New Energy Efficient Home Credit (sec 304 of the Act and sec 45L of the Code)

Present Law

The new energy efficient home credit is available to an eligible contractor for the construction of a qualified new energy-efficient home. To qualify as a new energy-efficient home, the home must be: (1) A dwelling located in the United States, (2) substantially completed after August 8, 2005, and (3) certified in accordance with guidance prescribed by the Secretary to achieve either a 30-percent or 50-percent reduction in heating and cooling energy consumption 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 August 8, 2005, and any applicable Federal minimum efficiency standards for heating and cooling equipment.

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.

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.

Only manufactured homes are eligible for the $1,000 credit. In lieu of meeting the 30 percent efficiency improvement relative to the standards of chapter 4 of the 2003 International Energy Conservation Code, 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.

Manufactured homes are homes that conform to Federal manufactured home construction and safety standards. The eligible contractor is the person who constructed the home, or in the case of a manufactured home, the producer of such home. The credit is part of the general business credit.

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, 2009.

Explanation of Provision

The provision extends the energy efficient new homes credit for one year, through December 31, 2009.

Effective Date

The provision is effective for homes purchased after December 31, 2008.

E. Extension and Modification of Energy Efficient Appliance Credit (sec. 305 of the Act and sec. 45M of the Code)

Present Law

A credit is allowed 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, and equals $32.31 per eligible dishwasher.[467]

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

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

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

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

The taxpayer may not claim credits in excess of $75 million for all taxable years, and may not claim credits in excess of $20 million with respect to refrigerators eligible for the $75 credit.

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.

Reasons for Change[468]

The Congress believes that incentives provided for the manufacture of energy-efficient household appliances are desirable to pro-

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[467] The credit amount equals $3 multiplied by 100 times the "energy savings percentage," but may not exceed $100 per dishwasher. The energy savings percentage is defined as the change in the energy factor (EF) required by the Energy Star program between 2007 and 2005 divided by the EF requirement for 2007. The EF required for the Energy Star program was 0.58 in 2005 and 0.65 in 2007, for a change of 0.07. The energy saving percentage is thus 0.07/0.65, which when multiplied by 100 times $3 equals $32.31 per refrigerator.

[468] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H.. Rept. No. 110–658).

mote the development of energy efficient appliance technologies and to help reduce energy consumption in the household sector. Hence the Congress extends the credit and strengthens the standards that must be met in order to be eligible for the credits.

Explanation of Provision

The provision extends and modifies the energy efficient appliance credit. The provision provides modified credits for eligible production as follows:

Dishwashers

1. $45 in the case of a dishwasher that is manufactured in calendar year 2008 or 2009 that uses no more than 324 kilowatt hours per year and 5.8 gallons per cycle, and
2. $75 in the case of a dishwasher that is manufactured in calendar year 2008, 2009, or 2010 and that uses no more than 307 kilowatt hours per year and 5.0 gallons per cycle (5.5 gallons per cycle for dishwashers designed for greater than 12 place settings).

Clothes washers

1. $75 in the case of a residential top-loading clothes washer manufactured in calendar year 2008 that meets or exceeds a 1.72 modified energy factor and does not exceed a 8.0 water consumption factor, and
2. $125 in the case of a residential top-loading clothes washer manufactured in calendar year 2008 or 2009 that meets or exceeds a 1.8 modified energy factor and does not exceed a 7.5 water consumption factor,
3. $150 in the case of a residential or commercial clothes washer manufactured in calendar year 2008, 2009, or 2010 that meets or exceeds a 2.0 modified energy factor and does not exceed a 6.0 water consumption factor, and
4. $250 in the case of a residential or commercial clothes washer manufactured in calendar year 2008, 2009, or 2010 that meets or exceeds a 2.2 modified energy factor and does not exceed a 4.5 water consumption factor.

Refrigerators

1. $50 in the case of a refrigerator manufactured in calendar year 2008 that consumes at least 20 percent but not more than 22.9 percent less kilowatt hours per year than the 2001 energy conservation standards,
2. $75 in the case of a refrigerator that is manufactured in calendar year 2008 or 2009 that consumes at least 23 percent but no more than 24.9 percent less kilowatt hours per year than the 2001 energy conservation standards,
3. $100 in the case of a refrigerator that is manufactured in calendar year 2008, 2009, or 2010 that consumes at least 25 percent but not more than 29.9 percent less kilowatt hours per year than the 2001 energy conservation standards, and
4. $200 in the case of a refrigerator manufactured in calendar year 2008, 2009, or 2010 that consumes at least 30 percent less energy than the 2001 energy conservation standards.

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

The aggregate credit amount allowed with respect to a taxpayer for all taxable years beginning after December 31, 2007 may not exceed $75 million, with the exception that the $200 refrigerator credit and the $250 clothes washer credit are not limited.

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

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

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

Effective Date

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

F. Accelerated Recovery Period for Depreciation of Smart Meters and Smart Grid Systems (sec. 306 of the Act and sec. 168 of the Code)

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[469] The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87–56.[470] Assets included in class 49.14, describing assets used in the transmission and distribution of electricity for sale and related land improvements, are assigned a class life of 30 years and a recovery period of 20 years.

Reasons for Change[471]

The Congress believes that smart electric meters and smart electric grid systems are integral to the development and use of technology to conserve energy resources. Therefore, the Congress believes that investment in smart electric meters and smart electric grid systems should be encouraged through a shorter recovery period for depreciation. The Congress also believes that smart electric

[469] Sec. 168.

[470] 1987–2 C.B. 674 (as clarified and modified by Rev. Proc. 88–22, 1988–1 C.B. 785).

[471] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

meters should be capable of net metering, which allows customers a credit for providing electricity to the supplier of electric energy or provider of electric energy services.

Explanation of Provision

The provision provides a 10-year recovery period and 150 percent declining balance method for any qualified smart electric meter and any qualified smart electric grid system. For purposes of the provision, a qualified smart electric meter means any time-based meter and related communication equipment which is placed in service by a taxpayer who is a supplier of electric energy or a provider of electric energy services, which does not have a class life of less than 10 years, and which is capable of being used by the taxpayer as part of a system that (1) measures and records electricity usage data on a time-differentiated basis in at least 24 separate time segments per day; (2) provides for the exchange of information between the supplier or provider and the customer's smart electric meter in support of time-based rates or other forms of demand response; and (3) provides data to such supplier or provider so that the supplier or provider can provide energy usage information to customers electronically; and (4) provides net metering.

For purposes of the provision, a qualified smart electric grid system means any smart grid property used as part of a system for electric distribution grid communications, monitoring, and management placed in service by a taxpayer who is a supplier of electric energy or a provider of electric energy services and which does not have a class life of less than 10 years. Smart grid property includes electronics and related equipment that is capable of (1) sensing, collecting, and monitoring data of or from all portions of a utility's electric distribution grid; (2) providing real-time, two-way communications to monitor to manage such grid; and (3) providing real-time analysis of an event prediction based upon collected data that can be used to improve electric distribution system reliability, quality, and performance.

Effective Date

The provision is effective for property placed in service after the date of enactment (October 3, 2008).

G. Extension of Issuance Authority for Qualified Green Building and Sustainable Design Project Bonds (sec. 307 of the Act and sec. 142 of the Code)

Present Law

In general

Private activity bonds are bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such private person. The exclusion from income for interest paid on State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds"). The definition of a qualified private activity bond includes exempt facility bonds.

In most cases, the aggregate volume of tax-exempt qualified private activity bonds, including most exempt facility bonds, is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2008, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $262.09 million, if greater.

Qualified green building and sustainable design project bonds

The definition of exempt facility bond includes qualified green building and sustainable design project bonds ("qualified green bond"). A qualified green bond is defined as any bond issued as part of an issue that finances a project designated by the Secretary, after consultation with the Administrator of the Environmental Protection Agency (the "Administrator") as a green building and sustainable design project that meets the following eligibility requirements: (1) at least 75 percent of the square footage of the commercial buildings that are part of the project is registered for the U.S. Green Building Council's LEED[472] certification and is reasonably expected (at the time of designation) to meet such certification; (2) the project includes a brownfield site;[473] (3) the project receives at least $5 million dollars in specific State or local resources; and (4) the project includes at least one million square feet of building or at least 20 acres of land.

Qualified green bonds are not subject to the State bond volume limitations. Rather, there is a national limitation of $2 billion of qualified green bonds that the Secretary may allocate, in the aggregate, to qualified green building and sustainable design projects. Qualified green bonds may be currently refunded if certain conditions are met, but cannot be advance refunded. The authority to issue qualified green bonds terminates after September 30, 2009.

Each green building and sustainable design project must certify to the Secretary, no later than 30 days after the completion of the project, that the net benefit of the tax-exempt financing was used for the purposes described in the project application. Issuers are required to maintain, on behalf of each project, an interest bearing reserve account equal to one percent of the net proceeds of any qualified green bond issued for such project. Not later than five years after the date of issuance of bonds with respect to the project, the Secretary, after consultation with the Administrator, shall determine whether the project financed with the proceeds of qualified green bonds has substantially complied with the requirements and goals of the project. If the Secretary, after such consultation, certifies that the project has substantially complied with the require-

[472] The LEED (Leadership in Energy and Environmental Design) Green Building Rating System is a voluntary, consensus-based national standard for developing high-performance sustainable buildings. Registration is the first step toward LEED certification. Actual certification requires that the applicant project satisfy a number of requirements. Commercial buildings, as defined by standard building codes are eligible for certification. Commercial occupancies include, but are not limited to, offices, retail and service establishments, institutional buildings (e.g. libraries, schools, museums, churches, etc.), hotels, and residential buildings of four or more habitable stories.

[473] For this purpose, a brownfield site is defined by section 101(39) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. sec. 9601), including a site described in subparagraph (D)(ii)(II)(aa) thereof (relating to a site that is contaminated by petroleum or a petroleum product excluded from the definition of 'hazardous substance' under section 101).

ments and goals, amounts in the reserve account, including all interest, shall be released to the project. If the Secretary determines that the project has not substantially complied with such requirements and goals, amounts in the reserve account, including all interest, shall be paid to the United States Treasury.

Reasons for Change[474]

The Congress believes that tax-exempt financing provides State and local governments with an effective tool for encouraging private investment in projects that promote energy conservation. The Congress believes that qualified green bonds provide such a tool and, thus, it is appropriate to extend the time period to issue such bonds.

Explanation of Provision

The provision extends the authority to issue qualified green bonds through September 30, 2012.

The provision also clarifies that the date for determining whether amounts in a reserve account may be released to a green building and sustainable design project is the date that is five years after the date of issuance of the last bond issue issued with respect to such project.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

H. Special Depreciation Allowance for Certain Reuse and Recycling Property (sec. 308 of the Act and sec. 168 of the Code)

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[475] Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

A special depreciation allowance is provided for certain property acquired after December 31, 2007, and before January 1, 2009

[474] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

[475] Sec. 168.

(January 1, 2010 in certain cases),[476] cellulosic biomass ethanol property,[477] and certain property used in the Gulf Opportunity Zone[478] and Kansas disaster area.[479]

Explanation of Provision

The provision includes an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of any qualified reuse and recycling property. The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there are no adjustments to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies.

For purposes of this provision, qualified reuse and recycling property means any reuse and recycling property: (1) which has a useful life of at least five years; (2) the original use of which commences with the taxpayer after August 31, 2008; and (3) which is acquired by purchase (as defined by section 179(d)(2)) by the taxpayer after August 31, 2008, but only if no written binding contract for the acquisition was in effect before September 1, 2008, or acquired by the taxpayer pursuant to a written binding contract which was entered into after August 31, 2008. For property manufactured, constructed, or produced by the taxpayer for the taxpayer's own use, the acquisition requirement is met if the taxpayer begins manufacturing, constructing, or producing the property after August 31, 2008.

For purposes of this provision, the term "reuse and recycling property" means any machinery and equipment (not including buildings or real estate), along with all appurtenances thereto, including software necessary to operate such equipment, which is used exclusively to collect, distribute, or recycle qualified reuse and recyclable materials. The term does not include rolling stock or other equipment used to transport reuse and recyclable materials. The term "qualified reuse and recyclable materials" means scrap plastic, scrap glass, scrap textiles, scrap rubber, scrap packaging, recovered fiber, scrap ferrous and nonferrous metals, or electronic scrap[480] generated by an individual or business. The term "recycling" or "recycle" means a process (including sorting) by which worn or superfluous materials are manufactured or processed into specification grade commodities that are suitable for use as a replacement or substitute for virgin materials in manufacturing tangible consumer or commercial products, including packaging.

Qualified reuse and recycling property does not include any property to which the special allowance for depreciation under section 168(k) applies or to which the alternative depreciation system

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[476] Sec. 168(k).
[477] Sec. 168(l).
[478] Sec. 1400N(d).
[479] Pub. L. No. 110–234, sec. 15345 (2008).
[480] The term "electronic scrap" means any cathode ray tube, flat panel screen, or similar video display device with a screen size greater than four inches measured diagonally, or any central processing unit.

under section 168(g) applies (determined without regard to the election to use such system under section 168(g)(7)). In addition, a taxpayer may elect to not apply the rules of this provision with respect to any class of property for any taxable year.

Effective Date

The provision is effective for property placed in service after August 31, 2008.

TITLE IV—REVENUE PROVISIONS

A. Limitation of Deduction for Income Attributable to Domestic Production of Oil, Gas, or Primary Products Thereof (sec. 401 of the Act and sec. 199 of the Code)

Present Law

In general

Section 199 of the Code provides a deduction equal to a portion of the taxpayer's qualified production activities income. For taxable years beginning after 2009, the deduction is nine percent of such income. For taxable years beginning in 2008 and 2009, the deduction is six percent of income. However, the deduction for a taxable year is limited to 50 percent of the wages properly allocable to domestic production gross receipts paid by the taxpayer during the calendar year that ends in such taxable year.[481]

Qualified production activities income

In general, "qualified production activities income" is equal to domestic production gross receipts (defined by section 199(c)(4)), reduced by the sum of: (1) the costs of goods sold that are allocable to such receipts; (2) other expenses, losses, or deductions which are properly allocable to such receipts.

Domestic production gross receipts

"Domestic production gross receipts" generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange or other disposition, or any lease, rental or license, of qualifying production property ("QPP") that was manufactured, produced, grown or extracted ("MPGE") by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange or other disposition, or any lease, rental or license, of qualified film produced by the taxpayer; (3) any sale, exchange or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction activities performed in the United States;[482] or (5) engineering or architectural services performed in the United States for construction projects located in the United States.

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[481] For this purpose, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. Elective deferrals include elective deferrals as defined in section 402(g)(3), amounts deferred under section 457, and designated Roth contributions (as defined in section 402A).

[482] For this purpose, construction activities include activities that are directly related to the erection or substantial renovation of residential and commercial buildings and infrastructure. Substantial renovation would include structural improvements, but not mere cosmetic changes, such as painting, that is not performed in connection with activities that otherwise constitute substantial renovation.

Congress granted Treasury broad authority to "prescribe such regulations as are necessary to carry out the purposes" of section 199.[483] In defining MPGE for purposes of section 199, Treasury described the following as MPGE activities: manufacturing, producing, growing, extracting, installing, developing, improving, and creating QPP; making QPP out of scrap, salvage, or junk material as well as from new or raw material by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles; cultivating soil, raising livestock, fishing, and mining minerals.[484]

The regulations specifically cite an example of oil refining activities in describing the "in whole or in significant part" test in determining domestic production gross receipts. QPP is generally considered to be MPGE in significant part by the taxpayer within the United States if such activities are substantial in nature taking into account all of the facts and circumstances, including the relative value added by, and relative cost of, the taxpayer's MPGE activity within the United States, the nature of the QPP, and the nature of the MPGE activity that the taxpayer performs within the United States.[485] The following example is provided in the regulations to illustrate this "substantial in nature" standard:

> X purchases from Y, an unrelated person, unrefined oil extracted outside the United States. X refines the oil in the United States. The refining of the oil by X is an MPGE activity that is substantial in nature.[486]

Natural gas transmission or distribution

Domestic production gross receipts include gross receipts from the production in the United States of natural gas, but excludes gross receipts from the transmission or distribution of natural gas.[487] Production activities generally include all activities involved in extracting natural gas from the ground and processing the gas into pipeline quality gas. However, gross receipts of a taxpayer attributable to transmission of pipeline quality gas from a natural gas field (or from a natural gas processing plant) to a local distribution company's citygate (or to another customer) are not qualified domestic production gross receipts. Likewise, gas purchased by a local gas distribution company and distributed from the citygate to the local customers does not give rise to domestic production gross receipts.

Drilling oil or gas wells

The Treasury regulations provide that qualifying construction activities performed in the United States include activities relating to drilling an oil or gas well.[488] Under the regulations, activities the cost of which are intangible drilling and development costs within the meaning of Treas. Reg. sec. 1.612–4 are considered to be activi-

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[483] Sec. 199(d)(9).
[484] Treas. Reg. sec. 1.199–3(e)(1).
[485] Treas. Reg. sec. 1.199–3(g)(2).
[486] Treas. Reg. sec. 1.199–3(g)(5), Example 1.
[487] H.R. Rep. No. 108–755 (conference report for the American Jobs Creation Act of 2004), footnote 28 at 272.
[488] Treas. Reg. sec. 1.199–3(m)(1)(i).

ties constituting construction for purposes of determining domestic production gross receipts.[489]

Qualifying in-kind partnerships

In general, an owner of a pass-thru entity is not treated as conducting the qualified production activities of the pass-thru entity, and vice versa. However, the Treasury regulations provide a special rule for "qualifying in-kind partnerships," which are defined as partnerships engaged solely in the extraction, refining, or processing of oil, natural gas, petrochemicals, or products derived from oil, natural gas, or petrochemicals in whole or in significant part within the United States, or the production or generation of electricity in the United States.[490] In the case of a qualifying in-kind partnership, each partner is treated as MPGE or producing the property MPGE or produced by the partnership that is distributed to that partner.[491] If a partner of a qualifying in-kind partnership derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of the property that was MPGE or produced by the qualifying in-kind partnership, then, provided such partner is a partner of the qualifying in-kind partnership at the time the partner disposes of the property, the partner is treated as conducting the MPGE or production activities previously conducted by the qualifying in-kind partnership with respect to that property.[492]

Alternative minimum tax

The deduction for domestic production activities is allowed for purposes of computing alternative minimum taxable income (including adjusted current earnings). The deduction in computing alternative minimum taxable income is determined by reference to the lesser of the qualified production activities income (as determined for the regular tax) or the alternative minimum taxable income (in the case of an individual, adjusted gross income as determined for the regular tax) without regard to this deduction.

Explanation of Provision

The provision reduces the section 199 deduction for taxpayers with oil related qualified production activities income for any taxable year beginning after 2009 by three percent of the least of: (1) oil related qualified production activities income of the taxpayer for the taxable year; (2) qualified production activities income of the taxpayer for the taxable year; or (3) taxable income (determined without regard to the section 199 deduction). For purposes of this provision, the term "oil related qualified production activities income" means qualified production activities income for any taxable year which is attributable to the production, refining, processing, transportation, or distribution of oil, gas, or any primary product thereof during such taxable year.

The term "primary product" has the same meaning as when used in section 927(a)(2)(C), as in effect before its repeal. The Treasury

[489] Treas. Reg. sec. 1.199–3(m)(2)(iii).
[490] Treas. Reg. sec. 1.199–9(i)(2).
[491] Treas. Reg. sec. 1.199–9(i)(1).
[492] *Id.*

regulations define the term "primary product from oil" to mean crude oil and all products derived from the destructive distillation of crude oil, including volatile products, light oils such as motor fuel and kerosene, distillates such as naphtha, lubricating oils, greases and waxes, and residues such as fuel oil.[493] Additionally, a product or commodity derived from shale oil which would be a primary product from oil if derived from crude oil is considered a primary product from oil.[494] The term "primary product from gas" is defined as all gas and associated hydrocarbon components from gas wells or oil wells, whether recovered at the lease or upon further processing, including natural gas, condensates, liquefied petroleum gases such as ethane, propane, and butane, and liquid products such as natural gasoline.[495] These primary products and processes are not intended to represent either the only primary products from oil or gas or the only processes from which primary products may be derived under existing and future technologies.[496] Examples of nonprimary products include, but are not limited to, petrochemicals, medicinal products, insecticides, and alcohols.[497]

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

B. Eliminate the Distinction Between FOGEI and FORI and Apply Present-Law FOGEI Rules to All Foreign Income from the Production and Sale of Oil and Gas Product (sec. 402 of the Act and sec. 907 of the Code)

Present Law

In general

Foreign Tax Credit

The United States taxes its citizens and residents (including U.S. corporations) on their worldwide income. Because the countries in which income is earned also may assert their jurisdiction to tax the same income on the basis of source, foreign-source income earned by U.S. persons may be subject to double taxation. In order to mitigate this possibility, the United States generally provides a credit against U.S. tax liability for foreign income taxes paid or accrued.[498] In the case of foreign income taxes paid or accrued by a foreign subsidiary, a U.S. parent corporation is generally entitled to an indirect (also referred to as a deemed paid) credit for those taxes when it receives an actual or deemed distribution of the underlying earnings from the foreign subsidiary.[499]

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[493] Treas. Reg. sec. 1.927(a)–1T(g)(2)(i).
[494] *Id.*
[495] Treas. Reg. sec. 1.927(a)–1T(g)(2)(ii).
[496] Treas. Reg. sec. 1.927(a)–1T(g)(2)(iii).
[497] Treas. Reg. sec. 1.927(a)–1T(g)(2)(iv).
[498] Sec. 901.
[499] Secs. 902, 960.

Foreign Tax Credit Limitations

The foreign tax credit generally is limited to the U.S. tax liability on a taxpayer's foreign-source income. This general limitation is intended to ensure that the credit serves its purpose of mitigating double taxation of foreign-source income without offsetting the U.S. tax on U.S.-source income.[500]

In addition, this limitation is calculated separately for various categories of income, generally referred to as "separate limitation categories." The total amount of foreign taxes attributable to income in a separate limitation category that may be claimed as credits may not exceed the proportion of the taxpayer's total U.S. tax liability which the taxpayer's foreign-source taxable income in that separate limitation category bears to the taxpayer's worldwide taxable income. The separate limitation rules are intended to reduce the extent to which excess foreign taxes paid in a high-tax foreign jurisdiction can be "cross-credited" against the residual U.S. tax on low-taxed foreign-source income.[501]

Special limitation on credits for foreign extraction taxes and taxes on foreign oil related income

In addition to the foreign tax credit limitations that apply to all foreign tax credits, a special limitation is placed on foreign income taxes on foreign oil and gas extraction income ("FOGEI").[502] Under this special limitation, amounts claimed as taxes paid on FOGEI of a U.S. corporation qualify as creditable taxes (if they otherwise so qualify) only to the extent they do not exceed the product of the highest marginal U.S. tax rate on corporations (presently 35 percent) multiplied by such extraction income. Foreign taxes paid in excess of that amount on such income are, in general, neither creditable nor deductible. The amount of any such taxes paid or accrued (or deemed paid) in any taxable year which exceeds the FOGEI limitation may be carried back to the immediately preceding taxable year and carried forward 10 taxable years and credited (not deducted) to the extent that the taxpayer otherwise has excess FOGEI limitation for those years.[503]

A similar special limitation applies, in theory, to foreign taxes paid on foreign oil related income ("FORI") in certain cases where the foreign law imposing such amount of tax is structured, or in fact operates, so that the amount of tax imposed with respect to foreign oil related income will generally be "materially greater," over a "reasonable period of time," than the amount generally imposed on income that is neither FORI nor FOGEI.[504] Under the FORI rules, if this theoretical limitation were to apply, then the

[500] Sec. 904(a).

[501] Sec. 904(d). For taxable years beginning prior to January 1, 2007, section 904(d) provides eight separate baskets as a general matter, and effectively many more in situations in which various special rules apply. The American Jobs Creation Act of 2004 reduced the number of baskets from nine to eight for taxable years beginning after December 31, 2002, and further reduced the number of baskets to two (i.e., "general" and "passive") for taxable years beginning after December 31, 2006. Pub. L. No. 108–357, sec. 404 (2004).

[502] Sec. 907(a).

[503] Sec. 907(f). These carryback and carryforward rules are similar to the general foreign tax credit carryback and carryforward rules of section 904(c).

[504] Sec. 907(b).

portion of the foreign taxes on FORI so disallowed would be recharacterized as a (non-creditable) deductible expense.[505]

As a general matter, the FOGEI and FORI rules of section 907 are informed by two related but distinct concerns. First, as described by the Staff of the Joint Committee on Taxation in 1982, the rules were designed to address the perceived problem of "disguised royalties" being improperly treated as creditable foreign taxes:

When U.S. oil companies began operations in a number of major oil exporting countries, they paid only a royalty for the oil extracted since there was generally no applicable income tax in those countries. However, in part because of the benefit to the oil companies of imposing an income tax, as opposed to a royalty, those countries have adopted taxes applicable to extraction income and have labeled them income taxes. Moreover, because of this relative advantage to the oil companies of paying income taxes rather than royalties, many oil-producing nations in the post-World II era have tended to increase their revenues from oil extraction by increasing their taxes on U.S. oil companies.[506]

In addition, the section 907 rules have also been described as intended to prevent the crediting of high foreign taxes on FOGEI and FORI against the residual U.S. tax on other types of lower-taxed foreign source income.[507] Consistent with this concern, between 1975 and 1982 the foreign tax credit rules provided a separate limitation category (or "basket") under the general section 904 limitation for foreign oil income (broadly defined to include both FORI and FOGEI within the meaning of present law section 907); this separate basket for foreign oil income was eliminated when the present law FORI rules were added and other changes were made by the Tax Equity and Reform Act of 1982.[508]

Determination of FOGEI and FORI

In general

Determination of a taxpayer's FOGEI and FORI is highly specific to the taxpayer's relevant facts and circumstances. Under section 907(c)(1), FOGEI is defined as taxable income derived from sources outside the United States and its possessions from the extraction (by the taxpayer or any other person) of minerals from oil or gas wells located outside the United States and its possessions or from the sale or exchange of assets used by the taxpayer in the trade or business of extracting those minerals.[509] The regulations provide that "gross income from extraction is determined by reference to the fair market value of the minerals in the immediate vicinity of the well."[510]

The regulations do not provide specific methods for determining the fair market value of the extracted oil or gas in the immediate vicinity of the well, but simply provide that all the facts and cir-

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[505] Treas. Reg. sec. 1.907(a)–0(d).

[506] Joint Committee on Taxation, Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, (JCS–38–82), December 31, 1982, sec. IV.A.7.a, footnote 63.

[507] H.R. Conf. Rept. No. 103–213, at 646 (1993).

[508] Pub. L. No. 97–248, sec. 211(c) (1982).

[509] Sec. 907(c)(1).

[510] Treas. Reg. sec. 1.907(c)–1(b)(2).

cumstances that exist in the particular case must be considered, including (but not limited to) facts and circumstances pertaining to the independent market value (if any) in the immediate vicinity of the well, the fair market value at the port of the foreign country, and the relationships between the taxpayer and the foreign government.[511]

Section 907(c)(2) defines FORI to include taxable income from the processing of oil and gas into their primary products, from the transportation or distribution and sale of oil and gas and their primary products, from the disposition of assets used in these activities, and from the performance of any other related service.[512]

As a result of these separate rules governing FOGEI and FORI and the interaction between them, a taxpayer's determination of the amounts of FOGEI and FORI, as well as the allocation of foreign taxes to each class of income, can have a significant impact on the taxpayer's overall U.S. tax liability.

IRS field directive

An October 12, 2004, IRS field directive (the "2004 Field Directive") sets forth guidance to international examiners and specialists on the application of what it describes as the two most commonly used methods for determining FOGEI and FORI when there is no ascertainable market price for the oil and gas in the immediate vicinity of the well, namely the residual (rate of return) method and the proportionate profits method.[513]

Under the residual (rate of return) method, the taxpayer first calculates FORI by applying an assumed after-tax rate of return to the cost of its fixed "FORI assets." Then, because income from the production and sale of oil and gas product is equal to the sum of FORI and FOGEI, FOGEI is determined by subtracting FORI (as calculated) from the taxpayer's total foreign income from the production and sale of oil and gas product.

Under the proportionate profits method, the taxpayer allocates total income from the production and sale of the oil or gas product between FOGEI and FORI based on the relative costs of the FOGEI and FORI activities.

Under either method, the taxpayer must determine its total income from the production and sale of oil and gas product, and must distinguish between costs and assets classified as relating to FOGEI and those relating to FORI. Under the residual (rate of return) method, the taxpayer must also determine appropriate rates of return for FORI assets. The 2004 Field Directive sets forth ex-

[511] Treas. Reg. sec. 1.907(c)–1(b)(6).

[512] Sec. 907(c)(1); Treas. Reg. sec. 1.907(c)–1(d).

[513] Memorandum for Industry Directors ("Field Directive on IRC § 907 Evaluating Taxpayer Methods of Determining Foreign Oil and Gas Extraction Income (FOGEI) and Foreign Oil Related Income (FORI)"), October 12, 2004 (Tax Analysts Doc 2004–23010; 2004 TNT 233–8). By its terms, the 2004 Field Directive "is not an official pronouncement of the law or the Service's position and cannot be used, cited, or relied upon as such."

amples of FOGEI assets[514] and FORI assets,[515] and further provides that assets that support both FOGEI and FORI may be allocated by any reasonable method.

Explanation of Provision

Under the provision, the scope of the present-law FOGEI rules is expanded to apply to all foreign income from production and other activity related to the sale of oil and gas product (i.e., the sum of FORI and FOGEI as classified under present law). Thus, amounts claimed as taxes paid on such amount of (combined) foreign oil and gas income are creditable in a given taxable year (if they otherwise so qualify) only to the extent they do not exceed the product of the highest marginal U.S. tax rate on corporations (in the case of corporations) multiplied by such combined foreign oil and gas income for such taxable year. As under the present-law FOGEI rules, excess foreign taxes may be carried back to the immediately preceding taxable year and carried forward 10 taxable years and credited (not deducted) to the extent that the taxpayer otherwise has excess limitation with regard to combined foreign oil and gas income in a carryover year. Under a transition rule, pre-2009 credits carried forward to post-2008 years will continue to be governed by present law for purposes of determining the amount of carryforward credits eligible to be claimed in a post-2008 year;[516] similarly, solely for purposes of determining whether excess credits generated in 2009 and carried back can be claimed to offset 2008 tax liability, the new rules will be deemed to apply in determining overall (combined FOGEI–FORI) limitation for the carryback year.

The provision repeals the present-law section 907(b) FORI limitation.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

C. Broker Reporting of Customer's Basis in Securities Transactions (sec. 403 of the Act and sec. 6045 and new secs. 6045A and 6045B of the Code)

Present Law

In general

Gain or loss generally is recognized for Federal income tax purposes on realization of that gain or loss (for example, through the

[514] Examples of FOGEI assets include wells, wellheads, and pumping equipment; slug catchers, separators, treaters, emulsion breakers and stock tanks needed to obtain marketable crude (for oil production); primary separation and dehydration equipment needed to arrive at a gaseous stream in which hydrocarbons may be recovered (for gas production); lines interconnecting the above; the infrastructure-type equipment to provide for the operation of the above; and structures to physically support the above (such as offshore platforms).

[515] Examples of FORI assets include lines that carry natural gas beyond the primary separator and dehydration equipment and towards its sales point, and compressors needed to transport through these lines; lines that carry marketable crude oil from the premises, as well as pumps needed to transport crude oil through these lines; and assets used to process crude oil and natural gas.

[516] A technical correction may be necessary so that the statute reflects this intent.

sale of property giving rise to the gain or loss). The taxpayer's gain or loss on a disposition of property is the difference between the amount realized and the adjusted basis.[517]

To compute adjusted basis, a taxpayer must first determine the property's unadjusted or original basis and then make adjustments prescribed by the Code.[518] The original basis of property is its cost, except as otherwise prescribed by the Code (for example, in the case of property acquired by gift or bequest or in a tax-free exchange). Once determined, the taxpayer's original basis generally is adjusted downward to take account of depreciation or amortization, and generally is adjusted upward to reflect income and gain inclusions or capital outlays with respect to the property.

Basis computation rules

If a taxpayer has acquired stock in a corporation on different dates or at different prices and sells or transfers some of the shares of that stock, and the lot from which the stock is sold or transferred is not adequately identified, the shares deemed sold are the earliest acquired shares (the "first-in-first-out rule").[519] If a taxpayer makes an adequate identification of shares of stock that it sells, the shares of stock treated as sold are the shares that have been identified.[520] A taxpayer who owns shares in a regulated investment company ("RIC") generally is permitted to elect, in lieu of the specific identification or first-in-first-out methods, to determine the basis of RIC shares sold under one of two average-cost-basis methods described in Treasury regulations.[521]

Information reporting

Present law imposes information reporting requirements on participants in certain transactions. Under these requirements, information is generally reported to the IRS and furnished to taxpayers. These requirements are intended to assist taxpayers in preparing their income tax returns and to help the IRS determine whether taxpayers' tax returns are correct and complete. For example, every person engaged in a trade or business generally is required to file information returns for each calendar year for payments of $600 or more made in the course of the payor's trade or business.[522]

Section 6045(a) requires brokers to file with the IRS annual information returns showing the gross proceeds realized by customers from various sale transactions. The Secretary is authorized to require brokers to report additional information related to customers.[523] Brokers are required to furnish to every customer information statements with the same gross proceeds information that is included in the returns filed with the IRS for that customer.[524] These information statements are required to be furnished by January 31 of the year following the calendar year for which the return under section 6045(a) is required to be filed.[525]

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[517] Sec. 1001.
[518] Sec. 1016.
[519] Treas. Reg. sec. 1.1012–1(c)(1).
[520] Treas. Reg. sec. 1.1012–1(c).
[521] Treas. Reg. sec. 1.1012–1(e).
[522] Sec. 6041(a).
[523] Sec. 6045(a).
[524] Sec. 6045(b).
[525] *Id.*

A person who is required to file information returns but who fails to do so by the due date for the returns, includes on the returns incorrect information, or files incomplete returns generally is subject to a penalty of $50 for each return with respect to which such a failure occurs, up to a maximum of $250,000 in any calendar year.[526] Similar penalties, with a $100,000 calendar year maximum, apply to failures to furnish correct information statements to recipients of payments for which information reporting is required.[527]

Present law does not require broker information reporting with respect to a customer's basis in property but does impose an obligation to keep records, as described below.

Basis recordkeeping requirements

Taxpayers are required to "keep such records * * * as the Secretary may from time to time prescribe."[528] Treasury regulations impose recordkeeping requirements on any person required to file information returns.[529]

Treasury regulations provide that donors and donees should keep records that are relevant in determining a donee's basis in property.[530] IRS Publication 552 states that a taxpayer should keep basis records for property until the period of limitations expires for the year in which the taxpayer disposes of the property.

Explanation of Provision

In general

Under the provision, every broker that is required to file a return under section 6045(a) reporting the gross proceeds from the sale of a covered security must include in the return (1) the customer's adjusted basis in the security and (2) whether any gain or loss with respect to the security is long-term or short-term (within the meaning of section 1222).

Covered securities

A covered security is any specified security acquired on or after the applicable date if the security was (1) acquired through a transaction in the account in which the security is held or (2) was transferred to that account from an account in which the security was a covered security, but only if the transferee broker received a statement under section 6045A (described below) with respect to the transfer. Under this rule, certain securities acquired by gift or inheritance are not covered securities.

A specified security is any share of stock in a corporation (including stock of a regulated investment company); any note, bond, debenture, or other evidence of indebtedness; any commodity or a contract or a derivative with respect to the commodity if the Secretary determines that adjusted basis reporting is appropriate; and any other financial instrument with respect to which the Secretary determines that adjusted basis reporting is appropriate.

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[526] Sec. 6721.
[527] Sec. 6722.
[528] Sec. 6001.
[529] Treas. Reg. sec. 1.6001–1(a).
[530] Treas. Reg. sec. 1.1015–1(g).

For stock in a corporation (other than stock for which an average basis method is permissible under section 1012), the applicable date is January 1, 2011. For any stock for which an average basis method is permissible under section 1012, the applicable date is January 1, 2012. Consequently, the applicable date for certain stock acquired through a dividend reinvestment plan (for which stock additional rules are described below) and for stock in a regulated investment company is January 1, 2012. A regulated investment company is permitted to elect to treat as a covered security any stock in the company acquired before January 1, 2012. This election is described below. For any specified security other than stock in a corporation or stock for which an average basis method is permitted, the applicable date is January 1, 2013, or a later date determined by the Secretary.

Computation of adjusted basis

The customer's adjusted basis required to be reported to the IRS is determined under the following rules. The adjusted basis of any security other than stock for which an average basis method is permissible under section 1012 is determined under the first-in, first-out method unless the customer notifies the broker by means of making an adequate identification (under the rules of section 1012 for specific identification) of the stock sold or transferred. The adjusted basis of stock for which an average basis method is permissible under section 1012 is determined in accordance with the broker's default method under section 1012 (that is, the first-in, first-out method, the average cost method, or the specific identification method) unless the customer notifies the broker that the customer elects another permitted method. This notification is made separately for each account in which stock for which the average cost method is permissible is held and, once made, applies to all stock held in that account. As a result of this rule, a broker's basis computation method used for stock held in one account with that broker may differ from the basis computation method used for stock held in another account with that broker.

For any sale, exchange, or other disposition of a specified security after the applicable date (defined previously), the provision modifies section 1012 so that the conventions prescribed by regulations under that section for determining adjusted basis (the first-in, first-out, specific identification, and average basis conventions) apply on an account-by-account basis. Under this rule, for example, if a customer holds shares of the same specified security in accounts with different brokers, each broker makes its adjusted basis determinations by reference only to the shares held in the account with that broker, and only shares in the account from which the sale is made may be identified as the shares sold. Unless the election described next applies, any stock for which an average basis method is permissible under section 1012 (that is, stock in a regulated investment company) which is acquired before January 1, 2012 is treated as a separate account from any such stock acquired on or after that date. A consequence of this rule is that if adjusted basis is being determined using an average basis method, average basis is computed without regard to any stock acquired before January 1, 2012. A regulated investment company, however, may elect

(at the time and in the form and manner prescribed by the Secretary), on a stockholder-by-stockholder basis, to treat as covered securities all stock in the company held by the stockholder without regard to when the stock was acquired. When this election applies, the average basis of a customer's regulated investment company stock is determined by taking into account shares of stock acquired before, on, and after January 1, 2012. A similar election is allowed for any broker holding stock in a regulated investment company as a nominee of the beneficial owner of the stock.

If stock is acquired on or after January 1, 2011 in connection with a dividend reinvestment plan, the basis of that stock is determined under one of the basis computation methods permissible for stock in a regulated investment company. Accordingly, an average cost method may be used for determining the basis of stock acquired under a dividend reinvestment plan. In determining basis under this rule, the account-by-account rules described previously, including the election available to regulated investment companies, apply. The special rule for stock acquired through a dividend reinvestment plan, however, applies only while the stock is held as part of the plan. If stock to which this rule applies is transferred to another account, the stock will have a cost basis in that other account equal to its basis in the dividend reinvestment plan immediately before the transfer (with any proper adjustment for charges incurred in connection with the transfer). After the transfer, however, the transferee broker may use the otherwise applicable convention (that is, the first-in, first-out method or the specific identification method) for determining which shares are sold when a sale is made of some but not all shares of a particular security. It is expected that when stock acquired through a dividend reinvestment plan is transferred to another account, the broker executing the transfer will provide information necessary in applying an allowable convention for determining which shares are sold. Accordingly, the transferor broker will be expected to state that shares transferred have a long-term holding period or, for shares that have a short-term holding period, the dates on which the shares were acquired.

A dividend reinvestment plan is any arrangement under which dividends on stock are reinvested in stock identical to the stock with respect to which the dividends are paid. Stock is treated as acquired in connection with a dividend reinvestment plan if the stock is acquired pursuant to the plan or if the dividends paid on the stock are subject to the plan.

Exception for wash sales

Unless the Secretary provides otherwise, a customer's adjusted basis in a covered security generally is determined without taking into account the effect on basis of the wash sale rules of section 1091. If, however, the acquisition and sale transactions resulting in a wash sale under section 1091 occur in the same account and are in identical securities, adjusted basis is determined by taking into account the effect of the wash sale rules. Securities are identical for this purpose only if they have the same Committee on Uniform Security Identification Procedures number.

Special rules for short sales

The provision provides that in the case of a short sale, gross proceeds and basis reporting under section 6045 generally is required in the year in which the short sale is closed (rather than, as under the present law rule for gross proceeds reporting, the year in which the short sale is entered into).

Reporting requirements for options

The provision generally eliminates the present-law regulatory exception from section 6045(a) reporting for certain options. If a covered security is acquired or disposed of by reason of the exercise of an option that was granted or acquired in the same account as the covered security, the amount of the premium received or paid with respect to the acquisition of the option is treated as an adjustment to the gross proceeds from the subsequent sale of the covered security or as an adjustment to the customer's adjusted basis in that security. Gross proceeds and basis reporting also is required when there is a lapse of, or a closing transaction with respect to, an option on a specified security or an exercise of a cash-settled option. Reporting is required for the calendar year that includes the date of the lapse, closing transaction, or exercise. For example, if a taxpayer acquires for $5 a cash settlement stock option with a strike price of $100 and settles the option when the stock trades at $120, a broker through which the acquisition and cash settlement are executed is required to report gross proceeds of $20 from the cash settlement and a basis in the option of $5. For purposes of the reporting requirement for closing transactions, a closing transaction includes a mark-to-market under section 1256. It is intended that a specified security for purposes of the reporting rules described in this paragraph includes a stock index such as the S&P 500. The reporting rules related to options transactions apply only to options granted or acquired on or after January 1, 2013.

Treatment of S corporations

The provision provides that for purposes of section 6045, an S corporation (other than a financial institution) is treated in the same manner as a partnership. This rule applies to any sale of a covered security acquired by an S corporation (other than a financial institution) after December 31, 2011. When this rule takes effect, brokers generally will be required to report gross proceeds and basis information to customers that are S corporations.

Time for providing statements to customers

The provision changes to February 15 the present-law January 31 deadline for furnishing certain information statements to customers. The statements to which the new February 15 deadline applies are (1) statements showing gross proceeds (under section 6045(b)) or substitute payments (under section 6045(d)) and (2) statements with respect to reportable items (including, but not limited to, interest, dividends, and royalties) that are furnished with consolidated reporting statements (as defined in regulations). The term "consolidated reporting statement" is intended to refer to annual account information statements that brokerage firms customarily provide to their customers and that include tax-related infor-

mation. It is intended that the February 15 deadline for consolidated reporting statements apply in the same manner to statements furnished for any account or accounts, taxable and retirement, held by a customer with a mutual fund or other broker.

Broker-to-broker and issuer reporting

Every broker (as defined in section 6045(c)(1)), and any other person specified in Treasury regulations, that transfers to a broker (as defined in section 6045(c)(1)) a security that is a covered security when held by that broker or other person must, under new section 6045A, furnish to the transferee broker a written statement that allows the transferee broker to satisfy the provision's basis and holding period reporting requirements. The Secretary may provide regulations that prescribe the content of this statement and the manner in which it must be furnished. It is contemplated that the Secretary will permit this broker-to-broker reporting requirement to be satisfied electronically rather than by paper. Unless the Secretary provides otherwise, the statement required by this rule must be furnished not later than 15 days after the date of the transfer of the covered security.

Present law penalties for failure to furnish correct payee statements apply to failures to furnish correct statements in connection with the transfer of covered securities.

New section 6045B requires, according to forms or regulations prescribed by the Secretary, any issuer of a specified security to file a return setting forth a description of any organizational action (such as a stock split or a merger or acquisition) that affects the basis of the specified security, the quantitative effect on the basis of that specified security, and any other information required by the Secretary. This return must be filed within 45 days after the date of the organizational action or, if earlier, by January 15 of the year following the calendar year during which the action occurred. Every person required to file this return for a specified security also must furnish, according to forms or regulations prescribed by the Secretary, to the nominee with respect to that security (or to a certificate holder if there is no nominee) a written statement showing the name, address, and phone number of the information contact of the person required to file the return, the information required to be included on the return with respect to the security, and any other information required by the Secretary. This statement must be furnished to the nominee or certificate holder on or before January 15 of the year following the calendar year in which the organizational action took place. No return or information statement is required to be provided under new section 6045B for any action with respect to a specified security if the action occurs before the applicable date (as defined previously) for that security.

The Secretary may waive the return filing and information statement requirements if the person to which the requirements apply makes publicly available, in the form and manner determined by the Secretary, the name, address, phone number, and email address of the information contact of that person, and the information about the organizational action and its effect on basis otherwise required to be included in the return.

The present-law penalties for failure to file correct information returns apply to failures to file correct returns in connection with organizational actions. Similarly, the present-law penalties for failure to furnish correct payee statements apply to a failure under new section 6045B to furnish correct statements to nominees or holders or to provide required publicly-available information in lieu of returns and written statements.

Effective Date

The provision generally takes effect on January 1, 2011. The change to February 15 of the present-law January 31 deadline for furnishing certain information statements to customers applies to statements required to be furnished after December 31, 2008.

D. One-Year Extension of Additional 0.2 Percent FUTA Surtax (sec. 404 of the Act and sec. 3301 of the Code)

Present Law

The Federal Unemployment Tax Act ("FUTA") imposes a 6.2 percent gross tax rate on the first $7,000 paid annually by covered employers to each employee (sec. 3301). Employers in States with programs approved by the Federal Government and with no delinquent Federal loans may credit 5.4 percentage points against the 6.2 percent tax rate, making the minimum, net Federal unemployment tax rate 0.8 percent (sec. 3302). Since all States have approved programs, the minimum Federal tax rate of 0.8 percent (sec. 3302) that generally applies. This Federal revenue finances administration of the unemployment system, half of the Federal-State extended benefits program, and a Federal account for State loans. The States use the revenue from the 5.4 percent credit to finance their regular State programs and half of the Federal-State extended benefits program.

In 1976, Congress passed a temporary surtax of 0.2 percent of taxable wages to be added to the permanent FUTA tax rate. Thus, the current 0.8 percent FUTA tax rate has two components: a permanent tax rate of 0.6 percent, and a temporary surtax rate of 0.2 percent. The temporary surtax was subsequently extended through 2008.

Explanation of Provision

The Act extends the temporary surtax rate (for one year) through December 31, 2009.

Effective Date

The provision is effective for wages paid after December 31, 2008.

E. Oil Spill Liability Trust Fund Tax (sec. 405 of the Act and sec. 4611 of the Code)

Present Law

The Oil Spill Liability Trust Fund financing rate ("oil spill tax") is five cents per barrel and generally applies to crude oil received at a U.S. refinery and to petroleum products entered into the United States for consumption, use, or warehousing.

The oil spill tax also applies to certain uses and exportation of domestic crude oil. If any domestic crude oil is used in or exported from the United States, and before such use or exportation no oil spill tax was imposed on such crude oil, then the oil spill tax is imposed on such crude oil. The tax does not apply to any use of crude oil for extracting oil or natural gas on the premises where such crude oil was produced.

For crude oil received at a refinery, the operator of the United States refinery is liable for the tax. For imported petroleum products, the person entering the product for consumption, use or warehousing is liable for the tax. For certain uses and exports, the person using or exporting the crude oil is liable for the tax. No tax is imposed with respect to any petroleum product if the person who would be liable for such tax establishes that a prior oil spill tax has been imposed with respect to such product.

The imposition of the tax is dependent in part on the balance of the Oil Spill Liability Trust Fund. The oil spill tax does not apply during a calendar quarter if the Secretary estimated that, as of the close of the preceding calendar quarter, the unobligated balance of the Oil Spill Liability Trust Fund exceeded $2.7 billion. If the Secretary estimates the unobligated balance in the Oil Spill Liability Trust Fund to be less than $2 billion at close of any calendar quarter, the oil spill tax will apply on the date that is 30 days from the last day of that quarter. The tax does not apply to any periods after December 31, 2014.

Explanation of Provision

The provision extends the oil spill tax through December 31, 2017. Beginning with the first calendar quarter beginning more than 60 days after the date of enactment, the tax rate is increased from five cents per barrel to eight cents per barrel. After December 31, 2016, the tax rate is increased to nine cents per barrel. The provision also repeals the requirement that the tax be suspended when the unobligated balance exceeds $2.7 billion.

Effective Date

The provision is generally effective on the date of enactment (October 3, 2008). The change in rate applies on and after the first day of the first calendar quarter beginning more than 60 days after the date of enactment.

DIVISION C—TAX EXTENDERS AND ALTERNATIVE MINIMUM TAX RELIEF

TITLE I—ALTERNATIVE MINIMUM TAX RELIEF

A. Extend Alternative Minimum Tax Relief for Individuals (secs. 101 and 102 of the Act and secs. 26 and 55 of the Code)

Present Law

Present law imposes an alternative minimum tax ("AMT") on individuals. The AMT is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments.

The present exemption amount is: (1) $66,250 ($45,000 in taxable years beginning after 2007) in the case of married individuals filing a joint return and surviving spouses; (2) $44,350 ($33,750 in taxable years beginning after 2007) in the case of other unmarried individuals; (3) $33,125 ($22,500 in taxable years beginning after 2007) in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust. The exemption amount is phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Present law provides for certain nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child credit[531], the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, the credit for savers, the credit for certain nonbusiness energy property, the credit for residential energy efficient property, and the D.C. first-time homebuyer credit).

For taxable years beginning before 2008, the nonrefundable personal credits are allowed to the extent of the full amount of the individual's regular tax and alternative minimum tax.

[531] The child credit may be refundable in whole or in part to a taxpayer.

For taxable years beginning after 2007, the nonrefundable personal credits (other than the adoption credit, child credit and saver's credit) are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit. The adoption credit, child credit, and saver's credit are allowed to the full extent of the individual's regular tax and alternative minimum tax.[532]

Reasons for Change[533]

The Congress is concerned about the projected increase in the number of individuals who will be affected by the individual alternative minimum tax and the projected increase in tax liability for those who are affected by the tax for 2008. The provision will reduce the number of individuals who would otherwise be affected by the alternative minimum tax and will reduce the tax liability of the families that continue to be affected by the alternative minimum tax.

Explanation of Provision

The provision provides that the individual AMT exemption amount for taxable years beginning in 2008 is (1) $69,950, in the case of married individuals filing a joint return and surviving spouses; (2) $46,200 in the case of other unmarried individuals; and (3) $34,975 in the case of married individuals filing separate returns.

For taxable years beginning in 2008, the Act allows individuals to offset their entire regular tax liability and alternative minimum tax liability by the nonrefundable personal credits.

Effective Date

The provision is effective for taxable years beginning in 2008.

B. Increase in AMT Refundable Credit Amount for Individuals With Long-Term Unused Credits for Prior Year Minimum Tax Liability, Etc. (sec. 103 of the Act and sec. 53 of the Code)

Present Law

In general

Present law imposes an alternative minimum tax on an individual taxpayer to the extent the taxpayer's tentative minimum tax liability exceeds his or her regular income tax liability. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is

[532] The rule applicable to the adoption credit and child credit is subject to the EGTRRA sunset.

[533] See H.R. 6275, the "Alternative Minimum Tax Relief Act of 2008," which was reported by the House Committee on Ways and Means on June 20, 2008 (H. Rept. No. 110–728).

the amount by which the alternative minimum taxable income exceeds an exemption amount.

An individual's AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

The individual AMT attributable to deferral adjustments generates a minimum tax credit that is allowable to the extent the regular tax (reduced by other nonrefundable credits) exceeds the tentative minimum tax in a future taxable year. Unused minimum tax credits are carried forward indefinitely.

AMT treatment of incentive stock options

One of the adjustments in computing AMTI is the tax treatment of the exercise of an incentive stock option. An incentive stock option is an option granted by a corporation in connection with an individual's employment, so long as the option meets certain specified requirements.[534]

Under the regular tax, the exercise of an incentive stock option is tax-free if the stock is not disposed of within one year of exercise of the option or within two years of the grant of the option.[535] When the stock is sold, the individual's long-term capital gain or loss is determined using the amount paid for the stock as the cost basis. If the holding period requirements are not satisfied, the individual generally takes into account at the exercise of the option an amount of ordinary income equal to the excess of the fair market value of the stock on the date of exercise over the amount paid for the stock. The basis of the stock is the amount paid for the stock increased by the amount taken into account as ordinary income.[536]

Under the individual alternative minimum tax, the exercise of an incentive stock option is treated as the exercise of an option other than an incentive stock option. Under this treatment, generally the individual takes into account as ordinary income for purposes of computing AMTI the excess of the fair market value of the stock at the date of exercise over the amount paid for the stock.[537] When the stock is later sold, for purposes of computing capital gain or loss for purposes of AMTI, the adjusted basis of the stock includes the amount taken into account as AMTI.

The adjustment relating to incentive stock options is a deferral adjustment and therefore generates an AMT credit in the year the stock is sold.[538]

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[534] Sec. 422.

[535] Sec. 421.

[536] If the stock is sold at a loss before the required holding periods are met, the amount taken into account may not exceed the amount realized on the sale over the adjusted basis of the stock. If the stock is sold after the taxable year in which the option was exercised but before the required holding periods are met, the required inclusion is made in the year the stock is sold.

[537] If the stock is sold in the same taxable year the option is exercised, no adjustment in computing AMTI is required.

[538] If the stock is sold for less than the amount paid for the stock, the loss may not be allowed in full in computing AMTI by reason of the $3,000 limit on the deductibility of net capital losses. Thus, the excess of the regular tax over the tentative minimum tax may not reflect the full amount of the loss.

Allowance of long-term unused credits

Under present law, an individual's minimum tax credit allowable for any taxable year beginning after December 31, 2006, and beginning before January 1, 2013, is not less than the "AMT refundable credit amount." The "AMT refundable credit amount" is the amount (not in excess of the long-term unused minimum tax credit) equal to the greatest of (1) $5,000, (2) 20 percent of the long-term unused minimum tax credit for the taxable year, or (3) the amount (if any) of the AMT refundable credit amount for the preceding taxable year before any reduction by reason of the reduction for adjusted gross income described below. The long-term unused minimum tax credit for any taxable year means the portion of the minimum tax credit attributable to the adjusted net minimum tax for taxable years before the 3rd taxable year immediately preceding the taxable year (assuming the credits are used on a first-in, first-out basis).

In the case of an individual whose adjusted gross income for a taxable year exceeds the threshold amount (within the meaning of section 151(d)(3)(C)), the AMT refundable credit amount is reduced by the applicable percentage (within the meaning of section 151(d)(3)(B)). The additional credit allowable by reason of this provision is refundable.

Reasons for Change[539]

The individual alternative minimum tax is intended to accelerate the tax on certain items of income that are deferred under the regular tax by initially imposing a tax and later allowing a minimum tax credit when the deferral ends. One of these items relates to the exercise of incentive stock options. However, because of technical problems, the credit may not be properly allowable where the value of the stock acquired on the exercise of an incentive stock option has declined in value when the stock is sold. In 2006, Congress provided certain relief in these situations. The Congress believes that additional relief should be provided to correct this problem so that taxpayers are not paying tax on "phantom" income attributable to incentive stock options.

Explanation of Provision

The provision generally allows the long-term unused minimum tax credit to be claimed over a two-year period (rather than five years) and eliminates the AGI phase-out.

The provision provides that any underpayment of tax outstanding on the date of enactment which is attributable to the application of the minimum tax adjustment for incentive stock options (including any interest or penalty relating thereto) is abated. No tax which is abated is taken into account in determining the minimum tax credit.

The provision provides that the AMT refundable credit amount and the AMT credit for each of the first two taxable years beginning after December 31, 2007, are increased by one-half of the

[539] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

amount of any interest and penalty paid before the date of enactment on account of the application of the minimum adjustment for incentive stock options.

Effective Date

The provision generally applies to taxable years beginning after December 31, 2007.

The provision relating to the abatement of tax, interest, and penalties takes effect on date of enactment (October 3, 2008).

TITLE II—EXTENSION OF INDIVIDUAL TAX PROVISIONS

A. Deduction of State and Local General Sales Taxes (sec. 201 of the Act and sec. 164 of the Code)

Present Law

For purposes of determining regular tax liability, an itemized deduction is permitted for certain State and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. The itemized deduction is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. For taxable years beginning in 2004 and 2005, at the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction provided under present law for State and local income taxes. As is the case for State and local income taxes, the itemized deduction for State and local general sales taxes is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. Taxpayers have two options with respect to the determination of the sales tax deduction amount. Taxpayers may deduct the total amount of general State and local sales taxes paid by accumulating receipts showing general sales taxes paid. Alternatively, taxpayers may use tables created by the Secretary of the Treasury that show the allowable deduction. The tables are based on average consumption by taxpayers on a State-by-State basis taking into account number of dependents, modified adjusted gross income and rates of State and local general sales taxation. Taxpayers who live in more than one jurisdiction during the tax year are required to pro-rate the table amounts based on the time they live in each jurisdiction. Taxpayers who use the tables created by the Secretary may, in addition to the table amounts, deduct eligible general sales taxes paid with respect to the purchase of motor vehicles, boats and other items specified by the Secretary. Sales taxes for items that may be added to the tables are not reflected in the tables themselves.

The term "general sales tax" means a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items. However, in the case of items of food, clothing, medical supplies, and motor vehicles, the fact that the tax does not apply with respect to some or all of such items is not taken into account in determining whether the tax applies with respect to a broad range of classes of items, and the fact that the rate of tax applicable with respect to some or all of such items is lower than the general rate of tax is not taken into account in determining whether the tax is imposed at one rate. Except in the case of a lower rate of tax applicable with respect to food, clothing, medical supplies, or motor vehicles, no deduction is allowed for any general sales tax imposed with respect to an item at a rate other than the general rate of tax.

However, in the case of motor vehicles, if the rate of tax exceeds the general rate, such excess shall be disregarded and the general rate is treated as the rate of tax.

A compensating use tax with respect to an item is treated as a general sales tax, provided such tax is complementary to a general sales tax and a deduction for sales taxes is allowable with respect to items sold at retail in the taxing jurisdiction that are similar to such item.

Reasons for Change[540]

The Congress believes an extension of the option to deduct State and local sales taxes in lieu of deducting State and local income taxes is appropriate to continue to provide similar Federal tax treatment to residents of States that rely on sales taxes, rather than income taxes, to fund State and local government functions.

Explanation of Provision

The present-law provision allowing taxpayers to elect to deduct State and local sales taxes in lieu of State and local income taxes is extended for two years (through December 31, 2009).

Effective Date

The provision applies to taxable years beginning after December 31, 2007.

B. Above-the-Line Deduction for Higher Education Expenses (sec. 202 of the Act and sec. 222 of the Code)

Present Law

An individual is allowed an above-the-line deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year.[541] Qualified tuition and related expenses are defined in the same manner as for the Hope and Lifetime Learning credits, and includes tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution.[542] The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic period beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

The maximum deduction is $4,000 for an individual whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individ-

[540] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

[541] Sec. 222.

[542] The deduction generally is not available for expenses with respect to a course or education involving sports, games, or hobbies, and is not available for student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.

uals whose adjusted gross income does not exceed $80,000 ($160,000 in the case of a joint return). No deduction is allowed for an individual whose adjusted gross income exceeds the relevant adjusted gross income limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be claimed by another taxpayer for the taxable year. The deduction is not available for taxable years beginning after December 31, 2007.

The amount of qualified tuition and related expenses must be reduced by certain scholarships, educational assistance allowances, and other amounts paid for the benefit of such individual,[543] and by the amount of such expenses taken into account for purposes of determining any exclusion from gross income of: (1) income from certain U.S. savings bonds used to pay higher education tuition and fees; and (2) income from a Coverdell education savings account.[544] Additionally, such expenses must be reduced by the earnings portion (but not the return of principal) of distributions from a qualified tuition program if an exclusion under section 529 is claimed with respect to expenses eligible for the qualified tuition deduction. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope or Lifetime Learning credit is elected for such taxable year.

Reasons for Change[545]

The Congress observes that the cost of a college education continues to rise, and thus believes that the extension of the qualified tuition deduction is appropriate to mitigate the impact of rising tuition costs on students and their families. The Congress further believes that the tuition deduction provides an important financial incentive for individuals to pursue higher education.

Explanation of Provision

The provision extends the qualified tuition deduction for two years so that it is generally available for taxable years beginning before January 1, 2010.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

C. Educator Expense Deduction (sec. 203 of the Act and sec. 62(a)(2)(D) of the Code)

Present Law

In general, ordinary and necessary business expenses are deductible. However, unreimbursed employee business expenses generally are deductible only as an itemized deduction and only to the extent

[543] Secs. 222(d)(1) and 25A(g)(2).

[544] Sec. 222(c). These reductions are the same as those that apply to the Hope and Lifetime Learning credits.

[545] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

that the individual's total miscellaneous deductions (including employee business expenses) exceed two percent of adjusted gross income. An individual's otherwise allowable itemized deductions may be further limited by the overall limitation on itemized deductions, which reduces itemized deductions for taxpayers with adjusted gross income in excess of $159,950 (for 2008).[546] In addition, miscellaneous itemized deductions are not allowable under the alternative minimum tax.

Eligible educators are allowed an above-the-line deduction for certain expenses.[547] Specifically, for taxable years beginning after December 31, 2001, and prior to January 1, 2008, an above-the-line deduction is allowed for up to $250 annually of expenses paid or incurred by an eligible educator for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom. To be eligible for this deduction, the expenses must be otherwise deductible under section 162 as a trade or business expense. A deduction is allowed only to the extent the amount of expenses exceeds the amount excludable from income under section 135 (relating to education savings bonds), section 529(c)(1) (relating to qualified tuition programs), and section 530(d)(2) (relating to Coverdell education savings accounts).

An eligible educator is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year. A school means any school that provides elementary education or secondary education, as determined under State law.

The above-the-line deduction for eligible educators is not allowed for taxable years beginning after December 31, 2007.

Reasons for Change[548]

The Congress recognizes that many elementary and secondary school teachers provide substantial classroom resources at their own expense, and believe that it is appropriate to extend the present law deduction for such expenses in order to continue to partially offset the substantial costs such educators incur for the benefit of their students.

Explanation of Provision

The provision extends the deduction for eligible educator expenses for two years so that it is available for taxable years beginning before January 1, 2010.

Effective Date

The provision is effective for expenses paid or incurred in taxable years beginning after December 31, 2007.

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[546] The adjusted gross income threshold is $79,975 in the case of a married individual filing a separate return (for 2008).

[547] Sec. 62(a)(2)(D).

[548] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

D. Additional Standard Deduction for State and Local Real Property Taxes (sec. 204 of the Act and sec. 63 of the Code)

Present Law

In general

An individual taxpayer's taxable income is computed by reducing adjusted gross income either by a standard deduction or, if the taxpayer elects, by the taxpayer's itemized deductions. Unless an individual taxpayer elects, no itemized deduction is allowed for the taxable year. The deduction for certain taxes, including income taxes, real property taxes, and personal property taxes, generally is an itemized deduction.[549]

Special rule for State and local property taxes

An individual taxpayer's standard deduction for a taxable year beginning in 2008 is increased by the lesser of (1) the amount allowable[550] to the taxpayer as a deduction for State and local taxes described in section 164(a)(1) (relating to real property taxes), or (2) $500 ($1,000 in the case of a married individual filing jointly). The increased standard deduction is determined by taking into account real estate taxes for which a deduction is allowable to the taxpayer under section 164 and, in the case of a tenant-stockholder in a cooperative housing corporation, real estate taxes for which a deduction is allowable to the taxpayer under section 216. No taxes deductible in computing adjusted gross income are taken into account in computing the increased standard deduction.

Reasons for Change[551]

The Congress believes an additional standard deduction for real property taxes is appropriate in order to help lessen the impact of rising State and local property tax bills on those individual taxpayers with insufficient total itemized deductions to elect not to take the standard deduction.

Explanation of Provision

The provision extends for one year (2009) the additional standard deduction for State and local property taxes.

Effective Date

The provision applies to taxable years beginning in 2009.

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[549] If the deduction for State and local taxes is attributable to business or rental income, the deduction is allowed in computing adjusted gross income and therefore is not an itemized deduction.

[550] In the case of an individual taxpayer who does not elect to itemize deductions, although no itemized deductions are allowed to the taxpayer, itemized deductions are nevertheless treated as "allowable." See section 63(e).

[551] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

E. Tax-Free Distributions from Individual Retirement Plans for Charitable Purposes (sec. 205 of the Act and sec. 408 of the Code)

Present Law

In general

If an amount withdrawn from a traditional individual retirement arrangement ("IRA") or a Roth IRA is donated to a charitable organization, the rules relating to the tax treatment of withdrawals from IRAs apply to the amount withdrawn and the charitable contribution is subject to the normally applicable limitations on deductibility of such contributions. An exception applies in the case of a qualified charitable distribution.

Charitable contributions

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to a charity described in section 501(c)(3), to certain veterans' organizations, fraternal societies, and cemetery companies,[552] or to a Federal, State, or local governmental entity for exclusively public purposes.[553] The deduction also is allowed for purposes of calculating alternative minimum taxable income.

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.[554]

A taxpayer who takes the standard deduction (i.e., who does not itemize deductions) may not take a separate deduction for charitable contributions.[555]

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate, among other things, that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution.[556] In addition, present law requires that any charity that receives a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that

[552] Secs. 170(c)(3)–(5).
[553] Sec. 170(c)(1).
[554] Secs. 170(b) and (e).
[555] Sec. 170(a).
[556] Sec. 170(f)(8).

only the portion exceeding the value of the goods or services may be deductible as a charitable contribution.[557]

Under present law, total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations may not exceed 50 percent of the taxpayer's contribution base, which is the taxpayer's adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base, (2) contributions of cash to private foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer's contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer's contribution base.

Contributions by individuals in excess of the 50-percent, 30-percent, and 20-percent limits may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

In addition to the percentage limitations imposed specifically on charitable contributions, present law imposes a reduction on most itemized deductions, including charitable contribution deductions, for taxpayers with adjusted gross income in excess of a threshold amount, which is indexed annually for inflation. The threshold amount for 2008 is $159,950 ($79,975 for married individuals filing separate returns). For those deductions that are subject to the limit, the total amount of itemized deductions is reduced by three percent of adjusted gross income over the threshold amount, but not by more than 80 percent of itemized deductions subject to the limit. Beginning in 2006, the overall limitation on itemized deductions phases-out for all taxpayers. The overall limitation on itemized deductions was reduced by one-third in taxable years beginning in 2006 and 2007, and is reduced by two-thirds in taxable years beginning in 2008 and 2009. The overall limitation on itemized deductions is eliminated for taxable years beginning after December 31, 2009; however, this elimination of the limitation sunsets on December 31, 2010.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity (e.g., a remainder) while also either retaining an interest in that property (e.g., an income interest) or transferring an interest in that property to a noncharity for less than full and adequate consideration.[558] Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, and present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property.[559] For such interests, a charitable deduction is allowed to the

[557] Sec. 6115.
[558] Secs. 170(f), 2055(e)(2), and 2522(c)(2).
[559] Sec. 170(f)(2).

extent of the present value of the interest designated for a charitable organization.

IRA rules

Within limits, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Individuals also may make nondeductible contributions to a Roth IRA. Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59½ are subject to an additional 10-percent early withdrawal tax, unless an exception applies. Under present law, minimum distributions are required to be made from tax-favored retirement arrangements, including IRAs. Minimum required distributions from a traditional IRA must generally begin by the April 1 of the calendar year following the year in which the IRA owner attains age 70½.[560]

If an individual has made nondeductible contributions to a traditional IRA, a portion of each distribution from an IRA is nontaxable until the total amount of nondeductible contributions has been received. In general, the amount of a distribution that is nontaxable is determined by multiplying the amount of the distribution by the ratio of the remaining nondeductible contributions to the account balance. In making the calculation, all traditional IRAs of an individual are treated as a single IRA, all distributions during any taxable year are treated as a single distribution, and the value of the contract, income on the contract, and investment in the contract are computed as of the close of the calendar year.

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions and distributions are deemed to be distributed in the following order: (1) regular Roth IRA contributions; (2) taxable conversion contributions;[561] (3) nontaxable conversion contributions; and (4) earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same taxable year are treated as a single distribution, all regular Roth IRA contributions for a year are treated as a single contribution, and all conversion contributions during the year are treated as a single contribution.

Distributions from an IRA (other than a Roth IRA) are generally subject to withholding unless the individual elects not to have withholding apply.[562] Elections not to have withholding apply are to be made in the time and manner prescribed by the Secretary.

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[560] Minimum distribution rules also apply in the case of distributions after the death of a traditional or Roth IRA owner.

[561] Conversion contributions refer to conversions of amounts in a traditional IRA to a Roth IRA.

[562] Sec. 3405.

Qualified charitable distributions

Present law provides an exclusion from gross income for otherwise taxable IRA distributions from a traditional or a Roth IRA in the case of qualified charitable distributions.[563] The exclusion may not exceed $100,000 per taxpayer per taxable year. Special rules apply in determining the amount of an IRA distribution that is otherwise taxable. The otherwise applicable rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions. Qualified charitable distributions are taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the qualified charitable distribution provision. An IRA does not fail to qualify as an IRA as a result of qualified charitable distributions being made from the IRA.

A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to an organization described in section 170(b)(1)(A) (other than an organization described in section 509(a)(3) or a donor advised fund (as defined in section 4966(d)(2)). Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70½.

The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the donor did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

If the IRA owner has any IRA that includes nondeductible contributions, a special rule applies in determining the portion of a distribution that is includible in gross income (but for the qualified charitable distribution provision) and thus is eligible for qualified charitable distribution treatment. Under the special rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income (but for the qualified charitable distribution provision) if the aggregate balance of all IRAs having the same owner were distributed during the same year. In determining the amount of subsequent IRA distributions includible in income, proper adjustments are to be made to reflect the amount treated as a qualified charitable distribution under the special rule.

Distributions that are excluded from gross income by reason of the qualified charitable distribution provision are not taken into account in determining the deduction for charitable contributions under section 170.

The exclusion for qualified charitable distributions applies to distributions made in taxable years beginning after December 31,

[563] The exclusion does not apply to distributions from employer-sponsored retirements plans, including SIMPLE IRAs and simplified employee pensions ("SEPs").

2005. Under present law, the exclusion does not apply to distributions made in taxable years beginning after December 31, 2007.

Reasons for Change[564]

The Congress believes that facilitating charitable contributions from IRAs will help increase giving to charitable organizations. Therefore, the Congress believes that the exclusion for qualified charitable distributions should be extended.

Explanation of Provision

The provision extends the exclusion for qualified charitable distributions to distributions made in taxable years beginning after December 31, 2007, and before January 1, 2010.

Effective Date

The provision is effective for distributions made in taxable years beginning after December 31, 2007.

F. Extension of Special Withholding Tax Rule for Interest-Related Dividends Paid by Regulated Investment Companies (sec. 206 of the Act and sec. 871(k) of the Code)

Present Law

In general

Under present law, a regulated investment company ("RIC") that earns certain interest income that would not be subject to U.S. tax if earned by a foreign person directly may, to the extent of such income, designate a dividend it pays as derived from such interest income. A foreign person who is a shareholder in the RIC generally would treat such a dividend as exempt from gross-basis U.S. tax, as if the foreign person had earned the interest directly.

Interest-related dividends

Under present law, a RIC may, under certain circumstances, designate all or a portion of a dividend as an "interest-related dividend," by written notice mailed to its shareholders not later than 60 days after the close of its taxable year. In addition, an interest-related dividend received by a foreign person generally is exempt from U.S. gross-basis tax under sections 871(a), 881, 1441 and 1442.

However, this exemption does not apply to a dividend on shares of RIC stock if the withholding agent does not receive a statement, similar to that required under the portfolio interest rules, that the beneficial owner of the shares is not a U.S. person. The exemption does not apply to a dividend paid to any person within a foreign country (or dividends addressed to, or for the account of, persons within such foreign country) with respect to which the Treasury Secretary has determined, under the portfolio interest rules, that exchange of information is inadequate to prevent evasion of U.S. income tax by U.S. persons.

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[564] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

In addition, the exemption generally does not apply to dividends paid to a controlled foreign corporation to the extent such dividends are attributable to income received by the RIC on a debt obligation of a person with respect to which the recipient of the dividend (i.e., the controlled foreign corporation) is a related person. Nor does the exemption generally apply to dividends to the extent such dividends are attributable to income (other than short-term original issue discount or bank deposit interest) received by the RIC on indebtedness issued by the RIC-dividend recipient or by any corporation or partnership with respect to which the recipient of the RIC dividend is a 10-percent shareholder. However, in these two circumstances the RIC remains exempt from its withholding obligation unless the RIC knows that the dividend recipient is such a controlled foreign corporation or 10-percent shareholder. To the extent that an interest-related dividend received by a controlled foreign corporation is attributable to interest income of the RIC that would be portfolio interest if received by a foreign corporation, the dividend is treated as portfolio interest for purposes of the de minimis rules, the high-tax exception, and the same country exceptions of subpart F (see sec. 881(c)(5)(A)).

The aggregate amount designated as interest-related dividends for the RIC's taxable year (including dividends so designated that are paid after the close of the taxable year but treated as paid during that year as described in section 855) generally is limited to the qualified net interest income of the RIC for the taxable year. The qualified net interest income of the RIC equals the excess of: (1) the amount of qualified interest income of the RIC; over (2) the amount of expenses of the RIC properly allocable to such interest income.

Qualified interest income of the RIC is equal to the sum of its U.S.-source income with respect to: (1) bank deposit interest; (2) short term original issue discount that is currently exempt from the gross-basis tax under section 871; (3) any interest (including amounts recognized as ordinary income in respect of original issue discount, market discount, or acquisition discount under the provisions of sections 1271–1288, and such other amounts as regulations may provide) on an obligation which is in registered form, unless it is earned on an obligation issued by a corporation or partnership in which the RIC is a 10-percent shareholder or is contingent interest not treated as portfolio interest under section 871(h)(4); and (4) any interest-related dividend from another RIC.

If the amount designated as an interest-related dividend is greater than the qualified net interest income described above, the portion of the distribution so designated which constitutes an interest-related dividend will be only that proportion of the amount so designated as the amount of the qualified net interest income bears to the amount so designated.

This withholding tax rule for interest-related dividends received from a RIC does not apply to any taxable year of a RIC beginning after December 31, 2007.

Reasons for Change[565]

Congress believes that, to the extent a RIC distributes to a foreign person a dividend attributable to amounts that would have been exempt from U.S. withholding tax had the foreign person received it directly (such as portfolio interest and capital gains, including short-term capital gains), such dividend similarly should be exempt from the U.S. gross-basis withholding tax. Therefore, Congress believes that it is desirable to extend the present law provision for two additional years.

Explanation of Provision

The provision extends the exemption from withholding tax of interest-related dividends received from a RIC to taxable years of a RIC beginning before January 1, 2010.

Effective Date

The provision applies to dividends with respect to taxable years of a RIC beginning after December 31, 2007.

G. Extension of Special Rule for Regulated Investment Company Stock Held in the Estate of a Nonresident Non-Citizen (sec. 207 of the Act and sec. 2105 of the Code)

Present Law

The gross estate of a decedent who was a U.S. citizen or resident generally includes all property—real, personal, tangible, and intangible—wherever situated.[566] The gross estate of a nonresident non-citizen decedent, by contrast, generally includes only property that at the time of the decedent's death is situated within the United States.[567] Property within the United States generally includes debt obligations of U.S. persons, including the Federal government and State and local governments, but does not include either bank deposits or portfolio obligations the interest on which would be exempt from U.S. income tax under section 871.[568] Stock owned and held by a nonresident non-citizen generally is treated as property within the United States if the stock was issued by a domestic corporation.[569]

Treaties may reduce U.S. taxation of transfers of the estates of nonresident non-citizens. Under recent treaties, for example, U.S. tax generally may be eliminated except insofar as the property transferred includes U.S. real property or business property of a U.S. permanent establishment.

Although stock issued by a domestic corporation generally is treated as property within the United States, stock of a regulated investment company ("RIC") that was owned by a nonresident non-

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[565] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

[566] Sec. 2031. The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") repealed the estate tax for estates of decedents dying after December 31, 2009. EGTRRA, however, included a termination provision under which EGTRRA's rules, including estate tax repeal, do not apply to estates of decedents dying after December 31, 2010.

[567] Sec. 2103.

[568] Secs. 2104(c), 2105(b).

[569] Sec. 2104(a); Treas. Reg. sec. 20.2104–1(a)(5)).

citizen is not deemed property within the United States in the proportion that, at the end of the quarter of the RIC's taxable year immediately before a decedent's date of death, the assets held by the RIC are debt obligations, deposits, or other property that would be treated as situated outside the United States if held directly by the estate (the "estate tax look-through rule for RIC stock").[570] This estate tax look-through rule for RIC stock does not apply to estates of decedents dying after December 31, 2007.

Reasons for Change[571]

If a RIC satisfies certain income, asset, and distribution requirements, only one level of income tax generally is imposed on the income and gains of a RIC, and this tax is imposed on the RIC stockholders. By extension, Congress believes it is appropriate to treat a RIC as a conduit under the rules for determining the extent to which the transfer of the estate of a nonresident non-citizen is subject to U.S. Federal estate tax. To the extent the assets of a RIC would not be subject to U.S. estate tax if held directly by an estate, Congress believes there should be no estate tax when the assets are owned indirectly by ownership of stock in a RIC.

Explanation of Provision

The provision permits the estate tax look-through rule for RIC stock to apply to estates of decedents dying before January 1, 2010.

H. Extend RIC "Qualified Investment Entity" Treatment Under FIRPTA (sec. 208 of the Act and sec. 897 of the Code)

Present Law

Special U.S. tax rules apply to capital gains of foreign persons that are attributable to dispositions of interests in U.S. real property. In general, a foreign person (a foreign corporation or a nonresident alien individual) is not generally taxed on U.S. source capital gains unless certain personal presence or effectively connected business requirements are met. However, under the Foreign Investment in Real Property Tax Act ("FIRPTA") provisions codified in section 897 of the Code, a foreign person who sells a U.S. real property interest (USRPI) is treated as if the gain from such a sale is effectively connected with a U.S. business, and is subject to tax at the same rates as a U.S. person. Withholding tax is also imposed under section 1445.

A USPRI, the sale of which is subject to FIRPTA tax, includes stock or a beneficial interest in any U.S. real property holding corporation (as defined), unless the stock is regularly traded on an established securities market and the selling foreign corporation or nonresident alien individual held no more than 5 percent of that stock within the 5-year period ending on date of disposition (or, if shorter, during the period in which the entity was in existence). There is an exception, however, for stock of a domestically controlled "qualified investment entity." However, if stock of a domes-

[570] Sec. 2105(d).

[571] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

tically controlled qualified investment entity is disposed of within the 30 days preceding a dividend distribution in an "applicable wash sale transaction," in which an amount that would have been a taxable distribution (as described below) is instead treated as nontaxable sales proceeds, but substantially similar stock is reacquired (or an option to obtain it is acquired) within a 61-day period, then the amount that would have been a taxable distribution continues to be taxed.

A distribution from a "qualified investment entity" that is attributable to the sale of a USRPI is subject to tax under FIRPTA unless the distribution is with respect to an interest that is regularly traded on an established securities market located in the United Sates and the recipient foreign corporation or nonresident alien individual held no more than 5 percent of that class of stock or beneficial interest within the 1-year period ending on the date of distribution. Special rules apply to situations involving tiers of qualified investment entities.

The term "qualified investment entity" includes a regulated investment company ("RIC") that meets certain requirements, although the inclusion of a RIC in that definition is scheduled to have expired, for certain purposes, on December 31, 2007.[572] The definition does not expire for purposes of taxing distributions from the RIC that are attributable directly or indirectly to a distribution to the entity from a real estate investment trust, nor for purposes of the applicable wash sale rules.

Reasons for Change[573]

Congress believes it is desirable to extend the present law provision for two additional years.

Explanation of Provision

The provision extends the inclusion of a regulated investment company ("RIC") within the definition of a "qualified investment entity" under section 897 of the Code through December 31, 2009, for those situations in which that inclusion otherwise would have expired at the end of 2007.

It is intended that the extension shall not apply to the application of withholding requirements with respect to any payments made on or before the date of enactment.[574]

Effective Date

The provision takes effect on January 1, 2008.

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[572] Sec. 897(h).

[573] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

[574] A technical correction may be needed so that the statute reflects this intent.

TITLE III—EXTENSION OF BUSINESS TAX PROVISIONS

A. Extend the Research and Experimentation Tax Credit (sec. 301 of the Act and sec. 41 of the Code)

Present Law

General rule

A taxpayer may claim a research credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses for a taxable year exceed its base amount for that year.[575] Thus, the research credit is generally available with respect to incremental increases in qualified research.

A 20-percent research tax credit is also available with respect 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.[576]

Finally, a research credit is available for a taxpayer's expenditures on research undertaken by an energy research consortium. This separate credit computation is commonly referred to as the energy research credit. Unlike the other research credits, the energy research credit applies to all qualified expenditures, not just those in excess of a base amount.

The research credit, including the university basic research credit and the energy research credit, has expired and does not apply to amounts paid or incurred after December 31, 2007.[577]

Computation of allowable credit

Except for energy research payments and certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenses for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's fixed-base percentage by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenses and had gross

[575] Sec. 41.

[576] Sec. 41(e).

[577] The research tax credit was initially enacted in the Economic Recovery Tax Act of 1981. It has been subsequently extended and modified numerous times. Most recently, the Tax Relief and Health Care Act of 2006 extended the research credit through December 31, 2007, modified the alternative incremental research credit, and added an election to claim an alternative simplified credit.

receipts during each of at least three years from 1984 through 1988, then its fixed-base percentage is the ratio that its total qualified research expenses for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum fixed-base percentage of 16 percent). All other taxpayers (so-called start-up firms) are assigned a fixed-base percentage of three percent.[578]

In computing the credit, a taxpayer's base amount cannot be less than 50 percent of its current-year qualified research expenses.

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, a special aggregation rule provides that all members of the same controlled group of corporations are treated as a single taxpayer.[579] Under regulations prescribed by the Secretary, special rules apply for computing the credit when a major portion of a trade or business (or unit thereof) changes hands, under which qualified research expenses and gross receipts for periods prior to the change of ownership of a trade or business are treated as transferred with the trade or business that gave rise to those expenses and receipts for purposes of recomputing a taxpayer's fixed-base percentage.[580]

Alternative incremental research credit regime

Taxpayers are allowed to elect an alternative incremental research credit regime.[581] 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.

Generally, for amounts paid or incurred prior to 2007, under the alternative incremental 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

[578] The Small Business Job Protection Act of 1996 expanded the definition of start-up firms under section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983. A special rule (enacted in 1993) is designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm is assigned a fixed-base percentage of three percent for each of its first five taxable years after 1993 in which it incurs qualified research expenses. A start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenses is a phased-in ratio based on the firm's actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage is its actual ratio of qualified research expenses to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993. Sec. 41(c)(3)(B).

[579] Sec. 41(f)(1).

[580] Sec. 41(f)(3).

[581] Sec. 41(c)(4).

of two percent. Generally, for amounts paid or incurred after 2006, the credit rates listed above are increased to three percent, four percent, and five percent, respectively.[582]

An election to be subject to this alternative incremental credit regime can 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.

Alternative simplified credit

Generally, for amounts paid or incurred after 2006, taxpayers may elect to claim an alternative simplified credit for qualified research expenses.[583] The alternative simplified research credit is equal to 12 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. The rate is reduced to six percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years.

An election to use the alternative simplified credit applies to all succeeding taxable years unless revoked with the consent of the Secretary. An election to use the alternative simplified credit may not be made for any taxable year for which an election to use the alternative incremental credit is in effect. A transition rule applies which permits a taxpayer to elect to use the alternative simplified credit in lieu of the alternative incremental credit if such election is made during the taxable year which includes January 1, 2007. The transition rule applies only to the taxable year which includes that date.

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).[584] Notwithstanding the limitation for contract research expenses, qualified research expenses include 100 percent of amounts paid or incurred by the taxpayer to an eligible small business, university, or Federal laboratory for qualified energy research.

To be eligible for the credit, the research not only has to satisfy the requirements of present-law section 174 (described below) but also 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

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[582] A special transition rule applies for fiscal year 2006–2007 taxpayers.

[583] A special transition rule applies for fiscal year 2006–2007 taxpayers.

[584] Under a special rule, 75 percent of amounts paid to a research consortium for qualified research are treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under section 41(b)(3) governing contract research expenses) 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. Sec. 41(b)(3)(C).

which constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors.[585] In addition, research does not qualify for the credit: (1) if conducted after the beginning of commercial production of the business component; (2) if related to the adaptation of an existing business component to a particular customer's requirements; (3) if related to the duplication of an existing business component from a physical examination of the component itself or certain other information; or (4) if related to certain efficiency surveys, management function or technique, market research, market testing, or market development, routine data collection or routine quality control.[586] Research does not qualify for the credit if it is conducted outside the United States, Puerto Rico, or any U.S. possession.

Relation to deduction

Under section 174, taxpayers may elect to deduct currently the amount of certain research or experimental expenditures paid or incurred in connection with a trade or business, notwithstanding the general rule that business expenses to develop or create an asset that has a useful life extending beyond the current year must be capitalized.[587] However, deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year.[588] Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed.[589]

Reasons for Change[590]

The Congress acknowledges that research is important to the economy. Research is the basis of new products, new services, new industries, and new jobs for the domestic economy. Therefore, the Congress believes it is appropriate to extend the present-law research credit.

Explanation of Provision

The provision generally extends for two years (through 2009) all elements of the research credit, except for the alternative incremental research credit, which is allowed to expire after 2008. The provision also modifies the alternative simplified credit by increasing from 12 to 14 percent the amount of credit available with respect to qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years.

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[585] Sec. 41(d)(3).
[586] Sec. 41(d)(4).
[587] Taxpayers may elect 10-year amortization of certain research expenditures allowable as a deduction under section 174(a). Secs. 174(f)(2) and 59(e).
[588] Sec. 280C(c).
[589] Sec. 280C(c)(3).
[590] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

Finally, the provision clarifies the computation of the alternative incremental research credit and the alternative simplified credit for the taxable year in which the credit terminates.

Effective Date

The extension of the research credit is effective for amounts paid or incurred after December 31, 2007. The termination of the alternative incremental credit and the modification of the alternative simplified credit are effective for taxable years beginning after December 31, 2008. The computational clarification for the year in which the credit terminates is effective for taxable years beginning after December 31, 2007.

B. Extend the New Markets Tax Credit (sec. 302 of the Act and sec. 45D of the Code)

Present Law

Section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity ("CDE").[591] The amount of the credit allowable to the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for each of the following two years, and (2) a six-percent credit for each of the following four years. The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available for a taxable year to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year. The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity ceases to be a qualified CDE, the proceeds of the investment cease to be used as required, or the equity investment is redeemed.

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE. A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired directly from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder. Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community businesses; (2) certain fi-

[591] Section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106–554 (2000).

nancial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.

A "low-income community" is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (rather than 80 percent) of statewide median family income. For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary has the authority to designate "targeted populations" as low-income communities for purposes of the new markets tax credit. For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (12 U.S.C. 4702(20)) to mean individuals, or an identifiable group of individuals, including an Indian tribe, who (A) are low-income persons; or (B) otherwise lack adequate access to loans or equity investments. Under such Act, "low-income" means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide non-metropolitan area median family income.[592] Under such Act, a targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under section 1391, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of such business is used in a low-income community; (3) a substantial portion of the services performed for such business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted bases of the property of such business is attributable to certain financial property or to certain collectibles.

The maximum annual amount of qualified equity investments is capped at $2.0 billion per year for calendar years 2004 and 2005,

[592] 12 U.S.C. 4702(17) (defines "low-income" for purposes of 12 U.S.C. 4702(20)).

and at $3.5 billion per year for calendar years 2006, 2007, and 2008.

Reasons for Change[593]

The Congress believes that the new markets tax credit has proved to be an effective means of providing equity and other investments to benefit businesses in low income communities and that it is appropriate to provide for the allocation of additional investments for another calendar year.

Explanation of Provision

The provision extends the new markets tax credit for one year, through 2009, permitting up to $3.5 billion in qualified equity investments for that calendar year.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

C. Subpart F Exception for Active Financing Income (sec. 303 of the Act and secs. 953 and 954 of the Code)

Present Law

Under the subpart F rules,[594] 10-percent-or-greater U.S. shareholders of a controlled foreign corporation ("CFC") are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, insurance income and foreign base company income. Foreign base company income includes, among other things, foreign personal holding company income and foreign base company services income (i.e., income derived from services performed for or on behalf of a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents, and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and REMICs; (3) net gains from commodities transactions; (4) net gains from certain foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; (7) payments in lieu of dividends; and (8) amounts received under personal service contracts.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income at-

[593] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).
[594] Secs. 951–964.

tributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income.[595]

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the conduct of an insurance business (so-called "active financing income").[596]

With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the active financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met. Additional exceptions from foreign personal holding company income apply for certain income derived by a securities dealer within the meaning of section 475 and for gain from the sale of active financing assets.

In the case of a securities dealer, the temporary exception from foreign personal holding company income applies to certain income. The income covered by the exception is any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of section 475. In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that this exception generally takes precedence over the exception for income of a banking, financing or similar business, in the case of a securities dealer.

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[595] Prop. Treas. Reg. sec. 1.953–1(a).

[596] Temporary exceptions from the subpart F provisions for certain active financing income applied only for taxable years beginning in 1998 (Taxpayer Relief Act of 1997, Pub. L. No. 105–34). Those exceptions were modified and extended for one year, applicable only for taxable years beginning in 1999 (the Tax and Trade Relief Extension Act of 1998, Pub. L. No. 105–277). The Tax Relief Extension Act of 1999 (Pub. L. No. 106–170) clarified and extended the temporary exceptions for two years, applicable only for taxable years beginning after 1999 and before 2002. The Job Creation and Worker Assistance Act of 2002 (Pub. L. No. 107–147) modified and extended the temporary exceptions for five years, for taxable years beginning after 2001 and before 2007. The Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. No. 109–222) extended the temporary provisions for two years, for taxable years beginning after 2006 and before 2009.

In the case of insurance, a temporary exception from foreign personal holding company income applies for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. In the case of insurance, temporary exceptions from insurance income and from foreign personal holding company income also apply for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Further, additional temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions are met. In the case of a life insurance or annuity contract, reserves for such contracts are determined under rules specific to the temporary exceptions. Present law also permits a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

Reasons for Change[597]

In the Taxpayer Relief Act of 1997, one-year temporary exceptions from foreign personal holding company income were enacted for income from the active conduct of an insurance, banking, financing, or similar business. In 1998, 1999, 2002, and 2006, the provisions were extended, and in some cases, modified. The Congress believes that it is appropriate to extend the temporary provisions, as modified by the previous legislation, for an additional year.

Explanation of Provision

The provision extends for one year (for taxable years beginning before 2010) the present-law temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business.

Effective Date

The provision is effective for taxable years of foreign corporations beginning after December 31, 2008, and for taxable years of U.S.

[597] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

shareholders with or within which such taxable years of such foreign corporations end.

D. Look-Through Treatment of Payments Between Related Controlled Foreign Corporations Under Foreign Personal Holding Company Income Rules (sec. 304 of the Act and sec. 954(c)(6) of the Code)

Present Law

In general

In general, the rules of subpart F (secs. 951–964) require U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation ("CFC") to include certain income of the CFC (referred to as "subpart F income") on a current basis for U.S. tax purposes, regardless of whether the income is distributed to the shareholders.

Subpart F income includes foreign base company income. One category of foreign base company income is foreign personal holding company income. For subpart F purposes, foreign personal holding company income generally includes dividends, interest, rents, and royalties, among other types of income. There are several exceptions to these rules. For example, foreign personal holding company income does not include dividends and interest received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized, or rents and royalties received by a CFC from a related corporation for the use of property within the country in which the CFC is organized. Interest, rent, and royalty payments do not qualify for this exclusion to the extent that such payments reduce the subpart F income of the payor. In addition, subpart F income of a CFC does not include any item of income from sources within the United States which is effectively connected with the conduct by such CFC of a trade or business within the United States ("ECI") unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a tax treaty.

The "look-through rule"[598]

Under the "look-through rule" (sec. 954(c)(6)), dividends, interest (including factoring income which is treated as equivalent to interest under section 954(c)(1)(E)), rents, and royalties received by one CFC from a related CFC are not treated as foreign personal holding company income to the extent attributable or properly allocable to income of the payor that is neither subpart F nor treated as ECI. For this purpose, a related CFC is a CFC that controls or is controlled by the other CFC, or a CFC that is controlled by the same person or persons that control the other CFC. Ownership of more than 50 percent of the CFC's stock (by vote or value) constitutes control for these purposes.

The Secretary is authorized to prescribe regulations that are necessary or appropriate to carry out the look-through rule, including

[598] The look-through rule was enacted by the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109–222, sec. 103(b)(1) (2006).

such regulations as are appropriate to prevent the abuse of the purposes of such rule.

The look-through rule is effective for taxable years of foreign corporations beginning after December 31, 2005, but before January 1, 2009, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

Reasons for Change[599]

The Congress believes that this provision should be extended for an additional year.

Explanation of Provision

The provision extends for one year the application of the look-through rule, to taxable years of foreign corporations beginning before January 1, 2010, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

Effective Date

The provision is effective for taxable years of foreign corporations beginning after December 31, 2008 (but before January 1, 2010), and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

E. Extension of 15-Year Straight-Line Cost Recovery for Qualified Leasehold Improvements and Qualified Restaurant Improvements; 15-Year Straight-Line Cost Recovery for Certain Improvements to Retail Space (sec. 305 of the Act and sec. 168 of the Code)

Present Law

In general

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[600] The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month.

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[599] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

[600] Sec. 168.

Depreciation of leasehold improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease. This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions exist for certain qualified leasehold improvements and qualified restaurant property.

Qualified leasehold improvement property

Section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2008. Qualified leasehold improvement property is recovered using the straight-line method and a half-year convention. Leasehold improvements placed in service in 2008 and later will be subject to the general rules described above.

Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met. The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.

If a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement. An exception to the rule applies in the case of death and certain transfers of property that qualify for nonrecognition treatment.

Qualified restaurant property

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property placed in service before January 1, 2008. For purposes of the provision, qualified restaurant property means any improvement to a building if such improvement is placed in service more than three years after the date such building was first placed in service and more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals. Qualified restaurant property is recovered using the straight-line method and a half-year convention. Restaurant property placed in service in 2008 and later will be subject to the general rules described above.

Reasons for Change[601]

The Congress believes that taxpayers should not be required to recover the costs of certain leasehold improvements beyond the useful life of the investment. The 39-year recovery period for leasehold improvements for property placed in service after December 31, 2007, extends beyond the useful life of many such investments. Although lease terms differ, the Congress believes that lease terms for commercial real estate are also typically shorter than the 39-year recovery period. In the interests of simplicity and administrability, a uniform period for recovery of leasehold improvements is desirable. Therefore, the provision extends the 15-year recovery period for leasehold improvements.

The Congress also believes that unlike other commercial buildings, restaurant buildings generally are more specialized structures. Restaurants also experience considerably more traffic, and remain open longer than most commercial properties. This daily use causes rapid deterioration of restaurant properties and forces restaurateurs to constantly repair and upgrade their facilities. As such, restaurant facilities generally have a shorter life span than other commercial establishments. The provision extends the 15-year recovery period for improvements made to restaurant buildings, and applies the 15-year recovery period to new restaurants, to more accurately reflect the true economic life of such properties.

The Congress believes that taxpayers should not be required to recover the costs of certain improvements beyond the useful life of the investment. The present law 39-year recovery period for improvements to owner occupied (i.e., not leased) retail property extends beyond the useful life of many such investments. Therefore, the provision includes a 15-year recovery period for qualified retail improvements.

Additionally, the Congress believes that retailers should not be treated differently based on whether the building in which they operate is owned or leased. The shorter 15-year recovery period for leasehold improvements under present law provides an unfair competitive advantage for those retailers who lease space. As many small business retailers own the building in which they operate their business, the Congress believes this provision will provide relief to small businesses.

Explanation of Provision

The present law provisions for qualified leasehold improvement property and restaurant improvements are extended for two years (through December 31, 2009). In addition, the three-year rule for restaurant property is repealed for property placed in service after December 31, 2008, and before January 1, 2010.[602] Thus, restaurant improvements made within the first three years also qualify for the 15-year recovery period.

The provision provides a statutory 15-year recovery period and straight-line method for qualified retail improvement property

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[601] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110-658).

[602] Qualified restaurant property placed in service after December 31, 2008, and before December 31, 2010 does not qualify for bonus depreciation under section 168(k).

placed in service after December 31, 2008, and before January 1, 2010. For purposes of the provision, qualified retail improvement property means any improvement to an interior portion of a building which is nonresidential real property if such portion is open to the general public[603] and is used in the retail trade or business of selling tangible personal property to the general public, and such improvement is placed in service more than three years after the date the building was first placed in service. Qualified retail improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building. In the case of an improvement made by the owner of such improvement, the improvement is a qualified retail improvement only so long as the improvement is held by such owner.

For the purposes of this provision, retail establishments that qualify for the 15-year recovery period include those primarily engaged in the sale of goods. Examples of these retail establishments include, but are not limited to, grocery stores, clothing stores, hardware stores and convenience stores. However, establishments primarily engaged in providing services, such as professional services, financial services, personal services, health services, and entertainment, do not qualify. It is generally intended that businesses defined as a store retailer under the current North American Industry Classification System (industry sub-sectors 441 through 453) qualify for the provision, while those in other industry classes do not qualify under the provision.

Effective Date

The extension of present law treatment of leasehold and restaurant improvements applies to property placed in service after December 31, 2007. The inclusion of new restaurant construction and the retail improvement provision apply to property placed in service after December 31, 2008.

F. Modification of Tax Treatment of Certain Payments to Controlling Exempt Organizations (sec. 306 of the Act and sec. 512 of the Code)

Present Law

In general, organizations exempt from Federal income tax are subject to the unrelated business income tax on income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[604] In general, interest, rents, royalties, and annuities are excluded from the unrelated business income of tax-exempt organizations.[605]

Section 512(b)(13) provides special rules regarding income derived by an exempt organization from a controlled subsidiary. In general, section 512(b)(13) treats otherwise excluded rent, royalty,

[603] Improvements to portions of a building not open to the general public (e.g., stock room in back of retail space) do not qualify under the provision.
[604] Sec. 511.
[605] Sec. 512(b).

annuity, and interest income as unrelated business income if such income is received from a taxable or tax-exempt subsidiary that is 50-percent controlled by the parent tax-exempt organization to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt). However, a special rule enacted as part of the Pension Protection Act of 2006[606] provides that, for payments made pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), the general rule of section 512(b)(13) applies only to the portion of payments received or accrued (before January 1, 2008) in a taxable year that exceeds the amount of the payment that would have been paid or accrued if the amount of such payment had been determined under the principles of section 482 (i.e., at arm's length).[607] In addition, the special rule imposes a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

In the case of a stock subsidiary, "control" means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, "control" means ownership of more than 50 percent of the profits, capital, or beneficial interests. In addition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

Reasons for Change[608]

In enacting the special rule described above, the Pension Protection Act also required that, not later than January 1, 2009, the Secretary shall submit a report to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives a report on the effectiveness of the Internal Revenue Service in administering the special rule and on the extent to which payments by controlled entities to the controlling exempt organization meet the requirements of section 482 of the Code. Such report is required to include the results of any audit of any controlling organization or controlled entity and recommendations relating to the tax treatment of payments from controlled entities to controlling organizations. Considering that the report is not due until January 1, 2009, the Congress believes it is appropriate to extend the special rule.

Explanation of Provision

The provision extends the special rule of the Pension Protection Act to payments received or accrued before January 1, 2010. Ac-

[606] Pub. L. No. 109–280 (2006).
[607] Sec. 512(b)(13)(E).
[608] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

cordingly, under the provision, payments of rent, royalties, annuities, or interest income by a controlled organization to a controlling organization pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), may be includible in the unrelated business taxable income of the controlling organization only to the extent the payment exceeds the amount of the payment determined under the principles of section 482 (i.e., at arm's length). Any such excess is subject to a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

Effective Date

The provision is effective for payments received or accrued after December 31, 2007.

G. Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property (sec. 307 of the Act and sec. 1367 of the Code)

Present Law

Under present law, if an S corporation contributes money or other property to a charity, each shareholder takes into account the shareholder's pro rata share of the contribution in determining its own income tax liability.[609] A shareholder of an S corporation reduces the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder.[610]

In the case of contributions made in taxable years beginning after December 31, 2005, and before January 1, 2008, the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation is equal to the shareholder's pro rata share of the adjusted basis of the contributed property. For contributions made in taxable years beginning after December 31, 2007, the amount of the reduction is the shareholder's pro rata share of the fair market value of the contributed property.

Reasons for Change[611]

The Congress believes that the present-law treatment of contributions of property by S corporations is appropriate and should be extended.

Explanation of Provision

The Act extends the rule relating to the basis reduction on account of charitable contributions of property for two years to contributions made in taxable years beginning before January 1, 2010.

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[609] Sec. 1366(a)(1)(A).

[610] Sec. 1367(a)(2)(B).

[611] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

Effective Date

The provision applies to contributions made in taxable years beginning after December 31, 2007.

H. Suspend Limitation on Rate of Rum Excise Tax Cover Over to Puerto Rico and Virgin Islands (sec. 308 of the Act and sec. 7652(f) of the Code)

Present Law

A $13.50 per proof gallon[612] excise tax is imposed on distilled spirits produced in or imported (or brought) into the United States.[613] The excise tax does not apply to distilled spirits that are exported from the United States, including exports to U.S. possessions (e.g., Puerto Rico and the Virgin Islands).[614]

The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.[615] The amount of the cover over is limited under Code section 7652(f) to $10.50 per proof gallon ($13.25 per proof gallon during the period July 1, 1999 through December 31, 2007).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are divided and covered over to the two possessions under a formula.[616] Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.[617] All of the amounts covered over are subject to the limitation.

Reasons for Change[618]

The Congress believes that it is appropriate to extend the increase in the amount of the rum excise tax covered over to these possessions.

Explanation of Provision

The provision suspends for two years the $10.50 per proof gallon limitation on the amount of excise taxes on rum covered over to Puerto Rico and the Virgin Islands. Under the provision, the cover over amount of $13.25 per proof gallon is extended for rum brought into the United States after December 31, 2007 and before January

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[612] A proof gallon is a liquid gallon consisting of 50 percent alcohol. *See* sec. 5002(a)(10) and (11).

[613] Sec. 5001(a)(1).

[614] Secs. 5062(b), 7653(b) and (c).

[615] Secs. 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under section 7652(b)(3).

[616] Sec. 7652(e)(2).

[617] Secs. 7652(a)(3), (b)(3), and (e)(1).

[618] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

1, 2010. After December 31, 2009, the cover over amount reverts to $10.50 per proof gallon.

Effective Date

The change in the cover over rate is effective for articles brought into the United States after December 31, 2007.

I. Extension of Economic Development Credit for American Samoa (sec. 309 of the Act and sec. 119 of Pub. L. No. 109–432)

Present and Prior Law

In general

For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit.[619] This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions.[620] For purposes of the credit, possessions included, among other places, American Samoa. Subject to certain limitations described below, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporation's non-U.S. source taxable income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions' investment.[621] No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936.[622] The section 936 credit generally expired for taxable years beginning after December 31, 2005, but a special credit, described below, was allowed with respect to American Samoa.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business.

The possession tax credit was available only to a corporation that qualified as an existing credit claimant. The determination of whether a corporation was an existing credit claimant was made separately for each possession. The possession tax credit was computed separately for each possession with respect to which the corporation was an existing credit claimant, and the credit was subject

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[619] Secs. 27(b), 936.

[620] Domestic corporations with activities in Puerto Rico are eligible for the section 30A economic activity credit. That credit is calculated under the rules set forth in section 936.

[621] Under phase-out rules described below, investment only in Guam, American Samoa, and the Northern Mariana Islands (and not in other possessions) now may give rise to income eligible for the section 936 credit.

[622] Sec. 936(c).

to either an economic activity-based limitation or an income-based limitation.

Qualification as existing credit claimant

A corporation was an existing credit claimant with respect to a possession if (1) the corporation was engaged in the active conduct of a trade or business within the possession on October 13, 1995, and (2) the corporation elected the benefits of the possession tax credit in an election in effect for its taxable year that included October 13, 1995.[623] A corporation that added a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceased to be an existing credit claimant as of the close of the taxable year ending before the date on which that new line of business was added.

Economic activity-based limit

Under the economic activity-based limit, the amount of the credit determined under the rules described above was not permitted to exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes.

Income-based limit

As an alternative to the economic activity-based limit, a taxpayer was permitted to elect to apply a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income; in taxable years beginning in 1998 and subsequent years, the applicable percentage was 40 percent.

Repeal and phase out

In 1996, the section 936 credit was repealed for new claimants for taxable years beginning after 1995 and was phased out for existing credit claimants over a period including taxable years beginning before 2006. The amount of the available credit during the phase-out period generally was reduced by special limitation rules. These phase-out period limitation rules did not apply to the credit available to existing credit claimants for income from activities in Guam, American Samoa, and the Northern Mariana Islands. As described previously, the section 936 credit generally was repealed for all possessions, including Guam, American Samoa, and the Northern Mariana Islands, for all taxable years beginning after 2005, but a modified credit was allowed for activities in American Samoa.

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[623] A corporation will qualify as an existing credit claimant if it acquired all the assets of a trade or business of a corporation that (1) actively conducted that trade or business in a possession on October 13, 1995, and (2) had elected the benefits of the possession tax credit in an election in effect for the taxable year that included October 13, 1995.

American Samoa economic development credit

A domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006 is allowed a credit based on the economic activity-based limitation rules described above. The credit is not part of the Code but is computed based on the rules secs. 30A and 936. The credit is allowed for the first two taxable years of a corporation that begin after December 31, 2005, and before January 1, 2008.

The amount of the credit allowed to a qualifying domestic corporation under the provision is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation (described previously) with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses and (2) 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

The section 936(c) rule denying a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the credit under section 936 does not apply with respect to the credit allowed by the provision.

The credit is not available for taxable years beginning after December 31, 2007.

Reasons for Change[624]

Congress believes that it is important to encourage investment in American Samoa. With the expiration of the possession tax credit, the American Samoa economic development credit is an appropriate temporary provision while Congress considers long-term tax policy toward the U.S. possessions.

Explanation of Provision

The provision allows the American Samoa economic development credit to apply for the first four taxable years of a corporation that begin after December 31, 2005, and before January 1, 2010.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

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[624] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

J. Extension of Mine Rescue Team Training Credit (sec. 310 of the Act and sec. 45N of the Code)

Present Law

As part of the general business credit, an eligible employer may claim a credit with respect to each qualified mine rescue team employee equal to the lesser of: (1) 20 percent of the amount paid or incurred by the taxpayer during the taxable year with respect to the training program costs of such qualified mine rescue team employee (including wages of the employee while attending the program); or (2) $10,000.[625] A qualified mine rescue team employee is any full-time employee of the taxpayer who is a miner eligible for more than six months of a taxable year to serve as a mine rescue team member by virtue of either having completed the initial 20-hour course of instruction prescribed by the Mine Safety and Health Administration's Office of Educational Policy and Development, or receiving at least 40 hours of refresher training in such instruction.[626]

An eligible employer is any taxpayer which employs individuals as miners in underground mines in the United States.[627] The term "wages" has the meaning given to such term by section 3306(b) (determined without regard to any dollar limitation contained in that section).[628]

No deduction is allowed for the amount of the expenses otherwise deductible which is equal to the amount of the credit.[629] The credit does not apply to taxable years beginning after December 31, 2008.

Explanation of Provision

The provision extends the termination of the credit for one year to taxable years beginning after December 31, 2009.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

K. Extension of Election To Expense Advanced Mine Safety Equipment (sec. 311 of the Act and sec. 179E of the Code)

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[630] Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property

[625] Sec. 45N(a).
[626] Sec. 45N(b).
[627] Sec. 45N(c).
[628] Sec. 45N(d).
[629] Sec. 280C(e).
[630] Sec. 168.

(generally tangible property other than residential rental property and nonresidential real property) range from 3 to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under section 179. Present law provides that the maximum amount a taxpayer may expense for taxable years beginning in 2008 is $250,000 of the cost of qualifying property placed in service for the taxable year.[631] For taxable years beginning in 2009 and 2010, the limitation is $125,000. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. For taxable years beginning in 2008, the $250,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $800,000. The reduction amount is $500,000 for taxable years beginning in 2009 and 2010. The $125,000 and $500,000 amounts are indexed for inflation in taxable years beginning in 2009 and 2010.

A taxpayer may elect to treat 50 percent of the cost of any qualified advanced mine safety equipment property as an expense in the taxable year in which the equipment is placed in service.[632] "Qualified advanced mine safety equipment property" means any advanced mine safety equipment property for use in any underground mine located in the United States the original use of which commences with the taxpayer and which is placed in service after December 20, 2006, and before January 1, 2009.[633]

Advanced mine safety equipment property means any of the following: (1) emergency communication technology or devices used to allow a miner to maintain constant communication with an individual who is not in the mine; (2) electronic identification and location devices that allow individuals not in the mine to track at all times the movements and location of miners working in or at the mine; (3) emergency oxygen-generating, self-rescue devices that provide oxygen for at least 90 minutes; (4) pre-positioned supplies of oxygen providing each miner on a shift the ability to survive for at least 48 hours; and (5) comprehensive atmospheric monitoring systems that monitor the levels of carbon monoxide, methane, and oxygen that are present in all areas of the mine and that can detect smoke in the case of a fire in a mine.[634]

The portion of the cost of any property with respect to which an expensing election under section 179 is made may not be taken into account for purposes of the 50-percent deduction under section 179E.[635] In addition, a taxpayer making an election under section 179E must file with the Secretary a report containing information

[631] Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A) and a renewal community (sec. 1400J).
[632] Sec. 179E(a).
[633] Secs. 179E(c) and (g).
[634] Sec. 179E(d).
[635] Sec. 179E(e).

with respect to the operation of the mines of the taxpayer as required by the Secretary.[636]

Explanation of Provision

The provision extends for one year, to December 31, 2009, the placed in service termination date for the present-law rule relating to expensing of mine safety equipment.

Effective Date

The provision is effective for property placed in service after December 31, 2008.

L. Extension of Deduction for Income Attributable to Domestic Production Activities in Puerto Rico (sec. 312 of the Act and sec. 199 of the Code)

Present Law

In general

Present law provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to a portion of the taxpayer's qualified production activities income. For taxable years beginning after 2009, the deduction is nine percent of that income. For taxable years beginning in 2005 and 2006, the deduction is three percent of qualified production activities income and for taxable years beginning in 2007, 2008, and 2009, the deduction is six percent of qualified production activities income. For taxpayers subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to just under 32 percent on qualified production activities income.

Qualified production activities income

In general, qualified production activities income is equal to domestic production gross receipts (defined by section 199(c)(4)), reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts and (2) other expenses, losses, or deductions which are properly allocable to those receipts.

Domestic production gross receipts

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[637] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film[638] produced by the taxpayer; (3)

[636] Sec. 179E(f).

[637] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

[638] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation

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any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.

Wage limitation

For taxable years beginning after May 17, 2006, the amount of the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[639] Wages paid to bona fide residents of Puerto Rico generally are not included in the wage limitation amount.[640]

Rules for Puerto Rico

When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia.[641] A special rule for determining domestic production gross receipts, however, provides that in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's gross receipts are taxable under the Federal income tax for individuals or corporations.[642] In computing the 50-percent wage limitation, that taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.[643]

The special rules for Puerto Rico apply only with respect to the first two taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2008.

Reasons for Change[644]

Congress believes that given the expiration of the Puerto Rico economic activity credit after 2005, it is appropriate to use other means to encourage investment in Puerto Rico. In particular, Congress believes it is appropriate to treat a U.S. taxpayer's manufacturing activities in Puerto Rico in a manner similar to the treatment of manufacturing activities in the United States.

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in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

[639] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. For taxable years beginning before May 18, 2006, the limitation is based upon all wages paid by the taxpayer, rather than only wages properly allocable to domestic production gross receipts.

[640] Sec. 3401(a)(8)(C).

[641] Sec. 7701(a)(9).

[642] Sec. 199(d)(8)(A).

[643] Sec. 199(d)(8)(B).

[644] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

Explanation of Provision

The provision allows the special domestic production activities rules for Puerto Rico to apply for the first four taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2010.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

M. Extend and Modify Qualified Zone Academy Bonds (sec. 313 of the Act and new sec. 54E 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. These can include tax-exempt bonds which finance public schools.[645] An issuer must file with the IRS certain information about the bonds issued in order for that bond issue to be tax-exempt.[646] 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.

The tax exemption for State and local bonds does not apply to any arbitrage bond.[647] 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.[648] 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.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments were given the authority to issue "qualified zone academy bonds."[649] A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2007. 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,

[645] Sec. 103.
[646] Sec. 149(e).
[647] Sec. 103(a) and (b)(2).
[648] Sec. 148.
[649] Sec. 1397E.

allocates the credit authority to qualified zone academies within such State.

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. Eligible financial institutions are limited to: (i) a bank (within the meaning of section 581 of the Code); (ii) an insurance company to which subchapter L of the Code applies; and (iii) a corporation actively engaged in the business of lending money. A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includible in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and alternative minimum tax liability.

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 maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the principal on the bond is 50 percent of the face value of the bond.

"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.

The Tax Relief and Health Care Act of 2006 ("TRHCA")[650] imposed the arbitrage requirements which generally apply to interest-bearing tax-exempt bonds on qualified zone academy bonds. In addition, an issuer of qualified zone academy bonds must reasonably expect to and actually spend 95 percent or more of the proceeds of such bonds on qualified zone academy 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 zone academy property during the five-year spending period, bonds will continue to qualify as qualified zone academy bonds if unspent proceeds are used within 90 days from the end of such five-year period to redeem any nonqualified bonds. The five-year spending period may be extended by the Secretary if the issuer establishes that the failure to meet the spending requirement is due to reasonable

[650] Pub. L. No. 109–432 (2006).

cause and the related purposes for issuing the bonds will continue to proceed with due diligence. Issuers of qualified zone academy bonds are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds.

Reasons for Change[651]

The Congress believes that tax-credit bonds provide an effective means of subsidizing rehabilitation and repairs to public school facilities. Thus, the Congress believes that the extension of authority to issue qualified zone academy bonds is appropriate in light of the educational needs that exist today. However, the Congress also recognizes that modifications to the present law qualified zone academy bond program may be necessary to increase the marketability of such bonds. These modifications also will promote additional investment in the beneficiary public schools.

Explanation of Provision

The provision extends and modifies the present-law qualified zone academy bond program. The provision authorizes issuance of up to $400 million of qualified zone academy bonds annually through 2009.

For bonds issued after the date of enactment, the provision also modifies the spending and arbitrage rules that apply to qualified zone academy bonds. The provision modifies the spending rule by requiring 100 percent of available project proceeds to be spent on qualified zone academy property. In addition, the provision modifies the arbitrage rules by providing that available project proceeds invested during the three-year period beginning on the date of issue are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). The provision defines "available project proceeds" as proceeds from the sale of an issue of qualified zone academy bonds, less issuance costs (not to exceed two percent) and any investment earnings on such proceeds. Thus, available project proceeds invested during the three-year spending period may be invested at unrestricted yields, but the earnings on such investments must be spent on qualified zone academy property.

The provision provides that amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified zone academy bonds are issued.

Effective Date

The provision applies to bonds issued after the date of enactment (October 3, 2008).

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[651] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

N. Indian Employment Tax Credit (sec. 314 of the Act and sec. 45A of the Code)

Present Law

In general, a credit against income tax liability is allowed to employers for the first $20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer with respect to certain employees (sec. 45A). The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs during the current year over the amount of such wages and costs incurred by the employer during 1993. The credit is an incremental credit, such that an employer's current-year qualified wages and qualified employee health insurance costs (up to $20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993. No deduction is allowed for the portion of the wages equal to the amount of the credit.

Qualified wages means wages paid or incurred by an employer for services performed by a qualified employee. A qualified employee means any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed. An "Indian reservation" is a reservation as defined in section 3(d) of the Indian Financing Act of 1974 or section 4(1) of the Indian Child Welfare Act of 1978. For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

An employee is not treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during the taxable year exceeds an amount determined at an annual rate of $30,000 (which after adjustment for inflation is currently $40,000).[652] In addition, an employee will not be treated as a qualified employee under certain specific circumstances, such as where the employee is related to the employer (in the case of an individual employer) or to one of the employer's shareholders, partners, or grantors. Similarly, an employee will not be treated as a qualified employee where the employee has more than a 5 percent ownership interest in the employer. Finally, an employee will not be considered a qualified employee to the extent the employee's services relate to gaming activities or are performed in a building housing such activities.

The Indian employment tax credit is not available for taxable years beginning after December 31, 2007.

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[652] See Form 8845, Indian Employment Credit (Rev. Dec. 2006).

Reasons for Change[653]

The Congress believes that extending the Indian employment credit will expand business and employment opportunities within Indian reservations.

Explanation of Provision

The provision extends for 2 years the present-law employment credit provision (through taxable years beginning on or before December 31, 2009).

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

O. Accelerated Depreciation for Business Property on Indian Reservations (sec. 315 of the Act and sec. 168(j) of the Code)

Present Law

With respect to certain property used in connection with the conduct of a trade or business within an Indian reservation, depreciation deductions under section 168(j) are determined using the following recovery periods:

3-year property	2 years
5-year property	3 years
7-year property	4 years
10-year property	6 years
15-year property	9 years
120-year property	12 years
Nonresidential real property	22 years

"Qualified Indian reservation property" eligible for accelerated depreciation includes property described in the table above which is: (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation; (2) not used or located outside the reservation on a regular basis; (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer;[654] and (4) is not property placed in service for purposes of conducting gaming activities.[655] Certain "qualified infrastructure property" may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities).[656]

An "Indian reservation" means a reservation as defined in section 3(d) of the Indian Financing Act of 1974 or section 4(10) of the Indian Child Welfare Act of 1978. For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the

[653] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).
[654] For these purposes, related persons is defined in Sec. 465(b)(3)(C).
[655] Sec. 168(j)(4)(A).
[656] Sec. 168(j)(4)(C).

jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax. The accelerated depreciation for Indian reservations is available with respect to property placed in service on or after January 1, 1994, and before January 1, 2008.

Reasons for Change[657]

The Congress believes that extending the depreciation incentive will encourage economic development within Indian reservations and expand employment opportunities on such reservations.

Explanation of Provision

The provision extends for two years the present-law incentive relating to depreciation of qualified Indian reservation property (to apply to property placed in service through December 31, 2009).

Effective Date

The provision is effective for property placed in service after December 31, 2007.

P. Railroad Track Maintenance (sec. 316 of the Act and sec. 45G of the Code)

Present Law

Present law provides a 50-percent business tax credit for qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer during the taxable year.[658] The credit is limited to the product of $3,500 times the number of miles of railroad track (1) owned or leased by an eligible taxpayer as of the close of its taxable year, and (2) assigned to the eligible taxpayer by a Class II or Class III railroad that owns or leases such track at the close of the taxable year.[659] Each mile of railroad track may be taken into account only once, either by the owner of such mile or by the owner's assignee, in computing the per-mile limitation. Under the provision, the credit is limited in respect of the total number of miles of track (1) owned or leased by the Class II or Class III railroad and (2) assigned to the Class II or Class III railroad for purposes of the credit.

Qualified railroad track maintenance expenditures are defined as gross expenditures (whether or not otherwise chargeable to capital account) for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by a Class II or Class III railroad (determined without regard

[657] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).
[658] Sec. 45G(a).
[659] Sec. 45G(b)(1).

to any consideration for such expenditure given by the Class II or Class III railroad which made the assignment of such track).[660]

An eligible taxpayer means any Class II or Class III railroad, and any person who transports property using the rail facilities of a Class II or Class III railroad or who furnishes railroad-related property or services to a Class II or Class III railroad, but only with respect to miles of railroad track assigned to such person by such railroad under the provision.[661]

The terms Class II or Class III railroad have the meanings given by the Surface Transportation Board.[662]

The provision applies to qualified railroad track maintenance expenditures paid or incurred during taxable years beginning after December 31, 2004, and before January 1, 2008.

Reasons for Change[663]

The Congress believes that Class II and Class III railroads are an important part of the nation's railway system. Therefore, the Congress believes that this incentive for railroad track maintenance expenditures should be extended.

Explanation of Provision

The provision extends the present law provision for two years, for qualified railroad track maintenance expenditures paid or incurred before January 1, 2010. The provision also permits the railroad track maintenance credit to reduce a taxpayer's tax liability below its tentative minimum tax.

Effective Date

The extension of present law is effective for expenditures paid or incurred during taxable years beginning after December 31, 2007. The modification to the alternative minimum tax rules applies to credits determined under section 45G in taxable years beginning after December 31, 2007, and to carrybacks of such credits.

Q. Seven-Year Cost Recovery Period for Motorsports Racing Track Facility (sec. 317 of the Act and sec. 168 of the Code)

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[664] The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39

[660] Sec. 45G(d).
[661] Sec. 45G(c).
[662] Sec. 45G(e)(1).
[663] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).
[664] Sec. 168.

years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month. Land improvements (such as roads and fences) are recovered over 15 years. An exception exists for the theme and amusement park industry, whose assets are assigned a recovery period of seven years. Additionally, a motorsports entertainment complex placed in service before December 31, 2007 is assigned a recovery period of seven years.[665] For these purposes, a motorsports entertainment complex means a racing track facility which is permanently situated on land that during the 36 month period following its placed in service date it hosts a racing event.[666] The term motorsports entertainment complex also includes ancillary facilities, land improvements (e.g., parking lots, sidewalks, fences), support facilities (e.g., food and beverage retailing, souvenir vending), and appurtenances associated with such facilities (e.g., ticket booths, grandstands).

Reasons for Change[667]

The Congress believes that extending the depreciation incentive will encourage economic development. The Congress also believes that taxpayers should not be required to recover the costs of motorsports entertainment complex beyond the useful life of the investment. Therefore, the provision extends the seven-year recovery period for motorsports entertainment complex property.

Explanation of Provision

The provision extends the present law seven-year recovery period for two years through December 31, 2009.

Effective Date

The provision is effective for property placed in service after December 31, 2007.

R. Expensing of Environmental Remediation Costs (sec. 318 of the Act and sec. 198 of the Code)

Present Law

Present law allows a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[668] Treasury regulations provide that the cost of incidental repairs that neither materially add to the value of property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted currently as a business expense. Section 263(a)(1) limits the scope of section 162 by prohibiting a current deduction for certain capital expenditures. Treasury regulations de-

[665] Sec. 168(e)(3)(C)(ii).
[666] Sec. 168(i)(15).
[667] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).
[668] Sec. 162.

fine "capital expenditures" as amounts paid or incurred to materially add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or to adapt property to a new or different use. Amounts paid for repairs and maintenance do not constitute capital expenditures. The determination of whether an expense is deductible or capitalizable is based on the facts and circumstances of each case.

Taxpayers may elect to treat certain environmental remediation expenditures paid or incurred before January 1, 2008, that would otherwise be chargeable to capital account as deductible in the year paid or incurred.[669] The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. In general, any expenditure for the acquisition of depreciable property used in connection with the abatement or control of hazardous substances at a qualified contaminated site does not constitute a qualified environmental remediation expenditure. However, depreciation deductions allowable for such property, which would otherwise be allocated to the site under the principles set forth in Commissioner v. Idaho Power Co.[670] and section 263A, are treated as qualified environmental remediation expenditures.

A "qualified contaminated site" (a so-called "brownfield") generally is any property that is held for use in a trade or business, for the production of income, or as inventory and is certified by the appropriate State environmental agency to be an area at or on which there has been a release (or threat of release) or disposal of a hazardous substance. Both urban and rural property may qualify. However, sites that are identified on the national priorities List under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA")[671] cannot qualify as targeted areas. Hazardous substances generally are defined by reference to sections 101(14) and 102 of CERCLA, subject to additional limitations applicable to asbestos and similar substances within buildings, certain naturally occurring substances such as radon, and certain other substances released into drinking water supplies due to deterioration through ordinary use, as well as petroleum products defined in section 4612(a)(3) of the Code.

In the case of property to which a qualified environmental remediation expenditure otherwise would have been capitalized, any deduction allowed under section 198 is treated as a depreciation deduction and the property is treated as section 1245 property. Thus, deductions for qualified environmental remediation expenditures are subject to recapture as ordinary income upon a sale or other disposition of the property. In addition, sections 280B (demolition of structures) and 468 (special rules for mining and solid waste reclamation and closing costs) do not apply to amounts that are treated as expenses under this provision.

Section 1400N(g) permits the expensing of environmental remediation expenditures paid or incurred on or after August 28, 2005,

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[669] Sec. 198.
[670] 418 U.S. 1 (1974).
[671] Pub. L. No. 96–510 (1980)

and before January 1, 2008, to abate contamination at qualified contaminated sites located in the Gulf Opportunity Zone.

Reasons for Change[672]

The Congress believes that the expensing of brownfields remediation costs promotes the goal of environmental remediation and promotes new investment and employment opportunities by lowering the net capital cost of a development project. Therefore, the Congress believes it is appropriate to extend the present-law provision permitting the expensing of these environmental remediation costs.

Explanation of Provision

The provision extends the present-law expensing provision under section 198 for two years through December 31, 2009.

Effective Date

The provision is effective for expenditures paid or incurred after December 31, 2007.

S. Extension of the Hurricane Katrina Work Opportunity Tax Credit (sec. 319 of the bill)

Present Law

Work opportunity tax credit

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally an employer is eligible for the credit only for qualified wages paid to members of a targeted group. There are nine targeted groups: (1) families receiving Temporary Assistance for Needy Families Program ("TANF"); (2) qualified veterans; (3) qualified ex-felons; (4) designated community residents; (5) vocational rehabilitation referrals; (6) qualified summer youth employees; (7) qualified food stamp recipients; (8) qualified supplemental security income ("SSI") benefit recipients; and (9) qualified long-term family assistance recipients.

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[672] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in sec. 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). There are two exceptions to this general rule. First, with respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Second, with respect to qualified veterans who are entitled to compensation for a service-connected disability, the maximum credit is $4,800 because qualified first-year wages are $12,000 rather than $6,000 for such individuals.[673] Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

Certification rules

An individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the indi-

[673] The expanded definition of qualified first-year wages does not apply to the veterans qualified with reference to a food stamp program, as defined under present law.

vidual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

Minimum employment period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

The work opportunity tax credit is not available for individuals who begin work for an employer after August 31, 2011.

Work Opportunity Tax Credit for Hurricane Katrina Employees

In general

The Katrina Emergency Tax Relief Act of 2005 provided that a Hurricane Katrina employee is treated as a member of a targeted group for purposes of the work opportunity tax credit. A Hurricane Katrina employee was: (1) an individual who on August 28, 2005, had a principal place of abode in the core disaster area and was hired during the two-year period beginning on such date for a position, the principal place of employment of which was located in the core disaster area; and (2) an individual who on August 28, 2005, had a principal place of abode in the core disaster area, who was displaced from such abode by reason of Hurricane Katrina and was hired during the period beginning on such date and ending on December 31, 2005 without regard to whether the new principal place of employment is in the core disaster area.

The present-law WOTC certification requirement was waived for such individuals. In lieu of the certification requirement, an individual may have provided to the employer reasonable evidence that the individual is a Hurricane Katrina employee.

The present-law rule that denies the credit with respect to wages of employees who had been previously employed by the employer was waived for the first hire of such employee as a Hurricane Katrina employee unless such employee was an employee of the employer on August 28, 2005.

Definitions

The term "Hurricane Katrina disaster area" means an area with respect to which a major disaster has been declared by the President before September 14, 2005 under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

The term "core disaster area" means that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

Reasons for Change[674]

The Congress believes that the work opportunity tax credit should continue to be available as an incentive to provide employment opportunities in the core disaster area of Hurricane Katrina.

Explanation of Provision

The provision extends through August 28, 2009, the work opportunity tax credit for certain Hurricane Katrina employees employed within the core disaster area. For this purpose, a Hurricane Katrina employee employed within the core disaster area is an individual who on August 28, 2005, had a principal place of abode in the core disaster area and is hired on or after August 28, 2005 and before August 29, 2009 for a position, the principal place of employment of which was located in the core disaster area.[675] The other special rules (e.g., certification and previous employment) for Hurricane Katrina employees apply.

Effective Date

The provision is effective for individuals hired after August 28, 2007, and before August 29, 2009.

T. Extension of Increased Rehabilitation Credit for Structures in the Gulf Opportunity Zone (sec. 320 of the bill and sec. 1400N(h) of the Code)

Present Law

Present law provides a two-tier tax credit for rehabilitation expenditures.

A 20-percent credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure. For this purpose, a certified historic structure means any building that is listed in the National Register, or that is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary of the Treasury as being of historic significance to the district.

A 10-percent credit is provided for qualified rehabilitation expenditures with respect to a qualified rehabilitated building, which

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[674] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

[675] The prior-law work opportunity tax credit for Katrina employees hired to a new place of employment outside of the core disaster area is not extended by this provision.

generally means a building that was first placed in service before 1936. The pre-1936 building must meet requirements with respect to retention of existing external walls and internal structural framework of the building in order for expenditures with respect to it to qualify for the 10-percent credit. A building is treated as having met the substantial rehabilitation requirement under the 10-percent credit only if the rehabilitation expenditures during the 24-month period selected by the taxpayer and ending within the taxable year exceed the greater of (1) the adjusted basis of the building (and its structural components), or (2) $5,000.

The provision requires the use of straight-line depreciation or the alternative depreciation system in order for rehabilitation expenditures to be treated as qualified under the provision.

Present law increases from 20 to 26 percent, and from 10 to 13 percent, respectively, the credit under section 47 with respect to any certified historic structure or qualified rehabilitated building located in the Gulf Opportunity Zone, provided the qualified rehabilitation expenditures with respect to such buildings or structures are incurred on or after August 28, 2005, and before January 1, 2009. The provision is effective for expenditures incurred on or after August 28, 2005, for taxable years ending on or after August 28, 2005.

Explanation of Provision

The provision extends for one additional year the increase in the rehabilitation credit from 20 to 26 percent, and from 10 to 13 percent, respectively, with respect to any certified historic structure or qualified rehabilitated building located in the Gulf Opportunity Zone. Thus, the increase applies for qualified rehabilitation expenditures with respect to such buildings or structures incurred before January 1, 2010.

Effective Date

The provision is effective upon enactment (October 3, 2008).

U. Extension of the Enhanced Charitable Deduction for Contributions of Computer Technology and Equipment (sec. 321 of the Act and sec. 170 of the Code)

Present Law

In the case of a charitable contribution of inventory or other ordinary-income or short-term capital gain property, the amount of the charitable deduction generally is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose. In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property.[676]

[676] Sec. 170(e)(1).

Under present law, a taxpayer's deduction for charitable contributions of computer technology and equipment generally is limited to the taxpayer's basis (typically, cost) in the property. However, certain corporations may claim a deduction in excess of basis for a "qualified computer contribution."[677] This enhanced deduction is equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis. The enhanced deduction for qualified computer contributions expires for any contribution made during any taxable year beginning after December 31, 2007.

A qualified computer contribution means a charitable contribution of any computer technology or equipment, which meets standards of functionality and suitability as established by the Secretary of the Treasury. The contribution must be to certain educational organizations or public libraries and made not later than three years after the taxpayer acquired the property or, if the taxpayer constructed or assembled the property, not later than the date construction or assembly of the property is substantially completed.[678] The original use of the property must be by the donor or the donee,[679] and in the case of the donee, must be used substantially for educational purposes related to the function or purpose of the donee. The property must fit productively into the donee's education plan. The donee may not transfer the property in exchange for money, other property, or services, except for shipping, installation, and transfer costs. To determine whether property is constructed or assembled by the taxpayer, the rules applicable to qualified research contributions apply. Contributions may be made to private foundations under certain conditions.[680]

Reasons for Change[681]

The Congress believes that public libraries and educational organizations continue to benefit from corporate contributions of computer technology and equipment and that it is appropriate to extend the enhanced deduction for such contributions.

Explanation of Provision

The provision extends the enhanced deduction for computer technology and equipment to apply to contributions made during any taxable year beginning after December 31, 2007, and before January 1, 2010.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

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[677] Secs. 170(e)(4) and 170(e)(6).

[678] If the taxpayer constructed the property and reacquired such property, the contribution must be within three years of the date the original construction was substantially completed. Sec. 170(e)(6)(D)(i).

[679] This requirement does not apply if the property was reacquired by the manufacturer and contributed. Sec. 170(e)(6)(D)(ii).

[680] Sec. 170(e)(6)(C).

[681] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

V. Tax Incentives for Investment in the District of Columbia (sec. 322 of the Act and secs. 1400, 1400A, 1400B, and 1400C of the Code)

Present Law

In general

The Taxpayer Relief Act of 1997 designated certain economically depressed census tracts within the District of Columbia as the District of Columbia Enterprise Zone (the "D.C. Zone"), within which businesses and individual residents are eligible for special tax incentives. The census tracts that compose the D.C. Zone are (1) all census tracts that presently are part of the D.C. enterprise community designated under section 1391 (i.e., portions of Anacostia, Mt. Pleasant, Chinatown, and the easternmost part of the District), and (2) all additional census tracts within the District of Columbia where the poverty rate is not less than 20 percent. The D.C. Zone designation remained in effect for the period from January 1, 1998, through December 31, 2007. In general, the tax incentives available in connection with the D.C. Zone are a 20-percent wage credit, an additional $35,000 of section 179 expensing for qualified zone property, expanded tax-exempt financing for certain zone facilities, and a zero-percent capital gains rate from the sale of certain qualified D.C. zone assets.

Wage credit

A 20-percent wage credit is available to employers for the first $15,000 of qualified wages paid to each employee (i.e., a maximum credit of $3,000 with respect to each qualified employee) who (1) is a resident of the D.C. Zone, and (2) performs substantially all employment services within the D.C. Zone in a trade or business of the employer.

Wages paid to a qualified employee who earns more than $15,000 are eligible for the wage credit (although only the first $15,000 of wages is eligible for the credit). The wage credit is available with respect to a qualified full-time or part-time employee (employed for at least 90 days), regardless of the number of other employees who work for the employer. In general, any taxable business carrying out activities in the D.C. Zone may claim the wage credit, regardless of whether the employer meets the definition of a "D.C. Zone business."[682]

An employer's deduction otherwise allowed for wages paid is reduced by the amount of wage credit claimed for that taxable year.[683] Wages are not to be taken into account for purposes of the wage credit if taken into account in determining the employer's work opportunity tax credit under section 51.[684] In addition, the $15,000 cap is reduced by any wages taken into account in com-

[682] However, the wage credit is not available for wages paid in connection with certain business activities described in section 144(c)(6)(B) or certain farming activities. In addition, wages are not eligible for the wage credit if paid to (1) a person who owns more than five percent of the stock (or capital or profits interests) of the employer, (2) certain relatives of the employer, or (3) if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the business.

[683] Sec. 280C(a).

[684] Secs. 1400H(a) and 1396(c)(3)(A).

puting the work opportunity tax credit.[685] The wage credit may be used to offset up to 25 percent of alternative minimum tax liability.[686]

Section 179 expensing

In general, a D.C. Zone business is allowed an additional $35,000 of section 179 expensing for qualifying property placed in service by a D.C. Zone business.[687] The section 179 expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified zone property placed in service during the year by the taxpayer exceeds $200,000 ($500,000 for taxable years beginning after 2006 and before 2011). The term "qualified zone property" is defined as depreciable tangible property (including buildings), provided that (1) the property is acquired by the taxpayer (from an unrelated party) after the designation took effect, (2) the original use of the property in the D.C. Zone commences with the taxpayer, and (3) substantially all of the use of the property is in the D.C. Zone in the active conduct of a trade or business by the taxpayer.[688] Special rules are provided in the case of property that is substantially renovated by the taxpayer.

Tax-exempt financing

A qualified D.C. Zone business is permitted to borrow proceeds from tax-exempt qualified enterprise zone facility bonds (as defined in section 1394) issued by the District of Columbia.[689] Such bonds are subject to the District of Columbia's annual private activity bond volume limitation. Generally, qualified enterprise zone facility bonds for the District of Columbia are bonds 95 percent or more of the net proceeds of which are used to finance certain facilities within the D.C. Zone. The aggregate face amount of all outstanding qualified enterprise zone facility bonds per qualified D.C. Zone business may not exceed $15 million and may be issued only while the D.C. Zone designation is in effect.

Zero-percent capital gains

A zero-percent capital gains rate applies to capital gains from the sale of certain qualified D.C. Zone assets held for more than five years.[690] In general, a qualified "D.C. Zone asset" means stock or partnership interests held in, or tangible property held by, a D.C. Zone business. For purposes of the zero-percent capital gains rate, the D.C. Enterprise Zone is defined to include all census tracts within the District of Columbia where the poverty rate is not less than 10 percent.

In general, gain eligible for the zero-percent tax rate means gain from the sale or exchange of a qualified D.C. Zone asset that is (1) a capital asset or property used in the trade or business as defined in section 1231(b), and (2) acquired before January 1, 2008. Gain that is attributable to real property, or to intangible assets, qualifies for the zero-percent rate, provided that such real property or

[685] Secs. 1400H(a) and 1396(c)(3)(B).
[686] Sec. 38(c)(2).
[687] Sec. 1397A.
[688] Sec. 1397D.
[689] Sec. 1400A.
[690] Sec. 1400B.

intangible asset is an integral part of a qualified D.C. Zone business.[691] However, no gain attributable to periods before January 1, 1998, and after December 31, 2012, is qualified capital gain.

District of Columbia homebuyer tax credit

First-time homebuyers of a principal residence in the District of Columbia are eligible for a nonrefundable tax credit of up to $5,000 of the amount of the purchase price. The $5,000 maximum credit applies both to individuals and married couples. Married individuals filing separately can claim a maximum credit of $2,500 each. The credit phases out for individual taxpayers with adjusted gross income between $70,000 and $90,000 ($110,000–$130,000 for joint filers). For purposes of eligibility, "first-time homebuyer" means any individual if such individual did not have a present ownership interest in a principal residence in the District of Columbia in the one-year period ending on the date of the purchase of the residence to which the credit applies. The credit expired for purchases after December 31, 2007.[692]

Reasons for Change[693]

The Congress believes that it continues to be important to provide tax incentives to individuals and businesses in the D.C. Zone and that it is appropriate to extend such incentives.

Explanation of Provision

The provision extends the designation of the D.C. Zone for two years (through December 31, 2009), thus extending the wage credit and section 179 expensing for one year.

The provision extends the tax-exempt financing authority for two years, applying to bonds issued during the period beginning on January 1, 1998, and ending on December 31, 2009.

The provision extends the zero-percent capital gains rate applicable to capital gains from the sale of certain qualified D.C. Zone assets for two years.

The provision extends the first-time homebuyer credit for two years, through December 31, 2009.

Effective Date

The provision is effective for periods beginning after, bonds issued after, acquisitions after, and property purchased after December 31, 2007.

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[691] However, sole proprietorships and other taxpayers selling assets directly cannot claim the zero-percent rate on capital gain from the sale of any intangible property (i.e., the integrally related test does not apply.

[692] Sec. 1400C(i).

[693] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

W. Extension of the Enhanced Charitable Deduction for Contributions of Food Inventory; Suspension of Percentage Limits on Certain Contributions of Food Inventory (sec. 323 of the Act and sec. 170 of the Code)

Present Law

Charitable contributions in general

In general, an income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization (sec. 170).

Charitable contributions of cash are deductible in the amount contributed. In general, contributions of capital gain property to a qualified charity are deductible at fair market value with certain exceptions. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of other appreciated property generally are deductible at the donor's basis in the property. Contributions of depreciated property generally are deductible at the fair market value of the property.

Percentage limitations in general

Contributions by individuals

For individuals, in any taxable year, the amount deductible as a charitable contribution is limited to a percentage of the taxpayer's contribution base. The applicable percentage of the contribution base varies depending on the type of donee organization and property contributed. The contribution base is defined as the taxpayer's adjusted gross income computed without regard to any net operating loss carryback.

Contributions by an individual taxpayer of property (other than appreciated capital gain property) to a charitable organization described in section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) may not exceed 50 percent of the taxpayer's contribution base. Contributions of this type of property to nonoperating private foundations and certain other organizations generally may be deducted up to 30 percent of the taxpayer's contribution base.

Contributions of appreciated capital gain property to charitable organizations described in section 170(b)(1)(A) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of appreciated capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of appreciated capital gain property to charitable organizations described in section 170(b)(1)(B) (e.g., private nonoperating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

Contributions by corporations

For corporations, in any taxable year, charitable contributions are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating loss or capital loss carrybacks.

For purposes of determining whether a corporation's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions.

Carryforward of excess contributions

Charitable contributions that exceed the applicable percentage limitation may be carried forward for up to five years (sec. 170(d)). The amount that may be carried forward from a taxable year ("contribution year") to a succeeding taxable year may not exceed the applicable percentage of the contribution base for the succeeding taxable year less the sum of contributions made in the succeeding taxable year plus contributions made in taxable years prior to the contribution year and treated as paid in the succeeding taxable year under this provision.

Special percentage limitation rules for qualified conservation contributions

The 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined in section 170(h)). Instead, individuals may deduct the fair market value of any qualified conservation contribution to an organization described in section 170(b)(1)(A) to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions.[694] These contributions are not taken into account in determining the amount of other allowable charitable contributions. Individuals are allowed to carry any qualified conservation contributions that exceed the 50-percent limitation forward for up to 15 years.

In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[695]

A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of

[694] Sec. 170(b)(1)(E).
[695] Sec. 170(b)(2)(B).

section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

General rules regarding contributions of food inventory

Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or if less the fair market value of the inventory.

For certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.[696] In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.[697] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory.[698] Accordingly, if the allowable charitable deduction for inventory is the fair market value of the inventory, the donor reduces its cost of goods sold by such value, with the result that the difference between the fair market value and the donor's basis may still be recovered by the donor other than as a charitable contribution.

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.[699]

Temporary rule expanding and modifying the enhanced deduction for contributions of food inventory

Under a temporary provision enacted as part of the Katrina Emergency Tax Relief Act of 2005[700] and extended by the Pension Protection Act of 2006,[701] any taxpayer, whether or not a C corporation, engaged in a trade or business is eligible to claim the en-

[696] ASec. 170(e)(3).
[697] Sec. 170(b)(2).
[698] Treas. Reg. sec. 1.170A–4A(c)(3).
[699] *Lucky Stores Inc.* v. *Commissioner,* 105 T.C. 420 (1995) (holding that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted).
[700] Pub. L. No. 109–73 (2005).
[701] Pub. L. No. 109–280 (2006).

hanced deduction for donations of food inventory.[702] For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 10 percent of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships (or other non C corporation) from which contributions of apparently wholesome food are made. For example, if a taxpayer is a sole proprietor, a shareholder in an S corporation, and a partner in a partnership, and each business makes charitable contributions of food inventory, the taxpayer's deduction for donations of food inventory is limited to 10 percent of the taxpayer's net income from the sole proprietorship and the taxpayer's interests in the S corporation and partnership. However, if only the sole proprietorship and the S corporation made charitable contributions of food inventory, the taxpayer's deduction would be limited to 10 percent of the net income from the trade or business of the sole proprietorship and the taxpayer's interest in the S corporation, but not the taxpayer's interest in the partnership.[703]

Under the temporary provision, the enhanced deduction for food is available only for food that qualifies as "apparently wholesome food." "Apparently wholesome food" is defined as food intended for human consumption that meets all quality and labeling standards imposed by Federal, State, and local laws and regulations even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

The temporary provision does not apply to contributions made after December 31, 2007.

Reasons for Change[704]

The Congress believes that charitable organizations benefit from charitable contributions of food by businesses other than C corporations and that the enhanced deduction is a useful incentive for the making of such contributions. Accordingly, the Congress believes it is appropriate to extend the special rule for charitable contributions of food inventory.

Explanation of Provision

The Act extends the expansion of, and modifications to, the enhanced deduction for charitable contributions of food inventory to contributions made before January 1, 2010.

In addition, the Act temporarily suspends the percentage limitations on certain contributions of food inventory. Specifically, in the case of a qualified farmer or rancher (as defined in section 170(b)(1)(E)), a charitable contribution of food inventory eligible for

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[702] Sec. 170(e)(3)(C).

[703] The 10 percent limitation does not affect the application of the generally applicable percentage limitations. For example, if 10 percent of a sole proprietor's net income from the proprietor's trade or business was greater than 50 percent of the proprietor's contribution base, the available deduction for the taxable year (with respect to contributions to public charities) would be 50 percent of the proprietor's contribution base. Consistent with present law, such contributions may be carried forward because they exceed the 50 percent limitation. Contributions of food inventory by a taxpayer that is not a C corporation that exceed the 10 percent limitation but not the 50 percent limitation could not be carried forward.

[704] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

the special enhanced deduction rules described above and made during the period beginning on the date of enactment (October 3, 2008) and ending on December 31, 2008, is treated as a qualified conservation contribution for purposes of section 170(b)(1)(E) (in the case of an individual) or 170(b)(1)(B) (in the case of a corporation).

As a result, in the case of an individual, the deduction for such contributions is allowed up to the amount by which the taxpayer's contribution base exceeds the deduction for other allowable charitable contributions. In the case of a corporation, the deduction for such contributions is allowed up to the amount by which the corporation's taxable income (as computed under section 170(b)(2)) exceeds the deduction for other allowable charitable contributions. Any excess qualifying contributions may be carried forward to the succeeding 15 taxable years (in a manner consistent with the rules of section 170(d)(1)).

Effective Date

The extension of the special enhanced deduction rules regarding contributions of food inventory is effective for contributions made after December 31, 2007. The temporary suspension of the percentage limitations on certain charitable contributions of food inventory is effective for taxable years ending after the date of enactment (October 3, 2008).

X. Extension of the Enhanced Charitable Deduction for Contributions of Book Inventory (sec. 324 of the Act and sec. 170 of the Code)

Present Law

Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or, if less, the fair market value of the inventory.

In general, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.[705] In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.[706] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, the property must satisfy the applicable requirements of

[705] Sec. 170(e)(3).
[706] Sec. 170(b)(2).

such Act on the date of transfer and for 180 days prior to the transfer.

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory.[707] Accordingly, if the allowable charitable deduction for inventory is the fair market value of the inventory, the donor reduces its cost of goods sold by such value, with the result that the difference between the fair market value and the donor's basis may still be recovered by the donor other than as a charitable contribution.

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

The Katrina Emergency Tax Relief Act of 2005[708] expanded the generally applicable enhanced deduction for C corporations to certain qualified book contributions made after August 28, 2005, and before January 1, 2006. The Pension Protection Act of 2006[709] extended the deduction for qualified book contributions to contributions made before January 1, 2008. A qualified book contribution means a charitable contribution of books to a public school that provides elementary education or secondary education (kindergarten through grade 12) and that is an educational organization that 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. The enhanced deduction for qualified book contributions is not allowed unless the donee organization certifies in writing that the contributed books are suitable, in terms of currency, content, and quantity, for use in the donee's educational programs and that the donee will use the books in such educational programs. The donee also must make the certifications required for the generally applicable enhanced deduction, i.e., the donee will (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.

Reasons for Change[710]

The Congress believes that public schools benefit from charitable contributions of book inventory and that the enhanced deduction is a useful incentive for the making of such contributions. Accordingly, the Congress believes it is appropriate to extend the enhanced deduction for charitable contributions of book inventory to public schools.

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[707] Treas. Reg. sec. 1.170A–4A(c)(3).

[708] Pub. L. No. 109–73 (2005).

[709] Pub. L. No. 109–180 (2006).

[710] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

Explanation of Provision

The provision extends the enhanced deduction for contributions of book inventory to contributions made before January 1, 2010.

Effective Date

The provision is effective for contributions made after December 31, 2007.

TITLE IV—EXTENSION OF TAX ADMINISTRATION PROVISIONS

A. Extension of IRS Authority to Fund Undercover Operations (sec. 401 of the Act and sec. 7608 of the Code)

Present Law

IRS undercover operations are statutorily exempt[711] from the generally applicable restrictions controlling the use of Government funds (which generally provide that all receipts must be deposited in the general fund of the Treasury and all expenses paid out of appropriated funds). In general, the Code permits the IRS to use proceeds from an undercover operation, through 2007. The IRS is required to conduct a detailed financial audit of large undercover operations in which the IRS is churning funds and to provide an annual audit report to the Congress on all such large undercover operations.

Reasons for Change[712]

The Congress believes it is appropriate to permanently extend the IRS's authority to use proceeds from undercover operations to pay additional enforcement expenses. This authority provides the IRS with an important enforcement tool and it is similar to the authority provided to other law enforcement agencies.

Explanation of Provision

The provision makes permanent the IRS's authority to use proceeds from an undercover operation to pay additional expenses incurred in the undercover operation.

Effective Date

The provision is effective for operations conducted after date of enactment (October 3, 2008).

B. Authority to Disclose Information Related to Terrorist Activity Made Permanent (sec. 402 of the Act and sec. 6103 of the Code)

Present Law

In general

Section 6103 provides that returns and return information may not be disclosed by the IRS, other Federal employees, State employ-

[711] Sec. 7608(c).

[712] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

ees, and certain others having access to the information except as provided in the Internal Revenue Code. Section 6103 contains a number of exceptions to this general rule of nondisclosure that authorize disclosure in specifically identified circumstances (including nontax criminal investigations) when certain conditions are satisfied.

Disclosure provisions relating to emergency circumstances

The IRS is authorized to disclose return information to apprise Federal law enforcement agencies of danger of death or physical injury to an individual or to apprise Federal law enforcement agencies of imminent flight of an individual from Federal prosecution.[713] This authority has been used in connection with the investigation of terrorist activity.[714]

Disclosure provisions relating specifically to terrorist activity

Also among the disclosures permitted under the Code is disclosure of returns and return information for purposes of investigating terrorist incidents, threats, or activities, and for analyzing intelligence concerning terrorist incidents, threats, or activities. The term "terrorist incident, threat, or activity" is statutorily defined to mean an incident, threat, or activity involving an act of domestic terrorism or international terrorism.[715]

The term "international terrorism" means activities that involve violent acts or acts dangerous to human life that are a violation of the criminal laws of the United States or of any State, or that would be a criminal violation if committed within the jurisdiction of the United States or of any State; appear to be intended to intimidate or coerce a civilian population, to influence the policy of a government by intimidation or coercion, or to affect the conduct of a government by mass destruction, assassination, or kidnapping; and occur primarily outside the territorial jurisdiction of the United States, or transcend national boundaries in terms of the means by which they are accomplished, the persons they appear intended to intimidate or coerce, or the locale in which their perpetrators operate or seek asylum. The term "domestic terrorism" means activities that involve acts dangerous to human life that are a violation of the criminal laws of the United States or of any State; appear to be intended to intimidate or coerce a civilian population, to influence the policy of a government by intimidation or coercion or to affect the conduct of a government by mass destruction, assassination, or kidnapping; and occur primarily within the territorial jurisdiction of the United States.

In general, returns and taxpayer return information must be obtained pursuant to an ex parte court order. Return information, other than taxpayer return information, generally is available upon a written request meeting specific requirements. The IRS also is permitted to make limited disclosures of such information on its own initiative to the appropriate Federal law enforcement agency.

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[713] Sec. 6103(i)(3)(B).

[714] See, Joint Committee on Taxation, *Disclosure Report for Public Inspection Pursuant to Internal Revenue Code Section 6103(p)(3)(C) for Calendar Year 2002 (JCX 29–04)* April 6, 2004.

[715] Sec. 6103(b)(11). For this purpose, "domestic terrorism" is defined in 18 U.S.C. sec. 2331(5) and "international terrorism" is defined in 18 U.S.C. sec. 2331(1).

No disclosures may be made under these provisions after December 31, 2007. The procedures applicable to these provisions are described in detail below.

Disclosure of returns and return information—by ex parte court order

Ex parte court orders sought by Federal law enforcement and Federal intelligence agencies

The Code permits, pursuant to an ex parte court order, the disclosure of returns and return information (including taxpayer return information) to certain officers and employees of a Federal law enforcement agency or Federal intelligence agency. These officers and employees are required to be personally and directly engaged in any investigation of, response to, or analysis of intelligence and counterintelligence information concerning any terrorist incident, threat, or activity. These officers and employees are permitted to use this information solely for their use in the investigation, response, or analysis, and in any judicial, administrative, or grand jury proceeding, pertaining to any such terrorist incident, threat, or activity.

The Attorney General, Deputy Attorney General, Associate Attorney General, an Assistant Attorney General, or a United States attorney, may authorize the application for the ex parte court order to be submitted to a Federal district court judge or magistrate. The Federal district court judge or magistrate would grant the order if based on the facts submitted he or she determines that: (1) there is reasonable cause to believe, based upon information believed to be reliable, that the return or return information may be relevant to a matter relating to such terrorist incident, threat, or activity; and (2) the return or return information is sought exclusively for the use in a Federal investigation, analysis, or proceeding concerning any terrorist incident, threat, or activity.

Special rule for ex parte court ordered disclosure initiated by the IRS

If the Secretary of the Treasury (or his delegate) possesses returns or return information that may be related to a terrorist incident, threat, or activity, the Secretary may, on his own initiative, authorize an application for an ex parte court order to permit disclosure to Federal law enforcement. In order to grant the order, the Federal district court judge or magistrate must determine that there is reasonable cause to believe, based upon information believed to be reliable, that the return or return information may be relevant to a matter relating to such terrorist incident, threat, or activity. The information may be disclosed only to the extent necessary to apprise the appropriate Federal law enforcement agency responsible for investigating or responding to a terrorist incident, threat, or activity and for officers and employees of that agency to investigate or respond to such terrorist incident, threat, or activity. Further, use of the information is limited to use in a Federal investigation, analysis, or proceeding concerning a terrorist incident, threat, or activity. Because the Department of Justice represents the Secretary in Federal district court, the Secretary is permitted

to disclose returns and return information to the Department of Justice as necessary and solely for the purpose of obtaining the special IRS ex parte court order.

Disclosure of return information other than by ex parte court order

Disclosure by the IRS without a request

The Code permits the IRS to disclose return information, other than taxpayer return information, related to a terrorist incident, threat, or activity to the extent necessary to apprise the head of the appropriate Federal law enforcement agency responsible for investigating or responding to such terrorist incident, threat, or activity. The IRS on its own initiative and without a written request may make this disclosure. The head of the Federal law enforcement agency may disclose information to officers and employees of such agency to the extent necessary to investigate or respond to such terrorist incident, threat, or activity. A taxpayer's identity is not treated as return information supplied by the taxpayer or his or her representative.

Disclosure upon written request of a Federal law enforcement agency

The Code permits the IRS to disclose return information, other than taxpayer return information, to officers and employees of Federal law enforcement upon a written request satisfying certain requirements. The request must: (1) be made by the head of the Federal law enforcement agency (or his delegate) involved in the response to or investigation of terrorist incidents, threats, or activities, and (2) set forth the specific reason or reasons why such disclosure may be relevant to a terrorist incident, threat, or activity. The information is to be disclosed to officers and employees of the Federal law enforcement agency who would be personally and directly involved in the response to or investigation of terrorist incidents, threats, or activities. The information is to be used by such officers and employees solely for such response or investigation.

The Code permits the redisclosure by a Federal law enforcement agency to officers and employees of State and local law enforcement personally and directly engaged in the response to or investigation of the terrorist incident, threat, or activity. The State or local law enforcement agency must be part of an investigative or response team with the Federal law enforcement agency for these disclosures to be made.

Disclosure upon request from the Departments of Justice or the Treasury for intelligence analysis of terrorist activity

Upon written request satisfying certain requirements discussed below, the IRS is to disclose return information (other than taxpayer return information) to officers and employees of the Department of Justice, Department of the Treasury, and other Federal intelligence agencies, who are personally and directly engaged in the collection or analysis of intelligence and counterintelligence or investigation concerning terrorist incidents, threats, or activities. Use

of the information is limited to use by such officers and employees in such investigation, collection, or analysis.

The written request is to set forth the specific reasons why the information to be disclosed is relevant to a terrorist incident, threat, or activity. The request is to be made by an individual who is: (1) an officer or employee of the Department of Justice or the Department of the Treasury, (2) appointed by the President with the advice and consent of the Senate, and (3) responsible for the collection, and analysis of intelligence and counterintelligence information concerning terrorist incidents, threats, or activities. The Director of the United States Secret Service also is an authorized requester.

Reasons for Change[716]

The Congress believes that the disclosure provisions relating to terrorist activities assist in the country's investigations of and response to terrorism. It is the understanding of the Congress that this assistance has been impaired by the expiration of the provisions on December 31, 2007. The Congress believes that it is appropriate to make the provisions permanent to avoid such interruptions in the future.

Explanation of Provision

The provision makes permanent the present-law disclosure authority relating to terrorist activities.

Effective Date

The provision is effective for disclosures made on or after the date of enactment (October 3, 2008).

[716] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

TITLE V—ADDITIONAL TAX RELIEF AND OTHER TAX PROVISIONS

SUBTITLE A—GENERAL PROVISIONS

A. Refundable Child Credit (sec. 501 of the Act and sec. 24(d) of the Code)

Present Law

An individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is $1,000 through 2010, and $500 thereafter. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The credit is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified adjusted gross income includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The credit is allowable against the regular tax and the alternative minimum tax. To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). The threshold dollar amount is $12,050 (2008), and is indexed for inflation.

Families with three or more children may determine the additional child tax credit using the "alternative formula," if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit ("EIC").

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. Unlike the EIC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EIC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

Reasons for Change[717]

The Congress believes it is appropriate to lower the threshold earnings level for the refundable child credit in order to increase the amount of available child credit for lower income households.

Explanation of Provision

The Act modifies the earned income formula for the determination of the refundable child credit to apply to 15 percent of earned income in excess of $8,500 for taxable years beginning in 2008.

Effective Date

The provision is effective for taxable years beginning in 2008.

B. Provisions Related to Film and Television Productions (sec. 502 of the Act and secs. 181 and 199 of the Code)

Present Law

Section 181

The Modified Accelerated Cost Recovery System ("MACRS") does not apply to certain property, including any motion picture film, video tape, or sound recording, or to any other property if the taxpayer elects to exclude such property from MACRS and the taxpayer properly applies a unit-of-production method or other method of depreciation not expressed in a term of years. Section 197 does not apply to certain intangible property, including property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in a transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. Thus, the recovery of the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a "stand-alone" basis by the taxpayer may not be determined under either the MACRS depreciation provisions or under the section 197 amortization provisions. The cost recovery of such property may be determined under section 167, which allows a depreciation deduction for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property. A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. Section 167(g) provides that the cost of motion picture films, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method of depreciation.

Under section 181, taxpayers may elect[718] to deduct the cost of any qualifying film and television production, commencing prior to January 1, 2009, in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances.[719] A qualified film or television production is one in which

[717] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

[718] See Treas. Reg. section 1.181–2T for rules on making an election under this section.

[719] For this purpose, a production is treated as commencing on the first date of principal photography.

the aggregate cost is $15 million or less.[720] The threshold is increased to $20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.[721]

A qualified film or television production means any production of a motion picture (whether released theatrically or directly to video cassette or any other format) or television program if at least 75 percent of the total compensation expended on the production is for services performed in the United States by actors, directors, producers, and other relevant production personnel.[722] The term "compensation" does not include participations and residuals (as defined in section 167(g)(7)(B)).[723] With respect to property which is one or more episodes in a television series, each episode is treated as a separate production and only the first 44 episodes qualify under the provision.[724] Qualified property does not include sexually explicit productions as defined by section 2257 of title 18 of the U.S. Code.[725]

For purposes of recapture under section 1245, any deduction allowed under section 181 is treated as if it were a deduction allowable for amortization.[726]

Section 199

Section 199 of the Code provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to a portion of the taxpayer's qualified production activities income. For taxable years beginning after 2009, the deduction is nine percent of such income. For taxable years beginning in 2008 and 2009, the deduction is six percent of such income. The deduction for a taxable year is limited to 50 percent of the wages properly allocable to domestic production gross receipts paid by the taxpayer during the calendar year that ends in such taxable year.[727]

In general, qualified production activities income ("QPAI") is equal to domestic production gross receipts ("DPGR"), reduced by the sum of: (1) the costs of goods sold that are allocable to such receipts; (2) other expenses, losses, or deductions which are properly allocable to such receipts.[728]

DPGR generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange or other disposition, or any lease, rental or license, of qualifying production property ("QPP") that was manufactured, produced, grown or extracted ("MPGE") by the tax-

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[720] Sec. 181(a)(2)(A). A qualifying film or television production that is co-produced is eligible for the benefits of the provision only if its aggregate cost, regardless of funding source, does not exceed the threshold.

[721] Sec. 181(a)(2)(B).

[722] Sec. 181(d)(3)(A).

[723] Sec. 181(d)(3)(B).

[724] Sec. 181(d)(2)(B).

[725] Sec. 181(d)(2)(C).

[726] Sec. 1245(a)(2)(C).

[727] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. Elective deferrals include elective deferrals as defined in section 402(g)(3), amounts deferred under section 457, and, designated Roth contributions (as defined in section 402A).

[728] Sec. 199(c)(1).

payer in whole or in significant part within the United States;[729] (2) any sale, exchange or other disposition, or any lease, rental or license, of qualified film produced by the taxpayer; (3) any sale, exchange or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) in the case of a taxpayer engaged in the active conduct of a construction trade or business, construction of real property performed in the United States by the taxpayer in the ordinary course of such trade or business;[730] or (5) in the case of a taxpayer engaged in the active conduct of an engineering or architectural services trade or business, engineering or architectural services performed in the United States by the taxpayer in the ordinary course of such trade or business with respect to the construction of real property in the United States.[731]

DPGR do not include any gross receipts of the taxpayer that are derived from: (1) the sale of food or beverages prepared by the taxpayer at a retail establishment; (2) the transmission or distribution of electricity, natural gas, or potable water; or (3) the lease, rental, license, sale, exchange, or other disposition of land.[732]

A special rule for government contracts provides that property that is manufactured or produced by the taxpayer pursuant to a contract with the Federal Government is considered to be DPGR even if title or risk of loss is transferred to the Federal Government before the manufacture or production of such property is complete to the extent required by the Federal Acquisition Regulation.[733]

For purposes of determining DPGR of a partnership and its partners, provided all of the interests in the capital and profits of the partnership are owned by members of the same expanded affiliated group ("EAG") at all times during the taxable year of the partnership, then the partnership and all members of that EAG are treated as a single taxpayer during such period.[734]

QPP generally includes any tangible personal property, computer software, or sound recordings. "Qualified film" includes any motion picture film or videotape[735] (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of such film (including compensation in the form of residuals and participations)[736] constitutes compensation for serv-

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[729] Domestic production gross receipts include gross receipts of a taxpayer derived from any sale, exchange or other disposition of agricultural products with respect to which the taxpayer performs storage, handling or other processing activities (other than transportation activities) within the United States, provided such products are consumed in connection with, or incorporated into, the manufacturing, production, growth or extraction of qualifying production property (whether or not by the taxpayer).

[730] For this purpose, construction activities include activities that are directly related to the erection or substantial renovation of residential and commercial buildings and infrastructure. Substantial renovation would include structural improvements, but not mere cosmetic changes, such as painting, that is not performed in connection with activities that otherwise constitute substantial renovation.

[731] Sec. 199(c)(4)(A).

[732] Sec. 199(c)(4)(B).

[733] Sec. 199(c)(4)(C).

[734] Sec. 199(c)(4)(D).

[735] The nature of the material on which properties described in section 168(f)(3) are embodied and the methods and means of distribution of such properties does not affect their qualification under this provision.

[736] To the extent that a taxpayer has included an estimate of participations and/or residuals in its income forecast calculation under section 167(g), the taxpayer must use the same estimate of participations and/or residuals for purposes of determining total compensation.

ices performed in the United States by actors, production personnel, directors, and producers.[737]

With respect to the domestic production activities of a partnership or S corporation, the deduction under section 199 is determined at the partner or shareholder level.[738] In performing the calculation, each partner or shareholder generally will take into account such person's allocable share of the components of the calculation (including domestic production gross receipts; the cost of goods sold allocable to such receipts; and other expenses, losses, or deductions allocable to such receipts) from the partnership or S corporation as well as any items relating to the partner or shareholder's own qualified production activities, if any.[739] Each partner or shareholder is treated as having W–2 wages for the taxable year in an amount equal to such person's allocable share of the W–2 wages of the partnership or S corporation for the taxable year.[740]

The Treasury regulations provide that, except for certain qualifying in-kind partnerships and EAG partnerships, an owner of a pass-thru entity is not treated as conducting the qualified production activities of the of the pass-thru entity, and vice versa.[741]

The deduction under section 199 is allowed for purposes of computing alternative minimum taxable income (including adjusted current earnings), without regard to alternative minimum tax adjustments.[742] The deduction in computing alternative minimum taxable income is determined by reference to the lesser of the qualified production activities income (as determined for the regular tax) or the alternative minimum taxable income (in the case of an individual, adjusted gross income as determined for the regular tax) without regard to this deduction.[743]

Reasons for Change[744]

The Congress believes that section 181 encourages domestic film production and that the provision should be extended and enhanced to include more expensive film productions. The issue of runaway production affects all productions, regardless of cost, and therefore the Congress believes that it is appropriate to treat as an expense the first $15 million ($20 million in certain cases) of production costs of otherwise qualified films.

The Congress believes that domestic film production is important to the United States economy and the domestic production activities deduction under section 199 should be modified to take into consideration how the film industry operates. Therefore, the Congress believes that it is appropriate to modify how the deduction is applied to this industry with regard to the type of qualifying property, the methods and means of distributing qualified films, commonly used structures for film production and distribution, and the W–2 wage limitation.

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[737] Sec. 199(c)(6).
[738] Sec. 199(d)(1)(A)(i).
[739] Sec. 199(d)(1)(A)(ii).
[740] Sec. 199(d)(1)(A)(iii).
[741] Treas. Reg. sec. 1.199–5T(g).
[742] Sec. 199(d)(6)(A).
[743] Sec. 199(d)(6)(A).
[744] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

Explanation of Provision

The provision extends the section 181 expensing provision for one year (for qualified film and television productions commencing prior to January 1, 2010). The provision also modifies the dollar limitation so that the first $15 million ($20 million for productions in low income communities or distressed area or isolated area of distress) of an otherwise qualified film or television production may be treated as an expense in cases where the aggregate cost of the production exceeds the dollar limitation. The cost of the production in excess of the dollar limitation is capitalized and recovered under the taxpayer's method of accounting for the recovery of such property.

The provision modifies the section 199 W–2 wage limitation by defining the term "W–2 wages" for qualified films to include any compensation for services performed in the United States by actors, production personnel, directors, and producers. Thus, compensation is not restricted to W–2 wages for the limitation of qualified films.

The provision provides that a qualified film for purposes of section 199 includes any copyrights, trademarks, and other intangibles with respect to the film.

The provision provides that the deduction under section 199 for qualified films is not affected by the methods and means of distributing an otherwise qualified film.[745] For example, the distribution of a qualified film via the internet (whether the film is viewed online or downloaded or whether or not there is a fee charged) is considered to be a disposition of the film for purposes of determining DPGR. Likewise, the distribution of a qualified film through an open air (free of charge) broadcast is considered a disposition of the film for these purposes.

The provision modifies the application of section 199 to partnerships and S corporations. First, the provision provides that each partner with at least a 20 percent capital interest or shareholder with at least a 20 percent ownership interest, either directly or indirectly, in such entity is treated as having engaged directly in any film produced by the partnership or S corporation. For example, Studio A and Studio B form a partnership in which each is a 50-percent partner to produce a qualified film. Studio A has the rights to distribute the film domestically and Studio B has the rights to distribute the film outside the United States. Under the provision, the production activities of the partnership are attributed to each partner, and thus each partner's revenue from the distribution of the qualified film is not treated as non-DPGR solely because neither Studio A nor Studio B produced the qualified film itself. Additionally, a partnership or S corporation is treated as having engaged directly in any film produced by any partner with at least a 20 percent capital interest or shareholder with at least a 20 percent ownership interest, either directly or indirectly, in the partnership or S corporation. For example, Studio A and Studio B form a partnership in which each is a 50-percent partner to distribute a qualified film. Studio A produced the film and contributes it to the partnership and Studio B contributes distribution services to the partnership. Under the provision, the production activities of

[745] This provision is consistent with H.R. Conf. Rep. No. 108–755, at 262, Footnote 30 (2004).

Studio A are attributed to the partnership, and thus the partnership's revenue from the distribution of the qualified film is not treated as non-DPGR solely because the partnership did not produce the qualified film. Thus, the Treasury regulation providing that an owner of a pass-thru entity is not treated as conducting the qualified production activities of the of the pass-thru entity, and vice versa,[746] does not apply to situations to which this provision applies.

Effective Date

The extension and modification of section 181 applies to qualified film and television productions commencing after December 31, 2007.

The modifications of section 199 are effective for taxable years beginning after December 31, 2007.

C. Exemption From Excise Tax for Certain Wooden Arrows Designed for Use by Children (sec. 503 of the Act and sec. 4161 of the Code)

Present Law

Under present law, section 4161(b)(2) of the Code imposes an excise tax of 39 cents, adjusted for inflation, on the first sale by the manufacturer, producer, or importer of any shaft (whether sold separately or incorporated as part of a finished or unfinished product) used to produce certain types of arrows.[747] These taxes support the Federal Aid to Wildlife Restoration Fund.[748]

Explanation of Provision

The provision exempts from the excise tax on arrow shafts certain shafts (whether sold separately or incorporated as part of a finished or unfinished product) that are made of all natural wood. The shaft cannot be in excess of 5/16 of an inch in diameter and cannot have any laminations or artificial means of enhancing the spine of the shaft. The shaft must be of a type used in the manufacture of an arrow which after its assembly is not suitable [illegible] with a bow that has a peak draw weight of 30 pounds or more.

Effective Date

This provision applies to shafts first sold after the date of enactment (October 3, 2008).

D. Treatment of Amounts Received in Connection With the Exxon Valdez Litigation (sec. 504 of the Act)

Present Law

Income averaging

Section 1301 provides special income averaging rules for individuals engaged in a farming business or fishing business. Under sec-

[746] Treas. Reg. sec. 1.199–5T(g).
[747] The tax on arrow shafts is 43 cents per arrow shaft beginning January 1, 2008.
[748] 16 U.S.C. sec. 669b

tion 1301, such an individual may elect to average the taxable income attributable to the farming or fishing business over a 3-year period.

Contributions to qualified retirement plans and IRAs

The Code provides for the favorable tax treatment of a variety of retirement savings plans sponsored by employers for the benefit of employees, provided that such plans meet certain qualification requirements. Such plans are commonly referred to as "qualified retirement plans." Qualified retirement plans include the following types of plans: (1) plans qualified under section 401(a) (such as a "section 401(k) plan"); (2) section 403(a) employee retirement annuities; (3) tax-sheltered annuities (described in section 403(b)); and (4) section 457(b) plans sponsored by State and local governments.

One of the qualification requirements that apply to qualified retirement plans is limits on the amount of contributions that may be made to such a plan. For example, in the case of a defined contribution plan, the annual additions that can be made to a participant's account balance is limited to the lesser of 100 percent of the participant's compensation or $46,000 (for 2008). Elective salary reduction deferrals by a participant in a section 401(k) plan, a tax-sheltered annuity, or a section 457(b) plan maintained by a State or local government are subject to a separate annual limitation. The limitation on the amount of annual elective deferrals is generally $15,500 (for 2008), although participants who have attained age 50 may be eligible to make an additional $5,000 (for 2008) in elective deferrals. In general, a distribution from a qualified retirement plan is includible in a participant's gross income except to the extent the distribution is attributable to employee after-tax contributions to the plan.

The Code also provides for two types of individual retirement arrangements ("IRAs"): traditional IRAs and Roth IRAs.[749] In general, contributions (other than a rollover contribution) to a traditional IRA may be deductible, and distributions from a traditional IRA are includible in gross income to the extent not attributable to a return of nondeductible contributions. In contrast, contributions to a Roth IRA are not deductible, and qualified distributions from a Roth IRA are excludable from gross income. Distributions from a Roth IRA that are not qualified distributions are includible in gross income to the extent attributable to earnings. In general, a qualified distribution is a distribution that is made on or after the individual attains age 59½, death, or disability or which is a qualified special purpose distribution.

The total amount that an individual may contribute to one or more IRAs for a year is generally limited to the lesser of: (1) a dollar amount ($5,000 for 2008); or (2) the amount of the individual's compensation that is includible in gross income for the year. As under the rules relating to traditional IRAs, a contribution of up to the dollar limit for each spouse may be made to a Roth IRA provided the combined compensation of the spouses is at least equal to the contributed amount. The maximum annual contribution that

[749] Traditional IRAs are described in Code section 408, and Roth IRAs are described in Code section 408A.

can be made to a Roth IRA is phased out for taxpayers with adjusted gross income for the taxable year over certain indexed levels. The adjusted gross income phase-out ranges for 2008 are: (1) for single taxpayers, $101,000 to $116,000; (2) for married taxpayers filing joint returns, $159,000 to $169,000; and (3) for married taxpayers filing separate returns, $0 to $10,000.

For taxable years beginning after December 31, 2005, a plan qualified under section 401(a) or a section 403(b) annuity is permitted to include a qualified Roth contribution program. Under such a program a participant can designate elective salary deferrals as designated Roth contributions. A designated Roth contribution is includible in the participant's gross income at the time of deferral and is generally excludable from gross income at the time of distribution.

The foregoing contribution limitations for qualified retirement plans and IRAs do not apply in the case of a rollover contribution to a qualified retirement plan or IRA. If certain requirements are satisfied, a participant in a tax-qualified retirement plan, a tax-sheltered annuity, a governmental section 457 plan, or a traditional IRA may roll over distributions from the plan, annuity or IRA into another plan, annuity or IRA. For distributions after December 31, 2007, certain taxpayers also are permitted to make rollover contributions into a Roth IRA (subject to inclusion in gross income of any amount that would be includible were it not part of the rollover contribution).

Explanation of Provision

Income averaging

Under the provision, any qualified taxpayer receiving qualified settlement income in any taxable year shall be treated as if engaged in a fishing business, and the qualified settlement income shall be treated as income attributable to a fishing business for the taxable year for purposes of applying the income averaging rules applicable to farming and fishing income under section 1301. The portion of a taxpayer's taxable income which he or she may elect to be treated as "elected farm income" eligible for income averaging under this provision is the amount of qualified settlement income reduced by the otherwise allowable deductions attributable to that income. Nothing in this provision changes the computation of taxable income or alternative minimum taxable income.

Contributions to retirement plans

Under the provision, a qualified taxpayer who receives qualified settlement income during a taxable year may, at any time before the end of such year, make one or more contributions to an eligible retirement plan. The amount that can be contributed under the provision (in aggregate for all taxable years) is the lesser of (1) the amount of qualified settlement income or (2) $100,000. If such a contribution is made, the contribution is excludible from the qualified taxpayer's gross income (unless the contribution is made to a Roth IRA or to a designated Roth account established under a qualified Roth contribution program) and is treated as a rollover contribution to the eligible retirement plan. Under the provision,

an eligible retirement plan includes an IRA (traditional or Roth), a section 401(a) plan, a section 403(a) employee retirement annuity, a tax-sheltered annuity, and a section 457(b) plan maintained by a State or local government.

Qualified taxpayer; qualified settlement income

Under the provision, the term a "qualified taxpayer" means any individual who is a plaintiff in the civil action *In re Exxon Valdez*, No. 89–095–CV (HRH) (Consolidated) (D. Alaska) or any individual who is a beneficiary of the estate of such a plaintiff who acquired the right to receive qualified settlement income from the plaintiff and who was the spouse or immediate relative of that plaintiff. "Qualified settlement income" means any interest and punitive damage awards which are includible in taxable income[750] and are received in connection with the before-described civil action, whether pre- or post-judgment and whether related to a settlement or judgment.

Effective Date

The provision is effective upon the date of enactment (October 3, 2008).

E. Certain Farming Business Machinery and Equipment Treated as 5-Year Property (sec. 505 of the Act and sec. 168 of the Code)

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[751] The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87–56.[752] Asset class 01.1 includes machinery and equipment, grain bins, and fences (but no other land improvements), that are used in the production of crops or plants, vines, and trees; livestock; the operation of farm dairies, nurseries, greenhouses, sod farms, mushrooms cellars, cranberry bogs, apiaries, and fur farms; and the performance of agricultural, animal husbandry, and horticultural services. These assets are assigned a class life of 10 years and a recovery period of seven years.

Reasons for Change[753]

The Congress believes that the depreciation incentive will provide important economic benefits to encourage development within the agricultural sector. The provision lowers the cost of capital for property used in agricultural trades or businesses which will lead

[750] This rule is applied without regard to the retirement plan contribution rule previously discussed.

[751] Sec. 168.

[752] 1987–2 C.B. 674 (as clarified and modified by Rev. Proc. 88–22, 1988–1 C.B. 785).

[753] See S. 2242, the "Heartland, Habitat, Harvest, and Horticulture Act of 2007", which was reported by the Senate Committee on Finance on October 25, 2007 (S. Rpt. No. 110–206).

to additional investment in more equipment and employment of more workers.

Explanation of Provision

The provision provides a five-year recovery period for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) which is used in a farming business and placed in service before January 1, 2010, and the original use of which commences with the taxpayer after December 31, 2008. For these purposes, the term "farming business" means a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity.[754] A farming business includes processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products.[755]

Effective Date

The provision is effective for property placed in service after December 31, 2008.

F. Modified Standard for Imposition of Tax Return Preparer Penalties (sec. 506 of the Act and sec. 6694 of the Code)

Present Law

In general, a tax return preparer is liable for a penalty for preparation of a return or refund claim with respect to which understatement of tax results. If the understatement is due to an unreasonable position, the penalty is the greater of $1,000 or 50% of the income derived by the return preparer with respect to that return.[756] If the understatement is due to willful or reckless conduct, the penalty increases to the greater of $5,000 or 50% of the income derived by the return preparer with respect to that return.[757] "Tax return preparer" is broadly defined as any person who prepares for compensation, or who employs other people to prepare for compensation, all or a substantial portion of a tax return or claim for refund.[758] Under present law, the definition of a tax return preparer includes persons preparing non-income tax returns, such as estate and gift, excise, or employment tax returns, as well as income tax returns. Preparation of a substantial portion of a return is treated as if it were the preparation of such return.

Legislation enacted as part of the Small Business and Work Opportunity Tax Act of 2007 broadened the scope of the preparer penalty by applying it to all tax return preparers and altered the standards of conduct a tax return preparer is required to meet in order to avoid the imposition of penalties for the preparation of a return with respect to which there is an understatement of tax. A tax return preparer now can be penalized for preparing a return on which there is an understatement of tax liability as a result of

[754] Treas. Reg. sec. 1.263A–4(a)(4)(i).
[755] Treas. Reg. sec. 1.263A–4(a)(4)(ii).
[756] 6694(a)(1)
[757] Sec. 6694(b)
[758] Sec. 7701(a)(36)(A).

an "unreasonable position." Any position that a return preparer does not reasonably believe is more likely than not to be sustained on its merits is an "unreasonable position" unless the position is disclosed on the return or there is a reasonable basis for the position.

Reasons for Change [759]

The Congress believes that the standards of conduct for taxpayers and return preparers generally should be uniform. The Congress believes that the present-law standard for return preparers, which is generally higher than that for taxpayers, can result in a conflict of interest for return preparers. The conflict of interest arises because it is in the interest of a preparer to advise his taxpayer client to either disclose a tax position or alter such position in order to avoid the preparer penalty, even though the taxpayer could legally and appropriately take the position without disclosure or facing penalties. This may have the unintended consequence of causing taxpayers to be less inclined to use the services of professional tax preparers, which could harm the system of tax collections. Thus, the Congress believes the standards of conduct for taxpayers and return preparers generally should be uniform.

Explanation of Provision

The provision revises the definition of an "unreasonable position" and changes the standards for imposition of the tax return preparer penalty. The preparer standard for undisclosed positions is reduced to "substantial authority," which conforms to the taxpayer standard. The preparer standard for disclosed positions is set at "reasonable basis." For tax shelters (as defined in section 6662(d)(2)(B)(ii)(I)) and reportable transactions to which section 6662A applies (i.e., listed transactions and reportable transactions with significant avoidance or evasion purposes), the preparer must have a reasonable belief that the position would more likely than not be sustained on its merits.

Effective Date

The provision generally is effective with respect to returns prepared after May 25, 2007. In the case of tax shelters and reportable transactions, the provision is effective for returns prepared for taxable years beginning after the date of enactment (October 3, 2008).

SUBTITLE B—MENTAL HEALTH PARITY PROVISIONS

A. Modification of Parity Rules for Mental Health Benefits (secs. 511–512 of the Act and sec. 9812 of the Code)

Present Law

The Code, ERISA and the Public Health Service Act ("PHSA") contain provisions under which group health plans that provide both medical and surgical benefits and mental health benefits can-

[759] See H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," which was reported by the House Committee on Ways and Means on May 20, 2008 (H. Rept. No. 110–658).

not impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits ("mental health parity requirements"). In the case of a group health plan which provides benefits for mental health, the mental health parity requirements do not affect the terms and conditions (including cost sharing, limits on numbers of visits or days of coverage, and requirements relating to medical necessity) relating to the amount, duration, or scope of mental health benefits under the plan, except as specifically provided in regard to parity in the imposition of aggregate lifetime limits and annual limits.

The Code imposes an excise tax on group health plans which fail to meet the mental health parity requirements. The excise tax is equal to $100 per day during the period of noncompliance and is generally imposed on the employer sponsoring the plan if the plan fails to meet the requirements. The maximum tax that can be imposed during a taxable year cannot exceed the lesser of 10 percent of the employer's group health plan expenses for the prior year or $500,000. No tax is imposed if the Secretary determines that the employer did not know, and in exercising reasonable diligence would not have known, that the failure existed.

The mental health parity requirements do not apply to group health plans of small employers (generally, an employer who employs an average of 2 to 50 employees) or if the application of the requirements would result in an increase of one percent or more in the cost of the plan. Further, the mental health parity requirements do not require group health plans to provide mental health benefits. The term mental health benefits means benefits with respect to mental health services, as defined under the terms of the specific group health plan, but does not include benefits with respect to the treatment of substance abuse or chemical dependency.

The Code, ERISA and PHSA mental health parity requirements expire with respect to benefits for services furnished after December 31, 2008.

Explanation of Provision

The provision expands the scope of mental health benefits that are subject to the mental health parity requirements of the Code by including "substance use disorder benefits" as benefits subject to the parity requirements. Substance use disorder benefits means benefits with respect to services for substance use disorders, as defined under the terms of the plan and in accordance with applicable Federal and State law.

The provision also expands the scope of parity that must be provided between mental health and substance use disorder benefits and medical and surgical benefits that are provided under the group health plan. Specifically, the financial requirements and treatment limitations for mental health and substance use disorder benefits cannot be more restrictive than the predominant financial requirements (or treatment limitations) that are applied to substantially all medical and surgical benefits covered by the plan, and no separate cost sharing requirements (or treatment limitations) may apply only to mental health or substance use disorder benefits. Financial requirement includes for this purpose deductibles, copay-

ments, coinsurance, and out-of-pocket expenses, but excludes an aggregate lifetime and annual limit that are subject to parity requirements under current law. Treatment limitation includes limits on the frequency of treatment, number of visits, days of coverage, or other similar limits on the scope or duration of treatment. The provision also requires parity of coverage of mental health and substance use disorder benefits with respect to out-of-network providers if the group health plan provides coverage for medical or surgical benefits provided by out-of-network providers.

Under the new requirements, an administrator of a group health plan must make the criteria for medical necessity determinations for mental health and substance use disorder benefits available upon request to current and potential plan participants and beneficiaries, and to contracting providers. Similarly, the reason for a denial of mental health and substance use disorder benefits must be made available by the plan administrator upon request by a participant or beneficiary.

The provision modifies the definition of small employer for purposes of the small employer exemption from the parity requirements. The provision also modifies the exemption from the parity requirements that applies in the case of increased costs that result from compliance with the parity requirements.

The provision makes parallel changes to the mental health parity rules of ERISA and PHSA, and directs the Secretaries of Labor, Health and Human Services, and the Treasury, to issue regulations within one year of enactment (October 3, 2008) to carry out the new parity requirements.

Effective Date

The new mental health parity requirements are generally effective for a group health plan for the first plan year that begins after the one-year anniversary of enactment of the new requirements (October 3, 2009). Special effective date rules apply in the case of a group health plan that is maintained pursuant to one or more collective bargaining agreements.[760] The provision extends the application of the present law mental health parity requirements until the revised requirements become applicable.

[760] Public Law 110–460 made a technical correction to the effective date of the new mental health parity requirements for a group health plan that is maintained pursuant to a collective bargaining agreement. S. 3712 passed the Senate on November 20, 2008, and passed the House without amendment on December 10, 2008. The president signed the bill on December 23, 2008.

TITLE VI—DISASTER RELIEF

SUBTITLE A—HEARTLAND AND HURRICANE IKE DISASTER RELIEF

A. Tax Benefits for Midwestern and Hurricane Ike Areas

1. Definition of "Midwestern disaster area," "applicable disaster date," "Hurricane Ike disaster area," Gulf Opportunity Zones, and Hurricane Katrina, Rita, and Wilma disaster areas (secs. 702 and 704 of the Act and sec. 1400M of the Code)

General Definitions

Midwestern disaster area

For purposes of the Act, the "Midwestern disaster area" is defined as an area with respect to which a major disaster was declared by the President on or after May 20, 2008, and before August 1, 2008, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act ("Stafford Act") by reason of severe storms, tornados, or flooding occurring in any of the States of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin, and determined by the President to warrant individual or individual and public assistance from the Federal government under such Act with respect to damages attributable to such severe storms, tornados, or flooding. For certain provisions, areas eligible for only public assistance are included in the definition of Midwestern disaster area.

Applicable disaster date

The term "applicable disaster date" means, with respect to any Midwestern disaster area, the date on which the severe storms, tornados, or flooding giving rise to the Presidential declaration occurred.

Hurricane Ike disaster area

For purposes of the Act, the " Hurricane Ike disaster area" is defined as an area in the State of Texas or Louisiana with respect to which a major disaster has been declared by the President on September 13, 2008, under section 401 of the Stafford Act by reason of Hurricane Ike, and determined by the President to warrant individual or individual and public assistance from the Federal government under such Act with respect to damages attributable to Hurricane Ike.

Gulf Opportunity Zones

The terms "Gulf Opportunity Zone" and "GO Zone" refer to that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the Federal government under the Stafford Act by reason of Hurricane Katrina.[761]

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[761] Sec. 1400M(1). These definitions are not changed by the Act.

The term "Rita GO Zone" means that portion of the Hurricane Rita disaster area determined by the President to warrant individual or individual and public assistance from the Federal government under the Stafford Act by reason of Hurricane Rita.[762]

The term "Wilma GO Zone" means that portion of the Hurricane Wilma disaster area determined by the President to warrant individual or individual and public assistance from the Federal government under the Stafford Act by reason of Hurricane Wilma.[763]

Hurricanes Katrina, Rita, and Wilma disaster areas

The "Hurricane Katrina disaster area" refers to the area with respect to which a major disaster had been declared by the President before September 14, 2005, under section 401 of the Stafford Act by reason of Hurricane Katrina.[764] The "Hurricane Rita disaster area" refers to the area with respect to which a major disaster had been declared by the President before October 6, 2005, under section 401 of the Stafford Act by reason of Hurricane Rita.[765] The "Hurricane Wilma disaster area" refers to the area with respect to which a major disaster had been declared by the President before November 14, 2005, under section 401 of the Stafford Act by reason of Hurricane Wilma.[766]

2. Tax-exempt bond financing for the Midwestern disaster area (sec. 702 of the Act)

Present Law

Gulf Opportunity Zone Bonds

Present law permits the issuance of qualified private activity bonds to finance the construction and rehabilitation of residential and nonresidential property located in the Gulf Opportunity Zone ("Gulf Opportunity Zone Bonds"). Gulf Opportunity Zone Bonds must be issued before January 1, 2011.

Gulf Opportunity Zone Bonds may be issued by the State of Alabama, Louisiana, or Mississippi, or any political subdivision thereof. Gulf Opportunity Zone Bonds are not subject to the State volume cap (sec. 146). Rather, the maximum aggregate face amount of Gulf Opportunity Zone Bonds that may be issued in any eligible State is limited to $2,500 multiplied by the number of residents of such eligible State who reside within the Gulf Opportunity Zone. Depending on the purpose for which such bonds are issued, Gulf Opportunity Zone Bonds are treated as either exempt facility bonds or qualified mortgage bonds.

Gulf Opportunity Zone Bonds are treated as exempt facility bonds if 95 percent or more of the net proceeds of such bonds are to be used for qualified project costs located in the Gulf Opportunity Zone. Qualified project costs include the cost of acquisition, construction, reconstruction, and renovation of nonresidential real property, qualified residential rental projects (as defined in section 142(d) with certain modifications), and public utility property.

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[762] Sec. 1400M(3). This definition is not changed by the Act.
[763] Sec. 1400M(5). This definition is not changed by the Act.
[764] Sec. 1400M(2). This definition is not changed by the Act.
[765] Sec. 1400M(4). This definition is not changed by the Act.
[766] Sec. 1400M(6). This definition is not changed by the Act.

Gulf Opportunity Zone Bonds are treated as qualified mortgage bonds if the bonds of such issue meet the general requirements of a qualified mortgage issue and the residences financed with such bonds are located in the Gulf Opportunity Zone. For these residences the first-time homebuyer rule is waived but purchase and income rules for targeted area residences apply. In addition, 100 percent of the mortgage loans must be made to mortgagors whose family income is 140 percent or less of the applicable median family income.

Explanation of Provision

The Act provides tax-exempt bond financing like Gulf Opportunity Zone Bonds with certain modifications to the Midwestern disaster area. Specifically, it allows the issuance of qualified private activity bonds (called, "qualified Midwestern disaster area bonds") to finance the construction and rehabilitation of certain residential and nonresidential property located in the Midwestern disaster area. Qualified Midwestern disaster area bonds must be issued before January 1, 2013.

Like Gulf Opportunity Zone Bonds, qualified Midwestern disaster area bonds are not subject to the State volume cap. The maximum aggregate face amount of qualified Midwestern disaster area bonds that may be issued in any State in which a Midwestern disaster area is located is limited to $1,000 multiplied by the population of the respective State within a Midwestern disaster area.

Depending on the purpose for which such bonds are issued, qualified Midwestern disaster area bonds are treated as either exempt facility bonds or qualified mortgage bonds. Qualified Midwestern disaster area bonds have certain limitations which did not apply to Gulf Opportunity Zone Bonds. In the case of exempt facility bonds, such financing is limited to projects where the person using the property either: (i) suffered a loss in a trade or business attributable to the severe storms, tornados, or flooding giving rise to a Midwestern disaster area; or (ii) is designated by the Governor as a person carrying on a trade or business replacing such a business.[767] In the case of qualified mortgage bonds, such financing is tax-exempt only if 95 percent or more of the net proceeds of the issue are used to provide financing to individuals who suffered damages to their principal residences attributable to the severe storms, tornados, or flooding giving rise to a Midwestern disaster area. For these residences, the first-time homebuyer rule is waived and purchase and income rules for targeted area residences apply. In addition, 100 percent of the mortgage loans must be made to mortgagors whose family income is 140 percent or less of the applicable median family income.

Other tax-exempt bond rules that apply to Gulf Opportunity Zone Bonds generally apply to qualified Midwestern disaster area bonds.

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[767] In the case of a project relating to public utility property, any financing is limited to the repair or reconstruction of public utility property damaged by reason of the severe storms, tornados, or flooding giving rise to a Midwestern disaster area.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

3. Low-income housing tax relief for the Midwestern disaster Area (sec. 702 of the Act)

Present Law

In general

The low-income housing credit may be claimed over a 10-year period by owners of certain residential rental property for the cost of rental housing occupied by tenants having incomes below specified levels (sec. 42). The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The qualified basis of any qualified low-income building for any taxable year equals the applicable fraction of the eligible basis of the building.

Volume limits

A low-income housing credit is allowable only if the owner of a qualified building receives a housing credit allocation from the State or local housing credit agency. Generally, the aggregate credit authority provided annually to each State for calendar years 2008 and 2009 is $2.20 per resident, with a minimum annual cap for certain small population States. In 2010, the volume limits will return to lower prescribed levels. These amounts are indexed for inflation. Projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit do not require an allocation of the low-income housing credit.

Certain distressed areas

In general

Special allocations of the low-income housing credit are not provided for distressed areas on a regular basis but rather must be enacted separately on a case-by-case basis (e.g., Gulf Opportunity Zones).

Gulf Opportunity Zones

Credit cap

The otherwise applicable low-income housing credit ceiling amount is increased for each of the States within the Gulf Opportunity Zone. This increase applies to calendar years 2006, 2007, and 2008. The additional credit cap for each of the affected States equals $18.00 times the number of such State's residents within the Gulf Opportunity Zone. This amount is not adjusted for inflation. For purposes of this additional credit cap amount, the determination of population for any calendar year is made on the basis of the most recent census estimate of the resident population of the State in the Gulf Opportunity Zone released by the Bureau of the Census before August 28, 2005.

Stacking rule

Within each calendar year (2006, 2007, and 2008), each applicable State within the Gulf Opportunity Zone must treat the additional credit cap allocable under the provision to that State as allocated before any other credit cap amounts. Therefore, under the provision, each applicable State within the Gulf Opportunity Zone is treated as using credits in the following order: (1) the additional credit cap (including any such credits returned to the State) under the Gulf Opportunity Zone, then (2) its allocation of the unused State housing credit ceiling (if any) from the preceding calendar, then (3) the current year's allocation of present-law credit (including any credits returned to the State) and then (4) any national pool allocations. This generally maximizes the total amount of credit (under both otherwise applicable low income housing credit cap and the additional credit cap for the Gulf Opportunity Zone) which may be carried forward.

Explanation of Provision

For each of three years (2008, 2009, and 2010), a special allocation of the low-income housing credit is provided to any State in which a Midwestern disaster area is located. The amount of each year's special allocation is limited to $8.00 multiplied by the population of the respective State in a Midwestern disaster area.

Other low-income housing credit rules (e.g., the stacking rule) that apply to Gulf Opportunity Zones may apply to these special allocations.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

4. Expensing for certain demolition and clean-up costs (sec. 702 of the Act)

Present Law

Under present law, the cost of demolition of a structure is capitalized into the taxpayer's basis in the land on which the structure is located.[768] Land is not subject to an allowance for depreciation or amortization.

The treatment of the cost of debris removal depends on the nature of the costs incurred. For example, the cost of debris removal after a storm may in some cases constitute an ordinary and necessary business expense which is deductible in the year paid or incurred. In other cases, debris removal costs may be in the nature of replacement of part of the property that was damaged. In such cases, the costs are capitalized and added to the taxpayer's basis in the property. For example, Revenue Ruling 71–161[769] permits the use of clean-up costs as a measure of casualty loss but requires that such costs be added to the post-casualty basis of the property.

[768] Sec. 280B.
[769] 1971–1 C.B. 76.

Under section 1400N(f), a taxpayer is permitted a deduction for 50 percent of any qualified Gulf Opportunity Zone clean-up cost paid or incurred during the period beginning on August 28, 2005, and ending on December 31, 2007. The remaining 50 percent is treated as described above. A qualified Gulf Opportunity Zone clean-up cost is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the Gulf Opportunity Zone to the extent that the amount would otherwise be capitalized. In order to qualify, the property must be held for use in a trade or business, for the production of income, or as inventory.

A taxpayer is permitted a deduction for 50 percent of any qualified Recovery Assistance clean-up cost paid or incurred during the period beginning on May 4, 2007, and ending on December 31, 2009.[770] The remaining 50 percent is treated under the general rules described above. A qualified Recovery Assistance clean-up cost is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the Kansas disaster area to the extent that the amount otherwise would be capitalized. In order to qualify, the property must be held for use in a trade or business, for the production of income, or as inventory.

Explanation of Provision

The provision permits a taxpayer to deduct 50 percent of any qualified Disaster Recovery Assistance clean-up cost paid or incurred during the period beginning on the applicable disaster date and ending on December 31, 2010. The remaining 50 percent is treated under the general rules described above. A qualified Disaster Recovery Assistance clean-up cost is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the Midwestern disaster area to the extent that the amount otherwise would be capitalized, and only if the removal of debris or demolition of any structure was necessary due to damage attributable to the severe storms, tornados, or flooding giving rise to any Presidential declaration described in the definition of Midwestern disaster area. In order to qualify, the property must be held for use in a trade or business, for the production of income, or as inventory.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

5. Extension of expensing for environmental remediation costs (sec. 702 of the Act)

Present Law

Present law allows a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[771] Treasury regulations provide that the cost of incidental repairs

[770] Pub. L. No. 110–234, sec. 15345 (2008).
[771] Sec. 162.

that neither materially add to the value of property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted currently as a business expense. Section 263(a)(1) limits the scope of section 162 by prohibiting a current deduction for certain capital expenditures. Treasury regulations define "capital expenditures" as amounts paid or incurred to materially add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or to adapt property to a new or different use. Amounts paid for repairs and maintenance do not constitute capital expenditures. The determination of whether an expense is deductible or must be capitalized is based on the facts and circumstances of each case.

Taxpayers may elect to treat certain environmental remediation expenditures paid or incurred before January 1, 2008, that would otherwise be chargeable to capital account as deductible in the year paid or incurred.[772] The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. In general, any expenditure for the acquisition of depreciable property used in connection with the abatement or control of hazardous substances at a qualified contaminated site does not constitute a qualified environmental remediation expenditure. However, depreciation deductions allowable for such property, which otherwise would be allocated to the site under the principles set forth in Commissioner v. Idaho Power Co.[773] and section 263A, are treated as qualified environmental remediation expenditures.

A "qualified contaminated site" (a so-called "brownfield") generally is any property that is held for use in a trade or business, for the production of income, or as inventory and is certified by the appropriate State environmental agency to be an area at or on which there has been a release (or threat of release) or disposal of a hazardous substance. Both urban and rural property may qualify. However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA")[774] cannot qualify as qualified sites. Hazardous substances generally are defined by reference to sections 101(14) and 102 of CERCLA, subject to additional limitations applicable to asbestos and similar substances within buildings, certain naturally occurring substances such as radon, and certain other substances released into drinking water supplies due to deterioration through ordinary use, as well as petroleum products defined in section 4612(a)(3) of the Code.

In the case of property to which a qualified environmental remediation expenditure otherwise would have been capitalized, any deduction allowed under section 198 is treated as a depreciation deduction and the property is treated as section 1245 property. Thus, deductions for qualified environmental remediation expenditures are subject to recapture as ordinary income upon a sale or other disposition of the property. In addition, sections 280B (demolition of structures) and 468 (special rules for mining and solid waste rec-

[772] Sec. 198.
[773] 418 U.S. 1 (1974).
[774] Pub. L. No. 96–510 (1980).

lamation and closing costs) do not apply to amounts that are treated as expenses under this provision.

Section 1400N(g) permits the expensing of environmental remediation expenditures paid or incurred on or after August 28, 2005, and before January 1, 2008, to abate contamination at qualified contaminated sites located in the Gulf Opportunity Zone.

Explanation of Provision

The provision permits the expensing of environmental remediation expenditures paid or incurred on or after the applicable disaster date and before January 1, 2011, to abate contamination at qualified contaminated sites located in the Midwestern disaster area. For these purposes, a site is a qualified contamination site only if the release (or threat of release) or disposal of a hazardous substance at the site was attributable to severe storms, tornados, or flooding that gave rise to any Presidential declaration described in the definition of Midwest disaster area.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

6. Increase in rehabilitation credit for certain areas damaged by 2008 Midwestern severe storms, tornados, and flooding (sec. 702 of the bill and sec. 1400N(h) of the Code)

Present Law

Present law provides a two-tier tax credit for rehabilitation expenditures.[775]

A 20-percent credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure. For this purpose, a certified historic structure means any building that is listed in the National Register, or that is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary of the Treasury as being of historic significance to the district.

A 10-percent credit is provided for qualified rehabilitation expenditures with respect to a qualified rehabilitated building, which generally means a building that was first placed in service before 1936. The pre-1936 building must meet requirements with respect to retention of existing external walls and internal structural framework of the building in order for expenditures with respect to it to qualify for the 10-percent credit. The building must be substantially rehabilitated, a requirement that may be satisfied only if the qualified rehabilitation expenditures during the 24-month period selected by the taxpayer and ending within the taxable year exceed the greater of (1) the adjusted basis of the building (and its structural components), or (2) $5,000.

[775] Sec. 47.

The provision requires the use of straight-line depreciation or the alternative depreciation system in order for rehabilitation expenditures to be treated as qualified under the provision.

Present law increases from 20 to 26 percent, and from 10 to 13 percent, respectively, the credit under section 47 with respect to any certified historic structure or qualified rehabilitated building located in the Gulf Opportunity Zone, provided the qualified rehabilitation expenditures with respect to such a building or structure are incurred on or after August 28, 2005, and before January 1, 2009.[776] The provision is effective for expenditures incurred on or after August 28, 2005, for taxable years ending on or after August 28, 2005.

Explanation of Provision

The provision applies the increase in the rehabilitation credit from 20 to 26 percent, and from 10 to 13 percent, respectively, with respect to any certified historic structure or qualified rehabilitated building which was damaged or destroyed as a result of the severe storms, tornados, or flooding giving rise to a Presidential declaration of a major disaster on or after May 20, 2008, and before August 1, 2008, as required under the provision. The increased rehabilitation credit percentage applies for qualified rehabilitation expenditures with respect to such buildings or structures incurred on or after the applicable disaster date (as prescribed by the provision) and before January 1, 2012.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

7. Treatment of net operating losses attributable to disaster losses (sec. 702 of the Act)

Present Law

Under present law, a net operating loss ("NOL") is, generally, the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[777] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[778]

Different rules apply with respect to NOLs arising in certain circumstances. 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 applies to NOLs (1) arising from a farming loss (regardless of whether the loss was incurred in a Presidentially declared disaster area), or (2) certain amounts related to the Gulf Opportunity Zone and Kansas disaster area. Special rules also apply to real estate investment trusts (no carryback), specified liability losses (10-year

[776] Sec. 1400N(h).
[777] Sec. 172(b)(1)(A).
[778] Sec. 172(b)(2).

carryback), and excess interest losses (no carryback to any year preceding a corporate equity reduction transaction). Additionally, a special rule applies to certain electric utility companies.

Explanation of Provision

In general

The provision provides a special five-year carryback period for NOLs to the extent of certain specified amounts related to the Midwestern disaster area. The amount of the NOL which is eligible for the five-year carryback ("eligible NOL") is limited to the aggregate amount of the following deductions: (i) qualified Disaster Recovery Assistance casualty losses; (ii) certain moving expenses; (iii) certain temporary housing expenses; (iv) depreciation deductions with respect to qualified Disaster Recovery Assistance property for the taxable year the property is placed in service; and (v) deductions for certain repair expenses attributable to severe storms, tornados, or flooding that gave rise to any Presidential declaration described in the Midwestern disaster area definition.

Qualified Disaster Recovery Assistance casualty losses

The amount of qualified Disaster Recovery Assistance casualty losses which may be included in the eligible NOL is the amount of the taxpayer's casualty losses with respect to (1) property used in a trade or business, and (2) capital assets held for more than one year in connection with either a trade or business or a transaction entered into for profit. In order for a casualty loss to qualify, the property must be located in the Midwestern disaster area and the loss must be attributable to severe storms, tornados, or flooding that gave rise to any Presidential declaration described in the Midwestern disaster area definition. As under present law, the amount of any casualty loss includes only the amount not compensated for by insurance or otherwise. In addition, the total amount of the casualty loss which may be included in the eligible NOL is reduced by the amount of any gain recognized by the taxpayer from involuntary conversions of property located in the Midwestern disaster area caused by the severe storms, tornados, or flooding giving rise to any Presidential declaration described in the Midwestern disaster area definition.

To the extent that a casualty loss is included in the eligible NOL and carried back under the provision, the taxpayer is not also eligible to treat the loss as having occurred in the prior taxable year under section 165(i). Similarly, the five-year carryback under the provision does not apply to any loss taken into account for purposes of the ten-year carryback of public utility casualty losses.

A qualified Disaster Recovery Assistance casualty loss does not include any loss with respect to property used in connection with any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises, or any gambling or animal racing property (as defined in section 1400N(p)(3)(B)).

Moving expenses

Certain employee moving expenses of an employer may be included in the eligible NOL. In order to qualify, an amount must be paid or incurred after the applicable disaster date and before January 1, 2011, with respect to an employee who (i) lived in the Midwestern disaster area before the applicable disaster date, (ii) was displaced from their home either temporarily or permanently as a result of the severe storms, tornados, or flooding giving rise to any Presidential declaration described in the Midwestern disaster area definition, and (iii) is employed in the Midwestern disaster area by the taxpayer after the expense is paid or incurred.

For this purpose, moving expenses are defined as under present law to include only the reasonable expenses of moving household goods and personal effects from the former residence to the new residence, and of traveling (including lodging) from the former residence to the new place of residence. However, for purposes of the provision, the former residence and the new residence may be the same residence if the employee initially vacated the residence as a result of the severe storms, tornados, or flooding giving rise to any Presidential declaration described in the Midwestern disaster area definition. It is not necessary for the individual with respect to whom the moving expenses are incurred to have been an employee of the taxpayer at the time the expenses were incurred. Thus, assuming the other requirements are met, a taxpayer who pays the moving expenses of a prospective employee and subsequently employs the individual in the Midwestern disaster area may include such expenses in the eligible NOL.

Temporary housing expenses

Any deduction for expenses of an employer to temporarily house employees who are employed in the Midwestern disaster area may be included in the eligible NOL. It is not necessary for the temporary housing to be located in the Midwestern disaster area in order for such expenses to be included in the eligible NOL; however, the employee's principal place of employment with the taxpayer must be in the Midwestern disaster area. So, for example, if a taxpayer temporarily houses an employee at a location outside of the Midwestern disaster area, and the employee commutes into the Midwestern disaster area to the employee's principal place of employment, such temporary housing costs will be included in the eligible NOL (assuming all other requirements are met).

Depreciation

The eligible NOL includes the depreciation deduction (or amortization deduction in lieu of depreciation) with respect to qualified Disaster Recovery Assistance property placed in service during the year. The special carryback period applies to the entire allowable depreciation deduction for such property for the year in which it is placed in service, including both the regular depreciation deduction and the additional first-year depreciation deduction, if any. An election out of the additional first-year depreciation deduction for qualified Disaster Recovery Assistance property does not preclude eligibility for the five-year carryback.

Qualified Disaster Recovery Assistance property does not include any property used in connection with any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises, or any gambling or animal racing property (as defined in section 1400N(p)(3)(B)).

Repair expenses

The eligible NOL includes deductions for repair expenses (including the cost of removal of debris) with respect to damage caused by the severe storms, tornados, or flooding giving rise to any Presidential declaration described in the Midwestern disaster area definition. In order to qualify, the amount must be paid or incurred after the applicable disaster date and before January 1, 2011, and the property must be located in the Midwestern disaster area.

Other rules

The amount of the NOL to which the five-year carryback period applies is limited to the amount of the taxpayer's overall NOL for the taxable year. Any remaining portion of the taxpayer's NOL is subject to the general two-year carryback period. Ordering rules similar to those for specified liability losses apply to losses carried back under the provision. An irrevocable election not to apply the five-year carryback under the provision may be made with respect to any taxable year.

In addition, the general rule which limits a taxpayer's NOL deduction to 90 percent of AMTI does not apply to any NOL to which the five-year carryback period applies under the provision. Instead, a taxpayer may apply such NOL carrybacks to offset up to 100 percent of AMTI.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

8. Tax credit bonds (sec. 702 of the Act)

Present Law

In general

As an alternative to traditional tax-exempt bonds, States and local governments may issue tax-credit bonds for limited purposes. Rather than receiving interest payments, a taxpayer holding a tax-credit bond on an allowance date is entitled to a credit. Generally, the credit amount is includible in gross income (as if it were a taxable interest payment on the bond), and the credit may be claimed against regular income tax and alternative minimum tax liability. Two types of tax-credit bonds may be issued under present law: "qualified zone academy bonds," which are bonds issued for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other personnel at certain school facilities, and "clean renewable energy bonds," which are bonds issued to finance facilities that would qualify for the tax

credit under section 45 without regard to the placed in service date requirements of that section.

Gulf tax credit bonds

These tax-credit bonds must be issued in calendar year 2006 by the States of Louisiana, Mississippi, and Alabama. The taxpayer holding Gulf Tax Credit Bonds on the allowance date is entitled to a tax credit. The amount of the credit is determined by multiplying the bond's credit rate (set by the Secretary of the Treasury) by the face amount on the holder's bond. The credit is includible in gross income (as if it were an interest payment on the bond) and can used against regular income tax liability and alternative minimum tax liability.

Under the provision, 95 percent or more of the proceeds of Gulf Tax Credit Bonds must be used to (i) pay principal, interest, or premium on a bond (other than a private activity bond) that was outstanding on August 28, 2005, and was issued by the State issuing the Gulf Tax Credit Bonds, or any political subdivision thereof, or (ii) make a loan to any political subdivision of such State to pay principal, interest, or premium on a bond (other than a private activity bond) issued by such political subdivision. In addition, the issuer of Gulf Tax Credit Bonds must provide additional funds to pay principal, interest, or premium on outstanding bonds equal to the amount of Gulf Tax Credit Bonds issued to repay such outstanding bonds. Gulf Tax Credit Bonds must be a general obligation of the issuing State and must be designated by the Governor of such issuing State. The maximum maturity on Gulf Tax Credit Bonds is two years. In addition, present-law arbitrage rules that restrict the ability of State and local governments to invest bond proceeds apply to Gulf Tax Credit Bonds.

The maximum amount of Gulf Tax Credit Bonds that may be issued pursuant to this provision is $200 million in the case of Louisiana, $100 million in the case of Mississippi, and $50 million in the case of Alabama. Gulf Tax Credit Bonds may not be used to pay principal, interest, or premium on any bond with respect to which there is any outstanding refunded or refunding bond. Moreover, Gulf Tax Credit Bonds may not be used to pay principal, interest, or premium on any prior bond if the proceeds of such prior bond were used to provide any property described in section 144(c)(6)(B) (i.e., any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal purpose of which is the sale of alcoholic beverages for consumption off premises).

Explanation of Provision

The Act allows tax credit bonds ("Midwestern Tax Credit Bonds") to be issued in 2009 by any State in which a Midwestern disaster area is located (or any instrumentality of the State). The operation and effect of these Midwestern Tax Credit Bonds are otherwise identical to Gulf Tax Credit Bonds except for different volume caps. Under the provision, the maximum amount of Midwestern Tax Credit Bonds that may be issued is: (1) $100 million for any State with an aggregate population located in all Midwestern disaster

areas within the State of at least 2,000,000; (2) $50 million for any State with an aggregate population located in all Midwestern disaster areas within the State of at least 1,000,000 but less than 2,000,000; and (3) $0 for any other State.

Effective Date

The provision is effective for bonds issued after December 31, 2008.

9. Representations regarding income eligibility for purposes of qualified residential rental project requirements (sec. 702 of the Act)

Present Law

In general

Under present law, gross income generally does not include interest on State or local bonds (sec. 103). State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit, providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds").

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. The definition of exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities.

Subject to certain requirements, qualified private activity bonds may be issued to finance residential rental property or owner-occupied housing. Residential rental property may be financed with exempt facility bonds if the financed project is a "qualified residential rental project." A project is a qualified residential rental project if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income (the "20–50 test"). Alternatively, a project is a qualified residential rental project if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income (the "40–60 test"). The issuer must elect to apply either the 20–50 test or the 40–60 test. Operators of qualified residential rental projects

must certify annually that such projects meet the requirements for qualification, including meeting the 20–50 test or the 40–60 test.

Special rule for Gulf Opportunity Zone

Under a special provision, the operator of a qualified residential rental project could rely on the representations of a prospective tenant displaced by reason of Hurricane Katrina for purposes of determining whether such project satisfies the income limitations for qualified residential rental projects and, thus, the project is in compliance with the 20–50 test or the 40–60 test. This rule only applied if the individual's tenancy began during the six-month period beginning on the date when such individual was displaced by Hurricane Katrina (sec. 1400N(n)).

Explanation of Provision

The Act provides relief for the Midwestern disaster area identical to the relief for the Gulf Opportunity Zone (except that this relief relates to the Midwestern disaster rather than Hurricane Katrina).

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

10. Expansion of the Hope and Lifetime Learning credits for students in any Midwestern disaster area (sec. 702 of the Act)

Present Law

Hope credit

Individual taxpayers are allowed to claim a nonrefundable credit, the Hope credit, against Federal income taxes of up to $1,800 per student per year for qualified tuition and related expenses paid for the first two years of the student's post-secondary education in a degree or certificate program.[779] The Hope credit rate is 100 percent on the first $1,200 of qualified tuition and related expenses, and 50 percent on the next $1,200 of qualified tuition and related expenses. The Hope credit that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified adjusted gross income between $48,000 and $58,000 ($96,000 and $116,000 for married taxpayers filing a joint return) for 2008. The adjusted gross income phaseout ranges are indexed for inflation. Also, each of the $1,200 amounts of qualified tuition and related expenses to which the 100 percent credit rate and 50 percent credit rate apply are indexed to inflation, with the amount rounded down to the next lowest multiple of $100. Thus, for example, an eligible student who incurs $1,200 of qualified tuition and related expenses is eligible (subject to the adjusted gross income phaseout) for a $1,200 Hope

[779] Sec. 25A. The Hope credit generally may not be claimed against a taxpayer's alternative minimum tax liability. However, the credit may be claimed against a taxpayer's alternative minimum tax liability for taxable years beginning prior to January 1, 2008. See further action that modifies this law in Part Seventeen, Division C, Title I.

credit. If an eligible student incurs $2,400 of qualified tuition and related expenses, then he or she is eligible for a $1,800 Hope credit.

The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer. The Hope credit is available with respect to an individual student for two taxable years, provided that the student has not completed the first two years of post-secondary education before the beginning of the second taxable year.

The Hope credit is available in the taxable year the expenses are paid, subject to the requirement that the education is furnished to the student during that year or during an academic period beginning during the first three months of the next taxable year. Qualified tuition and related expenses paid with the proceeds of a loan generally are eligible for the Hope credit. The repayment of a loan itself is not a qualified tuition or related expense.

A taxpayer may claim the Hope credit with respect to an eligible student who is not the taxpayer or the taxpayer's spouse (e.g., in cases in which the student is the taxpayer's child) only if the taxpayer claims the student as a dependent for the taxable year for which the credit is claimed. If a student is claimed as a dependent, the student is not entitled to claim a Hope credit for that taxable year on the student's own tax return. If a parent (or other taxpayer) claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of determining the amount of qualified tuition and related expenses paid by such parent (or other taxpayer) under the provision. In addition, for each taxable year, a taxpayer may elect either the Hope credit, the Lifetime Learning credit (described below), or an above-the-line deduction for qualified tuition and related expenses with respect to an eligible student.

The Hope credit is available for "qualified tuition and related expenses," which include tuition and fees (excluding nonacademic fees) required to be paid to an eligible educational institution as a condition of enrollment or attendance of an eligible student at the institution. Charges and fees associated with meals, lodging, insurance, transportation, and similar personal, living, or family expenses are not eligible for the credit. The expenses of education involving sports, games, or hobbies are not qualified tuition and related expenses unless this education is part of the student's degree program.

Qualified tuition and related expenses generally include only out-of-pocket expenses. Qualified tuition and related expenses do not include expenses covered by employer-provided educational assistance and scholarships that are not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and related expenses are reduced by any scholarship or fellowship grants excludable from gross income under section 117 and any other tax-free educational benefits received by the student (or the taxpayer claiming the credit) during the taxable year. The Hope credit is not allowed with respect to any education expense for which a deduction is claimed under section 162 or any other section of the Code.

An eligible student for purposes of the Hope credit is an individual who is enrolled in a degree, certificate, or other program (including a program of study abroad approved for credit by the institution at which such student is enrolled), leading to a recognized educational credential at an eligible educational institution. The student must pursue a course of study on at least a half-time basis. A student is considered to pursue a course of study on at least a half-time basis if the student carries at least one half the normal full-time work load for the course of study the student is pursuing for at least one academic period that begins during the taxable year. To be eligible for the Hope credit, a student must not have been convicted of a Federal or State felony consisting of the possession or distribution of a controlled substance.

Eligible educational institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. To qualify as an eligible educational institution, an institution must be eligible to participate in Department of Education student aid programs.

Effective for taxable years beginning after December 31, 2010, the changes to the Hope credit made by the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") no longer apply. The principal EGTRRA change scheduled to expire is the change that permitted a taxpayer to claim a Hope credit in the same year that he or she claimed an exclusion from a Coverdell education savings account. Thus, after 2010, a taxpayer cannot claim a Hope credit in the same year he or she claims an exclusion from a Coverdell education savings account.

Lifetime Learning credit

Individual taxpayers are allowed to claim a nonrefundable credit, the Lifetime Learning credit, against Federal income taxes equal to 20 percent of qualified tuition and related expenses incurred during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependents.[780] Up to $10,000 of qualified tuition and related expenses per taxpayer return are eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return is $2,000). In contrast with the Hope credit, the maximum credit amount is not indexed for inflation.

In contrast to the Hope credit, a taxpayer may claim the Lifetime Learning credit for an unlimited number of taxable years. Also in contrast to the Hope credit, the maximum amount of the Lifetime Learning credit that may be claimed on a taxpayer's return will not vary based on the number of students in the taxpayer's family—that is, the Hope credit is computed on a per student basis while the Lifetime Learning credit is computed on a family-wide basis. The Lifetime Learning credit amount that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified ad-

[780] Sec. 25A. The Lifetime Learning credit generally may not be claimed against a taxpayer's alternative minimum tax liability. However, the credit may be claimed against a taxpayer's alternative minimum tax liability for taxable years beginning prior to January 1, 2008. See further action that modifies this law in Part Seventeen, Division C, Title I.

justed gross income between $48,000 and $58,000 ($96,000 and $116,000 for married taxpayers filing a joint return) in 2008. These phaseout ranges are the same as those for the Hope credit, and are similarly indexed for inflation.

The Lifetime Learning credit is available in the taxable year the expenses are paid, subject to the requirement that the education is furnished to the student during that year or during an academic period beginning during the first three months of the next taxable year. As with the Hope credit, qualified tuition and related expenses paid with the proceeds of a loan generally are eligible for the Lifetime Learning credit. Repayment of a loan is not a qualified tuition expense.

As with the Hope credit, a taxpayer may claim the Lifetime Learning credit with respect to a student who is not the taxpayer or the taxpayer's spouse (e.g., in cases in which the student is the taxpayer's child) only if the taxpayer claims the student as a dependent for the taxable year for which the credit is claimed. If a student is claimed as a dependent by a parent or other taxpayer, the student may not claim the Lifetime Learning credit for that taxable year on the student's own tax return. If a parent (or other taxpayer) claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of the provision.

A taxpayer may claim the Lifetime Learning credit for a taxable year with respect to one or more students, even though the taxpayer also claims a Hope credit for that same taxable year with respect to other students. If, for a taxable year, a taxpayer claims a Hope credit with respect to a student, then the Lifetime Learning credit is not available with respect to that same student for that year (although the Lifetime Learning credit may be available with respect to that same student for other taxable years). As with the Hope credit, a taxpayer may not claim the Lifetime Learning credit and also claim the above-the-line deduction for qualified tuition and related expenses.

As with the Hope credit, the Lifetime Learning credit is available for "qualified tuition and related expenses," which include tuition and fees (excluding nonacademic fees) required to be paid to an eligible educational institution as a condition of enrollment or attendance of a student at the institution. Eligible educational institutions are defined in the same manner for purposes of both the Hope and Lifetime Learning credits. Charges and fees associated with meals, lodging, insurance, transportation, and similar personal, living, or family expenses are not eligible for the Lifetime Learning credit. The expenses of education involving sports, games, or hobbies are not qualified tuition expenses unless this education is part of the student's degree program, or the education is undertaken to acquire or improve the job skills of the student.

In contrast to the Hope credit, qualified tuition and related expenses for purposes of the Lifetime Learning credit include tuition and fees incurred with respect to undergraduate or graduate-level courses.[781] Additionally, in contrast to the Hope credit, the eligi-

[781] As explained above, the Hope credit is available only with respect to the first two years of a student's undergraduate education.

bility of a student for the Lifetime Learning credit does not depend on whether the student has been convicted of a Federal or State felony consisting of the possession or distribution of a controlled substance.

As with the Hope credit, qualified tuition and fees generally include only out-of-pocket expenses. Qualified tuition and fees do not include expenses covered by employer-provided educational assistance and scholarships that are not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and fees are reduced by any scholarship or fellowship grants excludable from gross income under section 117 and any other tax-free educational benefits received by the student during the taxable year (such as employer-provided educational assistance excludable under section 127). The Lifetime Learning credit is not allowed with respect to any education expense for which a deduction is claimed under section 162 or any other section of the Code.

Effective for taxable years beginning after December 31, 2010, the changes to the Lifetime Learning credit made by EGTRRA no longer apply. The principal EGTRRA change scheduled to expire is the change that permitted a taxpayer to claim a Lifetime Learning credit in the same year that he or she claimed an exclusion from a Coverdell education savings account. Thus, after 2010, a taxpayer cannot claim a Lifetime Learning credit in the same year he or she claims an exclusion from a Coverdell education savings account.

Definition of qualified higher education expenses for purposes of qualified tuition programs

Present law provides favorable tax treatment for qualified tuition programs that meet the requirements of section 529. For purposes of the rules relating to qualified tuition programs, "qualified higher education expenses" means tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible educational institution and expenses for special needs services, in the case of a special needs beneficiary, which are incurred in connection with such enrollment or attendance. In addition, in the case of at least half-time students, qualified higher education expenses include certain room and board expenses.

Special rule for Hurricane Katrina

Section 1400O temporarily expanded the Hope and Lifetime Learning credits for students attending (i.e., enrolled and paying tuition at) an eligible educational institution located in the Gulf Opportunity Zone. The provision applied to taxable years beginning in 2005 or 2006.

The provision doubled the dollar amounts (as indexed for inflation) to which the 100 percent and 50 percent Hope credit rates were applied. Thus, for taxable years beginning in 2005, the Hope credit was increased to 100 percent of the first $2,000 (instead of $1,000) of qualified tuition and related expenses and 50 percent of the next $2,000 (instead of $1,000) of qualified tuition and related expenses for a maximum credit of $3,000 (instead of $1,500) per student. For taxable years beginning in 2006, the Hope credit was increased to 100 percent of the first $2,200 (instead of $1,100) of

qualified tuition and related expenses and 50 percent of the next $2,200 (instead of $1,100) of qualified tuition and related expenses for a maximum credit of $3,300 per student (instead of $1,650). The Lifetime Learning credit rate was increased from 20 percent to 40 percent. The provision expanded the definition of qualified tuition and related expenses to include any costs that were qualified higher education expenses as defined under the rules relating to qualified tuition programs.

Explanation of Provision

For taxable years beginning in 2008 or 2009, the provision applies the special rule for Hurricane Katrina to students attending (i.e., enrolled and paying tuition at) an eligible educational institution located in any Midwestern disaster area.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

11. Housing relief for individuals affected by 2008 Midwestern severe storms, tornados, and flooding (sec. 702 of the Act)

Present Law

Employer-provided housing is generally includible in income as compensation and as wages for purposes of employment taxes.[782] The value of lodging furnished to an employee, the employee's spouse, or the employee's dependents by or on behalf of the employee's employer is excludable from income and wages, but generally only if the employee is required to accept the lodging on the business premises of the employer as a condition of employment.[783] Reasonable expenses for employee compensation are deductible by the employer.[784] Section 1400P provides special rules in the case of individuals affected by Hurricane Katrina.

Section 1400P provides an income exclusion for the value of in-kind lodging provided for certain months to a qualified employee (and the employee's spouse or dependents) by or on behalf of a qualified employer. The amount of the exclusion for any month for which lodging is furnished cannot exceed $600. The exclusion does not apply for purposes of employment taxes.

Section 1400P also provides a credit to a qualified employer of 30 percent of the value of lodging excluded from the income of a qualified employee under the section. The amount taken as a credit is not deductible by the employer.

Qualified employee means, with respect to a month, an individual who: (1) on August 28, 2005, had a principal residence in the Gulf Opportunity Zone; and (2) performs substantially all of his or her employment services in the Gulf Opportunity Zone for the qualified employer furnishing the lodging. Qualified employer means any employer with a trade or business located in the Gulf

[782] Secs. 61, 3121(a), 3306(b).
[783] Secs. 119, 3121(a)(19), 3306(b)(14).
[784] Sec. 162(a).

Opportunity Zone. Section 1400P applies to lodging provided during the period beginning on December 21, 2005, and ending on June 21, 2006.

Explanation of Provision

The provision extends the housing relief provided in section 1400P to certain individuals affected by the 2008 Midwestern severe storms, tornadoes, and flooding. Thus, an income exclusion is provided for the value of in-kind lodging provided for certain months to a qualified employee (and the employee's spouse or dependents) by or on behalf of a qualified employer. The amount of the exclusion for any month cannot exceed $600, and the exclusion does not apply for employment tax purposes.

The provision also extends the application of the present law credit to a qualified employer of 30 percent of the value of lodging excluded from the income of a qualified employee. The amount taken as a credit is not deductible by the employer.

Under the provision, qualified employee means, with respect to a month, an individual who: (1) on the applicable disaster date had a principal residence in the Midwestern disaster area; and (2) performs substantially all of his or her employment services in the Midwestern disaster area for the qualified employer furnishing the lodging. Qualified employer means any employer with a trade or business located in the Midwestern disaster area.

Effective Date

The provision applies to lodging provided during the period beginning on November 1, 2008, and ending on May 1, 2009.

12. Use of retirement funds from retirement plans relating to the Midwest disaster area (sec. 702 of the Act)

Present Law

In general

Withdrawals from retirement plans

A distribution from a qualified retirement plan under section 401(a), a qualified annuity plan under section 403(a), a tax-sheltered annuity under section 403(b) (a "403(b) annuity"), an eligible deferred compensation plan maintained by a State or local government under section 457 (a "governmental 457 plan"), or an individual retirement arrangement under section 408 (an "IRA") generally is included in income for the year distributed (secs. 402(a), 403(a), 403(b), 408(d), and 457(a)). (These plans are referred to collectively as "eligible retirement plans".) In addition, a distribution from a qualified retirement or annuity plan, a 403(b) annuity, or an IRA received before age 59½, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount includible in income, unless an exception applies (sec. 72(t)).

An eligible rollover distribution from a qualified retirement or annuity plan, a 403(b) annuity, or a governmental 457 plan, or a distribution from an IRA, generally can be rolled over within 60 days to another plan, annuity, or IRA. The IRS has the authority

to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual. Any amount rolled over is not includible in income (and thus also not subject to the 10-percent early withdrawal tax).

Distributions from a qualified retirement or annuity plan, 403(b) annuity, a governmental 457 plan, or an IRA are generally subject to income tax withholding unless the recipient elects otherwise. An eligible rollover distribution from a qualified retirement or annuity plan, 403(b) annuity, or governmental 457 plan is subject to income tax withholding at a 20-percent rate unless the distribution is rolled over to another plan, annuity or IRA by means of a direct transfer. Any distribution is an eligible rollover distribution unless specifically excepted. Exceptions include a distribution that is part of a series of substantially equal periodic payments made at least annually for the life of the employee.

Certain amounts held in a qualified retirement plan that includes a qualified cash-or-deferred arrangement (a "401(k) plan") or in a 403(b) annuity may not be distributed before severance from employment, age 59½, death, disability, or financial hardship of the employee. Amounts deferred under a governmental 457 plan may not be distributed before severance from employment, age 70½, or an unforeseeable emergency of the employee.

Loans from retirement plans

An individual is permitted to borrow from a qualified plan in which the individual participates (and to use his or her accrued benefit as security for the loan) provided the loan bears a reasonable rate of interest, is adequately secured, provides a reasonable repayment schedule, and is not made available on a basis that discriminates in favor of employees who are officers, shareholders, or highly compensated.

Subject to certain exceptions, a loan from a qualified employer plan to a plan participant is treated as a taxable distribution of plan benefits. A qualified employer plan includes a qualified retirement plan under section 401(a), a qualified annuity plan under section 403(a), a tax-deferred annuity under section 403(b), and any plan that was (or was determined to be) a qualified employer plan or a governmental plan.

An exception to this general rule of income inclusion is provided to the extent that the loan (when added to the outstanding balance of all other loans to the participant from all plans maintained by the employer) does not exceed the lesser of (1) $50,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or (2) the greater of $10,000 or one half of the participant's accrued benefit under the plan (sec. 72(p)). This exception applies only if the loan is required, by its terms, to be repaid within five years. An extended repayment period is permitted for the purchase of the principal residence of the participant. Plan loan repayments (principal and interest) must be amortized in level payments and made not less frequently than quarterly, over the term of the loan.

Plan amendments

A remedial amendment period applies during which, under certain circumstances, a plan may be amended retroactively in order to comply with the qualification requirements (sec. 401(b)). In general, plan amendments required to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs. The Secretary of the Treasury may extend the time by which plan amendments need to be made.

Use of retirement funds related to disaster relief for Hurricanes Katrina, Rita, and Wilma

In general

To provide disaster relief for Hurricanes Katrina, Rita, and Wilma, section 1400Q provides exceptions to certain rules regarding distributions from retirement plans, for loans from retirement plans, and for plan amendments to retirement plans.[785]

Tax favored withdrawals from retirement plans

Section 1400Q(a) provides an exception to the 10-percent early withdrawal tax in the case of a qualified hurricane distribution from a qualified retirement or annuity plan, a 403(b) annuity, or an IRA. In addition, as discussed more fully below, income attributable to a qualified hurricane distribution may be included in income ratably over three years, and the amount of a qualified hurricane distribution may be recontributed to an eligible retirement plan within three years.

A qualified hurricane distribution includes certain distributions from an eligible retirement plan related to Hurricanes Katrina, Wilma, and Rita. Specifically, qualified hurricane distributions include the following distributions from an eligible retirement plan: any distribution made on or after August 25, 2005, and before January 1, 2007, to an individual whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss by reason of Hurricane Katrina. Similar rules apply for qualified hurricane distributions with respect to Hurricanes Rita and Wilma. The total amount of qualified hurricane distributions that an individual can receive from all plans, annuities, or IRAs is $100,000. Thus, any distributions in excess of $100,000 during the applicable periods are not qualified hurricane distributions.

Any amount required to be included in income as a result of a qualified hurricane distribution is included in income ratably over the three-year period beginning with the year of distribution unless the individual elects not to have ratable inclusion apply.

Any portion of a qualified hurricane distribution may, at any time during the three-year period beginning the day after the date on which the distribution was received, be recontributed to an eligi-

[785] The relief with respect to Hurricane Katrina was initially provided in the Katrina Emergency Relief Act of 2005 (Pub. L. No. 109–73). The IRS provided guidance on those relief provisions in Notice 2005–92, 2005–2 C.B. 1165. The relief was codified in section 1400Q and was expanded to the Hurricanes Rita and Wilma Disaster areas in the Gulf Opportunity Zone Act of 2005 (Pub. L. No. 109–135).

ble retirement plan to which a rollover can be made. Any amount recontributed within the three-year period is treated as a rollover and thus is not includible in income. For example, if an individual receives a qualified hurricane distribution in 2005, that amount is included in income, generally ratably over the year of the distribution and the following two years, but is not subject to the 10-percent early withdrawal tax. If, in 2007, the amount of the qualified hurricane distribution is recontributed to an eligible retirement plan, the individual may file an amended return (or returns) to claim a refund of the tax attributable to the amount previously included in income. In addition, if, under the ratable inclusion provision, a portion of the distribution has not yet been included in income at the time of the contribution, the remaining amount is not includible in income.

A qualified hurricane distribution is a permissible distribution from a 401(k) plan, 403(b) annuity, or governmental 457 plan, regardless of whether a distribution otherwise would be permissible. A plan is not treated as violating any Code requirement merely because it treats a distribution as a qualified hurricane distribution, provided that the aggregate amount of such distributions from plans maintained by the employer and members of the employer's controlled group does not exceed $100,000. A plan is not treated as violating any Code requirement merely because an individual might receive total distributions in excess of $100,000, taking into account distributions from plans of other employers or IRAs.

Qualified hurricane distributions are subject to the income tax withholding rules applicable to distributions other than eligible rollover distributions. Thus, 20-percent mandatory withholding does not apply.

Recontributions of withdrawals for home purchases

Section 1400Q(b) generally provides that a distribution received from a 401(k) plan, 403(b) annuity, or IRA in order to purchase a home in the Hurricane Katrina, Rita, or Wilma disaster areas may be recontributed to such a plan, annuity, or IRA in certain circumstances.

The ability to recontribute applies to an individual who receives a qualified distribution. A qualified distribution is a hardship distribution from a 401(k) plan or 403(b) annuity, or a qualified first-time homebuyer distribution from an IRA, that is a qualified Katrina distribution, a qualified Rita distribution, or a qualified Wilma distribution.

A qualified Katrina distribution is a distribution: (1) That is received after February 28, 2005, and before August 29, 2005; and (2) that was to be used to purchase or construct a principal residence in the Hurricane Katrina disaster area, but the residence is not purchased or constructed on account of Hurricane Katrina. Any portion of a qualified Katrina distribution may be recontributed to a plan, annuity or IRA to which a rollover is permitted, during the period beginning on August 25, 2005, and ending on February 28, 2006. Any amount recontributed is treated as a rollover. Thus, the recontributed portion of the qualified distribution is not includible in income (and also is not subject to the 10-percent early with-

drawal tax). Similar rules apply to qualified Hurricane Rita and Hurricane Wilma distributions.

Loans from qualified plans to individuals sustaining an economic loss

Section 1400Q(c) provides an exception to the income inclusion rule for loans from a qualified employer plan related to Hurricanes Katrina, Rita, and Wilma made to a qualified individual during an applicable period and provides a repayment delay for loans that are outstanding on or after a qualified beginning date if the due date for any repayment with respect to such loan occurs after the qualified beginning date and December 31, 2006.

The exception to the general rule of income inclusion is provided to the extent that the loan (when added to the outstanding balance of all other loans to the participant from all plans maintained by the employer) does not exceed the lesser of (1) $100,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or (2) the greater of $10,000 or the participant's accrued benefit under the plan.

In the case of a qualified individual with an outstanding loan on or after the qualified beginning date from a qualified employer plan, if the due date for any repayment with respect to such loan occurs during the period beginning on the qualified beginning date, and ending on December 31, 2006, such due date is delayed for one year. Any subsequent repayments with respect to such loan shall be appropriately adjusted to reflect the delay in the due date and any interest accruing during such delay. The period during which required repayment is delayed is disregarded in complying with the requirements that the loan be repaid within five years and that level amortization payments be made.

A qualified individual entitled to this plan loan relief includes a qualified Hurricane Katrina individual, a qualified Hurricane Rita individual, or a qualified Hurricane Wilma individual. A qualified Hurricane Katrina individual is an individual whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss by reason of Hurricane Katrina. The qualified beginning date for a qualified Hurricane Katrina individual is August 25, 2005, and the applicable period is the period beginning on September 24, 2005, and ending December 31, 2006. Similar rules apply to qualified Hurricane Rita and Hurricane Wilma individuals. An individual cannot be a qualified individual with respect to more than one hurricane.

Plan amendments relating to Hurricanes Katrina, Rita, and Wilma

Section 1400Q(d) permits certain plan amendments made pursuant to any provision in section 1400Q, or regulations issued thereunder, to be retroactively effective. If the plan amendment meets the requirements of section 1400Q, then the plan will be treated as being operated in accordance with its terms. In order for this treatment to apply, the plan amendment is required to be made on or

before the last day of the first plan year beginning on or after January 1, 2007, or such later date as provided by the Secretary of the Treasury. Governmental plans are given an additional two years in which to make required plan amendments. If the amendment is required to be made to retain qualified status as a result of the changes made by section 1400Q (or regulations), the amendment is required to be made retroactively effective as of the date on which the change became effective with respect to the plan, and the plan is required to be operated in compliance until the amendment is made. Amendments that are not required to retain qualified status but that are made pursuant to section 1400Q may be made retroactively effective as of the first day the plan is operated in accordance with the amendment. A plan amendment will not be considered to be pursuant to section 1400Q (or regulations) if it has an effective date before the effective date of the provision (or regulations) to which it relates.

Explanation of Provision

The provision provides relief similar to the relief provided in section 1400Q with respect to use of retirement funds in connection with the Midwest disaster area. For this purpose the Midwest disaster area is not limited to areas determined by the President to warrant individual or individual and public assistance from the Federal government with respect to the disaster. The provision makes the relief available for an area by reference to the applicable disaster date with respect to that area.

The rules for tax favored withdrawals from retirement plans, and the special rules for loans from qualified plans that increase the loan limit and delay the due date for repayment, are available to any individual whose principal residence on the applicable disaster date is located in the relevant Midwest disaster area and who sustained a loss by reason of the relevant severe storm, tornado, or flood. The rules for tax favored withdrawals from retirement plans apply to distributions on or after the applicable disaster date and before January 1, 2010. The increased loan limit applies to loans during the period beginning on October 3, 2008 (the date of enactment) and ending on December 31, 2009, and the one year extension for the due date of loan payments applies to any loan payment due during the period beginning on the applicable disaster date and ending on December 31, 2009.

The special rule allowing recontribution of withdrawals for home purchases applies to any withdrawal to purchase a home in the Midwest disaster area that was not purchased or constructed on account of the relevant severe storm, tornado, or flooding. The provision applies to withdrawals after the date which is six months before the applicable disaster date and before the date which is the day after the applicable disaster date. The recontribution may be made up until March 3, 2009 (five months after date of enactment).

The provision also provides a similar delay until the last day of the first plan year beginning before January 1, 2010, for making plan amendments to tax qualified employer plans implementing these provisions. As provided under section 1400Q, an additional two years is provided for the amendment of qualified retirement plans of governmental employers.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

13. Employee retention credit (sec. 702 of the Act)

Present Law

For employers affected by Hurricane Katrina, Rita, or Wilma, section 1400R provides a credit of 40 percent of the qualified wages (up to a maximum of $6,000 in qualified wages per employee) paid by an eligible employer to an eligible employee. Public Law 110–246 provides that section 1400R applies, with modifications, to employers in the Kansas disaster area.

Hurricane Katrina

An eligible employer is any employer (1) that conducted an active trade or business on August 28, 2005, in the Gulf Opportunity Zone and (2) with respect to which the trade or business described in (1) is inoperable on any day after August 28, 2005, and before January 1, 2006, as a result of damage sustained by reason of Hurricane Katrina.

An eligible employee is, with respect to an eligible employer, an employee whose principal place of employment on August 28, 2005, with such eligible employer was in the Gulf Opportunity Zone. An employee may not be treated as an eligible employee for any period with respect to an employer if such employer is allowed a credit under section 51 with respect to the employee for the period.

Qualified wages are wages (as defined in section 51(c)(1), but without regard to section 3306(b)(2)(B)) paid or incurred by an eligible employer with respect to an eligible employee on any day after August 28, 2005, and before January 1, 2006, during the period (1) beginning on the date on which the trade or business first became inoperable at the principal place of employment of the employee immediately before Hurricane Katrina, and (2) ending on the date on which such trade or business has resumed significant operations at such principal place of employment. Qualified wages include wages paid without regard to whether the employee performs any services, performs services at a different place of employment than such principal place of employment, or performs services at such principal place of employment before significant operations have resumed.

The credit is a part of the current year business credit under section 38(b) and therefore is subject to the tax liability limitations of section 38(c). Rules similar to sections 51(i)(1) and 52 apply to the credit.

Hurricanes Rita and Wilma

The credit for employers affected by Hurricanes Rita and Wilma follows the same rules as the credit for employers affected by Hurricane Katrina, except the reference dates for affected employers, comparable to the August 28, 2005 date for employers affected by Hurricane Katrina, are September 23, 2005, and October 23, 2005, respectively.

Kansas Disaster Area

Public Law 110–246 extends the retention credit, as modified to include an employer size limitation, for employers affected by the storms and tornados in the Kansas disaster area. The term "Kansas disaster area" means an area with respect to which a major disaster has been declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (FEMA–1699–DR, as in effect on the date of enactment of this Act) by reason of severe storms and tornados beginning on May 4, 2007, and determined by the President to warrant individual or individual and public assistance from the Federal Government under such Act with respect to damages attributable to storms and tornados.

The reference dates for these employers, comparable to the August 28, 2005 and January 1, 2006, dates of present law for employers affected by Hurricane Katrina, are May 4, 2007, and January 1, 2008, respectively.

The retention credit for employers affected by the Kansas storms and tornados includes an employer size limitation. The credit only applies to eligible employers who employed an average of not more than 200 employees on business days during the taxable year before May 4, 2007.

Explanation of Provision

The Act extends the application of the retention credit, with the employer size limitation, for affected employers in the Midwestern disaster area.

The reference dates for employers in the Midwestern disaster area, comparable to the August 28, 2005 and January 1, 2006, dates of present law for employers affected by Hurricane Katrina, are the "applicable disaster date," and January 1, 2009, respectively. The "applicable disaster date" is the date on which the severe storms, tornados, or flooding giving rise to the Presidential disaster declaration occurred.

The retention credit for employers affected by the Midwestern storms, tornados, and floods includes an employer size limitation. The credit only applies to eligible employers who employed an average of not more than 200 employees on business days during the taxable year before the applicable disaster date.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

14. Suspension of limitations on charitable contributions for disaster relief (sec. 702 of the Act and sec. 170 of the Code)

Present Law

In general

In general, an income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type

of taxpayer, the property contributed, and the donee organization.[786]

Charitable contributions of cash are deductible in the amount contributed. In general, contributions of capital gain property to a qualified charity are deductible at fair market value with certain exceptions. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of other appreciated property generally are deductible at the donor's basis in the property. Contributions of depreciated property generally are deductible at the fair market value of the property.

Percentage limitations

Contributions by individuals

For individuals, in any taxable year, the amount deductible as a charitable contribution is limited to a percentage of the taxpayer's contribution base. The applicable percentage of the contribution base varies depending on the type of donee organization and property contributed. The contribution base is defined as the taxpayer's adjusted gross income computed without regard to any net operating loss carryback.

Contributions by an individual taxpayer of property (other than appreciated capital gain property) to a charitable organization described in section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) may not exceed 50 percent of the taxpayer's contribution base. Contributions of this type of property to nonoperating private foundations and certain other organizations generally may be deducted up to 30 percent of the taxpayer's contribution base.

Contributions of appreciated capital gain property to charitable organizations described in section 170(b)(1)(A) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of appreciated capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of appreciated capital gain property to charitable organizations described in section 170(b)(1)(B) (e.g., private nonoperating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

Contributions by corporations

For corporations, in any taxable year, charitable contributions are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating loss or capital loss carrybacks.

For purposes of determining whether a corporation's aggregate charitable contributions in a taxable year exceed the applicable

[786] Sec. 170

percentage limitation, contributions of capital gain property are taken into account after other charitable contributions.

Carryforward of excess contributions

Charitable contributions that exceed the applicable percentage limitation may be carried forward for up to five years.[787] The amount that may be carried forward from a taxable year ("contribution year") to a succeeding taxable year may not exceed the applicable percentage of the contribution base for the succeeding taxable year less the sum of contributions made in the succeeding taxable year plus contributions made in taxable years prior to the contribution year and treated as paid in the succeeding taxable year under this provision.

Overall limitation on itemized deductions ("Pease" limitation)

Under present law, the total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) is reduced by three percent of the amount of the taxpayer's adjusted gross income in excess of a certain threshold.[788] The otherwise allowable itemized deductions may not be reduced by more than 80 percent. For 2008, the adjusted gross income threshold is $159,950 ($79,975 for a married taxpayer filing a joint return). These dollar amounts are adjusted for inflation.

The otherwise applicable overall limitation on itemized deductions is reduced by two-thirds in taxable years beginning in 2008 and 2009. The overall limitation is repealed for taxable years beginning after December 31, 2009, and reinstated for taxable years beginning after December 31, 2010.

Special rule for Hurricanes Katrina, Rita, and Wilma

Section 1400S(a) includes a special rule that temporarily suspended the percentage limitations on certain charitable contributions following Hurricanes Katrina, Rita, and Wilma. Under section 1400S(a), in the case of an individual, the deduction for qualified contributions is allowed up to the amount by which the taxpayer's contribution base exceeds the deduction for other charitable contributions. Contributions in excess of this amount are carried over to succeeding taxable years as contributions described in section 170(b)(1)(A), subject to the limitations of section 170(d)(1)(A)(i) and (ii).

In the case of a corporation, the deduction for qualified contributions is allowed up to the amount by which the corporation's taxable income (as computed under section 170(b)(2)) exceeds the deduction for other charitable contributions. Contributions in excess of this amount are carried over to succeeding taxable years, subject to the limitations of section 170(d)(2).

In applying subsections (b) and (d) of section 170 to determine the deduction for other contributions, qualified contributions are not taken into account (except to the extent qualified contributions

[787] Sec. 170(d).
[788] Sec. 68.

are carried over to succeeding taxable years under the rules described above).

Under section 1400S(a), qualified contributions are cash contributions made during the period beginning on August 28, 2005, and ending on December 31, 2005, to a charitable organization described in section 170(b)(1)(A) (other than a supporting organization described in section 509(a)(3)). Contributions of noncash property, such as securities, are not qualified contributions. Under section 1400S, qualified contributions must be to an organization described in section 170(b)(1)(A); thus, contributions to, for example, a charitable remainder trust generally are not qualified contributions, unless the charitable remainder interest is paid in cash to an eligible charity during the applicable time period. In the case of a corporation, qualified contributions must be for relief efforts related to Hurricane Katrina, Hurricane Rita, or Hurricane Wilma. A taxpayer must elect to have the contributions treated as qualified contributions.

Qualified contributions do not include a contribution if the contribution is for establishment of a new, or maintenance in an existing, segregated fund or account with respect to which the donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to distributions or investments by reason of the donor's status as a donor.

The charitable contribution deduction up to the amount of qualified contributions (as defined above) paid during the year is not treated as an itemized deduction for purposes of the overall limitation on itemized deductions.

Explanation of Provision

The Act generally extends the above-described suspension of limitations on charitable contributions permitted following Hurricanes Katrina, Rita, and Wilma to contributions made for relief efforts in one or more Midwestern disaster areas, with certain modifications described below.

To be a qualified contribution under the Act, a contribution must meet the following requirements: (1) it is a cash contribution paid during the period beginning on the earliest applicable disaster date for all States and ending on December 31, 2008, to a charitable organization described in section 170(b)(1)(A) (generally, public charities); (2) it is made for relief efforts in one or more Midwestern disaster areas; (3) the donor obtains from the recipient organization a contemporaneous written acknowledgment (within the meaning of section 170(f)(8)) that such contribution was used (or is to be used) for such relief efforts; and (4) the taxpayer elects to have the contribution treated as a qualified disaster contribution. Contributions of noncash property, such as securities, are not qualified disaster contributions. Under the provision, qualified contributions must be to an organization described in section 170(b)(1)(A); thus, contributions to, for example, a charitable remainder trust generally are not qualified contributions, unless the charitable remainder interest is paid in cash to an eligible charity during the applicable time period.

Qualified contributions do not include a contribution if the contribution is: (1) to a supporting organization described in section

509(a)(3), or (2) for establishment of a new, or maintenance in an existing, donor advised fund (as defined in section 4966(d)(2)).

Below are examples illustrating the operation of the provision. (The examples assume the taxpayer makes an election to have the provision apply.)

Example 1.—Assume individual A's contribution base for 2009 is $100,000; aggregate qualified contributions are $70,000; and other charitable contributions to organizations described in section 170(b)(1)(A) are $60,000. Under the provision, A is allowed a deduction of $100,000 for 2009 ($50,000 determined without regard to qualified contributions plus $50,000 for the qualified contributions (the lesser of (i) the $70,000 amount of the qualified contribution or (ii) the $50,000 excess of the $100,000 contribution base over the $50,000 amount otherwise deductible)). $30,000 is treated as a contribution described in section 170(b)(1)(A) paid in each of the five succeeding taxable years (subject to the limitations of section 170(d)(1)(A)(i) and (ii)). $30,000 is the sum of the $10,000 excess referred to in section 170(d)(1)(A) (the excess of $60,000 over $50,000) and the $20,000 excess qualified contributions (the excess of $70,000 over $50,000).

Example 2.—For calendar year 2009, B, an individual, has a contribution base of $100,000. On January 10, 2009, B makes a $7,000 cash contribution to an organization described in section 170(b)(1)(A) and a $65,000 cash charitable contribution to an organization not so described. On October 10, 2009, B makes a $70,000 qualified contribution. In 2008, B made charitable contributions to organizations described in section 170(b)(1)(A) that exceeded 50 percent of the contribution base by $5,000.

First, subsections (b) and (d) of section 170 are applied by disregarding the qualified contribution. For 2009, a $12,000 deduction is allowed under section 170(b)(1)(A)—the $7,000 current year contribution and the $5,000 carryover from 2008. For 2009, a $30,000 deduction for the contribution to the organization not described in section 170(b)(1)(A) also is allowed. This amount is the lesser of (i) $38,000 ($50,000 (50 percent of B's contribution base) less the $12,000 allowed under section 170(b)(1)(A)) or (ii) $30,000 (30 percent of B's contribution base). The remaining contribution amount of $35,000 is carried over as a contribution to an organization which is not described in section 170(b)(1)(A). Thus, without regard to the qualified contribution, B is allowed a total contribution deduction of $42,000 in 2009 ($12,000 plus $30,000).

In addition, B may deduct $58,000 of the qualified contribution in 2009 (the lesser of (i) the $70,000 amount of the qualified contribution or (ii) the $58,000 excess of B's $100,000 contribution base over the $42,000 amount otherwise deductible). $12,000 is treated as a contribution described in section 170(b)(1)(A) paid in each of the five succeeding taxable years (subject to the limitations of section 170(d)(1)(A)(i) and (ii)).

In summary, B's deduction for 2009 is $100,000; $12,000 may be carried over as a contribution to an organization described in section 170(b)(1)(A) (subject to the limitations of section 170(d)(1)(A)(i) and (ii)); and $35,000 may be carried over as a contribution to an organization not so described (subject to similar limitations).

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

15. Suspension of certain limitations on personal casualty losses (sec. 702 of the Act)

Present Law

Under present law, a taxpayer may generally claim a deduction for any loss sustained during the taxable year and not compensated by insurance or otherwise.[789] For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Personal casualty or theft losses for the taxable year are allowable only if they exceed a $100 limitation per casualty or theft.[790] In addition, aggregate net casualty and theft losses are deductible only to the extent they exceed 10 percent of an individual taxpayer's adjusted gross income.[791] If the disaster occurs in a Presidentially declared disaster area, the taxpayer may elect to take into account the casualty loss in the taxable year immediately preceding the taxable year in which the disaster occurs.[792]

The two limitations on personal casualty or theft losses do not apply to the extent those losses arise in the Hurricane Katrina, Rita and Wilma disaster area on or after specified dates and are attributable to such hurricanes. Specifically, the casualty losses meeting the above requirements need not exceed $100 per casualty or theft. In addition, such losses are deductible without regard to whether aggregate net losses exceed 10 percent of a taxpayer's adjusted gross income. For purposes of applying the 10 percent threshold to other personal casualty or theft losses, these hurricane casualty losses are disregarded. Thus, such losses are effectively treated as a deduction separate from all other casualty losses.

Explanation of Provision

The Act generally extends the above-described suspension of certain limitations on personal casualty losses which arise in the Midwest disaster area on or after the applicable disaster date, and which are attributable to the severe storms, tornados, or flooding giving rise to any Presidential declaration on or after May 20, 2008, and before August 1, 2008, by reason of the disaster events in the Midwestern disaster area.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

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[789] Sec. 165(a).
[790] Sec. 165(h)(1).
[791] Sec. 165(h)(2).
[792] Sec. 165(i).

16. Special look-back rule for determining earned income credit and refundable child credit (sec. 702 of the Act)

Present Law

In general

Present law provides eligible taxpayers with an earned income credit and a child credit. In general, the earned income credit is a refundable credit for low-income workers.[793] The amount of the credit depends on the earned income of the taxpayer and whether the taxpayer has one, more than one, or no qualifying children. Earned income generally includes wages, salaries, tips, and other employee compensation, plus net earnings from self-employment.

Taxpayers with incomes below certain threshold amounts are eligible for a $1,000 credit for each qualifying child.[794] The child credit is refundable to the extent of 15 percent of the taxpayer's earned income in excess of $10,000 (indexed for inflation).[795] Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit, if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of $10,000 (indexed for inflation).

Hurricanes Katrina, Rita, and Wilma

Certain qualified individuals affected in 2005 by Hurricanes Katrina, Rita, or Wilma may elect to calculate their earned income credit and refundable child credit using their earned income from the prior taxable year.[796] Such qualified individuals are permitted to make the election only if their earned income for the taxable year affected by the hurricanes is less than their earned income for the preceding taxable year.

Generally, qualified individuals affected by Hurricanes Katrina, Rita, or Wilma are (1) individuals who, immediately before the relevant hurricane struck, had their principal place of abode in the hurricane's disaster area and were displaced from their home by reason of the hurricane; or (2) individuals who, immediately before the relevant hurricane struck, lived in the Gulf Opportunity Zone, the Rita GO Zone, or the Wilma GO Zone whether or not they were displaced from their home.

In the case of a joint return, an election may be made if either spouse is a qualified individual. In such cases, the earned income for the preceding taxable year which is attributable to the taxpayer filing the joint return is the sum of the earned income which is attributable to each spouse for such preceding taxable year.

Any election applies to both the earned income credit and refundable child credit. For administrative purposes, the incorrect use on a return of earned income pursuant to an election is treated as a mathematical or clerical error. An election is disregarded for purposes of calculating gross income in the election year.

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[793] Sec. 32.
[794] Sec. 24.
[795] This amount does not reflect the modification in Division C, section 501, of the Act.
[796] Sec. 1400S(d).

Explanation of Provision

The provision extends the special disaster election to the Midwestern disaster area.

Effective Date

The provision is effective for the taxable year that includes the date on which the severe storms, tornados, or flooding giving rise to the Presidential declarations under the Stafford Act with respect to the Midwestern disaster area occurred.

17. Secretarial authority to make adjustments regarding taxpayer and dependency status (sec. 702 of the Act)

Present Law

In general

In order to determine taxable income, an individual reduces adjusted gross income by any personal exemptions and either the standard deduction or itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents (as defined in section 151). Personal exemptions are not allowed for purposes of determining a taxpayer's alternative minimum taxable income.

Present law also provides eligible taxpayers with an earned income credit and a child credit. In general, the earned income credit is a refundable credit for low-income workers.[797] The amount of the credit depends on the earned income of the taxpayer and whether the taxpayer has one, more than one, or no qualifying children. Earned income generally includes wages, salaries, tips, and other employee compensation, plus net earnings from self-employment.

Taxpayers with incomes below certain threshold amounts are eligible for a $1,000 credit for each qualifying child.[798] The child credit is refundable to the extent of 15 percent of the taxpayer's earned income in excess of $10,000 (indexed for inflation).[799] Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit, if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of $10,000 (indexed for inflation).

Hurricanes Katrina, Rita, and Wilma

With respect to taxable years beginning in 2005 and 2006, the Secretary has authority to make such adjustments in the application of the Federal tax laws as may be necessary to ensure that taxpayers do not lose any deduction or credit or experience a change of filing status by reason of temporary relocations caused by Hurricanes Katrina, Rita or Wilma.[800] Such adjustments may include, for example, addressing the application of the residency requirements relating to dependency exemptions in the case of relocations due to the above-named hurricanes. Any adjustments made

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[797] Sec. 32.
[798] Sec. 24.
[799] This amount does not reflect the modification in Division C, section 501, of the Act.
[800] Sec. 1400S(e).

using this authority must ensure that an individual is not taken into account by more than one taxpayer with respect to the same tax benefit.

Explanation of Provision

The provision applies the special rule for Hurricanes Katrina, Rita, and Wilma to the Midwestern disaster area.

Effective Date

The provision is effective with respect to taxable years beginning in 2008 and 2009.

18. Special rules for mortgage revenue bonds (sec. 702 of the Act)

Present Law

In general

Under present law, gross income does not include interest on State or local bonds (sec. 103). State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds that are primarily used to finance governmental functions or are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to non-governmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") (secs. 103(b)(1) and 141).

Qualified mortgage bonds

Generally

The definition of a qualified private activity bond includes a qualified mortgage bond (sec. 143). Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for the purchase, improvement, or rehabilitation of owner-occupied residences. Rehabilitation loans are eligible for such financing if: (1) the mortgagor receiving the financing is the first resident after the completion of the rehabilitation; (2) at least 20 years have elapsed between the first use of the residence and the start of the physical work of the rehabilitation; (3) certain percentages of internal and external walls are retained after the rehabilitation; and (4) rehabilitation expenditures equal at least 25 percent of the taxpayer's adjusted basis in the residence after such rehabilitation (sec. 143 (k)(5)).

The Code imposes several limitations on qualified mortgage bonds, including purchase price limitations for the home financed with bond proceeds and income limitations for homebuyers. In general, the purchase price limitation is met if the acquisition cost of each residence financed does not exceed 90 percent of the average area purchase price (i.e., the average single-family residence purchase price purchased for the most recent one-year period in the

statistical area in which the residence is located) (sec. 143(e)). Also, the income limitation generally is met if all the owner-financing provided under the issue is provided to individuals who have family income of 115 percent or less of the applicable median family income (sec. 143(f)).

First-time homebuyers

In addition to the purchase price and income limitations, qualified mortgage bonds generally cannot be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the three years preceding the execution of the mortgage (the "first-time homebuyer" requirement) (sec. 143(d)). The first-time homebuyer requirement does not apply to targeted area residences (described below).

Special rules for targeted area residences

A targeted area residence is one located in either (1) a census tract in which at least 70 percent of the families have an income which is 80 percent or less of the state-wide median income or (2) an area of chronic economic distress (sec. 143(j)).

In addition to the waiver of the first-time homebuyer rule, targeted area residences have special purchase price limitations and income limitations. For targeted area residences, the purchase price limitation is applied by substituting 110 percent for 90 percent (i.e., the purchase price limitation is met if the acquisition cost of each residence financed does not exceed 110 percent of the average area purchase applicable to the residence) (sec. 143(e)(5)). For targeted area residences, the income limitation generally is met if at least two-thirds of all the owner-financing provided under the issue is provided to individuals who have family income of 140 percent or less of the applicable median family income. The other third is not subject to an income limitation (sec. 143(f)(3)).

Special rule for Gulf Opportunity Zone, Rita GO Zone or Wilma GO Zone

Under section 1400T residences located in the Gulf Opportunity Zone, the Rita GO Zone, or the Wilma GO Zone are treated as targeted area residences for purposes of section 143, with the modifications described below. Thus, the first-time homebuyer rule is waived and purchase and income rules for targeted area residences apply to residences located in the specified areas that are financed with qualified mortgage bonds. For these purposes, 100 percent of the mortgages must be made to mortgagors whose family income is 140 percent or less of the applicable median family income. Thus, the present law rule allowing one-third of the mortgages to be made without regard to any income limits does not apply. In addition, the proposal increases from $15,000 to $150,000 the amount of a qualified home-improvement loan with respect to residences located in the specified disaster areas.

The provision applies to residences financed before January 1, 2011.

Explanation of Provision

The Act provides mortgage revenue bond relief for the Midwestern disaster area identical to the relief for the Gulf Opportunity Zone, Rita GO Zone and Wilma GO Zone (except that this relief relates to the Midwestern disaster).

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

19. Additional personal exemption for housing Hurricane Katrina displaced individuals (sec. 702 of the Act)

Present Law

In general

In order to determine taxable income, an individual reduces adjusted gross income ("AGI") by any personal exemptions and either the standard deduction or itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse if filing jointly, and any dependents (as defined in sec. 151). Personal exemptions are not allowed for purposes of determining a taxpayer's alternative minimum taxable income.

For 2008, the amount deductible for each personal exemption is $3,500. This amount is indexed annually for inflation. The deduction for personal exemptions is phased out ratably for taxpayers with AGI over certain thresholds. These thresholds are indexed annually for inflation. Specifically, the total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each $2,500 (or portion thereof) by which the taxpayer's AGI exceeds the applicable threshold. (The phaseout rate is two percent for each $1,250 for married taxpayers filing separate returns.) Thus, the personal exemptions claimed are phased out over a $122,500 range (which is not indexed for inflation), beginning at the applicable threshold. The applicable thresholds for 2008 are $159,950 for single individuals, $239,950 for married individuals filing a joint return, $199,950 for heads of households, and $119,975 for married individuals filing separate returns. For 2008, the point at which a taxpayer's personal exemptions are completely phased out is $282,450 for single individuals, $362,450 for married individuals filing a joint return, $322,950 for heads of households, and $181,225 for married individuals filing separate returns.

Special rule for Hurricane Katrina

The provision provided an additional exemption of $500 for each Hurricane Katrina displaced individual of the taxpayer. The taxpayer could claim the additional exemption for no more than four individuals. Thus, the maximum additional exemption amount was $2,000. The provision applied only for taxable years beginning in 2005 and 2006; however, the exemption with respect to any Hurricane Katrina displaced individual could be claimed only one time for all taxable years.

A Hurricane Katrina displaced individual was a person (1) whose principal place of abode on August 28, 2005 was in the Hurricane

Katrina disaster area, (2) who was displaced from such abode, and (3) who was provided housing free of charge in the taxpayer's principal residence for a period of 60 consecutive days which ends in the taxable year in which the exemption is claimed. Additionally, in the case of a person whose principal place of abode on August 28, 2005 was located outside of the core disaster area, in order to qualify as a displaced individual such person's abode must have been damaged by Hurricane Katrina or such person must have been evacuated from such abode by reason of Hurricane Katrina. A Hurricane Katrina displaced individual could not be the spouse or any dependent of the taxpayer. In order to claim the additional exemption, the taxpayer must have provided the taxpayer identification number of the displaced individual. Additionally, the exemption was not allowed if the taxpayer received any rent or other amount from any source in connection with the providing of housing for a displaced individual.

The additional exemption was not subject to the income-based phaseouts applicable to personal exemptions, and was allowed as a deduction in computing alternative minimum taxable income.

Explanation of Provision

The Act provides relief for the Midwestern disaster area identical to the relief for the Gulf Opportunity Zone for 2008 and 2009 (except that this relief relates to the Midwestern disaster rather than Hurricane Katrina).

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

20. Increase in standard mileage rate for charitable use of a vehicle (sec. 702 of the Act)

Present Law

In general

In general, an itemized deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. Unreimbursed out-of-pocket expenditures made incident to providing donated services to a qualified charitable organization—such as out-of-pocket transportation expenses necessarily incurred in performing donated services—may qualify as a charitable contribution.[801] No charitable contribution deduction is allowed for traveling expenses (including expenses for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.[802]

In determining the amount treated as a charitable contribution where a taxpayer operates a vehicle in providing donated services to a charity, the taxpayer either may deduct actual out-of-pocket

[801] Treas. Reg. sec. 1.170A–1(g).
[802] Sec. 170(j).

expenditures or, in the case of a passenger automobile, may use the charitable standard mileage rate. The charitable standard mileage rate is set by statute at 14 cents per mile.[803] The taxpayer may also deduct (under either computation method), any parking fees and tolls incurred in rendering the services, but may not deduct any amount (regardless of the computation method used) for general repair or maintenance expenses, depreciation, insurance, registration fees, etc. Regardless of the computation method used, the taxpayer must keep reliable written records of expenses incurred. For example, where a taxpayer uses the charitable standard mileage rate to determine a deduction, the IRS has stated that the taxpayer generally must maintain records of miles driven, time, place (or use), and purpose of the mileage. If the charitable standard mileage rate is not used to determine the deduction, the taxpayer generally must maintain reliable written records of actual expenses incurred.

In lieu of actual operating expenses, an optional standard mileage rate may be used in computing the deductible costs of business use of an automobile. The business standard mileage rate is determined by the IRS and updated periodically. For expenses incurred on or after July 1, 2008, the business standard mileage rate specified by the IRS is 58.5 cents per mile (IRS Announcement 2008–63 (July 14, 2008)). Also, in lieu of actual operating expenses, an optional standard mileage rate may be used in computing deductible transportation expenses for medical purposes (section 213) or for moving (section 217). The medical and moving standard mileage rates are determined by the IRS and updated periodically. For expenses incurred on or after July 1, 2008, the rate for both such purposes is 27 cents per mile (IRS Announcement 2008–63 (July 14, 2008)).

The standard mileage rates for charitable, medical, and moving purposes are lower than the standard business rate because the charitable, medical, and moving rates generally cover only out-of-pocket operating expenses (including gasoline and oil) directly related to the use of the automobile in performing the donated services that a taxpayer may deduct as a charitable contribution or in traveling for medical or moving purposes. Such rates do not include costs that are not deductible for charitable, medical, or moving purposes, such as general maintenance expenses, depreciation, insurance, and registration fees. Such costs are, however, included in computing the business standard mileage rate.

Special rule for Hurricane Katrina

Section 303 of the Katrina Emergency Tax Relief Act of 2005 allowed a taxpayer who used a vehicle in providing donated services to charity solely for the provision of relief related to Hurricane Katrina to compute the taxpayer's charitable mileage deduction using a rate (rounded to the next highest cent) equal to 70 percent of the business mileage rate in effect on the date of the contribution, rather than the charitable standard mileage rate generally in effect under section 170(i) (14 cents per mile). For purposes of this provision, the term vehicle includes any vehicle described in section

[803] Sec. 170(i).

170(f)(12)(E)(i) (i.e., a motor vehicle manufactured primarily for use on the public streets, roads, and highways). As an alternative to determining the amount of the deduction using the mileage rate described in the provision, a taxpayer may determine the amount of the deduction using actual out-of-pocket expenditures.

The special rule applied for purposes of contributions made during the period beginning on August 25, 2005, and ending on December 31, 2006.

Explanation of Provision

The Act provides relief relating to a Midwestern disaster area during the period beginning on the applicable disaster date and ending on December 31, 2008, identical to the relief provided for Hurricane Katrina (except that this relief relates to the Midwestern disaster rather than Hurricane Katrina).

It is intended that in addition to the present-law substantiation requirements for use of the statutory mileage rate, a taxpayer must substantiate that expenses are incurred in providing relief related to a Midwestern disaster area. The present-law statutory rate applies if a taxpayer fails to substantiate that the expenses are incurred for the provision of such relief, assuming all other present-law requirements are met.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

21. Mileage reimbursements to charitable volunteers excluded from gross income (sec. 702 of the Act)

Present Law

In general

In general, an itemized deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. Unreimbursed out-of-pocket expenditures made incident to providing donated services to a qualified charitable organization—such as out-of-pocket transportation expenses necessarily incurred in performing donated services—may qualify as a charitable contribution.[804] No charitable contribution deduction is allowed for traveling expenses (including expenses for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.[805]

In determining the amount treated as a charitable contribution where a taxpayer operates a vehicle in providing donated services to a charity, the taxpayer either may deduct actual out-of-pocket expenditures or, in the case of a passenger automobile, may use the charitable standard mileage rate. The charitable standard mileage

[804] Treas. Reg. sec. 1.170A–1(g).
[805] Sec. 170(j).

rate is set by statute at 14 cents per mile.[806] The taxpayer may also deduct (under either computation method), any parking fees and tolls incurred in rendering the services, but may not deduct any amount (regardless of the computation method used) for general repair or maintenance expenses, depreciation, insurance, registration fees, etc. Regardless of the computation method used, the taxpayer must keep reliable written records of expenses incurred. For example, where a taxpayer uses the charitable standard mileage rate to determine a deduction, the IRS has stated that the taxpayer generally must maintain records of miles driven, time, place (or use), and purpose of the mileage. If the charitable standard mileage rate is not used to determine the deduction, the taxpayer generally must maintain reliable written records of actual expenses incurred.

In lieu of actual operating expenses, an optional standard mileage rate may be used in computing the deductible costs of business use of an automobile. The business standard mileage rate is determined by the IRS and updated periodically. For expenses incurred on or after July 1, 2008, the business standard mileage rate specified by the IRS is 58.5 cents per mile (IRS Announcement 2008–63 (July 14, 2008)). Also, in lieu of actual operating expenses, an optional standard mileage rate may be used in computing deductible transportation expenses for medical purposes (section 213) or for moving (section 217). The medical and moving standard mileage rates are determined by the IRS and updated periodically. For expenses incurred on or after July 1, 2008, the rate for both such purposes is 27 cents per mile (IRS Announcement 2008–63 (July 14, 2008)).

The standard mileage rates for charitable, medical, and moving purposes are lower than the standard business rate because the charitable, medical, and moving rates generally cover only the out-of-pocket operating expenses (including gasoline and oil) directly related to the use of the automobile in performing the donated services that a taxpayer may deduct as a charitable contribution or in traveling for medical or moving purposes. Such rates do not include costs that are not deductible for charitable, medical, or moving purposes, such as general maintenance expenses, depreciation, insurance, and registration fees. Such costs are, however, included in computing the business standard mileage rate.

Volunteer drivers who are reimbursed for mileage expenses have taxable income to the extent the reimbursement exceeds deductible travel expenses. Employees who are reimbursed for mileage expenses under a qualified arrangement that pays a mileage allowance in lieu of reimbursing actual expenses generally have taxable income to the extent the reimbursement exceeds the amount of the business standard mileage rate multiplied by the actual business miles.

Specials rule for Hurricane Katrina

Under section 304 of the Katrina Emergency Tax Relief Act of 2005, reimbursement by an organization described in section 170(c) (including public charities and private foundations) to a volunteer

[806] Sec. 170(i).

for the costs of using a passenger automobile in providing donated services to charity solely for the provision of relief related to Hurricane Katrina is excludable from the gross income of the volunteer up to an amount that does not exceed the amount that would be computed using the business standard mileage rate (as periodically adjusted), provided that recordkeeping requirements applicable to deductible business expenses are satisfied. The special rule does not permit a volunteer to claim a deduction or credit with respect to amounts excluded under the rule.

The special rule applies for purposes of use of a passenger automobile during the period beginning on August 25, 2005, and ending on December 31, 2006.

Explanation of Provision

In determining gross income of an individual for taxable years ending on or after the applicable disaster date, the Act provides for relief relating to a Midwestern disaster area during the period beginning on the applicable disaster date and ending on December 31, 2008, identical to the relief provided for Hurricane Katrina (except that this relief relates to a Midwestern disaster area rather than to Hurricane Katrina).

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

22. Exclusion for certain cancellations of indebtedness by reason of Midwestern disasters (sec. 702 of the Act)

Present Law

In general

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain farm indebtedness, certain real property business indebtedness, and qualified principal residence indebtedness (secs. 61(a)(12) and 108). In cases involving discharges of indebtedness that are excluded from gross income (except for discharges of real property business indebtedness and qualified principal residence indebtedness), taxpayers generally exclude discharge of indebtedness from income but reduce tax attributes by the amount of the discharge of indebtedness. The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

Present law generally requires "applicable entities" to file information returns with the IRS regarding any discharge of indebtedness in the amount of $600 or more (sec. 6050P). This requirement

applies without regard to whether the debtor is subject to tax on the discharged indebtedness. The term "applicable entities" (as defined in sec. 6050P(c)(1) includes: (1) any financial institution (as described in section 581 (relating to banks) or section 591(a) (relating to savings institutions)); (2) any credit union; (3) any corporation that is a direct or indirect subsidiary of an entity described in (1) or (2) which, by virtue of being affiliated with such entity, is subject to supervision and examination by a Federal or State agency regulating such entities; (4) the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the National Credit Union Administration, certain other Federal executive agencies, and any successor or subunit of any of them; (5) an executive, judicial, or legislative agency (as defined in 31 U.S.C. section 3701(a)(4)); and (6) any other organization a significant trade or business of which is the lending of money. Failures to file correct information returns with the IRS or to furnish statements to taxpayers with respect to these discharges of indebtedness are subject to the same general penalty that is imposed with respect to failures to provide other types of information returns. Accordingly, the penalty for failure to furnish statements to taxpayers generally is $50 per failure, subject to a maximum of $100,000 for any calendar year. These penalties are not applicable if the failure is due to reasonable cause and not to willful neglect.

Special rule for Hurricane Katrina disaster

This special rule provides that the gross income of a qualified individual does not include any amount which would otherwise be includible in gross income by reason of a discharge (in whole or in part) of nonbusiness debt if the indebtedness is discharged by an applicable entity. For these purposes, nonbusiness debt is any indebtedness other than indebtedness incurred in connection with a trade or business. The discharge of indebtedness relief allowed under this provision does not apply to any indebtedness to the extent that real property constituting security for such indebtedness is located outside the Hurricane Katrina disaster area. As under the present-law rules, the amount excluded from gross income under this provision reduces the tax attributes of the taxpayer.

A qualified individual is any natural person if the principal place of abode of such person on August 25, 2005 was located: (1) in the core disaster area; or (2) in the Hurricane Katrina disaster area and such person suffered economic loss by reason of Hurricane Katrina. An applicable entity is defined as under present-law section 6050P(c)(1).

The provision does not apply to discharges made after December 31, 2007.

Explanation of Provision

The Act provides relief for the Midwestern disaster area identical to the relief for the Gulf Opportunity Zone for 2008 and 2009 (except that this relief relates to the Midwestern disaster rather than Hurricane Katrina).

The provision does not apply to discharges made after December 31, 2009.

Effective Date

The provision applies to discharges made on or after the applicable disaster date.

23. Extension of replacement period for nonrecognition of gain (sec. 702 of the Act)

Present Law

Generally, a taxpayer realizes gain from the sale or other disposition of property to the extent the amount realized exceeds the taxpayer's basis in the property. The realized gain is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

Under section 1033, gain realized by a taxpayer from an involuntary conversion of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within the applicable period. The taxpayer's basis in the replacement property generally is the cost of such property, reduced by the amount of gain not recognized.

The applicable period for the taxpayer to replace the converted property begins with the date of the disposition of the converted property (or if earlier, the earliest date of the threat or imminence of requisition or condemnation of the converted property) and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized (the "replacement period").

Special rules extend the replacement period for certain real property[807] and principal residences damaged by a Presidentially declared disaster[808] to three years and four years, respectively, after the close of the first taxable year in which gain is realized. Similarly, the replacement period for livestock sold on account of drought, flood, or other weather-related conditions is extended from two years to four years after the close of the first taxable year in which any part of the gain on conversion is realized.[809]

The replacement period was extended to five years in the case of converted property located in the Hurricane Katrina disaster area that is compulsorily or involuntarily converted on or after August 25, 2005, by reason of Hurricane Katrina.[810] Substantially all of the use of the replacement property must be in the Hurricane Katrina disaster area.

The replacement period also was extended to five years in the case of converted property located in the Kansas disaster area that is compulsorily or involuntarily converted on or after May 4, 2007, by reason of the May 4, 2007, storms and tornados.[811] Substantially all of the use of the replacement property must be in the Kansas disaster area.

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[807] Sec. 1033(g)(4).
[808] Sec. 1033(h)(1)(B).
[809] Sec. 1033(e)(2).
[810] Pub. L. No. 109–73, sec. 405 (2005).
[811] Pub. L. No. 110–234, sec. 15345 (2008).

Explanation of Provision

The provision extends the replacement period to five years in the case of converted property located in the Midwestern disaster area[812] that is compulsorily or involuntarily converted on or after the applicable disaster date by reason of a major disaster that has been declared by the President on or after May 20, 2008, and before August 1, 2008, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of severe storms, tornados, or flooding occurring in any of the States of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin. Substantially all of the use of the replacement property must be in the Midwestern disaster area.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

B. Reporting Requirements Relating to Disaster Relief Contributions (sec. 703 of the Act and sec. 6033 of the Code)

Present Law

Exempt organizations generally are required to file an annual information return, stating specifically the items of gross income, receipts, disbursements, and such other information as the Secretary may prescribe.[813] The requirement that an exempt organization file an annual information return does not apply to certain exempt organizations, including organizations (other than private foundations) the gross receipts of which in each taxable year normally are not more than $25,000. Also exempt from the requirement are churches, their integrated auxiliaries, and conventions or associations of churches; the exclusively religious activities of any religious order; certain state institutions whose income is excluded from gross income under section 115; an interchurch organization of local units of a church; certain mission societies; certain church-affiliated elementary and high schools; and certain other organizations, including some that the IRS has relieved from the filing requirement pursuant to its statutory discretionary authority.[814]

Section 501(c)(3) organizations that are classified as public charities must file Form 990 (Return of Organization Exempt From Income Tax) including Schedule A thereto, which requests information specific to section 501(c)(3) organizations. An organization that is required to file an information return, but that has gross receipts of less than $100,000 during its taxable year, and total assets of less than $250,000 at the end of its taxable year, may file Form 990–EZ. Private foundations are required to file Form 990–PF rather than Form 990.

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[812] For purposes of this provision, the limitation to areas determined by the President to warrant individual or individual and public assistance from the Federal government does not apply.

[813] Sec. 6033(a). An organization that has not received a determination of its tax-exempt status, but that claims tax-exempt status under section 501(a), is subject to the same annual reporting requirements and exceptions as organizations that have received a tax-exemption determination.

[814] Sec. 6033(a)(2)(A); Treas. Reg. sec. 1.6033–2(a)(2)(i) and (g)(1).

On the applicable annual information return, organizations are required to report their gross income, information on their finances, functional expenses, compensation, activities, and other information required by the IRS.[815]

Explanation of Provision

The Act provides that section 501(c)(3) organizations that are required to file an annual information return must furnish, at such time and in such manner as the Secretary may by forms or regulations prescribe, such information as the Secretary may require with respect to the organization's disaster relief activities, including the amount and use of any qualified contributions eligible for special treatment under section 1400S(a).[816]

Effective Date

The provision is effective for returns the due date for which (determined without regard to any extension) occurs after December 31, 2008.

C. Temporary Tax-Exempt Bond Financing and Low-Income Housing Tax Relief for Areas Damaged by Hurricane Ike (sec. 704 of the Act and secs. 41 and 144 of the Code)

Present Law

Gulf opportunity zone bonds

Present law permits the issuance of qualified private activity bonds to finance the construction and rehabilitation of residential and nonresidential property located in the Gulf Opportunity Zone ("Gulf Opportunity Zone Bonds"). Gulf Opportunity Zone Bonds must be issued before January 1, 2011.

Gulf Opportunity Zone Bonds may be issued by the State of Alabama, Louisiana, or Mississippi, or any political subdivision thereof. Gulf Opportunity Zone Bonds are not subject to the State volume cap (sec. 146). Rather, the maximum aggregate face amount of Gulf Opportunity Zone Bonds that may be issued in any eligible State is limited to $2,500 multiplied by the number of residents of such eligible State who reside within the Gulf Opportunity Zone. Depending on the purpose for which such bonds are issued, Gulf Opportunity Zone Bonds are treated as either exempt facility bonds or qualified mortgage bonds.

Gulf Opportunity Zone Bonds are treated as exempt facility bonds if 95 percent or more of the net proceeds of such bonds are to be used for qualified project costs located in the Gulf Opportunity Zone. Qualified project costs include the cost of acquisition, construction, reconstruction, and renovation of nonresidential real property, qualified residential rental projects (as defined in section 142(d) with certain modifications), and public utility property.

Gulf Opportunity Zone Bonds are treated as qualified mortgage bonds if the bonds of such issue meet the general requirements of

[815] See sec. 6033(b).

[816] Section 1400S(a) generally suspends the percentage limits under section 170(b) with respect to certain charitable contributions made for disaster relief.

a qualified mortgage issue and the residences financed with such bonds are located in the Gulf Opportunity Zone. For these residences the first-time homebuyer rule is waived but purchase and income rules for targeted area residences apply. In addition, 100 percent of the mortgage loans must be made to mortgagors whose family income is 140 percent or less of the applicable median family income.

Low-income housing credit

In general

The low-income housing credit may be claimed over a 10-year period by owners of certain residential rental property for the cost of rental housing occupied by tenants having incomes below specified levels (sec. 42). The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The qualified basis of any qualified low-income building for any taxable year equals the applicable fraction of the eligible basis of the building.

Volume limits

A low-income housing credit is allowable only if the owner of a qualified building receives a housing credit allocation from the State or local housing credit agency. Generally, the aggregate credit authority provided annually to each State for calendar years 2008 and 2009 is $2.20 per resident, with a minimum annual cap for certain small population States. In 2010, the volume limits will return to lower prescribed levels. These amounts are indexed for inflation. Projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit do not require an allocation of the low-income housing credit.

Certain distressed areas

Special allocations of the low income credit are not provided for distressed areas on a regular basis but rather must be separately enacted on a case-by-case basis (e.g., Gulf Opportunity Zones).

Explanation of Provision

Tax-exempt bond financing

The Act provides tax-exempt bond financing like Gulf Opportunity Zone Bonds with certain modifications to Louisiana, and Texas (or any political subdivisions thereof). Specifically, it allows the issuance of qualified private activity bonds (called, "Hurricane Ike disaster area bonds") to finance the construction and rehabilitation of certain residential and nonresidential property located in the Hurricane Ike disaster area. Hurricane Ike disaster area bonds must be issued before January 1, 2013.

Like Gulf Opportunity Zone Bonds, Hurricane Ike disaster area bonds are not subject to the State volume cap. The maximum aggregate face amount of Hurricane Ike disaster area bonds that may be issued in either Louisiana or Texas is limited to $2,000 multiplied by the number of residents of the respective State residing within certain specified counties or parishes of the State. The

Texas counties are Brazoria, Chambers, Galveston, Jefferson and Orange. The Louisiana parishes are Calcasieu and Cameron.

Depending on the purpose for which such bonds are issued, Hurricane Ike disaster area bonds are treated as either exempt facility bonds or qualified mortgage bonds. Hurricane Ike disaster area bonds have certain limitations which did not apply to Gulf Opportunity Zone Bonds. In the case of exempt facility bonds, such financing is limited to projects where the person using the property either suffered a loss in a trade or business attributable to Hurricane Ike or is designated by the Governor as a person carrying on a trade or business replacing such a business.[817] In the case of mortgage bonds, an issue is a qualified mortgage issue only if 95 percent or more of the net proceeds of the issue are used to provide financing for mortgagors who suffered damage attributable to Hurricane Ike to their principal residences. For these residences the first-time homebuyer rule is waived and purchase and income rules for targeted area residences apply (sec. 143(k)(11)). In addition, 100 percent of the mortgages must be made to mortgagors whose family income is 140 percent or less of the applicable median family income (sec. 143(f)(3)).

Low-income housing credit

For each of three years (2008, 2009, and 2010), a special allocation of the low-income housing credit is provided to Louisiana and Texas. The amount of each year's special allocation is limited to $16.00 multiplied by the number of residents of the respective State residing within certain specified counties or parishes of the State. The Texas counties are Brazoria, Chambers, Galveston, Jefferson and Orange. The Louisiana parishes are Calcasieu and Cameron.

Effective Date

The provision is effective on the date of enactment (October 3, 2008).

SUBTITLE B—NATIONAL DISASTER RELIEF

A. Losses Attributable to Federally Declared Disasters (sec. 706 of the Act and secs. 63 and 165 of the Code)

Present Law

Casualty Losses

Under present law, a taxpayer may generally claim a deduction for any loss sustained during the taxable year and not compensated by insurance or otherwise.[818] For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Personal casualty or theft losses for the taxable year are allowable only if they exceed

[817] In the case of a project relating to public utility property, any financing is limited to the repair or reconstruction of public utility property damaged by Hurricane Ike.

[818] Sec. 165(a).

a $100 limitation per casualty or theft.[819] In addition, aggregate net casualty and theft losses are deductible only to the extent they exceed 10 percent of an individual taxpayer's adjusted gross income.[820] If the disaster occurs in a Presidentially declared disaster area, the taxpayer may elect to take into account the casualty loss in the taxable year immediately preceding the taxable year in which the disaster occurs.[821]

Standard Deduction

An individual taxpayer's taxable income is computed by reducing adjusted gross income either by a standard deduction or, if the taxpayer elects, by the taxpayer's itemized deductions.[822] Unless an individual elects, no itemized deductions are allowed for the taxable year. The deduction for casualty losses is an itemized deduction.

Explanation of Provision

Waiver of Adjusted Gross Income Limitation for Personal Casualty Losses

The provision waives the 10 percent of adjusted gross income limitation for a "net disaster loss." The term "net disaster loss" means the excess of personal casualty losses attributable to a "Federally declared disaster" declared in taxable years beginning after December 31, 2007, and occurring before January 1, 2010, occurring in a "disaster area," over personal casualty gains. The term "Federally declared disaster" means any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. The term "disaster area" means the area so determined to warrant assistance.

Net disaster losses are deductible without regard to whether aggregate net casualty losses exceed 10 percent of a taxpayer's adjusted gross income. For purposes of applying the 10-percent limitation to other personal casualty or theft losses, losses deductible under this provision are disregarded. Thus, the provision has the effect of treating net disaster losses attributable to Federally declared disasters as a deduction separate from all other non-disaster casualty and theft losses.

The following examples show the application of the provision.

Example 1.—An individual taxpayer with $100,000 of adjusted gross income has the following personal casualty items during the taxable year: $5,000 personal casualty gain, $30,000 allowable personal casualty loss attributable to a Federally declared disaster, and a $7,000 allowable personal casualty loss.[823] The deductible net disaster loss is $25,000 ($30,000 disaster casualty loss less the $5,000 personal casualty gain). The deductible non-disaster casualty loss is $0 ($7,000 non-disaster casualty loss less $10,000 (10 percent of adjusted gross income) limitation). The taxpayer's de-

[819] Sec. 165(h)(1).
[820] Sec. 165(h)(2).
[821] Sec. 165(i).
[822] Sec. 63.
[823] The allowable casualty losses are after application of the limitation per casualty under section 165(h)(1).

ductible net personal casualty loss for the taxable year is $25,000 (the sum of the net disaster loss and the excess of the other casualty losses over the 10-percent limitation).

Example 2.—An individual taxpayer with $100,000 of adjusted gross income has the following personal casualty items during the taxable year: $5,000 personal casualty gain, $30,000 allowable personal casualty loss attributable to a Federally declared disaster, and a $12,000 allowable personal casualty loss.[824] The deductible net disaster loss is $25,000 ($30,000 disaster casualty loss less the $5,000 personal casualty gain). The deductible non-disaster casualty loss is $2,000 ($12,000 non-disaster casualty loss less $10,000 (10 percent of adjusted gross income) limitation). The taxpayer's deductible net personal casualty loss for the taxable year is $27,000 (the sum of the net disaster loss and the excess of the other casualty losses over the 10-percent limitation).

Increase of Standard Deduction

The provision increases an individual taxpayer's standard deduction by the "disaster loss deduction." The "disaster loss deduction" is defined as the net disaster loss (as defined above).

Increase of Limitation Per Casualty

The provision increases the $100 limitation per casualty to $500 for taxable years beginning after December 31, 2008, and before January 1, 2010.

Except for certain conforming amendments, the provisions of this section of the Act do not apply to any disaster that has been declared by the President on or after May 20, 2008, and before August 1, 2008, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of severe storms, tornados, or flooding occurring in any of the States of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin.[825]

Effective Dates

The provision generally applies to disasters declared in taxable years beginning after December 31, 2007, and occurring before January 1, 2010.

The portion of the provision increasing the limitation per casualty to $500 applies to taxable years beginning after December 31, 2008, and before January 1, 2010.

B. Expensing of Qualified Disaster Expenses (sec. 707 of the Act and new sec. 198A of the Code)

Present Law

In general

Present law allows a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[826]

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[824] *Id.*
[825] Section 712 of the Act.
[826] Sec. 162.

Section 263(a)(1) limits the scope of section 162 by prohibiting a current deduction for certain capital expenditures. Treasury regulations define "capital expenditures" as amounts paid or incurred to add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or to adapt property to a new or different use.[827] Amounts paid or incurred for incidental repairs and maintenance of property that neither materially add to the value of the property nor appreciably prolong its life are not considered to be capital expenditures and may be deducted currently.[828] The determination of whether an expense is deductible or capitalizable is based on the facts and circumstances of each case.

Environmental remediation costs

Taxpayers may elect to treat certain environmental remediation expenditures paid or incurred before January 1, 2008, that would otherwise be chargeable to capital account as deductible in the year paid or incurred.[829] The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. In general, any expenditure for the acquisition of depreciable property used in connection with the abatement or control of hazardous substances at a qualified contaminated site does not constitute a qualified environmental remediation expenditure. However, depreciation deductions allowable for such property, which would otherwise be allocated to the site under the principles set forth in *Commissioner* v. *Idaho Power Co.*[830] and section 263A, are treated as qualified environmental remediation expenditures.

A "qualified contaminated site" (a so-called "brownfield") generally is any property that is held for use in a trade or business, for the production of income, or as inventory and is certified by the appropriate State environmental agency to be an area at or on which there has been a release (or threat of release) or disposal of a hazardous substance. Both urban and rural property may qualify. However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA")[831] cannot qualify as targeted areas. Hazardous substances generally are defined by reference to sections 101(14) and 102 of CERCLA, subject to additional limitations applicable to asbestos and similar substances within buildings, certain naturally occurring substances such as radon, and certain other substances released into drinking water supplies due to deterioration through ordinary use, as well as petroleum products defined in section 4612(a)(3) of the Code.

In the case of property to which a qualified environmental remediation expenditure otherwise would have been capitalized, any deduction allowed under section 198 is treated as a depreciation deduction and the property is treated as section 1245 property. Thus, deductions for qualified environmental remediation expenditures

[827] Treas. Reg. sec. 1.263(a)–1(b).
[828] Treas. Reg. sec. 1.162–4 and 1.263(a)–1(b).
[829] Sec. 198.
[830] 418 U.S. 1 (1974).
[831] Pub. L. No. 96–510 (1980).

are subject to recapture as ordinary income upon a sale or other disposition of the property. In addition, sections 280B (demolition of structures) and 468 (special rules for mining and solid waste reclamation and closing costs) do not apply to amounts that are treated as expenses under this provision.

Section 1400N(g) permits the expensing of environmental remediation expenditures paid or incurred on or after August 28, 2005, and before January 1, 2008, to abate contamination at qualified contaminated sites located in the Gulf Opportunity Zone.

Debris removal and demolition of structures

Under present law, the cost of demolishing a structure is generally capitalized into the taxpayer's basis in the land on which the structure is located.[832] Land is not subject to an allowance for depreciation or amortization.

The treatment of the cost of debris removal depends on the nature of the costs incurred. For example, the cost of debris removal after a storm may in some cases constitute an ordinary and necessary business expense which is deductible in the year paid or incurred. In other cases, debris removal costs may be in the nature of replacement of part of the property that was damaged. In such cases, the costs are capitalized and added to the taxpayer's basis in the property. For example, Revenue Ruling 71–161[833] permits the use of clean-up costs as a measure of casualty loss but requires that such costs be added to the post-casualty basis of the property.

Section 1400N(f) provides a special rule for certain demolition and clean-up costs. Under the provision, a taxpayer is permitted a deduction for 50 percent of any qualified Gulf Opportunity Zone clean-up cost paid or incurred on or after August 28, 2005, and before January 1, 2008. The remaining 50 percent is capitalized and treated under the general rules. A qualified Gulf Opportunity Zone clean-up cost is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the Gulf Opportunity Zone to the extent that the amount would otherwise be capitalized. In order to qualify, the property must be held for use in a trade or business, for the production of income, or as inventory. This special rule also applies to the Kansas disaster area, as added by the Heartland, Habitat, Harvest, and Horticulture Act of 2008.[834]

Repair of business property

As described above, the cost of incidental repairs that neither materially add to the value of property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted currently as a business expense. In the case of repair expenditures incurred subsequent to a casualty event, the IRS issued a Chief Counsel memorandum in 1999 stating that whether the costs of restoring uninsured property damage caused by severe flooding are deductible as repairs or capital expenditures "turns on

[832] Sec. 280B.
[833] 1971–1 C.B. 76.
[834] Pub. L. No. 110–234, sec. 15345(a)(3) (2008).

the taxpayer's particular set of facts."[835] In other words, the treatment of the costs to restore the property after a casualty is determined based on the general treatment of such costs, regardless of the fact that such costs are incurred as a result of a casualty event. In August 2006, Treasury issued proposed regulations providing that amounts paid or incurred to restore property are required to be capitalized to the extent the taxpayer deducts a casualty loss under section 165 with respect to the same property.[836] This proposal mandates capitalization of costs incurred by a taxpayer to repair property after suffering a casualty loss. In an internal legal memorandum issued after the proposed Treasury regulations were issued, the IRS stated that the proposed regulations, which contained a prospective effective date, were "essentially reflective of current law."[837] In March 2008, Treasury reissued the proposed regulations with the same treatment of restoration expenditures for property destroyed in a casualty.

Explanation of Provision

Under the provision, a taxpayer may elect to treat any qualified disaster expense that is paid or incurred by the taxpayer as a deduction for the taxable year in which paid or incurred.

For purposes of the provision, a qualified disaster expense is any otherwise capitalizable expenditure paid or incurred in connection with a trade or business or with business-related property that is: (1) for the abatement or control of hazardous substances that were released on account of a Federally declared disaster[838] occurring before January 1, 2010; (2) for the removal of debris from, or the demolition of structures on, real property damaged or destroyed as a result of a Federally declared disaster occurring before January 1, 2010; or (3) for the repair of business-related property damaged as a result of a Federally declared disaster occurring before January 1, 2010. No inference is intended as to the proper present law treatment of expenditures to repair business-related property damaged in a casualty event. The purpose of this provision is to provide that, in any case in which such costs are otherwise required to be capitalized, the costs may be deducted in the taxable year paid or incurred to the extent incurred as a result of a Federally declared disaster.

For purposes of this provision, "business-related property" is property held by the taxpayer for use in a trade or business, for the production of income, or as inventory. In addition, for purposes of recapture as ordinary income, any deduction allowed under this provision is treated as a deduction for depreciation and section 1245 property for purposes or depreciation recapture.

This provision does not apply to any disaster that has been declared by the President on or after May 20, 2008, and before August 1, 2008, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of severe storms, tornados, or flooding occurring in any of the States of Arkansas, Il-

[835] CCA 199903030.
[836] Prop. Reg. sec. 1.263(a)–3(f)(3)(iv). 2006–2 C.B. 532.
[837] AM 2006–006, footnote 2.
[838] See section 706 of the Act for the definition of "Federally declared disaster."

linois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin.[839]

Effective Date

The provision is effective for amounts paid or incurred after December 31, 2007 in connection with a disaster declared after such date.

C. Net Operating Losses Attributable to Federally Declared Disasters (sec. 708 of the Act and sec. 172 of the Code)

Present Law

Under present law, a net operating loss ("NOL") is, generally, the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[840] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[841]

Different rules apply with respect to NOLs arising in certain circumstances. 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 applies to NOLs (1) arising from a farming loss (regardless of whether the loss was incurred in a Presidentially declared disaster area), or (2) certain amounts related to the Gulf Opportunity Zone and Kansas 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). Additionally, a special rule applies to certain electric utility companies.

Explanation of Provision

The provision provides a special five-year carryback period for NOLs to the extent of a qualified disaster loss. For purposes of the provision, a qualified disaster loss is the lesser of: (1) the sum of (a) section 165 losses for the taxable year attributable to a Federally declared disaster[842] occurring after December 31, 2007, and before January 1, 2010, and occurring in a disaster area,[843] and (b) the deduction for the taxable year for qualified disaster expenses allowable under section 198A(a)[844] or which would be allowable as a deduction under that section if not treated as an expense in another section of the Code; or (2) the NOL for the taxable year.

A qualified disaster loss does not include any loss with respect to any property used in connection with any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, or any store the principal business of which is the sale of

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[839] Section 712 of the Act.
[840] Sec. 172(b)(1)(A).
[841] Sec. 172(b)(2).
[842] See section 706 of the Act for the definition of "Federally declared disaster."
[843] See section 706 of the Act for a definition of "disaster area."
[844] See section 707 of the Act.

alcoholic beverages for consumption off premises, or any gambling or animal racing property (as defined in section 1400N(p)(3)(B)).

The amount of the NOL to which the five-year carryback period applies is limited to the amount of the corporation's overall NOL for the taxable year. Any remaining portion of the taxpayer's NOL is subject to the general two-year carryback period. Ordering rules similar to those for specified liability losses apply to losses carried back under the provision.

Any taxpayer entitled to the five-year carryback under this provision may elect to have the carryback period determined without regard to this provision. In addition, the general rule which limits a taxpayer's NOL deduction to 90 percent of alternative minimum taxable income ("AMTI") does not apply to any NOL to which the five-year carryback period applies under the provision. Instead, a taxpayer may apply such NOL carrybacks to offset up to 100 percent of AMTI.

This provision does not apply to any disaster that has been declared by the President on or after May 20, 2008, and before August 1, 2008, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of severe storms, tornados, or flooding occurring in any of the States of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin.[845]

Effective Date

The provision is effective for losses arising in taxable years beginning after December 31, 2007, in connection with disasters declared after such date.

D. Special Rules for Mortgage Revenue Bonds in Federally Declared Disaster Areas (sec. 709 of the bill and sec. 143 of the Code)

Present Law

In general

Under present law, gross income does not include interest on State or local bonds (sec. 103). State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds that are primarily used to finance governmental functions or are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") (secs. 103(b)(1) and 141).

[845] Section 712 of the Act.

Qualified mortgage bonds

Generally

The definition of a qualified private activity bond includes a qualified mortgage bond (sec. 143). Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for the purchase, improvement, or rehabilitation of owner-occupied residences. Rehabilitation loans are eligible for such financing if: (1) the mortgagor receiving the financing is the first resident after the completion of the rehabilitation; (2) at least 20 years have elapsed between the first use of the residence and the start of the physical work of the rehabilitation; (3) certain percentages of internal and external walls are retained after the rehabilitation; and (4) rehabilitation expenditures equal at least 25 percent of the taxpayer's adjusted basis in the residence after such rehabilitation (sec. 143(k)(5)).

The Code imposes several limitations on qualified mortgage bonds, including purchase price limitations for the home financed with bond proceeds and income limitations for homebuyers. In general, the purchase price limitation is met if the acquisition cost of each residence financed does not exceed 90 percent of the average area purchase price (i.e., the average single-family residence purchase price purchased for the most recent one-year period in the statistical area in which the residence is located) (sec. 143(e)). Also, the income limitation generally is met if all the owner-financing provided under the issue is provided to individuals who have family income of 115 percent or less of the applicable median family income (sec. 143(f)).

First-time homebuyers

In addition to the purchase price and income limitations, qualified mortgage bonds generally cannot be used to finance a mortgage for a homebuyer who had an ownership interest in a principal residence in the three years preceding the execution of the mortgage (the "first-time homebuyer" requirement) (sec. 143(d)). The first-time homebuyer requirement does not apply to targeted area residences (described below).

Special rules for targeted area residences

A targeted area residence is one located in either (1) a census tract in which at least 70 percent of the families have an income which is 80 percent or less of the state-wide median income or (2) an area of chronic economic distress (sec. 143(j)).

In addition to the waiver of the first-time homebuyer rule, targeted area residences have special purchase price limitations and income limitations. For targeted area residences, the purchase price limitation is applied by substituting 110 percent for 90 percent (i.e., the purchase price limitation is met if the acquisition cost of each residence financed does not exceed 110 percent of the average area purchase applicable to the residence) (sec. 143(e)(5)). For targeted area residences, the income limitation generally is met if at least two-thirds of all the owner-financing provided under the issue is provided to individuals who have family income of 140 per-

cent or less of the applicable median family income. The other third is not subject to an income limitation (sec. 143(f)(3)).

Special rules for Federally declared disaster areas

A temporary provision waives the first-time homebuyer requirement for residences located in Federally declared disaster areas (sec. 143(k)(11)). Also, under the provision, residences located in Federally declared disaster areas are treated as targeted area residences for purposes of the income and purchase price limitations. The special rules for residences located in Federally declared disaster areas applies to bonds issued after May 1, 2008, and before January 1, 2010.

Explanation of Provision

In general

The Act allows certain taxpayers to elect to waive certain mortgage revenue bond rules. If a taxpayer makes such an election, then the otherwise applicable special rules for Federally declared disaster areas do not apply. If there is no such election, then the otherwise applicable special rules for Federally declared disaster areas apply.

Principal residence destroyed

This election is available for principal residences located in Federally declared disaster areas when the principal residence of a taxpayer is: (1) rendered unsafe for use by reason of a Federally declared disaster; or (2) demolished or relocated by reason of an order of the government of a State of political subdivision thereof on account of a Federally declared disaster. This election applies for the two-year period beginning on the date of the disaster.

The election provides for: (1) a waiver of the first-time homebuyer requirement; and (2) the purchase price limitation otherwise applicable to targeted area residences (i.e., the purchase price limitation is met if the acquisition cost of each residence financed does not exceed 110 percent of the average area purchase applicable to the residence).

Principal residence damaged

Also, the provision allows certain taxpayers to elect to waive the otherwise applicable qualified rehabilitation loans rules and treat the cost of repair or reconstruction of a taxpayer's principal residence as a qualified rehabilitation loan. This election is limited to taxpayers whose principal residence is damaged as a result of a Federally declared disaster occurring before January 1, 2010. Such rehabilitation loans are limited to the lesser of $150,000 or the cost of repair or reconstruction.

Other rules

Once made, an election under this Act may not be revoked by the taxpayer except with the consent of the Secretary of the Treasury.

For purposes of the provision, the term "Federally declared disaster" has the same definition as in section 165(h)(3)(C)(i) of the

Code except that it does not apply to any disaster occurring before January 1, 2008, or after December 31, 2009.

This provision does not apply to any disaster that has been declared by the President on or after May 20, 2008, and before August 1, 2008, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of severe storms, tornados, or flooding occurring in any of the States of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin.[846]

Effective Date

The provision is effective for disasters occurring after December 31, 2007.

E. Special Depreciation Allowance for Qualified Disaster Property (sec. 710 of the Act and new sec. 168(n) of the Code)

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[847] Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 20 years. The depreciation methods generally applicable to tangible personal property are the 200 percent and 150 percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

A special depreciation allowance is provided for certain property acquired after December 31, 2007, and before January 1, 2009 (January 1, 2010 in certain cases),[848] cellulosic biomass ethanol property,[849] and certain property used in the Gulf Opportunity Zone[850] and the Kansas disaster area.[851]

Explanation of Provision

The provision includes an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of any "qualified disaster assistance property." The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there are no adjustments to the allowable amount of de-

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[846] Section 712 of the Act.
[847] Sec. 168.
[848] Sec. 168(k).
[849] Sec. 168(l).
[850] Sec. 1400N(d).
[851] Pub. L. No. 110–234, sec. 15345 (2008).

preciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies.

For purposes of this provision, qualified disaster assistance property means any property: (1) to which the general rules of the MACRS apply with (a) an applicable recovery period of 20 years or less, (b) computer software other than computer software covered by section 197, (c) water utility property (as defined in section 168(e)(5)), (d) certain leasehold improvement property, or (e) certain nonresidential real property and residential rental property; (2) substantially all of which is used in a disaster area with respect to a Federally declared disaster occurring before January 1, 2010, in the active conduct of a trade or business by the taxpayer in such disaster area; (3) which rehabilitates property damaged, or replaces property destroyed or condemned, as a result of the Federally declared disaster, except that property is treated as replacing property destroyed or condemned if, as part of an integrated plan, the property replaces property which is included in a continuous area which includes real property destroyed or condemned, and is similar in nature to, and located in the same county as, the property being rehabilitated or replaced; (4) the original use of the property in the disaster area commences with an eligible taxpayer (a taxpayer who has suffered an economic loss attributable to a Federally declared disaster) on or after the applicable disaster date (the date on which a Federally declared disaster occurs); (5) which is acquired by an eligible taxpayer by purchase (as defined under section 179(d)) by the taxpayer on or after the applicable disaster date (and no written binding contract for the acquisition was in effect before such date); and (6) which is placed in service by an eligible taxpayer on or before the date which is the last day of the third calendar year following the applicable disaster date (the fourth calendar year in the case of nonresidential real property and residential rental property).

Qualified disaster assistance property does not include any property: (1) to which the special allowance for depreciation under section 168(k) (regardless of any election under section 168(k)(4)), section 168(l) for cellulosic biofuel property, or section 168(m) for reuse and recycling property applies; (2) to which the special allowance for qualified Gulf Opportunity Zone property under section 1400N(d) applies; (3) used in connection with any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises, or any gambling or animal racing property (as defined in section 1400N(p)(3)(B)); (4) to which the alternative depreciation system under section 168(g) applies (determined without regard to the election to use such system under section 168(g)(7)); (5) any portion of which is financed with proceeds of any obligation the interest on which is exempt from tax under section 103; and (6) which is a qualified revitalization building with respect to which the taxpayer has made an election under section 1400I(a) to either expense one-half of qualified revitalization expenditures or recover such expenditures over 120 months. A taxpayer may elect to not apply the rules

of this provision with respect to any class of property for any taxable year.

The special rules of section 168(k)(2)(E) apply with modifications. For example, property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after the applicable disaster date, and which is placed in service by an eligible taxpayer on or before the date which is the last day of the third calendar year following the applicable disaster date (the fourth calendar year in the case of nonresidential real property and residential rental property). Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

Recapture rules similar to section 179(d)(10) apply to any qualified disaster assistance property that ceases to be qualified disaster assistance property.

Effective Date

The provision is effective for property placed in service after December 31, 2007, with respect to disasters declared after such date.

F. Increased Expensing for Qualified Disaster Assistance Property (sec. 711 of the Act and sec. 179 of the Code)

Present Law

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under section 179. Present law provides that the maximum amount a taxpayer may expense for taxable years beginning in 2008 is $250,000 of the cost of qualifying property placed in service for the taxable year.[852] For taxable years beginning in 2009 and 2010, the limitation is $125,000. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2011 is treated as qualifying property. For taxable years beginning in 2008, the $250,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $800,000. The reduction amount is $500,000 for taxable years beginning in 2009 and 2010. The $125,000 and $500,000 amounts are indexed for inflation in taxable years beginning in 2009 and 2010.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

[852] Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), and a renewal community (sec. 1400J).

No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[853]

For taxable years beginning in 2011 and thereafter (or before 2003), the following rules apply. A taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed for inflation. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner.[854]

For qualified section 179 Gulf Opportunity Zone property, the maximum amount that a taxpayer may elect to deduct is increased by the lesser of $100,000 or the cost of qualified section 179 Gulf Opportunity Zone property for the taxable year.[855] The provision applies with respect to qualified section 179 Gulf Opportunity Zone property acquired on or after August 28, 2005, and placed in service on or before December 31, 2007. The placed in service date was extended to December 31, 2008 for property substantially all of the use of which is in one or more specified portions of the Gulf Opportunity Zone. The threshold for reducing the amount expensed is computed by increasing the $500,000 present-law amount by the lesser of (1) $600,000, or (2) the cost of qualified section 179 Gulf Opportunity Zone property placed in service during the taxable year. Neither the $100,000 nor $600,000 amounts are indexed for inflation.

Qualified section 179 Gulf Opportunity Zone property means section 179 property (as defined in section 179(d)) that also meets the following requirements: (1) The property must be property to which the general rules of the MACRS apply with (a) an applicable recovery period of 20 years or less, (b) computer software other than computer software covered by section 197, (c) water utility property (as defined in section 168(e)(5)), (d) certain leasehold improvement property; (2) substantially all of the use of which is in the Gulf Opportunity Zone and is in the active conduct of a trade or business by the taxpayer in that Zone; (3) the original use of which commences with the taxpayer on or after August 28, 2005; (4) which is acquired by the taxpayer by purchase on or after August 28, 2005, but only if no written binding contract for the acquisition was in effect before August 28, 2005; and (5) which is placed in service by the taxpayer on or before December 31, 2007 (December 31, 2008 in the case of extension property).

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[853] Sec. 179(c)(1). Under Treas. Reg. sec. 1.179–5, applicable to property placed in service in taxable years beginning after 2002 and before 2008, a taxpayer is permitted to make or revoke an election under section 179 without the consent of the Commissioner on an amended Federal tax return for that taxable year. This amended return must be filed within the time prescribed by law for filing an amended return for the taxable year. T.D. 9209, July 12, 2005.

[854] Sec. 179(c)(2).

[855] Sec. 1400N(e).

Rules similar to those for the Gulf Opportunity Zone apply to qualified Recovery Assistance property placed in service in the Kansas disaster area, which was declared a major disaster by the President by reason of severe storms and tornados.[856]

Explanation of Provision

The provision increases the maximum amount that a taxpayer may elect to deduct by the lesser of $100,000 or the cost of qualified section 179 disaster assistance property placed in service during the taxable year. The threshold for reducing the amount expensed is computed by increasing the present-law amount by the lesser of (1) $600,000, or (2) the cost of qualified section 179 disaster assistance property placed in service during the taxable year. Neither the $100,000 nor $600,000 amounts are indexed for inflation.

Qualified section 179 disaster assistance property means section 179 property (as defined in section 179(d)) that also meets the following requirements: (1) property to which the general rules of the MACRS apply with (a) an applicable recovery period of 20 years or less, (b) computer software other than computer software covered by section 197, (c) water utility property (as defined in section 168(e)(5)), (d) certain leasehold improvement property, or (e) certain nonresidential real property and residential rental property; (2) substantially all of the use of such property must be in a disaster area with respect to a Federally declared disaster occurring before January 1, 2010, in the active conduct of a trade or business by the taxpayer in such disaster area; (3) property which rehabilitates property damaged, or replaces property destroyed or condemned, as a result of the Federally declared disaster, except that property is treated as replacing property destroyed or condemned if, as part of an integrated plan, the property replaces property which is included in a continuous area which includes real property destroyed or condemned, and is similar in nature to, and located in the same county as, the property being rehabilitated or replaced; (4) the original use of the property in the disaster area commences with an eligible taxpayer (a taxpayer who has suffered an economic loss attributable to a Federally declared disaster) on or after the applicable disaster date (the date on which a Federally declared disaster occurs); (5) property which is acquired by an eligible taxpayer by purchase (as defined under section 179(d)) by the taxpayer on or after the applicable disaster date (and no written binding contract for the acquisition was in effect before such date); and (6) property which is placed in service by an eligible taxpayer on or before the date which is the last day of the third calendar year following the applicable disaster date (the fourth calendar year in the case of nonresidential real property and residential rental property).

The provision includes rules coordinating increased section 179 amounts included under the provision with present-law expensing rules with respect to enterprise zone businesses in empowerment zones and with respect to renewal communities. For purposes of those rules, qualified section 179 disaster assistance property is not

[856] Pub. L. No. 110–234, sec. 15345 (2008).

treated as qualified zone property or qualified renewal property, unless the taxpayer elects not to take such qualified section 179 disaster assistance property into account for purposes of this provision. Thus, a taxpayer acquiring property that could qualify as either qualified section 179 disaster assistance property, qualified zone property, or qualified renewal property may elect the additional expensing provided either under this provision, or under the empowerment zone or renewal community rules, but not both, with respect to the property.

Recapture rules similar to section 179(d)(10) apply to any qualified section 179 disaster assistance property that ceases to be qualified section 179 disaster assistance property.

Effective Date

The provision is effective for property placed in service after December 31, 2007, with respect to disasters declared after such date.

TITLE VII—REVENUE RAISERS

A. Modify Tax Treatment of Offshore Nonqualified Deferred Compensation (sec. 801 of the Act and new sec. 457A of the Code)

Present Law

In general

Under present law, the determination of when amounts deferred under a nonqualified deferred compensation arrangement are includible in the gross income of the person earning the compensation depends on the facts and circumstances of the arrangement. A variety of tax principles and Code provisions may be relevant in making this determination, including the doctrine of constructive receipt, the economic benefit doctrine,[857] the provisions of section 83 relating generally to transfers of property in connection with the performance of services, provisions relating specifically to nonexempt employee trusts (sec. 402(b)) and nonqualified annuities (sec. 403(c)), and the requirements of section 409A.

In general, the time for income inclusion of nonqualified deferred compensation depends on whether the arrangement is unfunded or funded. If the arrangement is unfunded, then the compensation generally is includible in income by a cash-basis taxpayer when it is actually or constructively received. If the arrangement is funded, then income is includible for the year in which the individual's rights are transferable or not subject to a substantial risk of forfeiture.

An arrangement generally is considered funded if there has been a transfer of property under section 83. Under that section, a transfer of property occurs when a person acquires a beneficial ownership interest in such property. The term "property" is defined very broadly for purposes of section 83.[858] Property includes real and personal property other than money or an unfunded and unsecured promise to pay money in the future. Property also includes a beneficial interest in assets (including money) that are transferred or set aside from claims of the creditors of the transferor, for example in a trust or escrow account. Accordingly, if, in connection with the performance of services, vested contributions are made to a trust on an individual's behalf and the trust assets may be used solely to provide future payments to the individual, the payment of the contributions to the trust constitutes a transfer of property to the individual that is taxable under section 83. On the other hand, deferred amounts generally are not includible in income if non-

[857] See, e.g., *Sproull* v. *Commissioner,* 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952); Rev. Rul. 60–31, 1960–1 C.B. 174.

[858] Treas. Reg. sec. 1.83–3(e). This definition, in part, reflects previous IRS rulings on nonqualified deferred compensation.

qualified deferred compensation is payable from general corporate funds that are subject to the claims of general creditors, as such amounts are treated as unfunded and unsecured promises to pay money or property in the future.

As discussed above, if the arrangement is unfunded, then the compensation generally is includible in income by a cash-basis taxpayer when it is actually or constructively received under section 451.[859] Income is constructively received when it is credited to a person's account, set apart, or otherwise made available so that it may be drawn on at any time. Income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. A requirement to relinquish a valuable right in order to make withdrawals is generally treated as a substantial limitation or restriction.

Prior to the enactment of section 409A, arrangements had developed in an effort to provide employees with security for nonqualified deferred compensation, while still allowing deferral of income inclusion under the constructive receipt doctrine (which applies to unfunded arrangements). One such arrangement is a "rabbi trust." A rabbi trust is a trust or other fund established by the employer to hold assets from which nonqualified deferred compensation payments will be made. The trust or fund is generally irrevocable and does not permit the employer to use the assets for purposes other than to provide nonqualified deferred compensation, except that the terms of the trust or fund provide that the assets are subject to the claims of the employer's creditors in the case of insolvency or bankruptcy. In the case of a rabbi trust, these terms had been the basis for the conclusion that the creation of a rabbi trust does not cause the related nonqualified deferred compensation arrangement to be funded for income tax purposes.[860] As a result, no amount was included in income by reason of the rabbi trust; generally income inclusion occurs as payments are made from the trust.

Section 409A

Reason for enactment

The Congress enacted section 409A[861] because it was concerned that many nonqualified deferred compensation arrangements had developed which allowed improper deferral of income. Executives often used arrangements that allowed deferral of income, but also provided security of future payment and control over amounts deferred. For example, nonqualified deferred compensation arrangements often contained provisions that allowed participants to receive distributions upon request, subject to forfeiture of a minimal amount (i.e., a "haircut" provision). In addition, Congress was aware that since the concept of a rabbi trust was developed, techniques had been used that attempted to protect the assets from creditors despite the terms of the trust. For example, the trust or

[859] Treas. Reg. sec. 1.451–1 and 1.451–2.

[860] This conclusion was first provided in a 1980 private ruling issued by the IRS with respect to an arrangement covering a rabbi; hence, the popular name "rabbi trust." Priv. Ltr. Rul. 8113107 (Dec. 31, 1980).

[861] Section 409A was added to the Code by section 885 of the American Job Creation Act of 2004, Pub. L. No. 108–357.

fund would be located in a foreign jurisdiction, making it difficult or impossible for creditors to reach the assets.

Prior to the enactment of section 409A, while the general tax principles governing deferred compensation were well established, the determination whether a particular arrangement effectively allowed deferral of income was generally made on a facts and circumstances basis. There was limited specific guidance with respect to common deferral arrangements. The Congress believed that it was appropriate to provide specific rules regarding whether deferral of income inclusion should be permitted and to provide a clear set of rules that would apply to these arrangements. The Congress believed that certain arrangements that allow participants inappropriate levels of control or access to amounts deferred should not result in deferral of income inclusion. The Congress also believed that certain arrangements, such as offshore trusts, which effectively protect assets from creditors of the employer, should be treated as funded and not result in deferral of income inclusion to the extent the amounts are vested.

General requirements of section 409A

In general.—Under section 409A, all amounts deferred by a service provider under a nonqualified deferred compensation plan[862] for all taxable years are currently includible in gross income of the service provider to the extent such amounts are not subject to a substantial risk of forfeiture[863] and not previously included in gross income, unless certain requirements are satisfied. If the requirements of section 409A are not satisfied, in addition to current income inclusion, interest at the rate applicable to underpayments of tax plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to a 20-percent additional tax. Section 409A does not limit the amount that may be deferred under a nonqualified deferred compensation plan.

The Secretary of the Treasury is authorized to prescribe regulations as are necessary or appropriate to carry out the purposes of section 409A. The Secretary of the Treasury published final regulations under section 409A on April 17, 2007.[864] Under these regulations, the term "service provider" includes an individual, corporation, subchapter S corporation, partnership, personal service corporation (as defined in section 269A(b)(1)), noncorporate entity that would be a personal service corporation if it were a corporation, or qualified personal service corporation (as defined in section 448(d)(2)) for any taxable year in which such individual or entity accounts for gross income from the performance of services under

[862] A plan includes an agreement or arrangement, including an agreement or arrangement that includes one person. Amounts deferred also include actual or notional earnings.

[863] The rights of a person to compensation are subject to a substantial risk of forfeiture if the person's rights to such compensation are conditioned upon the performance of substantial services by any individual.

[864] On October 22, 2007, the IRS announced that during 2008, taxpayers are not required to comply with the final regulations. Instead, taxpayers must operate a plan in compliance with section 409A and the otherwise applicable guidance. To the extent an issue is not addressed, a reasonable, good faith interpretation of the statute must be used. Notice 2007–86.

the cash receipts and disbursements method of accounting.[865] Section 409A does not apply to a service provider that provides significant services to at least two service recipients that are not related to each other or the service provider. This exclusion does not apply to a service provider who is an employee or a director of a corporation (or similar position in the case of an entity that is not a corporation).[866] In addition, the exclusion does not apply to an entity that operates as the manager of a hedge fund or private equity fund. This is because the exclusion does not apply to the extent that management services are provided to a service recipient by a service provider. Management services for this purpose means services that involve the actual or de facto direction or control of the financial or operational aspects of a trade or business of the service recipient or investment management or advisory services provided to a service recipient whose primary trade or business includes the investment of financial assets, such as a hedge fund.[867]

Permissible distribution events.—Under section 409A, distributions from a nonqualified deferred compensation plan may be allowed only upon separation from service (as determined by the Secretary of the Treasury), death, a specified time (or pursuant to a fixed schedule), change in control of a corporation (to the extent provided by the Secretary of the Treasury), occurrence of an unforeseeable emergency, or if the service provider becomes disabled. A nonqualified deferred compensation plan may not allow distributions other than upon the permissible distribution events and, except as provided in regulations by the Secretary of the Treasury, may not permit acceleration of a distribution. In the case of a specified employee who separates from service, distributions may not be made earlier than six months after the date of the separation from service or upon death. Specified employees are key employees[868] of publicly-traded corporations.

Elections.—Section 409A requires that a plan must provide that compensation for services performed during a taxable year may be deferred at the service provider's election only if the election to defer is made no later than the close of the preceding taxable year, or at such other time as provided in Treasury regulations. In the case of any performance-based compensation based on services performed over a period of at least 12 months, such election may be made no later than six months before the end of the service period. The time and form of distributions must be specified at the time of initial deferral. A plan may allow changes in the time and form of distributions subject to certain requirements.

Back-to-back arrangements.—Back-to-back service recipients (i.e., situations under which an entity receives services from a service provider such as an employee, and the entity in turn provides services to a client) that involve back-to-back nonqualified deferred compensation arrangements (i.e., the fees payable by the client are deferred at both the entity level and the employee level) are subject to special rules under section 409A. For example, the final regula-

[865] Treas. Reg. sec. 1.409A–1(f)(1).
[866] Treas. Reg. sec. 1.409A–1(f)(2).
[867] Treas. Reg. sec. 1.409A–1(f)(2)(iv).
[868] Key employees are defined in section 416(i) and generally include officers (limited to 50 employees) having annual compensation greater than $150,000 (for 2008), five percent owners, and one percent owners having annual compensation from the employer greater than $150,000.

tions generally permit the deferral agreement between the entity and its client to treat as a permissible distribution event those events that are specified as distribution events in the deferral agreement between the entity and its employee. Thus, if separation from employment is a specified distribution event between the entity and the employee, the employee's separation generally is a permissible distribution event for the deferral agreement between the entity and its client.[869]

Offshore funding arrangements.—Section 409A requires current income inclusion in the case of certain offshore funding of nonqualified deferred compensation. Under section 409A, in the case of assets set aside (directly or indirectly) in a trust (or other arrangement determined by the Secretary of the Treasury) for purposes of paying nonqualified deferred compensation, such assets are treated as property transferred in connection with the performance of services under section 83 (whether or not such assets are available to satisfy the claims of general creditors) at the time set aside if such assets are located outside of the United States or at the time transferred if such assets are subsequently transferred outside of the United States. Any subsequent increases in the value of, or any earnings with respect to, such assets are treated as additional transfers of property.

If an impermissible set aside of assets occurs, the tax otherwise imposed under the Code is increased by an interest charge. The interest charge is equal to the amount of interest at the underpayment rate plus one percentage point on the underpayments of tax that would have occurred had the amounts set aside been includible in income for the taxable year in which first deferred or, if later, the first taxable year not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to an additional 20-percent tax.

The special funding rule does not apply to assets located in a foreign jurisdiction if substantially all of the services to which the nonqualified deferred compensation relates are performed in such foreign jurisdiction. The Secretary of the Treasury has authority to exempt arrangements from the provision if the arrangements do not result in an improper deferral of U.S. tax and will not result in assets being effectively beyond the reach of creditors.

Definition of substantial risk of forfeiture

Under the Treasury regulations, compensation is subject to a substantial risk of forfeiture if entitlement to the amount is conditioned upon either the performance of substantial future services by any person or the occurrence of a condition related to a purpose of the compensation, provided that the possibility of forfeiture is substantial.[870]

Definition of nonqualified deferred compensation

Under section 409A, a nonqualified deferred compensation plan generally includes any plan that provides for the deferral of compensation other than a qualified employer plan or any bona fide va-

[869] Treas. Reg. sec. 1.409A–1(i)(6).
[870] Treas. Reg. sec. 1.409A–1(d)(1).

cation leave, sick leave, compensatory time, disability pay, or death benefit plan. A qualified employer plan means a qualified retirement plan, tax-deferred annuity, simplified employee pension, and a simple retirement account plan. A qualified governmental excess benefit arrangement (sec. 415(m)) and an eligible deferred compensation plan (sec. 457(b)) is a qualified employer plan.

The Treasury regulations also provide that certain other types of plans are not considered deferred compensation, and thus are not subject to section 409A. For example, if a service recipient transfers property to a service provider, there is no deferral of compensation merely because the value of the property is either not includible in income under section 83 by reason of the property being substantially nonvested or is includible in income because of a valid section 83(b) election.[871] Special rules apply in the case of stock options.[872] Another exception applies to amounts that are not deferred beyond a short period of time after the amount is no longer subject to a substantial risk of forfeiture (the "short-term deferral exception").[873] Under this exception, there generally is no deferral for purposes of section 409A if the service provider actually or constructively receives the amount on or before the last day of the applicable 2½ month period. The applicable 2½ month period is the period ending on the later of the 15th day of the third month following the end of: (1) the service provider's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture; or (2) the service recipient's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture.

Special rules apply in the case of stock appreciation rights ("SARs").[874] Under the final Treasury regulations, a SAR is a right to compensation based on the appreciation in value of a specified number of shares of service recipient stock occurring between the date of grant and the date of exercise of such right. The final regulations generally provide that a SAR does not result in a deferral of compensation for purposes of section 409A (and thus is not subject to section 409A) if the compensation payable under the SAR is not greater than the excess of the fair market value of the underlying stock on the date the SAR is exercised over the fair market value of the underlying stock on the date the SAR is granted.[875]

The Treasury regulations provide exclusions from the definition of nonqualified deferred compensation in the case of services performed by individuals who participate in certain foreign plans, including plans covered by an applicable treaty and broad-based foreign retirement plans.[876] In the case of a U.S. citizen or lawful permanent alien, nonqualified deferred compensation plan does not include a broad-based foreign retirement plan, but only with respect to the portion of the plan that provides for nonelective deferral of foreign earned income and subject to limitations on the annual amount deferred under the plan or the annual amount payable under the plan. In general, foreign earned income refers to

[871] Treas. Reg. sec. 1.409A–1(b)(6).
[872] Treas. Reg. sec. 1.409A–1(b)(5).
[873] Treas. Reg. sec. 1.409A–1(b)(4).
[874] Treas. Reg. sec. 1.409A–1(b)(5).
[875] Treas. Reg. sec. 1.409A–1(b)(5)(i)(B).
[876] Treas. Reg. sec. 1.409A–1(a)(3).

amounts received by an individual from sources within a foreign country that constitutes earned income attributable to services.

Timing of the service recipient's deduction

Special statutory provisions govern the timing of the deduction for nonqualified deferred compensation, regardless of whether the arrangement covers employees or nonemployees and regardless of whether the arrangement is funded or unfunded.[877] Under these provisions, the amount of nonqualified deferred compensation that is includible in the income of the service provider is deductible by the service recipient for the taxable year in which the amount is includible in the service provider's income.[878] Thus, for example, in the case of an unfunded nonqualified deferred compensation plan, a deduction to the taxable service recipient is deferred until the deferred compensation is actually paid or made available to the service provider.

Section 457

Special income recognition rules apply in the case of a participant in a deferred compensation plan that is sponsored by a State or local government or an organization that is exempt from Federal income tax under section 501(a). Section 457 provides for different income inclusion rules for two basic types of deferred compensation arrangements: (1) arrangements that limit the amount of compensation that may be deferred (generally, $15,500 in 2007) and that meet certain other requirements specified in section 457(b) (referred to as a "section 457(b) plan" or an "eligible deferred compensation plan"); and (2) arrangements that do not satisfy the requirements of section 457(b) (referred to as a "section 457(f) plan" or an "ineligible deferred compensation plan"). Section 457 does not provide a limit on the amount of compensation that may be deferred under a section 457(f) plan.

A participant in a section 457(b) plan does not recognize income with respect to the participant's interest in such plan until the time of actual distribution (or, if earlier, the time the participant's interest is made available to the participant, but only in the case of a section 457(b) plan maintained by a tax-exempt sponsor other than a State or local government). In contrast, a participant in a section 457(f) plan must include amounts deferred under such a plan in gross income for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation.

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[877] Secs. 404(a)(5), (b) and (d) and sec. 83(h).

[878] In the case of a publicly held corporation, under section 162(m), no deduction is allowed for a taxable year for remuneration with respect to a covered employee to the extent that the remuneration exceeds $1 million. Section 162(m) defines the term "covered employee" in part by reference to Federal securities law. In light of changes to Federal securities law, the IRS interprets the term covered employee as the principal executive officer of the taxpayer as of the close of the taxable year or the three most highly compensated employees of the taxpayer for the taxable year whose compensation must be disclosed to the taxpayer's shareholders (other than the principal executive officer or the principal financial officer). Notice 2007–49, 2007–25 I.R.B. 1429. For purposes of the deduction limit, remuneration generally includes all remuneration for which a deduction is otherwise allowable, although commission-based compensation and certain performance-based compensation are not subject to the limit. Remuneration does not include compensation for which a deduction is allowable after a covered employee ceases to be a covered employee. Thus, the deduction limitation often does not apply to deferred compensation that is otherwise subject to the deduction limitation (e.g., is not performance-based compensation) because the payment of the compensation is deferred until after termination of employment.

Reasons for Change

Under present law, there is a tension in the case of a nonqualified deferred compensation agreement between a service provider and a taxable service recipient. This arises because the timing rule under the Code defers the service recipient's deduction for nonqualified deferred compensation until the taxable year in which such compensation is includible in the service provider's gross income. This tension may limit the amount of compensation that a service recipient is willing to permit a service provider to defer under a nonqualified deferred compensation arrangement. Even when this tension does not limit the amount of compensation that a service recipient is willing to permit a service provider to defer under a nonqualified deferred compensation arrangement, this tension ensures that the cost of allowing this deferral is borne by the service recipient.

Under present law, the ability to defer nonqualified deferred compensation is limited in certain cases in which this tension is not present. When this tension is not present, the cost of allowing service providers to defer under a nonqualified deferred compensation arrangement is not borne by the service recipient. Instead, this cost is borne by the Treasury. In order to limit the cost to the Treasury, Congress passed special rules limiting deferral in certain situations. Specifically, section 457 provides special rules that limit deferred compensation arrangements sponsored by State and local governments and other tax-exempt entities.

Congress became aware of other situations in which the present law tension does not exist. Specifically, foreign corporations that are not subject to a comprehensive income tax and partnerships that are comprised of foreign persons and U.S. tax-exempt entities are indifferent to the timing of deductions for nonqualified deferred compensation. Congress believed that in such cases additional rules should apply that limit the ability to defer service provider compensation.

Explanation of Provision

In general

Under the provision, any compensation that is deferred under a nonqualified deferred compensation plan of a nonqualified entity is includible in gross income by the service provider when there is no substantial risk of forfeiture of the service provider's rights to such compensation. The provision is intended to apply without regard to the method of accounting of the service provider,[879] and applies regardless of whether the service recipient is taxed as a partnership, trust or corporation. The provision applies in addition to the requirements of section 409A (or any other provision of the Code or general tax law principle) with respect to nonqualified deferred compensation.

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[879] Due to the definition of substantial risk of forfeiture under the provision, an accrual-basis taxpayer might be required to include compensation as income under the provision at a date earlier than the accrual accounting method rules would otherwise require.

Nonqualified deferred compensation

For purposes of the provision, the term "nonqualified deferred compensation plan" is defined in the same manner as for purposes of section 409A, subject to certain modifications. As under section 409A, the term nonqualified deferred compensation includes earnings with respect to previously deferred amounts. Earnings are treated in the same manner as the amount deferred to which the earnings relate.

Under the provision, nonqualified deferred compensation includes any arrangement under which compensation is based on the increase in value of a specified number of equity units of the service recipient. Thus, stock appreciation rights ("SARs") are treated as nonqualified deferred compensation under the provision, regardless of the exercise price of the SAR. It is not intended that the term nonqualified deferred compensation plan include an arrangement taxable under section 83 providing for the grant of an option on employer stock with an exercise price that is not less than the fair market value of the underlying stock on the date of grant if such arrangement does not include a deferral feature other than the feature that the option holder has the right to exercise the option in the future. The provision is not intended to change the tax treatment of incentive stock options meeting the requirements of section 422 or options granted under an employee stock purchase plan meeting the requirements of section 423. Similarly, nonqualified deferred compensation for purposes of the provision generally does not include a transfer of property to which section 83 is applicable (such as a transfer of restricted stock), provided that the arrangement does not include a deferral feature. However, it is not intended that the provision may be avoided through the use of an instrument (such as an option to acquire a partnership interest or a notional principal contract) held or entered into directly or indirectly by a service provider, the value of which is determined in whole or part by reference to the profits or value (or any increase or decrease in the profits or value) of the business of the entity for which the services are effectively provided, particularly when the value of such instrument is not determinable at the time it is granted or received. Similarly, it is not intended that the purposes of the provision may be avoided through the use of "springing" partnerships or other entities or rights that come into existence in the future and serve a function similar to a conversion right.

The short-term deferral exception that applies for purposes of the provision is different from the short-term deferral exception that applies for purposes of section 409A. For all purposes of the provision, compensation is not treated as deferred if the service provider receives payment of the compensation not later than 12 months after the end of the taxable year of the service recipient during which the right to the payment of such compensation is no longer subject to a substantial risk of forfeiture. For purposes of this short-term deferral exception, whether compensation is subject to a substantial risk of forfeiture is determined under section 457A(d)(1).

Nonqualified entity

The term "nonqualified entity" includes certain foreign corporations and certain partnerships (either domestic or foreign). A foreign corporation is a nonqualified entity unless substantially all of its income is effectively connected with the conduct of a United States trade or business or is subject to a comprehensive foreign income tax. A partnership is a nonqualified entity unless substantially all of its income is allocated to persons other than foreign persons with respect to whom such income is not subject to a comprehensive foreign income tax and organizations which are exempt from U.S. income tax. It is intended that the Secretary of the Treasury issue guidance addressing the time at which (or period of time over which) an entity is tested for status as a nonqualified entity, the circumstances in which an entity's status as a nonqualified or qualified entity may change, and the consequences of any such change in status. For example, compensation that is deferred under a nonqualified deferred compensation plan that is no longer subject to a substantial risk of forfeiture may be includible in income when the entity later becomes a nonqualified entity.

In determining whether a partnership is considered a nonqualified entity, it is also intended that an organization that is a partner in the partnership not be considered exempt from U.S. income tax to the extent that the organization's share of the partnership's income is subject to U.S. tax as unrelated business taxable income. Similarly, it is intended that a foreign person that is a partner in a partnership not be considered a foreign person with respect to whom partnership income is not subject to a comprehensive foreign income tax to the extent that such person's share of partnership income is subject to U.S. income tax as income that is effectively connected with the conduct of a U.S. trade or business.[880]

The term comprehensive foreign income tax means with respect to a foreign person, the income tax of a foreign country if (1) such person is eligible for the benefits of a comprehensive income tax treaty between such foreign country and the United States, or (2) such person demonstrates to the satisfaction of the Secretary of the Treasury that such foreign country has a comprehensive income tax.

Congress intends that the requirement that substantially all of the income of an entity be "subject to" a comprehensive foreign income tax generally means that the income in question must be includible in the entity's taxable income under the laws of the entity's country of residence. Congress is aware, however, that many jurisdictions (including jurisdictions with which the United States has income tax treaties) partially or entirely exempt, under generally applicable rules (such as exclusions, exemptions and deductions), certain classes of income (such as foreign-source dividends or other foreign-source income) when certain conditions (such as holding period, ownership threshold, or foreign tax imposition requirements) are satisfied. Congress also is aware that the prin-

[880] The rules described in the foregoing paragraph were reflected in H.R. 7060, The Renewable Energy and Job Creation Tax Act of 2008, as passed by the House of Representatives on September 26, 2008. A technical correction may be necessary so that the statute reflects this intent.

ciples for determining what constitutes income under U.S. tax rules sometimes differ from the principles of other jurisdictions. It is expected that guidance issued by the Secretary will give due regard to common variations among income tax systems but will be consistent with Congress's general intent to treat a foreign corporation as a nonqualified entity if more than an insubstantial portion of the entity's income is excluded from the corporation's taxable income under the laws of the corporation's country of residence. In determining whether the laws of a corporation's jurisdiction of residence include an item of income in the corporation's taxable income, the Secretary should consider whether such income is received from a corporation organized in the United States; is effectively connected with the conduct of a trade or business in the United States or attributable to a U.S permanent establishment under a U.S. income tax treaty; or is received from a corporation subsantially all of the income of which is subject to a comprehensive foreign income tax.

Congress further does not intend to permit a taxpayer to avoid the application of the provision by availing itself of a legal entity that is considered resident in a country with which the United States has an income tax treaty but that pays little or no tax in that country because of a preferential regime that is available to certain types of qualified or special purpose entities (such as financial companies or holding companies) or specified income (such as investment income) or that provides liberal profit extraction rules. Accordingly, it is expected that the Secretary will provide guidance addressing the question of whether, or in which circumstances, a corporation is a nonqualified entity because it is subject to a preferential tax regime in its country of residence.

It is intended that the Secretary will provide guidance on the issue of which U.S. income tax treaties are considered comprehensive income tax treaties. Congress expects that one factor to be taken into account in this guidance will be whether a particular income tax treaty includes comprehensive limitation on benefits rules. A treaty with liberal, or no, limitation on benefits rules (such as the present treaties with Hungary and Poland) may, in the Secretary's discretion, be excluded from treament as a comprehensive income tax treaty because a corporation may be eligible for the benefits of that treaty even if most or all of its income is not subject to tax in the corporation's country of residence. Congess is aware that the term "comprehensive income tax treaty" is also used in the rules for determining whether dividend income received from a foreign corporation may be taxed at a reduced rate.[881] The substance and concerns of the permissive rules of section 1(h)(11) for determining eligibility for a reduced tax rate for certain dividend income are significantly different from the substance and concerns of this restrictive provision. Accordingly, guidance issued on what constitutes a "comprehensive income tax treaty" under section 1(h)(11) should in no way be considered to bind any guidance issued under this provision.

In the case of a foreign corporation with income that is taxable under section 882, the provision does not apply to compensation

[881] Section 1(h)(11)(C)(i)(II).

which, had such compensation been paid in cash on the date that such compensation ceased to be subject to a substantial risk of forfeiture, would have been deductible by such foreign corporation against such income.

Additional rules

In general, a nonqualified deferred compensation plan is considered to be a plan of an entity for purposes of the provision to the extent that compensation deferred under the plan is deductible by such entity. It is intended, however, that the Secretary may issue regulations that limit the application of this general rule as is necessary to prevent abuse or otherwise reflect the intent of the provision. Under the general rule, for example, the provision does not apply to compensation arrangements of employees of a U.S. corporation that is wholly owned by a nonqualified entity to the extent that the compensation is deductible by the U.S. subsidiary, even if both the U.S. corporation and the nonqualified entity are liable to pay the compensation. This is because the subsidiary is subject to the timing rule of section 404(a)(5) with respect to its deduction of its employees' nonqualified deferred compensation.

For purposes of the provision, compensation of a service provider is subject to a substantial risk of forfeiture only if such person's right to the compensation is conditioned upon the future performance of substantial services by any individual and the possibility of forfeiture is substantial. Substantial risk of forfeiture does not include a condition related to a purpose of the compensation (other than future performance of substantial services), regardless of whether the possibility of forfeiture is substantial.

To the extent provided in regulations prescribed by the Secretary, if compensation is determined solely by reference to the amount of gain recognized on the disposition of an investment asset, such compensation is treated as subject to a substantial risk of forfeiture until the date of such disposition. Investment asset means for this purpose any single asset (other than an investment fund or similar entity) (1) acquired directly by an investment fund or similar entity, (2) with respect to which such entity does not (nor does any person related to such entity) participate in the active management of such asset (or if such asset is an interest in an entity, in the active management of the assets of such entity), and (3) substantially all of any gain on the disposition of which (other than the nonqualified deferred compensation) is allocated to investors in such entity. The rule only applies if the compensation is determined solely by reference to the gain upon the disposition of an investment asset. Thus, for example, the rule does not apply in the case of an arrangement under which the amount of the compensation is reduced for losses on the disposition of any other asset. With respect to any gain attributable to the period before the asset is treated as no longer subject to a substantial risk of forfeiture, it is intended that Treasury regulations will limit the application of this rule to gain attributable to the period that the service provider is performing services.

The rule is intended to apply to compensation contingent on the disposition of a single asset held as a long-term investment, provided that the service provider does not actively manage the asset

(other than the decision to purchase or sell the investment). If the asset is an interest in an entity (such as a company that produces products or services), the rule does not apply if the service provider actively participates in the management of the entity. Active management is intended to include participation in the day-to-day activities of the asset, but does not include the election of a director or other voting rights exercised by shareholders.

The rule is intended to apply solely to compensation arrangements relating to passive investments by an investment fund in a single asset. For example, if an investment fund acquires XYZ operating corporation, the rule is intended to apply to an arrangement that the fund manager receive 20 percent of the gain from the disposition of XYZ operating corporation if the fund manager does not actively participate in the management of XYZ operating corporation. In contrast, the rule does not apply if the investment fund holds two or more operating corporations and the fund manager's compensation is based on the net gain resulting from the disposition of the operating corporations. The rule does not apply to the disposition of a foreign subsidiary which holds a variety of assets the investment of which is managed by the service provider.

Under the provision, if the amount of any deferred compensation is not determinable at the time that such compensation is otherwise required to be included in income under the provision, the amount is includible when such amount becomes determinable. This rule applies in lieu of the general rule of the provision, under which deferred compensation is includible in income when such compensation is no longer subject to a substantial risk of forfeiture. In addition, the income tax with respect to such amount is increased by the sum of (1) an interest charge, and (2) an amount equal to 20 percent of such compensation. The interest charge is equal to the interest at the rate applicable to underpayments of tax plus one percentage point imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture.

Treasury regulations

It is intended that the Secretary of the Treasury issue regulations as to when an amount is not determinable for purposes of the provision. It is intended that an amount of deferred compensation is not determinable at the time the amount is no longer subject to a substantial risk of forfeiture if the amount varies depending on the satisfaction of an objective condition. For example, if a deferred amount varies depending on the satisfaction of an objective condition at the time the amount is no longer subject to substantial risk of forfeiture (e.g., no amount is paid unless a certain threshold is achieved, 100 percent is paid if the threshold is achieved, and 200 percent is paid if a higher threshold is achieved), the amount deferred is not determinable.

The Secretary of the Treasury is also authorized to issue such regulations as may be necessary or appropriate to carry out the purposes of the provision, including regulations disregarding a substantial risk of forfeiture as necessary to carry out such purposes.

Entity aggregation rules similar to those that apply under section 409A apply for purposes of the provision. It is not intended that the aggregation rules treat every entity within an aggregated group as a nonqualified entity merely because one entity in the group is a nonqualified entity.[882] The determination of a particular entity's nonqualified entity status under the provision is generally performed on an entity-by-entity basis. It is intended, however, that the Secretary may permit or require (as appropriate under the circumstances) that the determination of nonqualified entity status be performed on an aggregated basis, for example, in the case of an aggregated group of entities that are organized in the same jurisdiction. Further, the determination of whether a nonqualified deferred compensation plan is a plan of a particular entity does not depend on whether such entity is aggregated with another employer that adopts and maintains the plan, but is instead determined generally (as discussed above) on the basis of which entity is entitled to deduct compensation that is deferred under the plan.

Effective Date

The provision is effective with respect to amounts deferred which are attributable to services performed after December 31, 2008. In the case of an amount deferred which is attributable to services performed on or before December 31, 2008, to the extent such amount is not includible in gross income in a taxable year beginning before 2018, then such amount is includible in gross income in the later of (1) the last taxable year beginning before 2018, or (2) the taxable year in which there is no substantial risk of forfeiture of the rights to such compensation (as determined for purposes of the provision). Earnings on amounts deferred which are attributable to services performed on or before December 31, 2008, are subject to the provision only to the extent that the amounts to which such earnings relate are subject to the provision.

No later than 120 days after date of enactment, the Secretary shall issue guidance providing a limited period of time during which a nonqualified deferred compensation arrangement attributable to services performed on or before December 31, 2008, may, without violating the requirements of section 409A(a), be amended to conform the date of distribution to the date the amounts are required to be included in income under the provision. If the taxpayer is also a service recipient and maintains one or more nonqualified deferred compensation arrangements for its service providers under which any amount is attributable to services performed on or before December 31, 2008, the guidance shall permit such arrangements to be amended to conform the dates of distribution under the arrangement to the date amounts are required to be included in income of the taxpayer under the provision. An amendment made pursuant to the Treasury guidance will not be treated as a material modification of the arrangement for purposes of section 409A.

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[882] A technical correction may be necessary so that the statute reflects this intent.

PART EIGHTEEN: FOSTERING CONNECTIONS TO SUCCESS AND INCREASING ADOPTIONS ACT OF 2008 (PUBLIC LAW 110–351)[883]

A. Clarify Uniform Definition of Child (sec. 501 of the Act and secs. 24 and 152 of the Code)

Present Law

Uniform definition of qualifying child

In general

Present law provides a uniform definition of qualifying child (the "uniform definition") for purposes of the dependency exemption, the child credit, the earned income credit, the dependent care credit, and head of household filing status. A taxpayer generally may claim an individual who does not meet the uniform definition (with respect to any taxpayer) as a dependent if the dependency requirements are satisfied. The uniform definition generally does not modify other parameters of each tax benefit (e.g., the earned income requirements of the earned income credit) or the rules for determining whether individuals other than children of the taxpayer qualify for each tax benefit.

Under the uniform definition, in general, a child is a qualifying child of a taxpayer if the child satisfies each of three tests: (1) the child has the same principal place of abode as the taxpayer for more than one half the taxable year; (2) the child has a specified relationship to the taxpayer; and (3) the child has not yet attained a specified age. A tie-breaking rule applies if more than one taxpayer claims a child as a qualifying child.

The support and gross income tests for determining whether an individual is a dependent generally do not apply to a child who meets the requirements of the uniform definition.

Residency test

Under the uniform definition's residency test, a child must have the same principal place of abode as the taxpayer for more than one half of the taxable year. Temporary absences due to special circumstances, including absences due to illness, education, business, vacation, or military service, are not treated as absences.

Relationship test

In order to be a qualifying child, the child must be the taxpayer's son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, or a descendant of any such individual. For purposes of determining whether an adopted child is treated as a child by

[883] H.R. 6893. H.R. 6893 passed the House on September 17, 2008, and passed the Senate without amendment on September 22, 2008. The President signed the bill on October 7, 2008.

blood, an adopted child means an individual who is legally adopted by the taxpayer, or an individual who is lawfully placed with the taxpayer for legal adoption by the taxpayer. A foster child who is placed with the taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction is treated as the taxpayer's child.

Age test

The age test varies depending upon the tax benefit involved. In general, a child must be under age 19 (or under age 24 in the case of a full-time student) in order to be a qualifying child. In general, no age limit applies with respect to individuals who are totally and permanently disabled within the meaning of section 22(e)(3) at any time during the calendar year. A child must be under age 13 (if he or she is not disabled) for purposes of the dependent care credit, and under age 17 (whether or not disabled) for purposes of the child credit.

Children who support themselves

A child who provides over one half of his or her own support generally is not considered a qualifying child of another taxpayer. However, a child who provides over one half of his or her own support may constitute a qualifying child of another taxpayer for purposes of the earned income credit.

Tie-breaking rules

If a child would be a qualifying child with respect to more than one individual (e.g., a child lives with his or her mother and grandmother in the same residence) and more than one person claims a benefit with respect to that child, then the following "tie-breaking" rules apply. First, if only one of the individuals claiming the child as a qualifying child is the child's parent, the child is deemed the qualifying child of the parent. Second, if both parents claim the child and the parents do not file a joint return, then the child is deemed a qualifying child first with respect to the parent with whom the child resides for the longest period of time, and second with respect to the parent with the highest adjusted gross income. Third, if the child's parents do not claim the child, then the child is deemed a qualifying child with respect to the claimant with the highest adjusted gross income.

Interaction with other rules

Taxpayers generally may claim an individual who does not meet the uniform definition with respect to any taxpayer as a dependent if the dependency requirements (including the gross income and support tests) are satisfied. Thus, for example, a taxpayer may claim a parent as a dependent if the taxpayer provides more than one half of the support of the parent and the parent's gross income is less than the personal exemption amount. As another example, a grandparent may claim a dependency exemption with respect to a grandson who does not reside with any taxpayer for over one half the year, if the grandparent provides more than one half of the support of the grandson and the grandson's gross income is less than the personal exemption amount.

Children of divorced or legally separated parents

In the case of divorced or legally separated parents, a custodial parent may release the claim to a dependency exemption and the child credit to a noncustodial parent. While the definition of qualifying child is generally uniform, this custodial waiver rule does not apply with respect to the earned income credit, head of household status, or the dependent care credit.

Other provisions

A taxpayer identification number for a child must be provided on the taxpayer's return. For purposes of the earned income credit, a qualifying child is required to have a social security number that is valid for employment in the United States (that is, the child must be a U.S. citizen, permanent resident, or have a certain type of temporary visa).

Dependency rules

In general

An individual may be claimed as a taxpayer's dependent if such individual is a qualifying child or a qualifying relative of the taxpayer and meets certain other requirements. An individual is a taxpayer's qualifying relative if such individual (1) bears the appropriate relationship to the taxpayer; (2) has a gross income that does not exceed the personal exemption amount; (3) receives one-half of his or her support from the taxpayer; and (4) is not a qualifying child of the taxpayer. Generally, an individual bears the appropriate relationship to the taxpayer if the individual is the taxpayer's lineal descendent or ancestor, brother, sister, aunt, uncle, niece, or nephew. Some relations by marriage also qualify, including stepmothers, stepfathers, stepbrothers, stepsisters, sons-in-law, daughters-in-law, fathers-in-law, mothers-in-law, brothers-in-law, and sisters-in-law. In addition, an individual bears the appropriate relationship if the individual has the same principal place of abode as the taxpayer and is a member of the taxpayer's household.

Dependents of dependents

Generally, if an individual is a dependent of a taxpayer for any taxable year, such individual is treated as having no dependents for such taxable year. Therefore, the individual is ineligible to claim:

1. head of household filing status;[884]
2. the dependent care credit;[885] or
3. a dependency exemption.[886]

Married dependents

Generally, an individual filing a joint return with such individual's spouse is not treated as the dependent of a taxpayer. Therefore, the taxpayer is ineligible to claim the earned income credit or a dependency exemption with respect to such individual.

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[884] Sec. 2.
[885] Sec. 21.
[886] Sec. 151.

Citizenship and residency

Children who are U.S. citizens or nationals living abroad or non-U.S. citizens or nationals living in Canada or Mexico may qualify as dependents. In addition, a legally adopted child who does not satisfy the residency or citizenship requirement may nevertheless qualify as a dependent if (1) the child's principal place of abode is the taxpayer's home and (2) the taxpayer is a citizen or national of the United States.

Earned income credit

The earned income credit is a refundable tax credit available to certain lower-income individuals. Generally, the amount of an individual's allowable earned income credit is dependent on the individual's earned income, adjusted gross income, and the number of qualifying children.

An individual who is a qualifying child of another individual is not eligible to claim the earned income credit. Thus, in certain cases a taxpayer caring for a younger sibling in a home with no parents would be ineligible to claim the earned income credit based solely on the fact that the taxpayer is a qualifying child of the younger sibling if the taxpayer meets the age, relationship, and residency tests.

Explanation of Provision

Limit definition of qualifying child

The provision adds a new requirement to the uniform definition. Specifically, it provides that an individual who otherwise satisfies the uniform definition is not treated as a qualifying child unless he or she is either: (1) younger than the individual claiming him or her as a qualifying child or (2) permanently and totally disabled.

The provision also provides that an individual who is married and files a joint return (unless the return is filed only as a claim for a refund) will not be considered a qualifying child for child-related tax benefits, including the child tax credit.

Restrict qualifying child tax benefits to child's parent

The provision provides that if a parent may claim a particular qualifying child, no other individual may claim that child. There is one exception to this rule: if no parent claims the qualifying child, another individual may claim such child if such other individual (1) is otherwise eligible to claim the child and (2) has a higher adjusted gross income for the taxable year than any parent eligible to claim the child.

The provision further provides that dependent filers are not eligible for child-related tax benefits.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

PART NINETEEN: MICHELLE'S LAW (PUBLIC LAW 110–381)[887]

Present Law

The Code generally excludes employer-provided health care coverage and amounts received under employer-provided health plans from an employee's gross income and wages for income and employment tax purposes.[888] These exclusions include amounts paid to an employee for expenses incurred for the medical care of a spouse or dependent.[889] For purpose of the exclusions, a dependent includes a "qualifying child" or "qualifying relative" as those terms are defined in the Code. A qualifying child is a child, sibling, or stepsibling (or a descendent of such relative) of the employee who (1) has the same principle abode as the employee for more than 6 months of the taxable year, (2) is either under age 19 or under age 24 and a full-time student at an educational institution during at least 5 months of the calendar year, and (3) has not provided more than half of his or her own support for the calendar year.[890] A qualifying relative is an individual who is the employee's close relative,[891] provides less than half of his or her own support for the calendar year, and is not a qualifying child of the employee or any other taxpayer.

Employer-provided group health plans are not required to cover dependents. Many plans do extend coverage to dependents and many plans limit such coverage to dependents whose coverage is excludable from an employee's gross income and wages.

The Code, ERISA and PHSA provide certain rules that a group health plan must satisfy. These rules include limits on the period when a plan is permitted to exclude coverage for pre-existing conditions[892] and a prohibition against plans discriminating among individual employee participants based on health status.[893] Generally, the anti-discrimination requirement prohibits eligibility, for both coverage and benefits, from being based on certain health related factors. The Code imposes an excise tax on a group health plan that fails to satisfy these rules, generally at a rate of $100 per indi-

[887] H.R. 2851. The House Committee on Energy and Commerce reported H. R. 2851 on July 30, 2008 (H. Rept. 110–806). H.R. 2851 passed the House on July 30, 2008, and passed the Senate without amendment on September 25, 2008. The President signed the bill on October 9, 2008.

[888] Secs. 105, 106, 3121(a)(2), 3306(b)(2).

[889] Sec. 105(b). Treas. Reg. sec. 1.106–1.

[890] Sec. 152.

[891] For these purposes, a close relative generally includes the employee's child (including children-in-law and the descendants of children), sibling (including stepsiblings and siblings-in-law), parent or ancestor (including stepparents and parents-in-law), niece or nephew, aunt or uncle, or an individual other than a spouse who has the same principle abode as the employee and is a member of the employee's household.

[892] Sec. 9801.

[893] Sec. 9802.

vidual per day of noncompliance.[894] A group health plan includes a plan of an employer that covers the employer's employees and families.

If a group health plan covers dependents of employee participants, the same rules with respect to pre-existing conditions and discrimination based on health status apply to the dependents. However, distinctions among groups of similarly situated employee participants and dependents in a health plan as to eligibility and benefits are permitted as long as the distinctions are based on bona-fide employment-based classifications consistent with the employer's usual business practice and are not prohibited health based distinctions. In addition, a plan generally may treat employee participants and beneficiaries as two separate groups of similarly situated individuals. Thus, a plan may distinguish between beneficiaries based on, for example, their relationship to the plan participant (such as spouse or dependent child) or based on the age or student status of dependent children.

The Code and ERISA also generally require a group health plan to offer continuation coverage to certain covered individuals in the event of a loss of plan coverage (often referred to as "COBRA coverage"). Specifically, the plan must allow any qualified beneficiary who would lose coverage as a result of a qualifying event to elect, during a specified election period, continuation coverage under the plan. A qualified beneficiary includes an individual who, on the day before a qualifying event is a beneficiary under the plan as the spouse of an employee covered under the plan or as the dependent child of the employee. The Code imposes an excise tax on a group health plan that fails to satisfy the COBRA coverage rules, generally at a rate of $100 per individual per day of noncompliance.[895]

Explanation of Provision

If a dependent child of a participant in a group health plan is eligible for coverage under the plan as a dependent child on the basis of being a student at a postsecondary educational institution, the provision requires the group health plan to continue coverage for the child as a dependent for the period of a medically necessary leave of absence from the educational institution.[896] However, coverage as a dependent during the leave of absence is only required to continue until the earlier of (1) one year after the first day of the leave of absence or (2) the date on which such coverage would otherwise terminate under the terms of the plan (the "required coverage period"). The provision applies if, under the terms of the plan, the child is a dependent who was enrolled in the plan on the basis of being a student at a postsecondary educational institution immediately before the first day of the medically necessary leave of absence. A medically necessary leave of absence is defined as a leave of absence (or any other change in enrollment) from a postsecondary educational institution that (1) begins while the child is suffering from a severe illness or injury, (2) is medically necessary, and (3) causes the child to lose student status for purposes of cov-

[894] Sec. 4980D.
[895] Sec. 4980B.
[896] Sec. 9813.

erage under the terms of the plan. The provision only applies if a certification by the child's treating physician is submitted to the plan stating that the dependent is suffering from a severe illness or injury and that the leave of absence (or change in enrollment) is medically necessary.

During the leave of absence, the child must continue to be entitled to the same benefits as he or she would have been entitled to if he or she had remained a covered student during the period. If, after the first day of the leave of absence but before the end of the required coverage period, the plan sponsor changes the group health plan and the changed coverage continues to cover dependent children, the provision applies in the same manner as if the changed coverage had been the previous coverage.

The provision makes parallel changes to ERISA and PHSA.

Effective Date

The provision is effective for plan years beginning on or after October 9, 2009 (one year after the date of enactment) and applies to medically necessary leaves of absence beginning during such plan years.

PART TWENTY: INMATE TAX FRAUD PREVENTION ACT OF 2008 (PUBLIC LAW 110–428)[897]

Present Law

Section 6103 provides that returns and return information are confidential and may not be disclosed by the IRS, other Federal employees, State employees, and certain others having access to the information except as provided in the Code.[898] A "return" is any tax or information return, declaration of estimated tax, or claim for refund required by, or permitted under, the Code, that is filed with the Secretary by, on behalf of, or with respect to any person.[899] "Return" also includes any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.

The definition of "return information" is very broad and includes any information gathered by the IRS with respect to a person's liability or possible liability under the Code.[900]

However, data in a form that cannot be associated with, or otherwise identify, directly or indirectly a particular taxpayer is not "return information" for section 6103 purposes.

Section 6103 contains a number of exceptions to the general rule of confidentiality, which permit disclosure in specifically identified circumstances when certain conditions are satisfied.[901] For example, the IRS is permitted to make investigative disclosures to the third parties to the extent such disclosure is necessary in obtaining information which is not otherwise reasonably available, with re-

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[897] H.R. 7082. H.R. 7082 passed the House on September 27, 2008, and passed the Senate without amendment on October 2, 2008. The President signed the bill on October 15, 2008.

[898] Sec. 6103(a).

[899] Sec. 6103(b)(1).

[900] Sec. 6103(b)(2). Return information is:

- a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.
- any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 611(b)) which is not open to public inspection under section 6110.
- any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement, and
- any closing agreement under section 7121, and any similar agreement, and any background information related to such an agreement or request for such an agreement.

[901] Sec. 6103(c)–(o). Such exceptions include disclosures by consent of the taxpayer, disclosures to State tax officials, disclosures to the taxpayer and persons having a material interest, disclosures to Committees of Congress, disclosures to the President, disclosures to Federal employees for tax administration purposes, disclosures to Federal employees for nontax criminal law enforcement purposes and to the Government Accountability Office, disclosures for statistical purposes, disclosures for miscellaneous tax administration purposes, disclosures for purposes other than tax administration, disclosures of taxpayer identity information, disclosures to tax administration contractors and disclosures with respect to wagering excise taxes.

spect to the correct determination of tax, liability for tax, the amount to be collected or with respect to the enforcement of any other provision of the Code.

None of the exceptions permit the IRS to refer the tax-related misconduct of specific inmates to prison officials for imposition of administrative sanctions against such individuals. The IRS does publicize information from prosecutions which has been made part of the public record of such proceedings.

Explanation of Provision

The provision permits disclosure to officers and employees of the Federal Bureau of Prisons of return information with respect to prisoners whom the Secretary has determined may have filed or facilitated the filing of false or fraudulent tax returns. The Secretary may disclose only such information as is necessary to permit effective tax administration with respect to prisoners. The disclosure authority does not apply after December 31, 2011.

The provision also requires the IRS to publish and submit to Congress an annual report containing statistics relating to the number of false and fraudulent returns associated with each Federal and State prison and such other information as the Secretary deems appropriate.[902]

The Treasury Inspector General for Tax Administration is to report to Congress on the implementation of the provision not later than December 31, 2010. It is expected that such report will include a description of how the provision has been implemented, an analysis of the effectiveness of the disclosures in preventing or reducing Federal tax fraud by prisoners, and such other information as the Inspector General deems appropriate.

Effective Date

In general, the provision is effective for disclosures made after December 31, 2008. The reporting requirements are effective on the date of enactment (October 15, 2008).

[902] It is assumed that the report will include, to the extent possible, the most current data available.

PART TWENTY-ONE: WORKER, RETIREE, AND EMPLOYER RECOVERY ACT OF 2008 (PUBLIC LAW 110–458)[903]

TITLE I—TECHNICAL CORRECTIONS RELATED TO THE PENSION PROTECTION ACT OF 2006 ("PPA")

A. Technical Corrections to the PPA (secs. 101 through 112 of the PPA)

1. Amendments relating to Title I of the PPA: Reform of the Funding Rules for Single-Employer Defined Benefit Pension Plans

Minimum Funding Standards (PPA secs. 101 and 111)

Prohibition on increases in benefits while a waiver is in effect (ERISA sec. 302(c)(7)(A) and Code sec. 412(c)(7)(A))

The Pension Protection Act of 2006 ("PPA") restates the prior-law provision prohibiting plan amendments that increase benefits while a waiver or amortization extension is in effect or if a retroactive amendment was previously made within a certain period. As under prior law, an exception applies for a plan amendment increasing benefits that only repeals a previously made retroactive amendment. The provision provides that the references to retroactive amendments are limited to those that reduced accrued benefits.

Minimum funding standards (ERISA sec. 302(d)(1) and Code sec. 412(d)(1))

Under the PPA, the Secretary of the Treasury must approve a change in a plan's funding method, valuation date, or plan year. The provision deletes the reference to valuation date because a change in such date is a change in the plan's funding method.

Funding Rules for Single-Employer Defined Benefit Plans (PPA secs. 102 and 112)

Determination of target normal cost (ERISA sec. 303(b), (i) and Code sec. 430(b), (i))

The PPA defines the term "target normal cost" for a plan year as the present value of all benefits which are expected to accrue or be earned under the plan during the plan year. The provision clarifies that a plan's target normal cost is increased by the amount of plan-related expenses expected to be paid from plan assets during the plan year, and is decreased by the amount of mandatory employee contributions expected to be made to the plan during the

[903] H.R. 7327 passed the House on December 10, 2008, and passed the Senate without amendment on December 11, 2008. The President signed the bill on December 23, 2008.

plan year. This clarification is effective for plan years beginning after December 31, 2008, and is elective for the preceding plan year.

Determination of at-risk status (ERISA sec. 303(i)(4)(B) and Code sec. 430(i)(4)(B))

Under the PPA, the 80-percent and 70-percent prongs of the at-risk status definition are based on funded status for the preceding plan year. The PPA provides that determination of the 70-percent prong for 2008 may be determined using methods of estimation provided by the Secretary of the Treasury. The provision applies this rule also for purposes of the 80-percent prong (as phased in under the PPA).

Quarterly contributions (ERISA sec. 303(j)(3)) and Code sec. 430(j)(3))

Under the PPA, quarterly contributions are required if a plan has a funding shortfall for the preceding year. The provision includes a transition rule for the 2008 plan year; under this rule, in the case of plan years beginning in 2008, the funding shortfall for the preceding plan year may be determined using such methods of estimation as the Secretary of the Treasury may provide.

The quarterly installment rules require a higher rate of interest to be charged on required contributions. Small plans are permitted to use a valuation date other than the first day of the plan year. The provision provides that the Secretary of the Treasury is to prescribe rules relating to interest charges and credits in the case of a plan with a valuation date other than the first day of the plan year.

Benefit Limitations under Single-Employer Plans (PPA secs. 103 and 113)

Definition of prohibited payment (ERISA sec. 206(g)(3)(E) and Code sec. 436(d)(5))

The PPA provides that certain underfunded plans may not make prohibited payments, which include accelerated forms of distribution such as lump sums. Present law provides that if the present value of a participant's vested benefit exceeds $5,000,[904] the benefit may not be distributed without the participant's consent. If the vested benefit is less than or equal to this amount, the consent requirement does not apply. The provision provides that the payment of benefits that may be immediately distributed without the consent of the participant is not a prohibited payment.

Small plans (ERISA sec. 206(g)(10) and Code sec. 436(k))

The benefit restriction provisions are based upon a plan's adjusted funding target attainment percentage as of the first day of the plan year. This presents issues for small plans, which are allowed to designate any day of the plan year as their valuation date, because a plan's adjusted funding target attainment percentage

[904] The portion of a participant's benefit that is attributable to amounts rolled over from another plan may be disregarded in determining the present value of the participant's vested benefit.

cannot be determined until the valuation date. The provision provides that the Secretary of the Treasury may prescribe rules for the application of the benefit restrictions which are necessary to reflect the alternate valuation date.

Notice requirement (PPA sec. 103(b) and ERISA sec. 101(j))

The provision provides that the Secretary of the Treasury, in consultation with the Secretary of Labor, has the authority to prescribe rules applicable to the notice of funding-based limitations on distributions required under section 101(j) of ERISA as added by the PPA.

Definition of single employer plan (Code sec. 436(l))

The PPA provides rules under ERISA and the Code that limit the benefits and benefit accruals that can be provided under a single employer plan, depending on the funding level of the plan. The provision adds a definition of the term "single employer plan" for purposes of the limitations in the Code.

Technical and Conforming Amendments (PPA secs. 107 and 114)

The PPA provides for technical and conforming amendments to reflect the new funding rules. The provision provides that the effective date for the amendments to the excise tax on a failure to satisfy the funding rules is taxable years beginning after 2007 and, for the other technical and conforming amendments, plan years beginning after 2007.

Restrictions on Funding of Nonqualified Deferred Compensation Plans by Employers Maintaining Underfunded or Terminated Single-Employer Plans (PPA sec. 116 and Code sec. 409A(b)(3)(A)(ii))

The PPA provides that if, during any restricted period in which a defined benefit pension plan of an employer is in at-risk status, assets are set aside (directly or indirectly) in a trust (or other arrangement as determined by the Secretary of the Treasury), or transferred to such a trust or other arrangement, for purposes of paying deferred compensation of an applicable covered employee, such assets are treated as property transferred in connection with the performance of services (whether or not such assets are available to satisfy the claims of general creditors) under Code section 83.

The PPA further provides that if a nonqualified deferred compensation plan of an employer provides that assets will be restricted to the provision of benefits under the plan in connection with a restricted period (or other similar financial measure as determined by the Secretary of the Treasury) of any defined benefit pension plan of the employer, or assets are so restricted, such assets are treated as property transferred in connection with the performance of services (whether or not such assets are available to satisfy the claims of general creditors) under Code section 83. The provision provides that this rule applies with respect to assets that are restricted under the plan with respect to a covered employee.

2. Amendments relating to Title II of the PPA: Funding Rules for Multiemployer Defined Benefit Plans

Funding Rules for Multiemployer Defined Benefit Plans (PPA secs. 201 and 211)

Shortfall funding method (PPA sec. 201(b))

The PPA provides that a multiemployer plan meeting certain criteria may adopt, use or cease using the shortfall funding method and such adoption, use, or cessation of use is deemed to be approved by the Secretary of the Treasury. One of the criteria is that "the plan has not used the shortfall funding method during the 5-year period ending on the day before the date the plan is to use the method" under the PPA. The provision changes this so that the criterion is that "the plan has not adopted or ceased using the shortfall funding method during the 5-year period ending on the day before the date the plan is to use the method" under the PPA.

Funding Rules for Multiemployer Plans in Endangered or Critical Status (PPA secs. 202 and 212)

Notice requirements (ERISA secs. 305(b)(3)(D), 305(e)(8)(C), and Code secs. 432(b)(3)(D), 432(e)(8)(C))

The PPA requires the plan sponsor of a multiemployer plan to distribute a notice if the plan is in endangered or critical status and if the plan is required to make reductions to adjustable benefits. The provision clarifies that the Secretary of the Treasury, in consultation with the Secretary of Labor, shall provide guidance with respect to the plan sponsor's notice obligations.

Implementation and enforcement of default schedule (ERISA secs. 305(c)(7), 305(e)(3)(C), and Code secs. 432(c)(7), 432(e)(3)(C))

Under the PPA, a default schedule applies if a funding improvement plan or rehabilitation plan is not timely adopted. The provision removes the rule that provides that the default schedule is implemented upon the date on which the Department of Labor certifies that the parties are at impasse. Thus, under the provisions, the plan trustees are required to implement the default schedule within 180 days of the expiration date of the collective bargaining agreement. In addition, the provision clarifies that any failure to make a default schedule contribution is enforceable under sec. 515 of ERISA.

Restriction on payment of lump sums while plan is in critical status (ERISA sec. 305(f)(2)(A) and Code sec. 432(f)(2)(A))

Under the PPA, the payment of accelerated forms of payment, including lump sums, while a plan is in critical status is restricted. Under the provision, the restriction on payment of accelerated forms of payment applies only to participants whose benefit commencement date is after notice of the plan's critical status is provided. This change conforms the rule for multiemployer plans to the rule applicable to single-employer plans.

Definition of plan sponsor (Code sec. 432(i)(9))

The funding rules for multiemployer plans and the excise tax rules that apply in the event of a failure to comply with the funding rules refer to the term "plan sponsor." This term is not defined in the Code. The provision adds a definition to the Code that conforms with the applicable ERISA definition.

Excise tax on trustees for failure to adopt a timely rehabilitation plan (Code sec. 4971(g)(4))

The PPA imposes an excise tax on the sponsor of a multiemployer plan in the event of a failure to timely adopt a rehabilitation plan. Under the PPA, the plan sponsor has a 240 day period in which it must adopt a plan. The excise tax for failure to timely adopt is based on the beginning of this 240 day period, rather than the end of the period. The provision revises the calculation of the excise tax so that it applies to the period beginning on the due date for adoption of the rehabilitation plan.

Effective date of excise tax provisions (PPA sec. 212(e))

The PPA provides that the excise tax provisions relating to a failure to satisfy the multiemployer plan funding rules are effective with respect to plan years beginning after 2007. The provision clarifies that the excise tax provisions are effective with respect to taxable years beginning after 2007.

3. Amendments relating to Title III of the PPA: Interest Rate Provisions

Extension of Replacement of 30-Year Treasury Rates (PPA sec. 301)

The Pension Funding Equity Act of 2004 provided for a temporary interest rate. The Pension Funding Equity Act of 2004 also provided that, if certain requirements were satisfied, plan amendments to reflect such interest rate did not need to be made before the last day of the first plan year beginning on or after January 1, 2006. The PPA extended the temporary interest rate through 2007 and also extended the required amendment date by changing "January 1, 2006" to "January 1, 2008." The provision further extends the required amendment date to conform generally to the amendment period permitted under the PPA.

Interest Rate Assumption for Determination of Lump Sum Distributions (PPA sec. 302 and Code sec. 415(b)(2)(E))

The PPA amended the interest rate and mortality table used in calculating the minimum value of certain optional forms of benefit, such as lump sums. The provision clarifies that the mortality table required to be used in calculating the minimum value of optional forms of benefit is also used in adjusting benefits and limits for purposes of applying the Code section 415 limitation on benefits that may be provided under a defined benefit plan. This clarification of the required mortality table is effective for years beginning after December 31, 2008. However, a plan may elect to use the new

mortality table for years beginning after December 31, 2007, and before January 1, 2009, or for any portion of such a year.

4. Amendments relating to Title IV of the PPA: PBGC Guarantee and Related Provisions

Missing Participants (PPA sec. 410)

Plans covered by missing participant program (ERISA sec. 4050(d))

The PPA extended the prior-law missing participant program to terminating multiemployer plans and to certain plans not subject to the termination insurance program of the Pension Benefit Guaranty Corporation ("PBGC"). Under the provision, the missing participant program applies to plans that have at no time provided for employer contributions. In addition, the provision limits the program to qualified plans.

5. Amendments relating to Title V of the PPA: Disclosure

Defined Benefit Plan Funding Notice and Disclosure of Withdrawal Liability (PPA sec. 501 and ERISA sec. 101(f))

Under the PPA, the administrator of a single employer or a multiemployer defined benefit plan must provide an annual plan funding notice (section 101(f) of ERISA). The provision conforms the measurement dates of several of the items that must be included in the notice and also conforms the information that must be provided by the administrator of a multiemployer plan with respect to the assets and liabilities of the plan to the information that must be provided by the administrator of a single employer plan.

Access to Multiemployer Pension Plan Information (PPA sec. 502 and ERISA secs. 101(k), 101(l), and 4221(e))

Under the PPA, the administrator of a multiemployer plan is required to provide participants and employers copies of certain financial reports prepared by an investment manager, advisor or other fiduciary, upon request (section 101(k) of ERISA). However, the administrator is prohibited from disclosing "any individually identifiable information regarding any plan participant, beneficiary, employee, fiduciary, or contributing employer." The provision clarifies that this prohibition does not prevent the plan from disclosing the identities of the investment managers or advisors, or any other person preparing a financial report (other than an employee of the plan), whose performance is being reported on or evaluated.

Under the PPA, the plan sponsor or administrator of a multiemployer plan must provide upon an employer's request certain information regarding the employer's withdrawal liability with respect to the plan (section 101(l) of ERISA). The provision repeals section 4221(e) of ERISA, which also requires the disclosure upon an employer's request of information relating to the employer's withdrawal liability.

Disclosure of Termination Information to Plan Participants (PPA sec. 506 and ERISA secs. 4041 and 4042)

In the case of an involuntary termination of a plan, the PPA requires the plan sponsor (or administrator) and the PBGC to disclose certain information to affected parties, and special rules apply with respect to the disclosure of confidential information by the plan sponsor (or administrator). Under the provision, these special rules relating to the disclosure of confidential information also apply to the PBGC.

Under the PPA, the plan administrator must provide affected parties with certain information that it has provided to the PBGC. The provision clarifies that this information includes information that the plan administrator is required to disclose to the PBGC at the time the written notice of intent to terminate is given as well as information the plan administrator is required to disclose to the PBGC after the notice of intent to terminate is given.

Periodic Pension Benefit Statements (PPA sec. 508 and ERISA sec. 209(a))

The PPA revises the rules that apply under ERISA with respect to a plan administrator's obligation to provide periodic information relating to a participant's accrued benefits under a plan (section 105 of ERISA). The provision makes conforming changes to section 209 of ERISA, which also imposes recordkeeping and reporting obligations with respect to participant benefits.

Notice to Participants or Beneficiaries of Blackout Periods (PPA sec. 509 and ERISA sec. 101(i)(8)(B))

The Sarbanes-Oxley Act of 2002 amended ERISA to require that participants and beneficiaries of an individual account plan be provided advance notice of a blackout period during which certain plan operations, such as the ability to make investment changes, will be restricted. The notice requirement does not apply to one-participant plans. The PPA amended the definition of one-participant plan to conform to Department of Labor regulations. The PPA, however, did not provide complete conformity with those regulations. The provision amends the PPA so that the definition of one-participant plan for purposes of the notice is in conformity with Department of Labor regulations. Under the provision, a one-participant plan means a retirement plan that on the first day of the plan year: (1) covered only one individual (or the individual and the individual's spouse) and the individual (or the individual and the individual's spouse) owned 100 percent of the plan sponsor (whether or not incorporated), or (2) covered only one or more partners (or partners and their spouses) in the plan sponsor. Thus, under the provision, plans that are not subject to title I of ERISA are not subject to the blackout notice provisions.[905]

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[905] This provision is effective as if included in the Sarbanes-Oxley Act.

6. Amendments relating to Title VI of the PPA: Investment Advice, Prohibited Transactions, and Fiduciary Rules

Prohibited Transaction Rules Relating to Financial Investments (PPA sec. 611, ERISA sec. 408(b)(18)(C), and Code sec. 4975(d)(21)(C))

Under the PPA, an exemption from the prohibited transaction rules of the Code and ERISA applies in the case of foreign exchange transactions between a plan and a bank or broker-dealer if certain requirements are met. Included in the PPA is a requirement that the exchange rate used by the bank or broker-dealer for a particular transaction cannot deviate by more or less than three percent from the interbank bid and asked rates for transactions of comparable size and maturity. Under the provision, the exchange rate cannot deviate by more than three percent.

7. Amendments relating to Title VII of the PPA: Benefit Accrual Standards

Benefit Accrual Standards (PPA sec. 701)

Preservation of capital (ERISA sec. 204(b)(5)(B)(i)(II) and Code sec. 411(b)(5)(B)(i)(II))

The PPA prohibits an applicable defined benefit plan account balance from being reduced below the aggregate amount of contributions. Under the provision, failure to comply with this rule is treated as a violation of the age discrimination rules under ERISA or the Code, as applicable.

Application of present-value rules (ERISA sec. 203(f)(1)(B) and Code sec. 411(a)(13)(A)(ii))

The PPA permits an applicable defined benefit plan to distribute a participant's accrued benefit under the plan in an amount equal to the participant's hypothetical account balance under the plan without violating the present-value rules of ERISA section 205(g) and Code section 417(e). ERISA section 203(e) and Code section 411(a)(11), which allow automatic cash-outs of amounts not exceeding $5,000, apply the section 205(g) and section 417(e) present-value rules by cross-reference. The provision adds cross-references to apply the new ERISA and Code provisions for purposes of ERISA section 203(e) and Code section 411(a)(11).

Effective date (PPA sec. 701(e))

The general effective date under PPA section 701(e)(1) is periods beginning on or after June 29, 2005, and special effective dates are provided for certain provisions. The provision provides that the vesting provisions under PPA section 701 are effective on the basis of plan years and that the vesting provisions apply with respect to participants with an hour of service after the applicable effective date for a plan.

The PPA established interest credit requirements for applicable defined benefit plans, which, under the general effective date, would apply to periods beginning on or after June 29, 2005. PPA section 701(e)(3) provides that, in the case of a plan in existence

on June 29, 2005, the new interest credit rules apply to years beginning after December 31, 2007, unless the employer elects to apply them for any period beginning after June 29, 2005, and before the rules would otherwise apply. The provision changes this rule so that it refers to any period beginning "on or after" June 29, 2005.

The PPA established rules with respect to a conversion of a plan into an applicable defined benefit plan. PPA section 701(e)(5) provides that these rules are applicable to plan amendments adopted after, and taking effect after, June 29, 2005. Similarly, ERISA section 204(b)(5)(B)(ii) and Code section 411(b)(5)(B)(ii) apply the conversion rules to conversion amendments adopted after June 29, 2005. The provision clarifies that the effective date for the conversion rules is on or after June 29, 2005.

The PPA establishes a special effective date for the vesting and interest crediting requirements for applicable defined benefit plans in the case of a collectively bargained plan. The provision clarifies that these rules do not apply to plan years beginning before the earlier of: (1) the later of the termination of the collective bargaining agreement or January 1, 2008, or (2) January 1, 2010.

8. Amendments relating to Title VIII of the PPA: Pension Related Revenue Provisions

Deduction Limitations (PPA secs. 801 and 803)

Increase in deduction limit for single-employer plans (PPA sec. 801 and Code sec. 404)

If an employer sponsors one or more defined benefit plans and one or more defined contribution plans that cover at least one of the same employees, an overall deduction limitation applies to the total contributions to all plans for a plan year. The overall deduction limit is generally the greater of (1) 25 percent of compensation or (2) the amount necessary to meet the minimum funding requirement of the defined benefit plan for the plan year. Under the PPA, in the case of a single-employer plan not covered by the PBGC, the combined plan limit is not less than the plan's funding shortfall as determined under the funding rules. Under the provision, in the case of a single-employer plan not covered by the PBGC, the combined plan limit is not less than the excess (if any) of the plan's funding target over the value of the plan's assets.

Updating deduction rules for combination of plans (PPA sec. 803 and Code sec. 404(a)(7))

If an employer sponsors one or more defined benefit plans and one or more defined contribution plans that cover at least one of the same employees, an overall deduction limitation applies to the total contributions to all plans for a plan year. The overall deduction limit is generally the greater of (1) 25 percent of compensation or (2) the amount necessary to meet the minimum funding requirement of the defined benefit plan for the plan year. The PPA provides that the overall deduction limit applies to contributions to one or more defined contribution plans only to the extent that such contributions exceed six percent of compensation. IRS guidance takes the position that if defined contribution plan contributions

are less than six percent of compensation, contributions to the defined benefit plan are still subject to limitation of the greater of 25 percent of compensation or the minimum required contribution.[906] The provision provides that if defined contributions are less than six percent of compensation, the defined benefit plan is not subject to the overall deduction limit. If defined contributions exceed six percent of compensation, only defined contributions in excess of six percent are counted toward the overall deduction limit.

Improvements in Portability, Distributions, and Contribution Rules (PPA secs. 824 and 829)

Allow direct rollovers from retirement plans to Roth IRAs (PPA sec. 824 and Code sec. 408A(c)(3)(B), (d)(3)(B))

The PPA permits distributions from tax-qualified retirement plans, tax-sheltered annuities, and governmental 457 plans to be rolled over directly from such plan into a Roth IRA, subject to certain conditions. Such conditions include recognition of the distribution in gross income (except to the extent it represents a return of after-tax contributions) and phase-out of the ability to perform such a rollover pursuant to the distributee's adjusted gross income. The provision provides that a rollover from a Roth designated account in a tax-qualified retirement plan or tax-sheltered annuity (described in section 402A of the Code) to a Roth IRA is not subject to the gross income inclusion and adjusted gross income conditions.

Allow rollovers by nonspouse beneficiaries of certain retirement plan distributions (PPA sec. 829 and Code sec. 402(c)(11), (f)(2)(A))

The PPA permits rollovers of benefits of nonspouse beneficiaries from qualified plans and similar arrangements. The provision clarifies that the current law treatment with respect to a trustee-to-trustee transfer from an inherited IRA to another inherited IRA continues to apply. Under the provision, effective for plan years beginning after December 31, 2009, rollovers by nonspouse beneficiaries are generally subject to the same rules as other eligible rollovers.

Health and Medical Benefits (PPA secs. 841 and 845)

Use of excess pension assets for future retiree health benefits and collectively bargained retiree health benefits (PPA sec. 841 and Code sec. 420)

In the case of a section 420 transfer, present law requires the funded status of the defined benefit plan to be maintained by employer contributions or asset transfers from the health accounts. Under the provision, asset transfers from the health accounts to maintain the plan's funded status are not subject to the excise tax on reversions.

The provision also allows assets transferred to a health benefits account in a qualified section 420 transfer to be used to pay health liabilities in excess of current-year retiree health liabilities. In the case of a qualified future transfer, assets may be used to pay quali-

[906] Notice 2007–28, 2007–14 I.R.B. 880.

fied current retiree health liabilities which the plan reasonably estimates will be incurred. In the case of a collectively bargained transfer, assets may be used to pay collectively bargained retiree health liabilities.

Distributions from governmental retirement plans for health and long-term care insurance for public safety officers (PPA sec. 845 and Code sec. 402(l))

The PPA provides an exclusion from gross income for up to $3,000 annually for certain pension distributions used to pay for qualified health insurance premiums. Under IRS Notice 2007–7,[907] Q&A 23, the exclusion applies only to insurance issued by an insurance company regulated by a State (including a managed care organization that is treated as issuing insurance) and thus does not apply to self-insured plans. Under the provision, the exclusion applies to coverage under an accident or health plan (rather than accident or health insurance). That is, the exclusion applies to self-insured plans as well as to insurance issued by an insurance company.

Under the provision, when determining the portion of a distribution that would otherwise be includible in income, the otherwise includible amount is determined as if all amounts to the credit of the eligible public safety officer in all eligible retirement plans were distributed during the taxable year. The provision also clarifies that the income exclusion only applies with respect to distributions from the plan (or plans) maintained by the employer from which the individual retired as a public safety officer.

United States Tax Court Modernization (PPA secs. 854 and 856)

Annuities to surviving spouses and dependent children of special trial judges (PPA sec. 854, Code sec. 3121(b)(5)(E), and Social Security Act sec. 210(a)(5)(E))

Under the PPA, participation in the survivor annuity program for survivors of judges of the United States Tax Court is extended to special trial judges of the United States Tax Court, and conforming changes are made to various provisions of the Code. One of the conforming changes is to specify that employment for purposes of the Federal Insurance Contributions Act ("FICA") includes service performed as a special trial judge of the United States Tax Court. Under the provision, this conforming amendment is repealed. Thus, the provision provides that employment as a special trial judge of the United States Tax Court is covered employment for purposes of FICA under the rules that otherwise apply to Federal employees.

Provisions for recall (PPA sec. 856 and Code Sec. 7443B)

The PPA provides for rules regarding the temporary recall to judicial duties of retired special trial judges of the United States Tax Court and the compensation of such judges during the period of recall. The provision repeals these rules.

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[907] 2007–5 I.R.B. 395. In anticipation of technical corrections, the IRS issued Notice 2007–99, 2007–43 I.R.B. 896.

9. Amendments relating to Title IX of the PPA: Increase in Pension Plan Diversification and Participation and Other Pension Provisions

Defined Contribution Plans Required to Provide Employees with Freedom to Invest Their Plan Assets (PPA sec. 901 and Code sec. 401(a)(35)(E))

Under the PPA, the diversification requirements do not apply with respect to a one-participant retirement plan. The provision conforms the Code's definition of the term "one-participant retirement plan" to the definition of the term under ERISA.

Increasing Participation through Automatic Contribution Arrangements (PPA sec. 902 and Code sec. 414(w))

The PPA provides rules permitting an employee to withdraw certain amounts (referred to as "permissible withdrawals") in the case of an eligible automatic contribution arrangement under an applicable employer plan. The provision repeals the requirement that an eligible automatic contribution arrangement satisfy, in the absence of a participant investment election, the requirements of ERISA section 404(c)(5) (which generally authorizes the Secretary of Labor to issue regulations under which a participant is treated as exercising control over the assets in the participant's account under a plan with respect to default investments). The provision also extends the permissible withdrawal rules to SIMPLE IRAs (Code sec. 408(p)) and SARSEPs (Code sec. 408(k)(6)). The provision also provides that a permissive withdrawal is disregarded for purposes of applying the annual limitation on elective deferrals that applies to a taxpayer under Code section 402(g)(1).

The PPA also provides that, in the case of a distribution of an excess contribution and income allocable to such contribution in order to satisfy the rules relating to a qualified cash or deferral arrangement under Code section 401(k) (or the similar distribution rules under Code section 401(m) in the case of excess aggregate contributions relating to matching contributions or employee contributions), the income that must be distributed is the income allocable to the excess contribution (or excess aggregate contribution) through the end of the year for which the distribution is made. The provision applies this limit on the amount of income that must be distributed to the rules that apply to the distribution of excess deferrals and allocable income under Code section 402(g).

Treatment of Eligible Combined Defined Benefit Plans and Qualified Cash or Deferred Arrangements (PPA sec. 903, Code sec. 414(x)(1), and ERISA sec. 210(e))

Under the PPA, a qualified employer may establish a combined plan that consists of a defined benefit plan and a qualified cash or deferral arrangement described in Code section 401(k), provided that certain requirements are satisfied. The PPA also provides that the rules of ERISA are applied to the defined benefit component and the individual account component of a combined plan in the same manner as if each component were not part of the combined plan. Thus, for example, the defined benefit component of the combined plan may be subject to the insurance program in Title IV of

ERISA, while the individual account component is not. The provision provides that in the case of a termination of a combined plan, the individual account and defined benefit components must be terminated separately.

10. Amendments relating to Title X of the PPA: Spousal Pension Protection Provisions

Extension of Tier II Railroad Retirement Benefits to Surviving Former Spouses (PPA sec. 1003)

The PPA provides rules relating to the survivor benefits payable under the Railroad Retirement Act. The provision clarifies that a former spouse has an independent entitlement to immediate commencement of benefits if three conditions are satisfied. First, the employee must have completed 10 years of service in the railroad industry (or five years of service after December 31, 1995); second, the spouse or former spouse must have attained age 62; and third, the employee must have attained age 62. In addition, the provision provides that a former spouse's Tier II benefits under the Railroad Retirement Act continue after the death of the employee. The provision is effective for payments due for months after August, 2007.

11. Amendments relating to Title XI of the PPA: Administrative Provisions

No Reduction in Unemployment Compensation as a Result of Pension Rollovers (PPA sec. 1105)

Under present law, unemployment compensation payable by a State to an individual generally is reduced by the amount of retirement benefits received by the individual. Under the PPA, rollover contributions are not included in retirement payments for which States are required to reduce unemployment compensation under Federal law, however, States are not prohibited from reducing unemployment compensation by such rollover contributions. Under the provision, unemployment compensation payable by a State to an individual may not be reduced by the amount of a rollover contribution.

B. Other Provisions

1. Amendments Related to Sections 102 and 112 of the Pension Protection Act of 2006 (sec. 121 of the Act and sec. 430(g)(3)(B) of the Code)

Present Law

In the case of a single-employer defined benefit pension plan, the PPA provides new rules for determining minimum required contributions that must be made to fund the plan.[908] In general, the minimum required contribution to a single-employer defined benefit pension plan for a plan year depends on a comparison of the value of the plan's assets as of the beginning of the plan year with

[908] The Code and ERISA contain parallel minimum funding rules.

the plan's funding target and the plan's target normal cost.[909] The plan's funding target for a plan year is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan's target normal cost for a plan year is the present value of benefits expected to accrue or be earned during the plan year. In general, a plan has a funding shortfall for a plan year if the plan's funding target for the year exceeds the value of the plan's assets. In such a case, the minimum required contribution for the plan year generally is equal to the sum of the plan's target normal cost for the year and a portion of the funding shortfall for that year and prior plan years.[910]

Under the PPA's minimum funding rules, the value of plan assets generally is the fair market value of the assets. However, the value of plan assets may be determined on the basis of the averaging of fair market values, but only if such method: (1) is permitted under regulations; (2) does not provide for averaging of fair market values over more than the period beginning on the last day of the 25th month preceding the month in which the plan's valuation date occurs and ending on the valuation date; and (3) does not result in a determination of the value of plan assets that at any time is less than 90 percent or more than 110 percent of the fair market value of the assets at that time. The PPA's rules also provide that any averaging must be adjusted for contributions to the plan and distributions to participants as provided by the Secretary of the Treasury.

Proposed regulations have been issued that permit the value of plan assets to be determined on the basis of averaging.[911] Under the proposed regulations, the average value of plan assets generally is increased for contributions that are included in the last valuation date during the averaging period but that were not included in the prior valuation dates during the averaging period. Similarly, the average value generally is decreased for distributions included in the last valuation date during the averaging period but that were not included in the prior valuation dates during the averaging period.

Explanation of Provision

The provision provides that, in determining the value of a plan's assets under the averaging method, such averaging will be adjusted for expected earnings as specified by the Secretary of the Treasury. Such an adjustment is in addition to the present law adjustments for contributions and distributions. Expected earnings are to be determined by a plan's actuary on the basis of an assumed earnings rate for the plan that is specified by the actuary.

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[909] A plan with 100 or fewer participants is permitted to designate any day during the plan year as its valuation date for purposes of the minimum funding rules.

[910] A shortfall amortization base is generally established for each year for which a plan has a funding shortfall, and each base is amortized over a seven-year period. The base is generally comprised of the funding shortfall for that year, less the present value of shortfall amortization installments that apply to the current year and succeeding years on account of prior-year shortfall amortization bases. The aggregate of the shortfall amortization installments for the current plan year is referred to as the shortfall amortization charge, and this charge is added to the plan's target normal cost in determining the minimum required contribution.

[911] 72 F.R. 74215 (December 31, 2007).

The assumed earnings rate specified by the actuary cannot exceed the applicable third segment rate.[912]

Effective Date

The provision is effective as if included in the PPA.

2. Modification of interest rate assumption required with respect to certain small employer plans (sec. 122 of the Act and sec. 415(b)(2)(E) of the Code)

Present Law

Annual benefits payable under a defined benefit pension plan generally may not exceed the lesser of (1) 100 percent of average compensation, or (2) $185,000 (for 2008).[913] The dollar limit generally applies to a benefit payable in the form of a straight life annuity. If the benefit is not in the form of a straight life annuity (e.g., a lump sum), the benefit generally is adjusted to an equivalent straight life annuity. For purposes of adjusting a benefit in a form that is subject to the minimum value rules, such as a lump-sum benefit, the interest rate used generally must be not less than the greater of: (1) 5.5 percent; (2) the rate that provides a benefit of not more than 105 percent of the benefit that would be provided if the rate (or rates) applicable in determining minimum lump sums were used; or (3) the interest rate specified in the plan.

Explanation of Provision

Under the provision, in the case of a plan maintained by an eligible employer, the interest rate used in adjusting a benefit in a form that is subject to the minimum value rules generally must be not less than the greater of: (1) 5.5 percent; or (2) the interest rate specified in the plan. The term eligible employer is defined in the same manner as under section 408(p) (describing an employer which is eligible to sponsor a SIMPLE plan).[914] Thus, for any year, the term means an employer which had no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year. An eligible employer who maintains a defined benefit pension plan for one or more years and who fails to be an eligible employer in a subsequent year is treated as an eligible employer for the two years following the last year the employer was an eligible employer (provided that the reason for failure to qualify is not due to an acquisition, disposition, or similar transaction involving the eligible employer).

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[912] The minimum funding rules specify the interest rates that must be used in determining a plan's target normal cost and funding target. Under the rules, present value generally is determined using three interest rates, each of which applies to benefit payments expected to be made from the plan during a certain period. The third segment rate applies to benefits reasonably determined to be payable after the end of the 20-year period that applies to the first and second segment rates. Each segment rate is a single interest rate determined by the Secretary of the Treasury on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period. The yield curve used by the Secretary is based on yields on investment grade corporate bonds that are in the top three quality levels available.

[913] Sec. 415(b)(1).

[914] Sec. 408(p)(1)(D).

Effective Date

The provision is effective for years beginning after December 31, 2008.

3. Determination of market rate of return for governmental plans (sec. 123 of the Act and sec. 4(i) of ADEA)

Present Law

The PPA amended the Code, ERISA, and ADEA, to provide for parallel age discrimination rules in the case of an applicable defined benefit plan. Included among the rules is a requirement relating to interest credits provided under such a plan. Under the PPA, an applicable defined benefit plan is a defined benefit pension plan under which the accrued benefit (or any portion thereof) is calculated as the balance of a hypothetical account maintained for the participant or as an accumulated percentage of the participant's final average compensation. The PPA also provides that the Secretary of the Treasury is to provide rules which include in the definition of an applicable defined benefit plan any defined benefit plan (or portion of such a plan) which has an effect similar to an applicable defined benefit plan.

Under the parallel Code, ERISA, and ADEA rules, an applicable defined benefit plan satisfies the interest credit requirement if the terms of the plan provide that any interest credit (or equivalent amount) for any plan year is at a rate that is not greater than a market rate of return. The PPA also provides that an interest rate (or equivalent amount) of less than zero shall in no event result in a hypothetical account balance or similar amount being less than the aggregate amount of hypothetical contributions credited to the account. The PPA provides that the Secretary of the Treasury may provide rules governing the calculation of a market rate of return and for permissible methods of crediting interest to the account (including fixed or variable interest rates) resulting in effective rates of return that meet the requirements of the provision. The Code and ERISA rules do not apply in the case of an applicable defined benefit plan that is a governmental plan. A governmental plan is generally defined for this purpose as a plan that is established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing.[915]

In the case of a plan in existence on June 29, 2005, the interest credit requirements for an applicable defined benefit plan generally apply to years beginning after December 31, 2007. In the case of a plan maintained pursuant to one or more collective bargaining agreements, a delayed effective date applies.

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[915] Sec. 414(d). The definition of governmental plan in section 414(d) has three provisions. The first provision includes any plan that is established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing. The second provision relates to certain Railroad Retirement Act plans and plans of international organizations. The third provision relates to any plan maintained by an Indian tribal government or political subdivision thereof, or by an agency or instrumentality of any of an Indian tribal government.

Explanation of Provision

Under the provision, ADEA is amended to provide that, in the case of a governmental plan, a rate of return or method of crediting interest that is established pursuant to any provision of Federal, State, or local law (including any administrative rule or policy adopted in accordance with any such law) is generally treated as a market rate of return and as a permissible method of crediting interest for purposes of the PPA's interest credit requirement.[916] This special treatment does not apply, however, if the rate of return or method of crediting interest violates another requirement of ADEA (other than the interest credit requirement).

Effective Date

The provision is effective as if included in the PPA.

4. Treatment of certain reimbursements from governmental plans for medical care (sec. 124 of the Act and sec. 105 of the Code)

Present Law

The gross income of an employee generally does not include employer-provided coverage under an accident or health plan. With respect to amounts received under such a plan, section 105(a) provides that such amounts are includible in gross income to the extent (1) such amounts are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer. Notwithstanding this general inclusion rule, section 105(b) provides that gross income does not include amounts received if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for medical care expenses of the taxpayer, the taxpayer's spouse, or the taxpayer's dependents.[917]

In Revenue Ruling 2006–36,[918] the Internal Revenue Service held that amounts paid to an employee under a medical expense reimbursement plan are not excludible from an employee's gross income if the plan permits amounts to be paid as medical benefits to a designated beneficiary, other than the employee's spouse or dependents. Thus, under the ruling, none of the amounts paid by such a plan to any person, including reimbursements of medical expenses of the employee, the employee's spouse, or the employee's dependents, are excludible.

Explanation of Provision

The provision provides that, for purposes of section 105(b), amounts paid (directly or indirectly) to a taxpayer from a specified health plan shall not fail to be excluded from gross income solely

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[916] The definition of governmental plan for purposes of this provision only includes a plan that is established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing.

[917] As defined in section 152, but determined without regard to sections (b)(1), (b)(2), and (d)(1)(B).

[918] 2006–2 C.B. 353. The ruling is effective for plan years beginning after December 31, 2008, in the case of plans including certain reimbursement provisions on or before August 14, 2006.

because the plan provides for reimbursements of health care expenses of a deceased plan participant's beneficiary. In order for the provision to apply, the plan must have provided for reimbursement of a deceased participant's beneficiary on or before January 1, 2008. A specified plan is an accident or health plan that is funded by a medical trust that is established in connection with a public retirement system if such trust (1) has been authorized by a State legislature; or (2) has received a favorable ruling from the Internal Revenue Service that the trust's income is not includible in gross income under section 115 (providing an exclusion from gross income for States and their political subdivisions).

Effective Date

The provision is effective with respect to payments made before, on, or after enactment.

5. Rollover of amounts received in airline carrier bankruptcy to Roth IRAs (sec. 125 of the Act)

Present Law

The Code provides for two types of individual retirement arrangements ("IRAs"): traditional IRAs and Roth IRAs.[919] In general, contributions (other than a rollover contribution) to a traditional IRA may be deductible, and distributions from a traditional IRA are includible in gross income to the extent not attributable to a return of nondeductible contributions. In contrast, contributions to a Roth IRA are not deductible, and qualified distributions from a Roth IRA are excludable from gross income. Distributions from a Roth IRA that are not qualified distributions are includible in gross income to the extent attributable to earnings. In general, a qualified distribution is a distribution that is made on or after the individual attains age 59½, death, or disability or which is a qualified special purpose distribution.

The total amount that an individual may contribute to one or more IRAs for a year is generally limited to the lesser of: (1) a dollar amount ($5,000 for 2008); or (2) the amount of the individual's compensation that is includible in gross income for the year. As under the rules relating to traditional IRAs, a contribution of up to the dollar limit for each spouse may be made to a Roth IRA provided the combined compensation of the spouses is at least equal to the contributed amount. The maximum annual contribution that can be made to a Roth IRA is phased out for taxpayers with adjusted gross income for the taxable year over certain indexed levels. The adjusted gross income phase-out ranges for 2008 are: (1) for single taxpayers, $101,000 to $116,000; (2) for married taxpayers filing joint returns, $159,000 to $169,000; and (3) for married taxpayers filing separate returns, $0 to $10,000.

The foregoing contribution limitations for IRAs do not apply in the case of a rollover contribution to an IRA. If certain requirements are satisfied, a participant in an employer-sponsored qualified plan (which includes a tax-qualified retirement plan described

[919] Traditional IRAs are described in section 408, and Roth IRAs are described in section 408A.

in section 401(a), an employee retirement annuity described in section 403(a), a tax-sheltered annuity described in section 403(b), and a governmental section 457(b) plan) or a traditional IRA may roll over distributions from the plan, annuity or IRA into another plan, annuity or IRA. For distributions after December 31, 2007, certain taxpayers also are permitted to make rollover contributions into a Roth IRA (subject to inclusion in gross income of any amount that would be includible were it not part of the rollover contribution).

Explanation of Provision

Under the provision, a qualified airline employee may contribute any portion of an airline payment amount to a Roth IRA within 180 days of receipt of such amount (or, if later, within 180 days of enactment of the provision). Such a contribution is treated as a qualified rollover contribution to the Roth IRA. Thus, the portion of the airline payment amount contributed to the Roth IRA is includible in gross income to the extent that such payment would be includible were it not part of the rollover contribution.

Under the provision, an airline payment amount is defined as any payment of any money or other property payable by a commercial passenger airline to a qualified airline employee: (1) under the approval of an order of a Federal bankruptcy court in a case filed after September 11, 2001, and before January 1, 2007; and (2) in respect of the qualified airline employee's interest in a bankruptcy claim against the airline carrier, any note of the carrier (or amount paid in lieu of a note being issued), or any other fixed obligation of the carrier to pay a lump sum amount. An airline payment amount shall not include any amount payable on the basis of the carrier's future earnings or profits. In determining the amount that may be contributed to a Roth IRA under the provision, any reduction in the airline payment amount on account of employment tax withholding is disregarded. A qualified airline employee is an employee or former employee of a commercial passenger airline carrier who was a participant in a defined benefit plan maintained by the carrier which (1) is qualified under section 401(a) and (2) was terminated or became subject to the benefit accrual and other restrictions applicable to plans maintained by commercial passenger airlines pursuant to paragraphs 402(b)(2) and (3) of the PPA.

The provision also requires certain information reporting to the Secretary of Treasury and qualified airline employees with respect to airline payment amounts within 90 days of such payment (or if later, within 90 days of enactment of this provision)

Effective Date

The proposal is effective with respect to contributions to a Roth IRA made after enactment with respect to airline payment amounts paid before, on, or after such date.

6. Determination of asset value for special airline funding rules (sec. 126 of the Act and sec. 402 of the PPA)

Present Law

The PPA provides for special minimum funding rules for certain eligible plans. For purposes of the rules, an eligible plan is a single-employer defined benefit pension plan sponsored by an employer that is a commercial passenger airline or the principal business of which is providing catering services to a commercial passenger airline.

The plan sponsor of an eligible plan may make one of two alternative elections. In the case of a plan that meets certain benefit accrual and benefit increase restrictions, an election allowing a 17-year amortization of the plan's unfunded liability is available, with the minimum required contribution being determined under a special method. A plan that does not meet such requirements may elect to use a 10-year amortization period in amortizing the plan's shortfall amortization base for the first taxable year beginning in 2008.

The employer may select either a plan year beginning in 2006 or 2007 as the first plan year to which the 17-year amortization period election applies. Under the special method applicable to a plan that elects the 17-year amortization period, the minimum required contribution for any applicable plan year during the amortization period is the amount required to amortize the plan's unfunded liability, determined as of the first day of the plan year, in equal annual installments over the remaining amortization period. For this purpose, the amortization period is the 17-plan-year period beginning with the first applicable plan year. Thus, the annual amortization amount is redetermined each year, based on the plan's unfunded liability at that time and the remainder of the amortization period. For any plan years beginning after the end of the amortization period, the plan is subject to the generally applicable minimum funding rules (as provided under the PPA, including the benefit limitations applicable to underfunded plans).

For purposes of the 17-year amortization period election, a plan's unfunded liability is the unfunded accrued liability under the plan, determined under the unit credit funding method and a rate of interest of 8.85 percent is used in determining the plan's accrued liability. In addition, the value of plan assets used must be the fair market value.

Explanation of Provision

Under the provision, the value of plan assets for purposes of determining the minimum required contribution of an eligible employer under the 17-year amortization period election may be determined under a valuation method that is permissible under the minimum funding rules applicable to a single-employer defined benefit pension plan that is not sponsored by an eligible employer. Thus, the value of plan assets may be determined as fair market value or on the basis of the averaging method specified in section 430(g)(3) of the Code and section 303(g)(3) of ERISA.

Effective Date

The provision is effective for plan years beginning after December 31, 2007.

7. Modification of penalty for failure to file partnership returns (sec. 127 of the Act and sec. 6698 of the Code)

Present Law

A partnership generally is treated as a pass-through entity. Income earned by a partnership, whether distributed or not, is taxed to the partners. Distributions from the partnership generally are tax-free. The items of income, gain, loss, deduction or credit of a partnership generally are taken into account by a partner as allocated under the terms of the partnership agreement. If the agreement does not provide for an allocation, or the agreed allocation does not have substantial economic effect, then the items are to be allocated in accordance with the partners' interests in the partnership. To prevent double taxation of these items, a partner's basis in its interest is increased by its share of partnership income (including tax-exempt income), and is decreased by its share of any losses (including nondeductible losses).

Under present law, a partnership is required to file a tax return for each taxable year. The partnership's tax return is required to include the names and addresses of the individuals who would be entitled to share in the taxable income if distributed and the amount of the distributive share of each individual. In addition to applicable criminal penalties, present law imposes an assessable civil penalty for the failure to timely file a partnership return. The penalty generally is $85 per partner for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months for returns required to be filed after December 20, 2007.

Explanation of Provision

Under the provision, the penalty for failure to file partnership returns is increased by $4 per partner.

Effective Date

The provision applies to returns required to be filed after December 31, 2008.

8. Modification of penalty for failure to file S corporation returns (sec. 128 of the Act and sec. 6699 of the Code)

Present Law

In general, an S corporation is not subject to corporate-level income tax on its items of income and loss. Instead, an S corporation passes through its items of income and loss to its shareholders. The shareholders take into account separately their shares of these items on their individual income tax returns.

Under present law, S corporations are required to file a tax return for each taxable year. The S corporation's tax return is required to include the following: the names and addresses of all persons owning stock in the corporation at any time during the tax-

able year; the number of shares of stock owned by each shareholder at all times during the taxable year; the amount of money and other property distributed by the corporation during the taxable year to each shareholder and the date of such distribution; each shareholder's pro rata share of each item of the corporation for the taxable year; and such other information as the Secretary may require.

Present law imposes an assessable monthly penalty for any failure to timely file an S corporation return or any failure to provide the information required to be shown on such a return. The penalty is $85 times the number of shareholders in the S corporation during any part of the taxable year for which the return was required, for each month (or a fraction of a month) during which the failure continues, up to a maximum of 12 months.

Explanation of Provision

Under the provision, the penalty for failure to file S corporation returns is increased by $4 per shareholder.

Effective Date

The provision applies to returns required to be filed after December 31, 2008.

TITLE II—PENSION PROVISIONS RELATING TO ECONOMIC CRISIS

A. Temporary Waiver of Required Minimum Distribution Rules for Certain Retirement Plans and Accounts (sec. 201 of the Act and sec. 401(a)(9) of the Code)

Present law

Required minimum distributions

Employer-provided qualified retirement plans and individual retirement accounts and annuities (IRAs) are subject to required minimum distribution rules. A qualified retirement plan for this purpose means a tax-qualified plan described in section 401(a) (such as a defined benefit pension plan or a section 401(k) plan), employee retirement annuities described in section 403(a), tax-sheltered annuities described in section 403(b), and a plan described in section 457(b) that is maintained by a governmental employer.[920] An employer-provided qualified retirement plan that is a defined contribution plan is a plan which provides (1) an individual account for each participant and (2) for benefits based on the amount contributed to the participant's account, and any income, expenses, gains, losses, and forfeitures of accounts of other participants which may be allocated to such participant's account.[921]

Required minimum distributions generally must begin by April 1 of the calendar year following the later of the calendar year in which the individual (employee or IRA owner) reaches age 70½. However, in the case of an employer-provided qualified retirement plan, the required minimum distribution date for an individual who is not a 5-percent owner of the employer maintaining the plan is delayed to April 1 of the year following the year in which the individual retires.

For IRAs and defined contributions plans, the required minimum distribution for each year generally is determined by dividing the account balance as of the end of the prior year by a distribution period,[922] generally a number in the uniform lifetime table.[923] This table is based on joint life expectancies of the individual and a hypothetical beneficiary 10 years younger than the individual. For an individual with a spouse as designated beneficiary who is more than 10 years younger (and thus the number of years in the couple's joint life expectancy is greater than the uniform life time table), the joint life expectancy of the couple is used. There are spe-

[920] The required minimum distribution rules also apply to section 457(b) plans maintained by tax-exempt employers other than governmental employers.
[921] Sec. 414(i).
[922] Treas. Reg. sec. 1.401(a)(9)–5.
[923] Treas. Reg. sec. 1.401(a)(9)–9.

cial rules in the case of annuity payments from an insurance contract.

If an individual dies on or after the individual's required beginning date, the required minimum distribution is also determined by dividing the account balance as of the end of the prior year by a distribution period. The distribution period is equal to the remaining years of the beneficiary's life expectancy or, if there is no designated beneficiary, a distribution period equal to the remaining years of the deceased individual's single life expectancy, using the age of the deceased individual in the year of death.[924]

In the case of an individual who dies before the individual's required beginning date, there are two methods for satisfying the after death required minimum distribution rules, the life expectancy rule or the five year rule. Under the life expectancy rule, annual required minimum distributions must begin no later than December 31 of the calendar year immediately following the calendar year in which the individual died. This rule is only available if the designated beneficiary is an individual (e.g., not the individual's estate or a charity). If the designated beneficiary is the individual's spouse, commencement of distributions can be delayed until December 31 of the calendar year in which the deceased individual would have attained age 70½. The required minimum distribution for each year is also determined by dividing the account balance as of the end of the prior year by a distribution period, which is determined by reference to the beneficiary's life expectancy.[925] Under the five-year rule, the individual's entire account must be distributed no later than December 31 of the calendar year containing the fifth anniversary of the individual's death.[926]

A special after-death rule applies for an IRA if the beneficiary of the IRA is the surviving spouse. The surviving spouse is permitted to choose to calculate required minimum distributions while the spouse is alive, and after the spouse's death, as though the spouse is the IRA owner, rather than a beneficiary.

Roth IRAs are not subject to the minimum distribution rules during the IRA owner's lifetime. However, Roth IRAs are subject to the post-death minimum distribution rules that apply to traditional IRAs. For Roth IRAs, the IRA owner is treated as having died before the individual's required beginning date. Thus only the life expectancy rule and the five year rule apply.

Failure to make a required minimum distribution triggers a 50-percent excise tax, payable by the individual or the individual's beneficiary. The tax is imposed during the taxable year that begins with or within the calendar year during which the distribution was required.[927]

The tax may be waived if the distribution did not occur because of reasonable error and reasonable steps are taken to remedy the violation.[928]

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[924] Treas. Reg. sec. 1.401(a)(9)–5, A–5(a).
[925] Treas. Reg. sec. 1.401(a)(9)–5, A–5(b).
[926] Treas. Reg. sec. 1.401(a)(9)–3, Q&As 1, 2.
[927] Sec. 4974(a).
[928] Sec. 4974(d).

Eligible rollover distributions

With certain exceptions, distributions from an employer-provided qualified retirement plan are eligible to be rolled over tax free into another employer-provided qualified retirement plan or an IRA. This can be achieved by contributing the amount of the distribution to the other plan or IRA within 60 days of the distribution, or by a direct payment by the plan to the other plan or IRA (referred to as a "direct rollover"). Distributions that are not eligible for rollover include (i) any distribution that is one of a series of periodic payments generally for a period of 10 years or more (or, if a shorter period, certain life expectancies) and (ii) any distribution to the extent that the distribution is a required minimum distribution.[929]

For any distribution that is eligible for rollover, an employer-provided tax-qualified retirement plan must offer the distributee the right to have the distribution made in a direct rollover[930] and, before making the distribution, the plan administrator must provide the distributee with a written explanation of the direct rollover right and related tax consequences.[931] If a distributee does not choose to have the distribution made in a direct rollover, the distribution is generally subject to mandatory 20-percent income tax withholding.[932]

Explanation of Provision

Under the provision, no minimum distribution is required for calendar year 2009 from individual retirement plans and employer-provided qualified retirement plans that are defined contribution plans (within the meaning of section 414(i)). Thus any annual minimum distribution for 2009 from these plans required under current law, otherwise determined by dividing the account balance by a distribution period, is not required to be made. The next required minimum distribution would be for calendar year 2010. This relief applies to life-time distributions to employees and IRA owners and after-death distributions to beneficiaries.

In the case of an individual whose required beginning date is April 1, 2010 (e.g., the individual attained age 70½ in 2009), the first year for which a minimum distribution is required under current law is 2009. Under the provision, no distribution is required for 2009 and, thus, no distribution will be required to be made by April 1, 2010. However, the provision does not change the individual's required beginning date for purposes of determining the required minimum distribution for calendar years after 2009. Thus, for an individual whose required beginning date is April 1, 2010, the required minimum distribution for 2010 will be required to be made no later than the last day of calendar year 2010. If the individual dies on or after April 1, 2010, the required minimum distribution for the individual's beneficiary will be determined using

[929] Sec. 402(c)(4). Distributions that are not eligible rollover distributions also include distributions made upon hardship of the employee and any qualified disaster relief distribution (within the meaning of section 72(t)(2)(G)).

[930] Sec. 401(a)(31).

[931] Sec. 402(f).

[932] Sec. 3405(c). This mandatory withholding does not apply to a distributee that is a beneficiary other than a surviving spouse of an employee.

the rule for death on or after the individual's required beginning date.

If the five year rule applies to an account with respect to any decedent, under the provision, the five year period is determined without regard to calendar year 2009. Thus, for example, for an account with respect to an individual who died in 2007, under the provision, the five year period ends in 2013 instead of 2012.

If all or a portion of a distribution during 2009 is an eligible rollover distribution because it is no longer a required minimum distribution under this provision, the distribution shall not be treated as an eligible rollover distribution for purposes of the direct rollover requirement and notice and written explanation of the direct rollover requirement, as well as the mandatory 20-percent income tax withholding for eligible rollover distributions, to the extent the distribution would have been a required minimum distribution for 2009 absent this provision. Thus, for example, if an employer-provided qualified retirement plan distributes an amount to an individual during 2009 that is an eligible rollover distribution but would have been a required minimum distribution for 2009, the plan is permitted but not required to offer the employee a direct rollover of that amount and provide the employee with a written explanation of the requirement. If the employee receives the distribution, the distribution is not subject to mandatory 20-percent income tax withholding, and the employee can roll over the distribution by contributing it to an eligible retirement plan within 60 days of the distribution.

Effective Date

The provision is effective for calendar years beginning after December 31, 2008. However, the provision does not apply to any required minimum distribution for 2008 that is permitted to be made in 2009 by reason of an individual's required beginning date being April 1, 2009.

B. Transition Rule Clarification (sec. 202 of the Act and sec. 430 of the Code)

Present Law

The PPA modified the minimum funding rules for single-employer defined benefit pension plans, generally for plan years beginning after December 31, 2007. Under the PPA, the minimum required contribution to a single-employer defined benefit pension plan for a plan year generally depends on a comparison of the value of the plan's assets with the plan's funding target and target normal cost. A plan's funding target is the present value of all benefits accrued or earned as of the beginning of the plan year and a plan's target normal cost for a plan year is the present value of benefits expected to accrue or be earned during the plan year. In general, a plan has a funding shortfall if the plan's funding target for the year exceeds the value of the plan's assets, and a shortfall amortization base is generally required to be established for a plan year if the plan has a funding shortfall for a plan year.

Under a special rule, a shortfall amortization base does not have to be established for a plan year if the value of a plan's assets[933] is at least equal to the plan's funding target for the plan year. For purposes of the special rule, a transition rule applies for plan years beginning after 2007 and before 2011. The transition rule does not apply to a plan that (1) is not in effect for 2007, or (2) was subject to certain deficit reduction contribution rules for 2007 (i.e., a plan covering more than 100 participants and with a funded current liability below a specified threshold).

Under the transition rule, a shortfall amortization base does not have to be established for a plan year during the transition period if the value of plan assets[934] for the plan year is at least equal to the applicable percentage of the plan's funding target for the year. The applicable percentage is 92 percent for 2008, 94 percent for 2009, and 96 percent for 2010. However, the transition rule does not apply to a plan for any plan year after 2008 unless, for each preceding plan year after 2007, the plan's shortfall amortization base was zero (i.e., the plan was eligible for the special rule each preceding year).

Explanation of Provision

The provision extends the transition rule to plan years beginning after 2008 even if, for each preceding plan year after 2007, the plan's shortfall amortization base was not zero.

The provision provides that in determining a plan's funding shortfall for the year only the applicable percentage of the funding target is taken into account, rather than the entire funding target. The applicable percentage is 92 percent for 2008, 94 percent for 2009, and 96 percent for 2010.[935] Thus, for example, if a plan was funded at 91 percent for 2008, the funding shortfall for 2008 would be 1 percent and the plan would be able to continue to use the transition rule in 2009. The plan would then need to fund to 94 percent, rather than 100 percent, in 2009.

Effective Date

The provision is effective as if included in the PPA.

C. Temporary Modification of Application of Limitation on Benefit Accruals (sec. 203 of the Act)

Present Law

A single-employer defined benefit pension plan is required to comply with certain funding-based limits described in section 436 on benefits and benefit accruals.[936] These limits were added by the PPA and are generally applicable to plan years beginning after December 31, 2007. Among the limitations is the requirement that if the plan's adjusted funding target attainment percentage is less than 60 percent for a plan year, all future benefit accruals under

[933] Plan assets are reduced by any prefunding balance, but only if the employer elects to use any portion of the prefunding balance to reduce required contributions for the year.

[934] Plan assets are reduced by any prefunding balance, but only if the employer elects to use the prefunding balance to reduce required contributions for the year.

[935] Sec. 430(c)(5)(B).

[936] Secs. 401(a)(29) and 436. Parallel rules apply under ERISA.

the plan must cease as of the valuation date for the plan year ("future benefit accrual limitation"). This future benefit accrual limitation applies only for purposes of the accrual of benefits; service during the freeze period is counted for other purposes. For example, if accruals are frozen pursuant to the limitation, service performed during the freeze period still counts for vesting purposes. Written notice must be provided to plan participants and beneficiaries if a section 436 limitation provision applies to a plan.

The term "funding target attainment percentage" is defined in the same way as under the minimum funding rules applicable to single-employer defined benefit pension plans, and is the ratio, expressed as a percentage, that the value of the plan's assets (generally reduced by any funding standard carryover balance and prefunding balance) bears to the plan's funding target for the year (determined without regard to whether a plan is in at-risk status under the minimum funding rules). A plan's adjusted funding target attainment percentage is determined in the same way, except that the value of the plan's assets and the plan's funding target are both increased by the aggregate amount of purchases of annuities for employees other than highly compensated employees made by the plan during the two preceding plan years. Special rules apply for determining a plan's adjusted funding target attainment percentage in the case of a fully funded plan and for plan years beginning in 2007 and before 2011.

The future benefit accrual limitation ceases to apply with respect to any plan year, effective as of the first day of the plan year, if the plan sponsor makes a contribution (in addition to any minimum required contribution for the plan year) equal to the amount sufficient to result in an adjusted funding target attainment percentage of 60 percent. The future benefit accrual limitation also does not apply for the first five years a plan (or a predecessor plan) is in effect.

If a limitation on future benefit accruals ceases to apply to a plan, all such benefit accruals resume, effective as of the day following the close of the period for which the limitation applies. In addition, section 436 provides that nothing in the rules is to be construed as affecting a plan's treatment of benefits which would have been paid or accrued but for the limitation.

Explanation of Provision

Under the provision, in the case of the first plan year beginning during the period of October 1, 2008, through September 30, 2009, the future benefit accrual limitation of section 436 is applied by substituting the plan's adjusted funding target attainment percentage for the preceding plan year for the percentage for such first plan year in the period. Thus, the future benefit accrual limitation of section 436 is avoided if the plan's adjusted funding target attainment percentage for the preceding plan year is 60 percent or greater. The provision is not intended to place a plan in a worse position with respect to the future benefit accrual limitation of section 436 than would apply absent the provision. Thus, the provision does not apply if the adjusted funding target attainment percentage for the current plan year is greater than the preceding year.

Effective Date

The provision is effective for the first plan year beginning during the period beginning on October 1, 2008, and ending on September 30, 2009.

D. Temporary Delay of Designation of Multiemployer Plans as in Endangered or Critical Status (sec. 204 of the Act)

Present Law

In General

Under section 432,[937] additional funding rules apply to a multiemployer defined benefit pension plan that is in endangered or critical status. These rules require the adoption of and compliance with (1) a funding improvement plan in the case of a multiemployer plan in endangered status, and (2) a rehabilitation plan in the case of a multiemployer plan in critical status. In the case of a plan in critical status, additional required contributions and benefit reductions apply and employers are relieved of liability for minimum required contributions under the otherwise applicable funding rules, provided that a rehabilitation plan is adopted and followed.

Section 432 is effective for plan years beginning after 2007. The additional funding rules for plans in endangered or critical status do not apply to plan years beginning after December 31, 2014. If a plan is operating under a funding improvement or rehabilitation plan for its last year beginning before January 1, 2015, the plan shall continue to operate under such funding improvement or rehabilitation plan during any period after December 31, 2014, that such funding improvement or rehabilitation plan is in effect.

Annual certification of status; notice; annual reports

Not later than the 90th day of each plan year, the plan actuary must certify to the Secretary of the Treasury and to the plan sponsor whether or not the plan is in endangered or critical status for the plan year. In the case of a plan that is in a funding improvement or rehabilitation period, the actuary must certify whether or not the plan is making scheduled progress in meeting the requirements of its funding improvement or rehabilitation plan.

Failure of the plan's actuary to certify the status of the plan is treated as a failure to file the annual report (thus, an ERISA penalty of up to $1,100 per day applies).

If a plan is certified to be in endangered or critical status, notification of the endangered or critical status must be provided within 30 days after the date of certification to the participants and beneficiaries, the bargaining parties, the PBGC and the Secretary of Labor.

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[937] Parallel rules apply under ERISA.

Endangered status

Definition of endangered status

A multiemployer plan is in endangered status if the plan is not in critical status and, as of the beginning of the plan year, (1) the plan's funded percentage for the plan year is less than 80 percent, or (2) the plan has an accumulated funding deficiency for the plan year or is projected to have an accumulated funding deficiency in any of the six succeeding plan years (taking into account amortization extensions). A plan's funded percentage is the percentage of plan assets over accrued liability of the plan. A plan that meets the requirements of both (1) and (2) is treated as in seriously endangered status.

Information to be provided to bargaining parties

Within 30 days of the adoption of a funding improvement plan, the plan sponsor must provide to the bargaining parties schedules showing revised benefit structures, revised contribution structures, or both, which, if adopted, may reasonably be expected to enable the multiemployer plan to meet the applicable benchmarks in accordance with the funding improvement plan. The applicable benchmarks are the requirements of the funding improvement plan (discussed below).

Funding improvement plan and funding improvement period

In the case of a multiemployer plan in endangered status, a funding improvement plan must be adopted within 240 days following the deadline for certifying a plan's status.[938] A funding improvement plan is a plan which consists of the actions, including options or a range of options, to be proposed to the bargaining parties, formulated to provide, based on reasonably anticipated experience and reasonable actuarial assumptions, for the attainment by the plan of certain requirements.

The funding improvement plan must provide that during the funding improvement period, the plan will have a certain required increase in the funded percentage and no accumulated funding deficiency for any plan year during the funding improvement period, taking into account amortization extensions (the "applicable benchmarks"). In the case of a plan that is not in seriously endangered status, under the applicable benchmarks, the plan's funded percentage must increase such that the funded percentage as of the close of the funding improvement period equals or exceeds a percentage equal to the sum of (1) the funded percentage at the beginning of the period, plus (2) 33 percent of the difference between 100 percent and the percentage in (1). Thus, the difference between 100 percent and the plan's funded percentage at the beginning of the period must be reduced by at least one-third during the funding improvement period.

The funding improvement period is the 10-year period beginning on the first day of the first plan year beginning after the earlier of (1) the second anniversary of the date of adoption of the funding

[938] This requirement applies for the initial determination year (i.e., the first plan year that the plan is in endangered status).

improvement plan, or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of endangered status for the initial determination year and covering, as of such date, at least 75 percent of the plan's active participants. The period ends if the plan is no longer in endangered status or if the plan enters critical status.

In the case of a plan in seriously endangered status that is funded 70 percent or less, under the applicable benchmarks, the difference between 100 percent and the plan's funded percentage at the beginning of the period must be reduced by at least one-fifth during the funding improvement period. In the case of such plans, a 15-year funding improvement period is used. Special rules apply in the case of a seriously endangered plan that is more than 70 percent funded as of the beginning of the initial determination year.

Certain restrictions apply during the period beginning on the date of certification for the initial determination year and ending on the day before the first day of the funding improvement period and during the funding improvement period (e.g., upon the adoption of a funding improvement plan, the plan may not be amended to be inconsistent with the funding improvement plan).

Excise taxes

If the funding improvement plan requires an employer to make contributions to the plan, an excise tax applies upon the failure of the employer to make such required contributions within the time required under the plan. The amount of tax is equal to the amount of the required contribution the employer failed to make in a timely manner.

In the case of a plan in endangered status, which is not in seriously endangered status, a civil penalty of $1,100 a day applies for the failure of the plan to meet the applicable benchmarks by the end of the funding improvement period.

In the case of a plan in seriously endangered status, an excise tax applies for the failure to meet the benchmarks by the end of the funding improvement period. In such case, an excise tax applies based on the greater of (1) the amount of the contributions necessary to meet such benchmarks or (2) the plan's accumulated funding deficiency. The excise tax applies for each succeeding plan year until the benchmarks are met.

In the case of a failure which is due to reasonable cause and not to willful neglect, the Secretary of the Treasury may waive all or part of the excise tax on employers failing to make required contributions and the excise tax for failure to achieve the applicable benchmarks. The party against whom the tax is imposed has the burden of establishing that the failure was due to reasonable cause and not willful neglect.

Critical status

Definition of critical status

A multiemployer plan is in critical status for a plan year if as of the beginning of the plan year:

1. The funded percentage of the plan is less than 65 percent and the sum of (A) the market value of plan assets, plus (B) the present value of reasonably anticipated employer and employee contributions for the current plan year and each of the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the six succeeding plan years (plus administrative expenses),

2. (A) The plan has an accumulated funding deficiency for the current plan year, not taking into account any amortization extension, or (B) the plan is projected to have an accumulated funding deficiency for any of the three succeeding plan years (four succeeding plan years if the funded percentage of the plan is 65 percent or less), not taking into account any amortization extension,

3. (A) The plan's normal cost for the current plan year, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value of the reasonably anticipated employer contributions for the current plan year, (B) the present value of nonforfeitable benefits of inactive participants is greater than the present value of nonforfeitable benefits of active participants, and (C) the plan has an accumulated funding deficiency for the current plan year, or is projected to have an accumulated funding deficiency for any of the four succeeding plan years (not taking into account amortization period extensions), or

4. The sum of (A) the market value of plan assets, plus (B) the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years (plus administrative expenses).

Additional contributions during critical status

In the case of a plan in critical status, the provision imposes an additional required contribution ("surcharge") on employers otherwise obligated to make a contribution in the initial critical year, i.e., the first plan year for which the plan is in critical status. The amount of the surcharge is five percent of the contribution otherwise required to be made under the applicable collective bargaining agreement. The surcharge is 10 percent of contributions otherwise required in the case of succeeding plan years in which the plan is in critical status. The surcharge applies 30 days after the employer is notified by the plan sponsor that the plan is in critical status and the surcharge is in effect. The surcharges are due and payable on the same schedule as the contributions on which the surcharges are based. Failure to make the surcharge payment is treated as a delinquent contribution. The surcharge is not required with respect to employees covered by a collective bargaining agreement (or other agreement pursuant to which the employer contributes), beginning

on the effective date of a collective bargaining agreement (or other agreement) that includes terms consistent with a schedule presented by the plan sponsor. The amount of the surcharge may not be the basis for any benefit accrual under the plan.

Reductions to previously earned benefits

Notwithstanding the anti-cutback rules that otherwise apply under the Code and ERISA, the plan sponsor may generally make any reductions to adjustable benefits[939] which the plan sponsor deems appropriate, based upon the outcome of collective bargaining over the schedules required to be provided by the plan sponsor (as discussed below).

The plan sponsor must include in the schedules provided to the bargaining parties an allowance for funding the benefits of participants with respect to whom contributions are not currently required to be made, and shall reduce their benefits to the extent permitted under the Code and ERISA and considered appropriate by the plan sponsor based on the plan's then current overall funding status.

Notice of any reduction of adjustable benefits must be provided at least 30 days before the general effective date of the reduction for all participants and beneficiaries. Benefits may not be reduced until the notice requirement is satisfied. Notice must be provided to (1) plan participants and beneficiaries; (2) each employer who has an obligation to contribute under the plans; and (3) each employee organization which, for purposes of collective bargaining, represents plan participants employed by such employer.

Notice to bargaining parties

Within 30 days after adoption of the rehabilitation plan, the plan sponsor must provide to the bargaining parties schedules showing revised benefit structures, revised contribution structures, or both which, if adopted, may reasonably be expected to enable the multiemployer plan to emerge from critical status in accordance with the rehabilitation plan.[940] The schedules must reflect reductions in future benefit accruals and adjustable benefits and increases in contributions that the plan sponsor determined are reasonably necessary to emerge from critical status. One schedule must be designated as the default schedule and must assume no increases in contributions other than increases necessary to emerge from critical status after future benefit accruals and other benefits (other than benefits the reduction or elimination of which are not permitted under the anti-cutback rules) have been reduced. The plan sponsor may also provide additional information as appropriate.

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[939] Adjustable benefits means (1) benefits, rights, and features under the plan, including post-retirement death benefits, 60-month guarantees, disability benefits not yet in pay status, and similar benefits; (2) any early retirement benefit or retirement-type subsidy and any benefit payment option (other than the qualified joint-and-survivor annuity); and (3) benefit increase that would not be eligible for PBGC guarantee on the first day of the initial critical year because the increases were adopted (or, if later, took effect) less than 60 months before such first day.

[940] A schedule of contribution rates provided by the plan sponsor and relied upon by bargaining parties in negotiating a collective bargaining agreement must remain in effect for the duration of the collective bargaining agreement.

Rehabilitation plan

If a plan is in critical status for a plan year, the plan sponsor must adopt a rehabilitation plan within 240 days following the required date for the actuarial certification of critical status.[941]

A rehabilitation plan is a plan which consists of actions, including options or a range of options to be proposed to the bargaining parties, formulated, based on reasonable anticipated experience and reasonable actuarial assumptions, to enable the plan to cease to be in critical status by the end of the rehabilitation period and may include reductions in plan expenditures (including plan mergers and consolidations), reductions in future benefits accruals or increases in contributions, if agreed to by the bargaining parties, or any combination of such actions.

A rehabilitation plan must provide annual standards for meeting the requirements of the rehabilitation. The plan must also include the schedules required to be provided to the bargaining parties.

If the plan sponsor determines that, based on reasonable actuarial assumptions and upon exhaustion of all reasonable measures, the plan cannot reasonably be expected to emerge from critical status by the end of the rehabilitation period, the plan must include reasonable measures to emerge from critical status at a later time or to forestall possible insolvency. In such case, the plan must set forth alternatives considered, explain why the plan is not reasonably expected to emerge from critical status by the end of the rehabilitation period, and specify when, if ever, the plan is expected to emerge from critical status in accordance with the rehabilitation plan.

Rehabilitation period

The rehabilitation period is the 10-year period beginning on the first day of the first plan year following the earlier of (1) the second anniversary of the date of adoption of the rehabilitation plan or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of critical status for the initial critical year and covering at least 75 percent of the active participants in the plan. The rehabilitation period ends if the plan emerges from critical status.

Restrictions apply during the period beginning on the date of certification and ending on the day before the first day of the rehabilitation period and during the rehabilitation period. For example, beginning on the date that notice of certification of the plan's critical status is sent, lump sum and other similar benefits may not be paid. The restriction does not apply if the present value of the participant's accrued benefit does not exceed $5,000. The restriction also does not apply to any makeup payment in the case of a retroactive annuity starting date or any similar payment of benefits owed with respect to a prior period.

Rules for reductions in future benefit accrual rates

Any schedule including reductions in future benefit accruals forming part of a rehabilitation plan must not reduce the rate of benefit accruals below (1) a monthly benefit (payable as a single

[941] The requirement applies with respect to the initial critical year.

life annuity commencing at the participant's normal retirement age) equal to one percent of the contributions required to be made with respect to a participant or the equivalent standard accrual rate for a participant or group of participants under the collective bargaining agreements in effect as of the first day of the initial critical year, or (2) if lower, the accrual rate under the plan on such first day.

The equivalent standard accrual rate is determined by the plan sponsor based on the standard or average contribution base units which the plan sponsor determines to be representative for active participants and such other factors that the plan sponsor determines to be relevant. The provision does not limit the ability of the plan sponsor to prepare and provide the bargaining parties with alternative schedules to the default schedule that establish lower or higher accrual and contribution rates than the rates described above.

Excise taxes

If the rehabilitation plan requires an employer to make contributions to the plan, an excise tax applies upon the failure of the employer to make such required contributions within the time required under the plan. The amount of tax is equal to the amount of the required contribution the employer failed to make in a timely manner.

In the case of a plan in critical status, if a rehabilitation plan is adopted and complied with, employers are not liable for contributions otherwise required under the general funding rules. In addition, the present-law excise tax on failures to make such contributions does not apply.

If a plan fails to leave critical status at the end of the rehabilitation period or fails to make scheduled progress in meeting its requirements under the rehabilitation plan for three consecutive years, the present law excise tax applies based on the greater of (1) the amount of the contributions necessary to leave critical status or make scheduled progress or (2) the plan's accumulated funding deficiency. The excise tax applies for each succeeding plan year until the requirements are met.

In the case of a failure which is due to reasonable cause and not to willful neglect, the Secretary of the Treasury may waive all or part of the excise tax on employers failing to make required contributions and the excise tax for failure to meet the rehabilitation plan requirements or make scheduled progress.

Explanation of Provision

Under the provision, the sponsor of a multiemployer defined benefit pension plan may elect for an applicable plan year to treat the plan's status for purposes of section 432 the same as the plan's status for the preceding plan year. The applicable plan year is the first plan year beginning during the period from October 1, 2008, through September 30, 2009. Thus, for example, a calendar year plan that is not in critical or endangered status for 2008 may elect to retain its non-critical and non-endangered status for 2009, and a plan that was in either critical or endangered status for 2008 may elect to retain such status for 2009. If section 432 did not

apply to a plan for the year preceding the applicable plan year, the plan's sponsor may elect to treat the plan's status for the applicable plan year as the status that would have applied to the plan had section 432 applied for the preceding plan year.

An election under the provision may only be revoked with the consent of the Secretary of the Treasury and special notice provisions apply with respect to the election and the notification of participants, the bargaining parties, the PBGC, and the Secretary of Labor.

In the case of a plan that elects to retain its endangered or critical status, the plan is not required to update its funding improvement or rehabilitation plan and schedules until the plan year that follows the applicable plan year. If an election is made by a plan under the provision and, without regard to the election, the plan is certified by the plan's actuary for the applicable plan year to be in critical status, the plan is treated as a plan in critical status for purposes of the special rules that relieve contributing employers from liability for minimum required contributions (that would apply under the otherwise applicable minimum funding rules) and the excise tax that applies in the case of a failure to make such contributions.

Effective Date

The provision is effective for the first plan year beginning during the period from October 1, 2008, through September 30, 2009.

E. Temporary Extension of the Funding Improvement and Rehabilitation Periods for Multiemployer Pension Plans in Critical and Endangered Status for 2008 or 2009 (sec. 205 of the Act)

Present Law

Under section 432, additional funding rules apply to a multiemployer defined benefit pension plan that is in endangered or critical status. These rules require the adoption of and compliance with (1) a funding improvement plan in the case of a multiemployer plan in endangered status, and (2) a rehabilitation plan in the case of a multiemployer plan in critical status. Section 432 is effective for plan years beginning after 2007.

The funding improvement period is the 10-year period beginning on the first day of the first plan year beginning after the earlier of (1) the second anniversary of the date of adoption of the funding improvement plan, or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of endangered status for the initial determination year and covering, as of such date, at least 75 percent of the plan's active participants. The period ends if the plan is no longer in endangered status or if the plan enters critical status.

The rehabilitation period is the 10-year period beginning on the first day of the first plan year following the earlier of (1) the second anniversary of the date of adoption of the rehabilitation plan or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of critical status

for the initial critical year and covering at least 75 percent of the active participants in the plan. The rehabilitation period ends if the plan emerges from critical status.

Explanation of Provision

Under the provision, a plan sponsor of a multiemployer defined benefit pension plan may elect for a plan year beginning in 2008 or 2009 to extend the plan's otherwise applicable funding improvement or rehabilitation period by three years.

Effective Date

The provision is effective for plan years beginning after December 31, 2007.

PART TWENTY-TWO: CUSTOM USER FEES AND CORPORATE ESTIMATED TAXES

A. Extension of Customs User Fees

Present Law

Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA")[942] authorized the Secretary of the Treasury to collect certain service fees. Section 412 of the Homeland Security Act of 2002[943] authorized the Secretary of the Treasury to delegate such authority to the Secretary of Homeland Security. Provided for under, these fees include: processing fees for air and sea passengers, commercial trucks, rail cars, private aircraft and vessels, commercial vessels, dutiable mail packages, barges and bulk carriers, merchandise, and Customs broker permits.[944] COBRA was amended on several occasions but most recently prior to the start of the 110th Congress by the American Jobs Creation Act of 2004,[945] which extended authorization for the collection of these fees through September 30, 2014.[946]

Explanation of Provision

The Andean Trade Preference Act extends the merchandise processing fees authorized under COBRA for 14 days (through October 14, 2014).[947]

Effective date.—The provision is effective on the date of enactment (June 30, 2007).

The renewal of the Burmese Freedom and Democracy Act of 2003 extends the merchandise processing fees authorized under COBRA for 7 days (through October 21, 2014).[948]

Effective date.—The provision is effective on July 26, 2007.

The extension of the trade adjustment assistance program under the Trade Act of 1974 extends the passenger and conveyance processing fees authorized under COBRA for 7 days (through October 7, 2014).[949]

Effective date.—The provision is effective on the date of enactment (September 28, 2007).

The United States-Peru Trade Promotion Agreement Implementation Act extends: (1) the passenger and conveyance processing fees authorized under COBRA for 67 days (from October 7, 2014

[942] Pub. L. No. 99–272.
[943] Pub. L. No. 107–296.
[944] 19 U.S.C. sec. 58c.
[945] Pub. L. No. 108–357.
[946] For fiscal years after September 30, 2005, the Secretary is to charge fees in amounts that are reasonably related to the costs of providing customs services in connection with the activity or item for which the fee is charged.
[947] Pub. L. No. 110–42.
[948] Pub. L. No. 110–52.
[949] Pub. L. No. 110–89.

through December 13, 2014); and (2) the merchandise processing fees authorized under COBRA for 53 days (from October 21, 2014 through December 13, 2014).[950]

Effective date.—The provision is effective on the date of enactment (December 14, 2007).

The Andean Trade Preference Extension Act of 2008 extends the passenger and conveyance processing fees and the merchandise processing fees authorized under COBRA through December 27, 2014.[951]

Effective date.—The provision is effective on the date of enactment (February 29, 2008).

The Food, Conservation, and Energy Act of 2008 extends: (1) the passenger and conveyance processing fees authorized under COBRA through September 30, 2017; and (2) the merchandise processing fees authorized under COBRA through November 14, 2017.[952]

Effective date.—The provision is effective on the date of enactment (June 18, 2008).

The Renewal of Import Restrictions under the Burmese Freedom and Democracy Act of 2003 extends the passenger and conveyance processing fees authorized under COBRA through October 07, 2017.[953]

Effective date.—The provision is effective on July 26, 2008.

The extension of the Andean Tax Preference Act of 2008 extends: (1) the passenger and conveyance processing fees authorized under COBRA through January 31, 2018; and (2) the merchandise processing fees authorized under COBRA through February 14, 2018.[954]

Effective date.—The provision is effective on the date of enactment (October 16, 2008).

B. Modifications to Corporate Estimated Tax Payments Due in July, August, and September, 2012

Prior and Present Law

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

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

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[950] Pub. L. No. 110–138.
[951] Pub. L. No. 110–191.
[952] Pub. L. No. 110–234 and Pub. L. No. 110–246.
[953] Pub. L. No. 110–287.
[954] Pub. L. No. 110–436.

Explanation of Provision

The U.S. Troop Readiness, Veteran's Care, Katrina Recovery and Iraq Accountability Appropriations Act of 2007 increases the 106.25 percent to 114.25 percent.[955]

Effective date.—The provision is effective on the date of enactment (May 25, 2007).

The Andean Trade Preference Act increases the 114.25 percent to 114.50 percent.[956]

Effective date.—The provision is effective on the date of enactment (June 30, 2007).

The renewal of the Burmese Freedom and Democracy Act of 2003 increases the 114.50 percent to 114.75 percent.[957]

Effective date.—The provision is effective on July 26, 2007.

The extension of the trade adjustment assistance program under the Trade Act of 1974 increases the 114.75 percent to 115.00 percent.[958]

Effective date.—The provision is effective on the date of enactment (September 28, 2007).

The United States-Peru Trade Promotion Agreement Implementation Act increases the 115.00 percent to 115.75 percent.[959]

Effective date.—The provision is effective on the date of enactment (December 14, 2007).[960]

The Mortgage Forgiveness Debt Relief Act of 2007 increases the otherwise applicable percentage (115.75) by 1.50 percentage points.[961]

Effective date.—The provision is effective on the date of enactment (December 20, 2007).

Effective date.—The provision is effective on the date of enactment (February 29, 2008).

The Food, Conservation, and Energy Act of 2008 increases the otherwise applicable percentage (117.25 percent) by 7.75 percentage points.[962]

Effective date.—The provision is effective on the date of enactment (June 18, 2008).

Effective date.—The provision is effective on July 26, 2008.

The Housing Assistance Tax Act of 2008 reduces the otherwise applicable percentage (125.00 percent) to 100 percent.[963] Thus, corporations will make estimated tax payments in 2012 as if the TIPRA legislation had never been enacted or amended.

Effective date.—The provision is effective on the date of enactment (July 30, 2008).

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[955] Pub. L. No. 110–28.
[956] Pub. L. No. 110–42.
[957] Pub. L. No. 110–52.
[958] Pub. L. No. 110–89.
[959] Pub. L. No. 110–138.
[960] A technical correction may have been necessary but for the enactment of Pub. L. No. 110–289.
[961] Pub. L. No. 110–142.
[962] Pub. L. No. 110–234 and Pub. L. No. 110–246.
[963] Pub. L. No. 110–289.

C. Modifications to Corporate Estimated Tax Payments Due in July, August, and September, 2013

Prior and Present Law

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

Under the Tax Increase Prevention Act of 2005 ("TIPRA"), in the case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2013, were increased to 100.75 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Explanation of Provision

The Andean Trade Preference Extension Act of 2008 increases the otherwise applicable percentage (100.75 percent) by 0.25 percentage points.[964]

Effective date.—The provision is effective on the date of enactment (February 29, 2008).

The Renewal of Import Restrictions under the Burmese Freedom and Democracy Act of 2003 increases the otherwise applicable percentage (101.00 percent) by 0.25 percentage points.[965]

Effective date.—The provision is effective on July 26, 2008.

The Housing Assistance Tax Act of 2008 increases the otherwise applicable percentage (101.25 percent) by 16.75 percentage points.[966]

Effective date.—The provision is effective on the date of enactment (July 30, 2008).

The extension of the Andean Tax Preference Act of 2008 increases the otherwise applicable percentage (118.00 percent) by 2.00 percentage points.[967]

Effective date.—The provision is effective on the date of enactment (October 16, 2008).

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[964] Pub. L. No. 110–191.
[965] Pub. L. No. 110–287.
[966] Pub. L. No. 110–289.
[967] Pub. L. No. 110–436.

APPENDIX: ESTIMATED BUDGET EFFECTS OF TAX LEGISLATION ENACTED IN THE 110TH CONGRESS

APPENDIX:
ESTIMATED BUDGET EFFECTS OF TAX LEGISLATION ENACTED IN THE 110TH CONGRESS

Fiscal Years 2007 - 2018

[Millions of Dollars]

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
PART ONE: U.S. TROOP READINESS, VETERANS' CARE, KATRINA RECOVERY, AND IRAQ ACCOUNTABILITY APPROPRIATIONS ACT OF 2007 (P.L. 110-028, signed into law by the President on May 25, 2007)														
I. Small Business Provisions Tax Relief Provisions														
A. General Provisions														
1. Extension and modification of the work opportunity tax credit ("WOTC") - extend present law WOTC and expand targeted groups relating to veterans, high-risk youth, and vocational rehabilitation referrals; include high out-migration counties (sunset 8/31/11)	wpoifibwa DOE	[1]	-153	-420	-582	-610	-420	-190	-100	-55	-28	-14	---	-2,571
2. Increase and extension of expensing for small business - increase section 179 expensing to $125,000 and increase the phaseout threshold amount to $500,000; include software in section 179 property; and index both the deduction limit and the phaseout threshold (sunset 12/31/10)	tyba 12/31/06	-140	-229	-157	-3,100	-1,832	1,955	1,242	896	680	410	207	---	-68
3. Tax credit for Social Security taxes paid with respect to employee cash tips - set applicable minimum wage for purposes of calculating the FICA tip credit at $5.15	trfspa 12/31/06	-3	-12	-27	-41	-49	-53	-54	-54	-54	-55	-55	---	-457
4. Allow work opportunity credit and credit for taxes paid with respect to employee cash tips against the alternative minimum tax ("AMT"):														
a. Permit individual and corporate taxpayers to claim the WOTC against the AMT [2]	cdi tyba 12/31/06	-11	-53	-58	-51	-38	[3]	42	36	28	22	17	---	-65

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
b. Permit individual and corporate taxpayers to claim the FICA tip credit against the AMT	cdi tyba 12/31/06	-19	-111	-78	-64	-53	-46	-42	-38	-36	-34	-34	---	-552
5. Family business tax simplification	tyba 12/31/06	*Negligible Revenue Effect*												
B. Gulf Opportunity Zone Tax Incentives														
1. One-year extension to special increase in expensing under section 179 for GO Zone property (sunset 12/31/08)	tyba DOE	---	-14	-10	7	5	3	3	2	1	1	---	---	-2
2. Extend enhanced credit treatment for two additional years (2009 and 2010) and modify the carryover allocation and Federally subsidized rules for certain low income housing credit buildings placed in service after 12/31/05, and before 1/1/11 in the Gulf Opportunity Zone, the Rita GO Zone, and the Wilma GO Zone	DOE	---	---	-61	-97	-53	-10	---	---	---	---	---	---	-221
3. Treatment of certain qualified GO Zone repairs or reconstruction as qualified rehabilitation for purposes of the mortgage revenue bond and Gulf Opportunity Zone bond rules	[4]	-1	-4	-7	-4	---	---	---	---	---	---	---	---	-16
4. GAO study of certain tax incentives in the GO Zones	DOE	*No Revenue Effect*												
C. Subchapter S Provisions														
1. Exclude capital gains from passive investment income	tyba DOE	---	-15	-30	-32	-34	-35	-37	-40	-43	-46	-49	---	-361
2. Treatment of qualifying director shares	tyba 12/31/06	-4	-10	-14	-18	-20	-21	-22	-23	-23	-23	-24	---	-201
3. Recapture of bad debt reserves	tyba 12/31/06	11	27	-22	-40	-36	-23	-21	-22	-23	-24	-26	---	-199
4. Treatment of sale of interest in a qualified subchapter S subsidiary	tyba 12/31/06	-1	-3	-3	-4	-4	-4	-5	-5	-5	-6	-6	---	-46
5. Elimination of all earnings and profits attributable to pre-1983 years	tyba DOE	-3	-2	-2	-2	-2	-2	-2	-2	-2	-2	-2	---	-21
6. Permit interest deduction to an electing small business trust to acquire S corporation stock	tyba 12/31/06	---	-2	-3	-4	-5	-5	-6	-8	-9	-11	-12	---	-64
II. Revenue Provisions														
A. Increase in Age of Children Whose Unearned Income is Taxed as if Parent's Income	tyba DOE	---	34	139	144	148	143	146	156	163	174	185	---	1,432
B. Modify Interest Suspension Under Section 6404(g) from 18 to 36 Months	[5]	---	162	246	248	250	251	252	254	255	256	257	---	2,430
C. Modification of Collection Due Process Procedures for Employment Tax Liabilities	[6]	---	50	51	27	19	16	19	22	25	28	31	---	288
D. Permanent Extension of IRS User Fees [7]	ra 9/30/14	---	---	---	---	---	---	---	---	30	30	30	---	90

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
E. Increase in Penalty for Bad Checks and Money Orders	comora DOE	2	2	2	2	2	2	2	2	2	2	2	---	22
F. Understatement of Taxpayer Liability by Return Preparers	rpa DOE	---	3	5	6	8	9	9	10	10	11	11	---	82
G. Penalty for Filing Erroneous Refund Claims	rfo/a 1/1/08	---	---	---	5	10	11	12	13	14	16	17	---	98
H. Increase Corporate Estimated Tax Payments Due July through September for Corporations with Assets in Excess of $1 Billion in 2012	DOE	---	---	---	---	---	4,955	-4,955	---	---	---	---	---	---
III. Pension-Related Provisions														
A. Revocation of Election Relating to Treatment as Multiemployer Plan	[8]	*Negligible Revenue Effect*												
B. Modification of Requirements for Qualified Transfers	generally DOE [9]	*Negligible Revenue Effect*												
C. Extension of Alternative Deficit Reduction Contribution Rules	[10]	---	[3]	[3]	[3]	[3]	[3]	[1]	[1]	[1]	[1]	[1]	---	[1]
D. Modification of the Interest Rate for Pension Funding Rules	[10]	---	[3]	[3]	[3]	[3]	[3]	[11]	[11]	[11]	[11]	[11]	---	[11]
TOTAL OF PART ONE		**-169**	**-330**	**-449**	**-3,600**	**-2,294**	**6,726**	**-3,607**	**1,099**	**958**	**721**	**535**	**—**	**-402**
PART TWO: REVENUE PROVISIONS OF ENERGY INDEPENDENCE AND SECURITY ACT OF 2007 (P.L. 110-140, signed into law by the President on December 19, 2007)														
A. Extension of FUTA Surtax of 0.2 Percent (sunset 12/31/08) [7]	1/1/08	---	1,041	405	---	---	---	---	---	---	---	---	---	1,446
B. 7-Year Amortization of Geological And Geophysical Expenditures for Major Integrated Oil Companies	apoia DOE	---	2	7	13	19	24	22	12	3	1	1	---	103
TOTAL OF PART TWO		**—**	**1,043**	**412**	**13**	**19**	**24**	**22**	**12**	**3**	**1**	**1**	**—**	**1,549**
PART THREE: HOKIE SPIRIT MEMORIAL FUND (P.L. 110-141, signed into law by the President on December 19, 2007)														
A. Exclusion from Income for Payments from the Hokie Spirit Memorial Fund	DOE	---	[1]	[1]	---	---	---	---	---	---	---	---	---	[1]

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
B. Increase in Penalty for Failure to File Partnership Returns by $1	DOE	---	[11]	1	---	---	---	---	---	---	---	---	---	1
TOTAL OF PART THREE		**---**	**[11]**	**[11]**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**[11]**
PART FOUR: MORTGAGE FORGIVENESS DEBT RELIEF ACT OF 2007 (P.L. 110-142, signed into law by the President on December 20, 2007)														
A. Exclude Discharges of Principal Residence Acquisition Indebtedness from Gross Income (sunset 12/31/09) [12]	1/1/07	---	-173	-241	-192	---	---	---	---	---	---	---	---	-606
B. Extension of Deduction for Private Mortgage Insurance as Deductible Qualified Interest for Three Years (sunset 12/31/10)	apoaa 12/31/07	---	-15	-109	-142	-115	-9	32	46	53	46	23	---	-191
C. Modify Tests to Qualify as Cooperative Housing Corporation	tyea DOE	---	-1	-2	-2	-2	-2	-3	-3	-3	-3	-3	---	-22
D. Exclusion from Income for Benefits Provided to Volunteer EMS and Firefighters (sunset 12/31/10)	tyba 2007	---	-21	-85	-90	-71	---	---	---	---	---	---	---	-267
E. Modify the Prohibition against Full-Time Students from Qualifying for LIHC	cabo/a DOE	---	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	---	[1]
F. Allow a Surviving Spouse to Exclude from Gross Income up to $500,000 of the Gain from the Sale of a Principal Residence Owned with a Deceased Spouse if the Sale Occurs Within 2 Years of the Death of the Spouse	soea 12/31/07	---	-1	-4	-4	-5	-7	-8	-8	-9	-10	-11	---	-67
G. Increase the Penalty for Failure to File Partnership Returns to $85; Limitation on Disclosure	rfa DOE	---	20	42	44	45	47	48	50	52	54	56	---	458
H. Impose a Penalty for Failure to File S Corporation Returns at $85	rfa DOE	---	29	76	79	82	84	87	90	94	97	100	---	818
I. Increase by 1.5 Percentage Points the Required Corporate Estimated Tax Payments Factor for Corporations With Assets of at Least $1 Billion for Payments Due in July, August, and September 2012	DOE	---	---	---	---	---	912	-912	---	---	---	---	---	---
TOTAL OF PART FOUR		**---**	**-162**	**-323**	**-307**	**-66**	**1,025**	**-756**	**175**	**187**	**184**	**165**	**---**	**123**

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
PART FIVE: EXTEND FUNDING AND EXPENDITURE AUTHORITY OF THE AIRPORT AND AIRWAY TRUST FUND (P.L. 110-92, signed into law by the President on September 29, 2007; P.L. 110-161, signed into law by the President on December 26, 2007; P.L. 110-190, signed into law by the President on February 28, 2008; P.L. 110-253, signed into law by the President on June 30, 2008; and P.L. 110-330, signed into law by the President on September 30, 2008	**DOE**	*No Revenue Effect*												
PART SIX: TAX INCREASE PREVENTION ACT OF 2007 - Set AMT Exemption Amounts at $44,350/$66,250 for 2007 and Extend Application of Nonrefundable Credits (P.L. 110-166, signed into law by the President on December 26, 2007)	**tyba 12/31/06**	**---**	**-50,593**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**-50,593**
PART SEVEN: TAX TECHNICAL CORRECTIONS ACT of 2007 (P.L. 110-172, signed into law by the President on December 29, 2007)	**[13]**	*No Revenue Effect*												
PART EIGHT: CLARIFY THE TERM OF THE IRS COMMISSIONER (P.L. 110-176, signed into law by the President on January 4, 2008)	**[14]**	*No Revenue Effect*												
PART NINE: ECONOMIC STIMULUS ACT OF 2008 (P.L. 110-185, signed into law by the President on February 13, 2008)														
A. 2008 Recovery Rebate for Individuals - $600 Single Filer ($1,200 for Joint Filers); Plus $300 per Qualifying Child for the Child Tax Credit; Credit Reduced by 5% of so Much of the Taxpayer's Adjusted Gross Income as Exceeds $75,000 ($150,000 for Joint Filers) [15]; and Treatment of the U.S. Possessions [16]	tyba 12/31/07	---	-105,740	-10,000	---	---	---	---	---	---	---	---	---	-115,740
B. Increase Section 179 Expensing and Phaseout Amounts for 2008 ($250,000 and $800,000)	tyba 12/31/07	---	-894	-591	490	310	225	174	110	62	30	14	13	-57

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
C. 50% Bonus Depreciation for Property Placed In Service in 2008 [17]	[18]	---	-43,907	-5,630	11,168	8,500	7,417	5,772	3,648	2,281	1,264	1,031	1,041	-7,414
TOTAL OF PART NINE		**---**	**-150,541**	**-16,221**	**11,658**	**8,810**	**7,642**	**5,946**	**3,758**	**2,343**	**1,294**	**1,045**	**1,054**	**-123,211**
PART TEN: GENETIC INFORMATION NONDISCRIMINATION ACT OF 2008 - Prohibition of Discrimination Based on Genetic Testing (P.L. 110-233, signed into law by the President on May 21, 2008)	**[19]**	---					***Negligible Revenue Effect***							
PART ELEVEN: FOOD, CONSERVATION, AND ENERGY ACT OF 2008 (P.L. 110-234, enacted into law on May 22, 2008; and P.L. 110-246, enacted into law on June 18, 2008)														
I. Revenue Provisions for Agriculture Programs														
A. Extension of Custom User Fees (sunset 9/30/17) [7]	DOE	---	---	---	---	---	---	---	---	2,339	3,496	4,176	---	10,011
B. Increase by 7.75 Percentage Points the Required Corporate Estimated Tax Payments Factor for Corporations with Assets of at Least $1 Billion for Payments due in July, August, and September 2012	DOE	---	---	---	---	---	4,529	-4,529	---	---	---	---	---	---
II. Tax Provisions														
A. Conservation Provisions														
1. Exclusion of Conservation Reserve Program Payments from SECA tax for individuals receiving Social Security retirement or disability benefits [20]	pma 12/31/07	---	[1]	-20	-21	-21	-21	-22	-22	-22	-21	-21	-21	-213
2. Extend the special rule for contributions of qualified conservation contributions (sunset 12/31/09)	cmi tyba 12/31/07	---	-27	-49	-29	---	---	---	---	---	---	---	---	-105
3. Deduction for endangered species recovery expenditures	epoia 12/31/08	---	---	-8	-18	-21	-25	-30	-35	-41	-48	-56	-64	-346
4. Certain timber provisions (sunset one year after date of enactment):														
a. 15% tax rate for gain on timber harvested by a C Corp; 15-year holding period	DOE	---	-8	-72	-47	-28	-27	-26	-9	---	---	---	---	-219
b. REIT provisions	DOE	---	1	4	-2	-3	-1	---	---	---	---	---	---	-2

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
5. Qualified forestry conservation bonds ($500 million allocation) [7] [21]	bia DOE	---	---	-250	---	---	---	---	---	---	---	---	---	-250
B. Energy Provisions														
1. Credit for production of cellulosic biofuel with a maximum credit of $1.01 per gallon and a revised definition of biofuels (sunset 12/31/12)	fpa 12/31/08	---	---	-6	-33	-121	-188	-54	---	---	---	---	---	-403
2. Comprehensive study of biofuels	DOE	---						*No Revenue Effect*						
3. Modification of the incentives relating to alcohol fuels (VEETC) 45 cents	DOE	---	---	427	610	167	---	---	---	---	---	---	---	1,203
4. Calculation of volume of alcohol for fuel credits (denaturants limited to 2%)	fsoua 12/31/08	---	---	42	63	19	---	---	---	---	---	---	---	124
5. Extension of temporary duty on ethyl alcohol through 12/31/10 [7] [22]	DOE	---	---	26	35	9	---	---	---	---	---	---	---	70
6. Limitations on duty drawback on certain imported ethanol [7]	[23]	---	5	4	1	1	1	1	1	1	1	1	1	17
C. Agricultural Provisions														
1. Qualified small issue bonds for farming - increase loan limit from $250,000 to $450,000 and index; and eliminate the dollar limitation in definition of substantial farmland	bia DOE	---	[1]	[1]	-1	-1	-2	-2	-3	-3	-4	-4	-4	-24
2. Allowance of section 1031 treatment for exchanges involving certain mutual ditch, reservoir, or irrigation company stock	eca DOE	---	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-2
3. Agricultural chemicals security tax credit	DOE	---	-1	-3	-3	-3	-3	-1	[11]	[11]	[11]	[11]	[11]	-14
4. Change the depreciation classification for race horses that are two years old or younger from seven-year property to three-year property (sunset 12/31/13)	ppisa 12/31/08	---	---	-18	-56	-78	-77	-68	-30	41	81	79	65	-61
5. Temporary relief for Kiowa County, KS and surrounding area:														
a. Suspension of certain limitations on personal casualty losses	laa 5/4/07	---	-4	-3	---	---	---	---	---	---	---	---	---	-8
b. Extension of replacement period for nonrecognition of gain	grooa 5/4/07	---	[1]	-1	-1	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-2
c. Employee retention credit for employers affected by May 4 storms and tornados	wpoia 5/4/07 & before 1/1/08	---	-3	-7	-1	[1]	---	---	---	---	---	---	---	-11
d. Special allowance for certain property acquired on or after May 5, 2007 (sunset equipment 12/31/08 and sunset structures 12/31/09)	ppisa 5/5/07	---	-25	-14	-5	1	1	1	1	1	1	1	1	-35

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
e. Increase in expensing under section 179	DOE	---	[1]	[1]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[1]
f. Expensing for certain demolition and clean-up costs (sunset 12/31/09)	apoia 5/4/07	---	[1]	[1]	---	---	---	---	---	---	---	---	---	[1]
g. Treatment of public utility property disaster losses	DOE	---	[1]	[11]	[11]	[11]	---	---	---	---	---	---	---	[1]
h. Treatment of net operating losses attributable to storm losses	DOE	---	-5	-2	1	1	[11]	[11]	[11]	[11]	[11]	[11]	[11]	-1
i. Treatment of representations regarding income eligibility for purposes of qualified rental project requirements	DOE	---	*Negligible Revenue Effect*											
j. Special rules for use of retirement funds (generally sunsets 12/31/08)	DOE	---	[1]	-3	1	[11]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-3
6. Modifications to the advance coal project credit and the gasification project credit	DOE	---	*No Revenue Effect*											
D. Other Revenue Provisions														
1. Limitation on excess farming losses of certain taxpayers ($300,000)	tyba 12/31/09	---	---	---	48	81	77	72	63	55	46	37	28	508
2. Increase and index dollar threshold for farm optional method and nonfarm optional method for computing net earnings from self-employment [20]	tyba 12/31/07	---	2	13	10	11	11	11	11	12	12	12	12	117
3. Information reporting for Commodity Credit Corporation transactions	lro/a 1/1/07	---	*No Revenue Effect*											
TOTAL OF PART ELEVEN		**—**	**-65**	**60**	**552**	**14**	**4,275**	**-4,647**	**-23**	**2,383**	**3,564**	**4,225**	**18**	**10,351**
PART TWELVE: HEROES EARNINGS ASSISTANCE AND RELIEF TAX ACT OF 2008 (P.L. 110-245, signed into law by the President on June 17, 2008)														
1. Benefits for the Military														
A. Allow Taxpayers Who File a Joint Return, and One of Whom is in the Armed Forces to be Eligible for the Recovery Rebates as Enacted in the Economic Stimulus Act of 2008	[24]	---	---	-14	---	---	---	---	---	---	---	---	---	-14
B. Permanently Extend the Election to Include Combat Pay as Earned Income	tyea 12/31/07	---	---	-20	-18	-11	-3	-3	-3	-3	-3	-3	-3	-70
C. Special Mortgage Bonds Rules for Veterans:														
1. Permanently extend the qualified mortgage bond first-time homebuyer exception for veterans	bia 12/31/07	---	-2	-10	-25	-41	-57	-73	-88	-102	-115	-126	-135	-776

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
2. Increase the veterans mortgage bond volume limitation for certain states and modify the definition of a qualified veteran	bia 12/31/07	---	-1	-6	-14	-21	-27	-33	-40	-46	-52	-58	-64	-362
D. Survivor and Disability Payments with Respect to Qualified Military Service	dodoo/a 1/1/07	---	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-2
E. Treatment of Differential Military Pay as Wages	Rpa 12/31/08 & yba 12/31/08	---	---	1	-2	-1	-1	-1	-1	-1	-1	-1	-1	-7
F. Special Period of Limitation When Uniformed Services Retired Pay is Reduced as a Result of Award of Disability Compensation	cfcorfa DOE	---	[1]	-2	-1	-1	-1	-1	-1	-1	-1	-1	-1	-10
G. Permanently Extend Treatment of Distributions to Guardsmen Called to Active Duty for at Least 180 Days	12/31/07	---	[1]	[1]	[1]	-1	-1	-1	-1	-1	-1	-1	-1	-7
H. Permanent Extension of Disclosure Authority to the Department of Veterans Affairs [7]	10/01/08	---	*No Revenue Effect*											
I. Contributions of Military Death Gratuities to Roth IRAs or Educational Savings Accounts	[25]	---	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-1	-4
J. Suspension of 5-Year Period for the Exclusion of Gain on Sale of a Principal Residence by Certain Peace Corps Volunteers	tyba 12/31/07	---	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-1
K. Employer Wage Credit for Activated Military Reservists (20% of Differential Pay up to $20,000; Employers with less than 50 Employees) (sunset 12/31/09)	apa DOE & before 1/1/10	---	[1]	-1	-2	-2	-2	-1	[1]	[1]	[1]	[1]	[1]	-9
L. Exclusion of Certain State Payments to Military Personnel	pmbo/a DOE	---	*Negligible Revenue Effect*											
M. Permanent Exclusion of Gain on Sale of a Principal Residence by Certain Employees of the Intelligence Community	soproo/a DOE & soproo/a 12/31/10	---	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-3
N. Special Distribution Rules for Unused Benefits in Health Flexible Spending Arrangements of Individuals Called to Active Duty	dma DOE	---	*Negligible Revenue Effect*											
O. Clarification Related to Exclusion of Certain Property Tax Rebates and Other Benefits Provided to Volunteer Firefighters and Emergency Medical Responders	[26]	---	*No Revenue Effect*											
II. Revenue Provisions														
1. Impose Mark-To-Market Regime (but not 10-Year Income Inclusion Rules) on Individuals Who Expatriate	[27]	---	10	56	52	48	44	39	34	29	31	33	35	411

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
2. Impose Employment Tax for Wages Paid for Services Performed by Employees of Foreign Subsidiaries of U.S. Parent Companies Under U.S. Government Contract [28]	spicmbmt 30da DOE	---	11	76	80	81	82	83	84	84	86	86	86	838
3. Increase in Penalty for Failure to File from $100 to $135	rrtbfa 12/31/08	---	---	2	9	9	9	9	9	9	9	9	9	83
III. Parity in the Application of Certain Limits to Mental Health Benefits (sunset 12/31/08) [7]	bfsfo/a DOE	---	---	-15	-10	---	---	---	---	---	---	---	---	-25
TOTAL OF PART TWELVE		---	**18**	**67**	**69**	**60**	**43**	**18**	**-7**	**-32**	**-47**	**-62**	**-76**	**42**
PART THIRTEEN: HOUSING AND ECONOMIC RECOVERY ACT OF 2008 (P.L. 110-289, signed into law by the President on July 30, 2008)														
Division C, the Housing Assistance Tax Act of 2008														
I. Benefits for Multi-Family Low-Income Housing														
A. Low-Income Housing Credit														
1. Temporary increase in volume cap for low-income housing tax credit ($0.20 per capita in each of 2008 and 2009)	DOE	---	[1]	-35	-76	-112	-123	-123	-123	-123	-123	-123	-123	-1,084
2. Determination of credit rate (sunset 12/31/12)	bpisa DOE	---	[1]	[1]	-1	-1	-1	-1	-1	[1]	[1]	[1]	[1]	-7
3. Modifications to definition of eligible basis	generally bpisa DOE	---	[1]	-5	-6	-9	-12	-13	-17	-18	-21	-23	-25	-149
4. Other simplification and reform of low-income housing incentives	generally bpisa DOE	---	[1]	-2	-3	-5	-6	-7	-9	-10	-11	-12	-13	-81
5. Treatment of basic housing allowances for purposes of income eligibility rules (sunset 12/31/11)	DA DOE	---	[1]	[1]	-2	-3	-4	-4	-4	-4	-4	-4	-4	-33
6. Refunding treatment for certain multi-family housing bonds	rolra DOE	---	[1]	-1	-4	-8	-14	-25	-41	-63	-89	-116	-147	-509
7. Coordination of certain rules applicable to low-income housing credit and qualified residential rental project exempt facility bonds	biob/a DOE	---	[1]	[1]	[1]	-1	-1	-1	-1	-1	-1	-2	-2	-10
8. Hold harmless for reductions in area median gross income	cya 2008	---	[1]	-2	-3	-4	-5	-7	-8	-9	-10	-12	-12	-72
9. Exception from the annual recertification requirement for projects which are entirely low-income use	yea DOE	---	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-1

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
B. Single Family Housing														
1. Refundable first-time homebuyer credit ($7,500) ($75,000/150,000 income caps) (sunset 6/30/09).....	po/a 4/9/08	---	-320	-13,583	480	1,873	1,677	1,481	1,285	1,088	782	260	124	-4,853
2. Additional standard deduction for State and local property taxes (cap at $500 ($1,000 for joint returns)) (sunset 1/1/09).....	tyba 12/31/07	---	---	-1,537	---	---	---	---	---	---	---	---	---	-1,537
C. General Provisions														
1. Modifications to qualified private activity bond rules for housing ($11 billion volume cap increase).	bia DOE	---	-6	-92	-156	-170	-168	-163	-155	-149	-142	-137	-137	-1,475
2. Repeal of alternative minimum tax limitations on tax-exempt housing bonds, the low-income housing credit, and rehabilitation credit [29].....	[30]	---	-30	-210	-206	-207	-206	-203	-203	-204	-206	-208	-210	-2,093
3. Bonds guaranteed by federal home loan banks eligible for treatment as tax-exempt bonds [31].....	[32]	---	[1]	49	-81	-13	-21	-15	-9	-9	-9	-9	-9	-126
4. Modification of rules pertaining to FIRPTA nonforeign affidavits.....	doUSrpia DOE	---	[1]	-1	-2	-2	-2	-2	-2	-2	-2	-2	-3	-20
5. Modify rehabilitation credit tax-exempt use safe harbor and definition of disqualified lease.....	ea 12/31/07	---	-4	-20	-22	-23	-24	-25	-26	-27	-29	-30	-31	-262
6. Relax mortgage revenue bond limitations for Presidentially declared disaster areas.....	bia 5/1/08 & bib 1/1/10	---	[1]	-3	-8	-11	-11	-11	-11	-11	-11	-11	-11	-96
7. Transfer of funds appropriated to carry out 2008 recovery rebates to individuals [7].....	DOE	---	-200	-100	---	---	---	---	---	---	---	---	---	-300
II. Reforms Related to Real Estate Investment Trust ("REIT")														
A. Foreign Currency and Other Qualified Activities.....	[33]	---	[1]	[1]	[1]	-1	-1	-2	-2	-3	-3	-3	-4	-19
B. Conforming Taxable REIT Subsidiary Asset Test....	tyba DOE	---	[1]	[1]	-2	-4	-7	-9	-11	-12	-14	-16	-17	-91
C. Holding Period Under Safe Harbor.....	sma DOE	---	1	36	22	7	2	[1]	[1]	-2	-3	-3	-4	54
D. Determining Value of Sales Under Safe Harbor.....	sma DOE	---	[1]	-1	-2	-5	-8	-11	-13	-15	-17	-19	-21	-113
E. Conformity for Health Care Facilities.....	tyba DOE	---	[1]	-1	-4	-9	-14	-18	-22	-26	-30	-33	-36	-191
Total of Reforms Related to Real Estate Investment Trust [34]			[1]	33	19	-9	-27	-39	-49	-60	-69	-76	-82	-359
III. Revenue Provisions														
A. General Provisions														
1. Election to accelerate AMT and R&E credits in lieu of bonus depreciation including requirement to use straight-line method [35].....	tyea 3/31/08	---	-27	-1,280	119	69	39	25	18	12	10	10	9	-996
2. Extension and expansion of certain GO Zone incentives:														
a. Election to amend returns with hurricane-related casualty losses for Louisiana, Mississippi, Alabama, Texas, and Florida.....	DOE	---	-784	-218	-20	---	---	---	---	---	---	---	---	-1,022

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
b. Waiver of deadline on construction of GO Zone property eligible for bonus depreciation	ppisa 12/31/07	---	---	-92	-173	-72	-6	-1	3	6	8	10	10	-308
c. Inclusion of certain counties in GO Zone for purposes of tax-exempt bond financing	[36]	---	[1]	-2	-1	---	---	---	---	---	---	---	---	-3
B. Revenue Offsets														
1. Require information reporting on payment card and third party payment transactions	[37]	---	---	---	---	21	608	793	1,231	1,594	1,678	1,760	1,844	9,529
2. Exclusion of gain on sale of principal residence exclusion not to apply to nonqualified use	soea 12/31/08	---	---	---	20	108	102	111	139	171	207	246	290	1,394
3. Delay for two years implementation of worldwide interest allocation and apply 70% limitation on the first year of worldwide interest allocation	tyba DOE	---	---	999	2,736	2,293	1,599	---	---	---	---	---	---	7,627
4. Modify timing for corporate estimated tax payment [38]	DOE	---	---	---	---	---	-9,934	19,420	-9,486	---	---	---	---	---
TOTAL OF PART THIRTEEN		**---**	**-1,371**	**-16,102**	**2,610**	**3,714**	**-6,540**	**21,190**	**-7,469**	**2,181**	**1,958**	**1,521**	**1,468**	**3,154**
PART FOURTEEN: REPEAL THE DOLLAR LIMITATION ON CONTRIBUTIONS TO FUNERAL TRUSTS (P.L. 110-317, signed into law by the President on August 29, 2008)	**tyoftba DOE**	**---**	**---**	**[11]**	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**6**
PART FIFTEEN: RESTORE THE HIGHWAY TRUST FUND BALANCE (P.L. 110-318, signed into law by the President on September 15, 2008)	**DOE**	**---**	***No Revenue Effect***											
PART SIXTEEN: SSI EXTENSION FOR ELDERLY AND DISABLED REFUGEES ACT - Collect Unemployment Compensation Debts Resulting from Fraud (P.L. 110-328, signed into law by the President on September 30, 2008)	**DOE**	**---**	**---**	**11**	**43**	**50**	**39**	**25**	**16**	**10**	**9**	**9**	**9**	**220**

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
PART SEVENTEEN: EMERGENCY ECONOMIC STABILIZATION ACT OF 2008, ENERGY IMPROVEMENT AND EXTENSION ACT OF 2008, AND THE ALTERNATIVE MINIMUM TAX RELIEF ACT OF 2008 (P.L. 110-343, signed into law by the President on October 3, 2008)														
Division A - the Emergency Economic Stabilization Act of 2008														
I. Tax Provisions														
A. Allow Ordinary Treatment for Gain or Loss from Sale or Exchange of Certain Preferred Stock by Certain Financial Institutions	soeoa 12/31/07 in tyea 12/31/07	---	---	-2,724	-423	-238	-53	116	95	87	58	25	12	-3,045
B. Special Rules for Tax Treatment of Executive Compensation of Employers Participating in the Troubled Assets Relief Program ("TARP")	tyea DOE & soo/a DOE	---	---	[39]	[39]	[39]	[39]	[39]	[39]	[39]	[39]	[39]	[39]	[39]
C. Extension of Exclusion of Discharges of Principal Residence Acquisition Indebtedness from Gross Income of Individuals (sunset 12/31/12)	doioa 1/1/10	---	---	---	-27	-165	-90	-80	---	---	---	---	---	-362
Total of Tax Provisions in Division A		---	---	-2,724	-450	-403	-143	36	95	87	58	25	12	-3,407
Division B - the Energy Improvement and Extension Act of 2008														
I. Energy Production Incentives														
A. Renewable Energy Incentives														
1. Extension and modification of the section 45 renewable energy credit - extend by two years (one year for wind and refined coal) the section 45 placed-in-service period (excluding Indian coal and solar facilities); add marine and hydrokinetic energy as qualified energy resource; allow new biomass units to qualify for credit; clarify definition of trash combustion facilities; change definition of qualified hydropower production; and remove market value test for refined coal and increase emissions standards for refined coal	[40]	---	---	-142	-395	-569	-633	-653	-661	-677	-694	-699	-695	-5,817
2. Extension and modification of the section 48 energy credit - add CHP and geothermal heat pump systems at 10% credit, increase fuel cell credit cap to $1,500 per half KW, waive public utility rule, and allow against AMT; (sunset 12/31/16)	[41]	---	---	-157	-198	-236	-217	-210	-224	-236	-230	-130	-56	-1,894

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
3. Energy credit for commercial small wind property (sunset 12/31/16)	ppisa DOE	---	---	-1	-2	-3	-4	-5	-7	-8	-10	-6	-2	-48
4. Extend and modify credit for residential energy efficient property - allow credit against AMT, remove solar electric property cap; and add small wind ($4,000 cap) and geothermal ($2,000 cap) property (sunset 12/31/16)	tyba 12/31/07	---	---	-47	-127	-130	-135	-140	-146	-152	-157	-156	-106	-1,294
5. New clean renewable energy bonds ($800 million of bond allocation) [42] extend termination date for section 54 CREBs	bia DOE	---	---	-3	-8	-18	-29	-34	-35	-35	-35	-35	-35	-267
6. Modify section 45 to add credit for steel industry fuel [43]	[44]	---	---	-18	-20	-10	-6	-4	-2	[1]	---	---	---	-61
7. Special rule to implement FERC and State electric restructuring policy (sunset 12/31/09)	[45]	---	---	-519	-39	90	90	90	90	109	72	16	---	---
B. Carbon Mitigation and Coal Provisions														
1. Expansion and modification of the advanced coal project investment credit	DOE	---	---	-389	-379	-312	-210	-111	-48	-10	9	14	14	-1,424
2. Expansion and modification of coal gasification investment credit	DOE	---	---	*Estimate Included in Line Above*										
3. Temporary increase in coal excise tax; funding of Black Lung Disability Trust Fund:														
a. Extend excise tax on coal at current rates (sunset 12/31/18)	DOE	---	---	---	---	---	---	---	203	271	271	271	271	1,287
b. Restructure Black Lung Trust Fund debt and authorize intergovernmental transfer [7]	DOE	---	---	*No Net Budget Effect*										
4. Special rules for refund of coal excise taxes paid by certain coal producers and exporters	DOE	---	---	-260	16	14	12	8	5	3	3	[11]	[11]	-199
5. Industrial CO2 capture and sequestration tax credit	cdca DOE	---	---	---	---	-60	-155	-234	-284	-194	-104	-61	-29	-1,119
6. Certain income and gains relating to industrial source carbon dioxide and to alcohol fuels and mixtures, biodiesl fuels and mixtures, and alternative fuels and mixtures treated as qualifying income for purposes of the exception from treatment of publicly traded partnerships as corporations	tyea DOE	---	---	-4	-4	-5	-7	-9	-11	-14	-17	-22	-26	-119
7. Carbon audit of provisions of the Internal Revenue Code of 1986	DOE	---	---	*No Revenue Effect*										

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
II. Transportation and Domestic Fuel Security Provisions														
A. Expansion of Special Depreciation Allowance for Cellulosic Biofuel Plant Property Through 2012.....	[46]	---	---	-1	-2	-1	---	---	1	1	1	---	---	---
B. Extension and Modification of Credits for Biodiesel and Renewable Diesel														
1. Extend biodiesel (including 10 cents per gallon small agri-biodesel producer credit), make $1.00 per gallon credit available to all biodiesel, and add camelina to the nonexclusive list of sources for agri-biodiesel (sunset 12/31/09).....	fpsoua 12/31/08	---	---	-370	-137	---	---	---	---	---	---	---	---	-507
2. Extend renewable diesel through 12/31/09; eliminate thermal depolymerization requirement; sunset credit for renewable diesel co-produced with petroleum products.....	fpsoua 12/31/08 & DOE	---	---	[1]	-5	---	---	---	---	---	---	---	---	-5
3. Qualify biomass jet fuel for renewable diesel credit.....	fpsoua 12/31/08	---	---	[1]	---	---	---	---	---	---	---	---	---	[1]
C. Clarification that Credits for Fuel are Designed to Provide Incentive for Fuels with Sufficient Nexus to the United States.....	[47]	---	---	42	16	3	---	---	---	---	---	---	---	61
D. Extension and Modification of Alternative Fuels Excise Tax Credits, Credit Allowed for Aviation Use of Fuel, Alternative Fuel to Include Compressed or Liquefied Biomass Gas, and Additional Carbon Dioxide Sequestration Requirements for Fischer-Tropsch Processing (sunset 12/31/09 for Non-Hydrogen Fuels).....	DOE & fsoua DOE	---	---	---	-61	---	---	---	---	---	---	---	---	-61
E. Credit for New Qualified Plug-in Electric Drive Motor Vehicles - 250,000 Vehicle Cap, 4 Kilowatt-Hour Battery Minimum.....	tyba 12/31/08	---	---	[1]	-3	-25	-130	-156	-212	-233	---	---	---	-758
F. Exclusion from Heavy Vehicles Excise Tax for Idling Reduction Units and Advanced Insulation.....	soia DOE	---	---	-2	-3	-5	-7	-9	-10	-12	-14	-15	-17	-95
G. Extension and Modification of Alternative Fuel Vehicle Refueling Property Credit - One-Year Extension Including Electric Vehicle Recharging Stations, Maximum $30,000/30% Credit.....	ppisa DOE & tyba DOE	---	---	-1	-31	-26	-9	-10	-12	-3	2	2	2	-87
H. Extension and Modification of Election to Expense Certain Refineries (sunset 12/31/13).....	ppisa DOE	---	---	-72	-79	-64	-721	-1,133	-144	443	356	288	233	-894

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
I. Extension of Suspension of 100 Percent-of-Net-Income Limitation on Percentage Depletion for Oil and Natural Gas from Marginal Properties (sunset 12/31/09)	tyba 12/31/08	---	---	-81	-43	---	---	---	---	---	---	---	---	-124
J. Extend Transportation Fringe Benefit to Bicycle Commuters	tyba 12/31/08	---	---	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-10
III. Energy Conservation and Efficiency Provisions														
A. Qualified Energy Conservation Bonds ($800 Million Allocation) [42]	bia DOE	---	---	-7	-18	-27	-32	-32	-32	-32	-32	-32	-32	-276
B. Extension and Modification of Credit for Energy Efficiency Improvements to Existing Homes (sunset 12/31/09)	ppisa 12/31/08	---	---	-10	-817	---	---	---	---	---	---	---	---	-827
C. Extension of Energy Efficient Commercial Buildings Deduction (sunset 12/31/13)	DOE	---	---	-113	-183	-193	-197	-201	-59	17	15	13	10	-891
D. Extension of Credit for Energy Efficient New Homes (sunset 12/31/09)	ppisa 12/31/08	---	---	-21	-16	-6	-5	-4	-4	-3	-1	---	---	-61
E. Extension and Modification of Energy Efficient Appliance Credit	apa 12/31/07	---	---	-182	-65	-36	-26	-11	-2	---	---	---	---	-322
F. 10-Year Applicable Recovery Period for Qualified Smart Electric Distribution Property, 150 Declining Balance Method	ppisa DOE	---	---	-5	-17	-34	-53	-70	-89	-114	-143	-176	-213	-915
G. Extension of Issuance Authority for Qualified Green Building and Sustainable Design Project Bonds (sunset 9/30/12)	DOE	---	---	---	-1	-3	-5	-6	-6	-6	-6	-6	-6	-45
H. Special Depreciation Allowance for Certain Reuse and Recycling Property	ppisa 8/31/08	---	---	-17	-32	-27	-21	-17	-14	-11	-8	-7	-8	-162
IV. Revenue Provisions														
A. Freeze at 6% the Section 199 Deduction for Income Attributable to Domestic Production of Oil, Gas, or Primary Products Thereof	tyba 12/31/08	---	---	---	226	450	483	519	557	598	642	690	741	4,906
B. Eliminate the Distinction Between FOGEI and FORI and apply Present-Law FOGEI Rules to all Foreign Income from the Production and Sale of Oil and Gas Product	tyba 2008	---	---	89	194	204	214	225	236	248	260	273	287	2,230
C. Broker Reporting of Customer's Basis in Securities Transactions	[48]	---	---	---	---	---	42	264	457	983	1,482	1,669	1,773	6,670
D. FUTA Surtax of 0.2 Percent (sunset 12/31/09) [7]	wpa 12/31/08	---	---	1,061	413	---	---	---	---	---	---	---	---	1,474

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
E. Extend and Increase Excise Tax Rate for the Oil Spill Liability Trust Fund ($0.08 through 12/31/16, and $0.09 for 1/1/17 through 12/31/17); Eliminate the Provision that Suspends the tax when the Trust Fund Unobligated Balance Exceeds $2.7 Billion.....	[49] & DOE	---	---	155	157	159	161	162	163	164	165	206	221	1,715
Total of Division B		---	---	-1,076	-1,664	-871	-1,601	-1,782	-291	1,096	1,826	2,096	2,326	61
Division C - the Tax Extenders and Alternative Minimum Tax Relief Act of 2008														
I. Alternative Minimum Tax														
A. Extension of Alternative Minimum Tax Relief for Nonrefundable Personal Credits and Increased AMT Exemption Amount (sunset 12/31/08).....	tyba 12/31/07	---	---	-76,668	14,851	---	---	---	---	---	---	---	---	-61,817
B. Increase of AMT Refundable Credit Amount for Individuals with Long-Term Unused Credits for Prior Year Minimum Tax Liability														
1. Remove AGI limits from refundable AMT credit and change usage rate of unused credit from 20% to 50%.....	tyba 12/31/07	---	---	-1,873	-262	200	276	191	120	106	99	91	84	-966
2. Abatement of incentive stock option AMT liability, penalty, and interest.....	DOE	---	---	-348	-151	-151	-136	-114	-99	-91	-84	-76	-76	-1,325
II. Extension of Individual Tax Provisions														
A. Deduction for State and Local General Sales Taxes (sunset 12/31/09).....	tyba 12/31/07	---	---	-1,628	-1,461	-214	---	---	---	---	---	---	---	-3,304
B. Deduction for Qualified Tuition and Related Expenses (sunset 12/31/09).....	tyba 12/31/07	---	---	-3,149	-2,184	---	---	---	---	---	---	---	---	-5,333
C. Above-The-Line Deduction of up to $250 for Teacher Classroom Expenses (sunset 12/31/09).....	tyba 12/31/07	---	---	-214	-196	---	---	---	---	---	---	---	---	-410
D. Additional Standard Deduction for State and Local Real Property Taxes for 2009.....	tyba 12/31/08	---	---	-374	-1,121	---	---	---	---	---	---	---	---	-1,495
E. Tax-Free Distributions from IRAs to Certain Public Charities from Age 70 1/2 or Older, Not to Exceed $100,000 Per Taxpayer Per Year (sunset 12/31/09).....	Da 12/31/07	---	---	-433	-157	-21	-23	-24	-25	-26	-27	-29	-30	-795
F. Treatment of Certain Dividends of Regulated Investment Companies ("RICs") (sunset 12/31/09)..	[50]	---	---	-71	-63	---	---	---	---	---	---	---	---	-134
G. Estate Tax Look-Through for Certain RIC Stock Held by Nonresidents (sunset 12/31/09).....	dda 12/31/07	---	---	*Negligible Revenue Effect*										
H. Extend the Treatment of RICs as "Qualified Investment Entities" Under Section 897 (FIRPTA) (sunset 12/31/09).....	1/1/08	---	---	-15	-5	---	---	---	---	---	---	---	---	-20

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
III. Extensions of Business Tax Provisions														
A. Extend and Modify the Tax Credit for R&E Expenses (Repeal the AIRC and Increase the Alternative Simplified Credit to 14% for 2009)	apoia 12/31/07 before 12/31/09	---	---	-8,378	-3,452	-1,744	-1,487	-1,271	-1,055	-775	-449	-257	-216	-19,084
B. Extend the New Markets Tax Credit (sunset 12/31/09)	ima 12/31/08	---	---	-106	-168	-170	-192	-205	-202	-202	-77	[11]	7	-1,315
C. Exception Under Subpart F for Active Financing Income (sunset 12/31/09)	tyba 12/31/08	---	---	-960	-3,010	---	---	---	---	---	---	---	---	-3,970
D. Look-Through Treatment of Payments Between Related CFCs Under Foreign Personal Holding Company Income Rules (sunset 12/31/09)	tyba 2008	---	---	-143	-468	---	---	---	---	---	---	---	---	-611
E. 15-Year Straight Line Cost Recovery for Qualified Leasehold, Restaurant and Retail Improvements and New Restaurants (sunset 12/31/09)	[51]	---	---	-1,931	-1,740	-755	-728	-639	-551	-596	-651	-645	-486	-8,721
F. Modify Tax Treatment of Certain Payments Under Existing Arrangements to Controlling Exempt Organizations (sunset 12/31/09)	proaa 12/31/07	---	---	-33	-13	-1	[1]	---	---	---	---	---	---	-47
G. Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property (sunset 12/31/09)	tyba 12/31/07	---	---	-59	-27	-7	-6	-6	-6	-6	-6	-6	-5	-132
H. Increase in Limit on Cover Over of Rum Excise Tax Revenues (from $10.50 to $13.25 Per Proof Gallon) to Puerto Rico and the Virgin Islands (sunset 12/31/09) [7]	abiUSa 12/31/07	---	---	-172	-20	---	---	---	---	---	---	---	---	-192
I. Economic Development Credit for American Samoa (sunset 12/31/09)	tyba 12/31/07	---	---	-22	-11	---	---	---	---	---	---	---	---	-33
J. Extension of Mine Rescue Team Training Credit (sunset 12/31/09)	pca DOE	---	---	-1	-1	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-4
K. Extension of Election to Expense Advanced Mine Safety Equipment (sunset 12/31/09)	ppisa DOE	---	---	-16	-3	6	4	3	3	2	1	[11]	---	---
L. Deduction Allowable With Respect to Income Attributable to Domestic Production Activities in Puerto Rico (sunset 12/31/09)	tyba 12/31/07	---	---	-175	-68	---	---	---	---	---	---	---	---	-243
M. Extension and Modification of Credit to Holders of Qualified Zone Academy Bonds - Allocations of Bond Authority (sunset 12/31/09)	oia 12/31/07	---	---	-6	-19	-32	-43	-49	-48	-47	-46	-45	-44	-379
N. Indian Employment Tax Credit (sunset 12/31/09)	tyba 12/31/07	---	---	-70	-38	-10	-1	---	---	---	---	---	---	-119
O. Accelerated Depreciation for Business Property on Indian Reservations (sunset 12/31/09)	ppisa 12/31/07	---	---	-486	-311	-66	80	159	176	122	48	-3	-13	-295

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
P. 50% Tax Credit for Certain Expenditures for Maintaining Railroad Tracks; Permit Credit Against the AMT (sunset 12/31/09)	epoid tyba 12/31/07	---	---	-231	-99	[1]	[1]	---	---	---	---	---	---	-331
Q. 7-Year Recovery Period for Certain Motorsports Racing Track Facilities (sunset 12/31/09)	ppisa 12/31/07	---	---	-109	-18	-9	-3	-1	-2	2	10	15	15	-100
R. Expensing of "Brownfields" Environmental Remediation Costs (sunset 12/31/09)	epoia 12/31/07	---	---	-572	-116	44	52	53	47	42	36	30	27	-357
S. Work Opportunity Tax Credit for Hurricane Katrina Employees (sunset 08/28/09)	8/28/07	---	---	-14	-8	-4	-2	-1	[1]	[1]	---	---	---	-29
T. Extension of Increased Rehabilitation Credit for Structures in the Go Zone (sunset 12/31/09)	1/1/08	---	---	-8	-21	-13	-3	-2	-2	-1	-1	-1	[1]	-50
U. Enhanced Charitable Deduction for Qualified Computer Contributions (sunset 12/31/09)	cmd tyba 12/31/07	---	---	-267	-89	---	---	---	---	---	---	---	---	-356
V. Tax Incentives for Investment in the District of Columbia (sunset 12/31/09)	tyba 12/31/07	---	---	-78	-20	-12	-11	-11	-10	-10	-9	-9	-7	-179
W. Extend Enhanced Charitable Deduction for Contributions of Food Inventory and Modify Enhanced Deduction to Include Special Basis Rule in Certain Cases (sunset 12/31/09); Suspend Percentage Limitations for Contributions of Food by Qualified Farmers and Ranchers (sunset 1/1/09)	cma 12/31/07	---	---	-104	-45	---	---	---	---	---	---	---	---	-149
X. Extend Enhanced Charitable Deduction for Contributions of Book Inventory (sunset 12/31/09)	cma 12/31/07	---	---	-34	-15	---	---	---	---	---	---	---	---	-49
IV. Extension of Tax Administration Provisions														
A. Permanent Authority for Undercover Operations	DOE	---	---	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]
B. Permanent Authority to Disclose Information Related to Terrorist Activities	da DOE	---	---	*No Revenue Effect*										
V. Additional Tax Relief and Other Tax Provisions														
A. General Provisions														
1. Set refundable threshold for the child tax credit at $8,500	tyba 12/31/07	---	---	-3,129	---	---	---	---	---	---	---	---	---	-3,129
2. Provisions relating to film and television productions:														
a. Extend and modify treatment of certain qualified film and television productions (sunset 12/31/09)	qfatpca 12/31/07	---	---	-340	-59	120	52	36	30	26	22	18	14	-81
b. Modification of domestic production activities deduction for film production under section 199	tyba 2007	---	---	-18	-25	-34	-37	-39	-42	-45	-49	-52	-56	-397

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
3. Exemption of excise tax on certain wooden arrows designed for use by children [52]	sfsa DOE	---	---	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-2
4. Tax treatment of certain income received in connection with the Exxon Valdez litigation (3-year income averaging with maximum retirement plan contribution of up to $100,000)	DOE	---	---	-27	-6	-2	-2	-2	-2	-2	-2	-2	-2	-49
5. Reduce the recovery period for certain farming business machinery or equipment from seven to five years (sunset 12/31/09)	ppisa 12/31/08	---	---	-146	-236	-174	-169	-165	81	397	328	82	[1]	[1]
6. Modification of penalty on understatement of taxpayer's liability by tax return preparer	rpa 5/25/07	---	---	-1	-1	-2	-2	-2	-2	-2	-3	-3	-3	-22
B. Parity in Mental Health and Substance Use Disorder Benefits [7] [53]	1/1/09	---	---	---	-180	-335	-395	-420	-455	-465	-515	-550	-585	-3,900
VI. Disaster Relief														
A. Tax Benefits for the Midwestern and Hurricane Ike Disaster Areas [54]														
1. Special allocation of private activity bond financing ($1,000 per capita)	bia DOE & before 1/1/13	---	---	-9	-45	-96	-137	-167	-178	-177	-174	-170	-167	-1,320
2. Low-income housing credit (special credit allocation of $8 per capita in 2008, 2009, and 2010) (sunset 12/31/10)	caa 12/31/08	---	---	-20	-86	-179	-251	-278	-278	-278	-278	-278	-278	-2,203
3. Partial expensing for certain demolition and clean-up costs (sunset 12/31/10)	apoia tadd	---	---	-2	-1	---	---	---	---	---	---	---	---	-3
4. Extension for expensing for environmental remediation costs (sunset 12/31/10)	epoia tadd	---	---	---	[1]	[1]	---	---	---	---	---	---	---	[1]
5. Increase rehabilitation credit (sunset 12/31/10)	epoia tadd	---	---	-2	-1	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	-3
6. Treatment of net operating losses attributable to storm disaster losses	DOE	---	---	-103	-23	12	15	15	13	11	9	8	7	-37
7. Credit to holders of Midwestern tax credit bonds	bia 12/31/08 & before 1/1/10	---	---	-7	-26	-41	-34	-8	-8	-7	-7	-7	-7	-152
8. Representations regarding income eligibility for purposes of qualified residential rental project requirements	DOE	---	---	*Negligible Revenue Effect*										
9. Expansion of Hope Scholarship and Lifetime Learning Credits for students in the Midwestern disaster area	tyba 12/31/07 & before 1/1/10	---	---	-71	-50	---	---	---	---	---	---	---	---	-121
10. Temporary income exclusion of $600 monthly for employer-provided lodging in Midwestern disaster area; employer credit of 30% of excluded amount	[55]	---	---	-20	-2	---	---	---	---	---	---	---	---	-23

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
11. Special Rules for Use of Retirement Funds for Relief Relating to the Midwestern disaster area:														
a. Penalty-free withdrawals from retirement plans for qualified disaster recovery assistance distributions (capped at $100,000 per taxpayer); allow amount of distribution to be repaid to an eligible retirement plan within three years and to be included in income ratably over three years	dmo/a tadd & before 1/1/10	---	---	-34	-6	3	-1	-1	-1	[1]	[1]	[1]	[1]	-42
b. Recontributions of withdrawals for home purchases cancelled due to qualified storm damage	[56]	---	---	*Negligible Revenue Effect*										
c. Loans from qualified plans to individuals sustaining an economic loss due to the Midwestern disaster area	[57]	---	---	*Negligible Revenue Effect*										
12. Employee Retention Credit for employers affected by severe storms, tornados, and flooding	wpoia tadd & before 1/1/09	---	---	-64	-18	-8	-2	---	---	---	---	---	---	-93
13. Temporary suspension of limitations on qualified charitable contributions for relief efforts related to the Midwestern disaster area	[58]			-700	92	66	53	26	13	7	5	3	2	-433
14. Suspension of the 10% and $100 thresholds on personal casualty losses for losses which arise in the Midwestern disaster area	lao/a tadd	---	---	-61	---	---	---	---	---	---	---	---	---	-61
15. Special look-back rules for determining earned income - allow residents of the Midwestern disaster area as of the applicable disaster date who experienced a loss of income due to severe storms, tornados, or flooding to elect to use prior year's income in the calculation of the EIC	tyi tadd	---	---	-89	---	---	---	---	---	---	---	---	---	-89
16. Secretarial authority to make adjustments regarding taxpayer and dependency status	tybi 2008 or 2009	---	---	*Negligible Revenue Effect*										
17. Special rules for mortgage revenue bonds	doa 12/31/07	---	---	*Estimate Contained in Division C., Item VI.D.4.*										
18. Additional $500 personal exemption for Midwestern displaced individuals (staying as houseguests for at least 60 days) subject to maximum additional exemptions of $2,000	tybi 2008 or 2009	---	---	-8	-2	---	---	---	---	---	---	---	---	-10
19. Increase in standard mileage rate for charitable use of a vehicle for providing relief related to the Midwestern disaster area	cmo/a tadd & before 1/1/09	---	---	-9	---	---	---	---	---	---	---	---	---	-9

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
20. Mileage reimbursements to charitable volunteers excluded from gross income for providing relief related to the Midwestern disaster area up to standard business mileage rate	uopao/a tadd & before 1/1/09	---	---	-1	---	---	---	---	---	---	---	---	---	-1
21. Exclusions of certain cancellations of indebtedness for certain taxpayers affected by severe storms, tornados, or flooding	Dmo/a tadd & before 1/1/10	---	---	-4	-2	---	---	---	---	---	---	---	---	-6
22. Extend replacement period for nonrecognition of gain for property located in Midwestern disaster area	DOE	---	---	-30	-41	-3	1	1	1	2	2	2	2	-65
B. Reporting Requirements Relating to Disaster Relief Contributions	rfa 12/31/08	---	---	*Negligible Revenue Effect*										
C. Temporary Tax-Exempt Bond Financing and Low-Income Housing Tax Relief for Areas Damaged by Hurricane Ike	DOE	---	---	-5	-24	-50	-70	-81	-83	-82	-82	-81	-81	-638
D. National Disaster Relief for Federally Declared Disaster Areas in 2008 and 2009 [59]														
1. Individual casualty losses deductible for itemizers without regard to AGI; $500 floor applicable to all casualty losses (sunset 12/31/09)	tyba 12/31/07 & tyba 12/31/08	---	---	-676	-259	---	---	---	---	---	---	---	---	-934
2. Expensing of qualified disaster expenses - environmental remediation, debris removal or demolition of structures, or repairs (sunset 12/31/09)	apoia 12/31/07	---	---	-5	-15	-11	-4	-1	[11]	[11]	[11]	[11]	[11]	-35
3. 5-year carryback of NOLs for qualified disaster losses (sunset 12/31/09)	lai tyba 12/31/07	---	---	-189	-301	-15	76	64	55	47	40	34	29	-162
4. Relax mortgage revenue bond limitations for presidentially declared disasters (sunset 12/31/09)	doa 12/31/07	---	---	-2	-3	-5	-5	-5	-5	-5	-5	-5	-5	-45
5. Special depreciation allowance for qualified disaster property ("bonus depreciation")	ppisa 12/31/07	---	---	-1,045	-1,299	-1,082	-372	234	377	316	245	176	132	-2,318
6. Increased expensing for qualified disaster property under section 179	ppisa 12/31/07	---	---	-67	-31	-25	11	37	25	18	12	7	4	-10
VII. Revenue Raiser - Modify Tax Treatment of Offshore Nonqualified Deferred Compensation from Certain Tax Indifferent Parties	spa 12/31/08 [60]	---	---	1,849	2,539	2,313	2,275	2,028	1,513	942	453	7,938	3,310	25,161
Total of Division C		---	---	-104,826	-1,501	-3,344	-1,909	-672	-626	-790	-1,149	6,190	1,576	-107,058
TOTAL OF PART SEVENTEEN		**---**	**---**	**-108,626**	**-3,615**	**-4,618**	**-3,653**	**-2,418**	**-822**	**393**	**735**	**8,311**	**3,914**	**-110,404**

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
PART EIGHTEEN: FOSTERING CONNECTIONS TO SUCCESS AND INCREASING ADOPTIONS ACT OF 2008 - Clarification of Uniform Definition of a Qualifying Child (P.L. 110-351, signed into law by the President on October 7, 2008)	**tyba 12/31/08**	---	---	**7**	**198**	**203**	**169**	**174**	**180**	**185**	**191**	**197**	**204**	**1,709**
PART NINETEEN: MICHELLE'S LAW - Ensure that Dependent Students Who Take a Medically Necessary Leave of Absence Do Not Lose Health Insurance Coverage (P.L. 110-381, signed into law by the President on October 9, 2008)	**[61]**	*Negligible Revenue Effect*												
PART TWENTY: INMATE TAX FRAUD PREVENTION ACT OF 2008 - Disclosure of Prisoner Return Information to Federal Bureau of Prisons and Annual Statistical Report on Fraudulent Activity in State and Federal Prisons (sunset 12/31/11) (P.L. 110-428, signed into law by the President on October 15, 2008)	**DMA 12/31/08 & rsa DOE**	—	—	**[11]**	**[11]**	**[11]**	**[11]**	—	—	—	—	—	—	**1**
PART TWENTY-ONE: WORKER, RETIREE, AND EMPLOYER RECOVERY ACT OF 2008 (P.L. 110-458, signed into law by the President on December 23, 2008)														
I. Technical Corrections Related to the Pension Protection Act of 2006														
A. Technical Corrections Related to the Pension Protection Act of 2006	[62]	---	*No Revenue Effect*											
B. Other Provisions														
1. Determination of value of single employer pension plan assets under averaging method	[62]	---	---	10	9	8	7	6	6	6	6	6	6	70
2. Modification of interest rate assumption required with respect to certain small employer plans	yba 12/31/08	---	---	---	[11]	-2	-5	-8	-9	-9	-9	-9	-9	-59
3. Determination of market rate of return for governmental plans	[62]	---	*Negligible Revenue Effect*											
4. Treatment of certain reimbursements from governmental plans for medical care	pbo/a DOE	---	---	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	1	1	3

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
5. Rollover of amounts received in airline carrier bankruptcy to Roth IRAs	tma DOE	---	---	-1	-5	-8	-9	-9	-9	-10	-10	-10	-10	-82
6. Determination of asset value for special airline funding rules	pyba 12/31/07	---	---	*Negligible Revenue Effect*										
7. Increase penalties for failure to file partnership returns by $4 per partner	rfa 12/31/08	---	---	[11]	4	4	4	4	5	5	5	5	5	42
8. Increase penalties for failure to file S corporation returns by $4 per shareholder	rfa 12/31/08	---	---	[11]	4	4	4	4	4	4	5	5	5	38
II. Pension Provisions Relating to Economic Crisis														
A. Temporary Waiver of Required Minimum Distribution Rules for Certain Retirement Plans and Accounts (sunset 12/31/09)	cyba 12/31/08	---	---	-37	-3,753	-28	-9	[11]	10	20	31	43	56	-3,666
B. Phase-in of Funding Target	[62]	---	---	516	614	443	-5	-242	-355	-396	-190	-148	-194	43
C. Temporary Waiver of Restriction on Benefit Accruals for Single Employer Plans	[63]	---	---	*Negligible Revenue Effect*										
D. Temporary Delay of Designation of Multiemployer Plans as in Endangered or Critical Status	[63]	---	---	115	136	98	-1	-54	-79	-88	-42	-33	-43	10
E. Temporary Extension of the Funding Improvement and Rehabilitation Periods for Multiemployer Pension Plans in Critical and Endangered Status for 2008 or 2009	pyba 12/31/07	---	---	2	4	7	9	10	10	10	10	10	-19	52
TOTAL OF PART TWENTY-ONE		**---**	**---**	**605**	**-2,987**	**526**	**-5**	**-289**	**-417**	**-458**	**-194**	**-130**	**-202**	**-3,549**
PART TWENTY-TWO: CUSTOM USER FEES AND CORPORATE ESTIMATED TAXES														
A. Extension of Customs User Fees [64]	various	*Estimated by the Congressional Budget Office*												
B. Modifications to Corporate Estimated Tax Payments Due in July, August, and September 2012														
1. Increase by .25 percentage points the required corporate estimated tax payments factor for corporations with assets of at least $1 billion for payments due in July, August, and September 2012 (P.L. 110-42, signed into law by the President on June 30, 2007)	DOE	---	---	---	---	---	155	-155	---	---	---	---	---	---

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
2. Increase by .25 percentage points the required corporate estimated tax payments factor for corporations with assets of at least $1 billion for payments due in July, August, and September 2012 (P.L. 110-52, signed into law by the President on August 1, 2007)	DOE	---	---	---	---	---	155	-155	---	---	---	---	---	---
3. Increase by .25 percentage points the required corporate estimated tax payments factor for corporations with assets of at least $1 billion for payments due in July, August, and September 2012 (P.L. 110-89, signed into law by the President on September 28, 2007)	DOE	---	---	---	---	---	155	-155	---	---	---	---	---	---
4. Increase by .75 percentage points the required corporate estimated tax payments factor for corporations with assets of at least $1 billion for payments due in July, August, and September 2012 (P.L. 110-138, signed into law by the President on December 14, 2007)	DOE	---	---	---	---	---	465	-465	---	---	---	---	---	---
C. Modifications to Corporate Estimated Tax Payments Due in July, August, and September 2013														
1. Increase by .25 percentage points the required corporate estimated tax payments factor for corporations with assets of at least $1 billion for payments due in July, August, and September 2013 (P.L. 110-191, signed into law by the President on February 29, 2008)	DOE	---	---	---	---	---	---	147	-147	---	---	---	---	---
2. Increase by .25 percentage points the required corporate estimated tax payments factor for corporations with assets of at least $1 billion for payments due in July, August, and September 2013 (P.L. 110-287, signed into law by the President on July 29, 2008)	DOE	---	---	---	---	---	---	147	-147	---	---	---	---	---

Provision	Effective	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2007-18
3. Increase by 2 percentage points the required corporate estimated tax payments factor for corporations with assets of at least $1 billion for payments due in July, August, and September 2013 (P.L. 110-436, signed into law by the President on October 16, 2008)	DOE	---	---	---	---	---	---	1,121	-1,121	---	---	---	---	---
TOTAL OF PART TWENTY-TWO		**---**	**---**	**---**	**---**	**---**	**930**	**485**	**-1,415**	**---**	**---**	**---**	**---**	**---**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

[Legend and Footnotes for the Appendix appear on the following pages]

Legend for the Appendix:

Legend for "Effective" column:

abiUSa = articles brought into the United States after
apa = appliances produced after
Apa = alcohol produced after
apoaa = amounts paid or accrued after
apoia = amounts paid or incurred after
bfsfo/a = benefits for services furnished on or after
bia = bonds issued after
bib = bonds issued before
biob/a = bonds issued on, before or after
bpisa = buildings placed in service after
bio/b = bonds issued on or before
caa = credits allocated after
cabo/a = credits allocated before, on, or after
cdca = carbon dioxide captured after
cdi = credits determined in
cfcorfa = claims for credit or refund filed after
cma = contributions made after
cmd = contributions made during
cmi = contributions made in
cmo/a = contributions made on or after
comora = checks or money orders received after
cyba = calendar years beginning after
da = disclosures after
DA = determinations after
Da = distributions after
dda = decedents dying after
dma = distributions made after
DMA = disclosures made after
dmo/a = distributions made on or after
Dmo/a = discharges made on or after
DOE = date of enactment
dodoo/a = deaths or disabilities occurring on or after
doioa = discharges of indebtedness occurring after
doUSrpia = dispositions of U.S. real property interests after
ea = expenditures after
eca = exchanges completed after
epoia = expenditures paid or incurred after
epoid = expenses paid or incurred during
fpa = fuel produced after
fpsoua = fuels produced, sold, or used after
frap = Federal regulations are prescribed
fsoua = fuel sold or used after
grooa = gains realized on or after
ima = investments made after
laa = losses arising after
lai = losses arising in
lao/a = losses arising on or after
lro/a = loans repaid on or after
oia = obligations issued after
pa = payments after
pbo/a = payments before, on, or after
pca = productions commencing after
pma = payments made after
pmbo/a = payments made before, on or after
po/a = purchases on or after
ppisa = property placed in service after
proaa = payments received or accrued after
pyba = plan years beginning after
qfatpca = qualified film and television productions commencing after
ra = requests after
rfa = returns filed after
rolra = repayments of loans received after
rpa = returns prepared after
Rpa = remuneration paid after
rsa = reports submitted after
rrtbfa = returns required to be filed after
sfsa = shafts first sold after
sma = sales made after
soea = sales or exchanges after
soeoa = sales or exchanges occurring after
soia = sales or installation after
soo/a = severances occurring on or after
soproo/a = sales of personal residences occurring on or after
spa = services performed after
spicmbmt = services performed in calendar months beginning more than
tadd = the applicable disaster date
tma = transfers made after
trfspa = tips received for services performed after
tyba = taxable years beginning after
tyea = taxable years ending after
tybi = taxable years beginning in
tyi = taxable year including
tyoftba = taxable years of funeral trusts beginning after
uopao/a = use of passenger automobile on or after
wpa = wages paid after
wpoia = wages paid or incurred after
wpoifibwa = wages paid or incurred for individuals beginning work after
yba = years beginning after
yea = years ending after
30da = 30 days after
60da = 60 days after

[Footnotes for the Appendix appear on the following pages]

Footnotes for the Appendix:

[1] Loss of less than $500,000.
[2] Estimate includes interaction with item I.A.1 in Part One.
[3] Negligible revenue effect.
[4] Effective for owner-financing provided after the date of enactment and before January 1, 2011.
[5] Effective for IRS notices issued after the date which is six months after the date of enactment.
[6] Effective for levies issued on or after 120 days after the date of enactment.
[7] Estimate provided by the Congressional Budget Office.
[8] Effective as if included in section 1106 of the Pension Protection Act of 2006.
[9] The technical corrections are effective as if included in the Pension Protection Act of 2006.
[10] Effective as if included in section 402 of the Pension Protection Act of 2006.
[11] Gain of less than $500,000.
[12] Acquisition indebtedness otherwise eligible for the exclusion is limited to $2 million.
[13] Effective as if included in the section of the bill to which the technical correction applies.
[14] Effective as if included in the amendment made by section 1102(a) of the Internal Revenue Service Restructuring and Reform Act of 1998.
[15] Some taxpayers will receive a refundable credit equal to $300 ($600 for joint filers) plus $300 per qualifying child if the sum of the their earned income, Social Security income, VA disability income, and VA dependent indemnity compensation equals at least $3,000. Only taxpayers with a valid Social Security number may receive the credit.
[16] Estimate includes effects on outlays.
[17] Estimate shown after interaction with section 179 provision in Part Nine.
[18] Effective for property placed in service after December 31, 2007, in taxable years ending after such date.
[19] Effective with respect to group health plans for plan years beginning after the date that is one year after the date of enactment.
[20] Estimate includes effects on Social Security outlays provided by the Congressional Budget Office.
[21] Credit rate set at 100 percent of the credit rate that would allow bonds to be issued without discount or premium.
[22] Estimate includes interactive effects of limitations and reductions of duty drawbacks. An estimate of a stand-alone extension of the temporary duty rate under subheading 9901.00.50 of the Harmonized Tariff Schedule would yield smaller changes in revenues.
[23] Effective for articles entered for consumption, or withdrawn from warehouse for consumption, on or after October 1, 2008; and articles entered for consumption, or withdrawn from warehouse for consumption, before October 1, 2008, if a duty drawback claim is filed with respect to such articles on or after October 1, 2010.
[24] Effective as if included in the Economic Stimulus Act of 2008.
[25] Generally effective with respect to deaths from injuries occurring on or after the date of enactment and deaths from injuries occurring on or after October 7, 2001, and before the date of enactment if such contribution is made not later than one year after the date of enactment.
[26] Effective as if included in section 5 of the Mortgage Forgiveness Debt Relief Act of 2007.
[27] Generally effective for expatriations on or after the date of enactment. The tax on covered gifts and bequests is effective for gifts and bequests received on or after the date of enactment from expatriates whose expatriation date is on or after the date of enactment.
[28] Estimate includes an increase in outlays provided by the Congressional Budget Office.
[29] Estimate includes interaction with item I.C.5 in Part Thirteen.
[30] Effective date applies to low income housing credits attributable to buildings placed in service after December 31, 2007, to historic rehabilitation expenditures after December 31, 2007, and bonds issued after the date of enactment.

[Footnotes for the Appendix are continued on the following page]

Footnotes for the Appendix continued:

[31] Estimate includes effects estimated by the Congressional Budget Office of revenues and outlays related to the Affordable Housing Program of the Federal Home Loan Banks and outlays of the Department of the Treasury for interest on bonds issued by the Resolution Funding Corporation.
[32] Effective for guarantees made in connection with bonds issued after date of the enactment and before December 31, 2010 (or a renewal or extension of a guarantee so made).
[33] Generally effective for taxable years beginning after the date of enactment. Under section 3031(a) and (c), effective for gains and items of income recognized after the date of enactment. Under section 3031(b), effective for transactions entered into after the date of enactment. Under section 3033(a), effective for gains recognized after the date of enactment. Under section 3033(b), effective for gains and deductions recognized after the date of enactment.
[34] The revenue estimates for each provision and for Title II. of Part Thirteen are measured against present law. The sum of provision estimates for each year do not add to the total for the year because of interactions among the provisions.
[35] Estimate includes effects on receipts and outlays.
[36] Effective as if included in the provisions of the Gulf Opportunity Zone Act of 2005 to which it relates.
[37] Generally effective for information returns for reportable transactions for calendar years beginning after December 31, 2010. The amendments to backup withholding apply to amounts paid after December 31, 2011.
[38] Reduce to 100 percent the required corporate estimated tax payments factor for corporations with assets of at least $1 billion for payments due in July, August, and September 2012; increase by 16.75 percentage points such payments due in July, August, and September 2013.
[39] The amount of revenue gain is indeterminate, as it will depend on how the underlying TARP program is implemented, including how many and which firms sell troubled assets to Treasury, and whether they sell them directly or through the auction process.
[40] The proposal is generally effective for property originally placed in service after December 31, 2008. The repeal of the credit phaseout is effective for taxable years ending after December 31, 2008. The production credit for marine renewables is effective for electricity produced and sold after the date of enactment in taxable years ending after the date of enactment.
[41] The provision extending the 30-percent credit is generally effective on the date of enactment. the CHP credit and the increase in the credit cap for fuel cells apply to periods after the date of enactment, in taxable years ending after such date, under rules similar to the rules of section 48(m) of the Internal Revenue Code (the "Code") (as in effect on the day before the enactment of the Revenue Reconciliation Act of 1990). The provision relating to the restrictions on public utility property applies to periods after February 13, 2008, in taxable years ending after such date, under rules similar to the rules of section 48(m) of the Code (as in effect on the day before the enactment of the Revenue Reconciliation Act of 1990). The allowance of the credit against the alternative minimum tax is effective for taxable years beginning after the date of enactment. The energy credit for geothermal heat pump systems is effective for property placed in service after the date of enactment.
[42] Credit rate set at 70 percent of the credit rate that would allow bonds to be issued without discount or premium.
[43] Credit is available for 15 months for existing facilities and one year for new facilities.
[44] Effective for fuel produced after October 1, 2008, and one year from date placed in service for new facilities.
[45] The extension and change in definition applies to transactions after December 31, 2007. The change in timing of transfer of operational control is effective as if included in the American Jobs Creation Act of 2004. the exception for property located outside the United States applies to transactions after the date of enactment.
[46] Effective for property placed in service after the date of enactment in taxable years ending after the date of enactment.
[47] Effective for claims for credit or payment made on or after May 15, 2008.
[48] Generally effective for transactions on or after January 1, 2011, for stock in a corporation; January 1, 2012, for mutual funds; and January 1, 2013, for other securities.
[49] Effective for the first quarter that begins more than 60 days after the date of enactment.
[50] Effective for dividends with respect to taxable years of regulated investment companies beginning after December 31, 2007.
[51] Effective for qualified leasehold and restaurant improvements placed in service after 12/31/07, and retail improvements and new restaurants placed in service after 12/31/08.
[52] Estimate does not include effects on outlays.

[Footnotes for the Appendix are continued on the following page]

Footnotes for the Appendix continued:

[53] Estimate includes effects on outlays.

[54] The "Midwestern Disaster Area" means an area to which a major disaster has been declared by the President after May 20, 2008, and before August 1, 2008, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of severe storms, tornados, or flooding occurring during 2008 in the states of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin. The "Midwestern Disaster Area" means an area determined by the President to warrant individual or individual and public assistance from the Federal Government under such Act with respect to damages attributable to such severe storms, tornados, or flooding.

[55] Effective for lodging provided during the six-month period beginning on the first day of the first month beginning after the date of enactment.

[56] Effective for distributions made after the date which is 6 months before the applicable disaster date and before the date which is the day after the applicable disaster date.

[57] Increase in loan limits effective for loans made after the date of enactment and before January 1, 2010; repayment relief for loans outstanding beginning on the date of enactment of the Housing and Economic Recovery Act of 2008, and ending on December 31, 2009.

[58] Effective for contributions paid during the period beginning on the earliest applicable disaster date and ending on December 31, 2008.

[59] The term "federally declared disaster" means any disaster subsequently declared by the President of the United States after December 31, 2007, and before January 1, 2010, to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. The term "disaster area" means the area so determined to warrant such assistance.

[60] in the case of compensation attributable to services performed on or before December 31, 2008, effective for last tax year beginning before 2018.

[61] Effective for plan years beginning on or after October 9, 2009, for absences beginning in such plan years.

[62] In general, effective as if included in the provisions of the Pension Protection Act of 2006 to which the amendments relate.

[63] Effective for the first plan year beginning after September 30, 2008, and before October 1, 2009.

[64] For the details relating to Custom User Fees, see Part Twenty-Two of the General Explanation. For the estimates relating to the Custom User Fees, see the Congressional Budget Office website, www.CBO.gov.