DESCRIPTION OF THE
"ENERGY ADVANCEMENT AND INVESTMENT ACT OF 2007"

Scheduled for Markup
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SENATE COMMITTEE ON FINANCE
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Prepared by the Staff
of the
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INTRODUCTION

The Senate Committee on Finance has scheduled a markup on June 19, 2007. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the "Energy Advancement and Investment Act of 2007."

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the "Energy Advancement and Investment Act of 2007,"* (JCX-31-07), June 14, 2007.

I. ADVANCED ELECTRICITY INFRASTRUCTURE

A. Extension and Modification of Credit for the Production of Electricity Production Credit from Renewable Resources, and of the Credits for Producing Refined Coal and Indian Coal

Present Law

In general

An income tax credit is allowed for the production of electricity at qualified facilities using qualified energy resources.[2] 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 and Indian coal at qualified facilities.

Credit amounts and credit period

In general

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 is 2 cents per kilowatt-hour for 2007. 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.

The amount of credit a taxpayer may claim is phased out as the market price of electricity (or refined coal in the case of the refined coal production credit) exceeds certain threshold levels. The electricity production credit is reduced over a 3 cent phase-out 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 8 cents (adjusted for inflation). The refined coal credit is reduced over an $8.75 phase-out 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).

Reduced credit amounts and credit periods

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, the 10-year credit period is reduced to five years commencing on the date the facility was originally placed in service, for qualified facilities placed in service before August 8, 2005. However, for qualified open-loop

[2] Sec. 45.

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 amount is 0.75 cent per kilowatt-hour, indexed for inflation measured after 1992 (currently 1 cent per kilowatt-hour for 2007).

<u>Credit applicable to refined coal</u>

The amount of the credit for refined coal is $4.375 per ton (also indexed for inflation after 1992 and equaling $5.877 per ton for 2007).

<u>Credit applicable to Indian coal</u>

A credit is available for the sale of Indian coal to an unrelated third part 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 2007 the Indian coal credit is $1.544 per ton.

<u>Other limitations on credit claimants and credit amounts</u>

In general, in order to claim the credit, a taxpayer must own the qualified facility and sell the electricity produced by the facility (or refined coal or Indian coal, with respect to those credits) 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 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.[3] Generally, the general business credit for any taxable year may not exceed the

[3] Sec. 38(b)(8).

amount by which the taxpayer's net income tax exceeds the greater of the tentative minimum tax or so much of the net regular tax liability as exceeds $25,000. Excess credits may be carried back one year and forward up to 20 years.

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

Qualified facilities

Wind energy facility

A wind energy facility is a facility that uses wind to produce electricity. To be a qualified facility, a wind energy facility must be placed in service after December 31, 1993, and before January 1, 2009.

Closed-loop biomass facility

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

To be a qualified facility, a closed-loop biomass facility must be placed in service after December 31, 1992, and before January 1, 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 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:

- 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 trimming; 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 which 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 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 and the turbines or other generating devices must be added to the facility after August 8, 2005 and before January 1, 2009. In addition there must not be any enlargement of the diversion structure, or construction or enlargement of a bypass channel, or the impoundment or any withholding of additional water from the natural stream channel.

Refined coal facility

A qualifying refined coal facility is a facility producing refined coal that is placed in service after October 22, 2004 and before January 1, 2009. Refined coal is a qualifying liquid, gaseous, or solid synthetic fuel produced from coal (including lignite) or high-carbon fly ash, including such fuel used as a feedstock. A qualifying fuel is a fuel that when burned emits 20 percent less nitrogen oxides and either SO2 or mercury than the burning of feedstock coal or comparable coal predominantly available in the marketplace as of January 1, 2003, and if the fuel sells at prices at least 50 percent greater than the prices of the feedstock coal or comparable coal. In addition, to be qualified refined coal the fuel must be sold by the taxpayer with the reasonable expectation that it will be used for the primary purpose of producing steam.

Indian coal facility

A qualified Indian coal facility is a facility which is 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 for Electricity Produced from Certain Renewable Resources and Refined Coal

Eligible electricity production or coal production activity	Credit amount for 2007 (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	10	10
Closed-loop biomass	2	10[1]	10
Open-loop biomass (including agricultural livestock waste nutrient facilities)	1	5[2]	10
Geothermal	2	5	10
Solar (pre-2006 facilities only)	2	5	10
Small irrigation power	1	5	10
Municipal solid waste (including landfill gas facilities and trash combustion facilities)	1	5	10
Qualified hydropower	1	N/A	10
Refined Coal	5.877	10	10
Indian Coal	1.544	7[3]	7[3]

[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 5-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, cooperatives that are subject to the cooperative tax rules of subchapter T of the Code[4] 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.[5] 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. For taxable years ending on or before August 8, 2005, cooperatives may not pass any portion of the income tax credit for electricity production through to their patrons.

For taxable years ending after August 8, 2005, eligible cooperatives may elect to pass any portion of the credit through to their patrons. An eligible cooperative is defined as a cooperative organization that is owned more than 50 percent by agricultural producers or entities owned by agricultural producers. The credit may be apportioned among patrons eligible to share in patronage dividends on the basis of the quantity or value of business done with or for such patrons for the taxable year. The election must be made on a timely filed return for the taxable year, and once made, is irrevocable for such taxable year. The amount of the credit apportioned to patrons is not included in the organization's credit for the taxable year of the organization. The amount of the credit apportioned to a patron is included in the taxable year the patron with or within which the taxable year of the organization ends. If the amount of the credit for any taxable year is less than the amount of the credit shown on the cooperative's return for such taxable year, an amount equal to the excess of the reduction in the credit over the amount not apportioned to patrons for the taxable year is treated as an increase in the cooperative's tax. The increase is not treated as tax imposed for purposes of determining the amount of any tax credit.

Description of Proposal

The proposal extends through December 31, 2010, the period during which certain facilities may be placed in service as qualified facilities for purposes of the electricity production and refined coal credits. The placed in service date extension applies for all qualified facilities, except for qualified solar and Indian coal facilities.

The proposal also modifies the definition of refined coal as a credit-eligible resource. The proposal repeals the requirement that refined coal be produced in such a manner as to increase its value by 50 percent over the value of the feedstock coal used to produce it. The proposal also modifies the emission reduction requirement for refined coal. Under the proposal, when used, refined coal must result in a 20 percent emissions reduction of nitrogen oxide and a 40 percent emissions reduction in either sulfur dioxide or mercury.

Effective Date

The extension is effective for qualified facilities placed in service after December 31, 2008. The refined coal modification is effective for refined coal produced and sold after December 31, 2007.

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[4] Sec. 1381, et seq.

[5] Sec. 1382.

B. Clean Renewable Energy Bonds

Present law

Tax-exempt bonds

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

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

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[6] 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.[7] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

An issuer must file with the IRS certain information about the bonds issued by them in order for that bond issue to be tax-exempt.[8] 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.

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

[7] Sec. 148.

[8] Sec. 149(e).

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.[9] 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. The discount rate used to determine the present value amount is the average annual interest rate of tax-exempt obligations having a term of 10 years or more which are issued during the month the CREBs are issued. In addition, the Code requires level amortization of CREBs during the period such bonds are outstanding.

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

In addition to the above requirements, at least 95 percent of the proceeds of CREBs must be spent on qualified projects within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified projects during the five-year spending period, bonds will continue to qualify as CREBs if unspent proceeds are used

[9] In addition, IRS Notice 2006-7, 2006-10 I.R.B. 559, provides that qualified projects include any facility owned by a qualified borrower that is functionally related and subordinate to any facility described in sections 45(d)(1) through (d)(9) and owned by such qualified borrower.

within 90 days from the end of such five-year period to redeem bonds. The five-year spending period may be extended by the Secretary upon the qualified issuer's request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

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

Description of Proposal

The proposal extends and modifies the CREBs program. The proposal authorizes $750 million of CREBs allocations annually in calendar years 2008 and 2009. The $750 million allocation in 2008 is in addition to any amounts that may be allocated under the present law CREBs limitations. To the extent less than $750 million is allocated by the Secretary in 2008 or 2009, such unused allocations may be carried forward to the next calendar year. In addition, a qualified issuer receiving an allocation must issue the bonds with respect to such allocation by the end of the calendar year following the year in which the allocation was received.

With respect to the $750 million allocations in 2008 and 2009, the maximum annual allocation to qualified projects of governmental bodies is $470 million. At least one-half of the amounts allocated to governmental bodies in any year must be allocated to qualified projects equaling or exceeding $10 million in expected capital expenditures.

The proposal also modifies the amortization requirement for CREBs. Under the proposal, level amortization of CREBs is required during the period beginning one year after the bonds are issued and ending on the final maturity date of the bonds.

Under the proposal, the definition of a qualified project is amended to include any electric transmission property capital expenditures (as defined in section 172(b)(1)(I)(v)(I)) related to section 45 facilities otherwise eligible for CREBs financing.

Effective Date

The proposal is effective for bonds issued with respect to allocations of the national annual limitations established under the proposal. Thus, the proposal does not apply to bonds issued with respect to allocations of the existing national limitations for CREBs.

C. Clean Energy Coal Bonds

Present law

Tax-exempt bonds

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

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

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[10] 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.[11] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

An issuer must file with the IRS certain information about the bonds issued by them in order for that bond issue to be tax-exempt.[12] 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.

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

[11] Sec. 148.

[12] Sec. 149(e).

Clean renewable energy bonds

As an alternative to tax-exempt bonds, States and local governments may issue clean renewable energy bonds ("CREBs"). CREBs are defined as any bond issued by a qualified issuer if, in addition to the requirements discussed below, 95 percent or more of the proceeds of such bonds are used to finance capital expenditures incurred by qualified borrowers for qualified projects. "Qualified projects" are facilities that qualify for the tax credit under section 45 (other than Indian coal production facilities), without regard to the placed-in-service date requirements of that section.[13] 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. The discount rate used to determine the present value amount is the average annual interest rate of tax-exempt obligations having a term of 10 years or more which are issued during the month the CREBs are issued. In addition, the Code requires level amortization of CREBs during the period such bonds are outstanding.

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

In addition to the above requirements, at least 95 percent of the proceeds of CREBs must be spent on qualified projects within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified projects during the five-year spending period, bonds will continue to qualify as CREBs if unspent proceeds are used

[13] In addition, IRS Notice 2006-7, 2006-10 I.R.B. 559, provides that qualified projects include any facility owned by a qualified borrower that is functionally related and subordinate to any facility described in sections 45(d)(1) through (d)(9) and owned by such qualified borrower.

within 90 days from the end of such five-year period to redeem bonds. The five-year spending period may be extended by the Secretary upon the qualified issuer's request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

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

Advanced coal project investment credit

Section 48A of the Code provides an investment tax credit for qualifying advanced coal projects. In addition to other requirements, qualifying advanced coal projects are 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.

A qualifying 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.[14]

The fuel input for a qualifying advanced coal 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 total 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,[15] 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

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[14] 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.

[15] The Secretary issued guidance establishing the certification program on February 21, 2006 (IRS Notice 2006-24, 2006-11 I.R.B. 595).

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.

Description of Proposal

The proposal creates a new category of tax credit bonds, clean energy coal bonds. Clean energy coal bonds 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 one or more qualified projects. The term "qualified project" means a qualifying advanced coal project (as defined in section 48A(c)(1)) placed in service by a qualified borrower.

There is a national limitation for clean energy coal bonds of $1.5 billion. The proposal limits to $930 million the total allocations that may be made to projects of governmental bodies. Otherwise, allocations of clean energy coal bonds shall be made in the manner the Secretary determines appropriate. In addition, clean energy coal bonds must be issued before January 1, 2018.

For purposes of the proposal, the term "qualified issuer" means: (1) governmental bodies; (2) cooperative electric companies; and (3) clean energy coal bond lenders. The term "governmental bodies" means a State, territory, possession of the United States, the District of Columbia, Indian tribal government, and 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), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act. The term "qualified borrower" means a cooperative electric company or governmental bodies. A "clean energy coal 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.

Clean energy coal bonds are subject to the arbitrage requirements of section 148 that apply to tax-exempt bonds. In addition, a qualified issuer of clean energy coal bonds must reasonably expect to and actually spend 95 percent or more of the proceeds of such bonds on qualified projects 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 as required during this five-year spending period, bonds will continue to qualify as clean energy coal bonds if unspent proceeds are used within 90 days from the end of such five-year period to redeem any "nonqualified bonds." For these purposes, the amount of nonqualified bonds is to be determined in the same manner as Treasury regulations under section 142.[16] In addition, the proposal provides that the five-year spending period may be extended by the Secretary upon the qualified issuer's request.

The proposal also imposes a maximum maturity limitation on any clean energy coal bonds. The maximum maturity is the term which the Secretary estimates will result in the

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

present value of the obligation to repay the principal on a clean energy coal bonds being equal to 50 percent of the face amount of such bond. The proposal requires level amortization of clean energy coal bonds during the period beginning one year after the bonds are issued and ending on the final maturity date of the bonds.

Like present-law tax credit bonds, the taxpayer holding clean energy coal bonds 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 clean energy coal bonds 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.

Under the proposal, issuers of clean energy coal bonds to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds.

Effective Date

The proposal is effective for bonds issued after December 31, 2007.

D. Extension and Modification of Energy Credit

Present Law

In general

A nonrefundable, 10-percent business energy credit[17] 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 purposes of heating a swimming pool is not eligible solar energy property.

The energy credit is a component of the general business credit[18] 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.[19] The taxpayer's basis in the property is reduced by 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. Similarly, 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. This rule is waived in the case of telecommunication companies' purchases of fuel cell and microturbine property.

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.

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[17] Sec. 48.

[18] Sec. 38(b)(1).

[19] Sec. 39.

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 efficiency of greater than 30 percent and a capacity of at least on-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.

Description of Proposal

The proposal extends the otherwise expiring credits and credit rates for two years, through December 31, 2010. Also, the restriction relating to public utility property eligibility for the credit is repealed.

Effective Date

The proposal is effective for taxable years beginning after the date of enactment.

E. Special Depreciation Allowance for Certain Power Generation Equipment Used in Alternative Fuel Production Facilities

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").[20] The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[21] 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.

Generally, assets used in the transmission and distribution of electricity for sale and related land improvements are assigned a 20-year recovery period and a class life of 30 years. However, certain assets used in the transmission of electricity at 69 or more kilovolts of electricity for sale have a 15-year recovery period.[22]

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 Small Business and Work Opportunity Tax Act of 2007[23] increased the amount a taxpayer may deduct, for taxable years beginning in 2007 through 2010, to $125,000 of the cost of qualifying property placed in service for the taxable year.[24] 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 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. For taxable years beginning in 2011 and thereafter (or before 2003), the

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[20] Sec. 168.

[21] 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

[22] Sec. 168(e)(3)(E)(vii).

[23] Pub. L. No. 110-28, sec. 8212 (2007).

[24] 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)).

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.

Description of Proposal

The proposal allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of specified electric transmission property. For these purposes, specified electric transmission property means depreciable property: (1) which is used in the United States solely to transmit electricity from any qualified facility described in section 45(d) or energy property described in section 48(a)(3); (2) the original use of which commences with the taxpayer after the date of the enactment; (3) which is acquired by the taxpayer by purchase (as defined in section 179(d)) after the date of enactment, but only if no written binding contract for the acquisition was in effect on or before the date of enactment; and (4) which is placed in service by the taxpayer before January 1, 2011. Such term does not include property subject to the alternative depreciation system.

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 date of enactment, and the property is placed in service before January 1, 2011 (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.

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes. 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 proposal 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 proposal applies. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year. Recapture rules apply under the proposal if the property ceases to be specified electric transmission property.

Effective Date

The proposal is effective for property placed in service after the date of enactment, in taxable years ending after such date.

F. Extension of Special Rule to Implement FERC Restructuring Policy

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[25] (the "reinvestment property"). If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain is recognized to the extent of such excess in the year of the qualifying electric transmission transaction.

A qualifying electric transmission transaction is the sale or other disposition of property used by the taxpayer in the trade or business of providing electric transmission services, or an ownership interest in such an entity, to an independent transmission company prior to January 1, 2008. In general, an independent transmission company is defined as: (1) an independent transmission provider[26] approved by the FERC; (2) a person (i) who the FERC determines under section 203 of the Federal Power Act (or by declaratory order) is not a "market participant" and (ii) whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider before the close of the period specified in such authorization, 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).

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[25] 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.

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

Description of Proposal

The proposal extends the present-law deferral provision to sales or dispositions by a taxpayer prior to January 1, 2010. 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 proposal must take place no later than December 31, 2009.

Effective Date

The extension proposal applies to 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.

G. Credit for Residential Energy Efficient Property

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.

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

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

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

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

Description of Proposal

The proposal extends the credit for two years, through December 31, 2010. Additionally, the credit cap for solar electric property is raised to $4,000.

Effective Date

The proposal is effective for expenditures after December 31, 2008.

H. Credit for Residential Wind Property

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.

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

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

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

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

Description of Proposal

The proposal provides a 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 is allowed for property placed in service after December 31, 2007, and prior to January 1, 2011.

Qualified small wind energy property expenditures are expenditures for property that uses a qualified wind turbine to generate electricity for use in a dwelling unit located in the U.S. and used as a residence by the taxpayer. A qualifying wind turbine means a wind turbine of 100 kilowatts of rated capacity or less and which meets the latest performance rating standards published by the American Wind Energy Association and meets certain other requirements.

<u>Effective Date</u>

The provision is effective for expenditures after December 31, 2007.

I. Expansion and Modification of the Advanced Coal Project Investment Credit

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 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.[27]

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,[28] 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

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[27] 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.

[28] The Secretary issued guidance establishing the certification program on February 21, 2006 (IRS Notice 2006-24).

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

Description of Proposal

The proposal permits the Secretary to allocate an additional $562.5 million of credits to qualifying IGCC projects and $375 million of credits to qualifying projects using other advanced coal-based electricity generation technologies. The proposal requires the Secretary to allocate the additional credits in a manner similar to the allocation of credits under present law. In addition, the proposal imposes carbon capture requirements on qualified projects. To qualify for an allocation of credits under the proposal, a project must capture and sequester at least 70 percent of the total carbon dioxide emissions from the facility built using the credits.

Effective Date

The proposal is effective on date of enactment.

J. Expansion and Modification of the Coal Gasification Investment Credit

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,[29] 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.

Description of Proposal

The proposal expands and modifies the coal gasification investment credit. The proposal permits the Secretary to allocate an additional $562.5 million of credits to qualifying coal gasification projects. The proposal requires the Secretary to allocate the additional credits in a manner similar to the allocation of credits under present law.

The proposal modifies the types of projects that are qualified gasification projects. The proposal expands such projects to include projects that convert coal into transportation grade liquid fuels using a Fischer-Tropsch process. In addition, the proposal imposes carbon capture requirements on qualified projects. To qualify for an allocation of credits under the proposal, a project must capture and sequester at least 70 percent of the total carbon dioxide emissions from the facility built using the credits.

Effective Date

The proposal is effective on the date of enactment.

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[29] The Secretary issued guidance establishing the certification program on February 21, 2006 (IRS Notice 2006-25).

II. DOMESTIC FUEL SECURITY

A. Small Producer Credit for Cellulosic Alcohol

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 produce 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.

Description of Proposal

The provides an income tax credit of 50 cents per gallon for up to 60 million gallons of qualified cellulosic fuel production of the producer for the taxable year. This credit is in addition to any credit that may be available under section 40 of the Code.

Qualified cellulosic fuel production is any cellulosic alcohol which is produced by a small cellulosic alcohol fuel producer during the taxable year which is 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 alcohol at retail to another person and places such alcohol in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c).

Cellulosic alcohol is alcohol that is produced in the United States and is derived from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis. Examples of lignocellulosic or hemicellulosic matter that is available of a renewable or recurring basis includes dedicated energy crops and trees, wood and wood residues, plants, grasses, agricultural residues, fibers, animal wastes and other waste materials, and municipal solid waste.

Generally, a small cellulosic alcohol fuel producer is a cellulosic alcohol producer whose production capacity does not exceed 60 million gallons.

The small cellulosic alcohol producer credit terminates at the end of the calendar year in which the Environmental Protection Agency certifies that it has received RINs representing one billion gallons of cellulosic alcohol.

Effective Date

The proposal is effective for alcohol produced after December 31, 2007.

B. Expansion of Special Depreciation Allowance for Cellulosic Biomass Ethanol Plant Property

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.

Description of Proposal

The proposal changes the definition of qualified property. Under the proposal, qualified property includes cellulosic biomass alcohol, which is defined as any alcohol produced by any process directly employing any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis. Examples of lignocellulosic or hemicellulosic matter that is available of a renewable or recurring basis includes dedicated energy crops and trees, wood and wood residues, plants, grasses, agricultural residues, fibers, animal wastes and other waste materials, and municipal solid waste.

Effective Date

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

C. Modification of the Incentives Relating to Alcohol Fuels

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.[30]

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.[31]

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 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.

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[30] 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.

[31] 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.

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.

Description of Proposal

Under the proposal, the 51-cent-per-gallon incentive for ethanol is adjusted to 46 cents per gallon beginning with the first calendar year after the year in which the Environmental Protection Agency receives RINs in an amount equivalent to 7.5 billion gallons of ethanol (including cellulosic ethanol).

Effective Date

The proposal is effective on the date of enactment.

D. Extension of Credit for Installation of Alternative Fuel Refueling Property

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.[32] 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 1 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 property, the property must be placed in service before January 1, 2015.

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[32] Sec. 30C.

Description of Proposal

The proposal extends through 2012 the credit for installing non-hydrogen alternative fuel refueling property.

Effective Date

The proposal is effective for property placed in service after the date of enactment, in taxable years ending after such date.

E. Extension of Credits for Biodiesel

Present Law

Income tax credit

Overview

The Code provides an income tax credit for biodiesel fuels (the "biodiesel fuels credit").[33] The biodiesel fuels credit is the sum of the biodiesel mixture credit, the biodiesel credit and 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.

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

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

Biodiesel mixture credit

The biodiesel mixture credit is 50 cents for each gallon of biodiesel (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 which is not in a mixture with diesel fuel (100 percent biodiesel or B-100) and which during the taxable year is (1) used by the

[33] Sec. 40A.

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 ethanol in the fuel tank of such other person; or (2) 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.[34] 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.[35]

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.[36] To the extent the biodiesel fuel mixture credit exceeds the section 4081 liability of a person, the Secretary is to pay such person an amount equal to the biodiesel fuel mixture credit with respect to such mixture.[37] Thus, if the person has no section 4081 liability, the credit is refundable. The

[34] Sec. 6426(c).

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

[36] Sec. 6427(e).

[37] Sec. 6427(e)(1) and 6427(e)(3).

Secretary is not required to make payments with respect to biodiesel fuel mixtures sold or used after December 31, 2008.

Description of Proposal

The proposal generally extends an additional two years (through December 31, 2010) the income tax credit, excise tax credit, and payment provisions for biodiesel (including agri-biodiesel). The small agri-biodiesel producer credit is extended an additional four years (through December 31, 2012).

Effective Date

The proposal is generally effective on the date of enactment.

F. Extension and Modification of Renewable Diesel Incentives

Present Law

Renewable diesel

The Code provides a tax incentive of $1.00 per gallon relating to renewable diesel. This incentive may be taken as an income tax credit, an excise tax credit, or as a payment from the Secretary.[38] "Renewable diesel" means 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 American Society of Testing and Materials (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.

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.

Description of Proposal

The proposal provides that, on a per year basis, producers of co-produced fuel may claim one dollar per gallon for up to 60 million gallons of renewable diesel contained in a qualified mixture. After 60 million gallons, the amount of credit or payment for each gallon of renewable diesel that is part of co-processed fuel is 50 cents. As under present law, the credit and payments are only for that volume of renewable diesel contained in the qualified mixture and not the total volume of co-produced fuel.

The proposal extends the tax incentives for renewable diesel (income tax credit, excise tax credit and payment provisions) an additional two years (through December 31, 2010).

Effective Date

The proposal restricting the amount of credit allowable for co-produced fuels is effective for fuels sold or used after date of enactment. The extension of the renewable diesel incentives is effective on the date of enactment.

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[38] Secs. 40A, 6426(c), and 6427(e). For purposes of the Code, renewable diesel is generally treated as biodiesel.

G. Extension of Small Ethanol Producer Credit

Present Law

The alcohol fuels credit is the sum of three credits: the alcohol mixture credit, the alcohol credit, and the small ethanol producer credit. Generally, the alcohol fuels credit expires after December 31, 2010.[39]

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.[40]

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 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.

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[39] 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.

[40] 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.

Description of Proposal

The proposal extends the small ethanol producer component of the alcohol fuels credit for an additional two years (through December 31, 2012).

Effective Date

The proposal is effective on the date of enactment.

H. Extension and Modification of Alternative Fuel Excise Tax Credit

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 Fisher-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[41] 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.

Description of Proposal

The proposal extends the alternative fuel excise tax credit and payment provisions through December 31, 2010. The incentives for hydrogen are unchanged by the proposal. The proposal provides the biomass gas based versions of liquified petroleum gas and liquified or compressed natural gas qualify for the credit.

Effective Date

The proposal is generally effective on the date of enactment. The expansion of qualified fuels to biomass gasses is effective for fuel sold or used after date of enactment.

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[41] "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).

I. Suspension of Taxable Income Limit on Percentage Depletion for Oil and Natural Gas Produced from Marginal Properties

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).

Description of Proposal

The proposal extends for two years the present-law taxable income limitation suspension provision for marginal production (through taxable years beginning on or before December 31, 2009).

Effective Date

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

J. Extension of Election to Expense Certain Refineries

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").[42] 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 ("EPA") which are paid or incurred by the taxpayer during the taxable year.[43]

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[44] 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.[45] 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.[46] The remaining 50 percent is generally recovered through MACRS depreciation

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[42] Sec. 168.

[43] Sec. 179B.

[44] Sec. 1381, et seq.

[45] Sec. 1382.

[46] 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 45K(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

deductions. 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;[47] (2) which are placed in service before January 1, 2012; (3) which increase the capacity of an existing refinery by at least five percent[48] or increase the percentage of total throughput[49] 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.[50]

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 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

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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.

[47] 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.

[48] 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.

[49] For purposes of the provision, the throughput of a refinery is measured on the basis of barrels per calendar day. Barrels per calendar day is the amount of fuels that a facility can process under usual operating conditions, expressed in terms of capacity during a 24-hour period and reduced to account for down time and other limitations.

[50] 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.

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).

Description of Proposal

The proposal extends the placed in service requirement to January 1, 2016, and the binding construction contract requirement to January 1, 2011. The extension applies to: (1) the cost of new qualified refinery property; and (2) existing property for costs that enable the existing qualified refinery to process qualified fuels (as defined in section 45K(c)) at a rate which is equal to or greater than 25 percent of the total throughput of such qualified refinery on an average daily basis. The proposal does not extend this provision for existing refineries that only meet the 5% increased capacity requirement.

Effective Date

The proposal is generally effective for property placed in service after December 31, 2011.

K. Extension of Temporary Duty on Ethyl Alcohol

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 United States prior to January 1, 2009. The temporary duty under heading 9901.00.50 offsets the alcohol fuels credit of 51 cents per gallon that is available to taxpayers that blend ethanol with gasoline; both domestic and imported ethanol is eligible for the alcohol fuels credit.

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.

Description of Proposal

The proposal 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 proposal is effective on the date of enactment.

L. Elimination of Certain Refunds of Duty Imposed on Ethanol

Present Law

Subheading 9901.00.50, 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 1313 of the Tariff Act of 1930, as amended, 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 1313 permits the refund of duty if the duty-paid good, or a substitute good, is exported. Subsection (p) of section 1313 permits the substitution on exportation for drawback eligibility of one motor fuel for anther 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.

Description of Proposal

The proposal eliminates the ability to obtain a refund of the duty imposed by subheading 9901.0050, HTSUS by substitution of ethanol not subject to the duty under subheading 9901.00.50, HTSUS for ethanol subject to the duty imposed under subheading 9901.00.50,HTSUS, for drawback purposes. The proposal also prevents a petroleum product which contains ethanol from being substituted for any other petroleum product that is exported to obtain drawback.

Effective Date

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

III. ADVANCED TECHNOLOGY VEHICLES

A. Expansion and Modification of Credit for Alternative Fuel Motor Vehicles

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.[51] 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 2002 model year city fuel economy rating for vehicles of various weight classes.[52] Table 1, below, shows the base credit amounts.

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[51] Sec. 30B.

[52] See discussion surrounding Table 6, below.

Table 1.–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 1, above is reduced to $4,000.

Table 2, below, shows the additional credits for passenger automobiles or light trucks.

Table 2.–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 vehicle

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[53] from the rechargeable energy storage system 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 3, 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 3.–Fuel Economy Credit

	If Fuel Economy of the Hybrid Vehicle Is:	
Credit	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 4, below, shows the conservation credit.

Table 4.–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

[53] 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 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)).

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 3, 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 4, 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 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 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 of all weight classes 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 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.[54]

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 5, 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.

[54] 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.

Table 5.–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 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 6, below, shows the 2002 model year city fuel economy for vehicles by type and by inertia weight class.

Table 6.–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.

Description of Proposal

The proposal extends the alternative fuel motor vehicle credit through 2012 for hybrid vehicles weighing more than 8,500 pounds, for advanced lean burn technology, and for alternative fuel vehicles. The proposal also extends the credit through 2016 for qualified fuel cell vehicles. The proposal further clarifies that a new qualified alternative fuel vehicle which weight more than 14,000 pounds is eligible for the additional credit available to vehicles meeting certain emissions standards so long as the vehicle is certified as exceeding the most stringent standard applicable to the model year in which such vehicle was produced.

The proposal also allows a credit for each qualified plug-in vehicle placed in service during each taxable year by a taxpayer. The base amount of the credit is $2,500. If the qualified vehicle draws propulsion from a battery with at least 5 kilowatt-hours of capacity, the credit amount is increased by $400, plus another $400 for each kilowatt-hour of battery capacity in excess of 5 kilowatt-hours. The maximum credit available for qualified plug-in vehicles is limited based on gross vehicle weight: $7,500 for vehicles weighing up to 10,000 pounds; $10,000 for vehicles weighing more than 10,000 pounds but not more than 14,000; $12,500 for vehicles weighing more than 14,000 pounds but not more than 26,000 pounds; and $15,000 for vehicles weighing more than 26,000 pounds. The credit is allowable against the alternative minimum tax.

A new qualified plug-in vehicle is a motor vehicle which meets certain emissions standards and is propelled to a significant extent by an electric motor that draws electricity from a battery which has a capacity of at least 4 kilowatt-hours and which is capable of being recharged from an external source of electricity.

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 a 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 with respect to such vehicle. A vehicle must be used predominantly in the United States to qualify for the credit.

There is a limitation on the number of qualified plug-in hybrid 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 plug-in vehicle sale. 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.

The basis of any qualified vehicle is reduced by the amount of the credit. The credit does not apply to vehicles placed in service after 2014. Vehicles eligible for credit as qualified plug-in vehicles are not eligible for any credits under section 30B.

Effective Date

The extension of section 30B is effective on the date of enactment. The plug-in vehicle proposal is effective for property placed in service after December 31, 2007, in taxable years beginning after such date.

IV. CONSERVATION AND ENERGY EFFICIENCY

A. Credit for Nonbusiness Energy Property

Present Law

Code section 25C provides a 10-percent credit for the purchase of qualified energy efficiency improvements to existing homes. A qualified energy efficiency improvement is any energy efficiency building envelope component that meets or exceeds the prescriptive criteria for such a component established by the 2000 International Energy Conservation Code as supplemented and as in effect on August 8, 2005 (or, in the case of metal roofs with appropriate pigmented coatings, meets the Energy Star program requirements), and (1) that is installed in or on a dwelling located in the United States; (2) owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) such component reasonably can be expected to remain in use for at least five years. The credit is nonrefundable.

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

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

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

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

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

Description of Proposal

The proposal extends the credit for two years, through December 31, 2009.

The proposal adds natural gas fired heat pumps with a heating coefficient of performance of at least 1.1 to the list of qualified energy efficient building property eligible for a $300 credit if it has.

The proposal also alters the requisite efficiency standards and modifies certain of the credits as follows:

The $150 credit for a qualified oil furnace, and for a qualified natural gas, propane or oil hot water boiler, is raised to $300.

The electric heat pump standard is modified to be the highest efficiency tier established by the Consortium for Energy Efficiency as in effect on January 1, 2008.

The standard for natural gas, propane, or oil water heaters is modified to be an energy factor of at least 0.80 or a thermal efficiency of at least 90 percent.

The standard for a qualified oil furnace, and for a qualified natural gas, propane or oil hot water boiler, is lowered from an annual fuel utilization efficiency of 95 to 90.

Effective Date

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

B. New Energy Efficient Home Credit

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 acquired from the eligible contractor, for use as a residence, after December 31, 2005 and prior to January 1, 2009.

Description of Proposal

The proposal extends the energy efficient new homes credit for two years, through December 31, 2010, and permits the eligible contractor to claim the credit on a home built for personal use as a residence.

Effective date

The provision is effective for homes purchased after December 31, 2008.

C. Energy Efficient Commercial Buildings Deduction

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 expenditures is defined as property (1) which is installed on or in any building located in the United States that is within the scope of Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America ("ASHRAE/IESNA"), (2) which is installed as part of (i) the interior lighting systems, (ii) the heating, cooling, ventilation, and hot water systems, or (iii) the building envelope, and (3) which is certified as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more in comparison to a reference building which meets the minimum requirements of Standard 90.1-2001 (as in effect on April 2, 2003). The deduction is limited to an amount equal to $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 comprises energy efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system-specific savings targets established by the Secretary of the Treasury. The applicable system-specific savings targets to be established by the Secretary are those that would result in a total annual energy savings with respect to the whole building of 50 percent, if each of the separate systems met the system specific target. The separate building systems are (1) the interior lighting system, (2) the heating, cooling, ventilation and hot water systems, and (3) the building envelope. The maximum allowable deduction is $0.60 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[55]. 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.

Description of Proposal

The proposal extends the energy efficient commercial buildings deduction for two years, through December 31, 2010, and increases the deduction amount to $2.25 per square foot ($0.75 in the case of subsystems).

Effective Date

The proposal is effective on the date of enactment.

[55] IRS Notice 2006-52 has set a target of a 16 2/3 percent reduction in total energy and power costs for each of the three subsystems.

V. ACCOUNTABILITY STUDIES

A. Cost Benefit Analysis of Pollution Reduction and Saving in Imported Oil Per Dollar of Tax Benefit

Present Law

Present law does not require a cost-benefit analysis of Code provisions designed to reduce pollution or reduce imported oil.

Description of Proposal

The proposal directs the Secretary to undertake a cost-benefit analysis of those provisions enacted as part of the current legislation that use tax incentives to reduce use of imported oil and to reduce the emissions of carbon dioxide and harmful air pollutants.

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

Effective Date

The proposal is effective on the date of enactment.

B. Effect of Energy Related Tax Benefits on Prices for Consumer Goods

Present Law

Present law does not require a study of the effect of energy related tax benefits on the prices for consumer goods.

Description of Proposal

The proposal directs the Secretary to undertake a study of the estimated changes in the price of consumer goods that may result from the enactment of the amendments to Code made by this act. In particular, the Secretary should estimate the effect of the tax provisions enacted by this act on the price of foodstuffs, soaps, automobiles, motor fuels, and any other product where the tax provisions of this act may be expected to significantly alter the supply and demand conditions of a consumer goods market.

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

Effective Date

The proposal is effective on the date of enactment.

VI. REVENUE RAISING PROVISIONS

A. Denial of Deduction for Major Integrated Oil Companies for Income Attributable to Domestic Production of Oil, Natural Gas, or Primary Products Thereof

Present Law

In general

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 2005 and 2006, the deduction is three percent of income and, for taxable years beginning in 2007, 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.[56]

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;[57] (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

[56] 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, for taxable years beginning after December 31, 2005, designated Roth contributions (as defined in section 402A).

[57] 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).

produced by the taxpayer in the United States; (4) construction activities performed in the United States;[58] or (5) engineering or architectural services performed in the United States for construction projects located in the United States.

Congress granted Treasury broad authority to "prescribe such regulations as are necessary to carry out the purposes" of section 199.[59] 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.[60]

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.[61] 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.[62]

Electricity or natural gas transmission or distribution

Although domestic production gross receipts include the gross receipts from the production in the United States of electricity and gas, the provision excludes gross receipts from the transmission or distribution of electricity and gas. Thus, in the case of a taxpayer who owns a facility for the production of electricity (either as part of a regulated utility or an independent power facility), the taxpayer's gross receipts from the production of electricity at that facility are qualified domestic production gross receipts. However, to the extent that the taxpayer is an

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[58] 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.

[59] Sec. 199(d)(9).

[60] Treas. Reg. sec. 1.199-3(e)(1).

[61] Treas. Reg. sec. 1.199-3(g)(2).

[62] Treas. Reg. sec. 1.199-3(g)(5), Example 1.

integrated producer that generates electricity and delivers electricity to end users, any gross receipts properly attributable to the transmission of electricity from the generating facility to a point of local distribution and any gross receipts properly attributable to the distribution of electricity to final customers are not qualified domestic production gross receipts.

For example, taxpayer A owns a wind turbine that generates electricity and taxpayer B owns a high-voltage transmission line that passes near taxpayer A's wind turbine and ends near the system of local distribution lines of taxpayer C.[63] Taxpayer A sells the electricity produced at the wind turbine to taxpayer C and contracts with taxpayer B to transmit the electricity produced at the wind turbine to taxpayer C who sells the electricity to his or her customers using taxpayer C's distribution network. The gross receipts received by taxpayer A for the sale of electricity produced at the wind turbine constitute qualifying domestic production gross receipts. The gross receipts of taxpayer B from transporting taxpayer A's electricity to taxpayer C are not qualifying domestic production gross receipts. Likewise, the gross receipts of taxpayer C from distributing the electricity are not qualifying domestic production gross receipts. Also, if taxpayer A made direct sales of electricity to customers in taxpayer C's service area and taxpayer C received remuneration for the distribution of electricity, the gross receipts of taxpayer C are not qualifying domestic production gross receipts. If taxpayers A, B, and C are all related taxpayers, then taxpayers A, B, and C must allocate gross receipts to production activities, transmission activities, and distribution activities in a manner consistent with the preceding example.

The same principles apply in the case of the natural gas industry. In the case of natural gas, production activities generally are all activities involved in extracting natural gas from the ground and processing the gas into pipeline quality gas. Such activities would produce qualifying domestic production gross receipts. 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.[64]

<u>Drilling oil or gas wells</u>

The Treasury regulations provide that qualifying construction activities performed in the United States include activities relating to drilling an oil or gas well.[65] Under the regulations, activities the cost of which are intangible drilling and development costs within the meaning of

[63] H.R. Rep No. 108-755 (conference report for the American Jobs Creation Act of 2004), footnote 28 at 272.

[64] Id.

[65] Treas. Reg. sec. 1.199-3(m)(1)(i).

Treas. Reg. sec. 1.612-4 are considered to be activities constituting construction for purposes of determining domestic production gross receipts.[66]

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.[67] 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.[68] 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.[69]

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.

Description of Proposal

The proposal excludes gross receipts of major integrated oil companies derived from the sale, exchange, or other disposition of oil, natural gas, or any primary product thereof from the term "domestic production gross receipts" for purposes of section 199. A major integrated oil company, as defined in section 167(h)(5)(B), is an integrated oil company[70] which has an

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[66] Treas. Reg. sec. 1.199-3(m)(2)(iii).

[67] Treas. Reg. sec. 1.199-9(i)(2).

[68] Treas. Reg. sec. 1.199-9(i)(1).

[69] Id.

[70] 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.

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.

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 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.[71] 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.[72] 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.[73] 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.[74] Examples of non-primary products include, but are not limited to, petrochemicals, medicinal products, insecticides, and alcohols.[75]

Effective Date

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

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[71] Treas. Reg. sec. 1.927(a)-1T(g)(2)(i).

[72] Id.

[73] Treas. Reg. sec. 1.927(a)-1T(g)(2)(ii).

[74] Treas. Reg. sec. 1.927(a)-1T(g)(2)(iii).

[75] Treas. Reg. sec. 1.927(a)-1T(g)(2)(iv).

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

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.[76] 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.[77]

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.[78]

In addition, this limitation is calculated separately for various categories of income, generally referred to as "separate limitation categories." The total amount of the foreign tax credit used to offset the U.S. tax on income in each separate limitation category may not exceed the proportion of the taxpayer's U.S. tax which the taxpayer's foreign-source taxable income in that category bears to its worldwide taxable income in that category. 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.[79]

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[76] Sec. 901.

[77] Secs. 902, 960.

[78] Sec. 904(a).

[79] 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

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").[80] 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.[81]

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.[82] Under the FORI rules, if this theoretical limitation were to apply, then the portion of the foreign taxes on FORI so disallowed would be recharacterized as a (non-creditable) deductible expense.[83]

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,

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two (i.e., "general" and "passive") for taxable years beginning after December 31, 2006. Pub. L. No. 108-357, sec. 404 (2004).

[80] Sec. 907(a).

[81] Sec. 907(f). These carryback and carryforward rules are similar to the general foreign tax credit carryback and carryforward rules of section 904(c).

[82] Sec. 907(b).

[83] Treas. Reg. sec. 1.907(a)-0(d).

> 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.[84]

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.[85] 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.[86]

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.[87] 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."[88]

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 circumstances 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

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[84] 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.

[85] H.R. Conf. Rep. No. 103-213, at 646 (1993).

[86] Pub. L. No. 97-248, sec. 211(c) (1982).

[87] Sec. 907(c)(1).

[88] Treas. Reg. sec. 1.907(c)-1(b)(2).

vicinity of the well, the fair market value at the port of the foreign county, and the relationships between the taxpayer and the foreign government.[89]

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.[90]

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.[91]

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

[89] Treas. Reg. sec. 1.907(c)-1(b)(6).

[90] Sec. 907(c)(1); Treas. Reg. sec. 1.907(c)-1(d).

[91] 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."

Directive sets forth examples of FOGEI assets[92] and FORI assets,[93] and further provides that assets that support both FOGEI and FORI may be allocated by any reasonable method.

Description of Proposal

Under the proposal, 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 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.

The proposal repeals the present-law section 907(b) FORI limitation.

Effective Date

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

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[92] 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).

[93] 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.

C. Oil Spill Liability Trust Fund Tax

The Oil Spill Liability Trust Fund financing rate ("oil spill tax") was reinstated effective April 1, 2006 (sec. 4611(f), as amended by the Energy Policy Act of 2005). The oil spill tax rate 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.[94]

The oil spill tax also applies to certain uses and the exportation of domestic crude oil.[95] 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 estimates that, as of the close of the preceding calendar quarter, the unobligated balance of the Oil Spill Liability Trust Fund exceeds $2.7 billion. If the Secretary estimates the unobligated balance in the Oil Spill Liability Trust Fund is 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.

Description of Proposal

The proposal extends the oil spill tax through December 31, 2017. The proposal also repeals the requirement that the tax be suspended when the unobligated balance exceeds $2.7 billion.

Effective Date

The proposal is effective on the date of enactment.

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[94] The term "crude oil" includes crude oil condensates and natural gasoline. The term "petroleum product" includes crude oil.

[95] The term "domestic crude oil" means any crude oil produced from a well located in the United States.

D. Impose Excise Tax on Certain Removals of Taxable Fuel from Foreign Trade Zones

Present Law

In general

Generally, excise taxes are imposed on gasoline, diesel fuel and kerosene (collectively referred to as "taxable fuel") when taxable fuel is removed from a refinery or terminal or upon its entry into the United States.[96] The tax does not apply to any removal or entry of taxable fuel transferred in bulk by pipeline or vessel to a terminal or refinery, if the person removing or entering the fuel, the pipeline or vessel operator, and the terminal or refinery operator are all registered with the IRS.[97]

The Code generally permits the Secretary of the Treasury to require persons to register with respect to taxable fuel.[98] The American Jobs Creation Act of 2004 requires persons that operate a terminal or refinery within a foreign trade zone or within a customs bonded storage facility, or that hold an inventory position with respect to taxable fuel in such a terminal, to register with the Secretary of the Treasury.[99] Treasury Regulations require blenders, enterers, pipeline operators, position holders, refiners, terminal operators, and vessel operators, among others, to register.[100]

The Code also provides that the Secretary may require information reporting from any registered person.[101] A Department of Treasury fuel information reporting program, the Excise Summary Terminal Activity Reporting System ("ExSTARS"), requires terminal operators and bulk transport carriers to report monthly on the movement of any liquid product into or out of an approved terminal. Terminal operators file Form 720-TO - Terminal Operator Report, which shows the monthly receipts and disbursements of all liquid products to and from an approved terminal.[102] Bulk transport carriers (vessels and pipelines) that receive liquid product from an

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

[97] Sec. 4081(a)(1)(B)(i). A vessel operator is not required to be registered with respect to certain deep draft ocean-going vessels. Sec. 4081(a)(1)(B)(ii).

[98] Sec. 4101(a).

[99] See Sec. 4101(a)(2), added by the American Jobs Creation Act of 2004, Pub. L. 108-357, sec. 861(a)(2).

[100] Treas. Reg. sec. 48.4101-1(c)(1).

[101] Sec. 4101(d)(1). See also Treas. Reg. sec. 48.4101-2. The reports are required to be filed by the end of the month following the month to which the report relates.

[102] See Announcement 2001-48, 2001 C.B. An approved terminal is a terminal that is operated by a taxable fuel registrant that is a terminal operator. Treas. Reg. sec. 48.4081-1(b).

approved terminal or deliver liquid product to an approved terminal file Form 720-CS - Carrier Summary Report, which details such receipts and disbursements.

Foreign trade zones

Foreign trade zones are established under chapter 1A of title 19 of the United States Code. Customs regulations issued pursuant to title 19 provide that merchandise taken into a foreign trade zone for the sole purpose of exportation or storage will be given "zone restricted" status on proper application and be considered exported for purposes of customs law. If merchandise is to be considered exported for the purpose of any Federal law other than customs laws, the port director shall be satisfied that all pertinent laws, regulations, and rules administered by the Federal agency concerned have been complied with before the application is approved. In general, zone restricted merchandise may not be returned to the customs territory of the United States for domestic consumption.[103]

Rev. Rul. 59-318 holds that an article subject to a manufacturers excise tax is "exported" when it is shipped to a foreign trade zone for the sole purpose of exportation.[104] Consequently, any later removal from such a refinery or terminal in a foreign trade zone for "actual" export is not considered a taxable event.[105] In contrast, if the terminal is located outside of a foreign trade zone, the removal for export is a taxable event unless certain conditions are met.[106]

Many petroleum refineries and terminals are located within foreign trade zones or subzones[107] or bonded warehouses. When taxable fuel is removed by truck or rail from such refinery or terminal, excise taxes may or may not be due at the rack, depending on the mode of removal, as follows. If the taxable fuel is entered into the United States upon such removal, excise taxes and duties are generally due at that point. However, the fuel may be removed under bonded transport without immediate tax or duties. Such transported fuel can be destined for export, for entry into another foreign trade zone (or subzone) or bonded warehouse, or may be entered into the United States at its destination. Excise tax only applies if and when the fuel is entered into the United States. No tax is due if the fuel is exported or re-entered into a foreign trade zone or subzone or bonded warehouse.

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[103] 19 C.F.R. sec. 146.44.

[104] 1959-2 C.B. 310. Under Rev. Rul. 59-318, a bill of lading containing the statement "Shipped into Foreign-Trade Zone for Export" is acceptable as proof of exportation.

[105] See, e.g., Priv. Ltr. Rul. 9351006 (Sept. 17, 1993), Transaction 4.

[106] For example, regulations provide that the tax does not apply if the buyer is outside the United States, the sale occurs as the fuel is delivered into a vessel with a capacity of at least 20,000 barrels, the seller is registered and is the exporter of record, and the fuel is exported in due course. Treas. Reg. sec. 48.4081-3(f)(2).

[107] A subzone is a special-purpose zone established as an adjunct to a zone project for a limited purpose. The rules and regulations applicable to foreign trade zones apply equally to subzones. 15 C.F.R. sec. 400.2(n)-(o).

U.S. Customs enforcement procedures, which may include forfeiture of the full value of the goods, are triggered if fuel removed under bonded transport is not reported within 30 days as exported, entered into another foreign trade zone or subzone or bonded warehouse, or entered into the United States.[108] Customs also tracks all entries and removals from foreign trade zones and subzones.

Refineries in general, and terminals within foreign trade zones or subzones or bonded warehouses, are not currently required to report under ExSTARS.

Description of Proposal

Under the proposal, excise tax is generally due on the non-bulk removal (i.e., removal by truck or train) of taxable fuel from terminals or refineries within a foreign trade zone or subzone or bonded warehouse at the same time and in the same manner as if such terminal or refinery were not located in such foreign trade zone or subzone or bonded warehouse, notwithstanding any Customs statute, rule, or regulation. Tax is due upon such removal even if the fuel is entered into another foreign trade zone or subzone or bonded warehouse or is eventually exported. If such taxable fuel is later exported, a credit or refund may be claimed. No interest shall be due on such credits or refunds.

Under the proposal, a removal from a refinery or terminal in a foreign trade zone or subzone or bonded warehouse is not treated any worse than would be the case if the refinery or terminal were not in such a foreign trade zone or subzone or bonded warehouse. Consequently, any removal that would be exempt if the refinery or terminal were not in a foreign trade zone or subzone or bonded warehouse will be exempt where the refinery or terminal is in a foreign trade zone or subzone or bonded warehouse.

The present-law rules continue to apply to any removal by pipeline or vessel of taxable fuel from a terminal or refinery located in a foreign trade zone or subzone or bonded warehouse.

It is intended that the Secretary of the Treasury will require owners and operators of terminals within a foreign trade zone or subzone or bonded warehouse to electronically report monthly all removals of taxable fuel, to the same extent as if such terminal were not located in a foreign trade zone or subzone or bonded warehouse, and it is anticipated that such reporting will be required to be done through ExSTARS or in some other reasonable form.

Effective Date

The proposal is effective for removals and entries after December 31, 2007.

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[108] See, e.g., 19 C.F.R. secs. 18.25 and 18.26.

E. Clarification of Penalty for Sale of Fuel Failing to Meet EPA regulations

Present Law

Under the present law, any person other than a retailer who knowingly transfers for resale, sells for resale, or holds out for resale for use in a diesel-powered highway vehicle (or train) any liquid that does not meet applicable Environmental Protection Agency ("EPA") regulations (as defined in section 45H(c)(3)) is subject to a penalty of $10,000 for each such transfer, sale, or holding out for resale, in addition to the tax on such liquid, if any.[109] Any retailer who knowingly holds out for sale (other than for resale) any such liquid, is subject to a $10,000 penalty for each such holding out for sale, in addition to the tax on such liquid, if any.

Description of Proposal

The proposal expands the penalty to include any fuel which does not meet EPA standards for distribution to the public. The proposal reaffirms that the Secretary is authorized to make the determination that the fuel does not comply with the applicable EPA regulations and standards for purposes of asserting the penalty.

Effective Date

The proposal is effective on the date of enactment.

[109] Sec. 6720A.

F. Treatment of Qualified Alcohol Fuel Mixtures and Qualified Biodiesel Fuel Mixtures as Taxable Fuel

Present Law

An excise tax is imposed upon (1) the removal of any taxable fuel from a refinery or terminal, (2) the entry of any taxable fuel into the United States, or (3) the sale of any taxable fuel to any person who is not registered with the IRS to receive untaxed fuel, unless there was a prior taxable removal or entry.[110] The tax does not apply to any removal or entry of taxable fuel transferred in bulk by pipeline or vessel to a terminal or refinery if the person removing or entering the taxable fuel, the operator of such pipeline or vessel (excluding deep draft vessels) and the operator of such terminal or refinery are registered with the Secretary.[111] The term "taxable fuel" means gasoline, diesel fuel, and kerosene.[112]

Diesel fuel is (1) any liquid suitable for use in a diesel powered highway vehicle or diesel powered train, (2) transmix, and (3) diesel fuel blendstocks identified by the Secretary.[113] By regulation, diesel fuel does not include kerosene, gasoline, No. 5 and No. 6 fuel oils (as described in ASTM Specification D 396), or F-76 (Fuel Naval Distillates MIL-F-16884) any liquid that contains less than four percent normal paraffins, or any liquid that has a distillation range of 125 degrees Fahrenheit or less, sulfur content of 10 ppm or less and minimum color of +27 Saybolt.[114]

Biodiesel is not a taxable fuel because it has less than four percent paraffin content. Ethanol and other fuel alcohols also are not treated as taxable fuel. However, such fuels are subject to the backup tax under section 4041 if sold for use or used as a fuel in a diesel powered highway vehicle or diesel powered train and not for a nontaxable use.

In addition, such fuels are taxable if used in the production of a blended taxable fuel.[115]

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[110] Sec. 4081(a)(1).

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

[112] Sec. 4083(a).

[113] Sec. 4083(a)(3).

[114] Treas. Reg. sec. 48.4081-1(c)(2)(ii).

[115] Under Treas. Reg. sec. 48.4081-1(c), blended taxable fuel generally means any taxable fuel that (1) is produced outside the bulk transfer/terminal system and (2) by mixing taxable fuel with respect to which tax has been imposed under sec. 4081(a) (gasoline, diesel fuel or kerosene) with any other liquid on which tax has not been imposed under sec. 4081.

The Code provides per-gallon tax incentives relating to biodiesel fuel used in a qualified mixture. The taxpayer has the option of taking the credit amount as an income tax credit, excise tax credit against the tax imposed on taxable fuels ("section 4081 liability") or as a payment from the Secretary in the amount of the credit. 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 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. Pursuant to Treasury Notice, a mixture of 99.9 percent biodiesel and diesel fuel is considered a mixture but such mixture is not a blended taxable fuel because it contains less than four percent paraffin content. Thus, while eligible for the biodiesel fuel mixture tax credit and payment provisions, such fuel would not be subject to tax until put in a motor vehicle for a taxable use.

The Code also provides a per-gallon tax incentives relating to alcohol used in a qualified mixture. 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 credit is 51 cents if the alcohol is ethanol (60 cents in the case of other alcohols).

Description of Proposal

The proposal adds qualified alcohol fuel mixtures and qualified biodiesel fuel mixtures to the definition of taxable fuel as a type of diesel fuel.

Effective Date

The proposal is effective for fuels removed, entered or sold after December 31, 2007.

G. Excluding Volume of Denaturants from the Alcohol Fuels Credit

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.[116] The denaturant must be added under a formula approved by the Secretary and the denaturant cannon exceed five percent of the volume of such alcohol (including denaturants).

Description of Proposal

The proposal provides that the volume of alcohol eligible for the credit does not include the volume of any denaturant.

Effective Date

The proposal is effective January 1, 2008.

[116] Sec. 40(d)(4).

H. Clarification of Eligibility for Certain Fuel Credits for Fuel with Insufficient Nexus to the United States

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.[117] 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 51 cents per gallon. 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. 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). Present law also provides a separate 10-cents-per-gallon incentive to small producers of ethanol and to small producers of agri-biodiesel for up to 15 million gallons.

The Code is silent as to the geographic limitations on where the fuel must be produced, used, or sold. For imported ethanol, there is an offsetting tariff of 54 cents per gallon. This tariff expires January 1, 2009.

Description of Proposal

On a prospective basis, the proposal limits the per-gallon tax incentives for alcohol fuels, biodiesel (including agri-biodiesel), renewable diesel, and alternative fuels to fuels that are consumed or sold for consumption in the United States. Thus, foreign-produced fuel must be entered into the United States for consumption in the United States. Similarly, domestically produced fuel sold for export will not qualify for the credit. However, these restrictions do not apply to the small ethanol producer credit or the small agri-biodiesel producer credit.

Effective Date

The proposal is effective for fuels sold or used after the date of enactment.

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[117] See secs. 40, 40A, 6426, and paragraph (e) of section 6427.

I. Tax Finished Gasoline at the Refinery Gate

Present Law

An excise tax is imposed upon (1) the removal of any taxable fuel from a refinery or terminal, (2) the entry of any taxable fuel into the United States, or (3) the sale of any taxable fuel to any person who is not registered with the IRS to receive untaxed fuel, unless there was a prior taxable removal or entry.[118] The tax does not apply to any removal or entry of taxable fuel transferred in bulk by pipeline or vessel to a terminal or refinery if the person removing or entering the taxable fuel, the operator of such pipeline or vessel (excluding deep draft vessels) and the operator of such terminal or refinery are registered with the Secretary.[119] The term "taxable fuel" means gasoline, diesel fuel (including any liquid, other than gasoline, which is suitable for use as a fuel in a diesel-powered highway vehicle or train), and kerosene.[120]

Description of Proposal

The proposal imposes a tax on finished gasoline upon removal from the refinery or entry into the United States. The bulk transfer exception would not apply. For purposes of the proposal, "finished gasoline" means gasoline which meets Environmental Protection Agency standards for distribution to the public, including gasoline certified for blending with oxygenates. Only the increased volume resulting from the addition of oxygenates, detergents and other untaxed liquids after the gasoline leaves the refinery would be subject to a subsequent tax.

Effective Date

The proposal is effective for fuel removed, entered, or sold after December 31, 2007.

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[118] Sec. 4081(a)(1).

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

[120] Sec. 4083(a).