

**DESCRIPTION OF THE
“AMERICAN INFRASTRUCTURE INVESTMENT
AND IMPROVEMENT ACT”**

Scheduled for Markup
By the
SENATE COMMITTEE ON FINANCE
on September 20, 2007

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION



September 18, 2007
JCX-79-07

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INTRODUCTION

The Airport and Airway Trust Fund (“AATF”) provides funding for capital improvements to the U.S. airport and airway system and funding for Federal Aviation Administration (“FAA”) operations and programs, among other purposes. The Internal Revenue Code (the “Code”) contains the provisions that dedicate revenues from certain excise taxes to the AATF, provide the relevant expenditure provisions governing the purposes for which AATF monies may be spent, and set the period for when those expenditures may occur. The excise taxes imposed to finance the AATF are:¹

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

Domestic commercial aviation (the use of an aircraft in a business of transporting persons or property for compensation) is subject to the ticket tax and air cargo tax, as well as a 4.4-cent-per-gallon fuel tax.² Noncommercial aviation is subject only to the fuel taxes, but at higher rates.

With the exception of 4.4 cents per gallon of the fuel tax rates, the taxes imposed and dedicated to the AATF do not apply after September 30, 2007. The AATF expenditure authority expires on October 1, 2007. The purposes for which AATF funds may be expended are fixed as of the date of enactment of the Vision 100—Century of Aviation Reauthorization Act (Pub. L. No. 108-176, December 12, 2003). As a result, the Code provisions must be amended to permit the expenditure of AATF monies for those purposes as provided for in any new reauthorization bill, as well as to authorize the imposition of the dedicated taxes beyond September 30, 2007.

The Senate Committee on Commerce, Science, and Transportation has considered and reported favorably with amendments S. 1300, the “Aviation Investment and Modernization Act

¹ Sec. 9502(b)(1). The AATF also is credited with interest under sec. 9602(b). Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended.

² As described below, the fuel tax consists of two components: 4.3 cents per gallon dedicated to the AATF and 0.1 cent per gallon dedicated to the Leaking Underground Storage Tank Trust Fund. The higher fuel tax imposed on noncommercial aviation similarly consists of an AATF component (21.8 cents per gallon for jet fuel, 19.3 cents for aviation gasoline) plus 0.1 cent per gallon for the Leaking Underground Storage Tank Trust Fund.

of 2007.” That bill authorizes appropriations for the FAA for fiscal years 2008 through 2011, among other provisions.³

The Senate Committee on Finance has scheduled a markup of a bill relating to the AATF reauthorization for September 20, 2007. This document,⁴ prepared by the staff of the Joint Committee on Taxation, provides a description of the present-law taxes dedicated to the AATF, a summary of the AATF expenditure purposes, and a description of the bill. That bill reauthorizes the taxes and amends the purposes for which AATF funds may be expended to include the reauthorization bill, increases the taxes on aviation-grade kerosene for use in noncommercial aviation, imposes a tax at the domestic commercial aviation rate to fuel consumed during wholly domestic segments of international flights, increases the tax on the use of international air facilities, creates a new sub-account within the AATF for air traffic control modernization, creates a new tax regime for fractional ownership aircraft programs, and repeals the exemption for small aircraft operating on nonestablished lines (other than exclusively for sightseeing). The bill also provides for increased funding for the Highway Trust Fund.

³ A complete description of S.1300 can be found in S. Rept. 110-144 (110th Cong. 1st Sess.)(August 3, 2007).

⁴ This document may be cited as follows: Joint Committee on Taxation, *Description of the “American Infrastructure Investment and Improvement Act”* (JCX-79-07), September 18, 2007. This document can be found on our website at www.house.gov/jct.

I. AVIATION TRUST FUND EXTENSION

A. Extension of Airport and Airway Trust Fund Tax and Expenditure Provisions

Present Law

Taxes on transportation of persons by air

The Code imposes an excise tax on both domestic and certain international transportation of passengers by air. The AATF is credited with amounts equivalent to these taxes. The taxes do not apply after September 30, 2007.⁵

Domestic air passenger excise tax

Domestic air passenger transportation generally is subject to a two-part excise tax. The first component is an *ad valorem* tax imposed at the rate of 7.5 percent of the amount paid for the transportation. The second component is a flight segment tax. For 2007, the flight segment tax rate is \$3.40.⁶ A flight segment is defined as transportation involving a single take-off and a single landing. For example, travel from New York to San Francisco, with an intermediate stop in Chicago, consists of two flight segments (without regard to whether the passenger changes aircraft in Chicago).

The flight segment component of the tax does not apply to segments to or from qualified “rural airports.” For any calendar year, a rural airport is defined as an airport that in the second preceding calendar year had fewer than 100,000 commercial passenger departures, and meets one of the following three additional requirements (1) the airport is not located within 75 miles of another airport that had more than 100,000 such departures in that year, (2) the airport is receiving payments under the Federal “essential air service” program, or (3) the airport is not connected by paved roads to another airport.⁷

The domestic air passenger excise tax applies to “taxable transportation.” Taxable transportation means transportation by air that begins in the United States or in the portion of Canada or Mexico that is not more than 225 miles from the nearest point in the continental United States and ends in the United States or in such 225-mile zone. If the domestic

⁵ Sec. 4261(j)(1)(A)(ii). The person making the payment (generally the passenger) is liable for the tax; airlines and others receiving payments are liable for remitting tax and are primarily liable if they fail to collect the tax. Secs. 4261(d) and 4263(c).

⁶ Sec. 4261(b)(1) and 4261(d)(4). The Code provides for a \$3 tax indexed annually for inflation, effective each January 1st, resulting in the current rate of \$3.40.

⁷ In the case of an airport qualifying as “rural” because it is not connected by paved roads to another airport, only departures for flight segments of 100 miles or more are considered in calculating whether the airport has fewer than 100,000 commercial passenger departures. The Department of Transportation has published a list of airports that meet the definition of rural airports. See Rev. Proc. 2005-45.

transportation is paid for outside of the United States, it is taxable only if it begins and ends in the United States.

For purposes of the domestic air passenger excise tax, taxable transportation does not include “uninterrupted international air transportation.” Uninterrupted international air transportation is any transportation that does not both begin and end in the United States or in the 225-mile zone and does not have a layover time of more than 12 hours. The tax on international air passenger transportation is discussed below.

Use of international air facilities

For 2007, international air passenger transportation is subject to a tax of \$15.10 per arrival or departure in lieu of the taxes imposed on domestic air passenger transportation if the transportation begins or ends in the United States.⁸ The definition of international transportation includes certain purely domestic transportation that is associated with an international journey. Under these rules, a passenger traveling on separate domestic segments integral to international travel is exempt from the domestic passenger taxes on those segments if the stopover time at any point within the United States does not exceed 12 hours.

In the case of a domestic segment beginning or ending in Alaska or Hawaii, the tax applies to departures only and is \$7.50 for calendar year 2007.

“Free” travel

Both the domestic air passenger tax and the use of international air facilities tax apply only to transportation for which an amount is paid. Thus, free travel, such as that awarded in “frequent flyer” programs and nonrevenue travel by airline industry employees, is not subject to tax. However, amounts paid to air carriers (in cash or in kind) for the right to award free or reduced-fare transportation are treated as amounts paid for taxable air transportation and are subject to the 7.5 percent *ad valorem* tax (but not the flight segment tax or the use of international air facilities tax). Examples of such payments are purchases of miles by credit card companies and affiliates (including airline affiliates) for use as “rewards” to cardholders.

Disclosure of air passenger transportation taxes on tickets and in advertising

Transportation providers are subject to special penalties if they do not separately disclose the amount of the passenger taxes on tickets and in advertising. Failure to satisfy these disclosure requirements is a misdemeanor, upon conviction of which the guilty party is fined not more than \$100 per violation.⁹

⁸ Secs. 4261(c) and 4261(d)(4). The international air facilities tax rate of \$12 is indexed annually for inflation, effective each January 1, resulting in the current rate of \$15.10.

⁹ Sec. 7275.

Tax on transportation of property (cargo) by air

The AATF is credited with amounts equivalent to the taxes received from the transportation of property by air. Domestic air cargo transportation is subject to a 6.25 percent *ad valorem* excise tax on the amount paid for the transportation.¹⁰ The tax applies only to transportation that both begins and ends in the United States. Unlike the air passenger taxes, only shippers (the persons paying for the transportation) are liable for payment of the air cargo tax. There is no disclosure requirement for the air cargo tax. This tax does not apply after September 30, 2007.¹¹

Aviation fuel taxes

The Code imposes excise taxes on gasoline used in commercial aviation and noncommercial aviation, and on jet fuel (kerosene) and other aviation fuels used in commercial aviation and noncommercial aviation. Amounts equivalent to these taxes are credited to the AATF. With the exception of 4.4 cents per gallon, the fuel taxes will not apply after September 30, 2007. Table 1 below summarizes the taxes on fuel used in aviation:

Table 1.—Taxes on Fuel Used in Aviation

Fuel Type	Tax Rate (including 0.1 cent for Leaking Underground Storage Tank Trust Fund Tax)
<u>Jet fuel and liquids other than aviation gasoline</u>	
Commercial aviation	4.4 cents per gallon
Noncommercial aviation.....	21.9 cents per gallon
Exempt use	0.1 cent per gallon
<u>Aviation gasoline</u>	
Commercial.....	4.4 cents per gallon
Noncommercial	19.4 cents per gallon
Exempt use.....	0.1 cent per gallon

Trust Fund expenditure provisions

In general

The AATF was created in 1970 to finance a major portion of the Federal expenditures on national aviation programs. Prior to that time, these expenditures had been financed with

¹⁰ Sec. 4271.

¹¹ Sec. 4271(d).

General Fund monies. The statutory provisions relating to the AATF were placed in the Code in 1982.¹²

Expenditures from the fund support the FAA and the majority of the FAA's programs and activities. The FAA budget has four major components: (1) operations and maintenance; (2) facilities and equipment; (3) research, engineering, and development; and (4) the airport improvement program.¹³ Operations and maintenance are the only segments of the FAA budget that are funded by both a trust fund contribution and a General Fund contribution.¹⁴ The remaining three items receive all their funding from the AATF.

The current expenditure purposes for the AATF are:

1. obligations incurred under provisions of previous aviation authorizing legislation enacted since 1970, as those provisions were in effect on the date of enactment of the Vision 100—Century of Aviation Reauthorization Act (December 12, 2003);¹⁵
2. obligations incurred under part A of subtitle VII of Title 49, United States Code (generally, FAA programmatic provisions), which are attributable to planning, research and development, construction, or operation and maintenance of—
 - (a) air traffic control,
 - (b) air navigation,
 - (c) communications, or

¹² Sec. 9502.

¹³ Congressional Research Service, *Aviation Taxes and the Airport and Airway Trust Fund*, CRS Report 97-657E at CRS-2 (1997). The airport improvement program is only for airports in the National Plan of Integrated Airport Systems.

¹⁴ *Id.*

¹⁵ The Acts (or provisions of Acts) pursuant to which aviation trust fund expenditures are allowed are Title I of the Airport and Airway Development Act of 1970; the Airport and Airway Development Act Amendments of 1976; the Aviation Safety and Noise Abatement Act of 1979; the Fiscal Year 1981 Airport Development Authorization Act; the provisions of the Airport and Airway Improvement Act of 1982; the Airport and Airway Safety and Capacity Expansion Act of 1987; the Federal Aviation Administration Research, Engineering, and Development Authorization Act of 1990; the Aviation Safety and Capacity Expansion Act of 1990; the Airport and Airway Safety, Capacity, Noise Improvement, and Intermodal Transportation Act of 1992; the Airport Improvement Program Temporary Extension Act of 1994; Federal Aviation Administration Authorization Act of 1994; Federal Aviation Reauthorization Act of 1996; the provisions of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 providing for payments from the Airport and Airway Trust Fund; the Interim Federal Aviation Administration Authorization Act; section 6002 of the 1999 Emergency Supplemental Appropriations Act; Public Law 106-59; the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century; the Aviation and Transportation Security Act; and the Vision 100—Century of Aviation Reauthorization Act.

- (d) supporting services for the airway system; and
- 3. obligations incurred for administrative expenses of the Department of Transportation that are attributable to activities described in items (1) and (2).

No expenditures are permitted to be made from the AATF after September 30, 2007. Because the purposes for which AATF funds are permitted to be expended are fixed as of the date of enactment of the Vision 100—Century of Aviation Reauthorization Act (December 12, 2003), the Code must be amended in order to accommodate new purposes. In addition, the Code contains a special enforcement provision to prevent expenditure of AATF monies for purposes not authorized in section 9502.¹⁶ This provision provides that, should such unapproved expenditures occur, no further excise tax receipts will be transferred to the AATF. Rather, the taxes will continue to be imposed but the receipts will be retained in the General Fund. This enforcement provision provides specifically that it applies not only to unauthorized expenditures under the current Code provisions, but also to expenditures pursuant to future legislation that may provide for them unless either the legislation providing for the expenditure amends section 9502's expenditure authorization provisions or otherwise authorizes the expenditure as part of a revenue Act.

Specific AATF expenditure programs

Authorized expenditures for the following airport and airway programs are included under the general purposes described above.

- 1. Airport Improvement Program (AIP).–
 - (a) Airport planning.–Planning for airport systems for airport master plans; also, airport noise compatibility planning for air carrier airports eligible for terminal development costs.
 - (b) Airport construction.–Construction, improvement, or repair of a public airport (includes removal of airport hazards and construction of physical barriers and landscaping to diminish noise).¹⁷
 - (c) Airport terminal facilities.–Non-revenue-producing public-use areas that are directly related to movement of passengers and baggage at certified air carrier airports; also, development of revenue-producing areas and construction of non-revenue-producing parking lots for nonhub airports (subject to certification that the grant will not defer needed development with respect to safety, security, or capacity).

¹⁶ Sec. 9502(f)(1).

¹⁷ Airport construction is usually limited to construction or improvements related to aircraft operations, such as runways, taxiways, etc.

- (d) Land acquisition.—Includes land or property interests for airport noise control purposes; also includes acquisition of land for, or work necessary to construct, pads suitable for aircraft deicing (subject to certain limitations).
 - (e) Airport-related equipment.—Airport security equipment required by Department of Transportation regulations, snow removal equipment, noise suppressing equipment, firefighting equipment, navigation aids, and safety equipment required for airport certification; also includes construction or purchase of capital equipment necessary for compliance by an airport with the Americans with Disabilities Act, the Clean Air Act, or the Federal Water Pollution Control Act, other than capital equipment that would primarily benefit a revenue-producing area of the airport used by a nonaeronautical business.
 - (f) Airport noise compatibility programs.—Includes sound-proofing of public buildings; local governmental units are eligible for project grants as well as airports.
2. Facilities and Equipment Program (F&E).—Costs of acquiring, establishing, and improving air navigation facilities.
 3. Research, Engineering, Development, and Demonstration Program (R&D).—Projects in connection with FAA research and development activities.
 4. Operations and Maintenance Programs (O&M).—Operations and maintenance of air navigation facilities, including air traffic control and flight checks; services provided under international agreements relating to the U.S. share of joint provision of air navigation services; weather reporting services provided to the FAA by the National Oceanic and Atmospheric Administration.
 5. Small Community Air Service Development Pilot Program.—For payments to ensure that eligible localities receiving airline service at the time of deregulation continue to have airline service.
 6. Vocational Technical Institutions.—Grants to up to four vocational technical institutions for the acquisition of facilities for the advanced training of maintenance technicians for air carrier aircraft.
 7. Airway Science Curriculum Grants.—Grants for higher education airway science study programs, including equipment, buildings, and associated facilities.
 8. Civil Aircraft Security Research and Development.—Grants relating to technologies and procedures to counteract terrorist activities against civil aviation.

Description of Proposal

The proposal extends the taxes imposed on the transportation of persons by air and on the transportation of property by air through September 30, 2011. The proposal extends the taxes imposed on aviation fuels through September 30, 2011. The proposal extends the expenditure

authority for the AATF through September 30, 2011, and conforms the purposes for which AATF funds are permitted to be expended to include those obligations authorized by S. 1300.

Effective Date

The proposal is effective on the date of enactment.

B. Taxation of Kerosene for Use in Aviation

Present Law

In general

Under section 4081, an excise tax is imposed upon (1) the removal of any taxable fuel from a refinery or terminal,¹⁸ (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.¹⁹ 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.²⁰ If the bulk transfer exception applies, tax is not imposed until the fuel “breaks bulk,” i.e., when it is removed from the terminal, typically by rail car or truck, for delivery to a smaller wholesale facility or retail outlet, or removed directly from the terminal into the fuel tank of an aircraft.²¹

The term “taxable fuel” means gasoline, diesel fuel (including any liquid, other than gasoline, that is suitable for use as a fuel in a diesel-powered highway vehicle or train), and kerosene.²² The term includes kerosene used in aviation (jet fuel) as well as aviation gasoline.

Section 4041(c) provides a back-up tax for liquids (other than aviation gasoline) that are sold for use as a fuel in aircraft and that have not been previously taxed under section 4081.²³

¹⁸ A “terminal” is a taxable fuel storage and distribution facility that is supplied by pipeline or vessel and from which taxable fuel may be removed at a rack. A “rack” is a mechanism capable of delivering taxable fuel into a means of transport other than a pipeline or vessel. A terminal can be located at an airport, or fuel may be delivered to the airport from a terminal located off the airport grounds.

¹⁹ Sec. 4081(a)(1).

²⁰ Sec. 4081(a)(1)(B).

²¹ In general, the party liable for payment of the taxes when the fuel breaks bulk at the terminal is the “position holder,” the person shown on the records of the terminal facility as holding the inventory position in the fuel. However, when fuel is removed directly into the fuel tank of an aircraft for use in commercial aviation, the person who uses the fuel is liable for the tax. The fuel is treated as used when such fuel is removed into the fuel tank. Sec. 4081(a)(4).

²² Sec. 4083(a).

²³ Sec. 4041(c).

Kerosene for use in aviation

In general

Present law generally imposes a tax of 24.4 cents per gallon on kerosene. However, reduced rates apply for kerosene removed directly from a terminal into the fuel tank of an aircraft.²⁴ For kerosene removed directly from a terminal into the fuel tank of an aircraft for use in commercial aviation, the tax rate is 4.4 cents per gallon.²⁵ For kerosene removed directly from a terminal into the fuel tank of an aircraft for use in noncommercial aviation, the tax rate is 21.9 cents per gallon. All of these tax rates include a 0.1 cent per gallon component for the Leaking Underground Storage Tank Trust Fund. For kerosene removed directly from a terminal into the fuel tank of an aircraft for an exempt use (such as foreign trade or for the exclusive use of a State or local government), only the Leaking Underground Storage Tank Trust Fund tax of 0.1 cent per gallon applies.

“Commercial aviation” generally means any use of an aircraft in the business of transporting by air persons or property for compensation or hire.²⁶ Commercial aviation does not include transportation exempt from the ticket taxes and air cargo taxes by reason of sections 4281 or 4282 or by reason of section 4261(h) or 4261(i). Thus, small aircraft operating on nonestablished lines (sec. 4281), air transportation for affiliated group members (sec. 4282), air transportation for skydiving (sec. 4261(h)), and certain air transportation by seaplane (sec. 4261(i)) are excluded from the definition of commercial aviation, and accordingly are subject to the tax regime applicable to noncommercial aviation.

²⁴ If certain conditions are met, present law permits the removal of kerosene from a refueler truck, tanker, or tank wagon to be treated as a removal from a terminal for purposes of determining whether kerosene is removed directly into the fuel tank of an aircraft. A refueler truck, tanker, or tank wagon is treated as part of a terminal if: (1) the terminal is located within an airport, (2) any kerosene which is loaded in such truck, tanker, or wagon at such terminal is for delivery only into aircraft at the airport in which such terminal is located, and (3) no vehicle licensed for highway use is loaded with kerosene at such terminal, except in exigent circumstances identified by the Secretary in regulations. In order to qualify for the special rule, a refueler truck, tanker, or tank wagon must: (1) have storage tanks, hose, and coupling equipment designed and used for the purposes of fueling aircraft; (2) not be registered for highway use; and (3) be operated by the terminal operator (who operates the terminal rack from which the fuel is unloaded) or by a person that makes a daily accounting to such terminal operator of each delivery of fuel from such truck, tanker, or tank wagon. Sec. 4081(a)(3).

²⁵ Tax is imposed at this rate if the commercial aircraft operator is registered with the IRS, and the fuel terminal is located within a secured area of an airport. The IRS has published a list of airports with secured areas in which a terminal is located. See Notice 2005-4, 2005-1 C.B. 289, at sec. 4(d)(2)(ii) (2005) (adopting the list from H.R. Conf. Rep. No. 755, 108th Cong., 2d Sess. 692 n. 718 (2004) with modifications) and Notice 2005-80, 2005-2 C.B. 953, at sec. 3(c)(2) (2005). If the fuel terminal is located at an unsecured airport, the fuel is taxed at 21.9 cents per gallon if the fuel is removed directly from the terminal into the fuel tank of an aircraft.

²⁶ Sec. 4083(b).

Refunds and credits to obtain the appropriate aviation tax rate

If the kerosene is not removed directly into the fuel tank of an aircraft, the fuel is taxed at 24.4 cents per gallon. (This is generally the rate applied to diesel fuel and kerosene used in highway vehicles). A claim for credit or payment may be made for the difference between the tax paid and the appropriate aviation rate (21.9 cents per gallon for noncommercial aviation, 4.4 cents per gallon for commercial aviation, and 0.1 cent per gallon for an exempt use).²⁷

For noncommercial aviation, other than for exempt use, only the registered ultimate vendor may make the claim for the 2.5-cent-per-gallon difference between the 24.4 cents per gallon rate and the noncommercial aviation rate of 21.9 cents per gallon.²⁸ For commercial aviation and exempt use (other than State and local government use), the ultimate purchaser may make a claim for the difference in tax rates, or the ultimate purchaser may waive the right to make the claim for payment to the ultimate vendor.²⁹ For State and local government use, the registered ultimate vendor is the proper claimant.³⁰

Commercial aviation claimants are permitted to credit their fuel tax claims against their other excise tax liabilities, thereby reducing the amount of excise tax to be paid with the excise tax return.

Transfers between the Highway Trust Fund and the AATF to account for aviation use

Kerosene that is not removed directly from the terminal into an airplane (e.g., the jet fuel is transferred from the terminal by highway vehicle to the airport) is taxed at the highway fuel rate of 24.4 cents per gallon. The Highway Trust Fund is credited with 24.3 cents per gallon of the 24.4 cents per gallon imposed. The remaining 0.1 cent is credited to the Leaking Underground Storage Tank Trust Fund. If a claim for payment is later made indicating that the fuel was used in aviation, the Secretary then transfers to the AATF 4.3 cents per gallon for commercial aviation use and 21.8 cents per gallon for noncommercial aviation use. These transfers initially are based on estimates, and proper adjustments are made in amounts subsequently transferred to the extent prior estimates were in excess of or less than the amounts required to be transferred. Thus, to the extent claims for credit or payment are not made for the difference between the highway rate and the aviation rate, the AATF will not be credited for fuel used in aviation that was taxed at the 24.4 cents per gallon rate.

Aviation gasoline

The tax on aviation gasoline is 19.4 cents per gallon (including 0.1 cent per gallon Leaking Underground Storage Tank Trust Fund component). If aviation gasoline is used in

²⁷ Sec. 6427(l)(4).

²⁸ Sec. 6427(l)(4)(C)(ii).

²⁹ Sec. 6427(l)(4)(C)(i).

³⁰ See secs. 6427(l)(5). Special rules apply if the kerosene is purchased with a credit card issued to a State or local government.

commercial aviation, the ultimate purchaser may obtain a credit or payment in the amount of 15 cents per gallon, such that the tax rate on such gasoline is 4.4 cents per gallon.³¹ If aviation gasoline is sold for an exempt use, a credit or refund is allowable for all but the Leaking Underground Storage Tank Trust Fund tax (0.1 cent per gallon).³²

Description of Proposal

The proposal creates a separate category of kerosene for tax purposes: aviation-grade kerosene.³³ Aviation-grade kerosene is taxed at 35.9 cents per gallon plus 0.1 cent per gallon for the Leaking Underground Storage Tank Trust Fund. Under the proposal, aviation-grade kerosene used in noncommercial aviation will bear the full rate of tax. The rate of tax for aviation-grade kerosene used in commercial aviation and exempt use remains unchanged.³⁴

Because the tax on aviation-grade kerosene used in noncommercial aviation is equal to the applicable rate of tax collected, the proposal repeals the ultimate vendor refund provisions for noncommercial aviation. In addition, the proposal eliminates the inter-fund transfers from the Highway Trust Fund to the AATF for kerosene used in aviation. Instead, the taxes imposed on aviation-grade kerosene will be credited to the AATF only. As a result, the AATF, rather than the Highway Trust Fund, will reimburse the General Fund for any amounts paid with respect to the use of aviation-grade kerosene for a nontaxable use. The proposal also provides a refund mechanism for aviation-grade kerosene used for a taxable purpose other than in an aircraft and the related-trust fund accounting.

In the case of aviation-grade kerosene held on January 1, 2008, by any person, a floor stocks tax is imposed equal to the tax that would have been imposed if the increased rates had been in effect before such date, less (1) the tax actually imposed on such fuel and (2) for fuel held by a person for his own use, the amount that such person would reasonably expect to be paid as a refund. The tax is to be paid at such time and in such manner as the Secretary shall prescribe.

The floor stocks tax does not apply to fuel held in the fuel tank of an aircraft on January 1, 2008. Nor does it apply to fuel held exclusively for any use to the extent a refund or credit of tax is allowable under the Code. The floor stocks tax does not apply if the amount of fuel held by a person does not exceed 2,000 gallons.

For purposes of the floor stocks tax, a controlled group is treated as one person. “Controlled group” for these purposes means a parent-subsidiary, brother-sister, or combined

³¹ Sec. 6421(f)(2).

³² Sec. 6416(a); sec. 6420 (farming purposes); sec. 6421(c); and sec. 6430.

³³ Aviation-grade kerosene means, as defined by the Internal Revenue Service, kerosene-type jet fuel covered by ASTM specification D1655, or military specification MIL-DTL-5624 (Grade JP-5) or MIL-DTL-83133E (Grade JP-8). See section 4(b) of Notice 2005-4.

³⁴ Accordingly, commercial aviation use will continue to be subject to a tax of 4.4 cents per gallon and exempt use will be subject to 0.1 cent per gallon.

corporate group with more than 50-percent ownership with respect to either combined voting power or total value. Under regulations, similar principles may apply to a group of persons under common control where one or more persons are not a corporation.

All provisions of law, including penalties, applicable with respect to the taxes imposed by section 4081 also apply to the floor stocks taxes to the extent not inconsistent with the provisions of the proposal. For purposes of determining receipts to the AATF, the floor stocks tax is treated as if it were a tax listed in section 9502(b)(1) (governing transfers to the AATF).

Effective Date

The proposal is generally effective for fuel removed, entered, or sold after December 31, 2007. The floor stocks tax is effective January 1, 2008.

**C. Subject Fuel Consumed During Wholly Domestic Segments
of International Flights to
Tax at the Domestic Commercial Aviation Rate**

Present Law

Aviation fuel that is sold for use or used as “supplies for vessels or aircraft” is a nontaxable use for purposes of the fuel taxes (other than the Leaking Underground Storage Tank Trust Fund tax). Under section 4221(d)(3) of the Code, the term “supplies for vessels and aircraft” includes fuel supplies, ships' stores, sea stores, or legitimate equipment on vessels actually engaged in foreign trade or trade between the United States and any of its possessions. For purposes of the preceding sentence, the term “vessels” includes civil aircraft employed in foreign trade or trade between the United States any of its possessions.³⁵ The term “trade” includes the transportation of persons or property for hire and the making of the necessary preparations for the transportation.³⁶

An aircraft that flies a person for hire between the United States and a foreign country is actually engaged in foreign trade within the meaning of section 4221(d)(3). Once an aircraft is actually engaged in foreign trade the aircraft remains so engaged even though it makes intermediate stops in the United States.³⁷ Under Revenue Ruling 2002-50, that aircraft is also actually engaged in foreign trade when flying a person from a city in the United States to another city in the United States as part of the transportation between the United States and the foreign country. Therefore, only the Leaking Underground Storage Tank Trust Fund tax applies to fuel used in such flights, including fuel consumed between domestic intermediate stops. For example, if an airline carries at least one passenger from Los Angeles to London, with an intermediate stop in New York, the entire flight including the Los Angeles to New York segment, is treated as an international flight subject only Leaking Underground Storage Tank Trust Fund tax even if all the other passengers are flying only from Los Angeles to New York. If the flight were purely domestic, i.e., Los Angeles to New York, the fuel would be taxed at the commercial aviation rate of 4.3 cents per gallon plus 0.1 cent per gallon for Leaking Underground Storage Tank Trust Fund, for a total of 4.4 cents per gallon.

³⁵ In the case of civil aircraft employed in foreign trade or trade between the U.S. and its possessions and registered in a foreign country, the exemption from tax is allowed only if the Secretary has been advised by the Secretary of Commerce that such foreign country allows, or will allow, substantially reciprocal privileges in respect of aircraft registered in the United States. If the Secretary has been advised that a foreign country has discontinued or will discontinue the allowance of such privileges, the exemption will not apply thereafter in respect of civil aircraft registered in that foreign country and employed in foreign trade or trade between the United States and any of its possessions. Sec. 4221(e).

³⁶ Treas. Reg. sec. 48.4221-4(b)(8).

³⁷ Treas. Reg. sec. 48.4221-4(b)(2).

Description of Proposal

The proposal taxes the fuel consumed during the wholly domestic segments of an international flight at the commercial aviation rate of 4.4 cents per gallon.

Effective Date

The proposal is effective on January 1, 2008.

D. Use of International Air Facilities Tax

Present Law

For 2007, international air passenger transportation is subject to a tax of \$15.10 per arrival or departure in lieu of the taxes imposed on domestic air passenger transportation if the transportation begins or ends in the United States.³⁸ The definition of international transportation includes certain purely domestic transportation that is associated with an international journey. Under these rules, a passenger traveling on separate domestic segments integral to international travel is exempt from the domestic passenger taxes on those segments if the stopover time at any point within the United States does not exceed 12 hours.

In the case of a domestic segment beginning or ending in Alaska or Hawaii, the tax applies to departures only and is \$7.50 for calendar year 2007.

Description of Proposal

Beginning January 1, 2008, the proposal increases the tax on the use of international facilities to \$16.50. This amount is indexed as under present law. The special rule for Alaska and Hawaii is unchanged by the proposal.

Effective Date

The proposal is effective on January 1, 2008.

³⁸ Sec. 4261(c) and 4261(d)(4). The international air facilities tax rate of \$12 is indexed annually for inflation, effective each January 1, resulting in the current rate of \$15.10.

E. Air Traffic Control System Modernization Sub-Account

Present Law

Under present law, there is no special sub-account of the AATF to which funds are dedicated for air traffic control systems modernization.

Description of Proposal

The proposal creates an Air Traffic Modernization Sub-Account within the AATF to ensure sufficient funding is provided for modernization of the air traffic control system. The Modernization Sub-Account is supported through annual transfers of approximately \$400 million from the parent Trust Fund. The funds are made available to the FAA through mandatory spending specifically dedicated to modernization costs approved by the Air Traffic Control Modernization Oversight Board. Use of the funds also may include FAA's Facility and Equipment account expenditures.

Effective Date

The proposal is effective on the date of enactment.

F. Treatment of Fractional Aircraft Ownership Programs

Present Law

For excise tax purposes, fractional ownership flights are treated as commercial aviation. As commercial aviation, such flights are subject to the *ad valorem* tax of 7.5 percent of the amount paid for the transportation, a \$3.40 segment tax, and tax of 4.4 cents per gallon on fuel. For international flights, fractional ownership flights pay the \$15.10 international travel facilities use tax and a fuel tax of 0.1 cents per gallon.

For purposes of the FAA safety regulations, fractional aircraft ownership programs are treated as a special category of general aviation.³⁹

Description of Proposal

Under the proposal, special rules apply to flights on aircraft that are part of a “fractional ownership aircraft program.” For this purpose, fractional ownership aircraft program is defined as a program in which:

- A single fractional ownership program manager provides fractional ownership program management services on behalf of the fractional owners;
- Two or more airworthy aircraft are part of the program;
- There are one or more fractional owners per program aircraft, with at least one program aircraft having more than one owner;
- Each fractional owner possesses at least a minimum fractional ownership interest in one or more program aircraft;⁴⁰
- There exists a dry-lease exchange arrangement among all of the fractional owners;⁴¹
- There are multi-year program agreements covering the fractional ownership, fractional ownership program management services, and dry-lease aircraft exchange aspects of the program.

³⁹ 14 C.F.R. Part 91, subpart k.

⁴⁰ A minimum fractional ownership interest means: (1) A fractional ownership interest equal to or greater than one-sixteenth of at least one subsonic, fixed wing or powered lift program aircraft; [or (2) a fractional ownership interest equal to, or greater than one-thirty-second of a least one rotorcraft program aircraft.]

⁴¹ A “dry-lease aircraft exchange” means an agreement, documented by the written program agreements, under which the program aircraft are available, on an as needed basis without crew, to each fractional owner.

Under the proposal, in lieu of the present-law taxes on domestic commercial aviation and international flights, every flight on an aircraft that is part of a fractional ownership aircraft program is subject to a \$58 departure tax and a fuel tax of 36 cents per gallon. The presence or absence of the fractional owner during the flight has no bearing on the amount of tax imposed on the flight. Thus, positioning the aircraft for the owner, as well as charter flights for non-owners are subject to the new tax regime.

Effective Date

The proposal is effective for transportation beginning after, and fuel sold or used after, December 31, 2007.

G. Repeal Exemption for Small Aircraft Operating on Nonestablished Lines

Present Law

Under present law, transportation by aircraft with a certificated maximum takeoff weight of 6,000 pounds or less is exempt from the excise taxes imposed on the transportation of persons by air and the transportation of cargo by air when operating on a nonestablished line. Similarly, when such aircraft are operating on a flight for the sole purpose of sightseeing, the taxes imposed on the transportation of persons or cargo by air do not apply.

Description of Proposal

The proposal repeals the exemption for transportation by small aircraft operating on nonestablished lines. The present-law exemption for flights operated for the sole purposes of sightseeing is unchanged by the proposal.

Effective Date

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

II. INCREASED FUNDING FOR THE HIGHWAY TRUST FUND

A. Replenish Emergency Spending From the Highway Trust Fund

Present Law

Certain trust funds defined under the Code receive amounts equivalent to the receipts from taxes dedicated to such trust funds, e.g., the Airports and Airways Trust Fund and the Highway Trust Fund. Receipts from undedicated taxes are deposited in the General Fund of the Treasury.

The Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users (“SAFETEA”) and previous legislation specifically allowed emergency relief to be paid out of the Highway Trust Fund. Since 1998, there have been six emergency appropriations (excluding regular annual appropriations of \$100 million for emergencies) from the Highway Trust Fund including responses to disaster relief from terrorism and from natural disasters.⁴² Infrastructure otherwise benefited by trust funds has previously received its disaster relief from the General Fund.

Description of Proposal

The proposal would replenish the Highway Trust Fund for emergency appropriations since 1998, through the previous reauthorization period by transferring \$3.4 billion from the General Fund of the Treasury to the Highway Trust Fund.

Effective Date

The proposal is effective on the date of enactment.

⁴² See Pub. L. No. 105-174 (\$259 million), Pub. L. No. 106-346 (\$720 million), Pub. L. No. 107-117 (\$175 million), Pub. L. No. 107-206 (\$265 million), Pub. L. No. 324 (\$1.2 billion), and Pub. L. No. 108-447 (\$741 million).

B. Suspension of Transfers from Highway Trust Fund for Certain Repayments and Credit

Present Law

Under sec. 9503(c)(2), certain transfers are made from the Highway Trust Fund to reimburse the General Fund for amounts paid in respect of gasoline used on farms⁴³, amounts paid in respect of gasoline used for certain nonhighway purposes or by local transit systems⁴⁴, amounts relating to fuels not used for taxable purposes⁴⁵, and income tax credits allowed with respect to the nontaxable uses of fuels.⁴⁶

Description of Proposal

Section 9503(c)(2), relating to certain transfers from the Highway Trust Fund to the General Fund, is suspended on the date of enactment and for six months thereafter.

Effective Date

The proposal applies to amounts paid for which no transfer has been made before the date of enactment.

⁴³ Sec. 6420.

⁴⁴ Sec. 6421.

⁴⁵ Sec. 6427.

⁴⁶ Sec. 34.

C. 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.⁴⁷ 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.⁴⁸

The Code generally permits the Secretary of the Treasury to require persons to register with respect to taxable fuel.⁴⁹ 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.⁵⁰ Treasury Regulations require blenders, enterers, pipeline operators, position holders, refiners, terminal operators, and vessel operators, among others, to register.⁵¹

The Code also provides that the Secretary may require information reporting from any registered person.⁵² 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.⁵³ Bulk transport carriers (vessels and pipelines) that receive liquid product from an approved terminal or deliver liquid product to an approved terminal file Form 720-CS - Carrier Summary Report, which details such receipts and disbursements.

⁴⁷ Sec. 4081(a)(1)(A).

⁴⁸ 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).

⁴⁹ Sec. 4101(a).

⁵⁰ See Sec. 4101(a)(2), added by the American Jobs Creation Act of 2004, Pub. L. 108-357, sec. 861(a)(2).

⁵¹ Treas. Reg. sec. 48.4101-1(c)(1).

⁵² 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.

⁵³ 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).

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.⁵⁴

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.⁵⁵ Consequently, any later removal from such a refinery or terminal in a foreign trade zone for “actual” export is not considered a taxable event.⁵⁶ 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.⁵⁷

Many petroleum refineries and terminals are located within foreign trade zones or subzones⁵⁸ 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.

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

⁵⁴ 19 C.F.R. sec. 146.44.

⁵⁵ 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.

⁵⁶ See, e.g., Priv. Ltr. Rul. 9351006 (Sept. 17, 1993), Transaction 4.

⁵⁷ 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).

⁵⁸ 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).

into the United States.⁵⁹ 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 Ex-STARS.

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 Ex-STARS or in some other reasonable form.

Effective Date

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

⁵⁹ See, e.g., 19 C.F.R. secs. 18.25 and 18.26.

D. 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.⁶⁰ 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.

⁶⁰ Sec. 6720A.

**E. 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.⁶¹ 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.

⁶¹ See secs. 40, 40A, 6426, and paragraph (e) of section 6427.

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.⁶² 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.⁶³ The term “taxable fuel” means gasoline, diesel fuel, and kerosene.⁶⁴

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.⁶⁵ 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.⁶⁶

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.⁶⁷

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

⁶² Sec. 4081(a)(1).

⁶³ Sec. 4081(a)(1)(B).

⁶⁴ Sec. 4083(a).

⁶⁵ Sec. 4083(a)(3).

⁶⁶ Treas. Reg. sec. 48.4081-1(c)(2)(ii).

⁶⁷ 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.

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 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.⁶⁸ The denaturant must be added under a formula approved by the Secretary and the denaturant cannot exceed five percent of the volume of such alcohol (including denaturants).

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.

⁶⁸ Sec. 40(d)(4).

H. 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.⁶⁹ 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.⁷⁰ 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.⁷¹

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. 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.

⁶⁹ Sec. 4081(a)(1).

⁷⁰ Sec. 4081(a)(1)(B).

⁷¹ Sec. 4083(a).

I. Oil Spill Liability Trust Fund Tax

Present Law

The Oil Spill Liability Trust Fund financing rate (“oil spill tax”) was reinstated effective April 1, 2006.⁷² 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.⁷³

The oil spill tax also applies to certain uses and the exportation of domestic crude oil.⁷⁴ 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 increases the tax rate from five cents to 10 cents per barrel. 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 beginning the first quarter that is more than 60 days after the date of enactment.

⁷² Sec. 4611(f)

⁷³ The term “crude oil” includes crude oil condensates and natural gasoline. The term “petroleum product” includes crude oil.

⁷⁴ The term “domestic crude oil” means any crude oil produced from a well located in the United States.

J. Tax Treatment of Certain Inverted Corporate Entities

Present Law

Determination of corporate residence

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

U.S. taxation of domestic corporations

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

Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income generally is deferred, and U.S. tax is imposed on such income when repatriated. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F⁷⁵ and the passive foreign investment company rules.⁷⁶ A foreign tax credit is generally available to offset, in whole or in part, the U.S. tax owed on this foreign-source income, whether such income is repatriated as an actual dividend or included under one of the anti-deferral regimes.

U.S. taxation of foreign corporations

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

⁷⁵ Secs. 951-964.

⁷⁶ Secs. 1291-1298.

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

U.S. tax treatment of inversion transactions prior to the AJCA

Prior to the AJCA, a U.S. corporation could reincorporate in a foreign jurisdiction and thereby replace the U.S. parent corporation of a multinational corporate group with a foreign parent corporation. These transactions were commonly referred to as inversion transactions. Inversion transactions could take many different forms, including stock inversions, asset inversions, and various combinations of and variations on the two. Most of the known transactions were stock inversions. In one example of a stock inversion, a U.S. corporation forms a foreign corporation, which in turn forms a domestic merger subsidiary. The domestic merger subsidiary then merges into the U.S. corporation, with the U.S. corporation surviving, now as a subsidiary of the new foreign corporation. The U.S. corporation's shareholders receive shares of the foreign corporation and are treated as having exchanged their U.S. corporation shares for the foreign corporation shares. An asset inversion could be used to reach a similar result, but through a direct merger of the top-tier U.S. corporation into a new foreign corporation, among other possible forms. An inversion transaction could be accompanied or followed by further restructuring of the corporate group. For example, in the case of a stock inversion, in order to remove income from foreign operations from the U.S. taxing jurisdiction, the U.S. corporation could transfer some or all of its foreign subsidiaries directly to the new foreign parent corporation or other related foreign corporations.

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

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

restructurings could be reduced or eliminated through the use of net operating losses, foreign tax credits, and other tax attributes.

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

U.S. tax treatment of inversion transactions under AJCA

In general

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

Transactions involving at least 80 percent identity of stock ownership

The first type of inversion is a transaction in which, pursuant to a plan⁷⁷ or a series of related transactions: (1) a U.S. corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity in a transaction completed after March 4, 2003; (2) the former shareholders of the U.S. corporation hold (by reason of holding stock in the U.S. corporation) 80 percent or more (by vote or value) of the stock of the foreign-incorporated entity after the transaction; and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50 percent ownership (i.e., the “expanded affiliated group”), does not have substantial business activities in the entity’s country of incorporation, compared to the total worldwide business activities of the expanded affiliated group. The provision denies the intended tax benefits of this type of inversion (“80-percent inversion”) by deeming the top-tier foreign corporation to be a domestic corporation for all purposes of the Code.⁷⁸

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

⁷⁷ Acquisitions with respect to a domestic corporation or partnership are deemed to be “pursuant to a plan” if they occur within the four-year period beginning on the date that is two years before the ownership threshold under the provision is met with respect to such corporation or partnership.

⁷⁸ Since the top-tier foreign corporation is treated for all purposes of the Code as domestic, the shareholder-level “toll charge” of section 367(a) does not apply to these inversion transactions.

provision. Stock sold in a public offering related to the transaction also is disregarded for these purposes.

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

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

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

Other rules

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

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

Description of Proposal

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

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

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

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

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

Effective Date

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