

**SUMMARY DESCRIPTION OF THE
“HIGHWAY REAUTHORIZATION AND EXCISE TAX
SIMPLIFICATION ACT OF 2005,”
TITLE V OF H.R. 3, AS PASSED BY THE SENATE
ON MAY 17, 2005**

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CONTENTS

	<u>Page</u>
INTRODUCTION	1
I. TRUST FUND REAUTHORIZATION	2
A. Extend Highway Trust Fund and Aquatic Resources Trust Fund Expenditure Authority through September 30, 2009, and Related Taxes Through September 30, 2011 (secs. 5101 and 5102 of the Senate amendment).....	2
B. Extend General Fund Retention of 4.8 Cents/Gallon of Taxes on Motorboat and Small Engine Gasoline (sec. 5101 of the Senate amendment)	3
II. EXCISE TAX REFORM AND SIMPLIFICATION	4
A. Highway Excise Taxes.....	4
1. Modify gas guzzler (sec. 5201 of the Senate amendment)	4
2. Exclusion for tractors weighing 19,500 pounds or less from the Federal excise tax on heavy trucks and trailers (sec. 5202 of the Senate amendment)	4
3. Exemption of bulk beds for farm crops from the Federal excise tax on heavy trucks and trailers (sec. 5203 of the Senate amendment).....	4
4. Volumetric excise tax credit for alternative fuels (sec. 5204 of the Senate amendment).....	4
B. Aquatic Excise Taxes.....	6
1. Eliminate Aquatic Trust Fund and transform Sport Fish Restoration Account (sec. 5211 of the Senate amendment)	6
2. Repeal harbor maintenance tax on exports (sec. 5212 of the Senate amendment).....	6
3. Cap excise tax on certain fishing equipment (sec. 5213 of the Senate amendment).....	6
C. Aerial Excise Taxes	7
1. Clarify excise tax exemptions for agricultural aerial applicators and exempt certain fixed-wing aircraft engaged in forestry operations (sec. 5221 of the Senate amendment).....	7
2. Modify the definition of rural airport (sec. 5222 of the Senate amendment)	7
3. Exempt from ticket taxes transportation provided by seaplanes (sec. 5223 of the Senate amendment).....	7
4. Exempt certain sightseeing flights from taxes on air transportation (sec. 5224 of the Senate amendment)	8
D. Taxes Relating to Alcohol	9
1. Repeal special occupational taxes on producers and marketers of alcoholic beverages (sec. 5231 of the Senate amendment)	9
2. Modify limitation on rate of rum excise tax cover over to Puerto Rico and Virgin Islands (sec. 5232 of the Senate amendment)	9

3.	Provide income tax credit for cost of carrying tax-paid distilled spirits in wholesale inventories and in control State bailment warehouses (sec. 5233 of the Senate amendment)	9
4.	Quarterly filing by small alcohol producers (sec. 5234 of the Senate amendment).....	10
E.	Sports Excise Taxes	11
1.	Provide exemption for certain custom gunsmiths (sec. 5241 of the Senate amendment).....	11
III.	MISCELLANEOUS AND REVENUE PROVISIONS	12
A.	Miscellaneous Provisions.....	12
1.	Establish a Motor Fuel Tax Enforcement Advisory Commission (sec. 5301 of the Senate amendment)	12
2.	Establish a National Surface Transportation Infrastructure Financing Commission (sec. 5302 of the Senate amendment).....	12
3.	Expand Highway Trust Fund expenditure purposes to include funding for studies of supplemental or alternative financing for the Highway Trust Fund (sec. 5303 of the Senate amendment)	12
4.	Delta Regional Transportation Plan (sec. 5304 of the Senate amendment)	13
5.	Establish the Build America Corporation (sec. 5305 of the Senate amendment).....	13
6.	Increase in dollar limitation for qualified transportation fringe benefits (sec. 5306 of the Senate amendment)	13
7.	Treasury study of highway fuels used by trucks for nontransportation purposes (sec. 5307 of the Senate amendment).....	14
8.	Private activity bonds for rail-truck transfer stations (sec. 5308 of the Senate amendment).....	14
9.	State acquisition of real estate investment trust interests (sec. 5309 of the Senate amendment).....	14
10.	Alternative fuel vehicle refueling property credit (sec. 5310 of the Senate amendment).....	15
11.	Modify recapture of section 197 amortization (sec. 5311 of the Senate amendment).....	15
12.	Diesel fuel tax evasion report (sec. 5312 of the Senate amendment)	15
B.	Revenue Provisions.....	16
1.	Modify the tax treatment of contingent convertible debt instruments (sec. 5501 of the Senate amendment)	16
2.	Frivolous tax submissions (sec. 5502 of the Senate amendment)	16
3.	Increase in certain criminal penalties (sec. 5503 of the Senate amendment)	17
4.	Doubling of penalties, fines, and interest on underpayments related to offshore financial arrangements (sec. 5504 of the Senate amendment)	17
5.	Modification of CFC-PFIC coordination rules (sec. 5505 of the Senate amendment).....	17
6.	Declaration by chief executive officer relating to federal annual income tax return of a corporation (sec. 5506 of the Senate amendment)	18

7. Grant Treasury regulatory authority to address foreign tax credit transactions involving inappropriate separation of foreign taxes from related foreign income (sec. 5507 of the Senate amendment)	18
8. Whistleblower reforms (sec. 5508 of the Senate amendment)	18
9. Denial of deduction for certain fines, penalties, and other amounts (sec. 5509 of the Senate amendment)	19
10. Freeze of interest suspension rules with respect to listed transactions (sec. 5510 of the Senate amendment)	19
11. Repeal section 470 exception for qualified transportation property (sec. 5511 of the Senate amendment)	20
12. Impose mark-to-market tax on individuals who expatriate (sec. 5512 of the Senate amendment).....	20
13. Deny deduction for punitive damages (sec. 5513 of the Senate amendment)...	20
14. Application of earnings stripping rules to partners which are C corporations (sec. 5514 of the Senate amendment)	21
15. Deferral of certain stock option and restricted stock gains prohibited (sec. 5515 of the Senate amendment)	21
16. Limitation of employer deduction for certain entertainment expenses (sec. 5516 of the Senate amendment)	21
17. Increase in penalty for bad checks and money orders (sec. 5517 of the Senate amendment).....	22
18. Eliminate double deduction of mining exploration and development costs under the minimum tax (sec. 5518 of the Senate amendment).....	22
19. Clarification of the economic substance doctrine and related penalty provisions (secs. 5521 through 5523 of the Senate amendment).....	22
20. Waiver of user fee for installment agreements using automated withdrawals (sec. 5531 of the Senate amendment)	23
21. Termination of installment agreements (sec. 5532 of the Senate amendment).....	24
22. Office of Chief Counsel review of offers-in-compromise (sec. 5533 of the Senate amendment).....	24
23. Require partial payments with submission of offers-in-compromise (sec. 5534 of the Senate amendment)	24
24. Joint task force study on offers-in-compromise (sec. 5535 of the Senate amendment).....	25
C. Additional Revenue Provisions Relating to the Highway Trust Fund.....	26
1. Suspend section 9503(c)(2) transfers from the Highway Trust Fund to the General Fund (sec. 5601 of the Senate amendment)	26
2. Temporary dedication of gas guzzler tax to Highway Trust Fund (sec. 5602 of the Senate amendment)	26
3. Treatment of kerosene used in aviation (sec. 5611 of the Senate amendment).....	26
4. Repeal of ultimate vendor refund claims with respect to farming (sec. 5612 of the Senate amendment)	27

5. Refunds of excise taxes on exempt sales of fuel by credit card (sec. 5613 of the Senate amendment)	27
6. Additional requirements for exempt purchases by State and local governments and nonprofit educational entities (sec. 5614 of the Senate amendment).....	27
7. Reregistration in event of change in ownership (sec. 5615 of the Senate amendment).....	27
8. Reconciliation of on-loaded cargo to entered cargo (sec. 5616 of the Senate amendment).....	28
9. Registration of operators of deep-draft vessels (sec. 5617 of the Senate amendment).....	28
10. Taxation of gasoline blend stocks and kerosene (sec. 5618 of the Senate amendment).....	28
11. Nonapplication of export exemption to delivery of fuel to motor vehicles departing the United States (sec. 5619 of the Senate amendment).....	29
12. Penalty with respect to certain adulterated fuels (sec. 5620 of the Senate amendment).....	29

IV. FUELS RELATED TECHNICAL CORRECTIONS

(sec. 5401 of the Senate amendment)	30
1. Volumetric ethanol excise tax credit (sec. 301 of American Jobs Creation Act of 2004 (“AJCA”)).....	30
2. Aviation fuel (sec. 853 of AJCA)	30
3. Coastal Wetlands sub-account (sec. 9005 of Transportation Equity Act for the 21st Century (“TEA 21”)).....	30

INTRODUCTION

On May 17, 2005, the Senate passed H.R. 3, as amended, the “Safe, Accountable, Flexible, and Efficient Transportation Equity Act of 2005.” Title V of H.R. 3, as amended, provides for the extension of the Highway Trust Fund and the Aquatic Resources Trust Fund expenditure authority and related taxes and contains provisions to provide for excise tax reform and simplification, and for other purposes. This document, prepared by the staff of the Joint Committee on Taxation, describes Title V of H.R. 3, as amended, the “Highway Reauthorization and Excise Tax Simplification Act of 2005.”¹ The “Senate amendment” refers to those provisions contained in Title V.

¹ This document may be cited as follows: Joint Committee on Taxation, *Summary Description of the “Highway Reauthorization and Excise Tax Simplification Act of 2005,” Title V of H.R. 3, as Passed by the Senate on May 17, 2005* (JCX-41-05), June 13, 2005.

I. TRUST FUND REAUTHORIZATION

A. Extend Highway Trust Fund and Aquatic Resources Trust Fund Expenditure Authority through September 30, 2009, and Related Taxes Through September 30, 2011 (secs. 5101 and 5102 of the Senate amendment)

Excise taxes on motor fuels, heavy vehicles, heavy vehicle tires, and an annual use tax on heavy vehicles finance the Federal Highway Trust Fund program. Generally, these taxes expire September 30, 2005.² Trust Fund expenditure authority expires after June 30, 2005. Highway Trust Fund spending is limited by anti-deficit provisions internal to the Highway Trust Fund. Generally, the anti-deficit rule prevents the further obligation of Federal highway funds if the Treasury Department determines that the amount (if any) by which unfunded highway authorizations exceed projected net Highway Trust Fund tax receipts for the 24-month period beginning at the close of each fiscal year. A similar rule applies to unfunded Mass Transit Account authorizations.

The Senate amendment extends expenditure authority for the Highway Trust Fund and Aquatic Resources Trust Fund through September 30, 2009. The Code provisions governing the purposes for which monies in the Highway Trust Fund and Aquatic Resources Trust Fund may be spent is updated to include the reauthorization bill. The Senate amendment also extends the motor fuel taxes and all three non-fuel excises taxes at their current rates through September 30, 2011.

The anti-deficit rule is changed from a 24-month to a 48-month receipt rule. Under the Senate amendment, the rule is not triggered unless unfunded highway authorizations exceed projected net Highway Trust Fund tax receipts for the 48-month period beginning at the close of each fiscal year. For purposes of the 48-month rule, taxes are assumed extended beyond their expiration date. The rule applies similarly to the Mass Transit Account.

The provisions are effective on the date of enactment.

² The heavy vehicle use tax expires September 30, 2006, and 4.3 cents per gallon of the tax rate imposed on fuels is without expiration.

**B. Extend General Fund Retention of 4.8 Cents/Gallon of Taxes
on Motorboat and Small Engine Gasoline
(sec. 5101 of the Senate amendment)**

The Aquatic Resources Trust Fund is funded from the Highway Trust Fund by a portion of the receipts from the excise taxes imposed on motorboat gasoline and special motor fuels and on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment. Of these collected tax amounts, 4.8 cents per gallon is retained in the General Fund. The retention of these amounts is scheduled to expire after September 30, 2005. The Senate amendment extends such retention until September 30, 2011.

The provision is effective October 1, 2005.

II. EXCISE TAX REFORM AND SIMPLIFICATION

A. Highway Excise Taxes

1. Modify gas guzzler (sec. 5201 of the Senate amendment)

Under present law, the Code imposes an excise tax on automobiles that are manufactured primarily for use on public streets, roads, and highways that and are rated at 6,000 pounds unloaded gross vehicle weight or less. The tax applies to limousines without regard to the weight requirement. The Senate amendment repeals the tax as it applies to limousines rated at greater than 6,000 pounds unloaded gross vehicle weight.

The provision is effective on October 1, 2005.

2. Exclusion for tractors weighing 19,500 pounds or less from the Federal excise tax on heavy trucks and trailers (sec. 5202 of the Senate amendment)

The Code imposes a 12-percent excise tax on the first retail sale of heavy trucks and trailers. In general, all tractors regardless of their gross vehicle weight are taxable. Trucks, however, are only taxable if the gross vehicle weight is in excess of 33,000 pounds. The Senate amendment excludes from taxation tractors with a gross vehicle weight of 19,500 pounds.

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

3. Exemption of bulk beds for farm crops from the Federal excise tax on heavy trucks and trailers (sec. 5203 of the Senate amendment)

The Code imposes a 12-percent excise tax on the first retail sale of heavy trucks and trailers. The Code provides an exemption for any body primarily designed to haul feed, seed or fertilizer to and on farms. The Senate amendment exempts bulk beds used for transporting farm crops to and on farms from the excise tax on the retail sale heavy trucks and trailers.

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

4. Volumetric excise tax credit for alternative fuels (sec. 5204 of the Senate amendment)

Under present law, a 24.3-cents-per-gallon excise tax is imposed on diesel fuel to finance the Highway Trust Fund. Gasoline and most special motor fuels are subject to tax at 18.3 cents per gallon for the Trust Fund. The statutory rate for certain special motor fuels is determined on an energy equivalent basis, as follows: liquefied petroleum gas (propane) (13.6 cents per gallon); liquefied natural gas (11.9 cents per gallon); methanol derived from petroleum or natural gas (9.15 cents per gallon); and compressed natural gas (48.54 cents per MCF). No excise tax credit is provided for the sale or use of those fuels.

Under the Senate amendment, P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)) are taxed at 18.3 cents per gallon; compressed natural gas and hydrogen are taxed at 18.3 cents per energy equivalent of a gallon of gasoline; and liquefied natural gas, any liquid fuel (other than ethanol or methanol) derived from coal, and liquid hydrocarbons

derived from biomass are taxed at 24.3 cents per gallon. The Senate amendment also provides a per-gallon excise tax credit in the amount of 50 cents for sale of these fuels as motor fuel in a highway vehicle, or used in producing an alternative fuel mixture sold for use as fuel in a highway vehicle. However, liquids derived from coal are eligible for the credit only if produced through the Fischer-Tropsch process. The taxes are dedicated to the Highway Trust Fund and the credit would be paid out of the General Fund. The credit sunsets after September 30, 2009.

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

B. Aquatic Excise Taxes

1. Eliminate Aquatic Trust Fund and transform Sport Fish Restoration Account (sec. 5211 of the Senate amendment)

The Aquatic Resources Trust Fund is funded from the Highway Trust Fund by a portion of the receipts from the excise taxes imposed on motorboat gasoline and special motor fuels and on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment. The Aquatics Resources Trust Fund is also funded with receipts from an excise tax on sport fishing equipment and by import duties on certain fishing tackle, yachts and pleasure craft. The Aquatic Resources Trust Fund is comprised of two accounts, the Boat Safety Account and the Sport Fish Restoration Account.

The Senate amendment eliminates the Aquatics Resources Trust Fund and future transfers to the Boat Safety Account and transforms the Sport Fish Restoration Account into the Sport Fish Restoration and Boating Trust Fund. After funding of the land and water conservation fund as under present law, the balance of the taxes on motorboat fuels in the Highway Trust Fund is transferred to the Sport Fish Restoration and Boating Trust Fund. In addition, the transfers from the Highway Trust Fund to the Sport Fish Restoration and Boating Trust Fund of amounts of taxes on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment are extended through September 30, 2011.

Existing amounts in the Boat Safety Account, plus interest accrued on interest-bearing obligations of such account, are made available as provided under expenditure provisions.

The provision is effective on October 1, 2005.

2. Repeal harbor maintenance tax on exports (sec. 5212 of the Senate amendment)

The Supreme Court has held that the harbor maintenance tax is unconstitutional as applied to exported cargo because it violates the “Export Clause” of the U.S. Constitution. The Senate amendment conforms the Code to the Supreme Court decision and exempts exported commercial cargo from the harbor maintenance tax.

The provision is effective before, on, and after the date of enactment.

3. Cap excise tax on certain fishing equipment (sec. 5213 of the Senate amendment)

In general, the Code imposes a 10-percent tax on the sale by the manufacturer, producer, or importer of specified sport fishing equipment, including fishing rods and poles. The Senate amendment provides that the tax applicable to a fishing rod or fishing pole is the lesser of 10 percent or \$10.00.

The provision is effective for articles sold by the manufacturer, producer, or importer after September 30, 2005.

C. Aerial Excise Taxes

1. Clarify excise tax exemptions for agricultural aerial applicators and exempt certain fixed-wing aircraft engaged in forestry operations (sec. 5221 of the Senate amendment)

Fuel used on a farm for farming purposes is a nontaxable use. Aerial applicators (crop dusters) are allowed to claim a refund instead of farm owners or operators in the case of aviation gasoline, if the owner or operator gives written consent to the aerial applicator. Under the Senate amendment, with regard to the exemption for aerial applicators, written consent from the farm owner or operator is no longer needed for the aerial applicator to claim exemption for aviation gasoline. The exemption also is expanded to include fuels consumed when flying between the farms where chemicals are applied and the airport where the airplane takes off and lands.

Most air passenger transportation is subject to an excise tax equal to 7.5 percent of the amount paid plus \$3.20 per domestic flight segment. The tax on air transportation does not apply to transportation by helicopter if the helicopter is used for (1) the exploration, or the development or removal of oil, gas, or hard minerals exploration, or (2) certain timber operations (planting, cultivating, cutting, transporting, or caring for trees, including logging operations). The exemption applies only when the helicopters are not using the Federally funded airport and airway services. The Senate amendment expands the present exemption for helicopters engaged in timber operations to include fixed-wing aircraft if such aircraft are not using the Federally funded airport and airway services.

The provisions are effective for fuel use and air transportation after September 30, 2005.

2. Modify the definition of rural airport (sec. 5222 of the Senate amendment)

Most air passenger transportation is subject to an excise tax equal to 7.5 percent of the amount paid plus \$3.20 per domestic flight segment. The flight segment component of the tax does not apply to segments to or from qualified "rural airports." A rural airport is defined as an airport that (1) in the second preceding calendar year had fewer than 100,000 commercial passenger departures, and (2) either (a) is not located within 75 miles of another airport that had more than 100,000 such departures in that year, or (b) is eligible for payments under the Federal "essential air service" program. The Senate amendment expands the definition of qualified rural airport to include an airport that (1) is not connected by paved roads to another airport and (2) had fewer than 100,000 commercial passengers departing by air on flight segments of at least 100 miles during the second preceding calendar year.

The provision is effective on October 1, 2005.

3. Exempt from ticket taxes transportation provided by seaplanes (sec. 5223 of the Senate amendment)

Most air passenger transportation is subject to an excise tax equal to 7.5 percent of the amount paid plus \$3.20 per domestic flight segment ("air passenger tax"). A 6.25-percent tax is imposed on amounts paid for transportation of property by air ("air cargo tax"). The Senate amendment provides that the air passenger tax and the air cargo tax do not apply to transportation by a seaplane with respect to any segment consisting of a takeoff from, and a

landing on, water, but only if the places at which such takeoff and landing occur have not received and are not receiving financial assistance from the Airport and Airway Trust Fund.

The provision is effective for transportation beginning after September 30, 2005.

**4. Exempt certain sightseeing flights from taxes on air transportation
(sec. 5224 of the Senate amendment)**

The air passenger tax does not apply to amounts paid for the transportation if furnished on an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less unless the aircraft is operated on an established line. The Senate amendment provides that for purposes of the exemption for small aircraft operated on nonestablished lines, an aircraft operated on a flight the sole purpose of which is sightseeing will not be considered as operated on an established line.

The provision is effective for transportation beginning after September 30, 2005, but does not apply to any amount paid before such date for such transportation.

D. Taxes Relating to Alcohol

1. Repeal special occupational taxes on producers and marketers of alcoholic beverages (sec. 5231 of the Senate amendment)

Under the law in effect prior to July 1, 2005, special occupational taxes are imposed on producers and others engaged in the marketing of distilled spirits, wine, and beer. These excise taxes vary in amount between \$250 and \$1,000 per year, and are payable on July 1 of each year. These taxes are currently suspended through June 30, 2008. The Senate amendment permanently repeals these special occupational taxes. The registration, recordkeeping, and inspection rules of current law are retained.

The provision is effective on July 1, 2008.

2. Modify limitation on rate of rum excise tax cover over to Puerto Rico and Virgin Islands (sec. 5232 of the Senate amendment)

A \$13.50 per proof gallon excise tax is imposed on distilled spirits produced in or imported into the United States (a proof gallon is a liquid gallon consisting of 50 percent alcohol). The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported into the United States, without regard to the country of origin. The amount of the cover over is limited to \$13.25 per proof gallon through December 31, 2005, after which the limitation decreases to \$10.50.

Under the Senate amendment, the cover over amount of \$13.25 per proof gallon is modified to \$13.50 for rum brought into the United States after December 31, 2005 and before January 1, 2007. After December 31, 2006, the cover over amount reverts to \$10.50 per proof gallon. The Senate amendment additionally requires the treasury of Puerto Rico to make periodic transfers to the Puerto Rico Conservation Trust Fund in an amount equal to 50 cents per proof gallon of the taxes covered over to Puerto Rico, and attributable to rum imported into the United States that was produced neither in Puerto Rico nor the Virgin Islands. The transfer requirement expires after December 31, 2006.

The change in the cover over rate is effective for articles brought into the United States after December 31, 2005. The provision regarding transfers to the Puerto Rico Conservation Trust Fund is effective January 1, 2006.

3. Provide income tax credit for cost of carrying tax-paid distilled spirits in wholesale inventories and in control State bailment warehouses (sec. 5233 of the Senate amendment)

The Senate amendment creates a new income tax credit for eligible wholesalers, distillers, and importers of distilled spirits. The credit is calculated by multiplying the number of cases of bottled distilled spirits by the average tax-financing cost per case for the most recent calendar year ending before the beginning of such taxable year. A case is 12 80-proof 750-milliliter bottles. The average tax-financing cost per case is the amount of interest that would accrue at corporate overpayment rates during an assumed 60-day holding period on an assumed tax rate of \$25.68 per case.

The wholesaler credit only applies to domestically bottled distilled spirits purchased directly from the bottler of such spirits. An eligible wholesaler is any person that holds a permit under the Federal Alcohol Administration Act as a wholesaler of distilled spirits that is not a State, or agency or political subdivision thereof. For distillers and importers that are not eligible wholesalers, the credit is limited to bottled inventory in a warehouse owned and operated by, or on behalf of, a State when title to such inventory has not passed unconditionally. The credit for these distillers and importers applies to distilled spirits bottled both domestically and abroad. The credit is treated as part of the general business credits.

The provision is effective for taxable years beginning after September 30, 2005.

4. Quarterly filing by small alcohol producers (sec. 5234 of the Senate amendment)

Domestic producers of distilled spirits, beer, and wine are generally required to file alcohol excise tax returns and to pay alcohol excise taxes within 14 days after the last day of the semi-monthly period during which the article is withdrawn under a deferred payment bond. Treasury regulations also permit certain very small wine producers to file and pay on an annual basis. In the case of distilled spirits, wines, and beer which are imported into the United States (other than in bulk containers), the importer is generally required to pay alcohol excise taxes within 14 days after the last day of the semi-monthly period during which the article is entered into the customs territory of the United States. In the case of imported articles entered for warehousing, the taxes are generally due within 14 days after the last day of the semi-monthly period during which the article is removed from the first such warehouse.

Under the Senate amendment, domestic producers and importers of distilled spirits, wines, and beers with annual excise tax liability of \$50,000 or less attributable to alcohol may file returns and pay taxes within 14 days after the end of the calendar quarter instead of on a semi-monthly basis. In order to qualify, the taxpayer's tax liability for such taxes during the immediately preceding year must have been \$50,000 or less, and, as of the beginning of the current calendar year, the taxpayer must reasonably expect to pay less than \$50,000 in such taxes for that year. The Senate amendment does not apply to a taxpayer for any portion of the calendar year following the first date on which the aggregate amount of tax due for that year exceeds the \$50,000 threshold. Very small wine producers may still file and pay on an annual basis as under present law.

The provision is effective for quarterly periods beginning on and after January 1, 2006.

E. Sports Excise Taxes

1. Provide exemption for certain custom gunsmiths (sec. 5241 of the Senate amendment)

The Senate amendment exempts from the firearms excise tax firearms, pistols, and revolvers manufactured, produced, or imported by a person who manufactures, produces, and imports less than 50 of such articles during the calendar year. Controlled groups are treated as a single person for determining the 50-article limit.

The provision is effective for articles sold by the manufacturer, producer or importer after September 30, 2005. No inference is intended as to the proper treatment of any sales prior to the effective date of this provision.

III. MISCELLANEOUS AND REVENUE PROVISIONS

A. Miscellaneous Provisions

1. Establish a Motor Fuel Tax Enforcement Advisory Commission (sec. 5301 of the Senate amendment)

The Senate amendment establishes a “Motor Fuel Tax Enforcement Advisory Commission” (the “Commission”). The purpose of the Commission is to (1) review motor fuel revenue collections, historical and current, (2) review the progress of investigations (3) develop and review legislative proposals with respect to motor fuel taxes, (4) monitor the progress of administrative regulation projects relating to fuel taxes, (5) review the results Federal and State agency cooperative efforts regarding motor fuel taxes, and (6) review the results of Federal interagency cooperative efforts regarding motor fuel taxes. The Commission also is to evaluate and make recommendations regarding (1) the effectiveness of existing Federal enforcement programs regarding motor fuel taxes, (2) enforcement personnel allocation, and (3) proposals for regulatory projects, legislation, and funding. The Commission is to terminate after September 30, 2009.

The provision is effective on the date of enactment.

2. Establish a National Surface Transportation Infrastructure Financing Commission (sec. 5302 of the Senate amendment)

The Senate amendment establishes a “National Surface Transportation Infrastructure Financing Commission” (the “Financing Commission”). The Financing Commission will investigate and study revenues flowing into the Highway Trust Fund under present law, and report to Congress within two years of its first meeting. The Financing Commission will consider alternative approaches to generating revenues for the Highway Trust Fund, and will consider the nations highway and transit needs. The Financing Commission’s study will address the period between the present and through the year 2015.

The provision is effective on the date of enactment.

3. Expand Highway Trust Fund expenditure purposes to include funding for studies of supplemental or alternative financing for the Highway Trust Fund (sec. 5303 of the Senate amendment)

The Senate amendment expands the expenditure authority and authorizes the expenditure of monies from the Highway Trust Fund to fund two comprehensive studies of supplemental or alternative funding sources for the Highway Trust Fund. One study, to receive \$1 million in funding, will review funding mechanisms of other industrialized nations and examine the viability of proposals such as congestion pricing, greater reliance on tolls, privatization of facilities, and other funding proposals. The other study, to receive \$16.5 million in funding, would report on a long-term field test of a new approach to assessing highway use taxes by use of an on-board computer that links to satellites to calculate road mileage traversed and compute the appropriate highway use tax for each of the Federal, State, and local government as the vehicle makes use of the roads.

The provision is effective on the date of enactment.

4. Delta Regional Transportation Plan (sec. 5304 of the Senate amendment)

The Senate amendment directs the Delta Regional Authority to conduct a comprehensive study of transportation assets and needs in the eight states comprising the Delta region (Alabama, Arkansas, Illinois, Kentucky, Louisiana, Mississippi, Missouri, and Tennessee). Upon completion of the study, the Delta Regional Authority is to create a regional strategic plan to achieve efficient transportation systems in the Delta region.

The Senate amendment authorizes the Delta Regional Authority to receive \$500,000 in fiscal year 2005, and \$500,000 in fiscal year 2006 to conduct a comprehensive study and plan. These funds are to remain available until spent.

The provision is effective on the date of enactment.

5. Establish the Build America Corporation (sec. 5305 of the Senate amendment)

The Senate amendment establishes a nonprofit corporation, to be known as the “Build America Corporation.” The Build America Corporation is not an agency or establishment of the United States Government. The Build America Corporation generally shall be subject to the laws of the State of Delaware applicable to corporations not for profit.

The purpose of the corporation is to provide financial support for qualified projects. Under the provision a “qualified project” generally is defined as any transportation infrastructure project of any governmental unit or other person that is proposed by a State, including a highway project, a transit system project, a railroad project, an airport project, a port project, and an inland waterways project. The Senate amendment imposes additional requirements if a qualified project is financed by debt issued by the Build America Corporation.

The provision is effective on the date of enactment.

6. Increase in dollar limitation for qualified transportation fringe benefits (sec. 5306 of the Senate amendment)

Under present law, qualified transportation benefits are excludable from gross income and wages for employment tax purposes. Qualified transportation benefits are: (1) transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee’s residence and place of employment (“van pooling”); (2) transit passes; and (3) qualified parking. The maximum amount of qualified parking that is excludable from income and wages is \$200 per month (for 2005). The maximum amount of van pooling and transit pass benefits that is excludable from income and wages per month is \$105 (for 2005). These dollar amounts are indexed for inflation.

Under the Senate amendment, the maximum dollar amount of excludable van pooling and transit pass benefits is increased to \$155 per month. The maximum amount of excludable qualified parking is \$200 per month. The dollar amounts are indexed for inflation after 2008 (with 2007 as a base year). Beginning in 2010, the maximum dollar amount of excludable van

pooling and transit pass benefits is increased so that it is equal to the maximum amount of excludable qualified parking.

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

7. Treasury study of highway fuels used by trucks for nontransportation purposes (sec. 5307 of the Senate amendment)

The Senate amendment directs the Secretary of the Treasury to study the use by trucks of highway motor fuel that is not used for the propulsion of the vehicle, both in the case of vehicles carrying equipment that is unrelated to the transportation function of the vehicle and in the case where non-transportation equipment is run by a separate motor. In addition, the Secretary is to estimate the amount of fuel consumed and pollutants emitted by trucks due to the long-term idling of diesel engines, and report on the cost of reducing long-term idling through various technologies.

The provision is effective on the date of enactment.

8. Private activity bonds for rail-truck transfer stations (sec. 5308 of the Senate amendment)

The Senate amendment establishes a new category of tax-exempt private activity bonds, “qualified highway facilities and qualified surface freight transfer facilities bonds.” Under the Senate amendment, a qualified highway facility is any surface transportation or international bridge or tunnel project (for which an international entity authorized under Federal or State law is responsible) which receives Federal assistance under title 23 of the United States Code (relating to Highways). A qualified surface freight transfer facility is a facility for the transfer of freight from truck to rail or rail to truck which receives Federal assistance under title 23 or title 49 of the United States Code (relating to Transportation).

The provision applies to bonds issued after the date of enactment.

9. State acquisition of real estate investment trust interests (sec. 5309 of the Senate amendment)

The Senate amendment permits the tax-free conversion of a railroad corporation that was a qualified real estate investment trust (and thus had the required 100 or more shareholders) into a 100-percent State-owned entity. The income of the entity is treated as accruing to the State, and thus eligible for exemption as income of a State, to the extent the described activities of the entity satisfy present-law requirements of activities that are an essential governmental function. Obligations of the entity are also treated as obligations of a State for purpose of applying the tax-exempt bond provisions.

The provision applies on and after the date a State becomes the owner of all the outstanding stock of a qualified railroad corporation, provided the State owned all of the voting stock of the corporation on or before December 31, 2003, and becomes the owner of all the outstanding stock of the corporation on or before December 31, 2006.

10. Alternative fuel vehicle refueling property credit (sec. 5310 of the Senate amendment)

The Senate amendment provides a 50-percent credit for the installation of qualified alternative fuel vehicle refueling property placed in service during the taxable year. The maximum credit that can be claimed with respect to such property is \$30,000 per year in the case of an installation as part of the taxpayer's business and \$1,000 for other installations. Qualified alternative fuel vehicle refueling property is property for the storage or dispensing of qualified fuels into the fuel tank of a motor vehicle. Any fuels at least 85 percent of which consist of ethanol, natural gas, compressed natural gas, liquefied natural gas, and hydrogen comprise qualified fuels.

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

11. Modify recapture of section 197 amortization (sec. 5311 of the Senate amendment)

Under present law, gain on the sale of depreciable property must be recaptured as ordinary income to the extent of depreciation deductions previously claimed, and the recapture amount is computed separately for each item of property. Section 197 intangibles, because they are treated as property of a character subject to the allowance for depreciation, are subject to these recapture rules. Under the Senate amendment, if multiple section 197 intangibles are sold (or otherwise disposed of) in a single transaction or series of transactions, the seller must calculate recapture as if all of the section 197 intangibles were a single asset. Thus, any gain on the sale (or other disposition) of the intangibles is recaptured as ordinary income to the extent of ordinary depreciation deductions previously claimed on any of the section 197 intangibles.

The provision is effective for dispositions of property after the date of enactment.

12. Diesel fuel tax evasion report (sec. 5312 of the Senate amendment)

The Senate amendment requires the Commissioner of the IRS to report on the availability of new technologies that can be employed to enhance the collections of the excise tax on diesel fuel and the plans of the IRS to employ such technologies. The report is to be submitted within 360 days from the date of enactment to the Senate Committees on Finance and Environment and Public Works, and the House Committees on Ways and Means and Transportation and Infrastructure.

The provision is effective on the date of enactment.

B. Revenue Provisions

1. Modify the tax treatment of contingent convertible debt instruments (sec. 5501 of the Senate amendment)

Under present law, debt instruments that provide for one or more contingent payments of principal or interest (“contingent payment debt instruments”) are, like debt instruments generally, subject to the original issue discount (“OID”) rules. Under the OID rules, an issuer of a debt instrument accrues and deducts as interest (and a holder includes as interest income) OID over the life of the instrument even though the amount of the OID may not be paid until maturity of the instrument. Treasury regulations provide rules for determining the amount of OID allocated to a particular period under a contingent payment debt instrument. These rules require the amount of an OID accrual for a particular period to be calculated by determining the instrument’s comparable yield by reference to the yield of a similar noncontingent debt instrument.

The contingent payment debt regulations do not specifically address the treatment of debt instruments that are convertible into the common stock of the issuer and which also include a contingent feature (“contingent payment convertible debt instruments”). Taxpayers have taken the position and the IRS has concluded that the amount of OID allocated to a period under a contingent payment convertible debt instrument should be determined by reference to a comparable noncontingent, nonconvertible debt instrument. This treatment results in larger interest deductions than would be allowable under a similar convertible debt instrument that did not include a contingent payment feature. The Senate amendment provides that any Treasury regulations that require OID to be determined by reference to the yield of a noncontingent debt instrument must be applied as if they required that the yield be determined by reference to a noncontingent, convertible (rather than, as under existing IRS guidance, a noncontingent, nonconvertible) debt instrument.

The provision applies to debt instruments issued on or after the date of enactment.

2. Frivolous tax submissions (sec. 5502 of the Senate amendment)

The Senate amendment modifies the IRS-imposed penalty by increasing the amount of the penalty to up to \$5,000 and by applying it to all taxpayers and to all types of Federal taxes.

The Senate amendment also modifies present law with respect to certain submissions that raise frivolous arguments or that are intended to delay or impede tax administration. The submissions to which this provision applies are requests for a collection due process hearing, installment agreements, offers-in-compromise, and taxpayer assistance orders. First, the Senate amendment permits the IRS to dismiss such requests. Second, the Senate amendment permits the IRS to impose a penalty of up to \$5,000 for such requests, unless the taxpayer withdraws the request after being given an opportunity to do so.

The Senate amendment requires the IRS to publish a list of positions, arguments, requests, and submissions determined to be frivolous for this purpose.

The provisions apply to submissions made and issued raised after the date on which the Secretary first prescribes a list under section 6702(c), as amended.

3. Increase in certain criminal penalties (sec. 5503 of the Senate amendment)

The Senate amendment increases the criminal penalties for attempting to evade or defeat tax and for fraud and false statements to \$500,000 for individuals and to \$1,000,000 for corporations. The provision increases the maximum prison sentence for attempting to evade or defeat tax to ten years and for fraud and false statements to five years. The Senate amendment also increases the criminal penalty for willful failures to file returns, supply information, or pay taxes from a misdemeanor to a felony for aggravated failures to file. An aggravated failure to file is defined as any case in which the taxpayer fails to file returns for three or more consecutive years and the aggregated tax liability during such years is \$100,000 or greater. The provision imposes a penalty for an aggravated failure to file up to \$500,000 for individuals and up to \$1,000,000 for corporations and imposes a maximum prison sentence of ten years. For misdemeanor failure to file cases, the provision increases the criminal penalty for individuals to \$50,000.

The provision is effective for actions and failures to act occurring after the date of enactment.

4. Doubling of penalties, fines, and interest on underpayments related to offshore financial arrangements (sec. 5504 of the Senate amendment)

Under present law, interest is added, and civil penalties and fines may be added, to underpayments of tax. In January 2003, Treasury announced the Offshore Voluntary Compliance Initiative (“OVCI”) to encourage the voluntary disclosure of previously unreported income placed by taxpayers in offshore accounts and accessed through credit card or other financial arrangements. Taxpayers entering into a closing agreement under the OVCI are not liable for certain civil penalties. The Senate amendment doubles the total amount of civil penalties, fines, and interest applicable to taxpayers who were eligible to participate in, but did not participate in, the OVCI and did not otherwise voluntarily disclose their underpayment of U.S. income tax through the use of such offshore financial arrangements.

The provision is effective with respect to a taxpayer’s open years on or after the date of enactment.

5. Modification of CFC-PFIC coordination rules (sec. 5505 of the Senate amendment)

Under present law, the Code contains two key sets of foreign anti-deferral rules, the controlled foreign corporation (CFC) rules and the passive foreign investment company (PFIC) rules. Under the CFC rules, the United States generally taxes a U.S. 10-percent shareholder of a CFC on its pro rata share of certain passive or highly mobile income of the CFC, without regard to whether the income is distributed to the shareholder. Under the PFIC rules, a U.S. shareholder may elect to be taxed under certain circumstances on the PFIC’s current income or on the basis of changes in the market value of the PFIC’s stock. Absent such an election, the U.S. shareholder pays tax on certain income or gain realized through the PFIC, plus an interest charge that is attributable to the value of deferral.

Under section 1297(e), which was enacted in 1997 to address the overlap of the PFIC and subpart F rules, a CFC generally is not also treated as a PFIC with respect to a U.S. shareholder of the corporation. Section 1297(e) may enable a U.S. shareholder (like Enron in the “Project Apache” transaction) to claim exemption from the PFIC rules with respect to ownership of CFC stock despite the fact that the U.S. shareholder may have implemented a structure intended to render it impossible for such shareholder to recognize any income under the CFC rules. The Senate amendment adds an exception to section 1297(e) for a U.S. shareholder that faces only a remote likelihood of incurring an inclusion in the event that a CFC earns subpart F income, thus preserving the potential application of the PFIC rules in such cases.

The provision is effective for taxable years of controlled foreign corporations beginning after March 2, 2005, and for taxable years of U.S. shareholders in which or with which such taxable years of controlled foreign corporations end.

6. Declaration by chief executive officer relating to federal annual income tax return of a corporation (sec. 5506 of the Senate amendment)

The Senate amendment requires that a corporation’s Federal annual income tax return include a declaration signed under penalties of perjury by the chief executive officer of the corporation that the corporation has in place processes and procedures to ensure that the return complies with the Internal Revenue Code and that the chief executive officer was provided reasonable assurance of the accuracy of all material aspects of the return. The provision is in addition to the requirement of present law as to the signing of the income tax return itself. If the corporation does not have a chief executive officer, the IRS may designate another officer of the corporation; otherwise, no other person is permitted to sign the declaration. The Senate amendment provides that the Secretary of the Treasury shall prescribe the matters to which the declaration of the chief executive officer applies.

The provision applies to Federal tax returns for taxable years ending after the date of enactment.

7. Grant Treasury regulatory authority to address foreign tax credit transactions involving inappropriate separation of foreign taxes from related foreign income (sec. 5507 of the Senate amendment)

The Senate amendment provides regulatory authority for the Treasury Department to address transactions that involve the inappropriate separation of foreign taxes from the related foreign income in cases in which taxes are imposed on any person in respect of income of an entity. Regulations issued pursuant to this authority could provide for the disallowance of a credit for all or a portion of the foreign taxes, or for the allocation of the foreign taxes among the participants in the transaction in a manner more consistent with the economics of the transaction.

The provision is effective for transactions entered into after the date of enactment.

8. Whistleblower reforms (sec. 5508 of the Senate amendment)

The Senate amendment creates a reward program for individuals who provide information regarding violations of the tax laws to the Secretary. Generally, the Senate

amendment establishes a reward floor of 15 percent of the collected proceeds (including penalties, interest, additions to tax and additional amounts) if the IRS moves forward with an administrative or judicial action based on information brought to the IRS's attention by an individual. The Senate amendment caps the available reward at 30 percent of the collected proceeds. The Senate amendment permits awards of lesser amounts (but no less than 10 percent) if the action was based principally on allegations (other than information provided by the individual) resulting from a judicial or administrative hearing, government report, hearing, audit, investigation, or from the news media.

The Senate amendment creates a Whistleblower Office within the IRS to administer this reward program. The Whistleblower Office may seek assistance from the individual providing information or from his or her legal representative, and may reimburse the costs incurred by any legal representative out of the amount of the reward. To the extent the disclosure of returns or return information is required to render such assistance, the disclosure must be pursuant to an IRS tax administration contract.

The provision is effective for information provided on or after the date of enactment.

9. Denial of deduction for certain fines, penalties, and other amounts (sec. 5509 of the Senate amendment)

The Senate amendment modifies the rules for determining whether payments are nondeductible payments in the nature of fines or penalties. The Senate amendment generally provides that amounts paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of a government in relation to the violation of any law or the investigation or inquiry into the potential violation of any law are nondeductible under any provision of the income tax provisions. The Senate amendment applies to any such payments, including those where there is no admission of guilt or liability and those made for the purpose of avoiding further investigation or litigation. An exception applies to amounts that the taxpayer establishes are for restitution (including remediation of property) and that are identified as restitution in the court order or settlement agreement.

The provision is effective for amounts paid or incurred after the date of enactment, with an exception for amounts paid or incurred under a binding order or agreement entered into before such date.

10. Freeze of interest suspension rules with respect to listed transactions (sec. 5510 of the Senate amendment)

Under present law, the accrual of certain penalties and interest owed by individual taxpayers is suspended starting 18 months after the filing of the tax return if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability within the specified period. The suspension of interest does not apply to interest accruing after October 3, 2004, with respect to underpayments resulting from listed transactions. Under the Senate amendment, the exception for listed transactions also applies to interest accruing on or before October 3, 2004. However, taxpayers remain eligible for the present-law suspension of interest if, as of May 9, 2005, (1) the taxpayer is participating in (and eventually reaches

resolution via) a published IRS settlement initiative with respect to the listed transaction, or (2) the year in which the underpayment occurred is barred by the statute of limitations.

The provision is effective as if included in the provisions of the American Jobs Creation Act of 2004 to which it relates.

11. Repeal section 470 exception for qualified transportation property (sec. 5511 of the Senate amendment)

Present law provides for the deferral of losses attributable to certain tax exempt use property, generally effective for leases entered into after March 12, 2004. However, the deferral provision does not apply to property located in the United States that is subject to a lease with respect to which a formal application (1) was submitted for approval to the Federal Transit Administration (an agency of the Department of Transportation) after June 30, 2003, and before March 13, 2004, (2) is approved by the Federal Transit Administration before January 1, 2006, and (3) includes a description and the fair market value of such property. The Senate amendment repeals the exception for leases approved by the Federal Transit Administration so that the general effective date applies to such leases.

The provision is effective as if included in the enactment of the American Jobs Creation Act of 2004.

12. Impose mark-to-market tax on individuals who expatriate (sec. 5512 of the Senate amendment)

The Senate amendment generally subjects certain U.S. citizens who relinquish their U.S. citizenship and certain long-term U.S. residents who terminate their U.S. residence to tax on the net unrealized gain in their property as if such property were sold for fair market value on the day before the expatriation or residency termination. Gain from the deemed sale is taken into account at that time without regard to other Code provisions; any loss from the deemed sale generally is taken into account to the extent otherwise provided in the Code. Any net gain on the deemed sale is recognized to the extent it exceeds \$600,000 (\$1.2 million in the case of married individuals filing a joint return, both of whom relinquish citizenship or terminate residency). The \$600,000 amount is indexed for inflation.

The provision is effective for U.S. citizens who expatriate or long-term residents who terminate their residency on or after date of enactment.

13. Deny deduction for punitive damages (sec. 5513 of the Senate amendment)

The Senate amendment denies any deduction for punitive damages that are paid or incurred by the taxpayer as a result of a judgment or in settlement of a claim. If the liability for punitive damages is covered by insurance, any such punitive damages paid by the insurer are included in gross income of the insured person and the insurer is required to report such amounts to both the insured person and the IRS.

The provision is effective for damages paid or incurred on or after the date of enactment.

14. Application of earnings stripping rules to partners which are C corporations (sec. 5514 of the Senate amendment)

Present law provides rules to limit the ability of U.S. corporations to reduce the U.S. tax on their U.S.-source income through earnings stripping transactions. These rules limit the deductibility of interest paid to certain related parties, if the payor's debt-equity ratio exceeds 1.5 to 1, the payor's net interest expense exceeds 50 percent of its adjusted taxable income and the interest payment is not subject to U.S. tax. Proposed Treasury regulations provide that a corporate partner's share of the liabilities of a partnership is treated as debt of the corporate partner for purposes of applying the earnings stripping limitation to the corporate partner's interest payments. The Senate amendment would codify the approach of the proposed Treasury regulation by providing that a corporate partner's share of partnership debt is attributed to the corporate partner for purposes of applying the earnings stripping rules to the corporate partner.

The provision is effective for taxable years beginning on or after the date of enactment.

15. Deferral of certain stock option and restricted stock gains prohibited (sec. 5515 of the Senate amendment)

Nonqualified stock options and stock granted to employees, as well as other forms of stock-based compensation, are subject to the rules of section 83. Under those rules, in the case of a nonqualified stock option, an individual generally does not have income inclusion until the stock option is exercised and stock is transferred to the individual. In the case of restricted stock, income inclusion generally results upon the vesting of the stock rather than upon receipt of the stock.

Under the Senate amendment, gains attributable to stock options (including exercises of stock options), vesting of restricted stock, and other compensation based on employer securities (including employer securities) cannot be deferred by exchanging such amounts for a right to receive a future payment. Under the Senate amendment, if a taxpayer exchanges (1) an option to purchase employer securities, (2) employer securities, or (3) any other property based on employer securities for a right to receive future payments, an amount equal to the present value of such right (or such other amount as the Secretary specifies) is required to be included in gross income for the taxable year of the exchange.

The provision applies to any exchange after the date of enactment.

16. Limitation of employer deduction for certain entertainment expenses (sec. 5516 of the Senate amendment)

Under present law, no deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement or recreation, unless the taxpayer establishes that the item was directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, or (2) a facility (e.g., an airplane) used in connection with such activity. Under an exception to this rule, the deduction disallowance rule does not apply to expenses for goods, services, and facilities to the extent that the expenses are reported by the taxpayer as compensation and wages to an employee. In the context of an employer providing an aircraft to employees for nonbusiness flights, this exception has been interpreted as not

limiting the company's deduction to the amount of compensation reportable to its employees. A similar exception applies for amounts includible in income of recipients who are not employees. In the case of specified individuals (as defined in sec. 274), the exceptions to the general entertainment expense disallowance rule for expenses treated as compensation or includible in income apply only to the extent of the amount of expenses treated as compensation or includible in income of the specified individuals.

Under the Senate amendment, in the case of all individuals, the exceptions to the general entertainment expense disallowance rule for expenses treated as compensation or includible in income apply only to the extent of the amount of expenses treated as compensation or includible in income.

The provision is effective for expenses incurred after the date of enactment.

17. Increase in penalty for bad checks and money orders (sec. 5517 of the Senate amendment)

The Code imposes a penalty for a bad check or money order on the person who tendered such check or money order. Under present law, the penalty is two percent of the amount of the bad check or money order. For checks that are less than \$750, the minimum penalty is \$15 (or, if less, the amount of the check). The Senate amendment increases the minimum penalty to \$25 (or, if less, the amount of the check), applicable to checks that are less than \$1,250.

The provision applies to checks or money orders received after the date of enactment.

18. Eliminate double deduction of mining exploration and development costs under the minimum tax (sec. 5518 of the Senate amendment)

Under present law, in determining alternative minimum taxable income ("AMTI") mining exploration and development costs with respect to a mine are required to be capitalized and amortized over a 10-year period, unless the deferred expense method is elected. In addition, the deduction for percentage depletion is limited to the adjusted basis of the property at the end of the taxable year (without regard to the depletion deduction for the year). Under these rules, it is possible to deduct an amount greater than the amount of the costs incurred. The Senate amendment provides that the exploration and development costs are not included in the adjusted basis of the property in computing the depletion deduction for purposes of AMTI. This limits the total deductions to the amount of costs incurred.

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

19. Clarification of the economic substance doctrine and related penalty provisions (secs. 5521 through 5523 of the Senate amendment)

Courts have developed several common-law doctrines that can be applied to deny the tax benefits of tax-motivated transactions, notwithstanding that the transaction may satisfy the literal requirements of a specific statutory tax provision. One such doctrine is the "economic substance" doctrine. Different courts have expressed different standards for application of this

doctrine. No penalties are specifically applicable to transactions that result in an understatement of tax solely by reason of lacking economic substance.

The Senate amendment provides that, in any case in which a court determines that the economic substance doctrine is relevant to a transaction, the transaction satisfies the economic substance doctrine only if: (1) the transaction changes in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position; and (2) the taxpayer has a substantial non-tax purpose for entering into such transaction and the transaction is a reasonable means of accomplishing such purpose. A purpose of achieving a financial accounting benefit is not a substantial non-tax purpose if the origin of the financial accounting benefit is a reduction of income tax.

The Senate amendment also provides that potential profit may not be relied upon to establish economic substance unless (1) the reasonably expected pre-tax profit is substantial in relation to the present value of expected net tax benefits and (2) it exceeds a risk-free rate of return. Fees and foreign taxes are taken into account as expenses. Certain tax benefits of lessors of tangible property are excluded in applying the potential profit rules.

In addition, financing transactions with tax-indifferent parties are not respected if the present value of deductions to be claimed is substantially in excess of the present value of the anticipated economic returns of the tax indifferent party. Other artificial income shifting to a tax indifferent party is also not respected.

A 40-percent penalty is imposed on an understatement of tax resulting from a transaction that lacks economic substance ("noneconomic substance transaction understatement") and the ability for IRS to assert, or to compromise an asserted penalty, is limited. The penalty is reduced to 20 percent for disclosed transactions. Publicly traded entities must disclose imposition of penalties in reports to the SEC. The Treasury is also required to make public the names of persons required to pay such penalties and the amount of the penalty.

No deduction is allowed for interest on an underpayment attributable to a noneconomic substance transaction understatement.

The provision is effective for transactions entered into after the date of enactment.

20. Waiver of user fee for installment agreements using automated withdrawals (sec. 5531 of the Senate amendment)

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer is allowed to pay taxes owed, as well as interest and penalties, in installment payments if the IRS determines that doing so will facilitate collection of the amounts owed. The IRS charges a \$43 user fee if a request for an installment agreement is approved. The Senate amendment waives the user fee for installment agreements in which the parties agree to the use of automated installment payments (such as automated debits from a bank account).

The provision applies to agreements entered into on or after the date which is 180 days after the date of enactment.

21. Termination of installment agreements (sec. 5532 of the Senate amendment)

Under present law, the IRS is permitted to terminate an installment agreement only if: (1) the taxpayer fails to pay an installment at the time the payment is due; (2) the taxpayer fails to pay any other tax liability at the time when such liability is due; (3) the taxpayer fails to provide a financial condition update as required by the IRS; (4) the taxpayer provides inadequate or incomplete information when applying for an installment agreement; (5) there has been a significant change in the financial condition of the taxpayer; or (6) the collection of the tax is in jeopardy. The Senate amendment grants the IRS authority to terminate installment agreement when a taxpayer fails to timely make a required Federal tax deposit or fails to timely file a tax return (including extensions). Under the Senate amendment, termination could occur even if the taxpayer remained current with payments under the installment agreement.

The provision is effective for failures occurring on or after the date of enactment.

22. Office of Chief Counsel review of offers-in-compromise (sec. 5533 of the Senate amendment)

The IRS has the authority to settle a tax debt pursuant to an offer-in-compromise. Under present law, offers proposing to compromise tax liabilities of \$50,000 or more can only be accepted if the reasons for the acceptance are documented in detail and supported by a written opinion from the IRS Chief Counsel. The Senate amendment repeals the requirement that offers to compromise liabilities of \$50,000 or more must be supported by a written opinion from the IRS Chief Counsel. Under the Senate amendment, written opinions must only be provided if the Secretary determines that an opinion is required with respect to a compromise.

The provision applies to offers-in-compromise submitted or pending on or after the date of enactment.

23. Require partial payments with submission of offers-in-compromise (sec. 5534 of the Senate amendment)

The IRS has the authority to settle a tax debt pursuant to an offer-in-compromise. The Senate amendment requires that a taxpayer make partial payments to the Government while the taxpayer's offer is being considered by the IRS. For lump-sum offers, taxpayers must make a down payment of 20 percent of the amount of the offer with any application. A lump-sum offer includes single payments as well as payments made in five or fewer installments. For periodic payment offers, the provision requires the taxpayer to comply with the taxpayer's own proposed payment schedule while the offer is being considered. Offers submitted to the IRS that do not comport with these payment requirements are returned to the taxpayer as unprocessable and immediate enforcement action is permitted.

The Senate amendment also provides that an offer is deemed accepted if the IRS does not make a decision with respect to the offer within two years of its submission. For offers submitted more than five years after the date of enactment, an offer is deemed accepted if the IRS does not make a decision with respect to the offer within 12 months of its submission.

The provision applies to offers-in-compromise submitted on and after the date which is 60 days after the date of enactment.

24. Joint task force study on offers-in-compromise (sec. 5535 of the Senate amendment)

The Senate amendment requires the Secretary to establish a joint task force to review the IRS's determinations with respect to offers-in-compromise, including offers which raise equitable, public policy, or economic hardship as grounds for compromising a tax liability. The task force shall consist of one representative each from the Department of Treasury, the IRS Oversight Board, the Office of Chief Counsel, the Office of the Taxpayer Advocate, the Office of Appeals, and the IRS office charged with operating the offer-in-compromise program. The task force is required to report annually to Congress regarding its findings and recommendations with respect to the offer-in-compromise program. The provision requires the filing of annual reports beginning in 2006.

The provision applies to reports beginning in 2006.

C. Additional Revenue Provisions Relating to the Highway Trust Fund

1. Suspend section 9503(c)(2) transfers from the Highway Trust Fund to the General Fund (sec. 5601 of the Senate amendment)

Under present law, the Highway Trust Fund reimburses the General Fund for the payment of certain refund claims and credits. These refund claims and credits generally involve the use of tax-paid fuel for purposes unrelated to highway transportation, although refunds related to fuel use by State and local governments, and certain intercity, local and school buses are also included. The Senate amendment temporarily suspends Highway Trust Fund reimbursement of the General Fund for the period April 1, 2005, through September 30, 2009. Thus, the Highway Trust Fund retains the taxes on fuel used for nontaxable purposes during this period.

The provision is effective for amount paid for which no transfer has been made before April 1, 2005.

2. Temporary dedication of gas guzzler tax to Highway Trust Fund (sec. 5602 of the Senate amendment)

Under present law, the Code imposes a tax (“the gas guzzler tax”) on the sale by a manufacturer of automobiles with a fuel economy of 22.5 miles per gallon or less. The tax range begins at \$1,000 and increases to \$7,700 for models with a fuel economy less than 12.5 miles per gallon. The Senate amendment dedicates these taxes to the Highway Trust Fund for the period July 1, 2005, through September 30, 2009.

The provision is effective for taxes imposed on and after July 1, 2005.

3. Treatment of kerosene used in aviation (sec. 5611 of the Senate amendment)

Under present law, aviation-grade kerosene is taxed at a rate of 21.8 cents per gallon (4.3 cents for commercial aviation); these taxes are credited to the Airport and Airway Trust Fund. All other kerosene used for surface transportation is taxed at the diesel tax rate of 24.3 cents per gallon and these taxes are credited to the Highway Trust Fund. (An additional 0.1 cent is imposed on these fuels and credited to the Leaking Underground Storage Tank Trust Fund.) If kerosene purchased for aviation use is fraudulently diverted to surface transportation, the taxes remain in the Airport and Airway Trust Fund and the Highway Trust Fund is not credited for the taxes on the diverted fuel.

In general, the provision requires taxes to be paid at the diesel tax rate (24.3) on all kerosene (subject to certain exceptions) and provides tax credits or refunds after the fact for kerosene that eventually is used for aviation purposes. Initially, all taxes collected are credited to the Highway Trust Fund. Transfers of 21.8 cents per gallon are made from the Highway Trust Fund to the Airport Trust Fund for kerosene used for aviation purposes (4.3 cents per gallon in the case of commercial aviation).

The provision would add \$4.81 billion through fiscal year 2015 to the Highway Trust Fund, representing the full 24.3 cents per gallon retained by the Highway Trust Fund on jet fuel

diverted to highway use. Airport and Airway Trust Fund receipts would decline. Net revenue would increase by \$495.0 million through fiscal year 2015. The increase is attributable to the collection of the 2.5 cents per gallon (24.3 minus 21.8) on aviation fuel diverted to highway use that is not being collected under present law and which would not be refunded or credited under the provision.

The provision is effective for fuels or liquids removed, entered, or sold after September 30, 2005.

4. Repeal of ultimate vendor refund claims with respect to farming (sec. 5612 of the Senate amendment)

Under present law, refunds related to the use of diesel fuel and kerosene sold for use on a farm for farming purposes are administered by ultimate vendors on behalf of the farmers. The Senate amendment repeals this rule, and requires that the farmers file refund claims related to farm use of tax-paid fuel. Farmers also may continue to purchase dyed fuel tax-free.

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

5. Refunds of excise taxes on exempt sales of fuel by credit card (sec. 5613 of the Senate amendment)

Under present law, refunds of tax related to the exempt use of fuel by State and local governments are administered by ultimate vendors, with a special administrative rule applicable to gasoline sales made using oil company credit cards. The Senate amendment permits credit card companies that register with the IRS to file refund claims on behalf of State and local governments if certain requirements are met.

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

6. Additional requirements for exempt purchases by State and local governments and nonprofit educational entities (sec. 5614 of the Senate amendment)

Under present law, State and local governments and nonprofit educational entities provide a certificate to the vendor certifying that they are entitled to purchase fuel tax-free. The Senate amendment requires that, in addition to the current certificate process, to qualify for a tax-free purchase, State governments also certify that an entity is part of the State or local government or a qualified volunteer fire department, and for nonprofit educational entities, the State must certify that the entity is in good standing in the State in which the organization is providing educational services.

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

7. Reregistration in event of change in ownership (sec. 5615 of the Senate amendment)

For purposes of certain excise taxes on fuels, certain persons are required to register with the Secretary of the Treasury. Treasury regulations require that if there is a change in ownership of a registrant, the registrant must notify the Secretary of such change. The Senate amendment

requires that upon a change in ownership of a registrant, the registrant must reregister with the Secretary. The Senate amendment does not apply to companies, the stock of which is regularly traded on an established securities market. The assessable civil penalty and the criminal penalty for failure to reregister are the same as the present law penalties for failure to register. The Senate amendment applies to changes in ownership occurring prior to the date of enactment.

The provision is effective for actions or failures to act after the date of enactment.

8. Reconciliation of on-loaded cargo to entered cargo (sec. 5616 of the Senate amendment)

The Senate amendment requires that, within one year of the date of enactment, the U.S. Customs and Border Protection (“Customs”) must provide electronically to the IRS information received by Customs pertaining to taxable fuels destined for the United States. It also requires within one year of the date of enactment that persons required to report such information to Customs do so electronically.

The provision is effective on the date of enactment.

9. Registration of operators of deep-draft vessels (sec. 5617 of the Senate amendment)

For purposes of certain excise taxes on fuels, present law requires that operators of a vessel register with the Secretary of the Treasury. A bulk transfer of fuel to a refinery or terminal is exempt from the fuels excise tax imposed if the persons transferring and receiving the fuel are registered. Operators of deep-draft ocean-going vessels are not required to register, with the result that if a deep-draft vessel is used as part of a bulk transfer, the tax exemption for bulk transfers applies even though the deep-draft vessel operator is not registered. The Code defines a deep-draft ocean-going vessel as a vessel designed primarily for use on the high seas that has a draft of more than 12 feet. The Senate amendment requires operators of deep-draft ocean-going vessels to register with the Secretary, with the result that if a deep-draft ocean going vessel is used as part of a bulk transfer, whether by removal or by entry into the United States, the operator of such vessel must be registered in order for the bulk transfer exemption to apply.

The provision is effective on the date of enactment.

10. Taxation of gasoline blend stocks and kerosene (sec. 5618 of the Senate amendment)

Treasury regulations permit the tax-free removal, entry, and sale of gasoline blend stocks if certain conditions are met. Generally, the exemption from tax applies if a gasoline blend stock (1) is not used to produce finished gasoline or (2) is received at an approved terminal or refinery. The Senate amendment overturns these regulations as it relates to nonbulk (generally transported by truck or rail car) removals, entries and sales of gasoline blend stocks. Under the Senate amendment, tax is imposed on such nonbulk removals, and entries after September 30, 2005, with a refund or credit provided for nontaxable use.

Under Treasury regulations, kerosene does not include (1) any liquid that contains less than four percent normal paraffins, or (2) any liquid that has a distillation range of 125 degrees Fahrenheit or less, sulfur content of 10 ppm or less, and minimum color of +27 Saybolt. These liquids are commonly known as “mineral spirits” and are obtained by distillation of crude oil.

Mineral spirits are used for a wide variety of purposes, such as in dry-cleaning fluids, paint thinners, varnishes, photocopy toners, inks, adhesives, and as general purpose cleaners and degreasers. The Senate amendment requires the Secretary of the Treasury to treat mineral spirits as kerosene with respect to removals, and entries after September 30, 2005.

The provision is effective for fuel entered or removed after September 30, 2005.

11. Nonapplication of export exemption to delivery of fuel to motor vehicles departing the United States (sec. 5619 of the Senate amendment)

It is the long-standing administrative position of the IRS that the exemption from excise tax by reason of exportation does not apply to the sale of motor fuel pumped into a fuel tank of a vehicle that is to be driven, or shipped, directly out of the United States. A retail fuel station continues to litigate IRS and Customs determinations that fuel may not be sold tax free in duty-free zones. The Senate amendment reaffirms the long-standing IRS position and restates present law by amending the Code definition of export to exclude the delivery of a taxable fuel into a fuel tank of a motor vehicle that is shipped or driven out of the United States. The Senate amendment also imposes a tax on the sale of taxable fuel at a duty-free sales enterprise unless there was a prior taxable removal, or entry of such fuel.

The provision is effective for sales or deliveries made after the date of enactment

12. Penalty with respect to certain adulterated fuels (sec. 5620 of the Senate amendment)

The Senate amendment imposes a \$10,000 penalty for anyone who knowingly transfers for resale, sells, or holds out for sale diesel fuel that does not comply with Environmental Protection Agency low sulfur diesel regulations. This penalty is in addition to any tax imposed on such liquid and is dedicated to the Highway Trust Fund.

The provision is generally effective after the date of enactment.

IV. FUELS RELATED TECHNICAL CORRECTIONS **(sec. 5401 of the Senate amendment)**

The technical corrections take effect as if included in the section of the original legislation to which they relate.

1. Volumetric ethanol excise tax credit (sec. 301 of American Jobs Creation Act of 2004 (“AJCA”))

AJCA repealed the reduced tax rates for alcohol fuels and taxable fuels to be blended with alcohol. The technical correction makes a conforming amendment to eliminate the refund provisions based on those reduced rates (secs. 6427(f) and 6427(o)).

2. Aviation fuel (sec. 853 of AJCA)

Section 853 of AJCA moved the taxation of jet fuel (aviation-grade kerosene) from section 4091 to section 4081 of the Code and repealed section 4091. The termination date for the 21.8 cent per gallon rate for noncommercial aviation jet fuel was inadvertently omitted from the Act. The technical correction clarifies that after September 30, 2007, the rate for jet fuel used in noncommercial aviation will be 4.3 cents per gallon.

An additional technical correction clarifies that users of aviation fuel in commercial aviation are required to be registered with the IRS in order for the 4.3-cents-per-gallon rate to apply (including for purposes of the self-assessment of tax by commercial aircraft operators).

3. Coastal Wetlands sub-account (sec. 9005 of Transportation Equity Act for the 21st Century (“TEA 21”))

Section 9005(b)(3) of TEA 21 redesignated Code section 9504(b)(2)(B), referring to the purposes of the Coastal Wetlands Planning, Protection and Restoration Act, as 9504(b)(2)(C), but did not cross reference the limitation for such purposes of taxes on gasoline used in the nonbusiness use of small-engine outdoor power equipment. The technical correction makes a conforming cross-reference amendment.