DESCRIPTION OF THE CHAIRMAN'S MARK OF THE "HEARTLAND, HABITAT, HARVEST AND HORTICULTURE ACT OF 2007"

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup of the "Heartland, Habitat, Harvest and Horticulture Act of 2007." This document,[1] prepared by the staff of the Joint Committee on Taxation provides a description of the Chairman's Mark.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Mark of the "Heartland, Habitat, Harvest and Horticulture Act of 2007"* October 2, 2007, (JCX-94-07). This document can also be found on our website at www.house.gov/jct.

I. SUPPLEMENTAL AGRICULTURAL DISASTER ASSISTANCE FROM THE AGRICULTURE DISASTER RELIEF TRUST FUND[2]

A. Crop Disaster Assistance Program and other Disaster Assistance

Present Law

The Farm Service Agency ("FSA") of the United States Department of Agriculture ("USDA") offers various ongoing programs for agricultural producers to facilitate recovery from losses caused by natural events.[3] Ongoing programs include the Emergency Conservation Program ("ECP"), the Noninsured Crop Disaster Assistance Program ("NAP"), the Disaster Debt Set-Aside Program ("DSA"), and the Emergency Loan Program ("EM").

ECP is a discretionary program funded through annual appropriations that provides funding for farmers and ranchers to rehabilitate farmland damaged by natural disaster and for carrying out emergency water conservation measures during severe drought. The natural disaster must create new conservation problems that if untreated would 1) impair or endanger the land; 2) materially affect the productive capacity of the land; 3) represent unusual damage which, except for wind erosion, is not the type likely to recur frequently in the same area; and 4) be so costly to repair that federal assistance is, or will be required, to return the land to productive agricultural use.

NAP provides a low level of insurance to producers who grow otherwise noninsurable crops. NAP provides coverage for crop losses and planting prevented by disasters. Landowners, tenants, or sharecroppers who share in the risk of producing an eligible crop may qualify for this program. Before payments can be issued, applications must first be received and approved, generally before the crop is planted, and the crop must have suffered a minimum of 50 percent loss in yield. Payments are 55 percent of the commodities' average market price on crop losses beyond 50 percent. Eligible crops include commercial crops and other agricultural commodities produced for food, including livestock feed or fiber for which the catastrophic level of crop insurance is unavailable. Also eligible for NAP coverage are controlled-environment crops (mushroom and floriculture), specialty crops (honey and maple sap), and value loss crops (aquaculture, Christmas trees, ginseng, ornamental nursery, and turfgrass sod).

DSA is available to those producers who are borrowers from the Farm Service Agency in primary or contiguous counties that have been declared by the President or designated by the Secretary of Agriculture ("Secretary") as a disaster area. When borrowers affected by natural disasters are unable to make their scheduled payments on any debt, FSA is authorized to consider the set-aside of some payments to allow the farming operation to continue. After a disaster

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[2] The description of these provisions was supplied by the Majority Staff of the Senate Finance Committee.

[3] For more information see the USDA FSA Ongoing Disaster Assistance Programs for Agricultural Producers Fact Sheet, January 2007 available at http://www.fsa.usda.gov/Internet/FSA_File/ongdisasst07.pdf

designation is made, FSA will notify borrowers of the availability of the DSA. Borrowers who are notified have eight months from the date of designation to apply. FSA borrowers may also request a release of income proceeds to meet current operating and family living expenses or may request special servicing provisions from their local FSA county offices to explore other options.

EM provides emergency loans to help producers recover from production and physical losses due to drought, flooding, other natural disasters, or quarantine. Emergency loans may be made to farmers and ranchers who own or operate land located in a county declared by the President as a disaster area or designated by the Secretary as a disaster area or quarantine area (for physical losses only, the FSA administrator may authorize emergency loan assistance). EM funds may be used to: 1) restore or replace essential property; 2) pay all or part of production costs associated with the disaster year; 3) pay essential family expenses; 4) reorganize the farming operation; and 5) refinance certain debts.

Description of Proposal

In general

The proposal amends the Federal Crop Insurance Act to create a permanent Agriculture Disaster Relief Trust Fund ("PADTF") that would provide payments to farmers and ranchers who suffer losses in areas that are declared disaster areas by the USDA. The trust fund will be funded by an amount equal to four percent of the amounts received in the general fund of the Treasury that are attributable to the duties collected on articles entered, or withdrawn from warehouse, for consumption under the Harmonized Tariff Schedule. The PADTF could make payments under four new disaster assistance programs: the permanent crop disaster assistance program, the permanent livestock indemnity program, the tree assistance program, and the emergency assistance program for livestock, honey bees, and farm raised fish. In addition, the PADTF will also fund a new pest and disease management and disaster prevention program. Amounts not required to meet current withdrawals may be invested in U.S. Treasury obligations with interest credited to the PADTF. The PADTF may also borrow, with interest, as repayable advances sums necessary to carry out the purposes of the fund.

Permanent Crop Disaster Assistance Program ("PCDP")

Generally, PCDP payments will be paid to producers located in disaster counties on 55 percent of the difference between the disaster program guarantee and the sum of total farm revenue. Disaster counties include counties receiving disaster declarations by the Secretary due to production losses resulting directly or indirectly from adverse weather, counties contiguous to such counties, and any farm whose production due to weather was less than 50 percent of normal production. To be eligible for PCDP payments, the producer must have purchased or enrolled in both crop insurance for insurable crops at a minimum of 50 percent of yield at 55 percent of price and NAP for uninsurable crops. The Secretary may waive this requirement under certain conditions.

The disaster program guarantee for insurable crops is equal to the product of a measure of crop yield, the percentage of crop insurance yield guarantee, the percentage of crop insurance

price elected by the producer, the crop insurance price, and 115 percent. The disaster program guarantee for noninsured crops is equal to the product of the yield as determined by NAP for each crop, 100 percent of the NAP established price, and 115 percent. The disaster program guarantee is the sum of the disaster program guarantee for insurable and noninsured crops.

Total farm revenue includes the sum of the estimated value of crops and grazing, crop insurance and NAP indemnities accruing to the farm, the value of prevented planting payments, the amount of other natural disaster assistance payments provided by the federal government to a farm for the same loss, and an amount equal to 20 percent of any direct payments made to the producer under section 1103 of the Farm Security and Rural Investment Act of 2002. The estimated value of crops is generally the product of actual crop acreage grazed or harvested, estimated actual yields of grazing land or crop production, and the average market price during the first five months of the marketing year in which a farm or portion of a farm is located.

Permanent Livestock Indemnity Program

The PADTF may also make payments under the permanent livestock indemnity program to eligible producers on farms that have incurred livestock death losses in excess of normal mortality rates during the calendar year due to adverse weather, as determined by the Secretary. Indemnity payments are made at a rate of 75 percent of the fair market value of the livestock on the day before the date of death of the livestock as determined by the Secretary.

Tree Assistance Program

The Secretary shall make payments to eligible orchardists as follows. Assistance is in the form of 1) 75 percent reimbursement for the cost of replanting trees lost due to a natural disaster if tree mortality is in excess of 15 percent, adjusted for normal mortality, or sufficient seedlings to reestablish a stand; and 2) 50 percent reimbursement of the cost of pruning, removal, and other costs incurred to salvage existing trees or to prepare land to replant trees lost due to a natural disaster in excess of 15 percent damage and/or mortality adjusted for normal tree damage and/or mortality.

Buy-up NAP Coverage

Under NAP, FSA compensates eligible producers for losses of noninsurable crops exceeding 50 percent of the expected yield based on 55 percent of the average market price of the commodity. This proposal permits producers to buy additional NAP coverage. Producers could purchase additional coverage guarantee up to 60 or 65 percent, as elected by the producers, of expected yield, and up to 100 percent of the average market price of the commodity. Fees would be established and collected by the Secretary to fully offset the cost of supplemental NAP coverage.

Emergency Assistance for livestock, honey bees, and farm-raised fish

The Secretary shall use up to $25,000,000 annually from the trust fund to provide emergency relief to producers of livestock, honey bees, and farm-raised fish due to losses from adverse weather or other environmental conditions, such as blizzards and wildfires, as

determined by the Secretary, that are not covered under the authority of the Secretary to make qualifying natural disaster declarations.

Limitations

No eligible producer may receive more than $100,000 annually in total disaster assistance under this Act. A producer is not eligible for benefits under the proposal if, as determined by the Secretary, such producer's adjusted gross income (as defined in section 1001D(a) of the Food Security Act of 1985[4] or any successor provision) exceeds $2.5 million, unless not less than 75 percent of the average adjusted gross income of such producer is derived from farming, ranching or forestry operations.

Pest and Disease Management and Disaster Prevention

The proposal also establishes a new program under which USDA will conduct early pest detection and surveillance activities in coordination with State departments of agriculture, will prioritize and create action plans to address pest and disease threats to specialty crops, and will create an audit-based certification approach to protect against the spread of plant pests.

Sunset of proposal

The authority provided by the proposal expires at the same time as the 2007 Farm Bill.

Effective Date

The proposal is effective on the date of enactment.

[4] 7 U.S.C. sec. 1308-3a(a).

II. CONSERVATION PROVISIONS

A. Provide Tax Credit for Eligible Farmland Enrolled in the Conservation Reserve Program

Present Law

The Department of Agriculture administers various programs designed to encourage conservation. Under the conservation reserve program, eligible producers generally enter into contracts under which they agree to establish long-term, resource conserving covers on eligible farmland in exchange for annual contract payments.

Present law does not provide an income tax credit for eligible farmland enrolled in the conservation reserve program.

Description of Proposal

In general, the proposal establishes as a credit against income taxes the conservation reserve credit. The credit is elective, but a taxpayer may not claim the credit for a particular year if the taxpayer receives a contract payment from the Department of Agriculture pursuant to the conservation reserve program[5] for such year.

The conservation reserve credit requires the taxpayer to be an eligible producer on eligible farmland enrolled in the conservation reserve program. The credit is equal to the rental value of any such property enrolled in the program, as determined by the Secretary in consultation with the Secretary of Agriculture. The Secretary may not allocate more than $50,000 of conservation reserve credit to any one taxpayer for any fiscal year. The credit is not includable in the taxpayer's gross income and is not subject to Self-Employment Contributions Act (SECA) tax.

The credit allowed under the proposal is taken into account after other credits (sections 21-27, 30, 30B, and 30C) and may not offset the alternative minimum tax. A taxpayer is not entitled to a deduction for any amount with respect to which a credit is allowed under the proposal. In the event a taxpayer terminates a conservation reserve program contract, the Secretary may recapture a portion of the credit corresponding to the portion of the taxable year during which the contract was not in effect.

The credit allowed under the proposal may not exceed the excess of the amount allocated to the taxpayer by the Secretary of the Treasury, in consultation with the Secretary of Agriculture, for the taxable year and all prior taxable years over the credit allowed for all prior taxable years. No amount of conservation reserve credit may be allocated to any taxpayer after fiscal year 2012. The taxpayer's basis in property subject to the proposal is reduced.

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[5] The term "conservation reserve program" means the conservation reserve program established under subchapter B of chapter 1 of subtitle D of title XII of the Food Security Act of 1985.

Effective Date

The proposal is effective on the date of enactment and applies with respect to conservation reserve program contracts entered into before, on, or after such date.

B. Exclusion of Conservation Reserve Program Payments From SECA Tax For Individuals Receiving Social Security Retirement or Disability Payments

Present Law

Generally, the Self-Employment Contributions Act ("SECA") tax is imposed on an individual's net earnings from self-employment income within the social security wage base. Net earnings from self-employment generally mean gross income (including the individual's net distributive share of partnership income) derived by an individual from any trade or business carried on by the individual less applicable deductions.[6]

Description of Proposal

The proposal excludes conservation reserve program payments from self-employment income for purpose of SECA tax in the case of individuals who are receiving social security retirement or disability benefits. The treatment of conservation reserve program payments received by other entities is not changed.

Effective Date

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

[6] Sec. 1402.

C. Make Permanent the Special Rule Encouraging Contributions of Capital Gain Real Property for Conservation Purposes

Present Law

Charitable contributions generally

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contributed property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.[7]

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

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

Capital gain property

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

[7] Secs. 170, 2055, and 2522, respectively. Unless otherwise provided, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

of capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(B) (e.g., private non-operating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

For purposes of determining whether a taxpayer's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions. Contributions of capital gain property that exceed the percentage limitation may be carried forward for five years.

Qualified conservation contributions

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

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

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

In general

Under a temporary provision that is effective for contributions made in taxable years beginning after December 31, 2005,[8] the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined under present law). Instead, individuals may deduct the fair market value of any qualified conservation contribution to an organization described in section 170(b)(1)(A) to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable

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

charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions.

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

For example, assume an individual with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions subject to the 50-percent limitation of $60. The individual is allowed a deduction of $50 in the current taxable year for the non-conservation contributions (50 percent of the $100 contribution base) and is allowed to carryover the excess $10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire $80 qualified conservation contribution may be carried forward for up to 15 years.

Farmers and ranchers

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

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

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[9]

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

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

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

Termination

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

Description of Proposal

The proposal makes permanent the special rule regarding contributions of capital gain real property for conservation purposes.

Effective Date

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

D. Provide Tax Credit for Recovery and Restoration of Endangered Species

Present Law

Present law does not provide an income tax credit for endangered species recovery expenditures.

Description of Proposal

In general

For eligible taxpayers, the proposal establishes a credit against income taxes for: (1) costs paid or incurred by an eligible taxpayer for the taxable year (reduced by the amount of government financing for conservation of a qualified species, and not including costs required by a Federal, State, or local government) pursuant to a habitat management plan entered into under certain qualified habitat protection agreements ("habitat restoration credit") and (2) a percentage of the loss in value to real property attributable to an easement placed on the property pursuant to such agreements (less any amount received in connection with the easement) ("habitat protection easement credit"). The allowable credit amount is 100 percent of costs paid or incurred and the loss in value to property pursuant to qualified perpetual habitat protection agreements; 75 percent of costs paid or incurred and the loss in value to property pursuant to qualified 30-year habitat protection agreements; and 50 percent of costs paid or incurred pursuant to a qualified habitat protection agreement.

For purposes of the habitat protection easement credit, the loss in value is the difference between the fair market value of the real property subject to the agreement determined on the day before the agreement is entered into less the fair market value of such property determined one day after the agreement is entered into. To claim such credit, the eligible taxpayer must own the real property with respect to which the easement is placed, and include on the tax return for the taxable year a qualified appraisal (within the meaning of section 170(f)(11)(E)) of the real property. The taxpayer's basis in such property is reduced.

The habitat restoration credit is taken into account after other credits (sections 21-27, 30, 30B, 30C, and the habitat protection easement credit) and may not offset the alternative minimum tax. The habitat protection easement credit is taken into account after other credits (sections 21-27, 30, 30B, and 30C) and such credit may offset the alternative minimum tax. Amounts allowed but in excess of either limitation may be carried forward to the succeeding taxable year. No deduction is allowed for any amount with respect to which a credit is allowed. The Secretary of the Treasury shall by regulations provide for the recapture of the credit if such Secretary determines that the eligible taxpayer has failed to carry out the duties required by the qualified agreement and there are no other available means to remediate such failure.

The sum of the two credits may not exceed the amount allocated to the eligible taxpayer for the calendar year in which the taxpayer's taxable year ends by the Secretary of the Treasury, in consultation with the Secretary of the Interior and the Secretary of Commerce, or by the Secretary of the Treasury in consultation with the Secretary of Agriculture. If the amount allowed as a credit exceeds the amount allocated for such year, the excess may be carried forward to the next taxable year for which the taxpayer has received an allocation. If the amount

allocated to a taxpayer for a calendar year exceeds the amount allowed as a credit for such year, the difference may be carried forward to the next taxable year and treated as allocated to the taxpayer for use in such year. No credit is allowed unless the appropriate Secretary certifies that a qualified agreement will contribute to the recovery of a qualified species.

The aggregate amount allocated by the Secretary of the Treasury, in consultation with the Secretary of the Interior and the Secretary of Commerce may not exceed in each year 2008 through 2012: $290,000,000 with respect to qualified perpetual habitat protection agreements, $55,000,000 with respect to qualified 30-year habitat protection agreements, and $35,000,000 with respect to qualified habitat protection agreements. The aggregate amount allocated by the Secretary of the Treasury, in consultation with the Secretary of Agriculture may not exceed in each year 2008 through 2012: $5,000,000 with respect to qualified perpetual habitat protection agreements, $2,000,000 with respect to qualified 30-year habitat protection agreements, and $1,000,000 with respect to qualified habitat protection agreements. No allocation is allowed after 2012, except that unallocated amounts with respect to any calendar year are carried forward to the allowable allocation for the next calendar year.

Not later than 180 days after the date of enactment, the Secretary of the Treasury, in consultation with the Secretary of the Interior and the Secretary of Commerce, shall by regulation establish a program to process applications from eligible taxpayers and to determine how best to allocate the credit. In allocating the credit, priority shall be given to taxpayers with agreements (1) relating to habitats that will significantly increase the likelihood of recovering and delisting a species as an endangered species or a threatened species (as defined under section 2 of the Endangered Species Act of 1973), (2) that are cost-effective and maximize the benefits to a qualified species per dollar expended, (3) relating to habitats of species that have a Federally approved recovery plan pursuant to section 4 of the Endangered Species Act of 1973, (4) relating to habitats with the potential to contribute significantly to the improvement of the status of a qualified species, (5) relating to habitats with the potential to contribute significantly to the eradication or control of invasive species that are imperiling a qualified species, (6) with habitat management plans that will manage multiple qualified species, (7) with habitat management plans that will create adjacent or proximate habitat for the recovery of a qualified species, (8) relating to habitats for qualified species with an urgent need for protection, (9) with habitat management plans that assist in preventing the listing of a species as endangered or threatened under the Endangered Species Act of 1973 or a similar State law, (10) with habitat management plans that may resolve conflicts between the protection of qualified species and otherwise lawful human activities, and (11) with habitat management plans that may resolve conflicts between the protection of a qualified species and military training or other military operation.

The Secretary of the Treasury shall request that the appropriate Secretary consider whether to authorize under the Endangered Species Act of 1973 takings by an eligible taxpayer of a qualified species to which a qualified agreement relates if the takings are incidental to (1) the restoration, enhancement, or management of the habitat pursuant to the habitat management plan under the agreement or (2) the use of the property to which the agreement pertains at any time after the expiration of the easement (or specified period of time pursuant to a qualified habitat protection agreement), but only if such use will leave the qualified species at least as well off on the property as it was before the agreement was made.

The Comptroller General of the United States shall undertake a study on the effectiveness of the credits. Such study shall evaluate the effectiveness of the credits in encouraging landowners to enter into agreements for the protection of the habitats of endangered and threatened species, and the degree to which such agreements are effective in preserving the habitats of such species and assisting in the recovery of such species, and shall include recommendations for improving the effectiveness of the credits. The Comptroller General shall issue an interim report based on such study within three years of the date of enactment and a final report within five years of such date.

Definitions

Eligible taxpayer

An eligible taxpayer is (1) a taxpayer who owns real property that contains habitat of a qualified species and enters into a qualified perpetual habitat protection agreement, a qualified 30-year habitat protection agreement, or a qualified habitat protection agreement with the appropriate Secretary with respect to such real property, and (2) a taxpayer who is a party to a qualified perpetual habitat protection agreement, a qualified 30-year habitat protection agreement, or a qualified habitat protection agreement and, as part of any such agreement, agrees to assume responsibility for costs paid or incurred as a result of implementing such agreement.

Qualified agreements

A qualified perpetual habitat protection agreement is an agreement under which an easement is granted to the appropriate Secretary, the Secretary of Agriculture, the Secretary of Defense, or a State to protect the habitat of a qualified species in perpetuity. A qualified 30-year habitat protection agreement is an agreement under which an easement is granted to the appropriate Secretary, the Secretary of Agriculture, the Secretary of Defense, or a State to protect the habitat of a qualified species for a period of not less than 30 years and less than perpetuity. A qualified habitat protection agreement requires agreement with the appropriate Secretary, the Secretary of Agriculture, the Secretary of Defense, or a State to protect the habitat of a qualified species for a specified period of time.

In addition, each of the three types of qualified agreement must meet the following requirements: (1) the agreement must be consistent with any recovery plan that is applicable and that has been approved for a qualified species under section 4 of the Endangered Species Act of 1973; (2) the appropriate Secretary and the eligible taxpayer must enter into a habitat management plan that is designed to restore or enhance the habitat of a qualified species or reduce threats to a qualified species through the management of the habitat; and (3) the agreement specifies the manner in which the taxpayer will be provided with technical assistance in carrying out the duties of the taxpayer under the terms of the agreement.

Habitat management plan

A habitat management plan means, with respect to any habitat, a plan that identifies one or more qualified species to which the plan applies, describes the management practices to be undertaken by the taxpayer, describes the technical assistance to be provided to the taxpayer and identifies the entity that will provide such assistance, provides a schedule of deadlines for

undertaking such management practices, and requires monitoring of the management practices and the status of the qualified species.

Qualified species

A qualified species is any species listed as an endangered species or threatened species under the Endangered Species Act of 1973 or any species for which a finding has been made under section 4(b)(3) of the Endangered Species Act of 1973 that listing under such Act may be warranted.

Taking

A taking has the meaning given to such term under the Endangered Species Act of 1973.

Appropriate Secretary

Appropriate Secretary has the meaning given to the term "Secretary" under section 3(15) of the Endangered Species Act of 1973.

Effective Date

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

E. Allow Deduction for Endangered Species Recovery Expenditures

Present Law

Under present law, a taxpayer engaged in the business of farming may treat expenditures that are paid or incurred by him during the taxable year for the purpose of soil or water conservation in respect of land used in farming, or for the prevention or erosion of land used in farming, as expenses that are not chargeable to capital account. Such expenditures are allowed as a deduction, not to exceed 25 percent of the gross income derived from farming during the taxable year.[10] Any excess above such percentage is deductible for succeeding taxable years, not to exceed 25 percent of the gross income derived from farming during such succeeding taxable year.

Description of Proposal

The proposal provides that expenditures paid or incurred by a taxpayer engaged in the business of farming for the purpose of achieving site-specific management actions pursuant to the Endangered Species Act of 1973[11] to be treated the same as expenditures for the purpose of soil or water conservation in respect of land used in farming, or for the prevention or erosion of land used in farming, i.e., such expenditures are treated as not chargeable to capital account and are deductible subject to the limitation that the deduction may not exceed 25 percent of the farmer's gross income derived from farming during the taxable year.

Effective Date

The proposal is effective for expenditures paid or incurred after the date of enactment.

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[10] Sec. 175.

[11] 16 U.S.C. 1533(f)(B).

F. Provide Exclusion for Certain Payments and Programs Relating to Fish and Wildlife

Present Law

Under present law, gross income does not include the excludable portion of payments made to taxpayers by the Federal and State governments for a share of the cost of improvements to property under certain conservation programs.[12]

The excludable portion is the portion (or all) of a payment made under such programs that is determined by the Secretary of Agriculture to be made primarily for the purpose of conserving soil and water resources, protecting or restoring the environment, improving forests, or providing a habitat for wildlife, and is determined by the Secretary of the Treasury as not increasing substantially the annual income derived from the property. The excludable portion does not include that portion of any payment that is properly associated with an amount that is allowable as a deduction for the taxable year in which such amount is paid or incurred.

Applicable conservation programs include (1) the rural clean water program authorized by section 208(j) of the Federal Water Pollution Control Act, (2) the rural abandoned mine program authorized by section 406 of the Surface Mining Control and Reclamation Act of 1977, (3) the water bank program authorized by the Water Bank Act, (4) the emergency conservation measures program authorized by title IV of the Agricultural Credit Act of 1978, (5) the agriculture conservation program authorized by the Soil Conservation and Domestic Allotment Act, (6) the great plains conservation program authorized by section 16 of the Soil Conservation and Domestic Policy Act, (7) the resource conservation and development program authorized by the Bankhead-Jones Farm Tenant Act and by the Soil Conservation and Domestic Allotment Act, (8) the forestry incentives program authorized by section 4 of the Cooperative Forestry Assistance Act of 1978, (9) any small watershed program administered by the Secretary of Agriculture which is determined by the Secretary of the Treasury or his delegate to be substantially similar to the type of programs described in items (1) through (8), and (10) any program of a State, possession of the United States, a political subdivision of any of the foregoing, or the District of Columbia under which payments are made to individuals primarily for the purpose of conserving soil, protecting or restoring the environment, improving forests, or providing a habitat for wildlife.

Description of Proposal

The proposal expands the exclusion for the excludable portion of certain payments to include the excludable portion of payments made under the Partners for Fish and Wildlife Program authorized by the Partners for Fish and Wildlife Act, the Landowner Incentive Program, the State Wildlife Grants Program, and the Private Stewardship Grants Program authorized by the Fish and Wildlife Act of 1956.

[12] Sec. 126.

Effective Date

The proposal is effective for payments received after the date of enactment.

G. Provide Tax Credit for Easements Made Pursuant to Certain U.S.D.A. Conservation Programs

Present Law

The Department of Agriculture administers various programs designed to encourage conservation. Under the wetlands reserve program and the grassland reserve program (referred to herein as the working grassland protection program), land owners generally place conservation easements on real property in exchange for payments from the Department of Agriculture.

Present law does not provide an income tax credit for easements placed on real property pursuant to the wetlands reserve program or the working grassland protection program.

Description of Proposal

In general, the proposal establishes two income tax credits: (1) the wetlands reserve conservation credit; and (2) the working grassland protection credit. The credits are elective, but a taxpayer may not claim the credits if the taxpayer receives a payment for an easement made pursuant to the wetlands reserve program[13] or the working grassland protection program.[14]

The wetlands reserve conservation credit requires the taxpayer to grant to the Secretary of Agriculture an easement pursuant to the wetlands reserve program. The credit is equal to the applicable percentage of the wetlands reserve easement value. The applicable percentage is the excess of 1 over the applicable marginal tax rate assuming that the taxpayer sold the easement on the date the easement is granted to the Secretary of Agriculture. The wetlands reserve easement value is the lesser of: (1) the wetlands reserve geographic area rate for the area in which the real property is located multiplied by the number of acres placed under easement and (2) the amount of the payment the taxpayer otherwise would have received from the Department of Agriculture in exchange for the easement pursuant to the wetlands reserve program. The wetlands reserve geographic area rate is a per-acre rate appropriate for easements made under the wetlands reserve program in the particular geographic area as determined by the Secretary of Treasury in consultation with the Secretary of Agriculture.

The working grassland protection credit requires the taxpayer to grant an easement in perpetuity or for a period not less than 30 years to the Secretary of Agriculture or to a State pursuant to the working grassland protection program. In the case of an easement in perpetuity, the working grassland protection credit for any taxable year is an amount equal to the applicable percentage of the working grassland easement value. The applicable percentage is the excess of

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[13] The term "wetlands reserve program" means the wetlands reserve program established under subchapter C of chapter 1 of subtitle D of title XII of the Food Security Act of 1985.

[14] The term "working grassland protection program" means the working grassland protection program established under subchapter C of chapter 2 of subtitle D of Title XII of the Food Security Act of 1985.

1 over the applicable marginal tax rate assuming that the taxpayer sold the easement on the date the easement is granted to the Department of Agriculture or a State. The working grassland easement value is the lesser of: (1) the working grassland geographic area rate for the area in which the property is located multiplied by the number of acres placed under easement and (2) the amount of the payment the taxpayer otherwise would have received from the Department of Agriculture pursuant to the working grassland protection program. The working grassland geographic area rate is a per-acre rate appropriate for easements granted under the working grassland protection program in the particular geographic area as determined by the Secretary of Treasury in consultation with the Secretary of Agriculture. In the case of a taxpayer who has entered into an easement of at least 30 years, the amount of the working grassland conservation credit is the lesser of: (1) 30 percent of the amount determined under (1) above; and (2) the amount of the payment the taxpayer otherwise would have received from the Department of Agriculture pursuant to the working grassland protection program.

The credits allowed under the proposal are taken into account after other credits (sections 21-27, 30, 30B, and 30C) and may not offset the alternative minimum tax. A taxpayer is not entitled to a deduction for any amount with respect to which a credit is allowed under the proposal. The Secretary of Treasury shall by regulations provide for the recapture of the wetlands reserve credit or the working grassland protection credit if the Secretary, in consultation with the Secretary of Agriculture, determines that the taxpayer has failed to carry out the duties of the taxpayer under the terms of the easement and there are no other available means to remediate such failure.

The credit allowed under the proposal may not exceed the excess of the amount allocated to the taxpayer by the Secretary of the Treasury, in consultation with the Secretary of Agriculture, for the taxable year and all prior taxable years over the credit allowed for all prior taxable years. The taxpayer's basis in property subject to an easement under the proposal is reduced.

The proposal establishes a national conservation credit limitation of $1 billion, which represents the aggregate amount of credits that may be allocated under the proposal for all taxpayers. The Secretary of Treasury, in consultation with the Secretary of Agriculture, shall allocate the national conservation credit limitation to taxpayers who grant easements under the wetlands reserve program or the working grassland protection program. No amount of national conservation credit limitation may be allocated to any taxpayer after fiscal year 2012.

Effective Date

The proposal is effective for easements granted after September 30, 2007, in taxable years ending after such date.

H. Provide for Tax-Exempt Facility Bonds for Forest Conservation Activities

Present Law

Tax-exempt bonds

In general

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

Qualified private activity bonds

As stated, interest on private activity bonds is taxable unless the bonds meet the requirements for qualified private activity bonds. Qualified private activity bonds permit States or local governments to act as conduits providing tax-exempt financing for certain private activities. The definition of qualified private activity bonds includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond (sec. 141(e)).

The definition of an exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities (sec. 142(a)).

In most cases, the aggregate volume of qualified private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State ("State volume cap"). For calendar year 2007, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $256.24 million, if greater. Exceptions to the State volume cap are provided for bonds for certain governmentally owned facilities (e.g., airports, ports, high-speed intercity rail, and solid waste disposal) and bonds which are subject to separate local, State, or national volume limits (e.g., public/private educational facility bonds, enterprise zone facility bonds, qualified green building bonds, and qualified highway or surface freight transfer facility bonds).

Qualified private activity bonds generally are subject to restrictions on the use of proceeds for the acquisition of land and existing property. For example, generally no more than 25 percent of the net proceeds of a qualified private activity bond may be used for the acquisition of land. In addition, the term of qualified private activity bonds generally may not exceed 120 percent of the economic life of the property being financed.

Taxation of income from timber harvesting

In general, gross income for Federal income tax purposes means all income from whatever source derived, including gross income derived from a trade or business. An organization exempt from taxation generally is subject to tax on its unrelated business taxable income, generally defined to mean gross income (less deductions) derived from a trade or business, the conduct of which is not substantially related to the exercise or performance of the organization's exempt purposes or functions, that is regularly carried on by the organization. Special unrelated trade or business income rules applicable to the cutting of timber are contained in sections 512(b)(5) and 631. Under these rules, the determination of whether income derived from the cutting of timber constitutes unrelated trade or business income depends upon a variety of factors.

Description of Proposal

Overview

In general

The proposal establishes a pilot project for forest conservation activities by providing two types of tax benefits available to qualified organizations that acquire forest and forest lands for conservation management. First, the proposal provides for the treatment of qualified forest conservation bonds as exempt facility bonds. Second, the proposal provides for the exclusion from gross income of income from certain timber harvesting activities conducted by a qualified organization on lands acquired with proceeds from qualified forest conservation bonds.

Qualified organizations

Under the proposal, an organization must be a qualified organization to be eligible for the tax-exempt financing benefit, and must be a qualified organization for whom qualified forest conservation bonds have been issued (and remain outstanding as tax-exempt bonds) to be eligible for the income exclusion. In general, under the proposal, a qualified organization means a nonprofit organization: (1) substantially all the activities of which are charitable, scientific, or educational, including acquiring, protecting, restoring, managing, and developing forest lands and other renewable resources for the long-term charitable, educational, scientific, and public benefit; (2) that periodically conducts educational programs designed to inform the public of environmentally sensitive forestry management and conservation techniques; (3) whose board satisfies certain board composition requirements designed to ensure that it represents public

conservation interests;[15] (4) with governance provisions contained in its bylaws that provide a supermajority vote of at least two-thirds of the members of the board of directors is required to approve and amend the qualified organization's qualified conservation plan; and (5) that upon dissolution, its assets are required to be dedicated to an organization exempt from tax under section 501(c)(3) that is organized and operated for conservation purposes, or to a governmental unit.

Qualified forest conservation bonds

In general

The proposal creates a new category of tax-exempt bonds, "qualified forest conservation bonds." For purposes of the Code, qualified forest conservation bonds are treated as exempt facility bonds, and therefore, unless otherwise provided, are governed by the same rules as exempt facility bonds. A qualified forest conservation bond means any bond issued as part of an issue if: (1) 95 percent or more of the net proceeds of such issue are to be used for qualified project costs; (2) such bond is issued for a qualified organization; and (3) such bond is issued within 36 months of the date of enactment of the proposal. The maximum aggregate face amount of bonds that may be issued is $1.5 billion.

The bonds are allocated by the Secretary generally as follows: (i) 35 percent for qualified project costs with respect to the cost of acquisition by any qualified organization in the Pacific Northwest region; (ii) 30 percent for qualified project costs with respect to the cost of acquisition by any qualified organization in the Western region; (iii) 17.5 percent for qualified project costs with respect to the cost of acquisition by any qualified organization in the Southeast region; (iv) 17.5 percent for qualified project costs with respect to the cost of acquisition by any qualified organization in the Northeast region.

The term "Pacific Northwest region" means Region 6 as defined by the United States Forest Service of the Department of Agriculture under section 202.2 of title 36, Code of Federal Regulations. The term "Western region" means Regions 1, 2, 3, 4, 5, and 10 (as so defined). The term "Southeast region" means Region 8 (as so defined). The term "Northeast region" means Region 9 (as so defined).

Qualified project costs

Qualified project costs include the cost of acquisition by the qualified organization, from an unrelated person, of forests and forest land that at the time of acquisition or immediately

[15] The proposal requires that at least 20 percent of the board members be comprised of representatives of the holders of the conservation restriction, and that at least 20 percent of the board members be public officials. Not more than one-third of the board members may be comprised of individuals who have or had (during a prescribed five year period) certain types of financial or contractual relationships with a commercial forest products enterprise.

thereafter are subject to a conservation restriction that meets certain requirements.[16] The conservation restriction must: (1) be granted in perpetuity to an unrelated charitable organization (other than a private foundation) that is organized and operated for conservation purposes, or to a governmental unit; (2) protect a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem, or preserve open space (including farmland and forest land) pursuant to a clearly delineated Federal, State, or local governmental conservation policy and yield a significant public benefit; (3) obligate the qualified organization to pay the costs incurred by the holder of the conservation restriction in monitoring compliance with such restriction; and (4) require that an increasing level of conservation benefits be provided whenever circumstances allow it.

The issuance of qualified forest conservation bonds generally is subject to the rules applicable to issuance of exempt-facility private activity bonds. However, the issuance of such bonds is not subject to the State volume cap. In addition, the restrictions on acquisition of land and existing property do not apply to such bonds. For purposes of determining the maximum maturity on such bonds, the land and standing timber acquired with the proceeds of the bonds is treated as having an economic life of 35 years.

Exclusion of certain qualified harvesting activity income from tax

Income from qualified harvesting activities

Under the proposal, income, gains, deductions, losses, or credits from a qualified harvesting activity conducted by a qualified organization generally are not subject to tax or taken into account for Federal income tax purposes. A qualified harvesting activity means the sale, lease, or harvesting of standing timber: (1) on land owned by a qualified organization that it acquired with proceeds of qualified forest conservation bonds; and (2) pursuant to a qualified conservation plan adopted by the organization. Qualified harvesting activity does not include any sale, lease, or harvesting for any period during which the organization ceases to qualify as a qualified organization.

Timber cutting and the sale or lease of timber is not a qualified harvesting activity to the extent the timber harvesting or removal exceeds prescribed limits. For this purpose, the average annual area of timber harvested cannot exceed 2.5 percent of the total area of the land acquired with the proceeds of qualified forest conservation bonds; or the quantity of timber removed from such land cannot exceed the quantity that can be removed from such land annually in perpetuity on a sustained-yield basis determined only with respect to such land. Certain deviations from these restrictions are permitted to protect the forest from catastrophic danger, such as by fire or windthrow, or from imminent danger from insect or disease attack.

[16] For this purpose, a person is related to another person if such person bears a relationship to such other person described in section 267(b) (determined without regard to paragraph (9) thereof), or section 707(b)(1), determined by substituting 25 percent for 50 percent for purposes of those determinations. If such other person is a nonprofit organization, a person is related to such nonprofit organization if such person controls directly or indirectly more than 25 percent of the governing body of such nonprofit organization.

The amount of income from a qualified harvesting activity that may be excluded from gross income for a taxable year may not exceed the amount used by the qualified organization to make debt service payments during such taxable year for qualified forest conservation bonds.[17] The exclusion of income from a qualified harvesting activity does not apply during any period the organization fails to qualify as a qualified organization, or after the bonds are no longer outstanding or fail to qualify as tax-exempt bonds.

Qualified conservation plan

A qualified conservation plan means a multiple land use plan (a) designed and administered primarily for the purposes of protecting and enhancing wildlife, fish, timber, scenic attributes, recreation, and soil and water quality of the forest and forest land, (b) mandates that conservation of the forest and forest land is the single-most significant use of the forest and land, and (c) requires that timber harvesting be consistent with (1) restoring and maintaining reference conditions for the region's ecotype (such as with respect to types of trees), (2) restoring and maintaining a representative sample of young, mid, and late successional forest age classes, (3) maintaining or restoring the resources' ecological health for purposes of preventing damage from fire, insect, or disease, (4) maintaining or enhancing wildlife or fish habitat, or (5) enhancing research opportunities in sustainable renewable resource uses.

Recapture taxes

Once the qualified forest conservation bonds issued for a qualified organization are no longer outstanding or cease to qualify as qualified private activity bonds, the qualified organization becomes liable for a recapture of tax benefits (plus interest) for its excess harvesting activities. Under the provision, if the average annual area of timber harvested from the land exceeds the applicable 2.5 percent average annual area limitation, the organization's income tax liability is increased by the amount of the tax benefits (plus interest) attributable to such excess harvesting.

Effective Date

The proposal is effective for obligations issued on or after the date that is 180 days after the date of enactment.

[17] This debt service limitation does not apply to income that otherwise is not subject to tax under other provisions of the Code (e.g., income from harvesting if such harvesting activity is not an unrelated trade or business within the meaning of section 513 with respect to the qualified organization).

III. ENERGY PROVISIONS

A. Credit for Residential Wind Property

Present Law

A personal tax credit is allowed for the purchase of qualified solar electric property and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs.[18] The credit is equal to 30 percent of qualifying expenditures, with a maximum credit for each of these systems of property of $2,000 per taxable year. A 30 percent credit is also allowed for the purchase of qualified fuel cell power plants. The credit for any fuel cell power plant may not exceed $500 for each 0.5 kilowatt of capacity.

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

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

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

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

Description of Proposal

The proposal provides a 30 percent credit for qualified small wind energy property expenses made by the taxpayer during the taxable year. The credit is limited to $500 with respect to each half kilowatt of capacity, not to exceed $4,000 per taxable year. The credit is allowed for expenditures after December 31, 2007 for property placed in service prior to January 1, 2009.

[18] Sec. 25D.

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

Effective Date

The provision is effective for expenditures after December 31, 2007, for property placed in service prior to January 1, 2009.

B. Landowner Incentive to Encourage Electric Transmission Build-Out

Present Law

Gross income includes all income from whatever source derived unless a specific exclusion applies.[19]

Description of Proposal

The proposal provides an exclusion from gross income for any qualified electric transmission easement payment. For purposes of the proposal, a qualified electric transmission easement payment is any payment by an electric utility or electric transmission entity pursuant to an easement or other agreement granted by the payee for the right to locate on the payee's property transmission lines and equipment used to transmit electricity at 230 or more kilovolts primarily from qualified facilities described in section 45(d) (without regard to any placed in service date).

Effective Date

The proposal is effective for payments received after the date of enactment.

[19] Sec. 61.

C. Small Producer Credit for Cellulosic Alcohol

Present Law

In the case of ethanol, the Code provides a separate 10-cents-per-gallon credit for up to 15 million gallons per year for small producers, defined generally as persons whose production capacity does not exceed 60 million gallons per year. The ethanol must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified alcohol fuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such ethanol at retail to another person and places such ethanol in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c). A cooperative may pass through the small ethanol producer credit to its patrons. The credit is includable in income and is treated as a general business credit, subject to the ordering rules and carryforward/carryback rules that apply to business credits generally. The alcohol fuels tax credit, of which the small producer credit is a part, is scheduled to expire after December 31, 2010.

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

Description of Proposal

The proposal provides an income tax credit for up to 60 million gallons of qualified cellulosic fuel production of the producer for the taxable year. The amount of the credit per gallon is $1.11 less the credit amount for alcohol fuel and the credit amount for small ethanol producers as of the date the cellulosic alcohol fuel is produced. This credit is in addition to any credit that may be available under section 40 of the Code. A small cellulosic alcohol fuel producer is not precluded from also claiming the alcohol or alcohol fuel mixture credit, or the small ethanol producer credit, if the requirements for those credits are also met. For example, in the case of a gallon of ethanol, a small producer may be able to claim 50 cents as a cellulosic alcohol producer, plus 51 cents under the alcohol fuel mixture credit, and an additional 10 cents as a small ethanol producer.

Qualified cellulosic fuel production is any cellulosic alcohol which is produced by a small cellulosic alcohol fuel producer during the taxable year which is sold by such producer to another person (a) for use by such other person in the production of a qualified alcohol fuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such alcohol at retail to another person and places such alcohol in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c).

Cellulosic alcohol is alcohol that is produced in the United States and is derived from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis. Examples of lignocellulosic or hemicellulosic matter that is available of a renewable or recurring

basis includes dedicated energy crops and trees, wood and wood residues, plants, grasses, agricultural residues, fibers, animal wastes and other waste materials, and municipal solid waste.

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

Like the small ethanol producer credit and small agri-biodiesel credit, the small cellulosic alcohol producer credit is limited to domestic production. Only domestically produced cellulosic alcohol sold for use, or used, in the United States qualifies for the credit.

The small cellulosic alcohol producer credit terminates at the later of December 31, 2012 or December 31 of the calendar year in which the Secretary, in consultation with the Environmental Protection Agency, certifies that one billion gallons of cellulosic alcohol have been produced or imported into the United States.

Effective Date

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

D. Extension of Small Ethanol Producer Credit

Present Law

The alcohol fuels credit is the sum of three credits: the alcohol mixture credit, the alcohol credit, and the small ethanol producer credit. Generally, the alcohol fuels credit expires after December 31, 2010.[20]

Taxpayers are eligible for an income tax credit of 51 cents per gallon of ethanol (60 cents in the case of alcohol other than ethanol) used in the production of a qualified mixture (the "alcohol mixture credit"). A "qualified mixture" means a mixture of alcohol and gasoline, (or of alcohol and a special fuel) sold by the taxpayer as fuel, or used as fuel by the taxpayer producing such mixture. The term "alcohol" includes methanol and ethanol but does not include (1) alcohol produced from petroleum, natural gas, or coal (including peat), or (2) alcohol with a proof of less than 150.

Taxpayers may reduce their income taxes by 51 cents for each gallon of ethanol, which is not in a mixture with gasoline or other special fuel, that they sell at the retail level as vehicle fuel or use themselves as a fuel in their trade or business ("the alcohol credit"). For alcohol other than ethanol, the rate is 60 cents per gallon.[21]

In the case of ethanol, the Code provides an additional 10-cents-per-gallon credit for up to 15 million gallons per year for small producers. Small producers are defined generally as persons whose production capacity does not exceed 60 million gallons per year. The ethanol must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified alcohol fuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such ethanol at retail to another person and places such ethanol in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c). A cooperative may pass through the small ethanol producer credit to its patrons.

The alcohol fuels credit is includable in income and is treated as a general business credit, subject to the ordering rules and carryforward/carryback rules that apply to business credits generally. The credit is allowable against the alternative minimum tax.

Description of Proposal

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

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[20] The alcohol fuels credit is unavailable when, for any period before January 1, 2011, the tax rates for gasoline and diesel fuels drop to 4.3 cents per gallon.

[21] In the case of any alcohol (other than ethanol) with a proof that is at least 150 but less than 190, the credit is 45 cents per gallon (the "low-proof blender amount"). For ethanol with a proof that is at least 150 but less than 190, the low-proof blender amount is 37.78 cents.

Effective Date

The proposal is effective on the date of enactment.

E. Extension of Credits for Biodiesel

Present Law

Income tax credit

Overview

The Code provides an income tax credit for biodiesel fuels (the "biodiesel fuels credit").[22] The biodiesel fuels credit is the sum of the biodiesel mixture credit, the biodiesel credit, and the small agri-biodiesel producer credit. The biodiesel fuels credit is treated as a general business credit. The amount of the biodiesel fuels credit is includable in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the biodiesel excise tax credit and payment provisions discussed below. The credit does not apply to fuel sold or used after December 31, 2008.

Biodiesel is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the Environmental Protection Agency under section 211 of the Clean Air Act and (2) the requirements of the American Society of Testing and Materials D6751. Agri-biodiesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, or animal fats. The language "including" indicates that this list is not exclusive.[23] Camelina is a plant from which oil can be extracted.

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

Biodiesel mixture credit

The biodiesel mixture credit is 50 cents for each gallon of biodiesel (other than agri-biodiesel) used by the taxpayer in the production of a qualified biodiesel mixture. For agri-biodiesel, the credit is $1.00 per gallon. A qualified biodiesel mixture is a mixture of biodiesel and diesel fuel that is (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) is used as a fuel by the taxpayer producing such mixture. The sale or use must be in the trade or business of the taxpayer and is to be taken into account for the taxable year in which such sale or use occurs. No credit is allowed with respect to any casual off-farm production of a qualified biodiesel mixture.

[22] Sec. 40A.

[23] Treasury Notice 2005-62.

Biodiesel credit

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

Small agri-biodiesel producer credit

The Code provides a small agri-biodiesel producer income tax credit, in addition to the biodiesel and biodiesel fuel mixture credits. The credit is a 10-cents-per-gallon credit for up to 15 million gallons of agri-biodiesel produced by small producers, defined generally as persons whose agri-biodiesel production capacity does not exceed 60 million gallons per year. The agri-biodiesel must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified biodiesel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such agri-biodiesel at retail to another person and places such ethanol in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c).

Biodiesel mixture excise tax credit

The Code also provides an excise tax credit for biodiesel mixtures.[24] The credit is 50 cents for each gallon of biodiesel used by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of the taxpayer. In the case of agri-biodiesel, the credit is $1.00 per gallon. A biodiesel mixture is a mixture of biodiesel and diesel fuel that (1) is sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) is used as a fuel by the taxpayer producing such mixture. No credit is allowed unless the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.[25]

The credit is not available for any sale or use for any period after December 31, 2008. This excise tax credit is coordinated with the income tax credit for biodiesel such that credit for the same biodiesel cannot be claimed for both income and excise tax purposes.

Payments with respect to biodiesel fuel mixtures

If any person produces a biodiesel fuel mixture in such person's trade or business, the Secretary is to pay such person an amount equal to the biodiesel mixture credit.[26] To the extent

[24] Sec. 6426(c).

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

[26] Sec. 6427(e).

the biodiesel fuel mixture credit exceeds the section 4081 liability of a person, the Secretary is to pay such person an amount equal to the biodiesel fuel mixture credit with respect to such mixture.[27] Thus, if the person has no section 4081 liability, the credit is refundable. The Secretary is not required to make payments with respect to biodiesel fuel mixtures sold or used after December 31, 2008.

Description of Proposal

The proposal generally extends an additional two years (through December 31, 2010) the income tax credit, excise tax credit, and payment provisions for biodiesel (including agri-biodiesel). The small agri-biodiesel producer credit is extended an additional four years (through December 31, 2012). The proposal adds camelina to the illustrative and nonexclusive list of sources of virgin oils for agri-biodiesel.

Effective Date

The proposal is effective on the date of enactment.

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

F. Small Fossil-Free Alcohol Producer Credit

Present Law

The alcohol fuels credit is the sum of three credits: the alcohol mixture credit, the alcohol credit, and the small ethanol producer credit. Generally, the alcohol fuels credit expires after December 31, 2010.[28]

Taxpayers are eligible for an income tax credit of 51 cents per gallon of ethanol (60 cents in the case of alcohol other than ethanol) used in the production of a qualified mixture (the "alcohol mixture credit"). A "qualified mixture" means a mixture of alcohol and gasoline, (or of alcohol and a special fuel) sold by the taxpayer as fuel, or used as fuel by the taxpayer producing such mixture. The term "alcohol" includes methanol and ethanol but does not include (1) alcohol produced from petroleum, natural gas, or coal (including peat), or (2) alcohol with a proof of less than 150.

Taxpayers may reduce their income taxes by 51 cents for each gallon of ethanol, which is not in a mixture with gasoline or other special fuel, that they sell at the retail level as vehicle fuel or use themselves as a fuel in their trade or business ("the alcohol credit"). For alcohol other than ethanol, the rate is 60 cents per gallon.[29]

In the case of ethanol, the Code provides an additional 10-cents-per-gallon credit for up to 15 million gallons per year for small producers. Small producer is defined generally as a producer whose production capacity does not exceed 60 million gallons per year. The ethanol must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified alcohol fuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such ethanol at retail to another person and places such ethanol in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c). A cooperative may pass through the small ethanol producer credit to its patrons.

The alcohol fuels credit is includable in income and is treated as a general business credit, subject to the ordering rules and carryforward/carryback rules that apply to business credits generally. The credit is allowable against the alternative minimum tax.

Description of Proposal

The proposal adds a new component to the alcohol fuels credit, the small fossil-free alcohol producer credit. The credit provides an additional 25-cents-per-gallon credit for up to 60

[28] The alcohol fuels credit is unavailable when, for any period before January 1, 2011, the tax rates for gasoline and diesel fuels drop to 4.3 cents per gallon.

[29] In the case of any alcohol (other than ethanol) with a proof that is at least 150 but less than 190, the credit is 45 cents per gallon (the "low-proof blender amount"). For ethanol with a proof that is at least 150 but less than 190, the low-proof blender amount is 37.78 cents.

million gallons of alcohol produced at a fossil-free facility during the calendar year for small producers. Small producer is defined generally as a producer whose fossil free alcohol production capacity does not exceed 60 million gallons per year. A fossil-free facility is one at which 90 percent of the fuel used in the production of alcohol at such facility is from biomass as defined in sec. 45K(c)(3).

The alcohol must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified alcohol fuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such ethanol at retail to another person and places such ethanol in the fuel tank of such other person; or (2) used by the producer for any purpose described in (1)(a), (b), or (c). Only domestically produced alcohol, sold for use or used in the United States qualifies for the credit. A cooperative may pass through the small producer credit to its patrons.

The credit terminates after December 31, 2012.

Effective Date

The proposal is effective after December 31, 2007.

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

Present Law

Section 168(l) allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified cellulosic biomass ethanol plant property. In order to qualify, the property generally must be placed in service before January 1, 2013.

Qualified cellulosic biomass ethanol plant property means property used in the U.S. solely to produce cellulosic biomass ethanol. For this purpose, cellulosic biomass ethanol means ethanol derived from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis. For example, lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis includes bagasse (from sugar cane), corn stalks, and switchgrass.

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service. The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or subject to capitalization under section 263 or section 263A. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

In order for property to qualify for the additional first-year depreciation deduction, it must meet the following requirements. The original use of the property must commence with the taxpayer on or after December 20, 2006. The property must be acquired by purchase (as defined under section 179(d)) by the taxpayer after December 20, 2006, and placed in service before January 1, 2013. Property does not qualify if a binding written contract for the acquisition of such property was in effect on or before December 20, 2006.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after December 20, 2006, and the property is placed in service before January 1, 2013 (and all other requirements are met). Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

Property any portion of which is financed with the proceeds of a tax-exempt obligation under section 103 is not eligible for the additional first-year depreciation deduction. Recapture rules apply if the property ceases to be qualified cellulosic biomass ethanol plant property.

Property with respect to which the taxpayer has elected 50 percent expensing under section 179C is not eligible for the additional first-year depreciation deduction.

Description of Proposal

The proposal changes the definition of qualified property. Under the proposal, qualified property includes property used solely to produce cellulosic biomass alcohol. Cellulosic biomass alcohol is defined as any alcohol produced by any process from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis.

Effective Date

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

H. Extension and Modification of Renewable Diesel Incentives

Present Law

The Code provides a tax incentive of $1.00 per gallon relating to renewable diesel that is part of a qualified mixture with diesel fuel. This incentive may be taken as an income tax credit, an excise tax credit, or as a payment from the Secretary.[30] The incentive is available only to the person who produced and sold or used the mixture in their trade or business and is based on the gallons of renewable diesel in the mixture. The provisions relating to renewable diesel do not apply after December 31, 2008.

"Renewable diesel" is diesel fuel that (1) is derived from biomass (as defined in section 45K(c)(3)[31]) using a thermal depolymerization process; (2) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency under section 211 of the Clean Air Act (42 U.S.C. sec. 7545); and (3) meets the requirements of the American Society of Testing and Materials (ASTM) D975 or D396. ASTM D975 provides standards for diesel fuel suitable for use in diesel engines. ASTM D396 provides standards for fuel oil intended for use in fuel-oil burning equipment, such as furnaces.

Pursuant to IRS Notice 2007-37, the Secretary provided that fuel produced as a result of co-processing biomass and petroleum feedstock ("co-produced fuel") qualifies for the renewable diesel incentives to the extent of the fuel attributable to the biomass in the mixture. In co-produced fuel, the fuel attributable to the biomass does not exist as a distinct separate quantity prior to mixing.

Description of Proposal

The proposal provides that, on a per year basis, producers of co-produced fuel may claim one dollar per gallon for up to 60 million gallons of renewable diesel contained in a qualified mixture. The 60 million gallons is determined on a per facility basis. No credit is allowable for gallons in excess of 60 million gallons produced at a facility. As under present law, the credit and payments are only for that volume of renewable diesel contained in the qualified mixture and not the total volume of co-produced fuel.

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

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[30] Secs. 40A, 6426(c), and 6427(e). For purposes of the Code, renewable diesel is generally treated as biodiesel. The Code also provides an income tax credit for renewable diesel that is not in a mixture which is sold at retail to a person and placed in the fuel tank of such person's vehicle or used by the taxpayer producing the renewable diesel as a fuel in a trade or business. See sec. 40A(b)(2) in conjunction with sec. 40A(f)(1).

[31] "Biomass" means any organic material other than (1) oil and natural gas (or any product thereof) and (2) coal (including lignite) or any product thereof (sec. 45K(c)(3)).

Effective Date

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

I. Extension and Modification of Alternative Fuel Excise Tax Credit

Present Law

The Code provides two per-gallon excise tax credits with respect to alternative fuel, the alternative fuel credit, and the alternative fuel mixture credit. For this purpose, the term "alternative fuel" means liquefied petroleum gas, P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)), compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process, or liquid hydrocarbons derived from biomass. Such term does not include ethanol, methanol, or biodiesel.

The alternative fuel credit is allowed against section 4041 liability and the alternative fuel mixture credit is allowed against section 4081 liability. Neither credit is allowed unless the taxpayer is registered with the Secretary. The alternative fuel credit is 50 cents per gallon of alternative fuel or gasoline gallon equivalents[32] of nonliquid alternative fuel sold by the taxpayer for use as a motor fuel in a motor vehicle or motorboat, or so used by the taxpayer.

The alternative fuel mixture credit is 50 cents per gallon of alternative fuel used in producing an alternative fuel mixture for sale or use in a trade or business of the taxpayer. The mixture must be sold by the taxpayer producing such mixture to any person for use as a fuel or used by the taxpayer for use as a fuel. The credits generally expire after September 30, 2009.

A person may file a claim for payment equal to the amount of the alternative fuel credit and alternative fuel mixture credits. These payment provisions generally also expire after September 30, 2009.

With respect to liquefied hydrogen, the credit and payment provisions expire after September 30, 2014. Under coordination rules, a claim for payment or credit may only be taken once with respect to any particular gallon or gasoline-gallon equivalent of alternative fuel.

Description of Proposal

The proposal extends the alternative fuel excise tax credit, alternative fuel mixture excise tax credit and related payment provisions through December 31, 2010, for all fuels other than liquid fuel derived from coal through the Fischer-Tropsch process and hydrogen. The incentives for liquid fuel derived from coal through the Fischer-Tropsch process and hydrogen are unchanged by the proposal and will expire as provided under present law. The proposal provides the biomass gas based versions of liquefied petroleum gas and liquefied or compressed natural gas qualify for the credit. The proposal also provides that alternative fuel that is not in a mixture may be used, or sold for use, as a fuel in aviation for purposes of the credit.

[32] "Gasoline gallon equivalent" means, with respect to any nonliquid alternative fuel, the amount of such fuel having a Btu content of 124,800 (higher heating value).

Effective Date

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

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

Present Law

Taxpayers may claim a 30-percent credit for the cost of installing qualified clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer.[33] The credit may not exceed $30,000 per taxable year per location in the case of qualified refueling property used in a trade or business and $1,000 per taxable year in the case of qualified refueling property installed on property which is used as a principal residence.

Qualified refueling property is property (not including a building or its structural components) for the storage or dispensing of a clean-burning fuel into the fuel tank of a motor vehicle propelled by such fuel, but only if the storage or dispensing of the fuel is at the point where such fuel is delivered into the fuel tank of the motor vehicle. The use of such property must begin with the taxpayer.

Clean-burning fuels are any fuel at least 85 percent of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, or hydrogen. In addition, any mixture of biodiesel and diesel fuel, determined without regard to any use of kerosene and containing at least 20 percent biodiesel, qualifies as a clean fuel.

Credits for qualified refueling property used in a trade or business are part of the general business credit and may be carried back for 1 year and forward for 20 years. Credits for residential qualified refueling property cannot exceed for any taxable year the difference between the taxpayer's regular tax (reduced by certain other credits) and the taxpayer's tentative minimum tax. Generally, in the case of qualified refueling property sold to a tax-exempt entity, the taxpayer selling the property may claim the credit.

A taxpayer's basis in qualified refueling property is reduced by the amount of the credit. In addition, no credit is available for property used outside the United States or for which an election to expense has been made under section 179.

The credit is available for property placed in service after December 31, 2005, and (except in the case of hydrogen refueling property) before January 1, 2010. In the case of hydrogen refueling property, the property must be placed in service before January 1, 2015.

[33] Sec. 30C.

Description of Proposal

The proposal extends for one year (through 2010) the credit for installing non-hydrogen alternative fuel refueling property.

Effective Date

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

K. Extension of Temporary Duty on Ethyl Alcohol

Present Law

Heading 9901.00.50 of the Harmonized Tariff Schedule of the United States imposes a cumulative general duty of 14.27 cents per liter (approximately 54 cents per gallon) to imports of ethyl alcohol, and any mixture containing ethyl alcohol, if used as a fuel or in producing a mixture to be used as a fuel, that are entered into the United States prior to January 1, 2009. The temporary duty under heading 9901.00.50 offsets the alcohol fuels credit of 51 cents per gallon that is available to taxpayers that blend ethanol with gasoline; both domestic and imported ethanol is eligible for the alcohol fuels credit.

Heading 9901.00.52 of the Harmonized Tariff Schedule of the United States imposes a general duty of 5.99 cents per liter to imports of ethyl tertiary-butyl ether, and any mixture containing ethyl tertiary-butyl ether, that are entered into the United States prior to January 1, 2009.

Description of Proposal

The proposal modifies the existing effective period for ethyl alcohol as classified under heading 9901.00.50 and 9901.00.52 of the Harmonized Tariff Schedule of the United States from before January 1, 2009 to before January 1, 2011.

Effective Date

The proposal is effective on the date of enactment.

L. Elimination of Certain Refunds of Duty Imposed on Ethanol

Present Law

Subheading 9901.00.50, Harmonized Tariff Schedule of the United States ("HTSUS"), imposed an additional duty on ethanol that is used as fuel or use to make fuel. Subsection (b) of Section 1313 of the Tariff Act of 1930, as amended, permits the refund of duty if the duty-paid good, or a substitute good, is used to make an article that is exported. Subsection (j)(2) of Section 1313 permits the refund of duty if the duty-paid good, or a substitute good, is exported. Subsection (p) of section 1313 permits the substitution on exportation for drawback eligibility of one motor fuel for another motor fuel. A person who manufactures or acquires gasoline with ethanol subject to the duty imposed by subheading 9901.00.50, HTSUS, can export jet fuel (which does not involve the use of ethanol) and obtain a refund of the duty paid under subheading 9901.00.50, HTSUS.

Description of Proposal

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

Effective Date

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

M. Modification of the Incentives Relating to Alcohol Fuels

Income tax credit

The alcohol fuels credit is the sum of three credits: the alcohol mixture credit, the alcohol credit, and the small ethanol producer credit. Generally, the alcohol fuels credit expires after December 31, 2010.[34]

Taxpayers are eligible for an income tax credit of 51 cents per gallon of ethanol (60 cents in the case of alcohol other than ethanol) used in the production of a qualified mixture (the "alcohol mixture credit"). A "qualified mixture" means a mixture of alcohol and gasoline, (or of alcohol and a special fuel) sold by the taxpayer as fuel, or used as fuel by the taxpayer producing such mixture. The term "alcohol" includes methanol and ethanol but does not include (1) alcohol produced from petroleum, natural gas, or coal (including peat), or (2) alcohol with a proof of less than 150.

Taxpayers may reduce their income taxes by 51 cents for each gallon of ethanol, which is not in a mixture with gasoline or other special fuel, that they sell at the retail level as vehicle fuel or use themselves as a fuel in their trade or business ("the alcohol credit"). For alcohol other than ethanol, the rate is 60 cents per gallon.[35]

In the case of ethanol, the Code provides an additional 10-cents-per-gallon credit for up to 15 million gallons per year for small producers. Small producer is defined generally as persons whose production capacity does not exceed 60 million gallons per year. The ethanol must (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified alcohol fuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such ethanol at retail to another person and places such ethanol in the fuel tank of such other person; or (2) used by the producer for any purpose described in (a), (b), or (c). A cooperative may pass through the small ethanol producer credit to its patrons.

The alcohol fuels credit is includable in income and is treated as a general business credit, subject to the ordering rules and carryforward/carryback rules that apply to business credits generally. The credit is allowable against the alternative minimum tax.

Excise tax credit and payment provision for alcohol fuel mixtures

The Code also provides an excise tax credit and payment provision for alcohol fuel mixtures. Like the income tax credit, the amount of the credit is 60 cents per gallon of alcohol

[34] The alcohol fuels credit is unavailable when, for any period before January 1, 2011, the tax rates for gasoline and diesel fuels drop to 4.3 cents per gallon.

[35] In the case of any alcohol (other than ethanol) with a proof that is at least 150 but less than 190, the credit is 45 cents per gallon (the "low-proof blender amount"). For ethanol with a proof that is at least 150 but less than 190, the low-proof blender amount is 37.78 cents.

used as part of a qualified mixture (51 cents in the case of ethanol). For purposes of the excise tax credit and payment provisions, alcohol includes methanol and ethanol but does not include (1) alcohol produced from petroleum, natural gas, or coal (including peat), or (2) alcohol with a proof of less than 190. Such term also includes an alcohol gallon equivalent of ethyl tertiary butyl either or other ethers produced from alcohol. In lieu of a tax credit, a person making a qualified mixture eligible for the credit may seek a payment from the Secretary in the amount of the credit. The payment provisions and credits are coordinated such that the incentive is not claimed more than once for each gallon of alcohol used as part of qualified mixture.

Renewable Fuels Standard Program

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

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

N. Treatment of Qualified 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.[36] 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.[37] The term "taxable fuel" means gasoline, diesel fuel, and kerosene.[38]

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.[39] 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 parafins, 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.[40]

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.[41]

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

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

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

[38] Sec. 4083(a).

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

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

[41] 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 kersosene) 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.

Effective Date

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

O. 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.[42] 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.

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

IV. AGRICULTURAL PROVISIONS

A. Qualified Small Issue Bonds for Farming

Present law

Qualified small issue bonds are tax-exempt bonds issued by State and local governments to finance private business manufacturing facilities (including certain directly related and ancillary facilities) or the acquisition of land and equipment by certain first-time farmers. A first-time farmer means any individual who has not at any time had any direct ownership interest in substantial farmland in the operation of which such individual materially participated. In addition, an individual does not qualify as a first-time farmer if such individual has received more than $250,000 in qualified small issue bond financing. Substantial farmland means any parcel of land unless (1) such parcel is smaller than 30 percent of the median size of a farm in the county in which such parcel is located and (2) the fair market value of the land does not at any time while held by the individual exceed $125,000.

Description of Proposal

The proposal increases the maximum amount of qualified small issue bond proceeds available to first-time farmers to $450,000 and indexes this amount for inflation. The proposal also eliminates the fair market value test from the definition of substantial farmland.

Effective Date

The proposal is effective for bonds issued after the date of enactment.

B. Modification of Installment Sale Rules for Certain Farm Property

Present Law

Taxpayers are permitted to recognize as gain on a disposition of property only that proportion of payments received in a taxable year that is the same as the proportion that the gross profit bears to the total contract price (the "installment method").[43] Notwithstanding this general rule, with respect to any installment sale, the aggregate amount that would be treated as ordinary income under section 1245 or section 1250 for the taxable year of the disposition if all payments to be received were received in the taxable year of disposition ("recapture income") is recognized in the year of the disposition.[44]

Description of Proposal

The proposal repeals the immediate recognition of recapture income for sales of any single purpose agricultural or horticultural structure (as defined in section 168(i)(13)) or any tree or vine bearing fruit or nuts.[45]

Effective Date

The proposal is effective for installment sales after the date of enactment.

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[43] Sec. 453.

[44] Sec. 453(i).

[45] This property is 10-year property described in section 168(e)(3)(D).

C. Allowance of Section 1031 Treatment for Exchanges Involving Certain Mutual Ditch, Reservoir, or Irrigation Company Stock

Present Law

An exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like kind" that is to be held for productive use in a trade or business or for investment.[46] If section 1031 applies to an exchange of properties, the basis of the property received in the exchange is equal to the basis of the property transferred, decreased by any money received by the taxpayer, and further adjusted for any gain or loss recognized on the exchange. In general, section 1031 does not apply to any exchange of stock in trade or other property held primarily for sale; stocks, bonds, or notes; other securities or evidences of indebtedness or interest; interests in a partnership; certificates of trust or beneficial interests; or choses in action.[47]

Description of Proposal

The proposal provides that the general exclusion from section 1031 treatment for stocks shall not apply to shares in a mutual ditch, reservoir, or irrigation company if at the time of the exchange: (1) the company is an organization described in section 501(c)(12)(A) (determined without regard to the percentage of its income that is collected from its members for the purpose of meeting losses and expenses); and (2) the shares in the company have been recognized by the highest court of the State in which such company was organized or by applicable State statute as constituting or representing real property or an interest in real property.

Effective Date

The proposal is effective for transfers after the date of enactment.

[46] Sec. 1031(a)(1).

[47] Sec. 1031(a)(2).

D. Rural Renaissance Tax Credit Bonds

Present law

Tax-exempt bonds

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

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[48] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[49] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal government.

An issuer of tax-exempt bonds must file with the IRS a return that provides certain information regarding the bond issuance.[50] Generally, this information return is required to be filed no later the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[51] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[52] In general, arbitrage

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

[49] Sec. 148.

[50] Sec. 149(e).

[51] Sec. 103(a) and (b)(2).

[52] Sec. 148.

profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal government.

Tax Credit Bonds

In general

As an alternative to traditional tax-exempt bonds, the Code permits three types of tax-credit bonds. States and local governments have the authority to issue qualified zone academy bonds ("QZABS"), clean renewable energy bonds ("CREBS"), and "Gulf tax credit bonds."[53]

A common feature of the present law tax-credit bonds is that the taxpayer holding such a bond receives a tax credit, rather than an interest payment. The amount of the credit is determined by multiplying the bond's credit rate by the face amount on the taxpayer's bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits issuance of such bonds without discount and interest cost to the qualified issuer. The credit is includable in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability.

Clean renewable energy bonds

CREBs are defined as any bond issued by a qualified issuer if, in addition to the requirements discussed below, 95 percent or more of the proceeds of such bonds are used to finance capital expenditures incurred by qualified borrowers for qualified projects. "Qualified projects" are facilities that qualify for the tax credit under section 45 (other than Indian coal production facilities), without regard to the placed-in-service date requirements of that section.[54] The term "qualified issuers" includes (1) governmental bodies (including Indian tribal governments); (2) mutual or cooperative electric companies (described in section 501(c)(12) or section 1381(a)(2)(C), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act); and (3) clean renewable energy bond lenders. The term "qualified borrower" includes a governmental body (including an Indian tribal government) and a mutual or cooperative electric company. A clean renewable energy bond lender means a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002.

In addition to the above requirements, at least 95 percent of the proceeds of CREBs must be spent on qualified projects within the five-year period that begins on the date of issuance. To

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[53] Secs. 1397E, 54, and 1400N(l), respectively.

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

the extent less than 95 percent of the proceeds are used to finance qualified projects during the five-year spending period, bonds will continue to qualify as CREBs if unspent proceeds are used within 90 days from the end of such five-year period to redeem any "nonqualified bonds." The five-year spending period may be extended by the Secretary upon the qualified issuer's request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

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

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

Qualified zone academy bonds

"QZABs" are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy," and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds. Eligible holders of QZABs are limited to financial institutions.

An issuer of QZABs must reasonably expect to and actually spend 95 percent or more of the proceeds of such bonds on qualified zone academy property within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified zone academy property during the five-year spending period, bonds will continue to qualify as QZABs if unspent proceeds are used within 90 days from the end of such five-year period to redeem any nonqualified bonds. For these purposes, the amount of nonqualified bonds is to be determined in the same manner as Treasury regulations under section 142. The provision provides that the five-year spending period may be extended by the Secretary if the issuer establishes that the failure to meet the spending requirement is due to reasonable cause and the related purposes for issuing the bonds will continue to proceed with due diligence.

A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2007. The $400 million aggregate bond cap is allocated to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

Issuers of QZABs are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds. In addition, QZABs are subject to the arbitrage requirements of section 148 that apply to tax-exempt bonds. Principles under section

148 and the regulations thereunder apply for purposes of determining the yield restriction and arbitrage rebate requirements applicable to QZABs.

Gulf tax credit bonds

Gulf tax credit bonds may be issued by the States of Louisiana, Mississippi, and Alabama. To qualify as Gulf tax credit bonds, 95 percent or more of the proceeds of such bonds must be used to (i) pay principal, interest, or premium on a bond (other than a private activity bond) that was outstanding on August 28, 2005, and was issued by the State issuing the Gulf tax credit bonds, or any political subdivision thereof, or (ii) make a loan to any political subdivision of such State to pay principal, interest, or premium on a bond issued by such political subdivision. In addition, the issuer of Gulf tax credit bonds must provide additional funds to pay principal, interest, or premium on outstanding bonds equal to the amount of Gulf tax credit bonds issued to repay such outstanding bonds. Gulf tax credit bonds must be a general obligation of the issuing State and must be designated by the Governor of such State. The maximum maturity on Gulf tax credit bonds is two years. In addition, present-law arbitrage rules that restrict the ability of State and local governments to invest bond proceeds apply to Gulf tax credit bonds.

Gulf tax credit bonds must have been issued in calendar year 2006. The maximum amount of Gulf tax credit bonds authorized to be issued was $200 million in the case of Louisiana, $100 million in the case of Mississippi, and $50 million in the case of Alabama. Gulf tax credit bonds may not be used to pay principal, interest, or premium on any bond with respect to which there is any outstanding refunded or refunding bond. Moreover, Gulf tax credit bonds may not be used to pay principal, interest, or premium on any prior bond if the proceeds of such prior bond were used to provide any property described in section 144(c)(6)(B) (i.e., any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal purpose of which is the sale of alcoholic beverages for consumption off premises).

As with CREBs and QZABs, issuers of Gulf tax credit bonds are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds.

Description of Proposal

The proposal provides for a new category of tax-credit bonds, "Rural Renaissance Bonds." A Rural Renaissance Bond means any bond if: (1) the bond is issued by a qualified issuer pursuant to an allocation of the national limitation on such bonds; (2) 95 percent or more of the proceeds of the bond are to be used for capital expenditures incurred by qualified borrowers for one or more qualified projects; (3) the qualified issuer designates the bond as a Rural Renaissance Bond and such bond is issued in registered form; (4) the bond meets the five-year spending requirement (described below); and (5) the bond is not Federally guaranteed (i.e., no portion of the bond is guaranteed in whole or in part by the United States).

Under the proposal, the term "qualified issuer" means: (1) a rural renaissance bond lender; (2) a cooperative electric company; and (3) a governmental body. A "rural renaissance bond lender" means a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002, including any affiliated

lender which is controlled by such lender. The term "cooperative electric company" means a mutual or cooperative electric company (described in section 501(c)(12) or section 1381(a)(2)(C), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act. The term "governmental body" means a State, territory, possession of the United States, the District of Columbia, Indian tribal government, and any political subdivision thereof. Under the proposal, a "qualified borrower" means a cooperative electric company or a governmental body.

The term "qualified projects" means: (1) a utilities program described in section 381E(d)(2) of the Consolidated Farm and Rural Development Act; (2) a distance learning or telemedicine program authorized pursuant to chapter 1 of subtitle D of title XXIII of the Food, Agriculture, Conservation, and Trade Act of 1990; (3) the rural electric programs authorized pursuant to the Rural Electrification Act of 1936; (4) the rural telephone programs authorized pursuant to the Rural Electrification Act of 1936; (5) the broadband access programs authorized pursuant to title VI of the Rural Electrification Act of 1936; and (6) the rural community facility programs as described in section 381E(d)(1) of the Consolidated Farm and Rural Development Act.

As with present-law tax credit bonds, the taxpayer holding Rural Renaissance Bonds on a credit allowance date is entitled to a tax credit. The amount of the credit is determined by multiplying the bond's credit rate by the face amount on the taxpayer's bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits issuance of such bonds without discount and interest cost to the qualified issuer. The credit is includable in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability.

Under the proposal, at least 95 percent or more of the proceeds of Rural Renaissance Bonds must be spent on qualified projects within the five-year period that begins on the date of issuance of such bonds. To the extent less than 95 percent of the proceeds are spent as required during the five-year spending period, bonds will continue to qualify as Rural Renaissance Bonds only if unspent proceeds are used within 90 days from the end of such five-year period to redeem outstanding bonds. The five-year spending period may be extended by the Secretary upon the qualified issuer's request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

The proposal requires level amortization of Rural Renaissance Bonds during the period such bonds are outstanding. In addition, Rural Renaissance Bonds are subject to the arbitrage requirements of section 148 that apply to tax-exempt bonds. Principles under section 148 and the regulations thereunder apply for purposes of determining the yield restriction and arbitrage rebate requirements applicable to Rural Renaissance Bonds.

The proposal establishes a national limitation of $400,000,000 on the amount of bonds that may be designated as Rural Renaissance Bonds. The Secretary, in consultation with the Secretary of Agriculture, shall make allocations of the national limitation to at least 20 qualified projects, or such lesser number of qualified projects based on the number of applications filed 12 months after applications for allocations have been solicited by the Secretary. In addition, no more than 15 percent of the national limitation may be allocated to qualified projects located in

any one State. Under the proposal, Rural Renaissance Bonds may not be issued after December 31, 2008.

Effective Date

The proposal is effective for bonds issued after the date of enactment.

E. Agricultural Business Security Tax Credit

Present Law

Present law does not provide a credit for agricultural business security.

Description of Proposal

The proposal establishes a 30 percent credit for qualified chemical security expenditures for the taxable year with respect to eligible agricultural businesses. The credit is a component of the general business credit.[55]

The credit is limited to $100,000 per facility, this amount is reduced by the aggregate amount of the credits allowed for the facility in the prior five years. In addition, each taxpayer's annual credit is limited to $2,000,000.[56] The credit only applies to expenditures paid or incurred before December 31, 2012. The taxpayer's deductible expense is reduced by the amount of the credit claimed.

Qualified chemical security expenditures are amounts paid by for: 1) employee security training and background checks; (2) limitation and prevention of access to controls of specific agricultural chemicals stored at a facility; (3) tagging, locking tank valves, and chemical additives to prevent the theft of specific agricultural chemicals or to render such chemicals unfit for illegal use; (4) protection of the perimeter of specified agricultural chemicals; (5) installation of security lighting, cameras, recording equipment and intrusion detection sensors (6) implementation of measures to increase computer or computer network security; (7) conducting security vulnerability assessments; (8) implementing a site security plan; and (9) other measures provided for by regulation. Amounts described in the preceding sentences are only eligible to the extent they are incurred by an eligible agricultural business for protecting specified agricultural chemicals.

Eligible agricultural businesses are businesses that: (1) sell agricultural products, including specified agricultural chemicals, at retail predominantly to farmers and ranchers; or (2) manufacture, formulate, distribute, or aerially apply specified agricultural chemicals.

Specified agricultural chemicals means: (1) are fertilizer commonly used in agricultural operations which is listed under section 302(a)(2) of the Emergency Planning and Community Right-to-know Act of 1986, section 101 or part 172 of title 49, Code of Federal Regulations, or part 126, 127 or 154 of title 33, Code of Federal Regulations; and (2) any pesticide (as defined in section 2(u) of the Federal Insecticide, Fungicide, and Rodenticide Act) including all active and inert ingredients which are used on crops grown for food, feed or fiber.

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

[56] The term taxpayer includes controlled groups under rules similar to the rules set out in section 41(f)(1) and (2).

Effective Date

The proposal is effective for expenses paid or incurred after date of enactment.

F. Credit for Drug Safety and Effectiveness Testing for Minor Species

Present Law

Present law does not provide a credit for drug safety and effectiveness testing for use in a minor animal species.

Description of Proposal

The proposal establishes, at the election of the taxpayer, a 50 percent credit for qualified safety and effectiveness testing expenses incurred during the taxable year for certain designated new animal drugs intended for use in a minor species. The taxpayer's otherwise deductible expenses are reduced by the amount of the credit claimed.

Safety and effectiveness testing is testing carried out under an exemption for a new animal drug for use on a minor species under section 512(j) of the Federal Food, Drug, and Cosmetic Act (or regulations issued under such section) (the "FFDC Act"). The testing must occur after a new animal drug request is filed for designation under section 573 of the FFDC Act but before the application with respect to such drug is approved under section 512(c) of such Act. Moreover, the testing must be conducted by or on behalf of the taxpayer who applied for the designation or by the owner of the animals that are the subject of the testing. Safety and effectiveness testing may be taken into account under the proposal only to the extent such testing is related to the use of a new animal drug for the minor species for which it was designated under section 573 of FFDC Act.

A "minor species" means animals other than humans that are not major species. A "major species" means cattle, horses, swine, chickens, turkeys, dogs, and cats, as well as any species the Secretary, in consultation with the Secretary of Agriculture, adds by regulation.[57]

Qualified safety and effectiveness testing expenses comprise both in-house and contract expenses incurred by a taxpayer[58] in carrying on a trade or business or by a taxpayer that owns animals that are the subject of safety and effectiveness testing. For purposes of the proposal, in-house expenses are (1) wages paid or incurred to an employee for safety and effectiveness testing or the direct supervision or support thereof; (2) any amount paid or incurred for supplies used in the conduct of safety and effectiveness testing; and (3) under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of safety and effectiveness testing. Contract expenses are any amounts paid or incurred by the taxpayer to any person (other than an employee of the taxpayer) for safety and effectiveness testing.

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[57] These definitions are intended to correspond with the definitions provided in section 201 of the FFDC Act.

[58] Under the proposal, the term taxpayer includes controlled groups under rules similar to the rules set out in section 41(f)(1) and (2).

Qualified safety and effectiveness testing expenses do not include amounts funded by any grant, contract, or otherwise by another person or government entity. In addition, qualified expenses will not be taken into account when determining the section 41 credit for research and experimentation except for purposes of calculating base period research expenses.

Effective Date

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

V. REVENUE RAISING PROVISIONS

A. Limitation on Farming Losses of Certain Taxpayers

Present Law

Farming income and expenses are reported by individuals, estates, trusts, and partnerships on IRS Schedule F, Profit and Loss from Farming. For taxpayers who materially participate (as defined in section 469(h)), net farming losses are reported in full as a reduction to income from both passive and nonpassive sources. To the extent taxpayers do not materially participate in the farming activity, the passive activity rules in section 469 may limit the ability to use such losses to reduce income from nonpassive sources.

Farming income generally includes sales of livestock, produce, grains, and other products; cooperative distributions; Agricultural Program Payments; certain Commodity Credit Corporation ("CCC") loans (if an election is made to include loan proceeds in income in the year received); certain crop insurance proceeds and federal crop disaster payments; and other income. Farm expenses generally include feed, fertilizers, gasoline, fuel, and oil; insurance; interest; hired labor; rent and lease payments; repairs and maintenance; taxes; utilities; depreciation; and other business-related expenses. Living expenses and other personal expenses are not deductible farming expenses.

Description of Proposal

The proposal limits the amount of losses that can be claimed by an individual, estate, trust, or partnership on Schedule F to $200,000 in cases where the taxpayer has received Agriculture Program Payments or CCC loans. Losses that are limited in a particular year may be carried forward to subsequent years.

Effective Date

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

B. Increase and Index Dollar Thresholds for Farm Optional Method and Nonfarm Optional Method for Computing Net Earnings from Self-Employment

Present Law

In general

Generally, tax under the Self-Employment Contributions Act (SECA) is imposed on the self-employment income of an individual. SECA tax has two components. Under the old-age, survivors, and disability insurance component, the rate of tax is 12.40 percent on self-employment income up to the Social Security wage base ($97,500 for 2007). Under the hospital insurance component, the rate is 2.90 percent of all self-employment income (without regard to the Social Security wage base).

Self-employment income subject to the SECA tax is determined as the net earnings from self-employment. An individual may use one of three methods to calculate net earnings from self-employment. Under the generally applicable rule, net earnings from self-employment means gross income (including the individual's net distributive share of partnership income) derived by an individual from any trade or business carried on by the individual, less the deductions attributable to the trade or business that are allowed under the SECA tax rules. Alternatively, an individual may elect to use one of two optional methods for calculating net earnings from self-employment. These methods are: (1) the farm optional method; and (2) the nonfarm optional method. The farm optional method allows individuals to pay SECA taxes (and secure Social Security benefit coverage) when they have low net income or losses from farming. The nonfarm optional method is similar to the farm optional method.

Farm optional method

If an individual is engaged in a farming trade or business, either as a sole proprietor or as a partner, the individual may elect to use the farm optional method in one of two instances. The first instance is an individual engaged in a farming business who has gross farm income of $2,400 or less for the taxable year. In this instance, the individual may elect to report two-thirds of gross farm income as net earnings from self-employment. In the second instance, an individual engaged in a farming business may elect the farm optional method even though gross farm income exceeds $2,400 for the taxable year but only if the net farm income is less than $1,733 for the taxable year. In this second instance, the individual may elect to report $1,600 as net earnings from self-employment for the taxable year. In all other instances (i.e., more than $2,400 of gross farm income and net farm income of at least $1,733) a person engaged in a farming business must compute net earnings from self-employment under the generally applicable rule. There is no limit on the number of years that an individual may elect the farm optional method during such individual's lifetime.

The dollar limits in the farm optional method are not indexed for inflation.

Nonfarm optional method

The nonfarm optional method is available only to individuals who have been self-employed for at least two of the three years before the year in which they seek to elect the

nonfarm optional method and who meet certain other requirements. Specifically, an individual may elect the nonfarm optional method if the individual's: (1) net nonfarm income for the taxable year is less than $1,733; and (2) net nonfarm income for the taxable year is less than 72.189 percent of gross nonfarm income. If a qualified individual engaged in a nonfarming business who elects the nonfarm optional method has gross nonfarm income of $2,400 or less for the taxable year, then the individual may elect to report two-thirds of gross nonfarm income as net earnings from self-employment. If the electing individual engaged in a nonfarming business has gross nonfarm income of at least $2,400 for the taxable year, then the individual may elect to report $1,600 as net earnings from self-employment for the taxable year. In all other instances, a person engaged in a nonfarming business must compute net earnings from self-employment under the generally applicable rule. An individual may elect to use the nonfarm optional method for no more than five years in the course of the individual's lifetime.

The dollar limits in the nonfarm optional method are not indexed for inflation.

Other rules applicable to farm optional and nonfarm optional methods

In the case of a cash method trade or business, gross income is defined as the gross receipts from such trade or business less the cost or other basis of property sold in carrying out such trade or business with certain adjustments. In the case of an accrual method trade or business, gross income is defined as the gross income from the trade or business with certain adjustments. If an individual (including a member of a partnership) derives gross income from more than one trade or business then such gross income (including the individual's distributive share of the gross income of any partnership) is treated as derived from a single trade or business.

Social Security benefit eligibility

Generally, Social Security benefits can be paid to an individual (and dependents or survivors) only if that individual has worked long enough in covered employment to be insured. Insured status is measured in terms of "credits," previously called "quarters of coverage." For this purpose, Social Security uses the lifetime record of earnings reported for that individual. In the case of a self-employed individual, net earnings from self-employment is used to calculate Social Security benefit eligibility.

Up to four quarters of coverage can be earned for a year, depending on covered wages for the year and the amount needed to earn each quarter of coverage. For 2007, credit for a quarter of coverage is provided for each $1,000 of wages.

Description of Proposal

The proposal modifies the farm optional method so that electing taxpayers may be eligible to secure four credits of Social Security benefit coverage each taxable year by increasing an indexing the thresholds. The proposal makes a similar modification to the nonfarm optional method.

Effective Date

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

C. Information reporting for Commodity Credit Corporation transactions

Present law

The Farm Security and Rural Investment Act of 2002[59] authorizes a marketing assistance loan program through the Commodity Credit Corporation ("CCC"). Under such program, the CCC may make loans for eligible commodities at a specified rate per unit of commodity (the original loan rate). The repayment amount for such a loan secured by an eligible commodity generally is based on the lower of the original loan rate or the alternative repayment rate, as determined by the CCC, as of the date of repayment. The alternative repayment rate may be adjusted to reflect quality and location for each type of commodity. A taxpayer receiving a CCC loan can use cash to repay such a loan, purchase CCC certificates for use in repayment of the loan, or deliver the pledged collateral as full payment for the loan at maturity.

If a taxpayer uses cash or CCC certificates to repay a CCC loan, and the loan is repaid at a time when the repayment rate is less than the original loan rate, the difference between the original loan amount and the lesser repayment amount is market gain. Regardless of whether a taxpayer repays a CCC loan in cash or uses CCC certificates in repayment of the loan, the market gain is taken into account either as income or as an adjustment to the basis of the commodity (if the taxpayer has made an election under section 77).

If a farmer uses cash instead of certificates, the farmer will receive a Form CCC-1099-G Information Return showing the market gain realized. For transactions prior to January 1, 2001, however, if a farmer uses CCC certificates to facilitate repayment of a CCC loan, the farmer will not receive an information return. For transactions after January 1, 2001, IRS Notice 2007-63 provides that the CCC reports market gain associated with the repayment of a CCC loan whether the taxpayer repays the loan with cash or uses CCC certificates in repayment of the loan.[60] The CCC reports the market gain on Form 1099-G, Certain Government Payments.

Description of Proposal

The proposal codifies the requirements of IRS Notice 2007-63 providing that the CCC reports market gain associated with the repayment of a CCC loan, regardless of whether the taxpayer repays the loan with cash or uses CCC certificates in repayment of the loan.

Effective Date

The proposal is effective for loans repaid on or after January 1, 2007.

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[59] Pub. L. No. 107-171.

[60] 2007-33 IRB.

D. Modification of Section 1031 Treatment for Certain Real Estate

Present Law

An exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like kind" that is to be held for productive use in a trade or business or for investment.[61] If section 1031 applies to an exchange of properties, the basis of the property received in the exchange is equal to the basis of the property transferred, decreased by any money received by the taxpayer, and further adjusted for any gain or loss recognized on the exchange. For purposes of section 1031, the determination of "like kind" relates to the nature or character of the property and not its grade or quality.[62] Therefore, improved real estate and unimproved real estate are generally considered to be property of a "like kind" as this distinction relates to the grade or quality of the real estate.[63]

Description of Proposal

The proposal modifies section 1031 to disallow nonrecognition treatment for exchanges of unimproved real estate for which the owner is receiving Agriculture Program Payments or Commodity Credit Corporation ("CCC") loans for improved real estate, unless the undeveloped land is permanently retired from farm program payments.

Effective Date

The proposal is effective for transfers after the date of enactment.

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[61] Sec. 1031(a)(1).

[62] Treas. Reg. sec. 1.1031(a)-1(b).

[63] Treas. Reg. sec. 1.1031(a)-1(c).

E. Modification of Effective Date of Leasing Provisions of the American Jobs Creation Act of 2004

Present Law

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. 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) was approved by the Federal Transit Administration before January 1, 2006; and (3) includes a description and the fair market value of such property (the "qualified transportation property exception").

Description of Proposal

The proposal changes the effective date of the loss deferral rules with respect to certain leases. Under the proposal, the loss deferral rules also apply to leases entered into on or before March 12, 2004, if the lessee is a foreign person or entity. With respect to such leases, losses are deferred starting in taxable years beginning after December 31, 2006.

No inference is intended regarding the appropriate present-law tax treatment of transactions entered into prior to March 12, 2004, if the lessee is not a foreign person or entity. In addition, it is intended that the proposal shall not be construed as altering or supplanting the present-law tax rules providing that a taxpayer is treated as the owner of leased property only if the taxpayer acquires and retains significant and genuine attributes of an owner of the property, including the benefits and burdens of ownership. The proposal also is not intended to affect the scope of any other present-law tax rules or doctrines applicable to purported leasing transactions.

Effective Date

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