DESCRIPTION OF THE CHAIRMAN'S MODIFICATION TO THE PROVISIONS OF THE "HEARTLAND, HABITAT, HARVEST AND HORTICULTURE ACT OF 2007"

Scheduled for Markup
by the
SENATE COMMITTEE ON FINANCE
on October 4, 2007

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's modification to the provisions of the "Heartland, Habitat, Harvest and Horticulture Act of 2007," which is to be marked up by the Senate Committee on Finance on October 4, 2007.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Modification to the Provisions of the "Heartland, Habitat, Harvest and Horticulture Act of 2007"* (JCX-96-07), October 4, 2007. This document can also be found on our website at www.house.gov/jct.

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

A. Modifications to Item I.A. of the Chairman's Mark Relating to the Permanent Crop Disaster Assistance Program and Other Disaster Assistance

The Chairman's Modification decreases the funding of the Agriculture Disaster Relief Trust Fund from 4.0 percent to 3.34 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received in the general fund of the Treasury that are attributable to the duties collected on articles entered, or withdrawn from warehouse, for consumption under the Harmonized Tariff Schedule.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 Chairman's Modification decreases the amount of payments under the Permanent Crop Disaster Assistance Program from 55 percent to 52 percent of the difference between the disaster program guarantee and the sum of total farm revenue.

The Chairman's Modification increases the annual amount that the Secretary shall use to provide emergency relief to producers of livestock (including horses), honey bees, and farm-raised fish from $25,000,000 to $35,000,000. The Chairman's modification clarifies that farm-raised fish includes the propagation and rearing of aquatic species (including any species of finfish, mollusk, crustacean, or other aquatic invertebrate, amphibian, reptile, or aquatic plant) in controlled or semi-controlled environments.

The Chairman's Modification clarifies that the proposal amends the Trade Act of 1974, and not the Federal Crop Insurance Act.

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

II. CONSERVATION PROVISIONS

A. Modification to Item II.A. of the Chairman's Mark Relating to Providing a Tax Credit for Eligible Farmland Enrolled in the Conservation Reserve Program

The Chairman's Modification establishes an annual conservation reserve credit limitation of $750 million for each of fiscal years 2009 through 2012, which represents the total amount of credits that may be allocated under the program for all taxpayers for such years.

B. Modification to Item II.F. of the Chairman's Mark Relating to Providing an Exclusion for Certain Payments and Programs Relating to Fish and Wildlife

The Chairman's Modification provides that the exclusion for the excludable portion of certain payments includes payments made under The Forest Health Protection Program authorized by the Cooperative Forestry Assistance Act of 1978 and the program related to integrated pest management authorized by section 8(i)(1)(A) of the Cooperative Forestry Act of 1978.

C. Deduction for Qualified Timber Gain and Timber REIT Provisions

Present Law

Treatment of certain timber gain

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

Under present law, for taxable years beginning before January 1, 2011, the maximum rate of tax on long term capital gain ("net capital gain")[3] of an individual, estate, or trust is 15 percent. Any net capital gain that otherwise would be taxed at a 10- or 15-percent rate is taxed at

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

a 5-percent rate (zero for taxable years beginning after 2007). These rates apply for purposes of both the regular tax and the alternative minimum tax.[4]

For taxable years beginning after December 31, 2010, the maximum rate of tax on the net capital gain of an individual is 20 percent. Any net capital gain that otherwise would be taxed at a 10- or 15-percent rate is taxed at a 10-percent rate. In addition, any gain from the sale or exchange of property held more than five years that would otherwise have been taxed at the 10-percent rate is taxed at an 8-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which began after December 31, 2000, which would otherwise have been taxed at a 20-percent rate, is taxed at an 18-percent rate. The net capital gain of a corporation is taxed at the same rates as ordinary income, up to a maximum rate of 35 percent.

Real estate investment trusts ("REITs") are subject to a special taxation regime. Under this regime, a REIT is allowed a deduction for dividends paid to its shareholders.[5] As a result, REITs generally do not pay tax on distributed income, but the income is taxed to the REIT shareholders. A REIT that has long term capital gain can declare a dividend that shareholders are entitled to treat as long term capital gain.

REITs generally are required to distribute 90 percent of their taxable income (other than net capital gain). A REIT generally must pay tax at regular corporate rates on any undistributed income. However, a REIT that has net capital gain can retain that gain without distributing it, and the shareholders can report the net capital gain as if it were distributed to them. In that case the REIT pays a C corporation tax on the retained gain, but the shareholders who report the income are entitled to a credit or refund for the difference between the tax that would be due if the income had been distributed and the 35-percent rate paid by the REIT.[6] In effect, net capital gain of a REIT (including but not limited to timber gain) can be taxed as net capital gain of the shareholders, whether or not the gain is distributed.

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

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

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

Other REIT provisions

A REIT is also subject to a 4-percent excise tax to the extent it does not distribute specified percentages of its income within any calendar year. The required distributed percentage is 85 percent in the case of the REIT ordinary income, and 95 percent in the case of the REIT capital gain net income (as defined).[7] The amount of the excess of the required distribution over the actual distribution is subject to the 4-percent tax.

A REIT generally is restricted to earning certain types of passive income. Among other requirements, at least 75 percent of the gross income of a REIT in a taxable year must consist of certain types of real estate related income, including rents from real property, income from the sale or exchange of real property (including interests in real property) that is not stock in trade, inventory, or held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, and interest on mortgages secured by real property or interests in real property.[8] Interests in real property are specifically defined to exclude mineral, oil, or gas royalty interests.[9] A REIT will not qualify as a REIT, and will be taxable as a C corporation, for any taxable year if it does not meet this income test.

Some REITs have been formed to hold land on which trees are grown. Upon maturity of the trees, the standing trees are sold by the REIT. The Internal Revenue Service has issued private letter rulings in particular instances stating that the income from the sale of the trees under section 631(b) can qualify as REIT real property income because the uncut timber and the timberland on which the timber grew is considered real property and the sale of uncut trees can qualify as capital gain derived from the sale of real property.[10]

A REIT is subject to a 100-percent excise tax on gain from any sale that is a "prohibited transaction," defined as a sale of property that is stock in trade, inventory, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.[11] This determination is based on facts and circumstances. However, a safe-harbor provides that no excise tax is imposed if certain requirements are met. In the case of timber property, the safe harbor is met, regardless of the number of sales that occur during the taxable year, if (i) the REIT

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

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

[9] Sec. 856(c)(5)(C).

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

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

has held the property for not less than 4 years in connection with the trade or business of producing timber; (ii) the aggregate adjusted bases of the property sold (other than foreclosure property) during the taxable year does not exceed 10 percent of the aggregate bases of all the assets of the REIT as of the beginning of the taxable year, and if certain other requirements are met. These include requirements that limit the amount of expenditures the REIT can make during the 4-year period prior to the sale that are includible in the adjusted basis of the property,[12] that require marketing to be done by an independent contractor, and that forbid a sales price that is based on the income or profits of any person.[13] There is a similar but separate safe harbor for sales of non-timber property, with similar rules, including a 4-year holding period requirement and a limit on the percentage of the aggregate adjusted basis of property that can be sold in one taxable year.[14]

A REIT is not generally permitted to hold securities representing more than 10 percent of the voting power or value of the securities of any one issuer; nor may more than 5 percent of the fair market value of REIT assets be securities of any one issuer.[15] However, under an exception, a REIT may hold any amount of securities of one or more "taxable REIT subsidiary" (TRS) corporations, provided that such TRS securities do not represent more than 20 percent of the fair market value of REIT assets at the end of any quarter. A TRS is a C corporation that is subject to regular corporate tax on its income and that meets certain other requirements. A taxable REIT subsidiary may conduct activities that would produce disqualified non-passive or non-real estate income that could disqualify the REIT if conducted by a REIT itself. Such business could include business relating to processing timber, or holding timber products or other assets for sale to customers in the ordinary course of business. Such income would be subject to regular corporate rates of tax as income of the TRS.[16]

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

[13] Sec. 857(b)(6)(D).

[14] Sec. 857(b)(6)(C).

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

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

Explanation of Provision

Elective deduction for 60 percent of qualified timber gain

The provision allows a taxpayer to elect to deduct an amount equal to 60 percent of the taxpayer's qualified timber gain (or, if less, the net capital gain) for a taxable year. In the case of an individual, the deduction reduces adjusted gross income. Qualified timber gain means the net gain described in section 631(a) and (b) for the taxable year.

The deduction is allowed in computing the regular tax and the alternative minimum tax (including the adjusted current earnings of a corporation).

If a taxpayer elects the deduction, the 40 percent of the gain subject to tax is taxed at ordinary income tax rates.[17]

In the case of a pass-thru entity other than a REIT, the election may be made separately by each taxpayer subject to tax on the gain. The Treasury Department may prescribe rules appropriate to apply this provision to gain taken into account by a pass-thru entity.

In the case of a REIT, the election to take the 60-percent deduction is made by the REIT. If a REIT makes the election, then the timber gain is excluded from the computation of capital gain or loss of the REIT and can no longer be designated as a capital gain dividend to shareholders. Instead, the gain is treated as ordinary income for purposes of applying the REIT income distribution requirements, but for this purpose 60-percent of the amount of the gain is deductible by the REIT in computing its income. REIT earnings and profits also exclude the portion of the timber gain that is deductible. Thus, 40 percent of the gain is subject to the REIT distribution requirements, and 40 percent of the gain increases REIT earnings and profits. Accordingly, because REIT earnings and profits have been increased by the 40-percent amount, there is sufficient earnings and profits that a distribution of that 40-percent amount that otherwise qualifies as a dividend would be treated as an ordinary dividend distribution to shareholders. Since this dividend is from a REIT and is not derived from an entity that was taxed as a C corporation, it would not qualify for the current 15 percent qualified dividend rates and would be taxed at the ordinary income rates of the shareholders.

REIT shareholders obtain an upward basis adjustment in their REIT interests, equal to the 60 percent of the timber gain that is deductible by the electing REIT. Because the 60 percent of timber gain that was deductible by the REIT does not increase REIT earnings and profits, a distribution of such 60 percent to the shareholder generally will not be treated as a dividend (in the absence of other retained earnings) but as a return of basis under the general rules of section 301(c). Because the shareholders' basis has been increased by this 60 percent, this distribution would not exceed the shareholders' basis and thus would be nontaxable return of basis, rather than capital gain in excess of basis. However, if a REIT shareholder has obtained such an upward basis adjustment for a REIT interest and disposes of the interest before having held the

[17] Under the provision, because only 40 percent of the gain is included in adjusted gross income and AMTI, only that amount of gain would result in the phase-out of tax benefits.

interest for at least 6 months, then any loss on disposition of the interest is disallowed to the extent of such upward basis adjustment.

Additional REIT provisions

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

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

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

REIT prohibited transaction safe harbor for timber property

For sales to a qualified organization for conservation purposes, as defined in section 170(h), the provision reduces to 2 years the present law 4-year holding period requirement under section 857(b)(6)(D), which provides a safe harbor from "prohibited transaction" treatment for certain timber property sales. Also, in the case of such sales, the safe-harbor limitations on how much may be added, within the 4-year period prior to the date of sale, to the aggregate adjusted basis of the property, are changed to refer to the 2-year period prior to the date of sale.

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

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

Special rules for Timber REITs

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

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

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

Effective Date

The provision applies to taxable years beginning after the date of enactment and before December 1, 2008.

III. ENERGY PROVISIONS

A. Modification to Item III.A. of the Chairman's Mark Relating to the Credit for Residential Wind Property.

The Chairman's Modification removes the credit limitation of $500 per half kilowatt of capacity. The modification also permits the credit to be claimed by business taxpayers, at the same 30 percent credit rate and $4,000 per taxpayer cap applicable to individuals.

B. Modification to Item III.I. of the Chairman's Mark Relating to the Extension and Modification of the Alternative Fuel Excise Tax Credit

The Chairman's Modification strikes all of the provisions relating to the alternative fuel excise tax credits, except for the provision allowing biomass-gas versions of liquefied petroleum gas and liquefied or compressed natural gas to qualify for the alternative fuel credit.

C. Modification to Item III.N. of the Chairman's Mark Relating to the Treatment of qualified Mixtures as Taxable Fuel

The Chairman's Modification requires that all producers of qualified mixtures file information reports with the Secretary. Present law requires that the producer or importer of biodiesel provide a certification (in such form and manner as prescribed by the Secretary) as to the product produced and the percentage of biodiesel and agri-biodiesel in the product. The certificate prescribed by the Secretary requires that the importer or producer certify that the biodiesel meets the requirements of ASTM D6751, however, the certificate does not require the attachment of any proof of testing. The Chairman's modification requires that certificate be accompanied by documentation that the biodiesel was tested and meets the requirements of ASTM D6751.

D. Modification of the Credit for the Production of Electricity from Renewable Resources

Present Law

In general

An income tax credit is allowed for the production of electricity at qualified facilities using qualified energy resources.[18] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, and qualified hydropower production. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to

[18] Sec. 45.

an unrelated person. In addition to the electricity production credit, an income tax credit is allowed for the production of refined coal and Indian coal at qualified facilities.[19]

Credit amounts and credit period

In general

The base amount of the electricity production credit is 1.5 cents per kilowatt-hour (indexed annually for inflation) of electricity produced. The amount of the credit is 2 cents per kilowatt-hour for 2007. A taxpayer may generally claim a credit during the 10-year period commencing with the date the qualified facility is placed in service. The credit is reduced for grants, tax-exempt bonds, subsidized energy financing, and other credits.

The amount of credit a taxpayer may claim is phased out as the market price of electricity (or refined coal in the case of the refined coal production credit) exceeds certain threshold levels. The electricity production credit is reduced over a 3 cent phase-out range to the extent the annual average contract price per kilowatt hour of electricity sold in the prior year from the same qualified energy resource exceeds 8 cents (adjusted for inflation). The refined coal credit is reduced over an $8.75 phase-out range as the reference price of the fuel used as feedstock for the refined coal exceeds the reference price for such fuel in 2002 (adjusted for inflation).

Reduced credit amounts and credit periods

Generally, in the case of open-loop biomass facilities (including agricultural livestock waste nutrient facilities), geothermal energy facilities, solar energy facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities, the 10-year credit period is reduced to five years commencing on the date the facility was originally placed in service, for qualified facilities placed in service before August 8, 2005. However, for qualified open-loop biomass facilities (other than a facility described in sec. 45(d)(3)(A)(i) that uses agricultural livestock waste nutrients) placed in service before October 22, 2004, the five-year period commences on January 1, 2005. In the case of a closed-loop biomass facility modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, the credit period begins no earlier than October 22, 2004.

In the case of open-loop biomass facilities (including agricultural livestock waste nutrient facilities), small irrigation power facilities, landfill gas facilities, trash combustion facilities, and qualified hydropower facilities the otherwise allowable credit amount is 0.75 cent per kilowatt-hour, indexed for inflation measured after 1992 (currently 1 cent per kilowatt-hour for 2007).

Credit applicable to refined coal

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

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[19] Collectively, the electricity production credit, the refined coal production credit, and the Indian coal production credit are referred to herein as the section 45 credit.

Credit applicable to Indian coal

A credit is available for the sale of Indian coal to an unrelated third part from a qualified facility for a seven-year period beginning on January 1, 2006, and before January 1, 2013. The amount of the credit for Indian coal is $1.50 per ton for the first four years of the seven-year period and $2.00 per ton for the last three years of the seven-year period. Beginning in calendar years after 2006, the credit amounts are indexed annually for inflation using 2005 as the base year; for 2007 the Indian coal credit is $1.544 per ton.

Special rules and other limitations on credit claimants and credit amounts

In general, in order to claim the credit, a taxpayer must own the qualified facility and sell the electricity produced by the facility (or refined coal or Indian coal, with respect to those credits) to an unrelated party. A lessee or operator may claim the credit in lieu of the owner of the qualifying facility in the case of qualifying open-loop biomass facilities and in the case of closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass. In the case of a poultry waste facility, the taxpayer may claim the credit as a lessee or operator of a facility owned by a governmental unit.

For all qualifying facilities, other than closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, the amount of credit a taxpayer may claim is reduced by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits, but the reduction cannot exceed 50 percent of the otherwise allowable credit. In the case of closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, there is no reduction in credit by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits.

The credit for electricity produced from renewable sources is a component of the general business credit.[20] For alternative minimum tax purposes, a taxpayer's tentative minimum tax is treated as being zero when determining the tax liability limitation for the section 45 credit for electricity produced from a facility (placed in service after October 22, 2004) during the first four years of production beginning on the date the facility is placed in service.

Special rules apply for eligible cooperatives claiming the section 45 credit. For taxable years ending after August 8, 2005, eligible cooperatives may elect to pass any portion of the credit through to their patrons. An eligible cooperative is defined as a cooperative organization that is owned more than 50 percent by agricultural producers or entities owned by agricultural producers. The credit may be apportioned among patrons eligible to share in patronage dividends on the basis of the quantity or value of business done with or for such patrons for the taxable year.

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

Qualified facilities

Wind energy facility

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

Closed-loop biomass facility

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

To be a qualified facility, a closed-loop biomass facility must be placed in service after December 31, 1992, and before January 1, 2009. In the case of a facility using closed-loop biomass but also co-firing the closed-loop biomass with coal, other biomass, or coal and other biomass, a qualified facility must be originally placed in service and modified to co-fire the closed-loop biomass at any time before January 1, 2009.

Open-loop biomass (including agricultural livestock waste nutrients) facility

An open-loop biomass facility is a facility that uses open-loop biomass to produce electricity. For purposes of the credit, open-loop biomass is defined as (1) any agricultural livestock waste nutrients or (2) any solid, nonhazardous, cellulosic waste material or any lignin material that is segregated from other waste materials and which is derived from:

- forest-related resources, including mill and harvesting residues, precommercial thinnings, slash, and brush;
- solid wood waste materials, including waste pallets, crates, dunnage, manufacturing and construction wood wastes, and landscape or right-of-way tree trimming; or
- agricultural sources, including orchard tree crops, vineyard, grain, legumes, sugar, and other crop by-products or residues.

Agricultural livestock waste nutrients are defined as agricultural livestock manure and litter, including bedding material for the disposition of manure. Wood waste materials do not qualify as open-loop biomass to the extent they are pressure treated, chemically treated, or painted. In addition, municipal solid waste, gas derived from the biodegradation of solid waste, and paper which is commonly recycled do not qualify as open-loop biomass. Open-loop biomass does not include closed-loop biomass or any biomass burned in conjunction with fossil fuel (co-firing) beyond such fossil fuel required for start up and flame stabilization.

In the case of an open-loop biomass facility that uses agricultural livestock waste nutrients, a qualified facility is one that was originally placed in service after October 22, 2004, and before January 1, 2009, and has a nameplate capacity rating which is not less than 150 kilowatts. In the case of any other open-loop biomass facility, a qualified facility is one that was originally placed in service before January 1, 2009.

Geothermal facility

A geothermal facility is a facility that uses geothermal energy to produce electricity. Geothermal energy is energy derived from a geothermal deposit that is a geothermal reservoir consisting of natural heat that is stored in rocks or in an aqueous liquid or vapor (whether or not under pressure). To be a qualified facility, a geothermal facility must be placed in service after October 22, 2004 and before January 1, 2009.

Solar facility

A solar facility is a facility that uses solar energy to produce electricity. To be a qualified facility, a solar facility must be placed in service after October 22, 2004, and before January 1, 2006.

Small irrigation facility

A small irrigation power facility is a facility that generates electric power through an irrigation system canal or ditch without any dam or impoundment of water. The installed capacity of a qualified facility must be at least 150 kilowatts but less than five megawatts. To be a qualified facility, a small irrigation facility must be originally placed in service after October 22, 2004, and before January 1, 2009.

Landfill gas facility

A landfill gas facility is a facility that uses landfill gas to produce electricity. Landfill gas is defined as methane gas derived from the biodegradation of municipal solid waste. To be a qualified facility, a landfill gas facility must be placed in service after October 22, 2004, and before January 1, 2009.

Trash combustion facility

Trash combustion facilities are facilities that burn municipal solid waste (garbage) to produce steam to drive a turbine for the production of electricity. To be a qualified facility, a trash combustion facility must be placed in service after October 22, 2004 and before January 1, 2009. A qualified trash combustion facility includes a new unit, placed in service after October 22, 2004, that increases electricity production capacity at an existing trash combustion facility. A new unit generally would include a new burner/boiler and turbine. The new unit may share certain common equipment, such as trash handling equipment, with other pre-existing units at the same facility. Electricity produced at a new unit of an existing facility qualifies for the production credit only to the extent of the increased amount of electricity produced at the entire facility.

Hydropower facility

A qualifying hydropower facility is (1) a facility that produced hydroelectric power (a hydroelectric dam) prior to August 8, 2005, at which efficiency improvements or additions to capacity have been made after such date and before January 1, 2009, that enable the taxpayer to produce incremental hydropower or (2) a facility placed in service before August 8, 2005, that did not produce hydroelectric power (a nonhydroelectric dam) on such date, and to which turbines or other electricity generating equipment have been added after such date and before January 1, 2009.

At an existing hydroelectric facility, the taxpayer may claim credit only for the production of incremental hydroelectric power. Incremental hydroelectric power for any taxable year is equal to the percentage of average annual hydroelectric power produced at the facility attributable to the efficiency improvement or additions of capacity determined by using the same water flow information used to determine an historic average annual hydroelectric power production baseline for that facility. The Federal Energy Regulatory Commission will certify the baseline power production of the facility and the percentage increase due to the efficiency and capacity improvements.

At a nonhydroelectric dam, the facility must be licensed by the Federal Energy Regulatory Commission and meet all other applicable environmental, licensing, and regulatory requirements and the turbines or other generating devices must be added to the facility after August 8, 2005 and before January 1, 2009. In addition there must not be any enlargement of the diversion structure, or construction or enlargement of a bypass channel, or the impoundment or any withholding of additional water from the natural stream channel.

Refined coal facility

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

Indian coal facility

A qualified Indian coal facility is a facility which is placed in service before January 1, 2009, that produces coal from reserves that on June 14, 2005, were owned by a Federally recognized tribe of Indians or were held in trust by the United States for a tribe or its members.

Summary of credit rate and credit period by facility type

Table 1.–Summary of Section 45 Credit

Eligible electricity production or coal production activity	Credit amount for 2007 (cents per kilowatt-hour; dollars per ton)	Credit period for facilities placed in service on or before August 8, 2005 (years from placed-in-service date)	Credit period facilities placed in service after August 8, 2005 (years from placed-in-service date)
Wind	2	10	10
Closed-loop biomass	2	10[1]	10
Open-loop biomass (including agricultural livestock waste nutrient facilities)	1	5[2]	10
Geothermal	2	5	10
Solar (pre-2006 facilities only)	2	5	10
Small irrigation power	1	5	10
Municipal solid waste (including landfill gas facilities and trash combustion facilities)	1	5	10
Qualified hydropower	1	N/A	10
Refined Coal	5.877	10	10
Indian Coal	1.544	7[3]	7[3]

[1] In the case of certain co-firing closed-loop facilities, the credit period begins no earlier than October 22, 2004.
[2] For certain facilities placed in service before October 22, 2004, the 5-year credit period commences on January 1, 2005.
[3] For Indian coal, the credit period begins for coal sold after January 1, 2006.

Description of Proposal

The proposal provides an exception to the reduction in the section 45 credit by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits. Under the proposal, the section 45 credit is not reduced by any loans, loan guarantees, or grants to farmers, ranchers, or rural small businesses issued by the Secretary of Agriculture under authority granted by section 9006 of the Farm Security and Rural Investment Act of 2002 (Pub. L. No. 107-171).

Effective Date

The modification is effective for facilities placed in service after the date of enactment.

IV. AGRICULTURAL PROVISIONS

A. Farm Equipment Treated as Five-Year Property

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[21] The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[22] Asset class 01.1 includes machinery and equipment, grain bins, and fences (but no other land improvements), that are used in the production of crops or plants, vines, and trees; livestock; the operation of farm dairies, nurseries, greenhouses, sod farms, mushrooms cellars, cranberry bogs, apiaries, and fur farms; and the performance of agricultural, animal husbandry, and horticultural services. These assets are assigned a class life of 10 years and a recovery period of seven years.

Description of Proposal

The proposal provides a five year recovery period for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) which is used in a farming business, the original use of which commences with the taxpayer, and placed in service before January 1, 2010. For these purposes, the term "farming business" means a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity.[23] A farming business includes processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products.[24]

Effective Date

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

[21] Sec. 168.

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

[23] Treas. Reg. sec. 1.263A-4(a)(4)(i).

[24] Treas. Reg. sec. 1.263A-4(a)(4)(ii).

B. Expensing of Broadband Internet Access Expenditures

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[25] Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under section 179. The Small Business and Work Opportunity Tax Act of 2007[26] increased the amount a taxpayer may deduct, for taxable years beginning in 2007 through 2010, to $125,000 of the cost of qualifying property placed in service for the taxable year.[27] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2010 is treated as qualifying property. The $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000. The $125,000 and $500,000 amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.

For taxable years beginning in 2011 and thereafter (or before 2003), the following rules apply. A taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed.

Description of Proposal

The proposal provides an election to treat any qualified broadband expenditure paid or incurred by the taxpayer as not chargeable to capital account, but rather, as a deduction. The

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[25] Sec. 168.

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

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

deduction is allowed in the first taxable year in which either current generation or next generation broadband services are provided through qualified equipment to qualified subscribers. Expenditures are eligible for this election only for qualified equipment, the original use of which commences with the taxpayer. The proposal applies for qualified broadband expenditures incurred after the date of enactment and on or before the first December 31 that is three years after such date.

"Current generation broadband services" are defined as the transmission of signals at a rate of at least 5 million bits per second to the subscriber and at a rate of at least 1 million bits per second from the subscriber. "Next generation broadband services" are defined as the transmission of signals at a rate of at least 100 million bits per second to the subscriber and at a rate of at least 20 million bits per second from the subscriber.

"Qualified broadband expenditures" means the direct or indirect costs properly taken into account for the taxable year for the purchase or installation of qualified equipment (including upgrades) and the connection of the equipment to a qualified subscriber. The term does not include costs of launching satellite equipment. For current generation broadband services, only 50 percent of the otherwise allowable amount of deduction is treated as qualified broadband expenditures.

Qualified broadband expenditures include only the portion of the purchase price paid by the lessor, in the case of leased equipment, that is attributable to otherwise qualified broadband expenditures by the lessee. In the case of property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was originally placed in service, the property is treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback.

A qualified subscriber, with respect to current generation broadband services, means any nonresidential subscriber maintaining a permanent place of business in a rural area or underserved area, or any residential subscriber residing in a rural area or underserved area that is not a saturated market. A qualified subscriber, with respect to next generation broadband services, means any nonresidential subscriber maintaining a permanent place of business in a rural area or underserved area, or any residential subscriber.

For this purpose, a rural area means any census tract not within 10 miles of an incorporated or census-designated place with more than 25,000 people and not within a county or county equivalent with overall population density of more than 500 people per square mile. An underserved area means a census tract located in an empowerment zone or enterprise community designated under section 1391 or the District of Columbia Enterprise Zone established under section 1400, or any census tract the poverty level of which is at least 30 percent and the median family income of which does not exceed (1) for a tract in a metropolitan statistical area, 70 percent of the greater of the metropolitan area median family income or the statewide median family income, and (2) for a tract that is not in a metropolitan statistical area, 70 percent of the nonmetropolitan statewide median family income.

A saturated market, for this purpose, means any census tract in which, as of the date of enactment, current generation broadband services have been provided by a single provider to 85 percent or more of the total potential residential subscribers. The services must be usable at least a majority of the time during periods of maximum demand, and usable in a manner substantially the same as services provided through equipment not eligible for the deduction under this proposal.

If current, or next, generation broadband services can be provided through qualified equipment to both qualified subscribers and to other subscribers, the proposal provides that the expenditures with respect to the equipment are allocated among subscribers to determine the amount of qualified broad broadband expenditures that may be deducted under the proposal.

Qualified equipment means equipment that provides current, or next, generation broadband services at least a majority of the time during periods of maximum demand to each subscriber, and in a manner substantially the same as such services are provided by the provider to subscribers through equipment with respect to which no deduction is allowed under the proposal. Limitations are imposed under the proposal on equipment depending on where it extends, and on certain packet switching equipment, and on certain multiplexing and demultiplexing equipment.

Expenditures generally are not taken into account for purposes of the deduction under the proposal with respect to property used predominantly outside the United States, used predominantly to furnish lodging, used by a tax-exempt organization (other than in a business whose income is subject to unrelated business income tax), or used by the United States or a political subdivision or by a possession, agency or instrumentality thereof or by a foreign person or entity. The basis of property is reduced by the cost of the property that is taken into account as a deduction under the proposal. Recapture rules are provided. No business credit under section 38 is allowed with respect to any amount allowed as a deduction under the proposal.

Effective Date

The proposal is effective on the date of enactment and applies to expenditures incurred after the date of enactment and on or before first December 31 that is three years after such date.

V. REVENUE PROVISIONS

A. Modifications to Corporate Estimated Tax Payments

Present Law

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

Under present law, in the case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, shall be increased to 115.0 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Description of Proposal

The proposal increases the otherwise applicable percentage (115.00 percent) by 6.75 percentage points.

Effective Date

The proposal is effective on the date of enactment.