

# CRS Report for Congress

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## **Energy Policy Act of 2005: Summary and Analysis of Enacted Provisions**

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Mark Holt and Carol Glover, Coordinators  
Resources, Science, and Industry Division

Section 201(f) of the Federal Power Act is amended to add that in addition to a political subdivision of a state, an electric cooperative that receives financing under the Rural Electrification Act of 1936 or an electric cooperative that sells less than 4,000,000 MW-hours of electricity per year is not subject to FERC rate regulation.

## **Subtitle I — Technical and Conforming Amendments**

**Conforming Amendments (Sec. 1295).** The Federal Power Act is amended to conform with this section.

## **Subtitle J — Economic Dispatch**

**Economic Dispatch (Sec. 1298).** FERC is directed to convene regional boards to study “security constrained economic dispatch.” A member of FERC will chair each regional joint board that is to be composed of a representative from each state. Within one year of enactment, FERC is required to submit a report to Congress on the recommendations of the joint regional boards. This section does not define “security constrained economic dispatch,” but it generally means a dispatch system that ensures that all normal and contingency limits of the system are simultaneously met under a base case with one contingency (i.e., the loss of a critical network element, N-1 security analysis).

## **Title XIII — Energy Policy Tax Incentives**

**Short Title (Sec. 1300).** This title may be cited as the “Energy Tax Incentives Act of 2005.”

### **Subtitle A — Electricity Infrastructure**

**Summary of Provisions.** This section generally liberalizes existing tax provisions to reduce taxes for the electric utility industry — businesses that supply electricity for residential, commercial, industrial and government use. It also, however, introduces two new energy tax subsidies for electricity: a tax credit for investors in clean renewable energy bonds, and a tax credit for electricity produced from nuclear energy.

The title “electricity infrastructure” implies the targeting of the industry’s capital in all segments of electricity supply — generation, transmission, and distribution. Included also are electricity production (generation) incentives such as an extension of the Internal Revenue Code (IRC) §45 tax credit, and the new nuclear credit. Some of the provisions are intended to facilitate the ongoing restructuring of the electric utility industry. For example, the deferral of gain on the sale of transmission assets is intended to foster a more competitive industry by facilitating the unbundling of transmission assets held by vertically integrated utilities.

**Extension and Modification of Renewable Electricity Production Credit (Sec. 1301).** This extends the availability of the §45 credit (the placed-in-

service deadline) for two years for electricity produced from renewable resources, except for solar energy facilities described in §45(d)(4) and refined coal production facilities described in §45(d)(8). For these two categories, the December 31, 2005, deadline remains unchanged. In addition, P.L. 109-58 extends the credit period to 10 years for all qualifying facilities placed in service after the date of enactment, eliminating the five-year credit period to which some facilities are currently subject. Also, the definition of qualified energy resources that qualify for the credit is expanded to include qualified hydropower production, although a qualified hydroelectric facility is entitled to only 50% of the usual credit. P.L. 109-58 also adds Indian coal production facilities to the list of those facilities eligible for the credit. The credit is available for sales of Indian coal to an unrelated party from a qualified facility beginning January 1, 2006, and ending December 31, 2012. The credit is \$1.50 per ton during 2006-2009 and increases to \$2.00 per ton in 2110-2012; the credit amount for Indian coal is also to be adjusted for inflation in calendar years after 2006. This is effective as of the date of enactment (August 8, 2005).

***Application of Section 45 Credit to Agricultural Cooperatives (Sec. 1302).*** This section allows cooperatives eligible for the §45 credit to elect to pass through any portion of the credit to their patrons. To be eligible for this election, the cooperative must be more than 50%-owned by agricultural producers or entities owned by agricultural producers. The election must be made on an annual basis and is irrevocable once made. This is effective for taxable years of cooperatives ending after the date of enactment.

***Clean Renewable Energy Bonds (Sec. 1303).*** This section adds a new section to the IRC, §54, providing a credit for holders of clean renewable energy bonds. To qualify for the credit, the bonds must be issued pursuant to an allocation by the Secretary of the Treasury, and at least 95% of the proceeds must be used for capital expenditures on a qualified facility (determined under §45(d) without regard to the date placed in service). The amount of the credit is the face amount of the bond, multiplied by a credit rate to be determined by Treasury. The credit rate is to permit the issuance of the bonds without discount or any interest cost to the issuer. There is a national limit of \$800 million for such bonds, and no more than \$500 million of the bonds may be allocated to finance projects for governmental borrowers. This is effective for bonds issued after December 31, 2005.

***Treatment of Income of Certain Electrical Cooperatives (Sec. 1304).*** This section repeals the sunset provisions of §501(c)(12)(C) and (H), which allow a mutual or cooperative electric company to treat income from the sale of electric transmission services, the sale of distribution services, nuclear decommissioning transactions, asset exchange or conversion transactions, and load loss transactions as member income. The provision is effective as of the date of enactment.

***Dispositions of Transmission Property to Implement FERC Restructuring Policy (Sec. 1305).*** The special capital gains tax treatment under IRC §451(i) of gains on the sale or disposition of certain property used in providing electric transmission services is extended to December 31, 2007. This is effective for transactions occurring after the date of enactment.

***Credit for Production from Advanced Nuclear Power Facilities (Sec. 1306).*** This section adds IRC §45J, providing a §38 business credit for electricity produced in the first eight years of operation of an advanced nuclear power facility. The credit is equal to 1.8¢ times the kilowatt hours of electricity produced and sold to an unrelated person, but is subject to a limitation based on the amount of the national megawatt capacity limitation allocated to the facility. The total national limitation is 6,000 megawatts, which is to be allocated as prescribed by the Secretary of Energy. The credit is further limited to \$125 million annually per thousand megawatts of capacity allocated to the facility. To qualify for the credit, a facility must be of a design first approved by the Nuclear Regulatory Commission after 1993, and must be placed in service after the date of enactment and before 2021. This is effective for production in taxable years beginning after date of enactment.

***Credit for Investment in Clean Coal Facilities (Sec. 1307).*** Two new §46 investment credits are established for advanced coal projects and qualified coal gasification projects, as new IRC §§48A and 48B, respectively. The credits would be 20% for coal gasification projects using integrated gasification combined cycle (IGCC) technology, and 15% for other advanced coal-based projects. The total credits available under §48A for qualifying advanced coal projects would be limited to \$1.3 billion, with \$800 million allocated to IGCC projects and the remaining \$500 million to projects using other advanced coal-based generation technologies. The §48B credit for qualifying gasification projects would be limited to \$350 million. Both credits would be allocated based on the amount invested. These credits are effective for periods after the date of enactment, using rules similar to those of former IRC §48(m) before its 1990 repeal.

***Electric Transmission Property Treated as 15-Year Property (Sec. 1308).*** Depreciable property used in the transmission of 69 or more kilovolts of electricity for sale is classified as 15-year property under the Modified Accelerated Cost Recovery System (MACRS) and assigned a 30-year class life for purposes of the alternative depreciation system. Prior to this amendment such transmission property generally had been assigned a 20-year recovery period. The new recovery period is effective for property placed in service after April 11, 2005, except for property that is the subject of a binding contract or is under construction (for self-constructed property) on or before April 11, 2005.

***Expansion of Amortization for Certain Atmospheric Pollution Control Facilities in Connection with Plants First Placed in Service After 1975 (Sec. 1309).*** Atmospheric pollution control facilities placed in service after April 11, 2005, and used in connection with an electric generation plant or other property which is primarily coal-fired, are eligible for an amortization period of 60 months (rather than 84 months). P.L. 109-58 eliminates the rule that to be a certified pollution control facility (and eligible for the faster depreciation), such facility needed to be in operation before January 1, 1976.

***Modification to Special Rules for Nuclear Decommissioning Costs (Sec. 1310).*** This section repeals the cost of service requirement for deductible contributions to a nuclear decommissioning fund. Thus, all taxpayers, including unregulated taxpayers, would be allowed a deduction for amounts contributed to a

qualified fund. The section also permits tax-deductible contributions to a qualified fund for pre-1984 decommissioning costs.

Section 1310 also repeals the limitation that a qualified fund accumulate only an amount sufficient to pay for a nuclear power plant's decommissioning costs incurred during the period that the qualified fund is in existence (generally post-1984 decommissioning costs). Thus, any taxpayer is permitted to accumulate an amount sufficient to cover the present value of 100% of a nuclear power plant's estimated decommissioning costs in a qualified fund.

The act does not change the requirement that contributions to a qualified fund not be deducted more rapidly than level funding. The act permits a taxpayer to make contributions to a qualified fund in excess of the "ruling amount" (determined by the Secretary) in one circumstance: specifically, a taxpayer is permitted to contribute up to the present value of total nuclear decommissioning costs with respect to a nuclear power plant previously excluded under §468A(d)(2)(A). It is anticipated that an amount permitted to be contributed under this special rule shall be determined using the estimate of total decommissioning costs used for purposes of determining the taxpayer's most recent ruling amount. Any amount transferred to the qualified fund under this special rule will be allowed as a deduction over the remaining useful life of the nuclear power plant. If a qualified fund that has received amounts under this rule is transferred to another person, the transferor is permitted a deduction for any remaining deductible amounts at the time of transfer. The act requires that a taxpayer apply for a new ruling amount with respect to a nuclear power plant in any tax year in which the power plant is granted a license renewal, extending its useful life. This is effective for taxable years beginning after December 31, 2005.

***Five-Year NOL Carryback for Certain Electric Utility Companies (Sec.1311).*** Certain electric utility companies are allowed to extend the Net Operating Loss (NOL) carryback period to five years for a portion of NOLs arising in 2003, 2004, and 2005. The election is to be made during any taxable year ending after 2005 and before 2009 and must specify the loss to which it applies. The election applies to 20% of the taxpayer's qualifying investment during the prior taxable year. Rules similar to those for specified liability losses apply, and any unused portion of the loss year NOL remains subject to previous carryover rules. A taxpayer is limited to one election per taxable year for no more than one taxable year beginning in the same calendar year. For calculating interest on overpayments, any overpayment resulting from a five-year NOL carryback election is deemed not to have been made before the filing date for the taxable year in which the taxpayer made the election. The statute of limitations for refund claims and assessment of deficiencies is extended. The Treasury is to prescribe the manner to make the election, with filing a refund claim as sufficient for making the election, provided the taxpayer attaches a statement specifying the election year, the loss year, and the amount of qualifying investment in electric transmission property and pollution control facilities in the preceding taxable year.

An investment qualifies for the extended carryback if it is a capital expenditure: (1) attributable to electric transmission property used by the taxpayer in the transmission at 69 or more kilovolts of electricity for sale; or (2) made by an electric

utility company (as defined in the Public Utility Holding Company Act) and attributable to a certified pollution control facility, as defined in §169(d)(1) but without the requirement that the facility either be new or be used with a plant or other property in operation before January 1, 1976. There is no requirement that the qualifying investment property be placed in service in the year that the taxpayer incurs the capital expenditures, so long as the taxpayer is committed to the expenditures and to placing the property in service in the taxpayer's trade or business. The extended carryback does not cover expenditures that, at the taxpayer's choice, are refundable or subject to material modification that would not meet the requirements of this provision. This is effective for elections made in taxable years ending after December 31, 2005, and before January 1, 2009, with respect to NOLs arising in taxable years ending in 2003, 2004, and 2005.

**Background and Policy Context.** Historically, the electric utility industry has not been provided special federal tax preferences, although it has benefitted significantly from 1) capital tax incentives (such as accelerated depreciation and investment tax credits) due to its capital-intensive production process, and 2) from special tax preferences for renewable electricity. While many of the new electricity industry tax incentives in this subtitle originated with electricity industry restructuring proposals, others were in response to specific electricity market conditions and negative trends in those markets, particularly spiking electricity prices, supply shortfalls, and bottlenecks.

Some energy market analysts believe that electricity supply problems are due to insufficient distribution/transportation infrastructure — insufficient transmission lines — to deliver the supplies to meet the demands of the market. Investment in transmission lines (the grid) and other distribution capital has not been commensurate with increases in the generation and bulk transfer of power. Growing spot markets that ship power supplies over ever greater distances have crammed more electrons onto wires built to serve utilities' local customers. But most of the grid was built in the 1950s and needs upgrading. The Electric Power Research Institute, a Palo Alto, California-based industry group, has pegged building costs at \$100 billion over the decade. The electricity tax subsidies increase the incentives to invest in electricity generation and transmission — capital incentives for utilities to construct new transmission facilities and new additional power lines. The goal is to reduce congestion in the nation's transmission grid, which has been blamed for power brownouts and blackouts and for electricity price spikes.

The new production tax credit for nuclear power appears to be consistent with the Bush Administration's support for new nuclear power plants, although the Administration had not proposed such a subsidy. Nuclear reactors generate about 20% of U.S. electricity, but the most recent U.S. reactor order (that was not subsequently canceled) was in 1973. Supporters of the nuclear tax credit contend that it would provide balance with the previously established renewable electricity production tax credit.

## Subtitle B — Domestic Fossil Fuel Security

**Summary of Provisions.** Subtitle B includes tax incentives for the production, transportation, and distribution of oil and gas, as well as capital incentives for refinery production of liquid fuels. Not included are coal supply incentives, which are subsumed in the electricity infrastructure subtitle described above. Many of the incentives are production tax credits and other such “upstream” production incentives, but some are also capital incentives for natural gas infrastructure (accelerated depreciation of natural gas lines).

These tax incentives mostly involve liberalization of existing tax code provisions. The incentives are both production incentives (i.e., tax benefits based on quantities of oil and gas) and capital incentives (i.e., tax benefits based on the magnitude of capital investment such as pipelines). Both unconventional, as well as conventional, oil and gas are targeted for tax cuts.

***Extension of Credit for Producing Fuel from a Nonconventional Source for Facilities Producing Coke or Coke Gas (Sec.1321).*** The IRC §29 production credit is made available for qualified facilities that produce coke or coke gas that were placed in service before January 1, 1993, or after June 30, 1998, and before January 1, 2010. Coke and coke gas produced and sold during the period beginning on the latter of January 1, 2006, or the date the facility is placed in service, and ending four years after such period begins, is eligible for the production credit. A facility that claims a credit under §29(g) is not eligible to claim the new credit for producing coke or coke gas. The provision also requires that the amount of credit-eligible coke produced cannot exceed an average barrel-of-oil equivalent of 4,000 barrels per day. The \$3.00 credit for coke and coke gas would be indexed for inflation with a 2004 base year. This section also states that the IRS should consider issuing rulings and guidance on an expedited basis to taxpayers who had pending ruling requests at the time that the IRS implemented a moratorium.

***Modification of Credit for Producing Fuel from a Nonconventional Source (Sec.1322).*** The §29 credit for producing fuel from a nonconventional source is made part of the general business credit, moving the credit from §29 to new §45K. This modification makes the general business limitations applicable to the §29 tax credit. Any unused credits could be carried back one year and forward 20 years, except that the credit could not be carried back to a taxable year ending before January 1, 2006. This is effective for fuel produced and sold after December 31, 2005, in taxable years ending after such date. The redesignation of the provision is effective for credits determined under the 1986 Code for taxable years ending after December 31, 2005.

***Temporary Expensing for Equipment Used in Refining of Liquid Fuels (Sec.1323).*** Refineries are allowed to irrevocably elect to expense 50% of the cost of qualified refinery property, with no limitation on the amount of the deduction. The deduction will be allowed in the taxable year in which the refinery is placed in service. The remaining 50% of the cost remains eligible for regular cost recovery provisions. To qualify for the deduction: (1) original use of the property must commence with the taxpayer; (2) (i) construction must be pursuant to a binding

construction contract entered into after June 14, 2005, and before January 1, 2008, (ii) in the case of self-constructed property, construction began after June 14, 2005, and before January 1, 2008, or (iii) the refinery is placed in service before January 1, 2008; (3) the property must be placed in service before January 1, 2012; (4) the property must meet certain production capacity requirements if it is an addition to an existing refinery; and (5) the property must meet all applicable environmental laws when placed in service. Certain types of refineries, including asphalt plants, are not eligible for the deduction, and there is a special rule for sale-leasebacks of qualifying refineries. If the owner of the refinery is a cooperative, it may elect to allocate all or a part of the deduction to the cooperative owners, allocated on the basis of ownership interests. This is effective for qualifying refineries placed in service after date of enactment.

***Pass Through to Owners of Deduction for Capital Costs Incurred by Small Refiner Cooperatives in Complying with Environmental Protection Agency Sulfur Regulations (Sec. 1324).*** The section provides that cooperative refineries that qualify for §179B expensing (writing off in one year) of capital costs incurred in complying with EPA sulfur regulations can elect to allocate all or part of the deduction to their owners, determined on the basis of their ownership interests. The election can be made on an annual basis and is irrevocable once made. This provision is effective as if included in §338(a) of the American Jobs Creation Act of 2004 (P.L. 108-357).

***Natural Gas Distribution Lines Treated as 15-Year Property (Sec. 1325).*** This section establishes a 15-year recovery period for MACRS and a 35-year class life for alternative depreciation system for natural gas distribution lines. Prior to this amendment, natural gas distribution lines were assigned a 20-year recovery period. This provision is effective for property, the original use of which began with the taxpayer after April 11, 2005, which is placed in service after April 11, 2005, and before January 1, 2011, and does not apply to property subject to a binding contract on or before April 11, 2005.

***Natural Gas Gathering Lines Treated as Seven-Year Property (Sec. 1326).***

Under prior law IRC §168(e)(3) and IRS regulations, the recovery period for natural gas gathering lines could be either 7 or 15 years, depending upon whether they were classified as production or transportation equipment. Recent court cases reflect the ambiguous tax treatment. Natural gas pipelines have a recovery period of 15 years, while natural gas distribution lines had a recovery period of 20 years (which, as noted above, has been reduced to 15 years). P.L. 109-58 assigns natural gas gathering lines a 7-year recovery period for MACRS and a class life of 14 years for the alternative depreciation system for natural gas gathering lines. The law also provides that no adjustment is made to the allowable amount of depreciation for alternative minimum taxable income purposes.

Section 1326 defines a natural gas gathering line as the pipe, equipment, and appurtenances determined to be a gathering line by FERC or used to deliver natural gas from the wellhead or commonpoint to the point at which the gas first reaches: (1) a gas processing plant; (2) an interconnection with an interstate transmission line; (3)



an interconnection with an intrastate transmission pipeline; or (4) a direct connection with a local distribution company, a gas storage facility, or an industrial consumer. Also, the section requires that the original use of the property begin with the taxpayer. This provision is effective for property placed in service after April 11, 2005, excluding property with respect to which the taxpayer or related party had a binding acquisition contract on or before April 11, 2005.

***Arbitrage Rules Not to Apply to Prepayments for Natural Gas (Sec. 1327).*** This section creates a safe harbor exception to the general rule that tax-exempt bond-financed prepayments violate arbitrage restrictions. The term “investment type property” would not include a prepayment under a qualified natural gas supply contract. The section also provides that such prepayments are not treated as private loans for purposes of the private business tests. Thus, a prepayment financed with tax-exempt bond proceeds for the purpose of obtaining a supply of natural gas for service area customers of a governmental utility would not be treated as the acquisition of investment-type property. The safe harbor provisions do not apply if the utility engages in intentional acts to render: (1) the volume of natural gas covered by the prepayment to be in excess of that needed for retail natural gas consumption; and (2) the amount of natural gas that is needed to fuel transportation of the natural gas to the governmental utility. This is effective for obligations issued after date of enactment.

***Determination of Small Refiner Exception to Oil Depletion Deduction (Sec. 1328).*** The percentage depletion allowance for oil and gas is 15% of revenues (gross income) and is available only to independent producers (not vertically integrated producers) and royalty owners. Independent producers (which may be large firms) can claim a higher depletion rate (up to 25%, rather than the normal 15%) for up to 15 barrels per day (bpd) of oil (or the equivalent amount of gas) from marginal wells (“stripper” oil/gas and heavy oil). For purposes of percentage depletion, an independent oil producer had been defined as one that does not refine more than 50,000 barrels of oil on any given day and does not have a retail operation grossing more than \$5 million/year (IRC§613A(d)). Under P.L. 109-58, the 50,000 barrel daily limit is raised to 75,000. In addition, the section changes the refinery limitation on claiming independent producer status from a limit based on actual daily production to a limit based on average daily production for the taxable year. Accordingly, the average daily refinery runs for the taxable year may not exceed 75,000 barrels. For this purpose, the taxpayer would calculate average daily refinery runs by dividing total refinery runs for the taxable year by the total number of days in the taxable year. This is effective for taxable years ending after the date of enactment.

***Amortization of Geological and Geophysical Expenditures (Sec. 1329).*** Geological and geophysical expenses paid or incurred in connection with the domestic exploration for, or development of, oil or gas can be amortized ratably (evenly) over two years using the half-year convention (considered to be incurred at the mid-point of the taxable year). If property to which such an expenditure relates is retired or abandoned during the 24-month period, no deduction would be allowed on account of the retirement or abandonment; however, the amortization deduction

under this provision would continue. This is effective for amounts paid or incurred in taxable years beginning after the date of enactment.

**Background and Policy Context.** The harbinger of the fossil fuel tax incentives in the Energy Policy Act of 2005 was the 106<sup>th</sup> Congress's effort in 1999 to help the ailing domestic oil and gas producing industry deal with depressed oil prices. The Energy Policy Act of 2005 includes a plethora of spending, tax, and deregulatory incentives to stimulate the production of conventional and unconventional oil and gas.

While it can be argued that the above tax subsidies are not justified based on economic theory — especially given the high oil and gas prices over much of the policy period — they are not large when measured relative to the industry's gross product. The industry did benefit historically from significant tax subsidies, but most of these have been either eliminated or pared back since the 1970s.

## **Subtitle C — Conservation and Energy Efficiency Provisions**

**Summary of Provisions.** Over the years, energy tax bills have taken a three-pronged approach to energy policy by providing incentives for 1) efforts to increase conventional energy supplies 2) conservation of conventional energy (fossil fuels) by enhancing energy efficiency, and 3) energy conservation through a substitution of alternative (including renewable fuels) for conventional fossil fuels. This subtitle includes the second type of measures.

***Energy Efficient Commercial Buildings Deduction (Sec. 1331).*** A new formula-based tax deduction is provided for energy-efficient commercial building property expenditures made by the taxpayer. The property must reduce the energy and power consumption of a commercial building by 50%. Qualifying property includes property installed as part of interior lighting systems, heating, cooling, ventilation and hot water systems, or the building envelope, to the extent certified as energy efficient. The provision limits the deduction to \$1.80 per square foot and would reduce the property basis by the amount of the deduction. The provision would allow a partial deduction for a building that does not meet the overall building requirement of a 50% energy savings. This is effective for property placed in service after December 31, 2005, and prior to January 1, 2008.

***Credit for Construction of New Energy Efficient Homes (Sec. 1332).*** A \$2,000 general business tax credit is provided to contractors for the construction of a qualified new energy-efficient home if the home achieves energy savings of 50% over a comparable unit built to the 2003 International Energy Conservation Code. For manufactured homes, a \$1,000 credit is provided for energy savings of 30%. This is effective for homes whose construction is substantially completed after December 31, 2005, and which are purchased after December 31, 2005, and prior to January 1, 2008.

***Credit for Certain Nonbusiness Energy Property (Sec. 1333).*** A 10% tax credit is provided for amounts paid or incurred for the installation of qualified energy efficiency improvements (building envelope components) to existing homes,

plus specified credits for expenditures on residential energy property (such as furnaces and boilers). The maximum credit for a taxpayer with respect to the same dwelling is limited to \$500 for all taxable years; no more than \$200 of the credit may be attributable to expenditures on windows. Thus, the maximum expenditure eligible for the credit is \$5,000; no more than \$2,000 can be spent on qualifying windows. The provision defines qualified energy efficiency improvements as any energy efficient building envelope component that meets the prescriptive criteria established by the 2000 International Energy Conservation Code and is installed in or on a U.S. dwelling unit (including certain manufactured homes) owned and used as the taxpayer's principal residence, first used by the taxpayer, and reasonably expected to remain in use for five or more years. The provision defines a building envelope components as (1) any insulation material or system specifically and primarily designed to reduce the heat loss or gain to a dwelling unit when installed; (2) exterior windows (including skylights); (3) exterior doors; and (4) any metal roof that has appropriate pigmented coatings.

The tax credits for residential energy property expenditures (as opposed to the 10% building envelope credit) are limited to the following amounts: a \$50 credit for each advanced main air circulating fan, \$150 for each qualified natural gas, propane, or oil furnace or hot water boiler, and \$300 for each item of energy efficient building property (including qualifying electric heat pump water heaters, electric heat pumps, geothermal heat pumps, central air conditioners, and natural gas, propane or oil water heaters).

The section includes certain expenditures for labor costs as eligible expenditures; it does not require certification of expenditures. The basis of the property would be required to be reduced by the amount of the credit. Special proration rules are applied for jointly owned property, condominiums, and cooperative housing corporations, and where less than 80% of the property is used for nonbusiness purposes. This is effective for property placed in service after December 31, 2005, and before January 1, 2008.

***Credit for Energy Efficient Appliances (Sec. 1334).*** A new IRC section is created that provides a credit for the eligible production (manufacture) of certain energy-efficient dishwashers, clothes washers, and refrigerators. The credit amount for dishwashers is \$3 multiplied by the percentage by which the efficiency of the 2007 standards (not yet known) exceeds that of the 2005 standards, up to \$100 per dishwasher. The credit for clothes washers is \$100 for each unit manufactured in 2006 and 2007 that meet the requirements of the Energy Star program in effect for clothes washers in 2007. The credit for dishwashers also applies to units produced in 2006 and 2007 that meet the Energy Star standards for 2007.

The credit for refrigerators is based on energy savings and the year of manufacture. A refrigerator must be an automatic defrost refrigerator-freezer with an internal volume of at least 16.5 cubic feet to qualify for the credit. The energy savings are determined relative to the energy conservation standards promulgated by the Department of Energy that took effect on July 1, 2001. Refrigerators that achieve a 15% to 20% energy saving and that are manufactured in 2006 receive a \$75 credit. Refrigerators that achieve a 20% to 25% energy saving receive a \$125 credit if

manufactured in 2006 or 2007. Refrigerators that achieve at least a 25% energy saving receive a \$175 credit if manufactured in 2006 or 2007. Appliances eligible for the credit include only those that exceed the average amount of production from the three prior calendar years for each category of appliance. However, eligible production of refrigerators is defined as production that exceeds 110% of the average amount of production from the three prior calendar years.

The manufacturer may not claim credits in excess of \$75 million for all taxable years, and may not claim credits in excess of \$20 million with respect to refrigerators eligible for the \$75 credit. The credit allowed in a taxable year for all appliances may not exceed 2% of the average annual gross receipts of the taxpayer for the three taxable years preceding the taxable year in which the credit is determined. The credit is part of the general business credit and is effective for appliances produced after December 31, 2005, and prior to January 1, 2008.

***Credit for Residential Energy Efficient Property (Sec. 1335).*** A 30% nonrefundable personal tax credit, not to exceed \$2,000, is provided for individuals for the purchase of qualified photovoltaic property and qualified solar water heating property used exclusively for residential purposes other than heating swimming pools and hot tubs. At least half of the energy used by the solar water heating property must be derived from the sun. A 30% tax credit is also provided for the purchase of qualified fuel cell electric generators, not to exceed \$1,000 for each kilowatt of capacity. The generator must have an electricity-only generation efficiency of greater than 30% and generate at least 0.5 kilowatts of electricity. The generator must also be installed on or in connection with a dwelling unit located in the United States and that is used by the taxpayer as a principal residence. The depreciable basis of the property must be reduced by the amount of the credit. Expenditures for labor costs are included in eligible expenditures. Certain equipment safety requirements must be met to qualify for the credit, and special proration rules apply for jointly owned property, condominiums, and cooperative housing corporations, and where less than 80% of the property is used for nonbusiness purposes. This is effective for property placed in service after December 31, 2005, and before January 1, 2008.

***Credit for Business Installation of Qualified Fuel Cells and Stationary Microturbine Power Plants (Sec. 1336).*** A 30% business energy tax credit is provided for the purchase of qualified fuel cell power plants for businesses, not to exceed \$1,000 for each kilowatt of capacity. The power plant must have an electricity-only generation efficiency of greater than 30% and generate at least 0.5 kilowatts of electricity. In addition, a 10% credit is provided for the purchase of qualifying stationary microturbine power plants, including secondary components located between the existing infrastructure for fuel delivery and the existing infrastructure for power distribution. The system must have an electricity-only generation efficiency of not less than 26% at International Standard Organization conditions and a capacity of less than 2,000 kilowatts. The credit would be limited to the lesser of 10% of the basis of the property or \$200 for each kilowatt of capacity. The energy credits would be part of the general business credit, and the taxpayer's basis in the property would be reduced by the amount of the credit claimed. This is effective for periods after December 31, 2005, and before January

1, 2008, for property placed in service in taxable years ending after December 31, 2005.

**Business Solar Investment Tax Credit (Sec. 1337).** Section 1337 of P.L. 109-58 provides that the energy credit percentage will be 30% for equipment that uses solar energy to generate electricity to heat or cool a structure, to illuminate the inside of a structure using fiber-optic distributed sunlight, or to provide solar process heat, and qualified fuel cell property. In the case of any other energy property the percentage is 10%. Property used to generate energy to heating a swimming pool is not eligible in any period after December 31, 2005. The increase in the credit rate — it is currently 10% — and the provision related to fiber-optic distributed sunlight are effective for periods after December 31, 2005, and before January 1, 2008, for property placed in service in taxable years ending after December 31, 2005.

**Background.** During the energy policy shift of the 1970s away from fossil fuels, several energy efficiency tax incentives were enacted as part of President Carter's National Energy Plan of 1978 — the residential and business energy tax credits — but these generally expired at the end on 1985. The credit for nonbusiness property under Sec. 1333 is structured similarly to the residential energy credit that was in effect from 1978-1985.

**Policy Context.** Despite its supply focus, P.L. 109-58 includes numerous tax incentives for energy conservation and energy efficiency. Most are relatively small, however, and several, such as the appliance credits, expire in two years, perhaps too brief a time period to have a significant impact on energy demand.

Aside from energy taxes or subsidies to correct for energy production and consumption externalities, and aside from possible user charges, economists generally argue there is no economic justification for additional tax subsidies to encourage greater energy conservation, or energy efficiency. This is because there is generally no market failure in energy use or in investment in energy-using technologies — at either the household or business level — that requires such tax subsidies. There are some market failures in energy use, however, that may be an economic justification for government intervention. (For more detail on these issues, see CRS Report RL30406, *Energy Tax Policy: An Economic Analysis*, by Salvatore Lazzari.

## **Subtitle D — Alternative Motor Vehicles and Fuel Incentives**

**Summary of Provisions.** Transportation is the largest U.S. energy consuming sector, accounting for about two-thirds of the nation's petroleum consumption. This subtitle provides tax incentives for substituting vehicles that use alternative fuels for vehicles that would otherwise use conventional petroleum-based fuels (gasoline and diesel). In addition, existing subsidies for the supply of fuel ethanol and fuel biodiesel are expanded.

**Alternative Motor Vehicle Credit (Sec. 1341).** This section adds a new nonrefundable personal credit equal to the sum of a new qualified fuel cell motor vehicle credit, a new advanced lean-burn technology motor vehicle credit, a new

qualified hybrid motor vehicle credit, and a new qualified alternative fuel motor vehicle credit.

The amount of the new qualified fuel cell motor vehicle credit would depend on the weight of the vehicle and range from \$8,000 (\$4,000 if placed in service after 2009) to \$40,000. If the new qualified fuel cell motor vehicle is a passenger automobile or light truck, the amount of the credit is increased if certain fuel efficiencies are met based on the 2002 model year city fuel economy for specified weight classes. A new qualified fuel cell motor vehicle would be defined as a motor vehicle: (1) which is propelled by power derived from one or more cells which convert chemical energy into electricity by combining oxygen and hydrogen fuel which is stored on board the vehicle in any form; (2) which, in the case of a passenger automobile or light truck, receives an EPA certification; (3) the original use of which commences with the taxpayer; (4) which is acquired for use or lease by the taxpayer and not for resale; and (5) which is made by a manufacturer.

The new advanced lean burn technology motor vehicle credit would be the sum of two components: a fuel economy credit amount that varies with the rated fuel economy of the vehicle compared to a 2002 model year standard, ranging from \$400 to \$2,400, and a conservation credit based on the estimated lifetime fuel savings of a qualifying vehicle compared to a comparable 2002 model year vehicle, ranging from \$250 to \$1,000. A qualifying advanced lean burn technology motor vehicle must incorporate direct injection, achieve at least 125% of the 2002 model year city fuel economy, and, for 2004 and later models, meet or exceed certain EPA emissions standards. A qualifying advanced lean burn technology motor vehicle must be placed in service before January 1, 2011.

The new qualified hybrid motor vehicle credit is based on weight. Lighter vehicles (8,500 pounds or less) are eligible for a credit containing two components: a fuel economy credit amount and a conservation amount. The fuel economy credit amount ranges from \$400 to \$2,400, depending on the extent to which the fuel efficiency exceeds 2002 standards. The conservation amount is based on the estimated lifetime fuel savings of a qualifying vehicle compared to a comparable 2002 model year vehicle and ranges from \$250 to \$1,000. Heavy-duty hybrid vehicles get a credit amount based on a certain percentage of the incremental cost of the hybrid over similar gas-powered vehicles within a dollar limitation of such incremental cost. A qualifying hybrid vehicle is a motor vehicle that draws propulsion energy from onboard sources of stored energy that include both an internal combustion engine or heat engine using combustible fuel and a rechargeable energy storage system (e.g., batteries). A qualifying hybrid automobile or light truck must have a maximum available power from the rechargeable energy storage system of at least 4%. In addition, the vehicle must meet or exceed certain EPA emissions standards.

The new qualified alternative fuel motor vehicle credit is equal to an applicable percentage multiplied by the incremental cost of any new qualified alternative fuel motor vehicle. A new qualified alternative fuel motor vehicle is defined as a motor vehicle: (1) which is only capable of operating on an alternative fuel; (2) the original use of which commences with the taxpayer; (3) which is acquired by the taxpayer for

use or lease, but not for resale; and (4) which is made by a manufacturer. An alternative fuel would be compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, and any liquid at least 85% of the volume of which consists of methanol. A different calculation, which produces a lower credit amount, applies to mixed-fuel vehicles.

A limit is imposed on the number of qualified hybrid motor vehicles and advanced lean-burn technology motor vehicles sold by each manufacturer of such vehicles that are eligible for the credit. No credit is allowed for any vehicle used outside of the United States. A taxpayer may elect not to take the credit.

The new qualified fuel cell motor vehicle credit does not apply to such vehicles purchased after December 31, 2014, the new advanced lean-burn technology credit does not apply to such vehicles purchased after December 31, 2010, the new qualified hybrid motor vehicle credit does not apply to such vehicles purchased after December 31, 2010 (or December 31, 2009, for qualified hybrid motor vehicles weighing more than 8,500 pounds), and the new qualified alternative fuel vehicle credit does not apply to such vehicles purchased after December 31, 2010. The portion of the credit attributable to vehicles of a character subject to an allowance for depreciation is treated as a portion of the general business credit; the remainder of the credit is allowable to the extent of the excess of the regular tax (reduced by certain other credits) over the alternative minimum tax for the taxable year. This is effective for property placed in service after the December 31, 2005, in taxable years ending after such date.

***Credit for Installation of Alternative Fueling Stations (Sec.1342).*** A tax credit is provided equal to 30% of the cost of any qualified alternative fuel vehicle refueling property installed to be used in a trade or business or at the taxpayer's principal residence. The credit is limited to \$30,000 for retail clean-fuel vehicle refueling property, and \$1,000 for residential clean-fuel vehicle refueling property. Clean fuels are those defined under §179A(d), limited to any fuel at least 85% of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, and hydrogen, or any mixture of biodiesel and diesel fuel, determined without regard to any use of kerosene and containing at least 20% biodiesel. If the property is installed at the taxpayer's principal residence, §179A(d)(1) (requiring the property to be subject to an allowance for depreciation) does not apply. The taxpayer's basis in the property is reduced by the amount of the credit and disallows deductions under §179A for that property, and for property installed for or used by a tax-exempt entity, the taxpayer that installs the property may claim the credit. No credit is available for property used outside the United States. A taxpayer may elect not to take the credit.

Only the portion of the credit attributable to property subject to an allowance for depreciation would be treated as a portion of the general business credit; the remainder of the credit would be allowable to the extent of the excess of the regular tax (reduced by certain other credits) over the alternative minimum tax for the year. This is effective for property placed in service after December 31, 2005, and before January 1, 2010, except for property relating to hydrogen, which must be placed in service before January 1, 2015.

**Reduced Motor Fuel Excise Tax on Certain Mixtures of Diesel Fuel (Sec. 1343).** Motor fuel excise tax on certain mixtures of diesel-water fuel emulsion which contain at least 14% water are reduced from \$0.243 per gallon to \$0.197 per gallon if the emulsion additive has been registered by a U.S. manufacturer with EPA. The section also provides for a refund based on the incentive rate for which the producer could file quarterly if the producer can claim at least \$750. If the producer cannot claim at least \$750, the amount may be carried over to the next quarter or may be claimed as a credit on the income tax return if the producer cannot claim at least \$750 by the end of the taxable year. A tax credit for certain diesel fuel used to produce such an emulsion is also provided. Further, the language provides that any person who later separated taxable fuel from the diesel-water fuel emulsion would be treated as a refiner of taxable fuel. This is effective January 1, 2006.

**Extension of Excise Tax Provisions and Income Tax Credit for Biodiesel (Sec. 1344).** This provision extends the existing income tax credit, excise tax credit, and payment provisions for biodiesel (which were enacted in 2004 under the “Jobs Bill,” P.L. 108-357) through December 31, 2008. It is effective on the date of enactment.

**Small Agri-Biodiesel Producer Credit (Sec. 1345).** This provision adds the “small agri-biodiesel producer credit” to the list of credits that make up the biodiesel fuels credit. The small agri-biodiesel producer credit is 10 cents for each gallon of “qualified agri-biodiesel production.” An eligible “small agri-biodiesel producer” is defined as any person who, at all times during the taxable year, has a productive capacity for agri-biodiesel not in excess of 60 million gallons. “Qualified agri-biodiesel production” is any agri-biodiesel, not to exceed 15 million gallons, that (1) the producer sells during the taxable year for use by the purchaser (a) in the production of a qualified biodiesel mixture in the purchaser’s trade or business, (b) as a fuel in a trade or business, or (c) for sale at retail to another person who places the agri-biodiesel in that person’s fuel tank; or (2) the producer uses or sells for any of such purposes. Aggregation rules are provided for determining the 15 million and 60 million gallon limits, rules for applying the limits to passthrough entities, and rules for allocating productive capacity among multiple persons with interests in one facility, and anti-abuse regulations are authorized. The section also permits IRC §1381(a) cooperative organizations to elect to apportion the eligible small agri-biodiesel producer credit among their patrons, and sets forth the election procedure. The eligible small agri-biodiesel producer credit is effective for taxable years ending after the date of enactment and sunsets after December 31, 2008.

**Renewable Diesel (Sec. 1346).** This provision extends the income tax credit, excise tax credit, and payment provisions for biodiesel (as discussed above) for “renewable diesel.” However, credit amounts differ from those for biodiesel, and there is no special credit for small producers of renewable diesel as there is for small ethanol producers. “Renewable diesel” is defined as diesel fuel derived from biomass (excluding petroleum, natural gas, coal, or any product thereof) using a thermal depolymerization process that meets certain registration and testing requirements. The section also requires that all producers of renewable diesel be registered with the Treasury Secretary. It is effective for fuel sold or used after December 31, 2005.



**Modification of Small Ethanol Producer Credit (Sec.1347).** Section 1347 of P.L. 109-58 liberalizes the previously existing small ethanol producer tax credit. It raises the maximum annual alcohol production capacity for an eligible small ethanol producer from 30 million gallons to 60 million gallons. The provision also modifies the election by a cooperative to allocate the credit to its patrons by conditioning the validity of the election on the cooperative's mailing a written notice of the allocation to its patrons during the period beginning on the first day of the taxable year covered by the election and ending with the fifteenth day of the ninth month following the close of that taxable year. This is effective for taxable years ending after the date of the enactment.

**Sunset of Deduction for Certain Clean-Fuel Vehicles and Certain Refueling Property (Sec.1348).** This provision accelerates the termination date of the IRC §179A deduction to December 31, 2005, from December 31, 2006.

**Background and Policy Context.** As a result of the two energy crises of the 1970s (the 1973 oil embargo and the Iranian revolution in 1979, which precipitated a tenfold increase in crude oil prices) there was a shift in the focus of energy tax policy away from oil and gas toward energy conservation and toward the development of alternative fuels and nonconventional forms of energy.

In the transportation sector, which is the single largest petroleum consuming sector in the United States, federal energy tax policies became focused on reducing petroleum consumption, stimulating the production and use of alternative fuels, and reducing petroleum import dependence. Beginning in 1978, the Energy Tax Act (P.L. 95-618), which was part of President Carter's National Energy Plan, provided gasohol (a blend of gasoline and 10% ethanol produced from corn and other grains or agricultural products) a total exemption from the 4¢ per gallon gasoline tax. Such a tax policy approach — subsidies to the supply of fuel ethanol — typically has been the way in which federal tax policy has promoted alternative fuels.

The Energy Policy Act of 1992 (P.L. 102-486) included another policy instrument in this area: a \$2,000 tax deduction for alternative fuel vehicles and to refueling facilities for alternative fuels, thus targeting the capital stock. This deduction expired at the end of 2005 and has been replaced by a system of tax credits for various types of alternative technology vehicles (ATVs), diesel, hybrid, advanced lean-burn, or fuel cell vehicles that meets certain fuel efficiency standards.

The ATV tax credits are somewhat complicated to calculate, but they are structured to give greater incentives for more energy efficient ATVs. For example, the credit for hybrids starts at a base level of \$400 but may be as high as \$3,400 depending on fuel efficiency and estimated lifetime fuel savings. Lifetime fuel savings are estimated for a vehicle that is assumed to travel, over its lifetime, 120,000 miles. Obviously, the potential tax benefit — the reduction in vehicle purchase price — is much greater under the new tax credit than under the previous tax deduction. The following table shows the structure of the hybrid vehicle tax credits.

**Table 1. Fuel Economy Credit**

Credit	If City Fuel Economy of the Hybrid Vehicle is:	
	at least	but less than
\$400	125% of base fuel economy	150% of base fuel economy
\$800	150% of base fuel economy	175% of base fuel economy
\$1,200	175% of base fuel economy	200% of base fuel economy
\$1,600	200% of base fuel economy	225% of base fuel economy
\$2,000	225% of base fuel economy	250% of base fuel economy
\$2,400	250% of base fuel economy	

**Table 2. Conservation Credit**

Estimated Lifetime Fuel Savings (gal.)	Conservation Amount
At least 1,200 but less than 1,800	\$250
At least 1,800 but less than 2,400	\$500
At least 2,400 but less than 3,000	\$750
At least 3,000	\$1,000

**Example.** As an example of how the credit would be computed for passenger cars and light trucks weighing 8,500 lbs. or less (which, incidentally, comprises the vast majority of the vehicle stock in the United States), consider a hybrid automobile weighing 4,000 lbs. and having a city fuel efficiency rating of 60 miles-per-gallon (MPG). Further, assume that a comparable 2002 gasoline engine automobile has a city fuel economy of 25 MPG. Since the fuel economy of the hybrid is 240% of the base fuel economy ( $60 \div 25 \times 100 = 240\%$ ), the purchaser of this vehicle would qualify for a fuel economy tax credit of \$2,000 (as shown in **Table 1**).

These tax credits are expected to increase the demand for hybrid vehicles, which are competitively priced with conventional gasoline vehicles. However, the phase-out of the credit that begins as soon as a manufacturer sells 60,000 vehicles might dampen demand, particularly from established automakers such as Toyota and

Honda. Conversely it rewards those manufacturers that have recently entered the hybrid market such as domestic auto manufacturers.

## **Subtitle E — Additional Energy Tax Incentives**

**Summary of Provisions.** This brief subtitle expands the research and development tax credit and authorizes two energy studies.

***Expansion of Research Credit (Sec. 1351).*** Section 1351 adds a third component to the amount of the research credit: 20% of the “qualified energy research expenditures” (as defined under previously existing law) that a taxpayer pays or contributes to an “energy research consortium” in carrying on a trade or business. “Energy research consortium” is defined as under previous law, but with the following additions: (1) the energy research consortium must be organized and operated primarily to conduct energy research and development in the public interest; (2) at least five unrelated persons must pay or incur amounts to the organization within the calendar year; and (3) no one person may pay or incur more than 50% of the total amounts that the research consortium receives during the calendar year. This section also repeals the 65% limitation under IRC §41(b)(3) on contract research expenses paid to a university, a federal laboratory, or an “eligible small business” (i.e., any person with an average of no more than 500 employees during either of the two preceding calendar years, with respect to which the taxpayer does not own 50% or more of the stock by vote or value if the business is a corporation or 50% of the capital and profits interests if the business is not a corporation). This section is effective for amounts paid or incurred after the date of enactment, in taxable years ending after that date.

***National Academy of Sciences Study and Report (Sec. 1352).*** No later than 60 days from the date of enactment, the Secretary of the Treasury must enter into an agreement with the National Academy of Sciences (NAS) to conduct a study of energy costs and benefits that are not or may not be fully incorporated into the market price or tax structure. A report on the study is to be submitted to Congress not later than two years after the agreement is entered into.

***Recycling Study (Sec. 1353).*** The Secretary of the Treasury, in consultation with the Secretary of Energy, is to conduct a study to determine and quantify the energy savings achieved through the recycling of glass, paper, plastic, steel, aluminum, and electronic devices, and to identify tax incentives that would encourage recycling of such materials. The study must be submitted to Congress within one year of the date of enactment.

**Background.** Prior to the enactment of P.L. 109-58 there were two tax incentives for research and development (R&D) spending: a 20% tax credit for a taxpayer’s qualified R&D spending above a base amount, or, alternatively, a deduction as a current business expense for certain R&D expenditures. Energy R&D was not excluded from qualifying for these incentives, but the new energy R&D credit targets R&D expenditures by firms specifically in the business of doing research on energy technology, such as the development of alternative fuels or more fuel-efficient and environmentally friendly ATVs.

**Policy Context.** The credit has the effect of lowering the net cost to a firm of conducting qualified research. Economists and policymakers agree that without tax incentives the market economy under-invests in R&D due to the external benefit (spillovers). Investment in R&D is also critical for innovation, which is a precursor to economic growth. The evidence suggests that the social rate of return to R&D investment is greater than the private rate of return. At the same time, it is unclear whether a new tax subsidy specifically targeted to the energy sector was necessary given that energy R&D already qualified for the preexisting tax subsidies.

## Subtitle F — Revenue Raising Provisions

**Summary of Provisions.** P.L. 109-58 includes \$2.9 billion of energy tax increases, and \$171 million of non-energy increases (both over 11 years). About \$2.5 billion of the \$2.9 billion of energy tax increases are from the reinstatement of the excise tax on oil purchased and used by U.S. refineries. The remaining \$400 million is from the reauthorization of the 0.1¢/gallon excise tax on motor fuels that goes into the Leaking Underground Storage Tank (LUST) Trust Fund.

**Oil Spill Liability Trust Fund Financing Rate (Sec. 1361).** In general, a 5¢ per-barrel tax was imposed on crude oil received at a U.S. refinery and on imported petroleum products received for consumption, use, or warehousing. The fund's tax applied after December 31, 1989, and before January 1, 1995, but was in effect only if the unobligated balance in the Fund was less than \$1 billion. Section 1361 reinstates the 5¢ Oil Spill Liability Trust Fund tax, applicable April 1, 2006. The tax is to be suspended during a calendar quarter if the Secretary estimates that, as of the close of the preceding calendar quarter, the unobligated balance in the fund exceeds \$2.7 billion. The tax terminates after December 31, 2014.

**Extension of Leaking Underground Storage Tank Trust Fund Financing Rate (Sec. 1362).** This provision extends until April 1, 2011, the 0.1¢ per-gallon Leaking Underground Storage Tank (LUST) Trust Fund tax of IRC §4081(d)(3). The excise tax expired April 1, 2005. Exported fuels are exempt. The LUST Fund is available only for purposes of §9003(h) of the Solid Waste Disposal Act. This is effective in general on October 1, 2005.

**Modification of Recapture Rules for Amortizable Section 197 Intangibles (Sec. 1363).** This section provides that, if multiple IRC §197 intangibles are sold or otherwise disposed of in a single transaction or series of transactions, the seller must calculate recapture as if all of the §197 intangibles were a single asset. Thus, any gain on the sale or other disposition of the intangibles would be recaptured as ordinary income to the extent of ordinary depreciation deductions previously claimed on any of the §197 intangibles. An exception is provided for any amortizable §197 intangible whose adjusted basis exceeds its fair market value. This is effective for dispositions of property after the date of enactment.

**Clarification of Tire Excise Tax (Sec. 1364).** This section adds to the existing definition of a “super single tire” (which is eligible for a special rate of tax) a sentence clarifying that the term does not include any tire designed for steering. This section also requires that the IRS report to the Congress on the amount of tax

collected under IRC §4071 for each class of taxable tire (e.g., bias-ply, super single, or other) for calendar year 2006 and the number of tires in each class on which tax is imposed during 2006.<sup>23</sup> The IRS must submit the report to Congress by July 1, 2007. This section is effective as if included in §869 of the American Jobs Creation Act of 2004 (sales in calendar years beginning after November 21, 2004).

**Background.** The Oil Spill Liability Trust Fund was created as part of the Omnibus Budget Reconciliation Act of 1986 (P.L. 99-510) to finance the costs of cleaning up oil spills. However, the 1.3¢ tax on refineries was not collected due to the absence of authorizing legislation (both the Omnibus Budget Reconciliation Act of 1986 and the 1988 Technical and Miscellaneous Revenue Act prohibited the tax from being collected until Congress enacted authorizing legislation for the fund). The Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239) authorized collection of the tax, which the law also raised to 5¢/barrel, but the tax expired on January 1, 1995.

The LUST Trust Fund was established by the Comprehensive Environmental Response, Compensation, and Liability Act (P.L. 96-510). All motor fuels for highway, aviation, and inland waterway use are assessed this 0.1¢/gallon tax with the exception of propane and liquefied natural gas. The tax has been amended and reauthorized several times, although the tax rate has remained unchanged at 0.1¢. Most recently, the LUST fund tax expired on October 1, 2005.

**Policy Context.** Tax increases were not originally a part of comprehensive energy policy legislation. The first comprehensive energy policy bill to be approved by the House (H.R. 4, 107<sup>th</sup> Congress) contained \$33.5 billion in energy tax cuts and no energy tax increases. This reflected the perceived seriousness of the country's energy difficulties and the relatively healthy fiscal balance (budget surpluses).

During 2001 and 2002, however, federal budget surpluses began to decline and then turned into deficits. These budgetary constraints implied that 1) any energy tax bill had to be smaller, and 2) there would have to be revenue offsets to minimize the cost of the incentives.

The \$2.9 billion in energy tax increases, which increase the tax burden of U.S. refineries, offsets the \$2.6 billion in tax cuts for the oil and gas industry as a whole. In fact, focusing only on refineries, their \$2.9 billion in tax increases far outweigh the \$400 million of tax cuts provided by the act (over 11 years).

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<sup>23</sup> The Conference Report statement, but not the statutory language itself, further states that (1) the IRS is directed to revise the Form 720, Quarterly Federal Excise Tax Return, to collect the information necessary to prepare the report; and (2) the report also must include total tire tax collections for an equivalent one-year period preceding October 22, 2004, the date of enactment of the American Jobs Creation Act of 2004.