TECHNICAL EXPLANATION OF H.R. 7060, THE "RENEWABLE ENERGY AND JOB CREATION TAX ACT OF 2008," AS SCHEDULED FOR CONSIDERATION BY THE HOUSE OF REPRESENTATIVES ON SEPTEMBER 25, 2008

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 technical explanation of H.R. 7060, the "Renewable Energy and Job Creation Tax Act of 2008" as scheduled for consideration by the House of Representatives on September 25, 2008.

[1] This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of H.R. 7060, the "Renewable Energy and Job Creation Tax Act of 2008," as Scheduled for Consideration by the House of Representatives on September 25, 2008* (JCX-75-08), September 25, 2008. This document can also be found on our website at www.jct.gov.

TITLE I – ENERGY TAX INCENTIVES

A. Energy Production Incentives

1. Extension and modification of the credit for the production of electricity from renewable resources (secs. 101 and 102 of the bill and sec. 45 of the Code)

Present Law

In general

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities.[2] 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 an unrelated person.

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 was 2.1 cents per kilowatt-hour for 2008. 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.

Credit phaseout

The amount of credit a taxpayer may claim is phased out as the market price of electricity exceeds certain threshold levels. The electricity production credit is reduced over a 3 cent phaseout 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; 11.8 cents for 2008).

Reduced credit periods and credit amounts

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 placed in service before

[2] Sec. 45. In addition to the electricity production credit, section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities. Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

August 8, 2005, the 10-year credit period is reduced to five years commencing on the date the facility was originally placed in service. 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 (1 cent per kilowatt-hour for 2008).

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 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.[3] Generally, the general business credit for any taxable year may not exceed the amount by which the taxpayer's net income tax exceeds the greater of the tentative minimum tax or so much of the net regular tax liability as exceeds $25,000. Excess credits may be carried back one year and forward up to 20 years.

A taxpayer's tentative minimum tax is treated as being zero for purposes of determining the tax liability limitation with respect to 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.

[3] 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 trimmings; 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, construction or enlargement of a bypass channel, or the impoundment or any withholding of additional water from the natural stream channel.

Summary of credit rate and credit period by facility type

Table 1.–Summary of Section 45 Credit for Electricity Produced from Certain Renewable Resources

Eligible electricity production activity	Credit amount for 2008 (cents per kilowatt-hour)	Credit period for facilities placed in service on or before August 8, 2005 (years from placed-in-service date)	Credit period for facilities placed in service after August 8, 2005 (years from placed-in-service date)
Wind	2.1	10	10
Closed-loop biomass	2.1	10[1]	10
Open-loop biomass (including agricultural livestock waste nutrient facilities)	1.0	5[2]	10
Geothermal	2.1	5	10
Solar (pre-2006 facilities only)	2.1	5	10
Small irrigation power	1.0	5	10
Municipal solid waste (including landfill gas facilities and trash combustion facilities)	1.0	5	10
Qualified hydropower	1.0	N/A	10

[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 five-year credit period commences on January 1, 2005.

Taxation of cooperatives and their patrons

For Federal income tax purposes, a cooperative generally computes its income as if it were a taxable corporation, with one exception: the cooperative may exclude from its taxable income distributions of patronage dividends. Generally, a cooperative that is subject to the cooperative tax rules of subchapter T of the Code[4] is permitted a deduction for patronage dividends paid only to the extent of net income that is derived from transactions with patrons who are members of the cooperative.[5] The availability of such deductions from taxable income

[4] Secs. 1381-1383.

[5] Sec. 1382.

has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative.

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. The election must be made on a timely filed return for the taxable year and, once made, is irrevocable for such taxable year.

Explanation of Provision

The provision extends and modifies the electricity production credit.

Extension of placed-in-service date for qualifying facilities

The provision extends for two years and nine months (through September 30, 2011) the period during which qualified facilities producing electricity from closed-loop biomass, open-loop biomass, geothermal energy, small irrigation power, municipal solid waste, and qualified hydropower may be placed in service for purposes of the electricity production credit. The provision extends for one year (through 2009) the placed-in-service period for qualified wind facilities.

Addition of marine and hydrokinetic renewable energy as a qualified resource

The provision adds marine and hydrokinetic renewable energy as a qualified energy resource and marine and hydrokinetic renewable energy facilities as qualified facilities. Marine and hydrokinetic renewable energy is defined as energy derived from (1) waves, tides, and currents in oceans, estuaries, and tidal areas; (2) free flowing water in rivers, lakes, and streams; (3) free flowing water in an irrigation system, canal, or other man-made channel, including projects that utilize nonmechanical structures to accelerate the flow of water for electric power production purposes; or (4) differentials in ocean temperature (ocean thermal energy conversion). The term does not include energy derived from any source that uses a dam, diversionary structure (except for irrigation systems, canals, and other man-made channels), or impoundment for electric power production. A qualified marine and hydrokinetic renewable energy facility is any facility owned by the taxpayer and placed in service after the date of enactment and before October 1, 2011, that produces electric power from marine and hydrokinetic renewable energy and that has a nameplate capacity rating of at least 150 kilowatts.

Under the provision, marine and hydrokinetic renewable energy facilities subsume small irrigation power facilities. The provision, therefore, terminates as a separate category of qualified facility small irrigation power facilities placed in service on or after the date of enactment. Such facilities qualify for the electricity production credit as marine and hydrokinetic renewable energy facilities.

Phaseout replaced by limitation based on investment in facility

The provision replaces the electricity production credit phaseout with an annual limit on the total credits that may be claimed with respect to any qualified facility placed in service after 2009 based on the investment in the facility. Under the limitation, the electricity production credit determined for any taxable year may not exceed the eligible basis of the facility multiplied by a limitation percentage (the "applicable percentage") determined by the Secretary for the month during which the facility is originally placed in service. The applicable percentage for any month is the percentage that yields over a 10-year period amounts of limitation that have a present value equal to 35 percent of the eligible basis of the facility. The discount rate for purposes of this calculation is the greater of 4.5 percent or 110 percent of the long-term Federal rate. The provision does not impose this limitation on the credit for electricity produced at qualified wind facilities. Whether it will apply in the future is a determination for another Congress.

Generally, the eligible basis of a facility is the basis of such facility at the time it is originally placed in service. In the case of a qualified geothermal facility, the eligible basis for purposes of the limitation includes intangible drilling and development costs described in section 263(c).

At the election of the taxpayer, all qualified facilities which are part of the same project and which are placed in service during the same calendar year may be treated as a single facility placed in service at either the mid-point of such year or the first day of the following calendar year.

Special rules apply for the first and last year of a facility's 10-year credit period to allocate the limitation across a taxpayer's taxable years. In addition, if a facility's production is less than the limitation amount for any taxable year, the limitation with respect to such facility for the next taxable year is increased by the amount of the unused limitation. Similarly, if the electricity production credit exceeds the limitation amount for any taxable year, but falls under the limit the following year, the credit for the following taxable year is increased, up to that year's limitation amount, by the amount of such excess, but not beyond the facility's 10-year credit eligibility period.

Clarification of the definition of trash combustion facility

The provision modifies the definition of qualified trash combustion facility to permit facilities that use municipal solid waste as part of an electricity generation process to qualify for the electricity production credit, whether or not such facilities utilize a process that involves burning the waste.

Modification of the definitions of open-loop biomass facility and closed-loop biomass facility to include new units added to existing qualified facilities

The definitions of qualified open-loop biomass facility and qualified closed-loop biomass facility are modified to include new power generation units placed in service at existing qualified facilities, but only to the extent of the increased amount of electricity produced at such facilities by reason of such new units.

Modification to definition of nonhydroelectric dam for purposes of qualified hydropower production

The provision modifies the definition of nonhydroelectric dam for purposes of qualified hydropower production. Under the new definition, the nonhydroelectric dam must have been operated for flood control, navigation, or water supply purposes.

The provision replaces the requirement that the project not enlarge the diversion structure or bypass channel, or impound additional water from the natural stream channel, with a requirement that the project be operated so that the water surface elevation at any given location and time be the same as would occur in absence of the project, subject to any license requirements aimed at improving the environmental quality of the affected waterway.

The hydroelectric project installed on the nonhydroelectric dam must still be licensed by the Federal Energy Regulatory Commission and meet all other applicable environmental, licensing, and regulatory requirements, including applicable fish passage requirements.

Effective Date

The extension of the electricity production credit is effective for facilities originally placed in service after 2008. The addition of marine and hydrokinetic renewable energy as a qualified energy resource is effective for electricity produced at qualified facilities and sold after the date of enactment in taxable years ending after such date. The repeal of the credit phaseout adjustment is effective for taxable years ending after 2008. The limitation based on investment is effective for facilities originally placed in service after 2009. The clarification of the definition of trash combustion facility is effective for electricity produced and sold after the date of enactment. The modifications to the definitions of open-loop biomass facility, closed-loop biomass facility, and nonhydroelectric dam are effective for property placed in service after the date of enactment.

2. Extension and modification of energy credit (sec. 103 of the bill and sec. 48 of the Code)

Present Law

In general

A nonrefundable, 10-percent business energy credit[6] is allowed for the cost of new property that is equipment that either (1) uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) is used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage. Property used to generate energy for the purposes of heating a swimming pool is not eligible solar energy property.

[6] Sec. 48.

The energy credit is a component of the general business credit[7] and as such is subject to the alternative minimum tax. An unused general business credit generally may be carried back one year and carried forward 20 years.[8] The taxpayer's basis in the property is reduced by one-half of the amount of the credit claimed. For projects whose construction time is expected to equal or exceed two years, the credit may be claimed as progress expenditures are made on the project, rather than during the year the property is placed in service. Similarly, the credit only applies to expenditures made after the effective date of the provision.

In general, property that is public utility property is not eligible for the credit. Public utility property is property that is used predominantly in the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas through a local distribution system, or (3) telephone service, domestic telegraph services, or other communication services (other than international telegraph services), if the rates for such furnishing or sale have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission. This rule is waived in the case of telecommunication companies' purchases of fuel cell and microturbine property.

Special rules for solar energy property

The credit for solar energy property is increased to 30 percent in the case of periods after December 31, 2005 and prior to January 1, 2009. Additionally, equipment that uses fiber-optic distributed sunlight to illuminate the inside of a structure is solar energy property eligible for the 30-percent credit.

Fuel cells and microturbines

The business energy credit also applies for the purchase of qualified fuel cell power plants, but only for periods after December 31, 2005 and prior to January 1, 2009. The credit rate is 30 percent.

A qualified fuel cell power plant is an integrated system composed of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, and (2) has an electricity-only generation efficiency of greater than 30 percent and a capacity of at least on-half kilowatt. The credit may not exceed $500 for each 0.5 kilowatt of capacity.

The business energy credit also applies for the purchase of qualifying stationary microturbine power plants, but only for periods after December 31, 2005 and prior to January 1, 2009. The credit is limited to the lesser of 10 percent of the basis of the property or $200 for each kilowatt of capacity.

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

[8] Sec. 39.

A qualified stationary microturbine power plant is an integrated system comprised of a gas turbine engine, a combustor, a recuperator or regenerator, a generator or alternator, and associated balance of plant components that converts a fuel into electricity and thermal energy. Such system also includes all secondary components located between the existing infrastructure for fuel delivery and the existing infrastructure for power distribution, including equipment and controls for meeting relevant power standards, such as voltage, frequency and power factors. Such system must have an electricity-only generation efficiency of not less that 26 percent at International Standard Organization conditions and a capacity of less than 2,000 kilowatts.

Additionally, for purposes of the fuel cell and microturbine credits, and only in the case of telecommunications companies, the general present-law section 48 restriction that would otherwise prohibit telecommunication companies from claiming the new credit due to their status as public utilities is waived.

Explanation of Provision

The provision extends the otherwise expiring credits and credit rates for eight years, through December 31, 2016. The provision raises the $500 per half kilowatt of capacity credit cap with respect to fuel cells to $1500 per half kilowatt of capacity. Also, the restrictions on public utility property being eligible for the credit are repealed. The provision makes the energy credit allowable against the alternative minimum tax.

The provision makes combined heat and power ("CHP") property eligible for the 10-percent energy credit through December 31, 2016.

CHP property is property: (1) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) that has an electrical capacity of not more than 50 megawatts or a mechanical energy capacity of no more than 67,000 horsepower or an equivalent combination of electrical and mechanical energy capacities; (3) that produces at least 20 percent of its total useful energy in the form of thermal energy that is not used to produce electrical or mechanical power, and produces at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof); and (4) the energy efficiency percentage of which exceeds 60 percent. CHP property does not include property used to transport the energy source to the generating facility or to distribute energy produced by the facility.

The otherwise allowable credit with respect to CHP property is reduced to the extent the property has an electrical capacity or mechanical capacity in excess of any applicable limits. Property in excess of the applicable limit (15 megawatts or a mechanical energy capacity of more than 20,000 horsepower or an equivalent combination of electrical and mechanical energy capacities) is permitted to claim a fraction of the otherwise allowable credit. The fraction is equal to the applicable limit divided by the capacity of the property. For example, a 45 megawatt property would be eligible to claim 15/45ths, or one third, of the otherwise allowable credit. Again, no credit is allowed if the property exceeds the 50 megawatt or 67,000 horsepower limitations described above.

Additionally, the provision provides that systems whose fuel source is at least 90 percent open-loop biomass and that would qualify for the credit but for the failure to meet the efficiency standard are eligible for a credit that is reduced in proportion to the degree to which the system fails to meet the efficiency standard. For example, a system that would otherwise be required to meet the 60-percent efficiency standard, but which only achieves 30-percent efficiency, would be permitted a credit equal to one-half of the otherwise allowable credit (i.e., a 5-percent credit).

Effective Date

The provision is generally effective on the date of enactment.

The provision relating to combined heat and power property applies to periods after the date of enactment, in taxable years ending after such date, under rules similar to the rules of section 48(m) of the Code (as in effect on the day before the enactment of the Revenue Reconciliation Act of 1990).

The provision relating to the restrictions on public utility property applies to periods after February 13, 2008, in taxable years ending after such date, under rules similar to the rules of section 48(m) of the Code (as in effect on the day before the enactment of the Revenue Reconciliation Act of 1990).

The allowance of the credit against the alternative minimum tax is effective for credits determined in taxable years beginning after the date of enactment.

3. Credit for residential energy efficient property (sec. 104 of the bill and sec. 25D of the Code)

Present Law

Code section 25D provides a personal tax credit for the purchase of qualified solar electric property and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs. The credit is equal to 30 percent of qualifying expenditures, with a maximum credit for each of these systems of property of $2,000. Section 25D also provides a 30 percent credit for the purchase of qualified fuel cell power plants. The credit for any fuel cell may not exceed $500 for each 0.5 kilowatt of capacity.

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

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

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

The credit applies to property placed in service prior to January 1, 2009.

Explanation of Provision

The provision extends the credit for eight years (through December 31, 2016) and allows the credit to be claimed against the alternative minimum tax. Additionally, the credit cap (currently $2,000) for solar electric property is eliminated.

The provision provides a new 30 percent credit for qualified small wind energy property expenses made by the taxpayer during the taxable year. The credit is limited to $500 with respect to each half kilowatt of capacity, not to exceed $4,000. The credit for qualified small wind energy property is allowed for expenditures after December 31, 2007, for property placed in service prior to January 1, 2017.

Qualified small wind energy property expenditures are expenditures for property that uses a wind turbine to generate electricity for use in a dwelling unit located in the U.S. and used as a residence by the taxpayer.

The provision also provides a 30 percent credit for qualified geothermal heat pump property expenditures, not to exceed $2,000. The term "qualified geothermal heat pump property expenditure" means an expenditure for qualified geothermal heat pump property installed on or in connection with a dwelling unit located in the United States and used as a residence by the taxpayer. Qualified geothermal heat pump property means any equipment which (1) uses the ground or ground water as a thermal energy source to heat the dwelling unit or as a thermal energy sink to cool such dwelling unit, and (2) meets the requirements of the Energy Star program which are in effect at the time that the expenditure for such equipment is made. The credit for qualified geothermal heat pump property is allowed for expenditures after December 31, 2007, for property placed in service prior to January 1, 2017.

Effective Date

Generally, the provision is effective for taxable years beginning after December 31, 2007, for property placed in service prior to January 1, 2017. The removal of the solar electric credit cap is effective for property placed in service after the date of enactment.

4. Special rule to implement FERC and State electric restructuring policy (sec. 105 of the bill and sec. 451(i) of the Code)

Present Law

Generally, a taxpayer selling property recognizes gain to the extent the sales price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

One such special tax provision permits taxpayers to elect to recognize gain from qualifying electric transmission transactions ratably over an eight-year period beginning in the year of sale if the amount realized from such sale is used to purchase exempt utility property within the applicable period[9] (the "reinvestment property"). If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain is recognized to the extent of such excess in the year of the qualifying electric transmission transaction.

A qualifying electric transmission transaction is the sale or other disposition of property used by the taxpayer in the trade or business of providing electric transmission services, or an ownership interest in such an entity, to an independent transmission company prior to January 1, 2008. In general, an independent transmission company is defined as: (1) an independent transmission provider[10] approved by the FERC; (2) a person (i) who the FERC determines under section 203 of the Federal Power Act (or by declaratory order) is not a "market participant" and (ii) whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider before the close of the period specified in such authorization, but not later than December 31, 2007; or (3) in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, (i) a person which is approved by that Commission as consistent with Texas State law regarding an independent transmission organization, or (ii) a political subdivision, or affiliate thereof, whose transmission facilities are under the operational control of an organization described in (i).

Exempt utility property is defined as: (1) property used in the trade or business of generating, transmitting, distributing, or selling electricity or producing, transmitting, distributing, or selling natural gas, or (2) stock in a controlled corporation whose principal trade or business consists of the activities described in (1).

If a taxpayer is a member of an affiliated group of corporations filing a consolidated return, the reinvestment property may be purchased by any member of the affiliated group (in lieu of the taxpayer).

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[9] The applicable period for a taxpayer to reinvest the proceeds is four years after the close of the taxable year in which the qualifying electric transmission transaction occurs.

[10] For example, a regional transmission organization, an independent system operator, or an independent transmission company.

Explanation of Provision

The provision extends the treatment under the present-law deferral provision to sales or dispositions by a qualified electric utility prior to January 1, 2010. A qualified electric utility is defined as an electric utility, which as of the date of the qualifying electric transmission transaction, is vertically integrated in that it is both (1) a transmitting utility (as defined in the Federal Power Act)[11] with respect to the transmission facilities to which the election applies, and (2) an electric utility (as defined in the Federal Power Act).[12]

The definition of an independent transmission company is modified for taxpayers whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider, which under the provision must take place no later than four years after the close of the taxable year in which the transaction occurs.

The provision also changes the definition of exempt utility property to exclude property that is located outside the United States.

Effective Date

The extension provision applies to transactions after December 31, 2007. The change in the definition of an independent transmission company is effective as if included in section 909 of the American Jobs Creation Act of 2004. The exclusion for property located outside the United States applies to transactions after the date of enactment.

5. Expansion and modification of the advanced coal project credit (sec. 111 of the bill and secs. 48A of the Code)

Present Law

An investment tax credit is available for power generation projects that use integrated gasification combined cycle ("IGCC") or other advanced coal-based electricity generation technologies. The credit amount is 20 percent for investments in qualifying IGCC projects and 15 percent for investments in qualifying projects that use other advanced coal-based electricity generation technologies.

To qualify, an advanced coal project must be located in the United States and use an advanced coal-based generation technology to power a new electric generation unit or to retrofit

[11] Sec. 3(23), 16 U.S.C. 796, defines "transmitting utility" as any electric utility, qualifying cogeneration facility, qualifying small power production facility, or Federal power marketing agency which owns or operates electric power transmission facilities which are used for the sale of electric energy at wholesale.

[12] Sec. 3(22), 16 U.S.C. 796, defines "electric utility" as any person or State agency (including any municipality) which sells electric energy; such term includes the Tennessee Valley Authority, but does not include any Federal power marketing agency.

or repower an existing unit. Generally, an electric generation unit using an advanced coal-based technology must be designed to achieve a 99 percent reduction in sulfur dioxide and a 90 percent reduction in mercury, as well as to limit emissions of nitrous oxide and particulate matter.[13]

The fuel input for a qualifying project, when completed, must use at least 75 percent coal. The project, consisting of one or more electric generation units at one site, must have a nameplate generating capacity of at least 400 megawatts, and the taxpayer must provide evidence that a majority of the output of the project is reasonably expected to be acquired or utilized.

Credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. Certifications are issued using a competitive bidding process. The Secretary of Treasury must establish a certification program no later than 180 days after August 8, 2005,[14] and each project application must be submitted during the three-year period beginning on the date such certification program is established. An applicant for certification has two years from the date the Secretary accepts the application to provide the Secretary with evidence that the requirements for certification have been met. Upon certification, the applicant has five years from the date of issuance of the certification to place the project in service.

The Secretary of Treasury may allocate $800 million of credits to IGCC projects and $500 million to projects using other advanced coal-based electricity generation technologies. Qualified projects must be economically feasible and use the appropriate clean coal technologies. With respect to IGCC projects, credit-eligible investments include only investments in property associated with the gasification of coal, including any coal handling and gas separation equipment. Thus, investments in equipment that could operate by drawing fuel directly from a natural gas pipeline do not qualify for the credit.

In determining which projects to certify that use IGCC technology, the Secretary must allocate power generation capacity in relatively equal amounts to projects that use bituminous coal, subbituminous coal, and lignite as primary feedstock. In addition, the Secretary must give high priority to projects which include greenhouse gas capture capability, increased by-product utilization, and other benefits.

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[13] For advanced coal project certification applications submitted after October 2, 2006, an electric generation unit using advanced coal-based generation technology designed to use subbituminous coal can meet the performance requirement relating to the removal of sulfur dioxide if it is designed either to remove 99 percent of the sulfur dioxide or to achieve an emission limit of 0.04 pounds of sulfur dioxide per million British thermal units on a 30-day average.

[14] The Secretary issued guidance establishing the certification program on February 21, 2006 (IRS Notice 2006-24).

Explanation of Provision

The provision increases to 30 percent the credit rate for IGCC and other advanced coal projects. In addition, the provision permits the Secretary to allocate an additional $950 million of credits to qualifying projects.

The provision modifies the definition of qualifying projects to require that projects include equipment which separates and sequesters at least 65 percent of the project's total carbon dioxide emissions. This percentage increases to 70 percent if the credits are later reallocated by the Secretary. The Secretary is required to recapture the benefit of any allocated credit if a project fails to attain or maintain these carbon dioxide separation and sequestration requirements.

In selecting projects, the provision requires the Secretary to give high priority to applicants who have a research partnership with an eligible educational institution. In addition, the Secretary must give the highest priority to projects with the greatest separation and sequestration percentage of total carbon dioxide emissions. The provision also requires that the Secretary disclose which projects receive credit allocations, including the identity of the taxpayer and the amount of the credit awarded.

Effective Date

The provision authorizing the Secretary to allocate additional credits is effective on the date of enactment. The increased credit rate along with the carbon dioxide sequestration and other rules are effective with respect to these additional credit allocations.

6. Expansion and modification of the coal gasification investment credit (sec. 112 of the bill and sec. 48B of the Code)

Present Law

A 20 percent investment tax credit is available for investments in certain qualifying coal gasification projects. Only property which is part of a qualifying gasification project and necessary for the gasification technology of such project is eligible for the gasification credit.

Qualified gasification projects convert coal, petroleum residue, biomass, or other materials recovered for their energy or feedstock value into a synthesis gas composed primarily of carbon monoxide and hydrogen for direct use or subsequent chemical or physical conversion. Qualified projects must be carried out by an eligible entity, defined as any person whose application for certification is principally intended for use in a domestic project which employs domestic gasification applications related to (1) chemicals, (2) fertilizers, (3) glass, (4) steel, (5) petroleum residues, (6) forest products, and (7) agriculture, including feedlots and dairy operations.

Credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. Certifications are issued using a competitive bidding process. The Secretary of Treasury must establish a certification program no later than 180 days

after August 8, 2005,[15] and each project application must be submitted during the 3-year period beginning on the date such certification program is established. The Secretary of Treasury may not allocate more than $350 million in credits. In addition, the Secretary may certify a maximum of $650 million in qualified investment as eligible for credit with respect to any single project.

Explanation of Provision

The provision expands and modifies the coal gasification investment credit. The provision increases gasification project credit rate to 30 percent and permits the Secretary to allocate an additional $150 million of credits to qualified projects that separate and sequester at least 75 percent of total carbon dioxide emissions. The Secretary is required to recapture the benefit of any allocated credit if a project fails to attain or maintain these carbon dioxide separation and sequestration requirements.

In selecting projects, the provision requires the Secretary to give high priority to applicants who have a research partnership with an eligible educational institution. In addition, the Secretary must give the highest priority to projects with the greatest separation and sequestration percentage of total carbon dioxide emissions. The provision also requires that the Secretary disclose which projects receive credit allocations, including the identity of the taxpayer and the amount of the credit awarded.

Effective Date

The provision authorizing the Secretary to allocate additional credits is effective on the date of enactment. The increased credit rate along with the carbon dioxide sequestration and other rules are effective with respect to these additional credit allocations.

7. Extend excise tax on coal at current rates (sec. 113 of the bill and sec. 4121 of the Code)

Present Law

A $1.10 per ton excise tax is imposed on coal sold by the producer from underground mines in the United States. The rate is 55 cents per ton on coal sold by the producer from surface mining operations. In either case, the tax cannot exceed 4.4 percent of the coal producer's selling price. No tax is imposed on lignite.

Gross receipts from the excise tax are dedicated to the Black Lung Disability Trust Fund to finance benefits under the Federal Black Lung Benefits Act. Currently, the Black Lung Disability Trust Fund is in a deficit position because previous spending was financed with interest-bearing advances from the General Fund.

The coal excise tax rates are scheduled to decline to 50 cents per ton for underground-mined coal and 25 cents per ton for surface-mined coal (and the cap is scheduled to decline to

[15] The Secretary issued guidance establishing the certification program on February 21, 2006 (IRS Notice 2006-25).

two percent of the selling price) for sales after January 1, 2014, or after any earlier January 1 on which there is no balance of repayable advances from the Black Lung Disability Trust Fund to the General Fund and no unpaid interest on such advances.

Explanation of Provision

The provision retains the excise tax on coal at the current rates until the earlier of the following dates: (1) January 1, 2019, and (2) the day after the first December 31 after 2007 on which the Black Lung Disability Trust Fund has repaid, with interest, all amounts borrowed from the General Fund. On and after that date, the reduced rates of $.50 per ton for coal from underground mines and $.25 per ton for coal from surface mines will apply and the tax per ton of coal will be capped at two percent of the amount for which it is sold by the producer.

Effective Date

The provision is effective on the date of enactment.

8. Temporary procedures for excise tax refunds on exported coal (sec. 114 of the bill)

Present Law

In general

Excise tax is imposed on coal, except lignite, produced from mines located in the United States.[16] The producer of the coal is liable for paying the tax to the IRS. Producers generally recover the tax from their purchasers.

The Export Clause of the U.S. Constitution provides that "no Tax or Duty shall be laid on Articles exported from any State."[17] Courts have determined that the Export Clause applies to excise tax on exported coal, and therefore such taxes are subject to a claim for refund.[18] The Supreme Court has ruled that taxpayers seeking a refund of such taxes must proceed under the rules of the Internal Revenue Code.[19]

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[16] Sec. 4121(a). Throughout the relevant period, the rate of tax on coal from underground mines has been $1.10 per ton and the rate of tax on coal from surface mines has been $0.55 per ton. These rates are subject to a limitation of 4.4 percent of the producer's sale price. Sec. 4121(b).

[17] U.S. Const., art. I, sec. 9, cl. 5.

[18] See *Ranger Fuel Corp. v. United States*, 33 F. Supp. 2d 466 (E.D. Va. 1998). The IRS subsequently provided guidance regarding how taxpayers may assure that exported coal would not be subject to excise tax. Notice 2000-28, 2000-1 C.B. 1116.

[19] *United States v. Clintwood Elkhorn Mining Co.*, 128 S. Ct. 1511 (April 15, 2008). Prior to the Supreme Court's decision, some courts had allowed taxpayers to bring claims under the Tucker Act, 28 U.S.C. sec. 1491(a), which confers jurisdiction upon the Court of Federal Claims "to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or

Claims under the Code

In order to obtain a refund of taxes on exported coal, a claimant must satisfy the following requirements of the Code and case law:

1. A claim for refund must be filed within three years from the time the return was filed, or within two years from the time the tax was paid, whichever period expires later;[20]

2. The person must establish that the goods were in the stream of export when the excise tax was imposed;[21]

3. The claimant must establish that it has borne the tax. More specifically, the claimant must establish that the tax was neither included in the price of the article nor collected from the purchaser (or if so, that the claimant has repaid the amount of tax to the ultimate purchaser), that the claimant has repaid or agreed to repay the tax to the ultimate vendor or has obtained the written consent of such ultimate vendor to the allowance of the claim, or that the claimant has filed the written consent of the ultimate purchaser to the allowance of the claim;[22]

4. In the case of an exporter or shipper of an article exported to a foreign country or shipped to a possession, the amount of tax may be refunded to the exporter or shipper if the person who paid the tax waives its claim to such amount;[23] and

5. A civil action for refund must not be begun before the expiration of six months from the date of filing the claim (unless the claim has been disallowed during that time), nor after the expiration of two years from the date of mailing the notice of claim disallowance.[24]

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any regulation of an executive department …." Lower courts had held that such a Tucker Act claim was subject to the Tucker Act's six-year statute of limitations and was not subject to the requirements of the Code. *Venture Coal Sales Co. v. U.S.*, 93 AFTR 2d 2004-2495 (Fed. Cir. 2004); *Cyprus Amax Coal Co. v. U.S.*, 205 F.3d 1369 (Fed. Cir. 2000). The Supreme Court held that the stricter Code rules apply to these refund claims.

[20] Sec. 6511(a).

[21] See *Ranger Fuel Corp. v. United States*, 33 F. Supp. 2d 466 (E.D. Va. 1998). See also *United States v. International Business Machines Corp.*, 517 U.S. 843 (1996); *Joy Oil, Ltd. v. State Tax Commission*, 337 U.S. 286 (1949).

[22] Sec. 6416(a)(1).

[23] Sec. 6416(c).

[24] Sec. 6532(a).

In 2000, the Internal Revenue Service ("IRS") issued Notice 2000-28,[25] which summarizes the IRS position regarding claims for credits or refunds of excise taxes on exported coal and sets forth procedural rules relating to such claims. Under Notice 2000-28, a coal producer or exporter must provide the following information as part of its claim:

1. A statement by the person that paid the tax to the government that provides the quarter and the year for which the tax was reported on Form 720, the line number on such Form, the amount of tax paid on the coal, and the date of payment;

2. In the case of an exporter, a statement by the person that paid the tax to the government that such person has waived the right to claim a refund;

3. A statement that the claimant has evidence that the coal was in the stream of export when sold by the producer;

4. In the case of an exporter, proof of exportation;

5. In the case of a coal producer, a statement that the coal actually was exported; and

6. A statement that the claimant:

    a. has neither included the tax in the price of the coal nor collected the amount of the tax from its buyer,

    b. has repaid the amount of the tax to the ultimate purchaser of the coal, or

    c. has obtained the written consent of the ultimate purchaser of the coal to the allowance of the claim.

If the IRS disallows the claim, the claimant may proceed in a Federal district court or the Court of Federal Claims under 28 U.S.C. sec. 1346(a)(1), which grants these courts concurrent jurisdiction over "[a]ny civil action against the United States for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected … or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws."

With respect to claims under the Code allowed by the IRS or by a court, prejudgment interest is generally allowed.[26]

Explanation of Provision

The provision creates a new procedure under which certain coal producers and exporters may claim a refund of excise taxes imposed on coal exported from the United States. Coal

[25] Notice 2000-28, 2001-1 C.B. 1116.

[26] See sec. 6611; 28 U.S.C. sec. 2411.

producers or exporters that exported coal during the period beginning on or after October 1, 1990 and ending on or before the date of enactment of the provision, with respect to which a return was filed on or after October 1, 1990, and on or before the date of enactment, and that file a claim for refund not later than the close of the 30-day period beginning on the day of enactment, may obtain a refund from the Secretary of the Treasury of excise taxes paid on such exported coal and any interest accrued from the date of overpayment. Interest on such claims is computed under the Code.[27] The Secretary of the Treasury is required to determine whether to approve the claim within 180 days after such claim is filed, and to pay such claim not later than 180 days after making such determination.

In order to qualify for a refund under the provision, a coal producer must establish that it, or a party related to such coal producer, exported coal produced by such coal producer to a foreign country or shipped coal produced by such coal producer to a U.S. possession, the export or shipment of which was other than through an exporter that has filed a valid and timely claim for refund under the provision. An exporter must establish that it exported coal to a foreign country, shipped coal to a U.S. possession, or caused such coal to be so exported or shipped. Refunds to producers are to be made in an amount equal to the tax paid on exported coal. Exporters are to receive a payment equal to $0.825 per ton of exported coal.

Special rules apply if a court has rendered a judgment. If a coal producer or a party related to a coal producer has received, from a court of competent jurisdiction in the United States, a judgment in favor of such coal producer (or party related to such coal producer) that relates to the constitutionality of Federal excise tax paid on exported coal, then such coal producer is deemed to have established the export of coal to a foreign country or shipment of coal to a possession of the United States. If such coal producer is entitled to a payment under this provision, the amount of such payment is reduced by any amount awarded under such court judgment. Subject to the rules below, a coal exporter may file a claim notwithstanding that a coal producer or a party related to a coal producer has received a court judgment relating to the same coal.

Under the provision, the term "coal producer" means the person that owns the coal immediately after the coal is severed from the ground, without regard to the existence of any contractual arrangement for the sale or other disposition of the coal or the payment of any royalties between the producer and third parties. The term also includes any person who extracts coal from coal waste refuse piles or from the silt waste product which results from the wet washing or similar processing of coal. The term "exporter" means a person, other than a coal producer, that does not have an agreement with a producer or seller of such coal to sell or export such coal to a third party on behalf of such producer or seller, and that is indicated as the exporter of record in the shipper's export declaration or other documentation, or actually exported such coal to a foreign country, shipped such coal to a U.S. possession, or caused such coal to be so exported or shipped. The term "a party related to such coal producer" means a person that is related to such coal producer through any degree of common management, stock ownership, or voting control, is related, within the meaning of section 144(a)(3), to such coal

[27] See sec. 6621.

producer, or has a contract, fee arrangement, or any other agreement with such coal producer to sell such coal to a third party on behalf of such coal producer.

The provision does not apply with respect to excise tax on exported coal if a credit or refund of such tax has been allowed or made, or if a "settlement with the Federal Government" has been made with and accepted by the coal producer, a party related to such coal producer, or the exporter of such coal, as of the date that the claim is filed under the provision. The term "settlement with the Federal Government" does not include a settlement or stipulation entered into as of the date of enactment, if such settlement or stipulation contemplates a judgment with respect to which any party has filed an appeal or has reserved the right to file an appeal. In addition, the provision does not apply to the extent that a credit or refund of tax on exported coal has been paid to any person, regardless of whether such credit or refund occurs prior to, or after, the date of enactment.

The provision is not intended to create any inference than an exporter has standing to commence, or intervene in, any judicial or administrative proceeding concerning a claim for refund by a coal producer of any Federal or State tax, fee, or royalty paid by the coal producer. Similarly, the provision is not intended to create any inference that a coal producer has standing to commence, or intervene in, any judicial or administrative proceeding concerning a claim for refund by an exporter of any Federal or State tax, fee, or royalty paid by the producer and alleged to have been passed on to an exporter.

Effective Date

The provision applies to claims on coal exported on or after October 1, 1990 through the date of enactment, with respect to amounts of tax for which a return was filed on or after October 1, 1990, and on or before the date of enactment, and for which a claim for refund is filed not later than the close of the 30-day period beginning on the date of enactment.

9. Carbon audit of provisions of the tax code (sec. 115 of the bill)

Present Law

Present law does not require a review of the Code for provisions that affect carbon emissions and climate. The National Research Council is part of the National Academies. The National Academy of Sciences serves to investigate, examine, experiment and report upon any subject of science whenever called upon to do so by any department of the government. The National Research Council was organized by the National Academy of Sciences in 1916 and is its principal operating agency for conducting science policy and technical work.

Explanation of Provision

The provision directs the Secretary to request that the National Academy of Sciences undertake a comprehensive review of the Code to identify the types of and specific tax provisions that have the largest effects on carbon and other greenhouse gas emissions and to

generally estimate the magnitude of those effects.[28] The report should identify the provisions of the Code that are most likely to have significant effects on carbon emissions and discuss the importance of controlling carbon and greenhouse gas emissions as part of a comprehensive national strategy for reducing U.S. contributions to global climate change.[29] The report will describe the processes by which the tax provisions affect emissions (both directly and indirectly), assess the relative influence of the identified provisions, and evaluate the potential for changes in the Code to reduce carbon emissions. The report also will identify other provisions of the Code that may have significant influence on other factors affecting climate change.

Within two years of the date of enactment, the National Academy of Sciences is to submit to Congress a report containing the results of the review. The provision authorizes the appropriation of $1,500,000 to carry out the review.

Effective Date

The provision is effective on the date of enactment.

[28] A detailed quantitative analysis is not required. It is envisioned that the review will catalogue and provide a general analysis of the effect of each identified provision.

[29] "Greenhouse gas emissions" include, but are not limited to, methane, nitrous oxide, ozone, and fluorinated hydrocarbons.

B. Transportation and Domestic Fuel Security Provisions

1. Inclusion of cellulosic biofuel in bonus depreciation for biomass ethanol plant property (sec. 121 of the bill and sec. 168(l) of the Code)

Present Law

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

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

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

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

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

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

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

Explanation of Provision

The provision changes the definition of qualified property. Under the provision, qualified property includes cellulosic biofuel, which is defined as any liquid fuel which is produced from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis.

Effective Date

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

2. Credits for biodiesel and renewable diesel (sec. 122 of the bill and secs. 40A, 6426, and 6427 of the Code)

Present Law

Income tax credit

Overview

The Code provides an income tax credit for biodiesel fuels (the "biodiesel fuels credit").[30] The biodiesel fuels credit is the sum of three credits: (1) the biodiesel mixture credit, (2) the biodiesel credit, and (3) the small agri-biodiesel producer credit. The biodiesel fuels credit is treated as a general business credit. The amount of the biodiesel fuels credit is includable in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the biodiesel excise tax credit and payment provisions discussed below. The credit does not apply to fuel sold or used after December 31, 2008.

Biodiesel is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the Environmental Protection Agency under section 211 of the Clean Air Act and (2) the requirements of the American Society of Testing and Materials ("ASTM") D6751. Agri-biodiesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, or animal fats.

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

[30] Sec. 40A.

Biodiesel mixture credit

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

Biodiesel credit

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

Small agri-biodiesel producer credit

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

Biodiesel mixture excise tax credit

The Code also provides an excise tax credit for biodiesel mixtures.[31] The credit is 50 cents for each gallon of biodiesel used by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of the taxpayer. In the case of agri-biodiesel, the credit is $1.00 per gallon. A biodiesel mixture is a mixture of biodiesel and diesel fuel that (1) is sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) is used as a fuel by the taxpayer producing such mixture. No credit is allowed unless the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.[32]

[31] Sec. 6426(c).

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

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

Payments with respect to biodiesel fuel mixtures

If any person produces a biodiesel fuel mixture in such person's trade or business, the Secretary is to pay such person an amount equal to the biodiesel mixture credit.[33] To the extent the biodiesel fuel mixture credit exceeds the section 4081 liability of a person, the Secretary is to pay such person an amount equal to the biodiesel fuel mixture credit with respect to such mixture.[34] Thus, if the person has no section 4081 liability, the credit is refundable. The Secretary is not required to make payments with respect to biodiesel fuel mixtures sold or used after December 31, 2008.

Renewable diesel

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

For purposes of the Code, renewable diesel is generally treated the same as biodiesel. Like biodiesel, the incentive may be taken as an income tax credit, an excise tax credit, or as a payment from the Secretary.[35] The incentive for renewable diesel is $1.00 per gallon. There is no small producer credit for renewable diesel. The incentives for renewable diesel expire after December 31, 2008.

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

Explanation of Provision

The provision extends an additional year (through December 31, 2009) the income tax credit, excise tax credit, and payment provisions for biodiesel (including agri-biodiesel) and

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[33] Sec. 6427(e).

[34] Sec. 6427(e)(1) and sec. 6427(e)(3).

[35] Secs. 40A(f), 6426(c), and 6427(e).

renewable diesel. The provision provides that both biodiesel and agri-biodiesel are entitled to a credit of $1.00 per gallon.

The provision modifies the definition of renewable diesel. The provision eliminates the requirement that the fuel be made using a thermal depolymerization process. The provision also permits the Secretary to identify standards equivalent to ASTM D975 and ASTM D396 for renewable diesel. Thus, under the provision, renewable diesel is liquid fuel derived from biomass which meets (a) the registration requirements for fuels and fuel additives established by the EPA under section 211 of the Clean Air Act, and (b) the requirements of the ASTM D975, ASTM D396, or other equivalent standard approved by the Secretary. The provision also provides that renewable diesel includes biomass fuel that meets a Department of Defense military specification for jet fuel or an ASTM for aviation turbine fuel ("renewable jet fuel"). For purposes of the mixture credit, kerosene is treated as diesel fuel when in a mixture with renewable jet fuel.

The provision also overrides IRS Notice 2007-37 with respect to co-produced fuel, providing that renewable diesel does not include any fuel derived from co-processing biomass with a feedstock that is not biomass. The de minimis use of catalysts, such as hydrogen, is permitted under the provision.

Effective Date

The provision is generally effective for fuel produced, and sold or used, after December 31, 2008. The provision making co-produced fuel ineligible for the renewable diesel incentives is effective for fuel produced, and sold or used, after February 13, 2008.

3. Clarification that credits for fuel are designed to provide an incentive for United States production (sec. 123 of the bill and secs. 40, 40A, 6426 and 6427 of the Code)

Present Law

The Code provides per-gallon incentives relating to the following qualified fuels: alcohol (including ethanol), biodiesel (including agri-biodiesel), renewable diesel, and certain alternative fuels.[36] The incentives may be taken as an income tax credit, excise tax credit or payment. The provisions are coordinated so that a gallon of qualified fuel is only taken into account once. If the qualified fuel is part of a qualified fuel mixture, the incentives apply only to the amount of qualified fuel in the mixture. The Code also provides an income tax credit for cellulosic biofuel. That credit is limited to fuel produced and sold in the United States. The cellulosic biofuel credit does not apply after December 31, 2012. Other than for cellulosic biofuel, the Code is silent as to the geographic limitations on where the fuel must be produced, used, or sold.

For alcohol, other than ethanol, the amount of the credit is 60 cents per gallon. For ethanol, the credit is 51 cents per gallon for calendar year 2008. An extra 10 cents per gallon

[36] See secs. 40, 40A, 6426, and 6427(e).

available for small ethanol producers. The alcohol incentives generally are available through December 31, 2010.

The amount of the credit for biodiesel is 50 cents. For agri-biodiesel and renewable diesel, the credit amount is $1.00 per gallon. An extra 10 cents per gallon is available for small producers of agri-biodiesel. The biodiesel, agri-biodiesel and renewable diesel incentives do not apply after December 31, 2008.

The credit amount for alternative fuels is 50 cents per gallon. The incentives for alternative fuels expire do not apply after September 30, 2009 (after September 30, 2014, in the case of liquefied hydrogen).

Explanation of Provision

The provision provides that fuel that is produced outside the United States for use as a fuel outside the United States is ineligible for the per-gallon tax incentives relating to alcohol, biodiesel, renewable diesel, and alternative fuel. For example, fuel in the following situations is ineligible for incentives: (1) biodiesel, which is not in a mixture, that is both produced and used outside the United States, (2) foreign-produced biodiesel that is used to make a qualified mixture outside of the United States for foreign use, and (3) foreign-produced biodiesel that is used to make a qualified mixture in the United States that is then exported for foreign use.

Effective Date

The provision is effective for claims for credit or payment made on or after May 15, 2008.

4. Alternative motor vehicle credit and plug-in electric vehicle credit (sec. 124 of the bill and sec. 30B and new sec. 30D of the Code)

Present Law

In general

A credit is available for each new qualified fuel cell vehicle, hybrid vehicle, advanced lean burn technology vehicle, and alternative fuel vehicle placed in service by the taxpayer during the taxable year.[37] In general, the credit amount varies depending upon the type of technology used, the weight class of the vehicle, the amount by which the vehicle exceeds certain fuel economy standards, and, for some vehicles, the estimated lifetime fuel savings. The credit generally is available for vehicles purchased after 2005. The credit terminates after 2009, 2010, or 2014, depending on the type of vehicle.

In general, the credit is allowed to the vehicle owner, including the lessor of a vehicle subject to a lease. If the use of the vehicle is described in paragraphs (3) or (4) of section 50(b)

[37] Sec. 30B.

(relating to use by tax-exempt organizations, governments, and foreign persons) and is not subject to a lease, the seller of the vehicle may claim the credit so long as the seller clearly discloses to the user in a document the amount that is allowable as a credit. A vehicle must be used predominantly in the United States to qualify for the credit.

Fuel cell vehicles

A qualified fuel cell vehicle is a motor vehicle that is propelled by power derived from one or more cells that convert chemical energy directly into electricity by combining oxygen with hydrogen fuel that is stored on board the vehicle and may or may not require reformation prior to use. A qualified fuel cell vehicle must be purchased before January 1, 2015. The amount of credit for the purchase of a fuel cell vehicle is determined by a base credit amount that depends upon the weight class of the vehicle and, in the case of automobiles or light trucks, an additional credit amount that depends upon the rated fuel economy of the vehicle compared to a base fuel economy. For these purposes the base fuel economy is the 2002 model year city fuel economy rating for vehicles of various weight classes.[38] Table 2, below, shows the base credit amounts.

Table 2.–Base Credit Amount for Fuel Cell Vehicles

Vehicle Gross Weight Rating (pounds)	Credit Amount
Vehicle ≤ 8,500	$8,000
8,500 < vehicle ≤ 14,000	$10,000
14,000 < vehicle ≤ 26,000	$20,000
26,000 < vehicle	$40,000

In the case of a fuel cell vehicle weighing less than 8,500 pounds and placed in service after December 31, 2009, the $8,000 amount in Table 2, above is reduced to $4,000.

Table 3, below, shows the additional credits for passenger automobiles or light trucks.

[38] See discussion surrounding Table 7, below.

Table 3.–Credit for Qualified Fuel Cell Vehicles

Credit	If Fuel Economy of the Fuel Cell Vehicle Is:	
	at least	**but less than**
$1,000	150% of base fuel economy	175% of base fuel economy
$1,500	175% of base fuel economy	200% of base fuel economy
$2,000	200% of base fuel economy	225% of base fuel economy
$2,500	225% of base fuel economy	250% of base fuel economy
$3,000	250% of base fuel economy	275% of base fuel economy
$3,500	275% of base fuel economy	300% of base fuel economy
$4,000	300% of base fuel economy	

Hybrid vehicles and advanced lean burn technology vehicles

Qualified hybrid vehicle

A qualified hybrid vehicle is a motor vehicle that draws propulsion energy from on-board 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 qualified hybrid vehicle must be placed in service before January 1, 2011 (January 1, 2010 in the case of a hybrid vehicle weighing more than 8,500 pounds).

Hybrid vehicles that are automobiles and light trucks

In the case of an automobile or light truck (vehicles weighing 8,500 pounds or less), the amount of credit for the purchase of a hybrid vehicle is the sum of two components: (1) a fuel economy credit amount that varies with the rated fuel economy of the vehicle compared to a 2002 model year standard and (2) a conservation credit based on the estimated lifetime fuel savings of the qualified vehicle compared to a comparable 2002 model year vehicle that is powered solely by a gasoline or diesel internal combustion engine. A qualified hybrid automobile or light truck must have a maximum available power[39] from the rechargeable energy storage system of at least four percent. In addition, the vehicle must meet or exceed certain Environmental Protection Agency ("EPA") emissions standards. For a vehicle with a gross vehicle weight rating of 6,000 pounds or less the applicable emissions standards are the Bin 5 Tier II emissions standards. For a vehicle with a gross vehicle weight rating greater than 6,000

[39] For hybrid passenger vehicles and light trucks, the term "maximum available power" means the maximum power available from the rechargeable energy storage system, during a standard 10 second pulse power or equivalent test, divided by such maximum power and the SAE net power of the heat engine. Sec. 30B(d)(3)(C)(i).

pounds and less than or equal to 8,500 pounds, the applicable emissions standards are the Bin 8 Tier II emissions standards.

Table 4, below, shows the fuel economy credit available to a hybrid passenger automobile or light truck whose fuel economy (on a gasoline gallon equivalent basis) exceeds that of a base fuel economy.

Table 4.–Fuel Economy Credit

Credit	If 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 5, below, shows the conservation credit.

Table 5.–Conservation Credit

Estimated Lifetime Fuel Savings (gallons of gasoline)	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

Advanced lean burn technology vehicles

The amount of credit for the purchase of an advanced lean burn technology vehicle is the sum of two components: (1) a fuel economy credit amount that varies with the rated fuel economy of the vehicle compared to a 2002 model year standard as described in Table 4, above, and (2) a conservation credit based on the estimated lifetime fuel savings of a qualified vehicle compared to a comparable 2002 model year vehicle as described in Table 5, above. The amounts of the credits are determined after an adjustment is made to account for the different BTU content of gasoline and the fuel utilized by the lean burn technology vehicle.

A qualified advanced lean burn technology vehicle is a passenger automobile or a light truck that incorporates direct injection, achieves at least 125 percent of the 2002 model year city fuel economy, and for 2004 and later model vehicles meets or exceeds certain Environmental Protection Agency emissions standards. For a vehicle with a gross vehicle weight rating of 6,000 pounds or less the applicable emissions standards are the Bin 5 Tier II emissions standards. For a vehicle with a gross vehicle weight rating greater than 6,000 pounds and less than or equal

to 8,500 pounds, the applicable emissions standards are the Bin 8 Tier II emissions standards. A qualified advanced lean burn technology vehicle must be placed in service before January 1, 2011.Limitation on number of qualified hybrid and advanced lean burn technology vehicles eligible for the credit

There is a limitation on the number of qualified hybrid vehicles and advanced lean burn technology vehicles sold by each manufacturer of such vehicles that are eligible for the credit. Taxpayers may claim the full amount of the allowable credit up to the end of the first calendar quarter after the quarter in which the manufacturer records the 60,000th hybrid and advanced lean burn technology vehicle sale occurring after December 31, 2005. Taxpayers may claim one half of the otherwise allowable credit during the two calendar quarters subsequent to the first quarter after the manufacturer has recorded its 60,000th such sale. In the third and fourth calendar quarters subsequent to the first quarter after the manufacturer has recorded its 60,000th such sale, the taxpayer may claim one quarter of the otherwise allowable credit.

Thus, for example, summing the sales of qualified hybrid vehicles of all weight classes and all sales of qualified advanced lean burn technology vehicles, if a manufacturer records the sale of its 60,000th qualified vehicle in February of 2007, taxpayers purchasing such vehicles from the manufacturer may claim the full amount of the credit on their purchases of qualified vehicles through June 30, 2007. For the period July 1, 2007, through December 31, 2007, taxpayers may claim one half of the otherwise allowable credit on purchases of qualified vehicles of the manufacturer. For the period January 1, 2008, through June 30, 2008, taxpayers may claim one quarter of the otherwise allowable credit on the purchases of qualified vehicles of the manufacturer. After June 30, 2008, no credit may be claimed for purchases of hybrid vehicles or advanced lean burn technology vehicles sold by the manufacturer.

Hybrid vehicles that are medium and heavy trucks

In the case of a qualified hybrid vehicle weighing more than 8,500 pounds, the amount of credit is determined by the estimated increase in fuel economy and the incremental cost of the hybrid vehicle compared to a comparable vehicle powered solely by a gasoline or diesel internal combustion engine and that is comparable in weight, size, and use of the vehicle. For a vehicle that achieves a fuel economy increase of at least 30 percent but less than 40 percent, the credit is equal to 20 percent of the incremental cost of the hybrid vehicle. For a vehicle that achieves a fuel economy increase of at least 40 percent but less than 50 percent, the credit is equal to 30 percent of the incremental cost of the hybrid vehicle. For a vehicle that achieves a fuel economy increase of 50 percent or more, the credit is equal to 40 percent of the incremental cost of the hybrid vehicle.

The credit is subject to certain maximum applicable incremental cost amounts. For a qualified hybrid vehicle weighing more than 8,500 pounds but not more than 14,000 pounds, the maximum allowable incremental cost amount is $7,500. For a qualified hybrid vehicle weighing more than 14,000 pounds but not more than 26,000 pounds, the maximum allowable incremental cost amount is $15,000. For a qualified hybrid vehicle weighing more than 26,000 pounds, the maximum allowable incremental cost amount is $30,000.

A qualified hybrid vehicle weighing more than 8,500 pounds but not more than 14,000 pounds must have a maximum available power from the rechargeable energy storage system of at least 10 percent. A qualified hybrid vehicle weighing more than 14,000 pounds must have a maximum available power from the rechargeable energy storage system of at least 15 percent.[40]

Alternative fuel vehicle

The credit for the purchase of a new alternative fuel vehicle is 50 percent of the incremental cost of such vehicle, plus an additional 30 percent if the vehicle meets certain emissions standards. The incremental cost of any new qualified alternative fuel vehicle is the excess of the manufacturer's suggested retail price for such vehicle over the price for a gasoline or diesel fuel vehicle of the same model. To be eligible for the credit, a qualified alternative fuel vehicle must be purchased before January 1, 2011.

The amount of the credit varies depending on the weight of the qualified vehicle. The credit is subject to certain maximum applicable incremental cost amounts. Table 6, below, shows the maximum permitted incremental cost for the purpose of calculating the credit for alternative fuel vehicles by vehicle weight class as well as the maximum credit amount for such vehicles.

Table 6.–Maximum Allowable Incremental Cost for Calculation of Alternative Fuel Vehicle Credit

Vehicle Gross Weight Rating (pounds)	Maximum Allowable Incremental Cost	Maximum Allowable Credit
Vehicle ≤ 8,500	$5,000	$4,000
8,500 < vehicle ≤ 14,000	$10,000	$8,000
14,000 < vehicle ≤ 26,000	$25,000	$20,000
26,000 < vehicle	$40,000	$32,000

Alternative fuels comprise compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, and any liquid fuel that is at least 85 percent methanol. Qualified alternative fuel vehicles are vehicles that operate only on qualified alternative fuels and are

[40] In the case of such heavy-duty hybrid motor vehicles, the percentage of maximum available power is computed by dividing the maximum power available from the rechargeable energy storage system during a standard 10-second pulse power test, divided by the vehicle's total traction power. A vehicle's total traction power is the sum of the peak power from the rechargeable energy storage system and the heat (e.g., internal combustion or diesel) engine's peak power. If the rechargeable energy storage system is the sole means by which the vehicle can be driven, then the total traction power is the peak power of the rechargeable energy storage system.

incapable of operating on gasoline or diesel (except to the extent gasoline or diesel fuel is part of a qualified mixed fuel, described below).

Certain mixed fuel vehicles, that is vehicles that use a combination of an alternative fuel and a petroleum-based fuel, are eligible for a reduced credit. If the vehicle operates on a mixed fuel that is at least 75 percent alternative fuel, the vehicle is eligible for 70 percent of the otherwise allowable alternative fuel vehicle credit. If the vehicle operates on a mixed fuel that is at least 90 percent alternative fuel, the vehicle is eligible for 90 percent of the otherwise allowable alternative fuel vehicle credit.

Base fuel economy

The base fuel economy is the 2002 model year city fuel economy by vehicle type and vehicle inertia weight class. For this purpose, "vehicle inertia weight class" has the same meaning as when defined in regulations prescribed by the EPA for purposes of Title II of the Clean Air Act. Table 7, below, shows the 2002 model year city fuel economy for vehicles by type and by inertia weight class.

Table 7.–2002 Model Year City Fuel Economy

Vehicle Inertia Weight Class (pounds)	Passenger Automobile (miles per gallon)	Light Truck (miles per gallon)
1,500	45.2	39.4
1,750	45.2	39.4
2,000	39.6	35.2
2,250	35.2	31.8
2,500	31.7	29.0
2,750	28.8	26.8
3,000	26.4	24.9
3,500	22.6	21.8
4,000	19.8	19.4
4,500	17.6	17.6
5,000	15.9	16.1
5,500	14.4	14.8
6,000	13.2	13.7
6,500	12.2	12.8
7,000	11.3	12.1
8,500	11.3	12.1

Other rules

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.

Explanation of Provision

Treatment of alternative motor vehicle credit as a personal credit

The provision modifies the alternative motor vehicle credit by treating the nonbusiness portion of that credit as a personal credit. As a result, in the event Congress extends the provision allowing personal credits to offset the alternative minimum tax, the alternative motor vehicle credit will be allowable against the alternative minimum tax.

Plug-in electric drive motor vehicle credit

The provision allows a credit for each qualified plug-in electric drive motor vehicle placed in service. A qualified plug-in electric drive motor vehicle is a motor vehicle that meets certain emissions standards and is propelled to a significant extent by an electric motor that draws electricity from a battery that (1) has a capacity of at least four kilowatt-hours and (2) is capable of being recharged from an external source of electricity. Qualified vehicles must have a gross weight of less than 14,000 pounds. In addition, qualified vehicles weighing less than 8,500 pounds must be passenger automobiles or light trucks.

The base amount of the plug-in electric drive motor vehicle credit is $3,000. If the qualified vehicle draws propulsion from a battery with at least five kilowatt-hours of capacity, the credit amount is increased by $200, plus another $200 for each kilowatt-hour of battery capacity in excess of five kilowatt-hours, up to a maximum additional credit of $2,000.

In general, the credit is available to the vehicle owner, including the lessor of a vehicle subject to lease. If the qualified vehicle is used by certain tax-exempt organizations, governments, or foreign persons and is not subject to a lease, the seller of the vehicle may claim the credit so long as the seller clearly discloses to the user in a document the amount that is allowable as a credit. A vehicle must be used predominantly in the United States to qualify for the credit.

There is a limitation on the number of qualified plug-in electric drive motor vehicles sold by each manufacturer of such vehicles that are eligible for the credit. Taxpayers may claim the full amount of the allowable credit up to the end of the first calendar quarter after the quarter in which the manufacturer records the 60,000th plug-in electric drive motor vehicle sale. Taxpayers may claim one half of the otherwise allowable credit during the two calendar quarters subsequent to the first quarter after the manufacturer has recorded its 60,000th such sale. In the third and fourth calendar quarters subsequent to the first quarter after the manufacturer has recorded its 60,000th such sale, the taxpayer may claim one quarter of the otherwise allowable credit.

The basis of any qualified vehicle is reduced by the amount of the credit. To the extent a vehicle is eligible for credit as a qualified plug-in electric drive motor vehicle, it is not eligible for credit as a qualified hybrid vehicle under section 30B. The portion of the credit attributable to vehicles of a character subject to an allowance for depreciation is treated as part of the general business credit; the nonbusiness portion of the credit is allowable to the extent of the excess of the regular tax and the alternative minimum tax (reduced by certain other credits) for the taxable year.

Effective Date

The plug-in electric drive motor vehicle credit provision is effective for taxable years beginning after December 31, 2008. The provision treating the nonbusiness portion of the alternative motor vehicle credit as a personal credit is effective for taxable years beginning after December 31, 2007.

5. Exclusion from heavy vehicle excise tax for idling reduction units and advanced insulation (sec. 125 of the bill and sec. 4053 of the Code)

Present Law

A 12 percent excise tax (the "heavy vehicle excise tax") is imposed on the first retail sale of automobile truck chassis and bodies, truck trailer and semitrailer chassis and bodies, and tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.[41] The heavy vehicle excise tax does not apply to automobile truck chassis and bodies suitable for use with a vehicle which has a gross vehicle weight of 33,000 pounds or less. The tax also does not apply to truck trailer and semitrailer chassis and bodies suitable for use with a trailer or semitrailer which has a gross vehicle weight of 26,000 pounds or less, or to tractors having a gross vehicle weight of 19,500 pounds or less if such tractor in combination with a trailer or semitrailer has a gross combined weight of 33,000 pounds or less.

If the owner, lessee, or operator of a taxable article installs any part or accessory within six months after the date such vehicle was first placed in service, a 12 percent tax applies on the price of such part or accessory and its installation.

Explanation of Provision

The provision provides an exemption from the heavy vehicle excise tax for the cost of qualifying idling reduction devices. A qualifying idling reduction device means any device or system of devices that (1) is designed to provide to a vehicle those services (such as heat, air conditioning, or electricity), which would otherwise require the operation of the main drive engine while the vehicle is temporarily parked or remains stationary, by using one or more devices affixed to a tractor or truck, and (2) is certified by the Secretary of Energy, in consultation with the Administrator of the Environmental Protection Agency and the Secretary of Transportation, to reduce idling of such vehicle at a motor vehicle rest stop or other location where such vehicles are temporarily parked or remain stationary.

The provision also provides an exemption for the installation of "advanced insulation" in a commercial refrigerated truck or trailer that is subject to the heavy vehicle excise tax. Advanced insulation means insulation that has an R value of not less than R35 per inch.

Both exemptions apply regardless of whether the device or insulation is factory installed or later added as an accessory.

Effective Date

The provision is effective for retail sales or installations made after the date of enactment.

[41] Sec. 4051.

6. Extension of transportation fringe benefit to bicycle commuters (sec. 126 of the bill and sec. 132(f) of the Code)

Present Law

Qualified transportation fringe benefits provided by an employer are excluded from an employee's gross income.[42] Qualified transportation fringe benefits include parking, transit passes, and vanpool benefits. In addition, no amount is includible in income of an employee merely because the employer offers the employee a choice between cash and qualified transportation fringe benefits. Up to $220 (for 2008) per month of employer-provided parking is excludable from income. Up to $115 (for 2008) per month of employer-provided transit and vanpool benefits are excludable from gross income. These amounts are indexed annually for inflation, rounded to the nearest multiple of $5.

Under present law, qualified transportation fringe benefits include a cash reimbursement by an employer to an employee. However, in the case of transit passes, a cash reimbursement is considered a qualified transportation fringe benefit only if a voucher or similar item which may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee.

Explanation of Provision

The provision adds a qualified bicycle commuting reimbursement fringe benefit as a qualified transportation fringe benefit. A qualified bicycle commuting reimbursement fringe benefit means, with respect to a calendar year, any employer reimbursement during the 15-month period beginning with the first day of such calendar year of an employee for reasonable expenses incurred by the employee during the calendar year for the purchase and repair of a bicycle, bicycle improvements, and bicycle storage, provided that the bicycle is regularly used for travel between the employee's residence and place of employment.

The maximum amount that can be excluded from an employee's gross income for a calendar year on account of a bicycle commuting reimbursement fringe benefit is the applicable annual limitation for the employee for that calendar year. The applicable annual limitation for an employee for a calendar year is equal to the product of $20 multiplied by the number of the employee's qualified bicycle commuting months for the year. The $20 amount is not indexed for inflation. A qualified bicycle commuting month means with respect to an employee any month for which the employee does not receive any other qualified transportation fringe benefit and during which the employee regularly uses a bicycle for a substantial portion of travel between the employee's residence and place of employment. Thus, no amount is credited towards an employee's applicable annual limitation for any month in which an employee's usage of a bicycle is infrequent or constitutes an insubstantial portion of the employee's commute.

A bicycle commuting reimbursement fringe benefit cannot be funded by an elective salary contribution on the part of an employee.

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[42] Sec. 132(f).

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

7. Extension and modification of alternative fuel vehicle refueling property credit (sec. 127 of the bill and sec. 30C of the Code)

Present Law

Taxpayers may claim a 30-percent credit for the cost of installing qualified clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer.[43] The credit may not exceed $30,000 per taxable year, per location, in the case of qualified refueling property used in a trade or business and $1,000 per taxable year per location in the case of qualified refueling property installed on property which is used as a principal residence.

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

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

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

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

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

[43] Sec. 30C.

Explanation of Provision

The provision extends and modifies the credit for installing alternative fuel refueling property. The provision extends for one year (through 2010) the credit for installing alternative fuel refueling property, other than property relating to natural gas, compressed natural gas (CNG), liquefied natural gas (LNG), or hydrogen. The credit for property relating to natural gas, CNG, and LNG is extended through 2014 for depreciable property and through 2017 for nondepreciable property. (The provision does not extend the credit for property relating to hydrogen, which continues through 2014 under present law.)

The provision increases the credit amount to 50 percent of the cost of the qualified property. It also raises to $50,000 per taxable year, per location, the limit with respect to depreciable qualified property. With respect to qualified property that is not subject to depreciation, the limit is raised to $2,000 per taxable year.

Effective Date

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

8. Certain income and gains relating to alcohol fuels and mixtures, biodiesel fuels and mixtures, and alternative fuels and mixtures treated as qualifying income for purposes of the exception from treatment of publicly traded partnerships as corporations (sec. 128 of the bill and sec. 7704 of the Code)

Present Law

Partnerships in general

A partnership generally is not treated as a taxable entity (except for certain publicly traded partnerships), but rather, is treated as a pass-through entity. Income earned by a partnership, whether distributed or not, is taxed to the partners.[44] The character of partnership items passes through to the partners, as if the items were realized directly by the partners.[45] For example, a partner's share of the partnership's dividend income is generally treated as dividend income in the hands of the partner.

Publicly traded partnerships

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes (sec. 7704(a)). For this purpose, a publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market, or

[44] Section 701.

[45] Section 702.

interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income (sec. 7704(c)(2)). However, this exception does not apply to any partnership that would be described in section 851(a) if it were a domestic corporation, which includes a corporation registered under the Investment Company Act of 1940 as a management company or unit investment trust.

Qualifying income includes interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held for the production of income that is qualifying income. Qualifying income also includes rents from real property, gains from the sale or other disposition of real property, and income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber). It also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) in the case of partnership, a principal activity of which is the buying and selling of such commodities, futures, options or forward contracts.

Explanation of Provision

The provision provides that qualifying income of a publicly traded partnership includes income or gains from the transportation or storage of certain fuels. Specifically, the fuels are: (1) any fuel described in subsection (b), (c), (d) or (e) of section 6426, namely, alcohol fuel mixtures, biodiesel mixtures, alternative fuels (which include liquefied petroleum gas, P Series Fuels, compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process, and liquid fuel derived from biomass), and alternative fuel mixtures; (2) neat alcohol other than alcohol derived from petroleum, natural gas, or coal, or having a proof of less than 190 (as defined in section 6426(b)(4)(A)), and (3) neat biodiesel (as defined in section 40A(d)(1)).

Effective Date

The provision applies to taxable years beginning after the date of enactment.

C. Energy Conservation and Efficiency Provisions

1. Extension and modification of energy efficient existing homes credit (sec. 131 of the bill and sec. 25C of the Code)

Present Law

Code section 25C provides a 10-percent credit for the purchase of qualified energy efficiency improvements to existing homes. A qualified energy efficiency improvement is any energy efficiency building envelope component that meets or exceeds the prescriptive criteria for such a component established by the 2000 International Energy Conservation Code as supplemented and as in effect on August 8, 2005 (or, in the case of metal roofs with appropriate pigmented coatings, meets the Energy Star program requirements), and (1) that is installed in or on a dwelling located in the United States; (2) owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) such component reasonably can be expected to remain in use for at least five years. The credit is nonrefundable.

Building envelope components are: (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling; (2) exterior windows (including skylights) and doors; and (3) metal roofs with appropriate pigmented coatings which are specifically and primarily designed to reduce the heat loss or gain for a dwelling.

Additionally, code section 25C provides specified credits for the purchase of specific energy efficient property. The allowable credit for the purchase of certain property is (1) $50 for each advanced main air circulating fan, (2) $150 for each qualified natural gas, propane, or oil furnace or hot water boiler, and (3) $300 for each item of qualified energy efficient property.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace originally placed in service by the taxpayer during the taxable year, and which has an annual electricity use of no more than two percent of the total annual energy use of the furnace (as determined in the standard Department of Energy test procedures).

A qualified natural gas, propane, or oil furnace or hot water boiler is a natural gas, propane, or oil furnace or hot water boiler with an annual fuel utilization efficiency rate of at least 95.

Qualified energy-efficient property is: (1) an electric heat pump water heater which yields an energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which has a heating seasonal performance factor (HSPF) of at least 9, a seasonal energy efficiency ratio (SEER) of at least 15, and an energy efficiency ratio (EER) of at least 13, (3) a geothermal heat pump which (i) in the case of a closed loop product, has an energy efficiency ratio (EER) of at least 14.1 and a heating coefficient of performance (COP) of at least 3.3, (ii) in the case of an open loop product, has an energy efficiency ratio (EER) of at least 16.2 and a heating coefficient of performance (COP) of at least 3.6, and (iii) in the case of a direct expansion (DX) product, has an energy efficiency ratio (EER) of at least 15 and a heating coefficient of performance (COP) of at least 3.5, (4) a central air conditioner with energy

efficiency of at least the highest efficiency tier established by the Consortium for Energy Efficiency as in effect on Jan. 1, 2006, and (5) a natural gas, propane, or oil water heater which has an energy factor of at least 0.80.

Under section 25C, the maximum credit for a taxpayer with respect to the same dwelling for all taxable years is $500, and no more than $200 of such credit may be attributable to expenditures on windows.

The taxpayer's basis in the property is reduced by the amount of the credit. Special rules apply in the case of condominiums and tenant-stockholders in cooperative housing corporations.

The credit applies to property placed in service prior to January 1, 2008.

Explanation of Provision

The 25C credit is expired for 2008. The provision reestablishes the credit for one year, for property placed in service after December 31, 2008 and before January 1, 2010. The provision also adds biomass fuel property to the list of qualified energy efficient building property eligible for a $300 credit. Biomass fuel property is a stove that burns biomass fuel to heat a dwelling unit located in the United States and used as a principal residence by the taxpayer, or to heat water for such dwelling unit, and that has a thermal efficiency rating of at least 75 percent. Biomass fuel is any plant-derived fuel available on a renewable or recurring basis, including agricultural crops and trees, wood and wood waste and residues (including wood pellets), plants (including aquatic plants, grasses, residues, and fibers.

The credit for geothermal heat pumps is eliminated to conform with the establishment of a residential geothermal heat pump credit under Code section 25D, as provided in section 104 of the bill.

Effective Date

The provision is effective for expenditures after December 31, 2008, for property placed in service after December 31, 2008 and prior to January 1, 2010.

2. Energy efficient commercial buildings deduction (sec. 132 of the bill and sec. 179D of the Code)

Present Law

In general

Code section 179D provides a deduction equal to energy-efficient commercial building property expenditures made by the taxpayer. Energy-efficient commercial building property expenditures is defined as property (1) which is installed on or in any building located in the United States that is within the scope of Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America ("ASHRAE/IESNA"), (2) which is installed as part of (i) the interior lighting systems, (ii) the heating, cooling, ventilation, and hot water systems, or (iii) the building

envelope, and (3) which is certified as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more in comparison to a reference building which meets the minimum requirements of Standard 90.1-2001 (as in effect on April 2, 2003). The deduction is limited to an amount equal to $1.80 per square foot of the property for which such expenditures are made. The deduction is allowed in the year in which the property is placed in service.

Certain certification requirements must be met in order to qualify for the deduction. The Secretary, in consultation with the Secretary of Energy, will promulgate regulations that describe methods of calculating and verifying energy and power costs using qualified computer software based on the provisions of the 2005 California Nonresidential Alternative Calculation Method Approval Manual or, in the case of residential property, the 2005 California Residential Alternative Calculation Method Approval Manual.

The Secretary shall prescribe procedures for the inspection and testing for compliance of buildings that are comparable, given the difference between commercial and residential buildings, to the requirements in the Mortgage Industry National Accreditation Procedures for Home Energy Rating Systems. Individuals qualified to determine compliance shall only be those recognized by one or more organizations certified by the Secretary for such purposes.

For energy-efficient commercial building property expenditures made by a public entity, such as public schools, the Secretary shall promulgate regulations that allow the deduction to be allocated to the person primarily responsible for designing the property in lieu of the public entity.

If a deduction is allowed under this section, the basis of the property shall be reduced by the amount of the deduction.

The deduction is effective for property placed in service after December 31, 2005 and prior to January 1, 2009.

Partial allowance of deduction

In the case of a building that does not meet the overall building requirement of a 50-percent energy savings, a partial deduction is allowed with respect to each separate building system that comprises energy efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system-specific savings targets established by the Secretary of the Treasury. The applicable system-specific savings targets to be established by the Secretary are those that would result in a total annual energy savings with respect to the whole building of 50 percent, if each of the separate systems met the system specific target. The separate building systems are (1) the interior lighting system, (2) the heating, cooling, ventilation and hot water systems, and (3) the building envelope. The maximum allowable deduction is $0.60 per square foot for each separate system.

Interim rules for lighting systems

In the case of system-specific partial deductions, in general no deduction is allowed until the Secretary establishes system-specific targets[46]. However, in the case of lighting system retrofits, until such time as the Secretary issues final regulations, the system-specific energy savings target for the lighting system is deemed to be met by a reduction in Lighting Power Density of 40 percent (50 percent in the case of a warehouse) of the minimum requirements in Table 9.3.1.1 or Table 9.3.1.2 of ASHRAE/IESNA Standard 90.1-2001. Also, in the case of a lighting system that reduces lighting power density by 25 percent, a partial deduction of 30 cents per square foot is allowed. A pro-rated partial deduction is allowed in the case of a lighting system that reduces lighting power density between 25 percent and 40 percent. Certain lighting level and lighting control requirements must also be met in order to qualify for the partial lighting deductions under the interim rule.

Explanation of Provision

The provision extends the energy efficient commercial buildings deduction for five years, through December 31, 2013.

Effective Date

The provision is effective on the date of enactment.

3. Extension and modification of energy efficient appliance credit (sec. 133 of the bill and sec. 45M of the Code)

Present Law

A credit is allowed for the eligible production of certain energy-efficient dishwashers, clothes washers, and refrigerators.

The credit for dishwashers applies to dishwashers produced in 2006 and 2007 that meet the Energy Star standards for 2007, and equals $32.31 per eligible dishwasher.[47]

[46] IRS Notice 2008-40 has set a target of a 10 percent reduction in total energy and power costs with respect to the building envelope, and 20 percent each with respect to the interior lighting system and the heating, cooling, ventilation and hot water systems.

[47] The credit amount equals $3 multiplied by 100 times the "energy savings percentage," but may not exceed $100 per dishwasher. The energy saving percentage is defined as the change in the energy factor (EF) required by the Energy Star program between 2007 and 2005 divided by the EF requirement for 2007. The EF required for the Energy Star program was 0.58 in 2005 and 0.65 in 2007, for a change of 0.07. The energy saving percentage is thus 0.07 / 0.65, which when multiplied by 100 times $3 equals $32.31 per refrigerator.

The credit for clothes washers equals $100 for clothes washers manufactured in 2006-2007 that meet the requirements of the Energy Star program that are in effect for clothes washers in 2007.

The credit for refrigerators is based on energy savings and year of manufacture. 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 percent energy saving and that are manufactured in 2006 receive a $75 credit. Refrigerators that achieve a 20 to 25 percent energy saving receive a (i) $125 credit if manufactured in 2006-2007. Refrigerators that achieve at least a 25 percent energy saving receive a (i) $175 credit if manufactured in 2006-2007.

Appliances eligible for the credit include only those produced in the United States and that exceed the average amount of U.S. production from the three prior calendar years for each category of appliance. In the case of refrigerators, eligible production is U.S. production that exceeds 110 percent of the average amount of U.S. production from the three prior calendar years.

A dishwasher is any a residential dishwasher subject to the energy conservation standards established by the Department of Energy. 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. A clothes washer is any residential clothes washer, including a residential style coin operated washer, that satisfies the relevant efficiency standard.

The taxpayer 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 clothes washers eligible for the $50 credit and refrigerators eligible for the $75 credit. A taxpayer may elect to increase the $20 million limitation described above to $25 million provided that the aggregate amount of credits with respect to such appliances, plus refrigerators eligible for the $100 and $125 credits, is limited to $50 million for all taxable years.

Additionally, the credit allowed in a taxable year for all appliances may not exceed two percent 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.

Explanation of Provision

The provision extends and modifies the energy efficient appliance credit. The provision provides modified credits for eligible production as follows:

Dishwashers

1. $45 in the case of a dishwasher that is manufactured in calendar year 2008 or 2009 that uses no more than 324 kilowatt hours per year and 5.8 gallons per cycle, and

2. $75 in the case of a dishwasher that is manufactured in calendar year 2008, 2009, or 2010 and that uses no more than 307 kilowatt hours per year and 5.0 gallons per cycle (5.5 gallons per cycle for dishwashers designed for greater than 12 place settings).

Clothes washers

1. $75 in the case of a residential top-loading clothes washer manufactured in calendar year 2008 that meets or exceeds a 1.72 modified energy factor and does not exceed a 8.0 water consumption factor, and

2. $125 in the case of a residential top-loading clothes washer manufactured in calendar year 2008 or 2009 that meets or exceeds a 1.8 modified energy factor and does not exceed a 7.5 water consumption factor,

3. $150 in the case of a residential or commercial clothes washer manufactured in calendar year 2008, 2009 or 2010 that meets or exceeds a 2.0 modified energy factor and does not exceed a 6.0 water consumption factor, and

4. $250 in the case of a residential or commercial clothes washer manufactured in calendar year 2008, 2009, or 2010 that meets or exceeds a 2.2 modified energy factor and does not exceed a 4.5 water consumption factor.

Refrigerators

1. $50 in the case of a refrigerator manufactured in calendar year 2008 that consumes at least 20 percent but not more than 22.9 percent less kilowatt hours per year than the 2001 energy conservation standards,

2. $75 in the case of a refrigerator that is manufactured in calendar year 2008 or 2009 that consumes at least 23 percent but no more than 24.9 percent less kilowatt hours per year than the 2001 energy conservation standards,

3. $100 in the case of a refrigerator that is manufactured in calendar year 2008, 2009 or 2010 that consumes at least 25 percent but not more than 29.9 percent less kilowatt hours per year than the 2001 energy conservation standards, and

4. $200 in the case of a refrigerator manufactured in calendar year 2008, 2009 or 2010 that consumes at least 30 percent less energy than the 2001 energy conservation standards.

Appliances eligible for the credit include only those that exceed the average amount of production from the two prior calendar years for each category of appliance, rather than the present law three prior calendar years. Additionally, the special rule with respect to refrigerators is eliminated.

The aggregate credit amount allowed with respect to a taxpayer for all taxable years beginning after December 31, 2007 may not exceed $75 million, with the exception that the $200 refrigerator credit and the $250 clothes washer credit are not limited.

The term "modified energy factor" means the modified energy factor established by the Department of Energy for compliance with the Federal energy conservation standard.

The term "gallons per cycle" means, with respect to a dishwasher, the amount of water, expressed in gallons, required to complete a normal cycle of a dishwasher.

The term "water consumption factor" means, with respect to a clothes washer, the quotient of the total weighted per-cycle water consumption divided by the cubic foot (or liter) capacity of the clothes washer.

Effective Date

The provision applies to appliances produced after December 31, 2007.

4. Accelerated recovery period for depreciation of smart meters and smart grid systems (sec. 134 of the bill and sec. 168 of the Code)

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[48] The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[49] Assets included in class 49.14, describing assets used in the transmission and distribution of electricity for sale and related land improvements, are assigned a class life of 30 years and a recovery period of 20 years.

Explanation of Provision

The provision provides a 10-year recovery period and 150 percent declining balance method for any qualified smart electric meter and any qualified smart electric grid system.[50] For purposes of the provision, a qualified smart electric meter means any time-based meter and related communication equipment which is placed in service by a taxpayer who is a supplier of electric energy or a provider of electric energy services and which is capable of being used by the taxpayer as part of a system that (1) measures and records electricity usage data on a time-differentiated basis in at least 24 separate time segments per day; (2) provides for the exchange of information between the supplier or provider and the customer's smart electric meter in

[48] Sec. 168.

[49] 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

[50] To the extent property otherwise qualified for a shorter recover period, such shorter recovery period shall apply.

support of time-based rates or other forms of demand response; and (3) provides data to such supplier or provider so that the supplier or provider can provide energy usage information to customers electronically; and (4) provides net metering.

For purposes of the provision, a qualified smart electric grid system means any smart grid property used as part of a system for electric distribution grid communications, monitoring, and management placed in service by a taxpayer who is a supplier of electric energy or a provider of electric energy services. Smart grid property includes electronics and related equipment that is capable of (1) sensing, collecting, and monitoring data of or from all portions of a utility's electric distribution grid; (2) providing real-time, two-way communications to monitor or manage such grid; and (3) providing real-time analysis of and event prediction based upon collected data that can be used to improve electric distribution system reliability, quality, and performance.

Effective Date

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

5. Extension of issuance authority for qualified green building and sustainable design project bonds (sec. 135 of the bill and sec. 142 of the Code)

Present Law

In general

Private activity bonds are bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such private person. The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds"). The definition of a qualified private activity bond includes exempt facility bonds.

In most cases, the aggregate volume of tax-exempt qualified private activity bonds, including most exempt facility bonds, is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2008, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $262.09 million, if greater.

Qualified green building and sustainable design project bonds

The definition of exempt facility bond includes qualified green building and sustainable design project bonds ("qualified green bond"). A qualified green bond is defined as any bond issued as part of an issue that finances a project designated by the Secretary, after consultation with the Administrator of the Environmental Protection Agency (the "Administrator") as a green building and sustainable design project that meets the following eligibility requirements: (1) at least 75 percent of the square footage of the commercial buildings that are part of the project is

registered for the U.S. Green Building Council's LEED[51] certification and is reasonably expected (at the time of designation) to meet such certification; (2) the project includes a brownfield site;[52] (3) the project receives at least $5 million dollars in specific State or local resources; and (4) the project includes at least one million square feet of building or at least 20 acres of land.

Qualified green bonds are not subject to the State bond volume limitations. Rather, there is a national limitation of $2 billion of qualified green bonds that the Secretary may allocate, in the aggregate, to qualified green building and sustainable design projects. Qualified green bonds may be currently refunded if certain conditions are met, but cannot be advance refunded. The authority to issue qualified green bonds terminates after September 30, 2009.

Under present law, each green building and sustainable design project must certify to the Secretary, no later than 30 days after the completion of the project, that the net benefit of the tax-exempt financing was used for the purposes described in the project application. Issuers are required to maintain, on behalf of each project, an interest bearing reserve account equal to one percent of the net proceeds of any qualified green bond issued for such project. Not later than five years after the date of issuance of bonds with respect to the project, the Secretary, after consultation with the Administrator, shall determine whether the project financed with the proceeds of qualified green bonds has substantially complied with the requirements and goals of the project. If the Secretary, after such consultation, certifies that the project has substantially complied with the requirements and goals, amounts in the reserve account, including all interest, shall be released to the project. If the Secretary determines that the project has not substantially complied with such requirements and goals, amounts in the reserve account, including all interest, shall be paid to the United States Treasury.

Explanation of Provision

The provision extends the authority to issue qualified green bonds through September 30, 2012.

The provision also clarifies that the date for determining whether amounts in a reserve account may be released to a green building and sustainable design project is the date that is five years after the date of issuance of the last bond issue issued with respect to such project.

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[51] The LEED ("Leadership in Energy and Environmental Design) Green Building Rating System is a voluntary, consensus-based national standard for developing high-performance sustainable buildings. Registration is the first step toward LEED certification. Actual certification requires that the applicant project satisfy a number of requirements. Commercial buildings, as defined by standard building codes are eligible for certification. Commercial occupancies include, but are not limited to, offices, retail and service establishments, institutional buildings (e.g. libraries, schools, museums, churches, etc.), hotels, and residential buildings of four or more habitable stories.

[52] For this purpose, a brownfield site is defined by section 101(39) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. sec. 9601), including a site described in subparagraph (D)(ii)(II)(aa) thereof (relating to a site that is contaminated by petroleum or a petroleum product excluded from the definition of 'hazardous substance' under section 101).

Effective Date

The provision applies on the date of enactment.

TITLE II – ONE YEAR EXTENSION OF TEMPORARY PROVISIONS

A. Extensions Primarily Affecting Individuals

1. Deduction of State and local general sales taxes (sec. 201 of the bill and sec. 164 of the Code)

Present Law

For purposes of determining regular tax liability, an itemized deduction is permitted for certain State and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. The itemized deduction is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. For taxable years beginning in 2004 and 2005, at the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction provided under present law for State and local income taxes. As is the case for State and local income taxes, the itemized deduction for State and local general sales taxes is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. Taxpayers have two options with respect to the determination of the sales tax deduction amount. Taxpayers may deduct the total amount of general State and local sales taxes paid by accumulating receipts showing general sales taxes paid. Alternatively, taxpayers may use tables created by the Secretary of the Treasury that show the allowable deduction. The tables are based on average consumption by taxpayers on a State-by-State basis taking into account number of dependents, modified adjusted gross income and rates of State and local general sales taxation. Taxpayers who live in more than one jurisdiction during the tax year are required to pro-rate the table amounts based on the time they live in each jurisdiction. Taxpayers who use the tables created by the Secretary may, in addition to the table amounts, deduct eligible general sales taxes paid with respect to the purchase of motor vehicles, boats and other items specified by the Secretary. Sales taxes for items that may be added to the tables are not reflected in the tables themselves.

The term "general sales tax" means a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items. However, in the case of items of food, clothing, medical supplies, and motor vehicles, the fact that the tax does not apply with respect to some or all of such items is not taken into account in determining whether the tax applies with respect to a broad range of classes of items, and the fact that the rate of tax applicable with respect to some or all of such items is lower than the general rate of tax is not taken into account in determining whether the tax is imposed at one rate. Except in the case of a lower rate of tax applicable with respect to food, clothing, medical supplies, or motor vehicles, no deduction is allowed for any general sales tax imposed with respect to an item at a rate other than the general rate of tax. However, in the case of motor vehicles, if the rate of tax exceeds the general rate, such excess shall be disregarded and the general rate is treated as the rate of tax.

A compensating use tax with respect to an item is treated as a general sales tax, provided such tax is complementary to a general sales tax and a deduction for sales taxes is allowable with respect to items sold at retail in the taxing jurisdiction that are similar to such item.

Explanation of Provision

The present-law provision allowing taxpayers to elect to deduct State and local sales taxes in lieu of State and local income taxes is extended for two years (through December 31, 2009).

Effective Date

The provision applies to taxable years beginning after December 31, 2007.

2. Above-the-line deduction for higher education expenses (sec. 202 of the bill and sec. 222 of the Code)

Present Law

An individual is allowed an above-the-line deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year.[53] Qualified tuition and related expenses are defined in the same manner as for the Hope and Lifetime Learning credits, and includes tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution.[54] The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic period beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

The maximum deduction is $4,000 for an individual whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose adjusted gross income does not exceed $80,000 ($160,000 in the case of a joint return). No deduction is allowed for an individual whose adjusted gross income exceeds the relevant adjusted gross income limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be claimed by another taxpayer for the taxable year. The deduction is not available for taxable years beginning after December 31, 2007.

The amount of qualified tuition and related expenses must be reduced by certain scholarships, educational assistance allowances, and other amounts paid for the benefit of such individual,[55] and by the amount of such expenses taken into account for purposes of determining

[53] Sec. 222.

[54] The deduction generally is not available for expenses with respect to a course or education involving sports, games, or hobbies, and is not available for student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.

[55] Secs. 222(d)(1) and 25A(g)(2).

any exclusion from gross income of: (1) income from certain U.S. savings bonds used to pay higher education tuition and fees; and (2) income from a Coverdell education savings account.[56] Additionally, such expenses must be reduced by the earnings portion (but not the return of principal) of distributions from a qualified tuition program if an exclusion under section 529 is claimed with respect to expenses eligible for the qualified tuition deduction. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope or Lifetime Learning credit is elected for such taxable year.

Explanation of Provision

The provision extends the qualified tuition deduction for two years so that it is generally available for taxable years beginning before January 1, 2010. However, the provision also modifies the qualified tuition deduction so that it is unavailable to any taxpayer for any taxable year beginning in 2008 or 2009 if the taxpayer would, in the absence of the alternative minimum tax, have a lower tax liability for that year if he or she elected the Hope or Lifetime Learning credit with respect to an eligible individual instead of the qualified tuition deduction.

Effective Date

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

3. Extension of special withholding tax rule for interest-related dividends paid by regulated investment companies (sec. 203 of the bill and sec. 871(k) of the Code)

Present Law

In general

Under present law, a regulated investment company ("RIC") that earns certain interest income that would not be subject to U.S. tax if earned by a foreign person directly may, to the extent of such income, designate a dividend it pays as derived from such interest income. A foreign person who is a shareholder in the RIC generally would treat such a dividend as exempt from gross-basis U.S. tax, as if the foreign person had earned the interest directly.

Interest-related dividends

Under present law, a RIC may, under certain circumstances, designate all or a portion of a dividend as an "interest-related dividend," by written notice mailed to its shareholders not later than 60 days after the close of its taxable year. In addition, an interest-related dividend received by a foreign person generally is exempt from U.S. gross-basis tax under sections 871(a), 881, 1441 and 1442.

[56] Sec. 222(c). These reductions are the same as those that apply to the Hope and Lifetime Learning credits.

However, this exemption does not apply to a dividend on shares of RIC stock if the withholding agent does not receive a statement, similar to that required under the portfolio interest rules, that the beneficial owner of the shares is not a U.S. person. The exemption does not apply to a dividend paid to any person within a foreign country (or dividends addressed to, or for the account of, persons within such foreign country) with respect to which the Treasury Secretary has determined, under the portfolio interest rules, that exchange of information is inadequate to prevent evasion of U.S. income tax by U.S. persons.

In addition, the exemption generally does not apply to dividends paid to a controlled foreign corporation to the extent such dividends are attributable to income received by the RIC on a debt obligation of a person with respect to which the recipient of the dividend (i.e., the controlled foreign corporation) is a related person. Nor does the exemption generally apply to dividends to the extent such dividends are attributable to income (other than short-term original issue discount or bank deposit interest) received by the RIC on indebtedness issued by the RIC-dividend recipient or by any corporation or partnership with respect to which the recipient of the RIC dividend is a 10-percent shareholder. However, in these two circumstances the RIC remains exempt from its withholding obligation unless the RIC knows that the dividend recipient is such a controlled foreign corporation or 10-percent shareholder. To the extent that an interest-related dividend received by a controlled foreign corporation is attributable to interest income of the RIC that would be portfolio interest if received by a foreign corporation, the dividend is treated as portfolio interest for purposes of the de minimis rules, the high-tax exception, and the same country exceptions of subpart F (see sec. 881(c)(5)(A)).

The aggregate amount designated as interest-related dividends for the RIC's taxable year (including dividends so designated that are paid after the close of the taxable year but treated as paid during that year as described in section 855) generally is limited to the qualified net interest income of the RIC for the taxable year. The qualified net interest income of the RIC equals the excess of: (1) the amount of qualified interest income of the RIC; over (2) the amount of expenses of the RIC properly allocable to such interest income.

Qualified interest income of the RIC is equal to the sum of its U.S.-source income with respect to: (1) bank deposit interest; (2) short term original issue discount that is currently exempt from the gross-basis tax under section 871; (3) any interest (including amounts recognized as ordinary income in respect of original issue discount, market discount, or acquisition discount under the provisions of sections 1271-1288, and such other amounts as regulations may provide) on an obligation which is in registered form, unless it is earned on an obligation issued by a corporation or partnership in which the RIC is a 10-percent shareholder or is contingent interest not treated as portfolio interest under section 871(h)(4); and (4) any interest-related dividend from another RIC.

If the amount designated as an interest-related dividend is greater than the qualified net interest income described above, the portion of the distribution so designated which constitutes an interest-related dividend will be only that proportion of the amount so designated as the amount of the qualified net interest income bears to the amount so designated.

This withholding tax rule for interest-related dividends received from a RIC does not apply to any taxable year of a RIC beginning after December 31, 2007.

Explanation of Provision

The provision extends the exemption from withholding tax of interest-related dividends received from a RIC to taxable years of a RIC beginning before January 1, 2010.

Effective Date

The provision applies to dividends with respect to taxable years of a RIC beginning after December 31, 2007.

4. Tax-free distributions from individual retirement plans for charitable purposes (sec. 204 of the bill and sec. 408 of the Code)

Present Law

In general

If an amount withdrawn from a traditional individual retirement arrangement ("IRA") or a Roth IRA is donated to a charitable organization, the rules relating to the tax treatment of withdrawals from IRAs apply to the amount withdrawn and the charitable contribution is subject to the normally applicable limitations on deductibility of such contributions. An exception applies in the case of a qualified charitable distribution.

Charitable contributions

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to a charity described in section 501(c)(3), to certain veterans' organizations, fraternal societies, and cemetery companies,[57] or to a Federal, State, or local governmental entity for exclusively public purposes.[58] The deduction also is allowed for purposes of calculating alternative minimum taxable income.

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.[59]

A taxpayer who takes the standard deduction (i.e., who does not itemize deductions) may not take a separate deduction for charitable contributions.[60]

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[57] Secs. 170(c)(3)-(5).

[58] Sec. 170(c)(1).

[59] Secs. 170(b) and (e).

[60] Sec. 170(a).

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate, among other things, that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution.[61] In addition, present law requires that any charity that receives a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services may be deductible as a charitable contribution.[62]

Under present law, total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations may not exceed 50 percent of the taxpayer's contribution base, which is the taxpayer's adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base, (2) contributions of cash to private foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer's contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer's contribution base.

Contributions by individuals in excess of the 50-percent, 30-percent, and 20-percent limits may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

In addition to the percentage limitations imposed specifically on charitable contributions, present law imposes a reduction on most itemized deductions, including charitable contribution deductions, for taxpayers with adjusted gross income in excess of a threshold amount, which is indexed annually for inflation. The threshold amount for 2008 is $159,950 ($79,975 for married individuals filing separate returns). For those deductions that are subject to the limit, the total amount of itemized deductions is reduced by three percent of adjusted gross income over the threshold amount, but not by more than 80 percent of itemized deductions subject to the limit. Beginning in 2006, the overall limitation on itemized deductions phases-out for all taxpayers. The overall limitation on itemized deductions was reduced by one-third in taxable years beginning in 2006 and 2007, and is reduced by two-thirds in taxable years beginning in 2008 and 2009. The overall limitation on itemized deductions is eliminated for taxable years beginning

[61] Sec. 170(f)(8).

[62] Sec. 6115.

after December 31, 2009; however, this elimination of the limitation sunsets on December 31, 2010.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity (e.g., a remainder) while also either retaining an interest in that property (e.g., an income interest) or transferring an interest in that property to a noncharity for less than full and adequate consideration.[63] Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, and present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property.[64] For such interests, a charitable deduction is allowed to the extent of the present value of the interest designated for a charitable organization.

IRA rules

Within limits, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Individuals also may make nondeductible contributions to a Roth IRA. Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59-½ are subject to an additional 10-percent early withdrawal tax, unless an exception applies. Under present law, minimum distributions are required to be made from tax-favored retirement arrangements, including IRAs. Minimum required distributions from a traditional IRA must generally begin by the April 1 of the calendar year following the year in which the IRA owner attains age 70-½.[65]

If an individual has made nondeductible contributions to a traditional IRA, a portion of each distribution from an IRA is nontaxable until the total amount of nondeductible contributions has been received. In general, the amount of a distribution that is nontaxable is determined by multiplying the amount of the distribution by the ratio of the remaining nondeductible contributions to the account balance. In making the calculation, all traditional IRAs of an individual are treated as a single IRA, all distributions during any taxable year are treated as a single distribution, and the value of the contract, income on the contract, and investment in the contract are computed as of the close of the calendar year.

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions and

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[63] Secs. 170(f), 2055(e)(2), and 2522(c)(2).

[64] Sec. 170(f)(2).

[65] Minimum distribution rules also apply in the case of distributions after the death of a traditional or Roth IRA owner.

distributions are deemed to be distributed in the following order: (1) regular Roth IRA contributions; (2) taxable conversion contributions;[66] (3) nontaxable conversion contributions; and (4) earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same taxable year are treated as a single distribution, all regular Roth IRA contributions for a year are treated as a single contribution, and all conversion contributions during the year are treated as a single contribution.

Distributions from an IRA (other than a Roth IRA) are generally subject to withholding unless the individual elects not to have withholding apply.[67] Elections not to have withholding apply are to be made in the time and manner prescribed by the Secretary.

Qualified charitable distributions

Present law provides an exclusion from gross income for otherwise taxable IRA distributions from a traditional or a Roth IRA in the case of qualified charitable distributions.[68] The exclusion may not exceed $100,000 per taxpayer per taxable year. Special rules apply in determining the amount of an IRA distribution that is otherwise taxable. The otherwise applicable rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions. Qualified charitable distributions are taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the qualified charitable distribution provision. An IRA does not fail to qualify as an IRA merely because qualified charitable distributions have been made from the IRA.

A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to an organization described in section 170(b)(1)(A) (other than an organization described in section 509(a)(3) or a donor advised fund (as defined in section 4966(d)(2)). Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70-½.

The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the donor did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

If the IRA owner has any IRA that includes nondeductible contributions, a special rule applies in determining the portion of a distribution that is includible in gross income (but for the

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[66] Conversion contributions refer to conversions of amounts in a traditional IRA to a Roth IRA.

[67] Sec. 3405.

[68] The exclusion does not apply to distributions from employer-sponsored retirements plans, including SIMPLE IRAs and simplified employee pensions ("SEPs").

qualified charitable distribution provision) and thus is eligible for qualified charitable distribution treatment. Under the special rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income (but for the qualified charitable distribution provision) if the aggregate balance of all IRAs having the same owner were distributed during the same year. In determining the amount of subsequent IRA distributions includible in income, proper adjustments are to be made to reflect the amount treated as a qualified charitable distribution under the special rule.

Distributions that are excluded from gross income by reason of the qualified charitable distribution provision are not taken into account in determining the deduction for charitable contributions under section 170.

The exclusion for qualified charitable distributions applies to distributions made in taxable years beginning after December 31, 2005. Under present law, the exclusion does not apply to distributions made in taxable years beginning after December 31, 2007.

Explanation of Provision

The provision would extend the exclusion for qualified charitable distributions to distributions made in taxable years beginning after December 31, 2007, and before January 1, 2010.

Effective Date

The provision is effective for distributions made in taxable years beginning after December 31, 2007.

5. Educator expense deduction (sec. 205 of the bill and sec. 62(a)(2)(D) of the Code)

Present Law

In general, ordinary and necessary business expenses are deductible. However, unreimbursed employee business expenses generally are deductible only as an itemized deduction and only to the extent that the individual's total miscellaneous deductions (including employee business expenses) exceed two percent of adjusted gross income. An individual's otherwise allowable itemized deductions may be further limited by the overall limitation on itemized deductions, which reduces itemized deductions for taxpayers with adjusted gross income in excess of $159,950 (for 2008).[69] In addition, miscellaneous itemized deductions are not allowable under the alternative minimum tax.

Eligible educators are allowed an above-the-line deduction for certain expenses.[70] Specifically, for taxable years beginning after December 31, 2001, and prior to January 1, 2008,

[69] The adjusted gross income threshold is $79,975 in the case of a married individual filing a separate return (for 2008).

[70] Sec. 62(a)(2)(D).

an above-the-line deduction is allowed for up to $250 annually of expenses paid or incurred by an eligible educator for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom. To be eligible for this deduction, the expenses must be otherwise deductible under section 162 as a trade or business expense. A deduction is allowed only to the extent the amount of expenses exceeds the amount excludable from income under section 135 (relating to education savings bonds), 529(c)(1) (relating to qualified tuition programs), and section 530(d)(2) (relating to Coverdell education savings accounts).

An eligible educator is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year. A school means any school that provides elementary education or secondary education, as determined under State law.

The above-the-line deduction for eligible educators is not allowed for taxable years beginning after December 31, 2007.

Explanation of Provision

The provision extends the deduction for eligible educator expenses for two years so that it is available for taxable years beginning before January 1, 2010.

Effective Date

The provision is effective for expenses paid or incurred in taxable years beginning after December 31, 2007.

6. Extension of special rule for regulated investment company stock held in the estate of a nonresident non-citizen (sec. 206 of the bill and sec. 2105 of the Code)

Present Law

The gross estate of a decedent who was a U.S. citizen or resident generally includes all property – real, personal, tangible, and intangible – wherever situated.[71] The gross estate of a nonresident non-citizen decedent, by contrast, generally includes only property that at the time of the decedent's death is situated within the United States.[72] Property within the United States generally includes debt obligations of U.S. persons, including the Federal government and State and local governments, but does not include either bank deposits or portfolio obligations the

[71] Sec. 2031. The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") repealed the estate tax for estates of decedents dying after December 31, 2009. EGTRRA, however, included a termination provision under which EGTRRA's rules, including estate tax repeal, do not apply to estates of decedents dying after December 31, 2010.

[72] Sec. 2103.

interest on which would be exempt from U.S. income tax under section 871.[73] Stock owned and held by a nonresident non-citizen generally is treated as property within the United States if the stock was issued by a domestic corporation.[74]

Treaties may reduce U.S. taxation of transfers of the estates of nonresident non-citizens. Under recent treaties, for example, U.S. tax generally may be eliminated except insofar as the property transferred includes U.S. real property or business property of a U.S. permanent establishment.

Although stock issued by a domestic corporation generally is treated as property within the United States, stock of a regulated investment company ("RIC") that was owned by a nonresident non-citizen is not deemed property within the United States in the proportion that, at the end of the quarter of the RIC's taxable year immediately before a decedent's date of death, the assets held by the RIC are debt obligations, deposits, or other property that would be treated as situated outside the United States if held directly by the estate (the "estate tax look-through rule for RIC stock").[75] This estate tax look-through rule for RIC stock does not apply to estates of decedents dying after December 31, 2007.

Explanation of Provision

The provision permits the estate tax look-through rule for RIC stock to apply to estates of decedents dying before January 1, 2010.

Effective Date

The provision applies to estates of decedents dying after December 31, 2007.

7. Extend RIC "qualified investment entity" treatment under FIRPTA (sec. 207 of the bill and sec. 897 of the Code)

Present law

Special U.S. tax rules apply to capital gains of foreign persons that are attributable to dispositions of interests in U.S. real property. In general, a foreign person (a foreign corporation or a nonresident alien individual) is not generally taxed on U.S. source capital gains unless certain personal presence or effectively connected business requirements are met. However, under the Foreign Investment in Real Property Tax Act ("FIRPTA") provisions codified in section 897 of the Code, a foreign person who sells a U.S. real property interest (USRPI) is treated as if the gain from such a sale is effectively connected with a U.S. business, and is subject to tax at the same rates as a U.S. person. Withholding tax is also imposed under section 1445.

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[73] Secs. 2104(c), 2105(b).

[74] Sec. 2104(a); Treas. Reg. sec. 20.2104-1(a)(5)).

[75] Sec. 2105(d).

A USPRI, the sale of which is subject to FIRPTA tax, includes stock or a beneficial interest in any U.S. real property holding corporation (as defined), unless the stock is regularly traded on an established securities market and the selling foreign corporation or nonresident alien individual held no more than 5 percent of that stock within the 5-year period ending on date of disposition (or, if shorter, during the period in which the entity was in existence). There is an exception, however, for stock of a domestically controlled "qualified investment entity." However, if stock of a domestically controlled qualified investment entity is disposed of within the 30 days preceding a dividend distribution in an "applicable wash sale transaction," in which an amount that would have been a taxable distribution (as described below) is instead treated as nontaxable sales proceeds, but substantially similar stock is reacquired (or an option to obtain it is acquired) within a 61 day period, then the amount that would have been a taxable distribution continues to be taxed.

A distribution from a "qualified investment entity" that is attributable to the sale of a USRPI is subject to tax under FIRPTA unless the distribution is with respect to an interest that is regularly traded on an established securities market located in the United Sates and the recipient foreign corporation or nonresident alien individual held no more than 5 percent of that class of stock or beneficial interest within the 1-year period ending on the date of distribution. Special rules apply to situations involving tiers of qualified investment entities.

The term "qualified investment entity" includes a regulated investment company ("RIC") that meets certain requirements, although the inclusion of a RIC in that definition is scheduled to have expired, for certain purposes, on December 31, 2007.[76] The definition does not expire for purposes of taxing distributions from the RIC that are attributable directly or indirectly to a distribution to the entity from a real estate investment trust, nor for purposes of the applicable wash sale rules.

Explanation of Provision

The provision extends the inclusion of a regulated investment company ("RIC") within the definition of a "qualified investment entity" under section 897 of the Code through December 31, 2009, for those situations in which that that inclusion would otherwise expire at the end of 2007. However, such extension does not apply to the application of withholding requirements with respect to any payment made on or before date of enactment.

Effective Date

The provision takes effect on January 1, 2008.

[76] Sec. 897(h).

8. Extension of the additional standard deduction for State and local real property taxes (sec. 208 of the Act and sec. 63 of the Code)

Present Law

In general

An individual taxpayer's taxable income is computed by reducing adjusted gross income either by a standard deduction or, if the taxpayer elects, by the taxpayer's itemized deductions. The deduction for certain taxes, including income taxes, real property taxes, and personal property taxes, generally is an itemized deduction.[77]

Additional standard deduction for State and local property taxes

An individual taxpayer's standard deduction for a taxable year beginning in 2008 is increased by the lesser of (1) the amount allowable[78] to the taxpayer as a deduction for State and local taxes described in section 164(a)(1) (relating to real property taxes), or (2) $500 ($1,000 in the case of a married individual filing jointly). The increased standard deduction is determined by taking into account real estate taxes for which a deduction is allowable to the taxpayer under section 164 and, in the case of a tenant-stockholder in a cooperative housing corporation, real estate taxes for which a deduction is allowable to the taxpayer under section 216. No taxes deductible in computing adjusted gross income are taken into account in computing the increased standard deduction.

Explanation of Provision

The provision extends the additional standard deduction for State and local real property taxes for one year.

Effective Date

The provision applies to taxable years beginning in 2009.

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[77] If the deduction for State and local taxes is attributable to business or rental income, the deduction is allowed in computing adjusted gross income and therefore is not an itemized deduction.

[78] In the case of an individual taxpayer who does not elect to itemize deductions, although no itemized deductions are allowed to the taxpayer, itemized deductions are nevertheless treated as "allowable." See section 63(e).

B. Extensions Primarily Affecting Businesses

1. Extend the research and experimentation tax credit (sec. 221 of the bill and sec. 41 of the Code)

Present Law

General rule

A taxpayer may claim a research credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses for a taxable year exceed its base amount for that year.[79] Thus, the research credit is generally available with respect to incremental increases in qualified research.

A 20-percent research tax credit is also available with respect to the excess of (1) 100 percent of corporate cash expenses (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the university basic research credit.[80]

Finally, a research credit is available for a taxpayer's expenditures on research undertaken by an energy research consortium. This separate credit computation is commonly referred to as the energy research credit. Unlike the other research credits, the energy research credit applies to all qualified expenditures, not just those in excess of a base amount.

The research credit, including the university basic research credit and the energy research credit, has expired and does not apply to amounts paid or incurred after December 31, 2007.[81]

Computation of allowable credit

Except for energy research payments and certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenses for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's fixed-base percentage by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenses and had gross receipts during each of at

[79] Sec. 41.

[80] Sec. 41(e).

[81] The research tax credit was initially enacted in the Economic Recovery Tax Act of 1981. It has been subsequently extended and modified numerous times. Most recently, the Tax Relief and Health Care Act of 2006 extended the research credit through December 31, 2007, modified the alternative incremental research credit, and added an election to claim an alternative simplified credit.

least three years from 1984 through 1988, then its fixed-base percentage is the ratio that its total qualified research expenses for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum fixed-base percentage of 16 percent). All other taxpayers (so-called start-up firms) are assigned a fixed-base percentage of three percent.[82]

In computing the credit, a taxpayer's base amount cannot be less than 50 percent of its current-year qualified research expenses.

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, a special aggregation rule provides that all members of the same controlled group of corporations are treated as a single taxpayer.[83] Under regulations prescribed by the Secretary, special rules apply for computing the credit when a major portion of a trade or business (or unit thereof) changes hands, under which qualified research expenses and gross receipts for periods prior to the change of ownership of a trade or business are treated as transferred with the trade or business that gave rise to those expenses and receipts for purposes of recomputing a taxpayer's fixed-base percentage.[84]

Alternative incremental research credit regime

Taxpayers are allowed to elect an alternative incremental research credit regime.[85] If a taxpayer elects to be subject to this alternative regime, the taxpayer is assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise is reduced.

Generally, for amounts paid or incurred prior to 2007, under the alternative incremental credit regime, a credit rate of 2.65 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of one percent (i.e., the base amount equals one percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base

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[82] The Small Business Job Protection Act of 1996 expanded the definition of start-up firms under section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983. A special rule (enacted in 1993) is designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm is assigned a fixed-base percentage of three percent for each of its first five taxable years after 1993 in which it incurs qualified research expenses. A start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenses is a phased-in ratio based on the firm's actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage is its actual ratio of qualified research expenses to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993. Sec. 41(c)(3)(B).

[83] Sec. 41(f)(1).

[84] Sec. 41(f)(3).

[85] Sec. 41(c)(4).

percentage of 1.5 percent. A credit rate of 3.2 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of two percent. A credit rate of 3.75 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of two percent. Generally, for amounts paid or incurred after 2006, the credit rates listed above are increased to three percent, four percent, and five percent, respectively.[86]

An election to be subject to this alternative incremental credit regime can be made for any taxable year beginning after June 30, 1996, and such an election applies to that taxable year and all subsequent years unless revoked with the consent of the Secretary of the Treasury.

Alternative simplified credit

Generally, for amounts paid or incurred after 2006, taxpayers may elect to claim an alternative simplified credit for qualified research expenses.[87] The alternative simplified research credit is equal to 12 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. The rate is reduced to six percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years.

An election to use the alternative simplified credit applies to all succeeding taxable years unless revoked with the consent of the Secretary. An election to use the alternative simplified credit may not be made for any taxable year for which an election to use the alternative incremental credit is in effect. A transition rule applies which permits a taxpayer to elect to use the alternative simplified credit in lieu of the alternative incremental credit if such election is made during the taxable year which includes January 1, 2007. The transition rule applies only to the taxable year which includes that date.

Eligible expenses

Qualified research expenses eligible for the research tax credit consist of: (1) in-house expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid or incurred by the taxpayer to certain other persons for qualified research conducted on the taxpayer's behalf (so-called contract research expenses).[88] Notwithstanding the limitation for

[86] A special transition rule applies for fiscal year 2006-2007 taxpayers.

[87] A special transition rule applies for fiscal year 2006-2007 taxpayers.

[88] Under a special rule, 75 percent of amounts paid to a research consortium for qualified research are treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under section 41(b)(3) governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research,

contract research expenses, qualified research expenses include 100 percent of amounts paid or incurred by the taxpayer to an eligible small business, university, or Federal laboratory for qualified energy research.

To be eligible for the credit, the research does not only have to satisfy the requirements of present-law section 174 (described below) but also must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and substantially all of the activities of which constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors.[89] In addition, research does not qualify for the credit: (1) if conducted after the beginning of commercial production of the business component; (2) if related to the adaptation of an existing business component to a particular customer's requirements; (3) if related to the duplication of an existing business component from a physical examination of the component itself or certain other information; or (4) if related to certain efficiency surveys, management function or technique, market research, market testing, or market development, routine data collection or routine quality control.[90] Research does not qualify for the credit if it is conducted outside the United States, Puerto Rico, or any U.S. possession.

Relation to deduction

Under section 174, taxpayers may elect to deduct currently the amount of certain research or experimental expenditures paid or incurred in connection with a trade or business, notwithstanding the general rule that business expenses to develop or create an asset that has a useful life extending beyond the current year must be capitalized.[91] However, deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year.[92] Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed.[93]

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and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer. Sec. 41(b)(3)(C).

[89] Sec. 41(d)(3).

[90] Sec. 41(d)(4).

[91] Taxpayers may elect 10-year amortization of certain research expenditures allowable as a deduction under section 174(a). Secs. 174(f)(2) and 59(e).

[92] Sec. 280C(c).

[93] Sec. 280C(c)(3).

Explanation of Provision

The provision extends the research credit for two years, through December 31, 2009. The provision also clarifies the computation of the alternative incremental research credit and the alternative simplified credit for the taxable year in which the credit terminates.

Effective Date

The provision is effective for amounts paid or incurred after December 31, 2007.

2. Indian employment tax credit (sec. 222 of the bill and sec. 45A of the Code)

Present Law

In general, a credit against income tax liability is allowed to employers for the first $20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer with respect to certain employees (sec. 45A). The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs during the current year over the amount of such wages and costs incurred by the employer during 1993. The credit is an incremental credit, such that an employer's current-year qualified wages and qualified employee health insurance costs (up to $20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993. No deduction is allowed for the portion of the wages equal to the amount of the credit.

Qualified wages means wages paid or incurred by an employer for services performed by a qualified employee. A qualified employee means any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed. An "Indian reservation" is a reservation as defined in section 3(d) of the Indian Financing Act of 1974 or section 4(1) of the Indian Child Welfare Act of 1978. For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

An employee is not treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during the taxable year exceeds an amount determined at an annual rate of $30,000 (which after adjustment for inflation is currently $40,000).[94] In addition, an employee will not be treated as a qualified employee under certain specific circumstances, such as where the employee is related to the employer (in the case of an individual employer) or to one of the employer's shareholders, partners, or grantors. Similarly, an employee will not be treated as a qualified employee where the employee has more than a 5 percent ownership interest in the employer. Finally, an

[94] See Form 8845, Indian Employment Credit (Rev. December 2006).

employee will not be considered a qualified employee to the extent the employee's services relate to gaming activities or are performed in a building housing such activities.

The Indian employment tax credit is not available for taxable years beginning after December 31, 2007.

Explanation of Provision

The provision extends for two years the present-law employment credit provision (through taxable years beginning on or before December 31, 2009).

Effective Date

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

3. Extend the new markets tax credit (sec. 223 of the bill and sec. 45D of the Code)

Present Law

Section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity ("CDE").[95] The amount of the credit allowable to the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for each of the following two years, and (2) a six-percent credit for each of the following four years. The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available for a taxable year to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year. The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity ceases to be a qualified CDE, the proceeds of the investment cease to be used as required, or the equity investment is redeemed.

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE. A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired directly from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder. Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments. For this purpose, qualified low-income community investments include: (1) capital

[95] Section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554 (December 21, 2000).

or equity investments in, or loans to, qualified active low-income community businesses; (2) certain financial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.

A "low-income community" is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (rather than 80 percent) of statewide median family income. For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary has the authority to designate "targeted populations" as low-income communities for purposes of the new markets tax credit. For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (12 U.S.C. 4702(20)) to mean individuals, or an identifiable group of individuals, including an Indian tribe, who (A) are low-income persons; or (B) otherwise lack adequate access to loans or equity investments. Under such Act, "low-income" means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide non-metropolitan area median family income.[96] Under such Act, a targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under section 1391, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of such business is used in a low-income community; (3) a substantial portion of the services performed for such business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted bases of the property of such business is attributable to certain financial property or to certain collectibles.

[96] 12 U.S.C. 4702(17) (defines "low-income" for purposes of 12 U.S.C. 4702(20)).

The maximum annual amount of qualified equity investments is capped at $2.0 billion per year for calendar years 2004 and 2005, and at $3.5 billion per year for calendar years 2006, 2007, and 2008.

Explanation of Provision

The provision extends the new markets tax credit for one year, through 2009, permitting up to $3.5 billion in qualified equity investments for that calendar year.

Effective Date

The provision is effective on the date of enactment.

4. Railroad track maintenance (sec. 224 of the bill and sec. 45G of the Code)

Present Law

Present law provides a 50-percent business tax credit for qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer during the taxable year.[97] The credit is limited to the product of $3,500 times the number of miles of railroad track (1) owned or leased by an eligible taxpayer as of the close of its taxable year, and (2) assigned to the eligible taxpayer by a Class II or Class III railroad that owns or leases such track at the close of the taxable year.[98] Each mile of railroad track may be taken into account only once, either by the owner of such mile or by the owner's assignee, in computing the per-mile limitation. Under the provision, the credit is limited in respect of the total number of miles of track (1) owned or leased by the Class II or Class III railroad and (2) assigned to the Class II or Class III railroad for purposes of the credit.

Qualified railroad track maintenance expenditures are defined as gross expenditures (whether or not otherwise chargeable to capital account) for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by a Class II or Class III railroad (determined without regard to any consideration for such expenditure given by the Class II or Class III railroad which made the assignment of such track).[99]

An eligible taxpayer means any Class II or Class III railroad, and any person who transports property using the rail facilities of a Class II or Class III railroad or who furnishes railroad-related property or services to a Class II or Class III railroad, but only with respect to miles of railroad track assigned to such person by such railroad under the provision.[100]

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[97] Sec. 45G(a).

[98] Sec. 45G(b)(1).

[99] Sec. 45G(d).

[100] Sec. 45G(c).

The terms Class II or Class III railroad have the meanings given by the Surface Transportation Board.[101]

The provision applies to qualified railroad track maintenance expenditures paid or incurred during taxable years beginning after December 31, 2004, and before January 1, 2008.

Explanation of Provision

The provision extends the present law provision for two years, for qualified railroad track maintenance expenditures paid or incurred before January 1, 2010.

Effective Date

The provision is effective for expenditures paid or incurred during taxable years beginning after December 31, 2007.

5. Fifteen-year straight-line cost recovery for qualified leasehold improvements and qualified restaurant property (sec. 225 of the bill and sec. 168 of the Code)

Present Law

In general

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[102] The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month.

Depreciation of leasehold improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease. This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the

[101] Sec. 45G(e)(1).

[102] Sec. 168.

improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions exist for certain qualified leasehold improvements and qualified restaurant property.

Qualified leasehold improvement property

Section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2008. Qualified leasehold improvement property is recovered using the straight-line method and a half-year convention. Leasehold improvements placed in service in 2008 and later will be subject to the general rules described above.

Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met. The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.

If a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement. An exception to the rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment.

Qualified restaurant property

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property placed in service before January 1, 2008. For purposes of the provision, qualified restaurant property means any improvement to a building if such improvement is placed in service more than three years after the date such building was first placed in service and more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals. Qualified restaurant property is recovered using the straight-line method and a half-year convention. Restaurant property placed in service in 2008 and later will be subject to the general rules described above.

Explanation of Provision

The present-law provisions for qualified leasehold improvement property and qualified restaurant property are extended for two years through December 31, 2009.

Effective Date

The provision applies to property placed in service after December 31, 2007.

6. Seven-year recovery period for motorsports racing track facility (sec. 226 of the bill and sec. 168 of the Code)

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[103] The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month. Land improvements (such as roads and fences) are recovered over 15 years. An exception exists for the theme and amusement park industry, whose assets are assigned a recovery period of seven years. Additionally, a motorsports entertainment complex placed in service before December 31, 2007 is assigned a recovery period of seven years.[104] For these purposes, a motorsports entertainment complex means a racing track facility which is permanently situated on land that during the 36 month period following its placed in service date it hosts a racing event.[105] The term motorsports entertainment complex also includes ancillary facilities, land improvements (e.g., parking lots, sidewalks, fences), support facilities (e.g., food and beverage retailing, souvenir vending), and appurtenances associated with such facilities (e.g., ticket booths, grandstands).

Explanation of Provision

The provision extends the present law seven year recovery period for two years through December 31, 2009.

Effective Date

The provision is effective for property placed in service after December 31, 2007.

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[103] Sec. 168.

[104] Sec. 168(e)(3)(C)(ii).

[105] Sec. 168(i)(15).

7. Accelerated depreciation for business property on Indian reservation (sec. 227 of the bill and sec. 168 of the Code)

Present Law

With respect to certain property used in connection with the conduct of a trade or business within an Indian reservation, depreciation deductions under section 168(j) are determined using the following recovery periods:

3-year property	2 years
5-year property	3 years
7-year property	4 years
10-year property	6 years
15-year property	9 years
20-year property	12 years
Nonresidential real property	22 years

"Qualified Indian reservation property" eligible for accelerated depreciation includes property described in the table above which is: (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation; (2) not used or located outside the reservation on a regular basis; (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer;[106] and (4) is not property placed in service for purposes of conducting gaming activities.[107] Certain "qualified infrastructure property" may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities).[108]

An "Indian reservation" means a reservation as defined in section 3(d) of the Indian Financing Act of 1974 or section 4(10) of the Indian Child Welfare Act of 1978. For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

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[106] For these purposes, related persons is defined in Sec. 465(b)(3)(C).

[107] Sec. 168(j)(4)(A).

[108] Sec. 168(j)(4)(C).

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax. The accelerated depreciation for Indian reservations is available with respect to property placed in service on or after January 1, 1994, and before January 1, 2008.

Explanation of Provision

The provision extends for two years the present-law incentive relating to depreciation of qualified Indian reservation property (to apply to property placed in service through December 31, 2009).

Effective Date

The provision applies to property placed in service after December 31, 2007.

8. Expensing of environmental remediation costs (sec. 228 of the bill and sec. 198 of the Code)

Present Law

Present law allows a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[109] Treasury regulations provide that the cost of incidental repairs that neither materially add to the value of property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted currently as a business expense. Section 263(a)(1) limits the scope of section 162 by prohibiting a current deduction for certain capital expenditures. Treasury regulations define "capital expenditures" as amounts paid or incurred to materially add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or to adapt property to a new or different use. Amounts paid for repairs and maintenance do not constitute capital expenditures. The determination of whether an expense is deductible or capitalizable is based on the facts and circumstances of each case.

Taxpayers may elect to treat certain environmental remediation expenditures paid or incurred before January 1, 2008, that would otherwise be chargeable to capital account as deductible in the year paid or incurred.[110] The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. In general, any expenditure for the acquisition of depreciable property used in connection with the abatement or control of hazardous substances at a qualified contaminated site does not constitute a qualified environmental remediation expenditure. However, depreciation deductions allowable for such property, which would otherwise be allocated to the site under the principles set forth in

[109] Sec. 162.

[110] Sec. 198.

Commissioner v. Idaho Power Co.[111] and section 263A, are treated as qualified environmental remediation expenditures.

A "qualified contaminated site" (a so-called "brownfield") generally is any property that is held for use in a trade or business, for the production of income, or as inventory and is certified by the appropriate State environmental agency to be an area at or on which there has been a release (or threat of release) or disposal of a hazardous substance. Both urban and rural property may qualify. However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA")[112] cannot qualify as targeted areas. Hazardous substances generally are defined by reference to sections 101(14) and 102 of CERCLA, subject to additional limitations applicable to asbestos and similar substances within buildings, certain naturally occurring substances such as radon, and certain other substances released into drinking water supplies due to deterioration through ordinary use, as well as petroleum products defined in section 4612(a)(3) of the Code.

In the case of property to which a qualified environmental remediation expenditure otherwise would have been capitalized, any deduction allowed under section 198 is treated as a depreciation deduction and the property is treated as section 1245 property. Thus, deductions for qualified environmental remediation expenditures are subject to recapture as ordinary income upon a sale or other disposition of the property. In addition, sections 280B (demolition of structures) and 468 (special rules for mining and solid waste reclamation and closing costs) do not apply to amounts that are treated as expenses under this provision.

Section 1400N(g) permits the expensing of environmental remediation expenditures paid or incurred on or after August 28, 2005, and before January 1, 2008, to abate contamination at qualified contaminated sites located in the Gulf Opportunity Zone.

Explanation of Provision

The provision extends the present law expensing provision under section 198 for two years through December 31, 2009.

Effective Date

The provision is effective for expenditures paid or incurred after December 31, 2007.

[111] 418 U.S. 1 (1974).

[112] Pub. L. No. 96-510 (1980).

9. Extension of deduction for income attributable to domestic production activities in Puerto Rico (sec. 229 of the bill and sec. 199 of the Code)

Present Law

In general

Present law provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to a portion of the taxpayer's qualified production activities income. For taxable years beginning after 2009, the deduction is nine percent of that income. For taxable years beginning in 2005 and 2006, the deduction is three percent of qualified production activities income and for taxable years beginning in 2007, 2008, and 2009, the deduction is six percent of qualified production activities income. For taxpayers subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to just under 32 percent on qualified production activities income.

Qualified production activities income

In general, qualified production activities income is equal to domestic production gross receipts (defined by section 199(c)(4)), reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts and (2) other expenses, losses, or deductions which are properly allocable to those receipts.

Domestic production gross receipts

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[113] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film[114] produced by the taxpayer; (3) any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.

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[113] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

[114] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

Wage limitation

For taxable years beginning after May 17, 2006, the amount of the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[115] Wages paid to bona fide residents of Puerto Rico generally are not included in the wage limitation amount.[116]

Rules for Puerto Rico

When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia.[117] A special rule for determining domestic production gross receipts, however, provides that in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's gross receipts are taxable under the Federal income tax for individuals or corporations.[118] In computing the 50-percent wage limitation, that taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.[119]

The special rules for Puerto Rico apply only with respect to the first two taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2008.

Explanation of Provision

The provision allows the special domestic production activities rules for Puerto Rico to apply for the first four taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2010.

Effective Date

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

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[115] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. For taxable years beginning before May 18, 2006, the limitation is based upon all wages paid by the taxpayer, rather than only wages properly allocable to domestic production gross receipts.

[116] Sec. 3401(a)(8)(C).

[117] Sec. 7701(a)(9).

[118] Sec. 199(d)(8)(A).

[119] Sec. 199(d)(8)(B).

10. Modification of tax treatment of certain payments to controlling exempt organizations (sec. 230 of the bill and sec. 512 of the Code)

Present Law

In general, organizations exempt from Federal income tax are subject to the unrelated business income tax on income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[120] In general, interest, rents, royalties, and annuities are excluded from the unrelated business income of tax-exempt organizations.[121]

Section 512(b)(13) provides special rules regarding income derived by an exempt organization from a controlled subsidiary. In general, section 512(b)(13) treats otherwise excluded rent, royalty, annuity, and interest income as unrelated business income if such income is received from a taxable or tax-exempt subsidiary that is 50-percent controlled by the parent tax-exempt organization to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt). However, a special rule enacted as part of the Pension Protection Act of 2006 provides that, for payments made pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), the general rule of section 512(b)(13) applies only to the portion of payments received or accrued (before January 1, 2008) in a taxable year that exceeds the amount of the payment that would have been paid or accrued if the amount of such payment had been determined under the principles of section 482 (i.e., at arm's length).[122] In addition, the special rule imposes a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

In the case of a stock subsidiary, "control" means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, "control" means ownership of more than 50 percent of the profits, capital, or beneficial interests. In addition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

Explanation of Provision

The provision extends the special rule of the Pension Protection Act to payments received or accrued before January 1, 2010. Accordingly, under the provision, payments of rent,

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[120] Sec. 511.

[121] Sec. 512(b).

[122] Sec. 512(b)(13)(E).

royalties, annuities, or interest income by a controlled organization to a controlling organization pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), may be includible in the unrelated business taxable income of the controlling organization only to the extent the payment exceeds the amount of the payment determined under the principles of section 482 (i.e., at arm's length). Any such excess is subject to a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

Effective Date

The provision is effective for payments received or accrued after December 31, 2007.

11. Extend and modify qualified zone academy bonds (sec. 231 of the bill and new sec. 54D of the Code)

Present Law

Tax-exempt bonds

Interest on State and local governmental bonds generally is excluded from gross income for Federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. Activities that can be financed with these tax-exempt bonds include the financing of public schools.[123] An issuer must file with the IRS certain information about the bonds issued by them in order for that bond issue to be tax-exempt.[124] Generally, this information return is required to be filed no later the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

The tax exemption for State and local bonds does not apply to any arbitrage bond.[125] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[126] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

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[123] Sec. 103.

[124] Sec. 149(e).

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

[126] Sec. 148.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments were given the authority to issue "qualified zone academy bonds."[127] A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2007. The $400 million aggregate bond cap is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

Financial institutions that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate multiplied by the face amount of the bond. A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includable in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and alternative minimum tax liability.

The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the bond was 50 percent of the face value of the bond.

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

A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community designated under the Code, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

The Tax Relief and Health Care Act of 2006 ("TRHCA")[128] imposed the arbitrage requirements that generally apply to interest-bearing tax-exempt bonds to qualified zone academy bonds. In addition, an issuer of qualified zone academy bonds must reasonably expect to and actually spend 95 percent or more of the proceeds of such bonds on qualified zone academy property within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified zone academy property during

[127] Sec. 1397E.

[128] Pub. L. No. 109-432 (2006).

the five-year spending period, bonds will continue to qualify as qualified zone academy bonds if unspent proceeds are used within 90 days from the end of such five-year period to redeem any nonqualified bonds. The five-year spending period may be extended by the Secretary if the issuer establishes that the failure to meet the spending requirement is due to reasonable cause and the related purposes for issuing the bonds will continue to proceed with due diligence. Issuers of qualified zone academy bonds are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds.

Explanation of Provision

The provision extends and modifies the present-law qualified zone academy bond program. The provision authorizes issuance of up to $400 million of qualified zone academy bonds annually through 2009.

For bonds issued after the date of enactment, the provision also modifies the spending and arbitrage rules that apply to qualified zone academy bonds. The provision modifies the spending rule by requiring 100 percent of available project proceeds to be spent on qualified zone academy property. In addition, the provision modifies the arbitrage rules by providing that available project proceeds invested during the five-year period beginning on the date of issue are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). The provision defines "available project proceeds" as proceeds from the sale of an issue of qualified zone academy bonds, less issuance costs (not to exceed two percent) and any investment earnings on such proceeds. Thus, available project proceeds invested during the five-year spending period may be invested at unrestricted yields, but the earnings on such investments must be spent on qualified zone academy property.

The provision provides that amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified zone academy bonds are issued.

Effective Date

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

12. Tax incentives for investment in the District of Columbia (sec. 232 of the bill and secs. 1400, 1400A, 1400B, and 1400C of the Code)

Present Law

In general

The Taxpayer Relief Act of 1997 designated certain economically depressed census tracts within the District of Columbia as the District of Columbia Enterprise Zone (the "D.C. Zone"), within which businesses and individual residents are eligible for special tax incentives. The census tracts that compose the D.C. Zone are (1) all census tracts that presently are part of the

D.C. enterprise community designated under section 1391 (i.e., portions of Anacostia, Mt. Pleasant, Chinatown, and the easternmost part of the District), and (2) all additional census tracts within the District of Columbia where the poverty rate is not less than 20 percent. The D.C. Zone designation remained in effect for the period from January 1, 1998, through December 31, 2007. In general, the tax incentives available in connection with the D.C. Zone are a 20-percent wage credit, an additional $35,000 of section 179 expensing for qualified zone property, expanded tax-exempt financing for certain zone facilities, and a zero-percent capital gains rate from the sale of certain qualified D.C. zone assets.

Wage credit

A 20-percent wage credit is available to employers for the first $15,000 of qualified wages paid to each employee (i.e., a maximum credit of $3,000 with respect to each qualified employee) who (1) is a resident of the D.C. Zone, and (2) performs substantially all employment services within the D.C. Zone in a trade or business of the employer.

Wages paid to a qualified employee who earns more than $15,000 are eligible for the wage credit (although only the first $15,000 of wages is eligible for the credit). The wage credit is available with respect to a qualified full-time or part-time employee (employed for at least 90 days), regardless of the number of other employees who work for the employer. In general, any taxable business carrying out activities in the D.C. Zone may claim the wage credit, regardless of whether the employer meets the definition of a "D.C. Zone business."[129]

An employer's deduction otherwise allowed for wages paid is reduced by the amount of wage credit claimed for that taxable year.[130] Wages are not to be taken into account for purposes of the wage credit if taken into account in determining the employer's work opportunity tax credit under section 51 or the welfare-to-work credit under section 51A.[131] In addition, the $15,000 cap is reduced by any wages taken into account in computing the work opportunity tax credit or the welfare-to-work credit.[132] The wage credit may be used to offset up to 25 percent of alternative minimum tax liability.[133]

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[129] However, the wage credit is not available for wages paid in connection with certain business activities described in section 144(c)(6)(B) or certain farming activities. In addition, wages are not eligible for the wage credit if paid to (1) a person who owns more than five percent of the stock (or capital or profits interests) of the employer, (2) certain relatives of the employer, or (3) if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the business.

[130] Sec. 280C(a).

[131] Secs. 1400H(a), 1396(c)(3)(A) and 51A(d)(2).

[132] Secs. 1400H(a), 1396(c)(3)(B) and 51A(d)(2).

[133] Sec. 38(c)(2).

Section 179 expensing

In general, a D.C. Zone business is allowed an additional $35,000 of section 179 expensing for qualifying property placed in service by a D.C. Zone business.[134] The section 179 expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified zone property placed in service during the year by the taxpayer exceeds $200,000 ($500,000 for taxable years beginning after 2006 and before 2011). The term "qualified zone property" is defined as depreciable tangible property (including buildings), provided that (1) the property is acquired by the taxpayer (from an unrelated party) after the designation took effect, (2) the original use of the property in the D.C. Zone commences with the taxpayer, and (3) substantially all of the use of the property is in the D.C. Zone in the active conduct of a trade or business by the taxpayer.[135] Special rules are provided in the case of property that is substantially renovated by the taxpayer.

Tax-exempt financing

A qualified D.C. Zone business is permitted to borrow proceeds from tax-exempt qualified enterprise zone facility bonds (as defined in section 1394) issued by the District of Columbia.[136] Such bonds are subject to the District of Columbia's annual private activity bond volume limitation. Generally, qualified enterprise zone facility bonds for the District of Columbia are bonds 95 percent or more of the net proceeds of which are used to finance certain facilities within the D.C. Zone. The aggregate face amount of all outstanding qualified enterprise zone facility bonds per qualified D.C. Zone business may not exceed $15 million and may be issued only while the D.C. Zone designation is in effect.

Zero-percent capital gains

A zero-percent capital gains rate applies to capital gains from the sale of certain qualified D.C. Zone assets held for more than five years.[137] In general, a qualified "D.C. Zone asset" means stock or partnership interests held in, or tangible property held by, a D.C. Zone business. For purposes of the zero-percent capital gains rate, the D.C. Enterprise Zone is defined to include all census tracts within the District of Columbia where the poverty rate is not less than 10 percent.

In general, gain eligible for the zero-percent tax rate means gain from the sale or exchange of a qualified D.C. Zone asset that is (1) a capital asset or property used in the trade or business as defined in section 1231(b), and (2) acquired before January 1, 2008. Gain that is attributable to real property, or to intangible assets, qualifies for the zero-percent rate, provided

[134] Sec. 1397A.

[135] Sec. 1397D.

[136] Sec. 1400A.

[137] Sec. 1400B.

that such real property or intangible asset is an integral part of a qualified D.C. Zone business.[138] However, no gain attributable to periods before January 1, 1998, and after December 31, 2012, is qualified capital gain.

District of Columbia homebuyer tax credit

First-time homebuyers of a principal residence in the District of Columbia are eligible for a nonrefundable tax credit of up to $5,000 of the amount of the purchase price. The $5,000 maximum credit applies both to individuals and married couples. Married individuals filing separately can claim a maximum credit of $2,500 each. The credit phases out for individual taxpayers with adjusted gross income between $70,000 and $90,000 ($110,000-$130,000 for joint filers). For purposes of eligibility, "first-time homebuyer" means any individual if such individual did not have a present ownership interest in a principal residence in the District of Columbia in the one-year period ending on the date of the purchase of the residence to which the credit applies. The credit expired for purchases after December 31, 2007.[139]

Explanation of Provision

The provision extends the designation of the D.C. Zone for two years (through December 31, 2009), thus extending the wage credit and section 179 expensing for two years.

The provision extends the tax-exempt financing authority for two years, applying to bonds issued during the period beginning on January 1, 1998, and ending on December 31, 2009.

The provision extends the zero-percent capital gains rate applicable to capital gains from the sale of certain qualified D.C. Zone assets for two years.

The provision extends the first-time homebuyer credit for two years, through December 31, 2009.

Effective Date

The provision is effective for periods beginning after, bonds issued after, acquisitions after, and property purchased after December 31, 2007.

[138] However, sole proprietorships and other taxpayers selling assets directly cannot claim the zero-percent rate on capital gain from the sale of any intangible property (i.e., the integrally related test does not apply).

[139] Sec. 1400C(i).

13. Extension of economic development credit for American Samoa (sec. 233 of the bill and sec. 119 of Pub. L. No. 109-432)

Present and Prior Law

In general

For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit.[140] This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions.[141] For purposes of the credit, possessions included, among other places, American Samoa. Subject to certain limitations described below, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporation's non-U.S. source taxable income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions investment.[142] No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936.[143] The section 936 credit generally expired for taxable years beginning after December 31, 2005, but a special credit, described below, was allowed with respect to American Samoa.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business.

The possession tax credit was available only to a corporation that qualified as an existing credit claimant. The determination of whether a corporation was an existing credit claimant was made separately for each possession. The possession tax credit was computed separately for each possession with respect to which the corporation was an existing credit claimant, and the credit was subject to either an economic activity-based limitation or an income-based limitation.

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[140] Secs. 27(b), 936.

[141] Domestic corporations with activities in Puerto Rico are eligible for the section 30A economic activity credit. That credit is calculated under the rules set forth in section 936.

[142] Under phase-out rules described below, investment only in Guam, American Samoa, and the Northern Mariana Islands (and not in other possessions) now may give rise to income eligible for the section 936 credit.

[143] Sec. 936(c).

Qualification as existing credit claimant

A corporation was an existing credit claimant with respect to a possession if (1) the corporation was engaged in the active conduct of a trade or business within the possession on October 13, 1995, and (2) the corporation elected the benefits of the possession tax credit in an election in effect for its taxable year that included October 13, 1995.[144] A corporation that added a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceased to be an existing credit claimant as of the close of the taxable year ending before the date on which that new line of business was added.

Economic activity-based limit

Under the economic activity-based limit, the amount of the credit determined under the rules described above was not permitted to exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes.

Income-based limit

As an alternative to the economic activity-based limit, a taxpayer was permitted elect to apply a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income; in taxable years beginning in 1998 and subsequent years, the applicable percentage was 40 percent.

Repeal and phase out

In 1996, the section 936 credit was repealed for new claimants for taxable years beginning after 1995 and was phased out for existing credit claimants over a period including taxable years beginning before 2006. The amount of the available credit during the phase-out period generally was reduced by special limitation rules. These phase-out period limitation rules did not apply to the credit available to existing credit claimants for income from activities in Guam, American Samoa, and the Northern Mariana Islands. As described previously, the section 936 credit generally was repealed for all possessions, including Guam, American Samoa, and the Northern Mariana Islands, for all taxable years beginning after 2005, but a modified credit was allowed for activities in American Samoa.

[144] A corporation will qualify as an existing credit claimant if it acquired all the assets of a trade or business of a corporation that (1) actively conducted that trade or business in a possession on October 13, 1995, and (2) had elected the benefits of the possession tax credit in an election in effect for the taxable year that included October 13, 1995.

American Samoa economic development credit

A domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006 is allowed a credit based on the economic activity-based limitation rules described above. The credit is not part of the Code but is computed based on the rules secs. 30A and 936. The credit is allowed for the first two taxable years of a corporation that begin after December 31, 2005, and before January 1, 2008.

The amount of the credit allowed to a qualifying domestic corporation under the provision is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation (described previously) with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses and (2) 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

The section 936(c) rule denying a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the credit under section 936 does not apply with respect to the credit allowed by the provision.

The credit is not available for taxable years beginning after December 31, 2007.

Explanation of Provision

The provision allows the American Samoa economic development credit to apply for the first four taxable years of a corporation that begin after December 31, 2005, and before January 1, 2010.

Effective Date

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

14. Extension of the enhanced charitable deduction for contributions of food inventory (sec. 234 of the bill and sec. 170 of the Code)

Present Law

General rules regarding contributions of food inventory

Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or if less the fair market value of the inventory.

For certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.[145] In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.[146] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory.[147] Accordingly, if the allowable charitable deduction for inventory is the fair market value of the inventory, the donor reduces its cost of goods sold by such value, with the result that the difference between the fair market value and the donor's basis may still be recovered by the donor other than as a charitable contribution.

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.[148]

Temporary rule expanding and modifying the enhanced deduction for contributions of food inventory

Under a temporary provision enacted as part of the Katrina Emergency Tax Relief Act of 2005 and extended by the Pension Protection Act of 2006, any taxpayer, whether or not a C corporation, engaged in a trade or business is eligible to claim the enhanced deduction for donations of food inventory.[149] For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 10 percent of the

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[145] Sec. 170(e)(3).

[146] Sec. 170(b)(2).

[147] Treas. Reg. sec. 1.170A-4A(c)(3).

[148] *Lucky Stores Inc. v. Commissioner,* 105 T.C. 420 (1995) (holding that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted).

[149] Sec. 170(e)(3)(C).

taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships (or other non C corporation) from which contributions of apparently wholesome food are made. For example, if a taxpayer is a sole proprietor, a shareholder in an S corporation, and a partner in a partnership, and each business makes charitable contributions of food inventory, the taxpayer's deduction for donations of food inventory is limited to 10 percent of the taxpayer's net income from the sole proprietorship and the taxpayer's interests in the S corporation and partnership. However, if only the sole proprietorship and the S corporation made charitable contributions of food inventory, the taxpayer's deduction would be limited to 10 percent of the net income from the trade or business of the sole proprietorship and the taxpayer's interest in the S corporation, but not the taxpayer's interest in the partnership.[150]

Under the temporary provision, the enhanced deduction for food is available only for food that qualifies as "apparently wholesome food." "Apparently wholesome food" is defined as food intended for human consumption that meets all quality and labeling standards imposed by Federal, State, and local laws and regulations even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

The temporary provision does not apply to contributions made after December 31, 2007.

Explanation of Provision

The provision extends the expansion of, and modifications to, the enhanced deduction for charitable contributions of food inventory to contributions made before January 1, 2010.

Effective Date

The provision is effective for contributions made after December 31, 2007.

15. Extension of the enhanced charitable deduction for contributions of book inventory (sec. 235 of the bill and sec. 170 of the Code)

Present Law

Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or, if less, the fair market value of the inventory.

[150] The 10 percent limitation does not affect the application of the generally applicable percentage limitations. For example, if 10 percent of a sole proprietor's net income from the proprietor's trade or business was greater than 50 percent of the proprietor's contribution base, the available deduction for the taxable year (with respect to contributions to public charities) would be 50 percent of the proprietor's contribution base. Consistent with present law, such contributions may be carried forward because they exceed the 50 percent limitation. Contributions of food inventory by a taxpayer that is not a C corporation that exceed the 10 percent limitation but not the 50 percent limitation could not be carried forward.

In general, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.[151] In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.[152] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory.[153] Accordingly, if the allowable charitable deduction for inventory is the fair market value of the inventory, the donor reduces its cost of goods sold by such value, with the result that the difference between the fair market value and the donor's basis may still be recovered by the donor other than as a charitable contribution.

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

The Katrina Emergency Tax Relief Act of 2005 expanded the generally applicable enhanced deduction for C corporations to certain qualified book contributions made after August 28, 2005, and before January 1, 2006. The Pension Protection Act of 2006 extended the deduction for qualified book contributions to contributions made before January 1, 2008. A qualified book contribution means a charitable contribution of books to a public school that provides elementary education or secondary education (kindergarten through grade 12) and that is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The enhanced deduction for qualified book contributions is not allowed unless the donee organization certifies in writing that the contributed books are suitable, in terms of currency, content, and quantity, for use in the donee's educational programs and that the donee will use the books in such educational programs. The donee also must make the certifications required for the generally applicable enhanced deduction, i.e., the donee will (1) use the property consistent with the donee's exempt purpose solely for the care of

[151] Sec. 170(e)(3).

[152] Sec. 170(b)(2).

[153] Treas. Reg. sec. 1.170A-4A(c)(3).

the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.

Explanation of Provision

The provision extends the enhanced deduction for contributions of book inventory to contributions made before January 1, 2010.

Effective Date

The provision is effective for contributions made after December 31, 2007.

16. Extension of the enhanced charitable deduction for contributions of computer technology and equipment (sec. 236 of the bill and sec. 170 of the Code)

Present Law

In the case of a charitable contribution of inventory or other ordinary-income or short-term capital gain property, the amount of the charitable deduction generally is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose. In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property.[154]

Under present law, a taxpayer's deduction for charitable contributions of computer technology and equipment generally is limited to the taxpayer's basis (typically, cost) in the property. However, certain corporations may claim a deduction in excess of basis for a "qualified computer contribution."[155] This enhanced deduction is equal to the lesser of (1) basis plus one-half of the item's appreciation (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis. The enhanced deduction for qualified computer contributions expires for any contribution made during any taxable year beginning after December 31, 2007.

A qualified computer contribution means a charitable contribution of any computer technology or equipment, which meets standards of functionality and suitability as established by the Secretary of the Treasury. The contribution must be to certain educational organizations or public libraries and made not later than three years after the taxpayer acquired the property or, if the taxpayer constructed or assembled the property, not later than the date construction or

[154] Sec. 170(e)(1).

[155] Secs. 170(e)(4) and 170(e)(6).

assembly of the property is substantially completed.[156] The original use of the property must be by the donor or the donee,[157] and in the case of the donee, must be used substantially for educational purposes related to the function or purpose of the donee. The property must fit productively into the donee's education plan. The donee may not transfer the property in exchange for money, other property, or services, except for shipping, installation, and transfer costs. To determine whether property is constructed or assembled by the taxpayer, the rules applicable to qualified research contributions apply. Contributions may be made to private foundations under certain conditions.[158]

Explanation of Provision

The provision extends the enhanced deduction for computer technology and equipment for one year to apply to contributions made during any taxable year beginning after December 31, 2007, and before January 1, 2010.

Effective Date

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

17. Basis adjustment to stock of S corporations making charitable contributions of property (sec. 237 of the bill and sec. 1367 of the Code)

Present Law

Under present law, if an S corporation contributes money or other property to a charity, each shareholder takes into account the shareholder's pro rata share of the contribution in determining its own income tax liability.[159] A shareholder of an S corporation reduces the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder.[160]

In the case of contributions made in taxable years beginning after December 31, 2005, and before January 1, 2008, the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation is equal to the shareholder's pro rata share of the adjusted basis of the contributed property. For contributions

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[156] If the taxpayer constructed the property and reacquired such property, the contribution must be within three years of the date the original construction was substantially completed. Sec. 170(e)(6)(D)(i).

[157] This requirement does not apply if the property was reacquired by the manufacturer and contributed. Sec. 170(e)(6)(D)(ii).

[158] Sec. 170(e)(6)(C).

[159] Sec. 1366(a)(1)(A).

[160] Sec. 1367(a)(2)(B).

made in taxable years beginning after December 31, 2007, the amount of the reduction is the shareholder's pro rata share of the fair market value of the contributed property.

Explanation of Provision

The bill extends the rule relating to the basis reduction on account of charitable contributions of property for two years to contributions made in taxable years beginning before January 1, 2010.

Effective Date

The provision applies to contributions made in taxable years beginning after December 31, 2007.

18. Extension of the Hurricane Katrina work opportunity tax credit (sec. 238 of the bill)

Present Law

Work opportunity tax credit

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally an employer is eligible for the credit only for qualified wages paid to members of a targeted group. There are nine targeted groups: (1) families receiving Temporary Assistance for Needy Families Program ("TANF"); (2) qualified veterans; (3) qualified ex-felons; (4) designated community residents; (5) vocational rehabilitation referrals; (6) qualified summer youth employees; (7) qualified food stamp recipients; (8) qualified supplemental security income ("SSI") benefit recipients; and (9) qualified long-term family assistance recipients.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in sec. 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). There are two exceptions to this general rule. First, with respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Second, with respect to qualified veterans who are entitled to compensation for a service-connected disability, the maximum credit is $4,800 because qualified first-year wages are $12,000 rather than $6,000 for such individuals.[161] Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

Certification rules

An individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group; or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

Minimum employment period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

[161] The expanded definition of qualified first-year wages does not apply to the veterans qualified with reference to a food stamp program, as defined under present law.

Other rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than fifty-percent owner of the entity. Similarly, wages paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

The work opportunity tax credit is not available for individuals who begin work for an employer after August 31, 2011.

Work Opportunity Tax Credit for Hurricane Katrina Employees

In general

The Katrina Emergency Tax Relief Act of 2005 provided that a Hurricane Katrina employee is treated as a member of a targeted group for purposes of the work opportunity tax credit. A Hurricane Katrina employee was: (1) an individual who on August 28, 2005, had a principal place of abode in the core disaster area and was hired during the two-year period beginning on such date for a position, the principal place of employment of which was located in the core disaster area; and (2) an individual who on August 28, 2005, had a principal place of abode in the core disaster area, who was displaced from such abode by reason of Hurricane Katrina and was hired during the period beginning on such date and ending on December 31, 2005 without regard to whether the new principal place of employment is in the core disaster area.

The present-law WOTC certification requirement was waived for such individuals. In lieu of the certification requirement, an individual may have provided to the employer reasonable evidence that the individual is a Hurricane Katrina employee.

The present-law rule that denies the credit with respect to wages of employees who had been previously employed by the employer was waived for the first hire of such employee as a Hurricane Katrina employee unless such employee was an employee of the employer on August 28, 2005.

Definitions

The term "Hurricane Katrina disaster area" means an area with respect to which a major disaster has been declared by the President before September 14, 2005 under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

The term "core disaster area" means that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the

Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

Explanation of Provision

The provision extends through August 28, 2009, the work opportunity tax credit for certain Hurricane Katrina employees employed within the core disaster area. For this purpose, a Hurricane Katrina employee employed within the core disaster area is an individual who on August 28, 2005, had a principal place of abode in the core disaster area and is hired on or after August 28, 2005 and before August 29, 2009 for a position, the principal place of employment of which was located in the core disaster area.[162] The other special rules (e.g., certification and previous employment) for Hurricane Katrina employees apply.

Effective Date

The provision is effective for individuals hired after August 28, 2007, and before August 29, 2009.

19. Subpart F exception for active financing income (sec. 239 of the bill and secs. 953 and 954 of the Code)

Present Law

Under the subpart F rules,[163] 10-percent-or-greater U.S. shareholders of a controlled foreign corporation ("CFC") are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, insurance income and foreign base company income. Foreign base company income includes, among other things, foreign personal holding company income and foreign base company services income (i.e., income derived from services performed for or on behalf of a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents, and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and REMICs; (3) net gains from commodities transactions; (4) net gains from certain foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; (7) payments in lieu of dividends; and (8) amounts received under personal service contracts.

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[162] The prior-law work opportunity tax credit for Katrina employees hired to a new place of employment outside of the core disaster area is not extended by this provision.

[163] Secs. 951-964.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income.[164]

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the conduct of an insurance business (so-called "active financing income").[165]

With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the active financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met. Additional exceptions from foreign personal holding company income apply for certain income derived by a securities dealer within the meaning of section 475 and for gain from the sale of active financing assets.

In the case of a securities dealer, the temporary exception from foreign personal holding company income applies to certain income. The income covered by the exception is any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of section 475. In

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[164] Prop. Treas. Reg. sec. 1.953-1(a).

[165] Temporary exceptions from the subpart F provisions for certain active financing income applied only for taxable years beginning in 1998 (Taxpayer Relief Act of 1997, Pub. L. No. 105-34). Those exceptions were modified and extended for one year, applicable only for taxable years beginning in 1999 (the Tax and Trade Relief Extension Act of 1998, Pub. L. No. 105-277). The Tax Relief Extension Act of 1999 (Pub. L. No. 106-170) clarified and extended the temporary exceptions for two years, applicable only for taxable years beginning after 1999 and before 2002. The Job Creation and Worker Assistance Act of 2002 (Pub. L. No. 107-147) modified and extended the temporary exceptions for five years, for taxable years beginning after 2001 and before 2007. The Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. No. 109-222) extended the temporary provisions for two years, for taxable years beginning after 2006 and before 2009.

the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that this exception generally takes precedence over the exception for income of a banking, financing or similar business, in the case of a securities dealer.

In the case of insurance, a temporary exception from foreign personal holding company income applies for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. In the case of insurance, temporary exceptions from insurance income and from foreign personal holding company income also apply for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Further, additional temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions are met. In the case of a life insurance or annuity contract, reserves for such contracts are determined under rules specific to the temporary exceptions. Present law also permits a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

Explanation of Provision

The provision extends for one year (for taxable years beginning before 2010) the present-law temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business.

Effective Date

The provision is effective for taxable years of foreign corporations beginning after December 31, 2008, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

20. Look-through treatment of payments between related controlled foreign corporations under foreign personal holding company income rules (sec. 240 of the bill and sec. 954(c)(6) of the Code)

Present Law

In general

In general, the rules of subpart F (secs. 951-964) require U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation ("CFC") to include certain income of the CFC (referred to as "subpart F income") on a current basis for U.S. tax purposes, regardless of whether the income is distributed to the shareholders.

Subpart F income includes foreign base company income. One category of foreign base company income is foreign personal holding company income. For subpart F purposes, foreign personal holding company income generally includes dividends, interest, rents, and royalties, among other types of income. There are several exceptions to these rules. For example, foreign personal holding company income does not include dividends and interest received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized, or rents and royalties received by a CFC from a related corporation for the use of property within the country in which the CFC is organized. Interest, rent, and royalty payments do not qualify for this exclusion to the extent that such payments reduce the subpart F income of the payor. In addition, subpart F income of a CFC does not include any item of income from sources within the United States which is effectively connected with the conduct by such CFC of a trade or business within the United States ("ECI") unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a tax treaty.

The "look-through rule"[166]

Under the "look-through rule" (sec. 954(c)(6)), dividends, interest (including factoring income which is treated as equivalent to interest under section 954(c)(1)(E)), rents, and royalties received by one CFC from a related CFC are not treated as foreign personal holding company income to the extent attributable or properly allocable to income of the payor that is neither subpart F nor treated as ECI. For this purpose, a related CFC is a CFC that controls or is controlled by the other CFC, or a CFC that is controlled by the same person or persons that control the other CFC. Ownership of more than 50 percent of the CFC's stock (by vote or value) constitutes control for these purposes.

The Secretary is authorized to prescribe regulations that are necessary or appropriate to carry out the look-through rule, including such regulations as are appropriate to prevent the abuse of the purposes of such rule.

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[166] The look-through rule was enacted by the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, sec. 103(b)(1) (2006).

The look-through rule is effective for taxable years of foreign corporations beginning after December 31, 2005, but before January 1, 2009, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

Explanation of Provision

The provision extends for one year the application of the look-through rule, to taxable years of foreign corporations beginning before January 1, 2010, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

Effective Date

The provision is effective for taxable years of foreign corporations beginning after December 31, 2008 (but before January 1, 2010), and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

21. Expensing for certain qualified film and television productions (sec. 241 of the bill and sec. 181 of the Code)

Present Law

The modified Accelerated Cost Recovery System ("MACRS") does not apply to certain property, including any motion picture film, video tape, or sound recording, or to any other property if the taxpayer elects to exclude such property from MACRS and the taxpayer properly applies a unit-of-production method or other method of depreciation not expressed in a term of years. Section 197 does not apply to certain intangible property, including property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in a transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. Thus, the recovery of the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a "stand-alone" basis by the taxpayer may not be determined under either the MACRS depreciation provisions or under the section 197 amortization provisions. The cost recovery of such property may be determined under section 167, which allows a depreciation deduction for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property. 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. Section 167(g) provides that the cost of motion picture films, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method of depreciation.

Under section 181, taxpayers may elect[167] to deduct the cost of any qualifying film and television production, commencing prior to January 1, 2009, in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances.[168] A

[167] See Treas. Reg. section 1.181-2T for rules on making an election under this section.

[168] For this purpose, a production is treated as commencing on the first date of principal photography.

qualified film or television production is one in which the aggregate cost is $15 million or less.[169] The threshold is increased to $20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.[170]

A qualified film or television production means any production of a motion picture (whether released theatrically or directly to video cassette or any other format) or television program if at least 75 percent of the total compensation expended on the production is for services performed in the United States by actors, directors, producers, and other relevant production personnel.[171] The term "compensation" does not include participations and residuals (as defined in section 167(g)(7)(B)).[172] With respect to property which is one or more episodes in a television series, each episode is treated as a separate production and only the first 44 episodes qualify under the provision.[173] Qualified property does not include sexually explicit productions as defined by section 2257 of title 18 of the U.S. Code.[174]

For purposes of recapture under section 1245, any deduction allowed under section 181 is treated as if it were a deduction allowable for amortization.[175]

Explanation of Provision

The provision extends the provision for one year, to qualified film and television productions commencing prior to January 1, 2010.

Effective Date

The provision applies to qualified film and television productions commencing after December 31, 2008.

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[169] Sec. 181(a)(2)(A). A qualifying film or television production that is co-produced is eligible for the benefits of the provision only if its aggregate cost, regardless of funding source, does not exceed the threshold.

[170] Sec. 181(a)(2)(B).

[171] Sec. 181(d)(3)(A).

[172] Sec. 181(d)(3)(B).

[173] Sec. 181(d)(2)(B).

[174] Sec. 181(d)(2)(C).

[175] Sec. 1245(a)(2)(C).

C. Other Extensions

1. Authority to disclose information related to terrorist activity made permanent (sec. 251 of the bill and sec. 6103 of the Code)

Present Law

In general

Section 6103 provides that returns and return information may not be disclosed by the IRS, other Federal employees, State employees, and certain others having access to the information except as provided in the Internal Revenue Code. Section 6103 contains a number of exceptions to this general rule of nondisclosure that authorize disclosure in specifically identified circumstances (including nontax criminal investigations) when certain conditions are satisfied.

Disclosure provisions relating to emergency circumstances

The IRS is authorized to disclose return information to apprise Federal law enforcement agencies of danger of death or physical injury to an individual or to apprise Federal law enforcement agencies of imminent flight of an individual from Federal prosecution.[176] This authority has been used in connection with the investigation of terrorist activity.[177]

Disclosure provisions relating specifically to terrorist activity

Also among the disclosures permitted under the Code is disclosure of returns and return information for purposes of investigating terrorist incidents, threats, or activities, and for analyzing intelligence concerning terrorist incidents, threats, or activities. The term "terrorist incident, threat, or activity" is statutorily defined to mean an incident, threat, or activity involving an act of domestic terrorism or international terrorism.[178]

The term "international terrorism" means activities that involve violent acts or acts dangerous to human life that are a violation of the criminal laws of the United States or of any State, or that would be a criminal violation if committed within the jurisdiction of the United States or of any State; appear to be intended to intimidate or coerce a civilian population, to influence the policy of a government by intimidation or coercion, or to affect the conduct of a government by mass destruction, assassination, or kidnapping; and occur primarily outside the territorial jurisdiction of the United States, or transcend national boundaries in terms of the

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[176] Sec. 6103(i)(3)(B).

[177] See, Joint Committee on Taxation, *Disclosure Report for Public Inspection Pursuant to Internal Revenue Code Section 6103(p)(3)(C) for Calendar Year 2002 (JCX-29-04)* April 6, 2004.

[178] Sec. 6103(b)(11). For this purpose, "domestic terrorism" is defined in 18 U.S.C. sec. 2331(5) and "international terrorism" is defined in 18 U.S.C. sec. 2331(1).

means by which they are accomplished, the persons they appear intended to intimidate or coerce, or the locale in which their perpetrators operate or seek asylum. The term "domestic terrorism" means activities that involve acts dangerous to human life that are a violation of the criminal laws of the United States or of any State; appear to be intended to intimidate or coerce a civilian population, to influence the policy of a government by intimidation or coercion or to affect the conduct of a government by mass destruction, assassination, or kidnapping; and occur primarily within the territorial jurisdiction of the United States.

In general, returns and taxpayer return information must be obtained pursuant to an ex parte court order. Return information, other than taxpayer return information, generally is available upon a written request meeting specific requirements. The IRS also is permitted to make limited disclosures of such information on its own initiative to the appropriate Federal law enforcement agency.

No disclosures may be made under these provisions after December 31, 2007. The procedures applicable to these provisions are described in detail below.

Disclosure of returns and return information - by ex parte court order

Ex parte court orders sought by Federal law enforcement and Federal intelligence agencies

The Code permits, pursuant to an ex parte court order, the disclosure of returns and return information (including taxpayer return information) to certain officers and employees of a Federal law enforcement agency or Federal intelligence agency. These officers and employees are required to be personally and directly engaged in any investigation of, response to, or analysis of intelligence and counterintelligence information concerning any terrorist incident, threat, or activity. These officers and employees are permitted to use this information solely for their use in the investigation, response, or analysis, and in any judicial, administrative, or grand jury proceeding, pertaining to any such terrorist incident, threat, or activity.

The Attorney General, Deputy Attorney General, Associate Attorney General, an Assistant Attorney General, or a United States attorney, may authorize the application for the ex parte court order to be submitted to a Federal district court judge or magistrate. The Federal district court judge or magistrate would grant the order if based on the facts submitted he or she determines that: (1) there is reasonable cause to believe, based upon information believed to be reliable, that the return or return information may be relevant to a matter relating to such terrorist incident, threat, or activity; and (2) the return or return information is sought exclusively for the use in a Federal investigation, analysis, or proceeding concerning any terrorist incident, threat, or activity.

Special rule for ex parte court ordered disclosure initiated by the IRS

If the Secretary of the Treasury (or his delegate) possesses returns or return information that may be related to a terrorist incident, threat, or activity, the Secretary may, on his own initiative, authorize an application for an ex parte court order to permit disclosure to Federal law enforcement. In order to grant the order, the Federal district court judge or magistrate must determine that there is reasonable cause to believe, based upon information believed to be

reliable, that the return or return information may be relevant to a matter relating to such terrorist incident, threat, or activity. The information may be disclosed only to the extent necessary to apprise the appropriate Federal law enforcement agency responsible for investigating or responding to a terrorist incident, threat, or activity and for officers and employees of that agency to investigate or respond to such terrorist incident, threat, or activity. Further, use of the information is limited to use in a Federal investigation, analysis, or proceeding concerning a terrorist incident, threat, or activity. Because the Department of Justice represents the Secretary in Federal district court, the Secretary is permitted to disclose returns and return information to the Department of Justice as necessary and solely for the purpose of obtaining the special IRS ex parte court order.

Disclosure of return information other than by ex parte court order

Disclosure by the IRS without a request

The Code permits the IRS to disclose return information, other than taxpayer return information, related to a terrorist incident, threat, or activity to the extent necessary to apprise the head of the appropriate Federal law enforcement agency responsible for investigating or responding to such terrorist incident, threat, or activity. The IRS on its own initiative and without a written request may make this disclosure. The head of the Federal law enforcement agency may disclose information to officers and employees of such agency to the extent necessary to investigate or respond to such terrorist incident, threat, or activity. A taxpayer's identity is not treated as return information supplied by the taxpayer or his or her representative.

Disclosure upon written request of a Federal law enforcement agency

The Code permits the IRS to disclose return information, other than taxpayer return information, to officers and employees of Federal law enforcement upon a written request satisfying certain requirements. The request must: (1) be made by the head of the Federal law enforcement agency (or his delegate) involved in the response to or investigation of terrorist incidents, threats, or activities, and (2) set forth the specific reason or reasons why such disclosure may be relevant to a terrorist incident, threat, or activity. The information is to be disclosed to officers and employees of the Federal law enforcement agency who would be personally and directly involved in the response to or investigation of terrorist incidents, threats, or activities. The information is to be used by such officers and employees solely for such response or investigation.

The Code permits the redisclosure by a Federal law enforcement agency to officers and employees of State and local law enforcement personally and directly engaged in the response to or investigation of the terrorist incident, threat, or activity. The State or local law enforcement agency must be part of an investigative or response team with the Federal law enforcement agency for these disclosures to be made.

Disclosure upon request from the Departments of Justice or the Treasury for intelligence analysis of terrorist activity

Upon written request satisfying certain requirements discussed below, the IRS is to disclose return information (other than taxpayer return information) to officers and employees of

the Department of Justice, Department of the Treasury, and other Federal intelligence agencies, who are personally and directly engaged in the collection or analysis of intelligence and counterintelligence or investigation concerning terrorist incidents, threats, or activities. Use of the information is limited to use by such officers and employees in such investigation, collection, or analysis.

The written request is to set forth the specific reasons why the information to be disclosed is relevant to a terrorist incident, threat, or activity. The request is to be made by an individual who is: (1) an officer or employee of the Department of Justice or the Department of the Treasury, (2) appointed by the President with the advice and consent of the Senate, and (3) responsible for the collection, and analysis of intelligence and counterintelligence information concerning terrorist incidents, threats, or activities. The Director of the United States Secret Service also is an authorized requester.

Explanation of Provision

The provision makes permanent the present-law disclosure authority relating to terrorist activities.

Effective Date

The provision is effective for disclosures made on or after the date of enactment.

2. Extension of IRS authority to fund undercover operations (sec. 252 of the bill and sec. 7608 of the Code)

Present Law

IRS undercover operations are statutorily[179] exempt from the generally applicable restrictions controlling the use of Government funds (which generally provide that all receipts must be deposited in the general fund of the Treasury and all expenses be paid out of appropriated funds). In general, the Code permits the IRS to use proceeds from an undercover operation to pay additional expenses incurred in the undercover operation, through 2007. The IRS is required to conduct a detailed financial audit of large undercover operations in which the IRS is churning funds and to provide an annual audit report to the Congress on all such large undercover operations.

Explanation of Provision

The provision makes permanent the IRS's authority to use proceeds from an undercover operation to pay additional expenses incurred in the undercover operation.

[179] Sec. 7608(c).

Effective Date

The provision shall take effect on January 1, 2008.

3. Suspend limitation on rate of rum excise tax cover over to Puerto Rico and Virgin Islands (sec. 253 of the bill and sec. 7652(f) of the Code)

Present Law

A $13.50 per proof gallon[180] excise tax is imposed on distilled spirits produced in or imported (or brought) into the United States.[181] The excise tax does not apply to distilled spirits that are exported from the United States, including exports to U.S. possessions (e.g., Puerto Rico and the Virgin Islands).[182]

The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.[183] The amount of the cover over is limited under Code section 7652(f) to $10.50 per proof gallon ($13.25 per proof gallon during the period July 1, 1999 through December 31, 2007).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are divided and covered over to the two possessions under a formula.[184] Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.[185] All of the amounts covered over are subject to the limitation.

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[180] A proof gallon is a liquid gallon consisting of 50 percent alcohol. *See* sec. 5002(a)(10) and (11).

[181] Sec. 5001(a)(1).

[182] Secs. 5062(b), 7653(b) and (c).

[183] Secs. 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under section 7652(b)(3).

[184] Sec. 7652(e)(2).

[185] Secs. 7652(a)(3), (b)(3), and (e)(1).

Explanation of Provision

The provision suspends for two years the $10.50 per proof gallon limitation on the amount of excise taxes on rum covered over to Puerto Rico and the Virgin Islands. Under the provision, the cover over amount of $13.25 per proof gallon is extended for rum brought into the United States after December 31, 2007 and before January 1, 2010. After December 31, 2009, the cover over amount reverts to $10.50 per proof gallon.

Effective Date

The change in the cover over rate is effective for articles brought into the United States after December 31, 2007.

TITLE III ─ADDITIONAL TAX RELIEF AND OTHER TAX PROVISIONS

1. Refundable child credit (sec. 301 of the bill and sec. 24(d) of the Code)

Present Law

An individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is $1,000 through 2010, and $500 thereafter. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The credit is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified adjusted gross income includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The credit is allowable against the regular tax and the alternative minimum tax. To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). The threshold dollar amount is $12,050 (2008), and is indexed for inflation.

Families with three or more children may determine the additional child tax credit using the "alternative formula," if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit ("EIC").

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. Unlike the EIC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EIC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

Explanation of Provision

The provision modifies the earned income formula for the determination of the refundable child credit to apply to 15 percent of earned income in excess of $8,500 for taxable years beginning in 2009.

Effective Date

The provision is effective for taxable years beginning in 2009.

2. Modification of expensing for certain qualified film and television production (sec. 302(a) of the bill and sec. 181 of the Code)

Present Law

The modified Accelerated Cost Recovery System ("MACRS") does not apply to certain property, including any motion picture film, video tape, or sound recording, or to any other property if the taxpayer elects to exclude such property from MACRS and the taxpayer properly applies a unit-of-production method or other method of depreciation not expressed in a term of years. Section 197 does not apply to certain intangible property, including property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in a transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. Thus, the recovery of the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a "stand-alone" basis by the taxpayer may not be determined under either the MACRS depreciation provisions or under the section 197 amortization provisions. The cost recovery of such property may be determined under section 167, which allows a depreciation deduction for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property. 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. Section 167(g) provides that the cost of motion picture films, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method of depreciation.

Under section 181, taxpayers may elect[186] to deduct the cost of any qualifying film and television production, commencing prior to January 1, 2009, in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances.[187] A qualified film or television production is one in which the aggregate cost is $15 million or less.[188] The threshold is increased to $20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.[189]

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[186] See Treas. Reg. section 1.181-2T for rules on making an election under this section.

[187] For this purpose, a production is treated as commencing on the first date of principal photography.

[188] Sec. 181(a)(2)(A). A qualifying film or television production that is co-produced is eligible for the benefits of the provision only if its aggregate cost, regardless of funding source, does not exceed the threshold.

[189] Sec. 181(a)(2)(B).

A qualified film or television production means any production of a motion picture (whether released theatrically or directly to video cassette or any other format) or television program if at least 75 percent of the total compensation expended on the production is for services performed in the United States by actors, directors, producers, and other relevant production personnel.[190] The term "compensation" does not include participations and residuals (as defined in section 167(g)(7)(B)).[191] With respect to property which is one or more episodes in a television series, each episode is treated as a separate production and only the first 44 episodes qualify under the provision.[192] Qualified property does not include sexually explicit productions as defined by section 2257 of title 18 of the U.S. Code.[193]

For purposes of recapture under section 1245, any deduction allowed under section 181 is treated as if it were a deduction allowable for amortization.[194]

Explanation of Provision

The provision modifies the dollar limitation so that the first $15 million ($20 million for productions in low income communities or distressed area or isolated area of distress) of an otherwise qualified film or television production may be treated as an expense in cases where the aggregate cost of the production exceeds the dollar limitation. The cost of the production in excess of the dollar limitation is capitalized and recovered under the taxpayer's method of accounting for the recovery of such property.

Effective Date

The provision applies to qualified film and television productions commencing after December 31, 2007.

3. Modification of domestic production activities deduction for film production (sec. 302(b) of the bill and sec. 199 of the Code)

Present Law

In general

Section 199 of the Code provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to a portion of the taxpayer's qualified production activities income. For taxable years beginning after 2009, the deduction is nine

[190] Sec. 181(d)(3)(A).

[191] Sec. 181(d)(3)(B).

[192] Sec. 181(d)(2)(B).

[193] Sec. 181(d)(2)(C).

[194] Sec. 1245(a)(2)(C).

percent of such income. For taxable years beginning in 2008 and 2009, the deduction is six percent of such income. The deduction for a taxable year is limited to 50 percent of the wages properly allocable to domestic production gross receipts paid by the taxpayer during the calendar year that ends in such taxable year.[195]

Qualified production activities income

In general, qualified production activities income ("QPAI") is equal to domestic production gross receipts ("DPGR"), reduced by the sum of: (1) the costs of goods sold that are allocable to such receipts; (2) other expenses, losses, or deductions which are properly allocable to such receipts.[196]

Domestic production gross receipts

DPGR generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange or other disposition, or any lease, rental or license, of qualifying production property ("QPP") that was manufactured, produced, grown or extracted ("MPGE") by the taxpayer in whole or in significant part within the United States;[197] (2) any sale, exchange or other disposition, or any lease, rental or license, of qualified film produced by the taxpayer; (3) any sale, exchange or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) in the case of a taxpayer engaged in the active conduct of a construction trade or business, construction of real property performed in the United States by the taxpayer in the ordinary course of such trade or business;[198] or (5) in the case of a taxpayer engaged in the active conduct of an engineering or architectural services trade or business, engineering or architectural services performed in the United States by the taxpayer in the

[195] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. Elective deferrals include elective deferrals as defined in section 402(g)(3), amounts deferred under section 457, and, designated Roth contributions (as defined in section 402A).

[196] Sec. 199(c)(1).

[197] Domestic production gross receipts include gross receipts of a taxpayer derived from any sale, exchange or other disposition of agricultural products with respect to which the taxpayer performs storage, handling or other processing activities (other than transportation activities) within the United States, provided such products are consumed in connection with, or incorporated into, the manufacturing, production, growth or extraction of qualifying production property (whether or not by the taxpayer).

[198] For this purpose, construction activities include activities that are directly related to the erection or substantial renovation of residential and commercial buildings and infrastructure. Substantial renovation would include structural improvements, but not mere cosmetic changes, such as painting, that is not performed in connection with activities that otherwise constitute substantial renovation.

ordinary course of such trade or business with respect to the construction of real property in the United States.[199]

Domestic production gross receipts do not include any gross receipts of the taxpayer that are derived from: (1) the sale of food or beverages prepared by the taxpayer at a retail establishment; (2) the transmission or distribution of electricity, natural gas, or potable water; or (3) the lease, rental, license, sale, exchange, or other disposition of land.[200]

A special rule for government contracts provides that property that is manufactured or produced by the taxpayer pursuant to a contract with the Federal Government is considered to be DPGR even if title or risk of loss is transferred to the Federal Government before the manufacture or production of such property is complete to the extent required by the Federal Acquisition Regulation.[201]

For purposes of determining DPGR of a partnership and its partners, provided all of the interests in the capital and profits of the partnership are owned by members of the same expanded affiliated group ("EAG") at all times during the taxable year of the partnership, then the partnership and all members of that EAG are treated as a single taxpayer during such period.[202]

Qualifying production property and qualified film

QPP generally includes any tangible personal property, computer software, or sound recordings. "Qualified film" includes any motion picture film or videotape[203] (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of such film (including compensation in the form of residuals and participations)[204] constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.[205]

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[199] Sec. 199(c)(4)(A).

[200] Sec. 199(c)(4)(B).

[201] Sec. 199(c)(4)(C).

[202] Sec. 199(c)(4)(D).

[203] The nature of the material on which properties described in section 168(f)(3) are embodied and the methods and means of distribution of such properties does not affect their qualification under this provision.

[204] To the extent that a taxpayer has included an estimate of participations and/or residuals in its income forecast calculation under section 167(g), the taxpayer must use the same estimate of participations and/or residuals for purposes of determining total compensation.

[205] Sec. 199(c)(6).

Other rules

Qualified production activities income of partnerships and S corporations

With respect to the domestic production activities of a partnership or S corporation, the deduction under section 199 is determined at the partner or shareholder level.[206] In performing the calculation, each partner or shareholder generally will take into account such person's allocable share of the components of the calculation (including domestic production gross receipts; the cost of goods sold allocable to such receipts; and other expenses, losses, or deductions allocable to such receipts) from the partnership or S corporation as well as any items relating to the partner or shareholder's own qualified production activities, if any.[207] Each partner or shareholder is treated as having W-2 wages for the taxable year in an amount equal to such person's allocable share of the W-2 wages of the partnership or S corporation for the taxable year.[208]

The Treasury regulations provide that, except for certain qualifying in-kind partnerships and EAG partnerships, an owner of a pass-thru entity is not treated as conducting the qualified production activities of the of the pass-thru entity, and vice versa.[209]

Alternative minimum tax

The deduction under section 199 is allowed for purposes of computing alternative minimum taxable income (including adjusted current earnings), without regard to alternative minimum tax adjustments.[210] The deduction in computing alternative minimum taxable income is determined by reference to the lesser of the qualified production activities income (as determined for the regular tax) or the alternative minimum taxable income (in the case of an individual, adjusted gross income as determined for the regular tax) without regard to this deduction.[211]

Explanation of Provision

The provision modifies the W-2 wage limitation by defining the term "W-2 wages" for qualified films to include any compensation for services performed in the United States by actors, production personnel, directors, and producers. Thus, compensation is not restricted to W-2 wages for the limitation of qualified films.

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[206] Sec. 199(d)(1)(A)(i).

[207] Sec. 199(d)(1)(A)(ii).

[208] Sec. 199(d)(1)(A)(iii).

[209] Treas. Reg. sec. 1.199-5T(g).

[210] Sec. 199(d)(6)(A).

[211] Sec. 199(d)(6)(A).

The provision provides that a qualified film includes any copyrights, trademarks, and other intangibles with respect to the film.

The provision provides that the deduction under section 199 for qualified films is not affected by the methods and means of distributing an otherwise qualified film.[212] For example, the distribution of a qualified film via the internet (whether the film is viewed online or downloaded or whether or not there is a fee charged) is considered to be a disposition of the film for purposes of determining DPGR. Likewise, the distribution of a qualified film through an open air (free of charge) broadcast is considered a disposition of the film for these purposes.

The provision modifies the application of section 199 to partnerships and S corporations. First, the provision provides that each partner with at least a 20 percent capital interest or shareholder with at least a 20 percent ownership interest, either directly or indirectly, in such entity is treated as having engaged directly in any film produced by the partnership or S corporation. For example, Studio A and Studio B form a partnership in which each is a 50-percent partner to produce a qualified film. Studio A has the rights to distribute the film domestically and Studio B has the rights to distribute the film outside the United States. Under the provision, the production activities of the partnership are attributed to each partner, and thus each partner's revenue from the distribution of the qualified film is not treated as non-DPGR solely because neither Studio A nor Studio B produced the qualified film itself. Additionally, a partnership or S corporation is treated as having engaged directly in any film produced by any partner with at least a 20 percent capital interest or shareholder with at least a 20 percent ownership interest, either directly or indirectly, in the partnership or S corporation. For example, Studio A and Studio B form a partnership in which each is a 50-percent partner to distribute a qualified film. Studio A produced the film and contributes it to the partnership and Studio B contributes distribution services to the partnership. Under the provision, the production activities of Studio A are attributed to the partnership, and thus the partnership's revenue from the distribution of the qualified film is not treated as non-DPGR solely because the partnership did not produce the qualified film. Thus, the Treasury regulation providing that an owner of a pass-thru entity is not treated as conducting the qualified production activities of the of the pass-thru entity, and vice versa,[213] does not apply to situations to which this provision applies.

Effective Date

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

[212] This provision is consistent with H.R. Conf. Rep. No. 108-755, at 262, Footnote 30 (2004).

[213] Treas. Reg. sec. 1.199-5T(g).

4. Exemption from excise tax for certain wooden and fiberglass arrows designed for use by children (sec. 303 of the bill and sec. 4161 of the Code)

Present Law

Under present law, section 4161(b)(2) of the Code imposes an excise tax of 39 cents, adjusted for inflation, on the first sale by the manufacturer, producer, or importer of any shaft (whether sold separately or incorporated as part of a finished or unfinished product) used to produce certain types of arrows.[214] These taxes support the Federal Aid to Wildlife Restoration Fund.[215]

Explanation of Provision

The provision exempts from the excise tax on arrow shafts certain shafts (whether sold separately or incorporated as part of a finished or unfinished product) that are all fiberglass and hollow, or made of all natural wood. The shaft cannot be in excess of 5/16 of an inch in diameter and cannot have any laminations or artificial means of enhancing the spine of the shaft. The shaft must be of a type used in the manufacture of an arrow which after its assembly is not suitable for use with a bow that has a peak draw weight of 30 pounds or more.

Effective Date

This provision applies to shafts first sold after the date of enactment.

5. Modified standard for imposition of tax return preparer penalties (sec. 304 of the bill and sec. 6694 of the Code)

Present Law

The provision revises the definition of an "unreasonable position" and changes the standards for imposition of the tax return preparer penalty. The preparer standard for undisclosed positions is reduced to "substantial authority," which conforms to the taxpayer standard. The preparer standard for disclosed positions is set at "reasonable basis." The preparer standard for reportable transactions, to which section 6662A applies (i.e., listed transactions and reportable transactions with significant avoidance or evasion purposes), remains unchanged. For reportable transactions the preparer must have a reasonable belief that the position would more likely than not be sustained on its merits.

Prior to enactment of the Small Business and Work Opportunity Tax Act of 2007, an income tax return preparer who prepared a tax return with respect to which there was an understatement of tax that was due to an undisclosed position for which there was not a realistic

[214] The tax on arrow shafts is 43 cents per arrow shaft beginning January 1, 2008.

[215] 16 U.S.C. sec. 669b

possibility of being sustained on its merits was liable for a $250 penalty. For a disclosed position, the preparer was liable only if the position was frivolous.

Legislation enacted as part of the Small Business and Work Opportunity Tax Act of 2007 broadened the scope of the preparer penalty by applying it to all tax return preparers and altered the standards of conduct a tax return preparer is required to meet in order to avoid the imposition of penalties for the preparation of a return with respect to which there is an understatement of tax. A tax return preparer now can be penalized for preparing a return on which there is an understatement of tax liability as a result of an "unreasonable position." Any position that a return preparer does not reasonably believe is more likely than not to be sustained on its merits is an "unreasonable position" unless the position is disclosed on the return and there is a reasonable basis for the position.

In general, the term "tax return preparer" is broadly defined as any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax or any claim for refund of tax.[216] Preparation of a substantial portion of a return is treated as if it were the preparation of such return.

Explanation of Provision

The provision revises the definition of an "unreasonable position" and changes the standards for imposition of the tax return preparer penalty. The preparer standard for undisclosed positions is reduced to "substantial authority," which conforms to the taxpayer standard. The preparer standard for disclosed positions is set at "reasonable basis." The preparer standard for reportable transactions, to which section 6662A applies (i.e., listed transactions and reportable transactions with significant avoidance or evasion purposes), remains unchanged. For reportable transactions the preparer must have a reasonable belief that the position would more likely than not be sustained on its merits.

Effective Date

The provision generally is effective with respect to returns prepared after May 25, 2007. In the case of reportable transactions, the provision is effective for returns prepared for taxable years beginning after the date of enactment.

[216] Sec. 7701(a)(36)(A).

TITLE IV – REVENUE PROVISIONS

1. Limitation of deduction for income attributable to domestic production of oil, gas, or primary products thereof (sec. 401 of the bill and sec. 199 of the Code)

Present Law

In general

Section 199 of the Code provides a deduction equal to a portion of the taxpayer's qualified production activities income. For taxable years beginning after 2009, the deduction is nine percent of such income. For taxable years beginning in 2008 and 2009, the deduction is six percent of income. However, the deduction for a taxable year is limited to 50 percent of the wages properly allocable to domestic production gross receipts paid by the taxpayer during the calendar year that ends in such taxable year.[217]

Qualified production activities income

In general, "qualified production activities income" is equal to domestic production gross receipts (defined by section 199(c)(4)), reduced by the sum of: (1) the costs of goods sold that are allocable to such receipts; (2) other expenses, losses, or deductions which are properly allocable to such receipts.

Domestic production gross receipts

"Domestic production gross receipts" generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange or other disposition, or any lease, rental or license, of qualifying production property ("QPP") that was manufactured, produced, grown or extracted ("MPGE") by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange or other disposition, or any lease, rental or license, of qualified film produced by the taxpayer; (3) any sale, exchange or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction activities performed in the United States;[218] or (5) engineering or architectural services performed in the United States for construction projects located in the United States.

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[217] For this purpose, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. Elective deferrals include elective deferrals as defined in section 402(g)(3), amounts deferred under section 457, and designated Roth contributions (as defined in section 402A).

[218] For this purpose, construction activities include activities that are directly related to the erection or substantial renovation of residential and commercial buildings and infrastructure. Substantial renovation would include structural improvements, but not mere cosmetic changes, such as painting, that is not performed in connection with activities that otherwise constitute substantial renovation.

Congress granted Treasury broad authority to "prescribe such regulations as are necessary to carry out the purposes" of section 199.[219] In defining MPGE for purposes of section 199, Treasury described the following as MPGE activities: manufacturing, producing, growing, extracting, installing, developing, improving, and creating QPP; making QPP out of scrap, salvage, or junk material as well as from new or raw material by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles; cultivating soil, raising livestock, fishing, and mining minerals.[220]

The regulations specifically cite an example of oil refining activities in describing the "in whole or in significant part" test in determining domestic production gross receipts. QPP is generally considered to be MPGE in significant part by the taxpayer within the United States if such activities are substantial in nature taking into account all of the facts and circumstances, including the relative value added by, and relative cost of, the taxpayer's MPGE activity within the United States, the nature of the QPP, and the nature of the MPGE activity that the taxpayer performs within the United States.[221] The following example is provided in the regulations to illustrate this "substantial in nature" standard:

> X purchases from Y, an unrelated person, unrefined oil extracted outside the United States. X refines the oil in the United States. The refining of the oil by X is an MPGE activity that is substantial in nature.[222]

Natural gas transmission or distribution

Domestic production gross receipts include gross receipts from the production in the United States of natural gas, but excludes gross receipts from the transmission or distribution of natural gas.[223] Production activities generally include all activities involved in extracting natural gas from the ground and processing the gas into pipeline quality gas. However, gross receipts of a taxpayer attributable to transmission of pipeline quality gas from a natural gas field (or from a natural gas processing plant) to a local distribution company's citygate (or to another customer) are not qualified domestic production gross receipts. Likewise, gas purchased by a local gas distribution company and distributed from the citygate to the local customers does not give rise to domestic production gross receipts.

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[219] Sec. 199(d)(9).

[220] Treas. Reg. sec. 1.199-3(e)(1).

[221] Treas. Reg. sec. 1.199-3(g)(2).

[222] Treas. Reg. sec. 1.199-3(g)(5), Example 1.

[223] H.R. Rep. No. 108-755 (conference report for the American Jobs Creation Act of 2004), footnote 28 at 272.

Drilling oil or gas wells

The Treasury regulations provide that qualifying construction activities performed in the United States include activities relating to drilling an oil or gas well.[224] Under the regulations, activities the cost of which are intangible drilling and development costs within the meaning of Treas. Reg. sec. 1.612-4 are considered to be activities constituting construction for purposes of determining domestic production gross receipts.[225]

Qualifying in-kind partnerships

In general, an owner of a pass-thru entity is not treated as conducting the qualified production activities of the pass-thru entity, and vice versa. However, the Treasury regulations provide a special rule for "qualifying in-kind partnerships," which are defined as partnerships engaged solely in the extraction, refining, or processing of oil, natural gas, petrochemicals, or products derived from oil, natural gas, or petrochemicals in whole or in significant part within the United States, or the production or generation of electricity in the United States.[226] In the case of a qualifying in-kind partnership, each partner is treated as MPGE or producing the property MPGE or produced by the partnership that is distributed to that partner.[227] If a partner of a qualifying in-kind partnership derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of the property that was MPGE or produced by the qualifying in-kind partnership, then, provided such partner is a partner of the qualifying in-kind partnership at the time the partner disposes of the property, the partner is treated as conducting the MPGE or production activities previously conducted by the qualifying in-kind partnership with respect to that property.[228]

Alternative minimum tax

The deduction for domestic production activities is allowed for purposes of computing alternative minimum taxable income (including adjusted current earnings). The deduction in computing alternative minimum taxable income is determined by reference to the lesser of the qualified production activities income (as determined for the regular tax) or the alternative minimum taxable income (in the case of an individual, adjusted gross income as determined for the regular tax) without regard to this deduction.

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[224] Treas. Reg. sec. 1.199-3(m)(1)(i).

[225] Treas. Reg. sec. 1.199-3(m)(2)(iii).

[226] Treas. Reg. sec. 1.199-9(i)(2).

[227] Treas. Reg. sec. 1.199-9(i)(1).

[228] *Id*.

Explanation of Provision

The provision reduces the section 199 deduction for taxpayers with oil related qualified production activities income for any taxable year beginning after 2009 by three percent of the least of: (1) oil related qualified production activities income of the taxpayer for the taxable year; (2) qualified production activities income of the taxpayer for the taxable year; or (3) taxable income (determined without regard to the section 199 deduction). For purposes of this provision, the term "oil related qualified production activities income" means qualified production activities income for any taxable year which is attributable to the production, refining, processing, transportation, or distribution of oil, gas, or any primary product thereof during such taxable year.

The term "primary product" has the same meaning as when used in section 927(a)(2)(C), as in effect before its repeal. The Treasury regulations define the term "primary product from oil" to mean crude oil and all products derived from the destructive distillation of crude oil, including volatile products, light oils such as motor fuel and kerosene, distillates such as naphtha, lubricating oils, greases and waxes, and residues such as fuel oil.[229] Additionally, a product or commodity derived from shale oil which would be a primary product from oil if derived from crude oil is considered a primary product from oil.[230] The term "primary product from gas" is defined as all gas and associated hydrocarbon components from gas wells or oil wells, whether recovered at the lease or upon further processing, including natural gas, condensates, liquefied petroleum gases such as ethane, propane, and butane, and liquid products such as natural gasoline.[231] These primary products and processes are not intended to represent either the only primary products from oil or gas or the only processes from which primary products may be derived under existing and future technologies.[232] Examples of nonprimary products include, but are not limited to, petrochemicals, medicinal products, insecticides, and alcohols.[233]

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

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[229] Treas. Reg. sec. 1.927(a)-1T(g)(2)(i).

[230] *Id*.

[231] Treas. Reg. sec. 1.927(a)-1T(g)(2)(ii).

[232] Treas. Reg. sec. 1.927(a)-1T(g)(2)(iii).

[233] Treas. Reg. sec. 1.927(a)-1T(g)(2)(iv).

2. Eliminate the distinction between FOGEI and FORI and apply present-law FOGEI rules to all foreign income from the production and sale of oil and gas product (sec. 402 of the bill and sec. 907 of the Code)

Present Law

In general

Foreign tax credit

The United States taxes its citizens and residents (including U.S. corporations) on their worldwide income. Because the countries in which income is earned also may assert their jurisdiction to tax the same income on the basis of source, foreign-source income earned by U.S. persons may be subject to double taxation. In order to mitigate this possibility, the United States generally provides a credit against U.S. tax liability for foreign income taxes paid or accrued.[234] In the case of foreign income taxes paid or accrued by a foreign subsidiary, a U.S. parent corporation is generally entitled to an indirect (also referred to as a deemed paid) credit for those taxes when it receives an actual or deemed distribution of the underlying earnings from the foreign subsidiary.[235]

Foreign tax credit limitations

The foreign tax credit generally is limited to the U.S. tax liability on a taxpayer's foreign-source income. This general limitation is intended to ensure that the credit serves its purpose of mitigating double taxation of foreign-source income without offsetting the U.S. tax on U.S.-source income.[236]

In addition, this limitation is calculated separately for various categories of income, generally referred to as "separate limitation categories." The total amount of the foreign tax credit used to offset the U.S. tax on income in each separate limitation category may not exceed the proportion of the taxpayer's U.S. tax which the taxpayer's foreign-source taxable income in that category bears to its worldwide taxable income in that category. The separate limitation rules are intended to reduce the extent to which excess foreign taxes paid in a high-tax foreign jurisdiction can be "cross-credited" against the residual U.S. tax on low-taxed foreign-source income.[237]

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[234] Sec. 901.

[235] Secs. 902, 960.

[236] Sec. 904(a).

[237] Sec. 904(d). For taxable years beginning prior to January 1, 2007, section 904(d) provides eight separate baskets as a general matter, and effectively many more in situations in which various special rules apply. The American Jobs Creation Act of 2004 reduced the number of baskets from nine to eight for taxable years beginning after December 31, 2002, and further reduced the number of baskets to

Special limitation on credits for foreign extraction taxes and taxes on foreign oil related income

In addition to the foreign tax credit limitations that apply to all foreign tax credits, a special limitation is placed on foreign income taxes on foreign oil and gas extraction income ("FOGEI").[238] Under this special limitation, amounts claimed as taxes paid on FOGEI of a U.S. corporation qualify as creditable taxes (if they otherwise so qualify) only to the extent they do not exceed the product of the highest marginal U.S. tax rate on corporations (presently 35 percent) multiplied by such extraction income. Foreign taxes paid in excess of that amount on such income are, in general, neither creditable nor deductible. The amount of any such taxes paid or accrued (or deemed paid) in any taxable year which exceeds the FOGEI limitation may be carried back to the immediately preceding taxable year and carried forward 10 taxable years and credited (not deducted) to the extent that the taxpayer otherwise has excess FOGEI limitation for those years.[239]

A similar special limitation applies, in theory, to foreign taxes paid on foreign oil related income ("FORI") in certain cases where the foreign law imposing such amount of tax is structured, or in fact operates, so that the amount of tax imposed with respect to foreign oil related income will generally be "materially greater," over a "reasonable period of time," than the amount generally imposed on income that is neither FORI nor FOGEI.[240] Under the FORI rules, if this theoretical limitation were to apply, then the portion of the foreign taxes on FORI so disallowed would be recharacterized as a (non-creditable) deductible expense.[241]

As a general matter, the FOGEI and FORI rules of section 907 are informed by two related but distinct concerns. First, as described by the Staff of the Joint Committee on Taxation in 1982, the rules were designed to address the perceived problem of "disguised royalties" being improperly treated as creditable foreign taxes:

> When U.S. oil companies began operations in a number of major oil exporting countries, they paid only a royalty for the oil extracted since there was generally no applicable income tax in those countries. However, in part because of the benefit to the oil companies of imposing an income tax, as opposed to a royalty, those countries have adopted taxes applicable to extraction income

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two (i.e., "general" and "passive") for taxable years beginning after December 31, 2006. Pub. L. No. 108-357, sec. 404 (2004).

[238] Sec. 907(a).

[239] Sec. 907(f). These carryback and carryforward rules are similar to the general foreign tax credit carryback and carryforward rules of section 904(c).

[240] Sec. 907(b).

[241] Treas. Reg. sec. 1.907(a)-0(d).

> and have labeled them income taxes. Moreover, because of this relative advantage to the oil companies of paying income taxes rather than royalties, many oil-producing nations in the post-World II era have tended to increase their revenues from oil extraction by increasing their taxes on U.S. oil companies.[242]

In addition, the section 907 rules have also been described as intended to prevent the crediting of high foreign taxes on FOGEI and FORI against the residual U.S. tax on other types of lower-taxed foreign source income.[243] Consistent with this concern, between 1975 and 1982 the foreign tax credit rules provided a separate limitation category (or "basket") under the general section 904 limitation for foreign oil income (broadly defined to include both FORI and FOGEI within the meaning of present law section 907); this separate basket for foreign oil income was eliminated when the present law FORI rules were added and other changes were made by the Tax Equity and Reform Act of 1982.[244]

Determination of FOGEI and FORI

In general

Determination of a taxpayer's FOGEI and FORI is highly specific to the taxpayer's relevant facts and circumstances. Under section 907(c)(1), FOGEI is defined as taxable income derived from sources outside the United States and its possessions from the extraction (by the taxpayer or any other person) of minerals from oil or gas wells located outside the United States and its possessions or from the sale or exchange of assets used by the taxpayer in the trade or business of extracting those minerals.[245] The regulations provide that "gross income from extraction is determined by reference to the fair market value of the minerals in the immediate vicinity of the well."[246]

The regulations do not provide specific methods for determining the fair market value of the extracted oil or gas in the immediate vicinity of the well, but simply provide that all the facts and circumstances that exist in the particular case must be considered, including (but not limited to) facts and circumstances pertaining to the independent market value (if any) in the immediate

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[242] Joint Committee on Taxation, *Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982*, (JCS-38-82), December 31, 1982, sec. IV.A.7.a, footnote 63.

[243] H.R. Conf. Rep. No. 103-213, at 646 (1993).

[244] Pub. L. No. 97-248, sec. 211(c) (1982).

[245] Sec. 907(c)(1).

[246] Treas. Reg. sec. 1.907(c)-1(b)(2).

vicinity of the well, the fair market value at the port of the foreign county, and the relationships between the taxpayer and the foreign government.[247]

Section 907(c)(2) defines FORI to include taxable income from the processing of oil and gas into their primary products, from the transportation or distribution and sale of oil and gas and their primary products, from the disposition of assets used in these activities, and from the performance of any other related service.[248]

As a result of these separate rules governing FOGEI and FORI and the interaction between them, a taxpayer's determination of the amounts of FOGEI and FORI, as well as the allocation of foreign taxes to each class of income, can have a significant impact on the taxpayer's overall U.S. tax liability.

IRS field directive

An October 12, 2004, IRS field directive (the "2004 Field Directive") sets forth guidance to international examiners and specialists on the application of what it describes as the two most commonly used methods for determining FOGEI and FORI when there is no ascertainable market price for the oil and gas in the immediate vicinity of the well, namely the residual (rate of return) method and the proportionate profits method.[249]

Under the residual (rate of return) method, the taxpayer first calculates FORI by applying an assumed after-tax rate of return to the cost of its fixed "FORI assets." Then, because income from the production and sale of oil and gas product is equal to the sum of FORI and FOGEI, FOGEI is determined by subtracting FORI (as calculated) from the taxpayer's total foreign income from the production and sale of oil and gas product.

Under the proportionate profits method, the taxpayer allocates total income from the production and sale of the oil or gas product between FOGEI and FORI based on the relative costs of the FOGEI and FORI activities.

Under either method, the taxpayer must determine its total income from the production and sale of oil and gas product, and must distinguish between costs and assets classified as relating to FOGEI and those relating to FORI. Under the residual (rate of return) method, the taxpayer must also determine appropriate rates of return for FORI assets. The 2004 Field

[247] Treas. Reg. sec. 1.907(c)-1(b)(6).

[248] Sec. 907(c)(1); Treas. Reg. sec. 1.907(c)-1(d).

[249] Memorandum for Industry Directors ("Field Directive on IRC §907 Evaluating Taxpayer Methods of Determining Foreign Oil and Gas Extraction Income (FOGEI) and Foreign Oil Related Income (FORI)"), October 12, 2004 (Tax Analysts Doc 2004-23010; 2004 TNT 233-8). By its terms, the 2004 Field Directive "is not an official pronouncement of the law or the Service's position and cannot be used, cited, or relied upon as such."

Directive sets forth examples of FOGEI assets[250] and FORI assets,[251] and further provides that assets that support both FOGEI and FORI may be allocated by any reasonable method.

Explanation of Provision

Under the provision, the scope of the present-law FOGEI rules is expanded to apply to all foreign income from production and other activity related to the sale of oil and gas product (i.e., the sum of FORI and FOGEI as classified under present law). Thus, amounts claimed as taxes paid on such amount of (combined) foreign oil and gas income are creditable in a given taxable year (if they otherwise so qualify) only to the extent they do not exceed the product of the highest marginal U.S. tax rate on corporations (in the case of corporations) multiplied by such combined foreign oil and gas income for such taxable year. As under the present-law FOGEI rules, excess foreign taxes may be carried back to the immediately preceding taxable year and carried forward 10 taxable years and credited (not deducted) to the extent that the taxpayer otherwise has excess limitation with regard to combined foreign oil and gas income in a carryover year. Under a transition rule, pre-2009 credits carried forward to post-2008 years will continue to governed by present law for purposes of determining the amount of carryforward credits eligible to be claimed in a post-2008 year; similarly, solely for purposes of determining whether excess credits generated in 2009 and carried back can be claimed to offset 2008 tax liability, the new rules will be deemed to apply in determining overall (combined FOGEI-FORI) limitation for the carryback year.

The provision repeals the present-law section 907(b) FORI limitation.

Effective Date

The provision is effective for taxable years beginning after December 31, 2008.

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[250] Examples of FOGEI assets include wells, wellheads, and pumping equipment; slug catchers, separators, treaters, emulsion breakers and stock tanks needed to obtain marketable crude (for oil production); primary separation and dehydration equipment needed to arrive at a gaseous stream in which hydrocarbons may be recovered (for gas production); lines interconnecting the above; the infrastructure-type equipment to provide for the operation of the above; and structures to physically support the above (such as offshore platforms).

[251] Examples of FORI assets include lines that carry natural gas beyond the primary separator and dehydration equipment and towards its sales point, and compressors needed to transport through these lines; lines that carry marketable crude oil from the premises, as well as pumps needed to transport crude oil through these lines; and assets used to process crude oil and natural gas.

3. Broker reporting of customer's basis in securities transactions (sec. 403 of the bill and sec. 6045 and new secs. 6045A and 6045B of the Code)

Present Law

In general

Gain or loss generally is recognized for Federal income tax purposes on realization of that gain or loss (for example, through the sale of property giving rise to the gain or loss). The taxpayer's gain or loss on a disposition of property is the difference between the amount realized and the adjusted basis.[252]

To compute adjusted basis, a taxpayer must first determine the property's unadjusted or original basis and then make adjustments prescribed by the Code.[253] The original basis of property is its cost, except as otherwise prescribed by the Code (for example, in the case of property acquired by gift or bequest or in a tax-free exchange). Once determined, the taxpayer's original basis generally is adjusted downward to take account of depreciation or amortization, and generally is adjusted upward to reflect income and gain inclusions or capital outlays with respect to the property.

Basis computation rules

If a taxpayer has acquired stock in a corporation on different dates or at different prices and sells or transfers some of the shares of that stock, and the lot from which the stock is sold or transferred is not adequately identified, the shares deemed sold are the earliest acquired shares (the "first-in-first-out rule").[254] If a taxpayer makes an adequate identification of shares of stock that it sells, the shares of stock treated as sold are the shares that have been identified.[255] A taxpayer who owns shares in a regulated investment company ("RIC") generally is permitted to elect, in lieu of the specific identification or first-in-first-out methods, to determine the basis of RIC shares sold under one of two average-cost-basis methods described in Treasury regulations.[256]

Information reporting

Present law imposes information reporting requirements on participants in certain transactions. Under these requirements, information is generally reported to the IRS and furnished to taxpayers. These requirements are intended to assist taxpayers in preparing their

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[252] Sec. 1001.

[253] Sec. 1016.

[254] Treas. Reg. sec. 1.1012-1(c)(1).

[255] Treas. Reg. sec. 1.1012-1(c).

[256] Treas. Reg. sec. 1.1012-1(e).

income tax returns and to help the IRS determine whether taxpayers' tax returns are correct and complete. For example, every person engaged in a trade or business generally is required to file information returns for each calendar year for payments of $600 or more made in the course of the payor's trade or business.[257]

Section 6045(a) requires brokers to file with the IRS annual information returns showing the gross proceeds realized by customers from various sale transactions. The Secretary is authorized to require brokers to report additional information related to customers.[258] Brokers are required to furnish to every customer information statements with the same gross proceeds information that is included in the returns filed with the IRS for that customer.[259] These information statements are required to be furnished by January 31 of the year following the calendar year for which the return under section 6045(a) is required to be filed.[260]

A person who is required to file information returns but who fails to do so by the due date for the returns, includes on the returns incorrect information, or files incomplete returns generally is subject to a penalty of $50 for each return with respect to which such a failure occurs, up to a maximum of $250,000 in any calendar year.[261] Similar penalties, with a $100,000 calendar year maximum, apply to failures to furnish correct information statements to recipients of payments for which information reporting is required.[262]

Present law does not require broker information reporting with respect to a customer's basis in property but does impose an obligation to keep records, as described below.

Basis recordkeeping requirements

Taxpayers are required to "keep such records . . . as the Secretary may from time to time prescribe."[263] Treasury regulations impose recordkeeping requirements on any person required to file information returns.[264]

Treasury regulations provide that donors and donees should keep records that are relevant in determining a donee's basis in property.[265] IRS Publication 552 states that a taxpayer should

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[257] Sec. 6041(a).

[258] Sec. 6045(a).

[259] Sec. 6045(b).

[260] *Id*.

[261] Sec. 6721.

[262] Sec. 6722.

[263] Sec. 6001.

[264] Treas. Reg. sec. 1.6001-1(a).

keep basis records for property until the period of limitations expires for the year in which the taxpayer disposes of the property.

Explanation of Provision

In general

Under the provision, every broker that is required to file a return under section 6045(a) reporting the gross proceeds from the sale of a covered security must include in the return (1) the customer's adjusted basis in the security and (2) whether any gain or loss with respect to the security is long-term or short-term (within the meaning of section 1222).

Covered securities

A covered security is any specified security acquired on or after an applicable date if the security was (1) acquired through a transaction in the account in which the security is held or (2) was transferred to that account from an account in which the security was a covered security, but only if the transferee broker received a statement under section 6045A (described below) with respect to the transfer. Under this rule, certain securities acquired by gift or inheritance are not covered securities.

A specified security is any share of stock in a corporation (including stock of a regulated investment company); any note, bond, debenture, or other evidence of indebtedness; any commodity or a contract or a derivative with respect to the commodity if the Secretary determines that adjusted basis reporting is appropriate; and any other financial instrument with respect to which the Secretary determines that adjusted basis reporting is appropriate.

For stock in a corporation (other than stock for which an average basis method is permissible under section 1012), the applicable date is January 1, 2011. For any stock for which an average basis method is permissible under section 1012, the applicable date is January 1, 2012. Consequently, the applicable date for certain stock acquired through a periodic stock investment plan (for which stock additional rules are described below) and for stock in a regulated investment company is January 1, 2012. A regulated investment company is permitted to elect to treat as a covered security any stock in the company acquired before January 1, 2012. This election is described below. For any specified security other than stock in a corporation or stock for which an average basis method is permitted, the applicable date is January 1, 2013, or a later date determined by the Secretary.

Computation of adjusted basis

The customer's adjusted basis required to be reported to the IRS is determined under the following rules. The adjusted basis of any security other than stock for which an average basis method is permissible under section 1012 is determined under the first-in, first-out method unless the customer notifies the broker by means of making an adequate identification (under the rules

[265] Treas. Reg. sec. 1.1015-1(g).

of section 1012 for specific identification) of the stock sold or transferred. The adjusted basis of stock for which an average basis method is permissible under section 1012 is determined in accordance with the broker's default method under section 1012 (that is, the first-in, first-out method, the average cost method, or the specific identification method) unless the customer notifies the broker that the customer elects another permitted method. This notification is made separately for each account in which stock for which the average cost method is permissible is held and, once made, applies to all stock held in that account. As a result of this rule, a broker's basis computation method used for stock held in one account with that broker may differ from the basis computation method used for stock held in another account with that broker.

For any sale, exchange, or other disposition of a specified security after the applicable date (defined previously), the provision modifies section 1012 so that the conventions prescribed by regulations under that section for determining adjusted basis (the first-in, first-out, specific identification, and average basis conventions) apply on an account-by-account basis. Under this rule, for example, if a customer holds shares of the same specified security in accounts with different brokers, each broker makes its adjusted basis determinations by reference only to the shares held in the account with that broker, and only shares in the account from which the sale is made may be identified as the shares sold. Unless the election described next applies, any stock for which an average basis method is permissible under section 1012 which is acquired before January 1, 2012 is treated as a separate account from any such stock acquired on or after that date. A consequence of this rule is that if adjusted basis is being determined using an average basis method, average basis is computed without regard to any stock acquired before January 1, 2012. A regulated investment company, however, may elect (at the time and in the form and manner prescribed by the Secretary), on a stockholder-by-stockholder basis, to treat as covered securities all stock in the company held by the stockholder without regard to when the stock was acquired. When this election applies, the average basis of a customer's regulated investment company stock is determined by taking into account shares of stock acquired before, on, and after January 1, 2012. A similar election is allowed for any broker holding stock in a regulated investment company as a nominee of the beneficial owner of the stock.

If stock is acquired on or after January 1, 2011 in connection with a periodic stock investment plan, the basis of that stock is determined under one of the basis computation methods permissible for stock in a regulated investment company. Accordingly, an average cost method may be used for determining the basis of stock acquired under a periodic stock investment plan. In determining basis under this rule, the account-by-account rules described previously, including the election available to regulated investment companies, apply. The special rule for stock acquired through a periodic stock investment plan, however, applies only while the stock is held as part of the plan. If stock to which this rule applies is transferred to another account, the stock will have a cost basis in that other account equal to its basis in the periodic stock investment plan immediately before the transfer (with any proper adjustment for charges incurred in connection with the transfer). After the transfer, however, the transferee broker may use the otherwise applicable convention (that is, the first-in, first-out method or the specific identification method) for determining which shares are sold when a sale is made of some but not all shares of a particular security. It is expected that when stock acquired through a periodic stock investment plan is transferred to another account, the broker executing the transfer will provide information necessary in applying an allowable convention for determining which shares are sold. Accordingly, the transferor broker will be expected to state that shares

transferred have a long-term holding period or, for shares that have a short-term holding period, the dates on which the shares were acquired.

A periodic stock investment plan is any stock purchase plan and any dividend reinvestment plan. A stock purchase plan is any arrangement under which identical stock is periodically purchased pursuant to a written plan. A dividend reinvestment plan is any arrangement under which dividends on stock are reinvested in stock identical to the stock with respect to which the dividends are paid. Stock is treated as acquired in connection with a dividend reinvestment plan if the stock is acquired pursuant to the plan or if the dividends paid on the stock are subject to the plan.

Exception for wash sales

Unless the Secretary provides otherwise, a customer's adjusted basis in a covered security generally is determined without taking into account the effect on basis of the wash sale rules of section 1091. If, however, the acquisition and sale transactions resulting in a wash sale under section 1091 occur in the same account and are in identical securities, adjusted basis is determined by taking into account the effect of the wash sale rules. Securities are identical for this purpose only if they have the same Committee on Uniform Security Identification Procedures number.

Special rules for short sales

The provision provides that in the case of a short sale, gross proceeds and basis reporting under section 6045 generally is required in the year in which the short sale is closed (rather than, as under the present law rule for gross proceeds reporting, the year in which the short sale is entered into).

Reporting requirements for options

The provision generally eliminates the present-law regulatory exception from section 6045(a) reporting for certain options. If a covered security is acquired or disposed of by reason of the exercise of an option that was granted or acquired in the same account as the covered security, the amount of the premium received or paid with respect to the acquisition of the option is treated as an adjustment to the gross proceeds from the subsequent sale of the covered security or as an adjustment to the customer's adjusted basis in that security. Gross proceeds and basis reporting also is required when there is a lapse of, or a closing transaction with respect to, an option on a specified security or an exercise of a cash-settled option. Reporting is required for the calendar year that includes the date of the lapse, closing transaction, or exercise. For example, if a taxpayer acquires for $5 a cash settlement stock option with a strike price of $100 and settles the option when the stock trades at $120, a broker through which the acquisition and cash settlement are executed is required to report gross proceeds of $20 from the cash settlement and a basis in the option of $5. For purposes of the reporting requirement for closing transactions, a closing transaction includes a mark-to-market under section 1256. It is intended that a specified security for purposes of the reporting rules described in this paragraph includes a stock index such as the S&P 500. The reporting rules related to options transactions apply only to options granted or acquired on or after January 1, 2013.

Treatment of S corporations

The provision provides that for purposes of section 6045, an S corporation (other than a financial institution) is treated in the same manner as a partnership. This rule applies to any sale of a covered security acquired by an S corporation (other than a financial institution) after December 31, 2011. When this rule takes effect, brokers generally will be required to report gross proceeds and basis information to customers that are S corporations.

Time for providing statements to customers

The provision changes to February 15 the present-law January 31 deadline for furnishing certain information statements to customers. The statements to which the new February 15 deadline applies are (1) statements showing gross proceeds (under section 6045(b)) or substitute payments (under section 6045(d)) and (2) statements with respect to reportable items (including, but not limited to, interest, dividends, and royalties) that are furnished with consolidated reporting statements (as defined in regulations). The term "consolidated reporting statement" is intended to refer to annual account information statements that brokerage firms customarily provide to their customers and that include tax-related information. It is intended that the February 15 deadline for consolidated reporting statements apply in the same manner to statements furnished for any account or accounts, taxable and retirement, held by a customer with a mutual fund or other broker.

Broker-to-broker and issuer reporting

Every broker (as defined in section 6045(c)(1)), and any other person specified in Treasury regulations, that transfers to a broker (as defined in section 6045(c)(1)) a security that is a covered security when held by that broker or other person must, under new section 6045A, furnish to the transferee broker a written statement that allows the transferee broker to satisfy the provision's basis and holding period reporting requirements. The Secretary may provide regulations that prescribe the content of this statement and the manner in which it must be furnished. It is contemplated that the Secretary will permit this broker-to-broker reporting requirement to be satisfied electronically rather than by paper. Unless the Secretary provides otherwise, the statement required by this rule must be furnished not later than 15 days after the date of the transfer of the covered security.

Present law penalties for failure to furnish correct payee statements apply to failures to furnish correct statements in connection with the transfer of covered securities.

New section 6045B requires, according to forms or regulations prescribed by the Secretary, any issuer of a specified security to file a return setting forth a description of any organizational action (such as a stock split or a merger or acquisition) that affects the basis of the specified security, the quantitative effect on the basis of that specified security, and any other information required by the Secretary. This return must be filed within 45 days after the date of the organizational action or, if earlier, by January 15 of the year following the calendar year during which the action occurred. Every person required to file this return for a specified security also must furnish, according to forms or regulations prescribed by the Secretary, to the nominee with respect to that security (or to a certificate holder if there is no nominee) a written

statement showing the name, address, and phone number of the information contact of the person required to file the return, the information required to be included on the return with respect to the security, and any other information required by the Secretary. This statement must be furnished to the nominee or certificate holder on or before January 15 of the year following the calendar year in which the organizational action took place. No return or information statement is required to be provided under new section 6045B for any action with respect to a specified security if the action occurs before the applicable date (as defined previously) for that security.

The Secretary may waive the return filing and information statement requirements if the person to which the requirements apply makes publicly available, in the form and manner determined by the Secretary, the name, address, phone number, and email address of the information contact of that person, and the information about the organizational action and its effect on basis otherwise required to be included in the return.

The present-law penalties for failure to file correct information returns apply to failures to file correct returns in connection with organizational actions. Similarly, the present-law penalties for failure to furnish correct payee statements apply to a failure under new section 6045B to furnish correct statements to nominees or holders or to provide required publicly-available information in lieu of returns and written statements.

Effective Date

The provision generally takes effect on January 1, 2011. The change to February 15 of the present-law January 31 deadline for furnishing certain information statements to customers applies to statements required to be furnished after December 31, 2008.

4. One-year extension of additional 0.2 Percent FUTA surtax (sec. 404 of the bill and sec. 3301 of the Code)

Present Law

The Federal Unemployment Tax Act ("FUTA") imposes a 6.2 percent gross tax rate on the first $7,000 paid annually by covered employers to each employee. Employers in States with programs approved by the Federal Government and with no delinquent Federal loans may credit 5.4 percentage points against the 6.2 percent tax rate, making the minimum, net Federal unemployment tax rate 0.8 percent. Since all States have approved programs, 0.8 percent is the Federal tax rate that generally applies. This Federal revenue finances administration of the unemployment system, half of the Federal-State extended benefits program, and a Federal account for State loans. The States use the revenue turned back to them by the 5.4 percent credit to finance their regular State programs and half of the Federal-State extended benefits program.

In 1976, Congress passed a temporary surtax of 0.2 percent of taxable wages to be added to the permanent FUTA tax rate. Thus, the current 0.8 percent FUTA tax rate has two components: a permanent tax rate of 0.6 percent, and a temporary surtax rate of 0.2 percent. The temporary surtax subsequently has been extended through 2008.

Explanation of Provision

The Act extends the temporary surtax rate (for one year) through December 31, 2009.

Effective Date

The provision is effective for wages paid after December 31, 2008.

5. Oil spill liability trust fund tax (sec. 405 of the bill and sec. 4611 of the Code)

Present Law

The Oil Spill Liability Trust Fund financing rate ("oil spill tax") was reinstated effective April 1, 2006.[266] The oil spill tax rate is five cents per barrel and generally applies to crude oil received at a U.S. refinery and to petroleum products entered into the United States for consumption, use, or warehousing.[267]

The oil spill tax also applies to certain uses and the exportation of domestic crude oil.[268] If any domestic crude oil is used in or exported from the United States, and before such use or exportation no oil spill tax was imposed on such crude oil, then the oil spill tax is imposed on such crude oil. The tax does not apply to any use of crude oil for extracting oil or natural gas on the premises where such crude oil was produced.

For crude oil received at a refinery, the operator of the U.S. refinery is liable for the tax. For imported petroleum products, the person entering the product for consumption, use, or warehousing is liable for the tax. For certain uses and exports, the person using or exporting the crude oil is liable for the tax. No tax is imposed with respect to any petroleum product if the person who would be liable for such tax establishes that a prior oil spill tax has been imposed with respect to such product.

The imposition of the tax is dependent in part on the balance of the Oil Spill Liability Trust Fund. The oil spill tax does not apply during a calendar quarter if the Secretary estimates that, as of the close of the preceding calendar quarter, the unobligated balance of the Oil Spill Liability Trust Fund exceeds $2.7 billion. If the Secretary estimates that the unobligated balance in the Oil Spill Liability Trust Fund is less than $2 billion at close of any calendar quarter, the oil spill tax will apply on the date that is 30 days from the last day of that quarter. The tax does not apply to any periods after December 31, 2014.

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[266] Sec. 4611(f).

[267] The term "crude oil" includes crude oil condensates and natural gasoline. The term "petroleum product" includes crude oil.

[268] The term "domestic crude oil" means any crude oil produced from a well located in the United States.

Explanation of Provision

The provision extends the oil spill tax through December 31, 2017. The provision increases the tax rate from five cents to eight cents per barrel for the first quarter that is more than 60 days after the date of enactment through December 31, 2016, and then increases the rate to nine cents per barrel for calendar year 2017. The tax does not apply after December 31, 2017. The provision also repeals the requirement that the tax be suspended when the unobligated balance exceeds $2.7 billion.

Effective Date

The provision increasing the tax rate is effective beginning the first quarter that is more than 60 days after the date of enactment. The remaining provisions are effective on the date of enactment.

6. Modify tax treatment of nonqualified deferred compensation from certain tax indifferent parties (sec. 406 of the bill and new sec. 457A of the Code)

Present Law

In general

Under present law, the determination of when amounts deferred under a nonqualified deferred compensation arrangement are includible in the gross income of the person earning the compensation depends on the facts and circumstances of the arrangement. A variety of tax principles and Code provisions may be relevant in making this determination, including the doctrine of constructive receipt, the economic benefit doctrine,[269] the provisions of section 83 relating generally to transfers of property in connection with the performance of services, provisions relating specifically to nonexempt employee trusts (sec. 402(b)) and nonqualified annuities (sec. 403(c)), and the requirements of section 409A.

In general, the time for income inclusion of nonqualified deferred compensation depends on whether the arrangement is unfunded or funded. If the arrangement is unfunded, then the compensation generally is includible in income by a cash-basis taxpayer when it is actually or constructively received. If the arrangement is funded, then income is includible for the year in which the individual's rights are transferable or not subject to a substantial risk of forfeiture.

An arrangement generally is considered funded if there has been a transfer of property under section 83. Under that section, a transfer of property occurs when a person acquires a beneficial ownership interest in such property. The term "property" is defined very broadly for purposes of section 83.[270] Property includes real and personal property other than money or an

[269] See, e.g., *Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff'd, per curiam*, 194 F.2d 541 (6th Cir. 1952); Rev. Rul. 60-31, 1960-1 C.B. 174.

[270] Treas. Reg. sec. 1.83-3(e). This definition, in part, reflects previous IRS rulings on nonqualified deferred compensation.

unfunded and unsecured promise to pay money in the future. Property also includes a beneficial interest in assets (including money) that are transferred or set aside from claims of the creditors of the transferor; for example, in a trust or escrow account. Accordingly, if, in connection with the performance of services, vested contributions are made to a trust on an individual's behalf and the trust assets may be used solely to provide future payments to the individual, the payment of the contributions to the trust constitutes a transfer of property to the individual that is taxable under section 83. On the other hand, deferred amounts generally are not includible in income if nonqualified deferred compensation is payable from general corporate funds that are subject to the claims of general creditors, as such amounts are treated as unfunded and unsecured promises to pay money or property in the future.

As discussed above, if the arrangement is unfunded, then the compensation generally is includible in income by a cash-basis taxpayer when it is actually or constructively received under section 451.[271] Income is constructively received when it is credited to a person's account, set apart, or otherwise made available so that it may be drawn on at any time. Income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. A requirement to relinquish a valuable right in order to make withdrawals is generally treated as a substantial limitation or restriction.

Prior to the enactment of section 409A, arrangements had developed in an effort to provide employees with security for nonqualified deferred compensation, while still allowing deferral of income inclusion under the constructive receipt doctrine (which applies to unfunded arrangements). One such arrangement is a "rabbi trust." A rabbi trust is a trust or other fund established by the employer to hold assets from which nonqualified deferred compensation payments will be made. The trust or fund is generally irrevocable and does not permit the employer to use the assets for purposes other than to provide nonqualified deferred compensation, except that the terms of the trust or fund provide that the assets are subject to the claims of the employer's creditors in the case of insolvency or bankruptcy. In the case of a rabbi trust, these terms had been the basis for the conclusion that the creation of a rabbi trust does not cause the related nonqualified deferred compensation arrangement to be funded for income tax purposes.[272] As a result, no amount was included in income by reason of the rabbi trust; generally income inclusion occurs as payments are made from the trust.

Section 409A

Reason for enactment

The Congress enacted section 409A[273] because it was concerned that many nonqualified deferred compensation arrangements had developed which allowed improper deferral of income. Executives often used arrangements that allowed deferral of income, but also provided security

[271] Treas. Reg. secs. 1.451-1 and 1.451-2.

[272] This conclusion was first provided in a 1980 private ruling issued by the IRS with respect to an arrangement covering a rabbi; hence, the popular name "rabbi trust." Priv. Ltr. Rul. 8113107 (Dec. 31, 1980).

of future payment and control over amounts deferred. For example, nonqualified deferred compensation arrangements often contained provisions that allowed participants to receive distributions upon request, subject to forfeiture of a minimal amount (i.e., a "haircut" provision). In addition, Congress was aware that since the concept of a rabbi trust was developed, techniques had been used that attempted to protect the assets from creditors despite the terms of the trust. For example, the trust or fund would be located in a foreign jurisdiction, making it difficult or impossible for creditors to reach the assets.

Prior to the enactment of section 409A, while the general tax principles governing deferred compensation were well established, the determination whether a particular arrangement effectively allowed deferral of income was generally made on a facts and circumstances basis. There was limited specific guidance with respect to common deferral arrangements. The Congress believed that it was appropriate to provide specific rules regarding whether deferral of income inclusion should be permitted and to provide a clear set of rules that would apply to these arrangements. The Congress believed that certain arrangements that allow participants inappropriate levels of control or access to amounts deferred should not result in deferral of income inclusion. The Congress also believed that certain arrangements, such as offshore trusts, which effectively protect assets from creditors of the employer, should be treated as funded and not result in deferral of income inclusion to the extent the amounts are vested.

General requirements of section 409A

In general.–Under section 409A, all amounts deferred by a service provider under a nonqualified deferred compensation plan[274] for all taxable years are currently includible in gross income of the service provider to the extent such amounts are not subject to a substantial risk of forfeiture[275] and not previously included in gross income, unless certain requirements are satisfied. If the requirements of section 409A are not satisfied, in addition to current income inclusion, interest at the rate applicable to underpayments of tax plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to a 20-percent additional tax. Section 409A does not limit the amount that may be deferred under a nonqualified deferred compensation plan.

The Secretary of the Treasury is authorized to prescribe regulations as are necessary or appropriate to carry out the purposes of section 409A. The Secretary of the Treasury published

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[273] Section 409A was added to the Code by section 885 of the American Job Creation Act of 2004, Pub. L. No. 108-357.

[274] A plan includes an agreement or arrangement, including an agreement or arrangement that includes one person. Amounts deferred also include actual or notional earnings.

[275] The rights of a person to compensation are subject to a substantial risk of forfeiture if the person's rights to such compensation are conditioned upon the performance of substantial services by any individual.

final regulations under section 409A on April 17, 2007.[276] Under these regulations, the term "service provider" includes an individual, corporation, subchapter S corporation, partnership, personal service corporation (as defined in section 269A(b)(1)), noncorporate entity that would be a personal service corporation if it were a corporation, or qualified personal service corporation (as defined in section 448(d)(2)) for any taxable year in which such individual or entity accounts for gross income from the performance of services under the cash receipts and disbursements method of accounting.[277] Section 409A does not apply to a service provider that provides significant services to at least two service recipients that are not related to each other or the service provider. This exclusion does not apply to a service provider who is an employee or a director of a corporation (or similar position in the case of an entity that is not a corporation).[278] In addition, the exclusion does not apply to an entity that operates as the manager of a hedge fund or private equity fund. This is because the exclusion does not apply to the extent that a service provider provides management services to a service recipient. Management services for this purpose means services that involve the actual or de facto direction or control of the financial or operational aspects of a trade or business of the service recipient or investment management or advisory services provided to a service recipient whose primary trade or business includes the investment of financial assets, such as a hedge fund.[279]

Permissible distribution events.–Under section 409A, distributions from a nonqualified deferred compensation plan may be allowed only upon separation from service (as determined by the Secretary of the Treasury), death, a specified time (or pursuant to a fixed schedule), change in control of a corporation (to the extent provided by the Secretary of the Treasury), occurrence of an unforeseeable emergency, or if the service provider becomes disabled. A nonqualified deferred compensation plan may not allow distributions other than upon the permissible distribution events and, except as provided in regulations by the Secretary of the Treasury, may not permit acceleration of a distribution. In the case of a specified employee who separates from service, distributions may not be made earlier than six months after the date of the separation from service or upon death. Specified employees are key employees[280] of publicly-traded corporations.

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[276] On October 22, 2007, the IRS announced that during 2008, taxpayers are not required to comply with the final regulations. Instead, taxpayers must operate a plan in compliance with section 409A and the otherwise applicable guidance. To the extent an issue is not addressed, a reasonable, good faith interpretation of the statute must be used. Notice 2007-86.

[277] Treas. Reg. sec. 1.409A-1(f)(1).

[278] Treas. Reg. sec. 1.409A-1(f)(2).

[279] Treas. Reg. sec. 1.409A-1(f)(2)(iv).

[280] Key employees are defined in section 416(i) and generally include officers (limited to 50 employees) having annual compensation greater than $150,000 (for 2008), five percent owners, and one percent owners having annual compensation from the employer greater than $150,000.

Elections.–Section 409A requires that a plan must provide that compensation for services performed during a taxable year may be deferred at the service provider's election only if the election to defer is made no later than the close of the preceding taxable year, or at such other time as provided in Treasury regulations. In the case of any performance-based compensation based on services performed over a period of at least 12 months, such election may be made no later than six months before the end of the service period. The time and form of distributions must be specified at the time of initial deferral. A plan may allow changes in the time and form of distributions subject to certain requirements.

Back-to-back arrangements.–Back-to-back service recipients (i.e., situations under which an entity receives services from a service provider such as an employee, and the entity in turn provides services to a client) that involve back-to-back nonqualified deferred compensation arrangements (i.e., the fees payable by the client are deferred at both the entity level and the employee level) are subject to special rules under section 409A. For example, the final regulations generally permit the deferral agreement between the entity and its client to treat as a permissible distribution event those events that are specified as distribution events in the deferral agreement between the entity and its employee. Thus, if separation from employment is a specified distribution event between the entity and the employee, the employee's separation generally is a permissible distribution event for the deferral agreement between the entity and its client.[281]

Offshore funding arrangements.–Section 409A requires current income inclusion in the case of certain offshore funding of nonqualified deferred compensation. Under section 409A, in the case of assets set aside (directly or indirectly) in a trust (or other arrangement determined by the Secretary of the Treasury) for purposes of paying nonqualified deferred compensation, such assets are treated as property transferred in connection with the performance of services under section 83 (whether or not such assets are available to satisfy the claims of general creditors) at the time set aside if such assets are located outside of the United States or at the time transferred if such assets are subsequently transferred outside of the United States. Any subsequent increases in the value of, or any earnings with respect to, such assets are treated as additional transfers of property.

Interest at the underpayment rate plus one percentage point is imposed on the underpayments of tax that would have occurred had the amounts set aside been includible in income for the taxable year in which first deferred or, if later, the first taxable year not subject to a substantial risk of forfeiture. The amount required to be included in income also is subject to an additional 20-percent tax.

The special funding rule does not apply to assets located in a foreign jurisdiction if substantially all of the services to which the nonqualified deferred compensation relates are performed in such foreign jurisdiction. The Secretary of the Treasury has authority to exempt arrangements from the provision if the arrangements do not result in an improper deferral of U.S. tax and will not result in assets being effectively beyond the reach of creditors.

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[281] Treas. Reg. sec. 1.409A-3(i)(6).

Definition of substantial risk of forfeiture

Under the Treasury regulations, compensation is subject to a substantial risk of forfeiture if entitlement to the amount is conditioned upon either the performance of substantial future services by any person or the occurrence of a condition related to a purpose of the compensation, provided that the possibility of forfeiture is substantial.[282]

Definition of nonqualified deferred compensation

Under section 409A, a nonqualified deferred compensation plan generally includes any plan that provides for the deferral of compensation other than a qualified employer plan or any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan. A qualified employer plan means a qualified retirement plan, tax-deferred annuity, simplified employee pension, and SIMPLE. A qualified governmental excess benefit arrangement (sec. 415(m)) and an eligible deferred compensation plan (sec. 457(b)) is a qualified employer plan.

The Treasury regulations also provide that certain other types of plans are not considered deferred compensation, and thus are not subject to section 409A. For example, if a service recipient transfers property to a service provider, there is no deferral of compensation merely because the value of the property is either not includible in income under section 83 by reason of the property being substantially nonvested or is includible in income because of a valid section 83(b) election.[283] Special rules apply in the case of stock options.[284] Another exception applies to amounts that are not deferred beyond a short period of time after the amount is no longer subject to a substantial risk of forfeiture.[285] Under this exception, there generally is no deferral for purposes of section 409A if the service provider actually or constructively receives the amount on or before the last day of the applicable 2½ month period. The applicable 2½ month period is the period ending on the later of the 15th day of the third month following the end of: (1) the service provider's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture; or (2) the service recipient's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture.

Special rules apply in the case of stock appreciation rights ("SARs").[286] Under the final Treasury regulations, a SAR is a right to compensation based on the appreciation in value of a specified number of shares of service recipient stock occurring between the date of grant and the date of exercise of such right. The final regulations generally provide that a SAR does not result in a deferral of compensation for purposes of section 409A (and thus is not subject to section

[282] Treas. Reg. sec. 1.409A-1(d)(1).

[283] Treas. Reg. Sec. 1.409A-1(b)(6).

[284] Treas. Reg. Sec. 1.409A-1(b)(5).

[285] Treas. Reg. sec. 1.409A-1(b)(4).

[286] Treas. Reg. sec. 1.409A-1(b)(5).

409A) if the compensation payable under the SAR is not greater than the excess of the fair market value of the underlying stock on the date the SAR is exercised over the fair market value of the underlying stock on the date the SAR is granted.[287]

The Treasury regulations provide exclusions from the definition of nonqualified deferred compensation in the case of services performed by individuals who participate in certain foreign plans, including plans covered by an applicable treaty and broad-based foreign retirement plans.[288] In the case of a U.S. citizen or lawful permanent alien, nonqualified deferred compensation plan does not include a broad-based foreign retirement plan, but only with respect to the portion of the plan that provides for nonelective deferral of foreign earned income and subject to limitations on the annual amount deferred under the plan or the annual amount payable under the plan. In general, foreign earned income refers to amounts received by an individual from sources within a foreign country that constitutes earned income attributable to services.

Timing of the service recipient's deduction

Special statutory provisions govern the timing of the deduction for nonqualified deferred compensation, regardless of whether the arrangement covers employees or nonemployees and regardless of whether the arrangement is funded or unfunded.[289] Under these provisions, the amount of nonqualified deferred compensation that is includible in the income of the service provider is deductible by the service recipient for the taxable year in which the amount is includible in the service provider's income.[290] Thus, for example, in the case of an unfunded nonqualified deferred compensation plan, a deduction to the taxable service recipient is deferred until the deferred compensation is actually paid or made available to the service provider.

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[287] Treas. Reg. sec. 1.409A-1(b)(5)(i)(B).

[288] Treas. Reg. sec. 1.409A-1(a)(3).

[289] Secs. 404(a)(5), (b) and (d) and sec. 83(h).

[290] In the case of a publicly held corporation, no deduction is allowed for a taxable year for remuneration with respect to a covered employee to the extent that the remuneration exceeds $1 million. Code sec. 162(m). The Code defines the term "covered employee" in part by reference to Federal securities law. In light of changes to Federal securities law, the Internal Revenue Service interprets the term covered employee as the principal executive officer of the taxpayer as of the close of the taxable year or the three most highly compensated employees of the taxpayer for the taxable year whose compensation must be disclosed to the taxpayer's shareholders (other than the principal executive officer or the principal financial officer). Notice 2007-49, 2007-25 I.R.B. 1429. For purposes of the deduction limit, remuneration generally includes all remuneration for which a deduction is otherwise allowable, although commission-based compensation and certain performance-based compensation are not subject to the limit. Remuneration does not include compensation for which a deduction is allowable after a covered employee ceases to be a covered employee. Thus, the deduction limitation often does not apply to deferred compensation that is otherwise subject to the deduction limitation (e.g., is not performance-based compensation) because the payment of the compensation is deferred until after termination of employment.

Section 457

Special income recognition rules apply in the case of a participant in a deferred compensation plan that is sponsored by a State or local government or an organization that is exempt from Federal income tax under section 501(a). Section 457 provides for different income inclusion rules for two basic types of deferred compensation arrangements: (1) arrangements that limit the amount of compensation that may be deferred (generally, $15,500 in 2007) and that meet certain other requirements specified in section 457(b) (referred to as a "section 457(b) plan" or an "eligible deferred compensation plan"); and (2) arrangements that do not satisfy the requirements of section 457(b) (referred to as a "section 457(f) plan" or an "ineligible deferred compensation plan"). Section 457 does not provide a limit on the amount of compensation that may be deferred under a section 457(f) plan.

A participant in a section 457(b) plan does not recognize income with respect to the participant's interest in such plan until the time of actual distribution (or, if earlier, the time the participant's interest is made available to the participant, but only in the case of a section 457(b) plan maintained by a tax-exempt sponsor other than a State or local government). In contrast, a participant in a section 457(f) plan must include amounts deferred under such a plan in gross income for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation.

Explanation of Provision

In general

Under the provision, any compensation of a service provider that is deferred under a nonqualified deferred compensation plan of a nonqualified entity is includible in gross income by the service provider when there is no substantial risk of forfeiture of the service provider's rights to such compensation. The provision applies in addition to the requirements of section 409A (or any other provision of the Code or general tax law principle) with respect to nonqualified deferred compensation. The term service provider has the same meaning as under the regulations under section 409A except that whether a person is a service provider is determined without regard to the person's method of accounting.

Nonqualified deferred compensation

For purposes of the provision, the term nonqualified deferred compensation plan is defined in the same manner as for purposes of section 409A. As under section 409A, the term nonqualified deferred compensation includes earnings with respect to previously deferred amounts. Earnings are treated in the same manner as the amount deferred to which the earnings relate.

Under the provision, nonqualified deferred compensation includes any arrangement under which compensation is based on the increase in value of a specified number of equity units of the service recipient. Thus, stock appreciation rights (SARs) are treated as nonqualified deferred compensation under the provision, regardless of the exercise price of the SAR. It is not intended that the term nonqualified deferred compensation plan include an arrangement taxable under section 83 providing for the grant of an option on employer stock with an exercise price that is

not less than the fair market value of the underlying stock on the date of grant if such arrangement does not include a deferral feature other than the feature that the option holder has the right to exercise the option in the future. The provision is not intended to change the tax treatment of incentive stock options meeting the requirements of section 422 or options granted under an employee stock purchase plan meeting the requirements of section 423. Similarly, nonqualified deferred compensation for purposes of the provision does not include a transfer of property to which section 83 is applicable (such as a transfer of restricted stock), provided that the arrangement does not include a deferral feature. However, it is not intended that the provision be avoided through the use of an instrument (such as an option or a notional principal contract) held or entered into directly or indirectly by a service provider, the value of which is determined in whole or part by reference to the profits or value (or any increase or decrease in the profits or value) of the business of the entity for which the services are effectively provided, particularly when the value of such instrument is not determinable at the time it is granted or received. Similarly, it is not intended that the purposes of the provision be avoided through the use of "springing" partnerships or other entities or rights that come into existence in the future and serve a function similar to a conversion right.

Compensation is not treated as deferred for purposes of the provision if the service provider receives payment of the compensation not later than 12 months after the end of the first taxable year of the service recipient during which the right to the payment of such compensation is no longer subject to a substantial risk of forfeiture.

Nonqualified entity

The term nonqualified entity includes certain foreign corporations and certain partnerships (either domestic or foreign). A foreign corporation is a nonqualified entity unless substantially all of its income is effectively connected with the conduct of a United States trade or business or is subject to a comprehensive foreign income tax. A partnership is a nonqualified entity unless substantially all of its income is, directly or indirectly, allocated to (1) United States persons (other than persons exempt from U.S. income tax); (2) foreign persons with respect to whom such income is subject to a comprehensive foreign income tax; (3) foreign persons with respect to whom such income is effectively connected with the conduct of a United States trade or business and a withholding tax is paid under section 1446 with respect to such income; or (4) organizations which are exempt from US income tax if such income is unrelated business taxable income (as defined in section 512) with respect to such organization. It is intended that substantially all the income of a partnership--whether allocated directly, or, in the case of tiered partnerships, indirectly--be taxed in the hands of partners under the U.S. income tax, or be subject to a comprehensive foreign income tax, for the partnership not to be treated as a nonqualified entity. It is not intended that tiered partnerships, or intermediate entities, be used to achieve deferral of compensation that would otherwise not be permitted under the provision.

The term comprehensive foreign income tax means with respect to a foreign person, the income tax of a foreign country if (1) such person is eligible for the benefits of a comprehensive income tax treaty between such foreign county and the United States, or (2) such person demonstrates to the satisfaction of the Secretary of the Treasury that such foreign country has a comprehensive income tax.

The Secretary may provide guidance concerning the case of a corporation resident in a country that has an income tax treaty with the United States but that does not generally tax the foreign-source income of its residents (a "territorial country"). This guidance may address the question whether, or in which circumstances, substantially all the income of such a corporation will be considered to be subject to a comprehensive income tax if the corporation derives income not only from its country of residence but also from one or more countries that may or may not have tax treaties with the United States. For example, it is intended that if a corporation resident in a territorial country that has an income tax treaty with the United States derives a portion of its income from dividends paid by a subsidiary organized in another country that also has an income tax treaty with the United States, and the dividends are paid out of income that is subject to tax by that other treaty country, the Secretary may provide guidance under which the dividend income is considered subject to a comprehensive income tax in determining whether substantially all of the income of the recipient corporation is subject to a comprehensive income tax.

In the case of a foreign corporation with income that is taxable under section 882, the provision does not apply to compensation which, had such compensation been paid in cash on the date that such compensation ceased to be subject to a substantial risk of forfeiture, would have been deductible by such foreign corporation against such income. The provision does not apply to a nonqualified deferred compensation plan of a nonqualified entity if such compensation is payable to an employee of a domestic subsidiary of such entity and such compensation is reasonably expected to be deductible by such subsidiary under section 404(a)(5) when such compensation is includible in income by such employee.

Additional rules

For purposes of the provision, compensation of a service provider is subject to a substantial risk of forfeiture only if such person's right to the compensation is conditioned upon the future performance of substantial services by any person. Thus, compensation is subject to a substantial risk of forfeiture only if entitlement to the compensation is conditioned on the performance of substantial future services and the possibility of forfeiture is substantial. Substantial risk of forfeiture does not include a condition related to a purpose of the compensation (other than future performance of substantial services), regardless of whether the possibility of forfeiture is substantial.

To the extent provided in regulations prescribed by the Secretary, if compensation is determined solely by reference to the amount of gain recognized on the disposition of an investment asset, such compensation is treated as subject to a substantial risk of forfeiture until the date of such disposition. Investment asset means any single asset (other than an investment fund or similar entity) (1) acquired directly by an investment fund or similar entity, (2) with respect to which such entity does not (nor does any person related to such entity) participate in the active management of such asset (or if such asset is an interest in an entity, in the active management of the assets of such entity), and (3) substantially all of any gain on the disposition of which (other than the nonqualified deferred compensation) is allocated to investors of such entity. The rule only applies if the compensation is determined solely by reference to the gain upon the disposition of an investment asset. Thus, for example, the rule does not apply in the case of an arrangement under which the amount of this compensation is reduced for losses on the

disposition of any other asset. With respect to any gain attributable to the period before the asset is treated as no longer subject to a substantial risk of forfeiture, it is intended that Treasury regulations will limit the application of this rule to gain attributable to the period that the service provider is performing services.

The rule is intended to apply to compensation contingent on the disposition of a single asset held as a long-term investment, provided that the service provider does not actively manage the asset (other than the decision to purchase or sell the investment). If the asset is an interest in an entity (such as a company that produces products or services), the rule does not apply if the service provider actively participates in the management of the entity. Active management is intended to include participation in the day-to-day activities of the asset, but does not include the election of a director or other voting rights exercised by shareholders.

The rule is intended to apply solely to compensation arrangements relating to passive investments by an investment fund in a single asset. For example, if an investment fund acquires XYZ operating corporation, the rule is intended to apply to an arrangement that the fund manager receive 20 percent of the gain from the disposition of XYZ operating corporation if the fund manager does not actively participate in the management of XYZ operating corporation. In contrast, the rule does not apply if the investment fund holds two or more operating corporations and the fund manager's compensation is based on the net gain resulting from the disposition of the operating corporations. The rule does not apply to the disposition of a foreign subsidiary which holds a variety of assets the investment of which is managed by the service provider.

Under the provision, if the amount of any deferred compensation is not determinable at the time that such compensation is otherwise required to be taken into account into income under the provision, the amount is taken into account when such amount becomes determinable. This rule applies in lieu of the general rule of the provision, under which deferred compensation is taken into account in income when such compensation is no longer subject to a substantial risk of forfeiture. In addition, the income tax with respect to such amount is increased by the sum of (1) an interest charge, and (2) an amount equal to 20 percent of such compensation. The interest charge is equal to the interest at the rate applicable to underpayments of tax plus one percentage point imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture.

Treasury regulations

It is intended that the Secretary of the Treasury issue regulations as to when an amount is not determinable for purposes of the provision. It is intended that an amount of deferred compensation is not determinable at the time the amount is no longer subject to a substantial risk of forfeiture if the amount varies depending on the satisfaction of an objective condition. For example, if a deferred amount varies depending on the satisfaction of an objective condition at the time the amount is no longer subject to substantial risk of forfeiture (e.g., no amount is paid unless a certain threshold is achieved, 100 percent is paid if the threshold is achieved, and 200 percent is paid if a higher threshold is achieved), the amount deferred is not determinable.

The Secretary of the Treasury is authorized to issue such regulations as may be necessary or appropriate to carry out the purposes of the provision, including regulations disregarding a substantial risk of forfeiture as necessary to carry out such purposes and regulations that provide appropriate treatment where an individual who was employed by an employer which is not a nonqualified entity is temporarily employed by a nonqualified entity which is related to such employer.

Under the provision, aggregation rules similar to those that apply under section 409A apply for purposes of determining whether a plan sponsor is a nonqualified entity. It is intended, however, that such aggregation rules are limited by the Secretary to operate in accordance with the purposes of the provision. For example, it is intended that that the aggregation rules do not result in the application of the provision to a nonqualified deferred compensation plan of a foreign corporation that is not a nonqualified entity (disregarding the aggregation rule) to the extent of deferred compensation expenses that are properly allocable to such corporation, despite the fact that such corporation is aggregated with a nonqualified entity.

Effective Date

The provision is effective with respect to amounts deferred which are attributable to services performed after December 31, 2008. In the case of an amount deferred which is attributable to services performed on or before December 31, 2008, to the extent such amount is not includible in gross income in a taxable year beginning before 2018, then such amount is includible in gross income in the later of (1) the last taxable year beginning before 2018, or (2) the taxable year in which there is no substantial risk of forfeiture of the rights to such compensation. Earnings on amounts deferred which are attributable to services performed on or before December 31, 2008, are subject to the provision only to the extent that the amounts to which such earnings relate are subject to the provision.

No later than 120 days after date of enactment, the Secretary shall issue guidance providing a limited period of time during which a nonqualified deferred compensation arrangement attributable to services performed on or before December 31, 2008, may, without violating the requirements of section 409A(a), be amended to conform the date of distribution to the date the amounts are required to be included in income. If the taxpayer is also a service recipient and maintains one or more nonqualified deferred compensation arrangements for its service providers under which any amount is attributable to services performed on or before December 31, 2008, the guidance shall permit such arrangements to be amended to conform the dates of distribution under the arrangement to the date amounts are required to be included in income of the taxpayer under the provision. An amendment made pursuant to the Treasury guidance will not be treated as a material modification of the arrangement for purposes of section 409A.

A special transition rule applies to nonqualified deferred compensation that is determined based on gain recognized on the disposition of a specified asset held by a service recipient on the date of enactment. Under this rule, if any portion of compensation payable under a binding written contract entered into on or before December 31, 2007, is determined as a portion of the amount of gain recognized on the disposition during such period of the specified asset, the provision will not apply to the portion of compensation attributable to such disposition even

though such portion of compensation may be reduced by realized losses or depreciation in the value of other assets during such period or a prior period or be attributable in part to services performed after December 31, 2008. However, this rule only applies if payment of such portion of compensation is received by the service provider and included in its gross income no later than the earlier of 12 months after the end of the taxable year of the service recipient during which the disposition of the specified asset occurs and the last taxable year of the service provider beginning before January 1, 2018.

7. Delay implementation of worldwide interest allocation (sec. 407 of the bill and sec. 864(f) of the Code)

Present Law

In general

In order to compute the foreign tax credit limitation, a taxpayer must determine the amount of its taxable income from foreign sources. Thus, the taxpayer must allocate and apportion deductions between items of U.S.-source gross income, on the one hand, and items of foreign-source gross income, on the other.

In the case of interest expense, the rules generally are based on the approach that money is fungible and that interest expense is properly attributable to all business activities and property of a taxpayer, regardless of any specific purpose for incurring an obligation on which interest is paid.[291] For interest allocation purposes, all members of an affiliated group of corporations generally are treated as a single corporation (the so-called "one-taxpayer rule") and allocation must be made on the basis of assets rather than gross income. The term "affiliated group" in this context generally is defined by reference to the rules for determining whether corporations are eligible to file consolidated returns.

For consolidation purposes, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if: (1) the common parent owns directly stock possessing at least 80 percent of the total voting power and at least 80 percent of the total value of at least one other includible corporation; and (2) stock meeting the same voting power and value standards with respect to each includible corporation (excluding the common parent) is directly owned by one or more other includible corporations.

Generally, the term "includible corporation" means any domestic corporation except certain corporations exempt from tax under section 501 (for example, corporations organized and operated exclusively for charitable or educational purposes), certain life insurance companies, corporations electing application of the possession tax credit, regulated investment companies, real estate investment trusts, and domestic international sales corporations. A foreign corporation generally is not an includible corporation.

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[291] However, exceptions to the fungibility principle are provided in particular cases, some of which are described below.

Subject to exceptions, the consolidated return and interest allocation definitions of affiliation generally are consistent with each other.[292] For example, both definitions generally exclude all foreign corporations from the affiliated group. Thus, while debt generally is considered fungible among the assets of a group of domestic affiliated corporations, the same rules do not apply as between the domestic and foreign members of a group with the same degree of common control as the domestic affiliated group.

Banks, savings institutions, and other financial affiliates

The affiliated group for interest allocation purposes generally excludes certain corporations that are financial institutions. These include any corporation, otherwise a member of the affiliated group for consolidation purposes, that is a financial institution (described in section 581 or section 591), the business of which is predominantly with persons other than related persons or their customers, and which is required by State or Federal law to be operated separately from any other entity which is not a financial institution (sec. 864(e)(5)(C)). The category of corporate financial institutions also includes, to the extent provided in regulations, bank holding companies (including financial holding companies), subsidiaries of banks and bank holding companies (including financial holding companies), and savings institutions predominantly engaged in the active conduct of a banking, financing, or similar business (sec. 864(e)(5)(D)).

These corporate financial institutions are not treated as members of the regular affiliated group for purposes of applying the one-taxpayer rule to other non-financial members of that group. Instead, all such corporate financial institutions that would be so affiliated are treated as a separate single corporation for interest allocation purposes.

Worldwide interest allocation

In general

The American Jobs Creation Act of 2004 ("AJCA")[293] modifies the interest expense allocation rules described above (which generally apply for purposes of computing the foreign tax credit limitation) by providing a one-time election (the "worldwide affiliated group election") under which the taxable income of the domestic members of an affiliated group from sources outside the United States generally is determined by allocating and apportioning interest expense of the domestic members of a worldwide affiliated group on a worldwide-group basis (i.e., as if all members of the worldwide group were a single corporation). If a group makes this election, the taxable income of the domestic members of a worldwide affiliated group from sources outside the United States is determined by allocating and apportioning the third-party interest expense of those domestic members to foreign-source income in an amount equal to the excess (if any) of (1) the worldwide affiliated group's worldwide third-party interest expense multiplied

[292] One such exception is that the affiliated group for interest allocation purposes includes section 936 corporations that are excluded from the consolidated group.

[293] Pub. L. No. 108-357, sec. 401 (2004).

by the ratio which the foreign assets of the worldwide affiliated group bears to the total assets of the worldwide affiliated group,[294] over (2) the third-party interest expense incurred by foreign members of the group to the extent such interest would be allocated to foreign sources if the principles of worldwide interest allocation were applied separately to the foreign members of the group.[295]

For purposes of the new elective rules based on worldwide fungibility, the worldwide affiliated group means all corporations in an affiliated group as well as all controlled foreign corporations that, in the aggregate, either directly or indirectly,[296] would be members of such an affiliated group if section 1504(b)(3) did not apply (i.e., in which at least 80 percent of the vote and value of the stock of such corporations is owned by one or more other corporations included in the affiliated group). Thus, if an affiliated group makes this election, the taxable income from sources outside the United States of domestic group members generally is determined by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group as if all of the interest expense and assets of 80-percent or greater owned domestic corporations (i.e., corporations that are part of the affiliated group, as modified to include insurance companies) and certain controlled foreign corporations were attributable to a single corporation.

The common parent of the domestic affiliated group must make the worldwide affiliated group election. Under AJCA, the election must be made for the first taxable year beginning after December 31, 2008, in which a worldwide affiliated group exists that includes at least one foreign corporation that meets the requirements for inclusion in a worldwide affiliated group. Once made, the election applies to the common parent and all other members of the worldwide affiliated group for the taxable year for which the election was made and all subsequent taxable years, unless revoked with the consent of the Secretary of the Treasury.

Financial corporation election

Taxpayers are allowed to apply the corporate financial institution ("bank") group rules to exclude certain financial institutions from the affiliated group for interest allocation purposes under the worldwide fungibility approach. The rules also provide a one-time "financial corporation" election that expands the bank group. At the election of the common parent of the

[294] For purposes of determining the assets of the worldwide affiliated group, neither stock in corporations within the group nor indebtedness (including receivables) between members of the group is taken into account.

[295] Although the interest expense of a foreign subsidiary is taken into account for purposes of allocating the interest expense of the domestic members of the electing worldwide affiliated group for foreign tax credit limitation purposes, the interest expense incurred by a foreign subsidiary is not deductible on a U.S. return.

[296] Indirect ownership is determined under the rules of section 958(a)(2) or through applying rules similar to those of section 958(a)(2) to stock owned directly or indirectly by domestic partnerships, trusts, or estates.

pre-election worldwide affiliated group, the interest expense allocation rules are applied separately to a subgroup of the worldwide affiliated group that consists of (1) all corporations that are part of the bank group, and (2) all "financial corporations." For this purpose, a corporation is a financial corporation if at least 80 percent of its gross income is financial services income (as described in section 904(d)(2)(C)(i) and the regulations thereunder) that is derived from transactions with unrelated persons.[297] For these purposes, items of income or gain from a transaction or series of transactions are disregarded if a principal purpose for the transaction or transactions is to qualify any corporation as a financial corporation.

Under AJCA, the common parent of the pre-election worldwide affiliated group must make the election for the first taxable year beginning after December 31, 2008, in which a worldwide affiliated group includes a financial corporation. Once made, the election applies to all of the financial corporations which are members of the electing bank group for the taxable year and all subsequent taxable years. In addition, anti-abuse rules are provided under which certain transfers from one member of an expanded financial institution group to a member of the worldwide affiliated group outside of the financial institution group are treated as reducing the amount of indebtedness of the separate financial institution group. Regulatory authority is provided with respect to the election to provide for the direct allocation of interest expense in circumstances in which such allocation is appropriate to carry out the purposes of these rules, to prevent assets or interest expense from being taken into account more than once, or to address changes in members of any group (through acquisitions or otherwise) treated as affiliated under these rules.

Effective date of worldwide interest allocation under AJCA

Under AJCA, the worldwide interest allocation rules were effective for taxable years beginning after December 31, 2008.

Housing and Economic Recovery Act of 2008

The Housing and Economic Recovery Act of 2008[298] delays the effective date of the worldwide interest allocation rules for two years, until taxable years beginning after December 31, 2010. The required dates for making the worldwide affiliated group election and the financial corporation election are changed accordingly. That provision also provides a special phase-in rule in the case of the first taxable year to which the worldwide interest allocation rules apply. For that year, the amount of the taxpayer's taxable income from foreign sources is reduced by 70 percent of the excess of (i) the amount of its taxable income from foreign sources as calculated using the worldwide interest allocation rules, over (ii) the amount of its taxable income from foreign sources as calculated using the present-law interest allocation rules. Any foreign tax credits disallowed by virtue of this reduction in foreign-source taxable income may

[297] See Treas. Reg. sec. 1.904-4(e)(2).

[298] Pub. L. No. 110-289, sec. 3093 (2008).

be carried back or forward under the normal rules for carrybacks and carryforwards of excess foreign tax credits.

Explanation of Provision

The provision delays the effective date of the worldwide interest allocation rules until taxable years beginning after December 31, 2016. The required dates for making the worldwide affiliated group election and the financial corporation election are changed accordingly. The provision also provides a phase-in rule in the case of the first taxable year to which the worldwide interest allocation rules apply. For that year, the amount of the taxpayer's taxable income from foreign sources is reduced by 45 percent of the excess of (i) the amount of its taxable income from foreign sources as calculated using the worldwide interest allocation rules, over (ii) the amount of its taxable income from foreign sources as calculated using the present-law interest allocation rules. Any foreign tax credits disallowed by virtue of this reduction in foreign-source taxable income may be carried back or forward under the normal rules for carrybacks and carryforwards of excess foreign tax credits.

The provision provides a set of alternative rules if H.R. 6983 (of the 110th Congress) is enacted into law. In that case, for purposes of the provision, H.R. 6983 shall be treated as having been enacted immediately before the enactment of the provision. In addition, in lieu of the rules set forth in the paragraph immediately above, the provision would delay the effective date of the worldwide interest allocation rules until taxable years beginning after December 31, 2018. The required dates for making the worldwide affiliated group election and the financial corporation election would be changed accordingly. The alternative provision would also repeal the phase-in rule.

Effective Date

The provision is effective on the date of enactment.

8. Modifications to corporate estimated tax payments (sec. 408 of the bill)

Present Law

In general

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.

Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA")

TIPRA provided that in case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2013, shall be increased to 100.75 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Subsequent legislation

The TIPRA percentage was further increased by 16.75 percentage points by Public Law 110-289.

Explanation of Provision

In case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2013, are increased by 58 percentage points of the payment otherwise due and the next required payment shall be reduced accordingly.

Effective Date

The provision is effective on the date of enactment.