UNCORRECTED

1 EXECUTIVE BUSINESS MEETING TO CONSIDER THE HEARTLAND,
2 HABITAT, HARVEST, AND HORTICULTURE ACT OF 2007; AND
3 LEGISLATION IMPLEMENTING THE U.S.-PERU TRADE PROMOTION
4 AGREEMENT
5 THURSDAY, OCTOBER 4, 2007
6 U.S. Senate,
7 Committee on Finance,
8 Washington, DC.
9 The meeting was convened, pursuant to recess, at
10 5:07 pm., in room 215, Dirksen Senate Office Building,
11 Hon. Max Baucus (chairman of the committee) presiding.
12 Present: Senators Rockefeller, Conrad, Bingaman,
13 Kerry, Lincoln, Wyden, Stabenow, Cantwell, Salazar,
14 Grassley, Hatch, Snowe, Kyl, Smith, Bunning, Crapo, and
15 Roberts.
16 Also present: Russ Sullivan, Democratic Staff
17 Director; Kolan Davis, Republican Staff Director and
18 Chief Counsel; Dean Zerbe, Senior Counsel and Tax Counsel
19 to the Ranking Member; Demetrious Manratios, Chief Trade
20 Counsel; Pat Heck, Chief Tax Counsel; Pat Bousliman,
21 Professional Staff Member; Mark Prater, Chief Tax
22 Counsel; Chris Javens, Tax Counsel; Steven Schafer, Chief
23 Trade Counsel; and Carla Martin, Chief Clerk.
24 Also present: Eric Solomon, Assistant Secretary for
25 Tax Policy, Department of the Treasury; Edward D.

1 Kleinbard, Chief of Staff, Joint Committee on Taxation;
2 Rebecca Baxter, Tax Counsel; Elizabeth Paris, Tax
3 Counsel; and Joshua Levasseur, Archivist.
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

1 The Chairman. The committee will come to order.
2 The committee meetings today to consider two items,
3 an original bill entitled "The Heartland, Habitat,
4 Harvest, and Horticulture Act of 2007", otherwise known
5 as the 4-H Act, and the U.S.-Peru Trade Promotion
6 Agreement.
7 I am going to omit my opening statement, and I urge
8 others to do the same.
9 The next order of business really is the mark, the
10 Farm Tax mark. There is a modification before the
11 committee in connection with the Farm Tax mark. The mark
12 is so modified.
13 Do any Senators have any questions regarding the
14 mark or the modification? We had discussion previously,
15 and I just wondered if any Senators have any other
16 comments they wished to make, or any questions they might
17 have.
18 Senator Kyl. Mr. Chairman, I do not have a
19 question, but in lieu of an opening statement I am not
20 going to offer an amendment on two of the provisions, but
21 I would like to express the reasons why I do not support
22 these two provisions. Then I will have an amendment
23 later on.
24 The first has to do with the codification of the
25 Economic Substance Doctrine, and I want to thank you and

1 the Ranking Member for making certain modifications to
2 codify the Economic Substance Doctrine, but explain why I
3 still oppose the proposal.
4 First, codifying the Economic Substance Doctrine is
5 not necessary. The Justice Department is winning a good
6 number of the tax shelter cases that it brings based upon
7 the doctrine. Second, the proposal retains the strict
8 liability feature, which I think is a big mistake. When
9 a taxpayer discloses a transaction to the IRS, it seems
10 unfair and inappropriate then to hit them with strict
11 liability penalties.
12 Finally, I am concerned that the proposal will
13 significantly increase administrative and litigation
14 costs for companies. In the end, I am concerned that the
15 only reason we are legislating it is to use the provision
16 as a revenue raiser, since, as I said, it is being done
17 anyway.
18 We often speak in terms of revenue raises or pay-go
19 around here, but the American people need to know that we
20 mean tax increases. In this case, it is a tax increase
21 on corporations, so most folks will not have to worry
22 about it. But here is why I think it is a bad idea:
23 corporations do not pay taxes, we know that people pay
24 taxes. Whether it is shareholders, customers, or
25 employees, someone must pay for the additional revenue

1 that the Federal Government will collect based on this
2 proposal.
3 The second of the three raisers here that I think
4 are troublesome has to do with the so-called silo
5 provision that applies to foreign leases. We have made
6 this provision retroactive, and this committee ordinarily
7 does not do that.
8 I know that even the Ranking Member will dispute
9 that it is really retroactive, but my view is that we set
10 the silo rules in the FSC-ETI bill back in 2004 and
11 should not go back now and change the rules simply to
12 raise more revenue. Retroactive tax increases are unfair
13 and make it difficult for taxpayers to rely on the bills
14 we pass.
15 Finally, the element of rural renaissance bonds. I
16 want to raise an objection to expanding the use of these
17 tax credit bonds. We currently allow these kind of bonds
18 in only a very small, defined set of circumstances and I
19 strongly urge the committee against expanding their use.
20 Tax credit bonds shift the entire cost of borrowing to
21 the Federal Government--to taxpayers, in other words--
22 rather than requiring the local entity to share the
23 burden: interest payments which are tax deductible to the
24 bond holder.
25 Tax-exempt bonds already give States and local

1 governments a leg up on other borrowers in the financial
2 markets, allowing them to borrow at preferred rates
3 because of the tax exemption. If States and local
4 governments want to borrow to finance projects, fine, but
5 taxpayers in other States should not be on the hook for
6 even more of the financing costs than they already are.
7 Thank you, Mr. Chairman.
8 The Chairman. Thank you, Senator.
9 Any other questions before we go to amendments? I
10 urge Senators to be brief because I think the next series
11 of votes will begin in about 30 minutes, and I hope we
12 can transact our business before those votes begin.
13 I saw the Senator from Michigan seeking recognition.
14 Senator Stabenow. Thank you, Mr. Chairman. I will
15 be very brief. And thank you and your staff for working
16 with us on a number of issues. I just want to point out
17 that there are important first steps in this bill on
18 agricultural for 50 percent of the cash receipts in the
19 country, which are fruits and vegetables. We are
20 beginning to deal with pest, disease, and tree assistance
21 disaster relief. We have much more to do on the farm
22 bill side of things, and we will be asking all of our
23 colleagues on the Agriculture Committee to work with us.
24 But this is an important first step, and I want to thank
25 you.

1 The Chairman. You are very welcome.
2 Senator Hatch?
3 Senator Hatch. Mr. Chairman, you and I have a
4 colloquy to make.
5 The Chairman. Yes.
6 Senator Hatch. Should I hold off from making it or
7 could we make it now and get it out of the way?
8 The Chairman. Let us get it out of the way. Let
9 us do it.
10 Senator Hatch. That is what I thought.
11 Mr. Chairman, I filed an amendment dealing with
12 rural State investment trusts. The amendment is another
13 in a series of similar bills I have sponsored over the
14 years to improve and modernize the tax rules for these
15 important investment vehicles.
16 Now, though this amendment is relatively low-cost,
17 non-controversial, and enjoys bipartisan support, it is
18 not terribly relevant to the agriculture tax bill we are
19 marking up today, therefore, I will not offer my
20 amendment. However, I did want to bring to your
21 attention the need for us to update the tax rules
22 governing REITs and urge you to include this legislation
23 in a vehicle that is moving forward this year.
24 The Chairman. Well, Senator, I appreciate that. I
25 appreciate you holding off on offering the amendment. I

1 agree that REIT rules must be kept up to date, and I
2 anticipate the committee could be taking up legislation
3 dealing with real estate and mortgage issues in the
4 future, and I look forward to working with you to make
5 sure that what you desire is done.
6 Senator Hatch. Well, thank you, Mr. Chairman. I
7 am a co-sponsor of Senator Stabenow's bill to provide the
8 exclusion for debt forgiveness in the case of
9 foreclosure, so I am pleased to hear that the committee
10 may act on this issue soon. I am grateful that you will
11 consider favorably adding the REIT provisions to that
12 bill.
13 The Chairman. Thank you, Senator.
14 Senator Hatch. Thank you.
15 The Chairman. Senator Rockefeller?
16 Senator Rockefeller. Mr. Chairman, as I said a
17 moment ago to you, I am very grateful to you for
18 accepting a really new, beefed up, broadband incentive to
19 get it out into the rural areas, and I want to not only
20 thank you, but I want to thank Olympia Snowe. We have
21 been working on this for years and years. She and I
22 introduced a bill back in 2000. I also want to thank
23 Maria Cantwell, who is intimately involved with this.
24 I thank you, sir.
25 The Chairman. You are welcome, Senator.

1 Mr. Kleinbard, did you have any other modifications
2 you wished to mention to the mark?
3 Mr. Kleinbard. Yes, sir. I would like to describe
4 my understanding of Senator Bunning's amendment #4
5 relating to coal-to-liquids, and I will do my best to
6 summarize my understanding of what the proposal would be.
7 The proposal, as I understand it, would restore the
8 Chairman's mark that extends the alternative fuel excise
9 tax through December 31, 2010, so to go from the
10 Chairman's modification that removed that provision back
11 to the Chairman's mark, which would extend the
12 availability of the credit on the excise tax through
13 December 31, 2010.
14 It would further modify the Chairman's mark in the
15 following respects: first, it would include coal-to-
16 liquid fuels in that extension of the availability of the
17 credit through December 31, 2010; second, it would
18 require that facilities producing coal-to-liquid fuels
19 that qualify for the credit apply sequestration
20 technologies to sequester 50 percent of their carbon
21 output for the period between the date of enactment and
22 December 30, 2010, which number would then increase to a
23 75 percent sequestration requirement as of December 31,
24 2010, the last day to which the extension would apply,
25 unless the following condition is satisfied, at which

1 point the 75 percent sequestration figure would come into
2 effect at an earlier date.
3 An arbitration panel of three arbitrators concludes
4 that it is feasible to move to a 75 percent sequestration
5 capture rate more quickly than the December 31, 2010
6 date. The arbitrators would consist of the National
7 Academy of Sciences, a second arbitrator to be drawn from
8 independent experts and nominated by Senator Bunning, and
9 a third arbitrator to be chosen by the first two.
10 The pay-for for the restoration of this issue back
11 to the Chairman's mark with the further modifications
12 that I have just described would be an increase in
13 information return penalties. Today we have a three-tier
14 structure for penalties of $15, $30, and $50, depending
15 on the delay in filing required information returns, and
16 the proposal would change that to $50, $100, and $150,
17 respectively.
18 Senator Bunning. There is only one thing you left
19 out.
20 Mr. Kleinbard. Sorry, sir.
21 Senator Bunning. And that was the commercially
22 feasible portion. The commercially feasible portion is
23 essential in that we can do it in the lab, we can do it
24 for very, very small plants, but we need the commercial
25 feasibility to be determined by the arbitrators.

1 Mr. Kleinbard. Yes, sir. I used the term
2 "feasible", as I understood that the term would be
3 further refined through discussions, as reflected in
4 committee reports. But I apologize. That is correct.
5 The Chairman. I think that is right. That issue
6 was raised. Senator Kerry is not here to --
7 Senator Bunning. It was raised in our discussions.
8 The Chairman. It was. It definitely was. I do
9 not know if it was concluded, frankly.
10 Senator Bunning. But it does no good --
11 The Chairman. I want to make sure that Senator
12 Kerry is protected --
13 Senator Bunning. Well, let us let the three
14 arbitrators decide?
15 The Chairman. Let us defer on this until Senator
16 Kerry is back. We will come back to this, if you do not
17 mind.
18 Senator Bunning. All right.
19 The Chairman. Are there any other questions?
20 Senator Lincoln?
21 Senator Lincoln. Thanks, Mr. Chairman. Mr.
22 Chairman, I can either enter the colloquy or just mention
23 -- I would like to ask unanimous consent to enter the
24 colloquy in the record and just visit briefly. The last
25 four years, Senator Smith and I have worked diligently

1 alongside you and Senator Grassley to ensure the survival
2 of rail transportation for the benefit of farmers, grain
3 elevators, and the consumers of American agriculture.
4 You all have agreed to work with us on that, and we would
5 love to see that. I think maybe perhaps, with the
6 possibility of that being something we can do later, and
7 extenders, and others, we would really like to have the
8 short line rail --
9 The Chairman. The short line.
10 Senator Lincoln. Extension of the short line rail.
11 It is not in the bill, but we wanted to get the assurance
12 of the Chairman and Senator Grassley, who we have been
13 working with, that this would be something we could move
14 to in the extenders package if we have one later on.
15 The Chairman. Yes. I might say, as you said, it
16 expires at the end of this year.
17 Senator Lott. Is this the short line?
18 The Chairman. Short line.
19 Senator Lincoln. Yes.
20 The Chairman. We are just trying to work out some
21 way, since it is not really the subject of this bill, to
22 deal with it.
23 Senator Lincoln. Right. Well, they do a
24 tremendous service to rural America and for agricultural
25 products, and we would certainly like to make sure that

1 we can see that happen later on.

2 The Chairman. You bet.

3 Senator Lincoln. Just one last thing. We visited,
4 and I think there was consensus. There was no objection
5 to the other amendment that I had in terms of the small
6 motors credit, which is predominantly used in
7 agriculture. I did not know if I needed to --

8 The Chairman. All right. We are going to get to
9 that in a second.

10 Senator Lincoln. Great. Thank you.

11 The Chairman. All right. Thank you, Senator.

12 Senator Snowe, by chance are you ready to offer your
13 amendment?

14 Senator Snowe. Yes. Thank you, Mr. Chairman.

15 Mr. Chairman, the amendment that I am offering would
16 close a major trade loophole that has significantly
17 disadvantaged our Nation's 70,000 dairy farm families,
18 certainly in Maine and across this country. This
19 amendment essentially incorporates legislation called the
20 Milk Import Equity Act that was introduced by Senator
21 Clinton and myself in May of this year. It would impose
22 tariff rate quotas on imports of milk, protein
23 concentrates, and caseins.

24 This amendment is extremely important because our
25 dairy farmers and producers have been deluged by imports

1 from other countries at a time in which it has actually
2 devastated not only small family farms across this
3 country and producers, but it certainly has even affected
4 the U.S. Government, because it has added to the
5 inventories of surpluses in government warehouses.
6 This developed essentially in 1994 during the World
7 Trade Organization negotiations, and these products were
8 not identified as commercially feasible to market. So,
9 it obviously now has been developed to the point where
10 there is a more than 600 percent increase in the volume
11 of imports between 1995 and 2001, and since 2001 a 75
12 percent increase. It represents a loss of more than $5
13 billion.
14 In my State, for example, dairy farmers are just
15 mom-and-pop operations trying to eke out a living, and
16 producing milk, frankly, for the consumers in Maine, and
17 the same is true throughout New England and in many parts
18 of this country. Many of you have supported this
19 legislation because it has been introduced by Senator
20 Clinton since 2003. So, there have been more than 10
21 members of this committee that have co-sponsored
22 legislation at one point. This creates equity in the
23 market. That is the bottom line.
24 Now, I have heard that this contravenes the World
25 Trade Organization. To the contrary. In fact, there

1 have been 12 instances over this last decade where there
2 have been 12 re-negotiation of tariffs. This legislation
3 that Senator Clinton and I have introduced essentially
4 gives the President the authority to renegotiate, and
5 also to address, the impact it would have with the other
6 countries where we would be reducing the imports or
7 increasing the rate above a certain ceiling of those
8 imports coming in to this country. It is only fair.
9 It has been done consistently under Article 28 of
10 the WTO. And certainly this legislation is consistent
11 with the standards, and the principles, and the
12 obligations of members. It is not unique. It does not
13 contravene WTO, it does not violate WTO. This is
14 creating equity and that is why the National Milk
15 Producers Federation supports this legislation, as well
16 as the National Farmer's Union, because it represents
17 restoring an equal playing field, a level playing field
18 in the marketplace. It was not anticipated that it would
19 manifest itself to the point that it is devastating small
20 family farms across this country.
21 So, Mr. Chairman, I would urge adoption of this
22 amendment.
23 The Chairman. Any debate? Senator Conrad?
24 Senator Conrad. I want to support Senator Snowe
25 because what is going on here is a giant scam. That is

1 what is going on, and we all know it. What they are
2 doing, is they are bringing product in after they take
3 the liquid off, and then they bring it in to avoid tariff
4 rate quotas and then they re-liquify on this side of the
5 border and escape what is the announced policy of the
6 United States. It is a giant scam and we should not
7 permit it. This is the kind of thing that helps explode
8 the trade deficit. It is unfair to the country and it is
9 just a giant loophole.
10 The Chairman. Any other discussion?
11 [No response].
12 The Chairman. I would like to begin by noting a
13 couple of things. One, is since these bills were
14 introduced--that is, those bills referred to--the imports
15 of milk protein concentrates has been declining very
16 precipitously, so there is a change in circumstances
17 since those bills referred to were introduced.
18 Second, U.S. exports of milk protein products and
19 dry milk powder have increased nearly 400 percent during
20 that same period. That is, demand for all milk protein
21 products continues to rise.
22 The key point here, too, is this amendment would
23 subject the United States to retaliation under WTO rules.
24 I am not going to get into it for various reasons which I
25 do not want to get into here as to whether or not this is

1 WTO-inconsistent, but it is clear that it would subject
2 this country to significant retaliation under WTO rules
3 if this amendment were adopted.
4 Any WTO member who unilaterally raises tariffs above
5 agreed-upon levels must pay compensation to members
6 affected by tariffs, and this bill would force us to
7 negotiate compensation for our trading partners, but ties
8 our hands by placing further conditions on what we are
9 allowed to negotiate. It also undermines U.S.
10 credibility. How can we ask other countries to lower
11 their tariffs on U.S. products when we are unwilling to
12 live up to our own tariff commitments?
13 In addition to WTO concerns, this amendment raises
14 concerns about meeting our commitments under our
15 bilateral free trade agreements, under which we are not
16 allowed to enforce tariff rate quotas. So, overall, I
17 think this sends a very negative message about our
18 commitment to our trade agreements in order to protect an
19 industry that is the healthiest that it has been in
20 years. So, I respectfully urge members to not support
21 the amendment.
22 Senator Roberts. Mr. Chairman?
23 The Chairman. Senator Roberts?
24 Senator Roberts. Mr. Chairman, for the non-Aggie
25 audience, milk protein concentrates are an important

1 ingredient in processed food products and demand right
2 now actually surpasses our domestic production. The crux
3 of the matter is that the dairy price support program, as
4 mentioned, requires the Federal Government to purchase
5 surplus non-fat dry milk, which does actually create a
6 disincentive for the production of AMPCs.
7 As you stated, it pits one commodity against any
8 number of products that the exporting country would
9 choose to retaliate with. I think that the Senator from
10 Iowa was talking about Canada. I cannot remember the
11 product; perhaps it was cheese. I cannot remember.
12 Senator Grassley. It was cheese.
13 Senator Roberts. At a time when MPC imports are
14 decreasing, as the Chairman has indicated, and non-fat
15 dry milk exports are at historic highs, limiting imports
16 of a product which the United States cannot produce
17 enough of does not seem to be very logical. So in my
18 view, I am going to choose to reluctantly oppose the
19 amendment because of what I think has been stated by the
20 Chairman, and also Senator Grassley, and the facts that I
21 have presented.
22 Senator Grassley. Mr. Chairman?
23 The Chairman. Senator Grassley?
24 Senator Grassley. Yes. If I could, and this is
25 repetitive of what I told some of the members in the

1 back, but at a time when we are very dramatically
2 expanding our exports of cheese, as an example, we have
3 countries like Canada that are thinking about rewriting
4 their standards for the sole purpose of keeping our
5 cheese out. If we start down this road, I do not know
6 where we are going to end up with having retaliation.
7 We have got the administration fighting Canada right
8 now on that issue. We have got the diary producers'
9 associations backing the administration up on fighting
10 what Canada is doing. We should not go down this road,
11 so I ask you to vote against the amendment.
12 Senator Snowe. Mr. Chairman?
13 The Chairman. Senator Snowe?
14 Senator Snowe. Yes. Thank you very much. I know
15 time is of the essence, but a couple of points. First of
16 all, this is a unilateral action. It would give the
17 President the authority to negotiate those concessions.
18 It would not curtail imports. In fact, it would create a
19 ceiling above which they would have to pay a tariff.
20 So when you are talking about a 600 percent increase
21 of these products between 1995 and 2001 and 75 percent
22 since 2001, that is a significant volume of imports that
23 has devastated producers. That is why the national
24 producer's association supports this, that is why the
25 National Farmer's Union supports this, because they have

1 experienced the impact of the volume.

2 So when you mention there is a declining rate, that
3 may be true in the first few months of this year, but
4 when you talk about what the volume has been over this
5 last decade, it has been tremendous. There has been no
6 consistent trend, and three months does not make a trend.
7 This has been absolutely devastating and costly to our
8 farmers.

9 Finally, with respect to Canada, Canada is
10 representing its own interests. We should be
11 representing ours. They are moving in this direction
12 because they recognize the impact it is having on its own
13 producers. We should be recognizing the same for our
14 small family farmers as well. So, this is certainly
15 consistent with WTO Article 28 in allowing for
16 negotiations and working with those countries who have
17 been exporting to the United States these products, so it
18 is certainly in keeping with those standards. So, I
19 would hope that we would support the small family farms.

20 Finally, I would say when people say, well, why do
21 we have stockpiles in government warehouses, such a
22 demand that there is a stockpile of surpluses in
23 government warehouses as we speak, it is because of the
24 deluge and because our farmers and producers are not able
25 to sell. So that is putting them at a competitive

1 disadvantage. Those are the facts. I would hope that we
2 would stand up and represent our interests, as other
3 countries like Canada are doing, on behalf of their
4 farmers.
5 Senator Lott. Mr. Chairman?
6 The Chairman. Senator Lott?
7 Senator Lott. I will not prolong this point. I
8 just want to say that, within 35 minutes, we are going to
9 have four stacked votes. If we could move this along,
10 whether you are going to vote "aye" or "no" on anything,
11 I wish we would do it.
12 The Chairman. One small point here, too. With all
13 respect to the Senator from North Dakota, it is my
14 understanding that a lot of this product is not going
15 back into fat milk, rather, it goes into candy bars and
16 other products, so there is not circumvention to the
17 degree to which as has been represented. So, again, I
18 just think this is not good policy and it invites
19 retaliation. It is not needed nearly as much as it was
20 several years ago, and on balance I just do not think it
21 is the right thing to do.
22 All those in favor of the amendment say "aye".
23 [Chorus of ayes].
24 The Chairman. Those opposed?
25 [Chorus of nays].

1 The Chairman. The nays have it. The amendment is
2 not agreed to, unless the Senator seeks a roll call vote.
3 She does not seem to seek a vote. No, she does not. All
4 right. The amendment is not agreed to.
5 Further amendments?
6 Senator Kyl. Mr. Chairman? Over here.
7 The Chairman. Oh. Sorry. Senator Kyl?
8 Senator Kyl. Mr. Chairman, I would like to call up
9 my amendment #1. I had hoped that we could work out
10 something on the estate tax. I am not sure we have been
11 able to do that, however. I think most people on this
12 committee would like to deal with estate tax reform.
13 Certainly there is no subject more important to most
14 farmers. Twice in the last several months we have voted
15 overwhelmingly in support of a proposal which is
16 essentially the amendment that I offer here today.
17 It is virtually identical to H.R. 5970, the Estate
18 Tax and Extension of Tax Relief Act of 2006, which was
19 passed by the House in 2006 and which the Senate failed
20 to invoke cloture on by only three votes. It got 57
21 votes in the Senate last year.
22 The only changes are that this proposal today does
23 not include any of the unrelated tax extenders that were
24 on that bill, and also it is not phased in, which was
25 done in order to reduce the score of last year. Rather,

1 it would become effective in 2010. Remember, that is the
2 year that the State tax is repealed under existing law.
3 Second, it is very similar to the motion on budget
4 conferees that we voted on in May of this year. We
5 passed that 54:41. The Chairman supported it. It also
6 provided for most of the same features as the bill that
7 we almost got cloture on in 2006.
8 So my hope is that the committee would express its
9 strong support for the farmers of this country by
10 supporting tax reform, and provides that the exemption is
11 $5 million per State. It is indexed for inflation. It
12 is portable, meaning that the surviving spouse can more
13 easily use the unused portion of it. The rate, beginning
14 in 2010, estates up to $25 million would be taxed at the
15 capital gains rate; after that they would be taxed at a
16 rate of 30 percent. That is all indexed for inflation.
17 Finally, beginning in 2010, estates and gifts would
18 be unified, which obviously gives individuals more
19 options and planning during their lifetimes. Gifts over
20 the Unified Credit exemption amount would be taxed the
21 same as estates.
22 I would just note, I think we all understand the
23 arguments so I am not going to go over them all. But we
24 did some work with the Joint Committee on Taxation to
25 find out how many people would be relieved of the burden

1 of paying this tax with a proposal similar to the one
2 that I am offering here.
3 If we enacted this proposal in the year 2011 alone,
4 just that one year, we would shield nearly 120,000
5 families from the estate tax because they would have
6 estates of less than $5 million, and every year
7 thereafter we would be saving a similar number of estates
8 from having the burden of the tax.
9 There are almost 16,000 by the year 2015 that would
10 be subject to the tax in that year alone under this
11 proposal. And if we fail to act, the exempted amount
12 would revert to $1 million and the rate will be 55
13 percent. We would have over 127,000 estates every year
14 subject to the tax.
15 So I hope that my colleagues will recognize that we
16 cannot just keep talking about it. We need to do
17 something about it. It has been some time since we have
18 had a hearing. We need to have a mark-up. We need to
19 get the bill out. If we could do it on this bill, it
20 would be an important way of demonstrating our commitment
21 to estate tax reform instead of simply just talking about
22 it.
23 Senator Conrad. Mr. Chairman?
24 The Chairman. Senator Conrad?
25 Senator Conrad. Mr. Chairman, could I inquire of

1 the Senator if he has a pay-for for this amendment?
2 Senator Kyl. Mr. Chairman, Senator Conrad, the
3 answer to that is no. The reason is because most people
4 believe that the estate tax is a very unfair tax and that
5 the elimination of it should not require either the
6 person who is currently paying it, or somebody else, to
7 have to come up with an amount of money to make up for
8 what they just got saved. It is a false premise that the
9 revenue belongs to the government, and if the people get
10 to keep more of it, somehow we have to make the
11 government whole. That is especially true with regard to
12 the estate tax, which, in the year 2010, goes to zero.
13 Senator Conrad. Mr. Chairman, might I reclaim my
14 time?
15 Senator Kyl. Oh, sure. I am sorry.
16 The Chairman. Is there any further discussion?
17 Senator Conrad. I thank Senator Kyl for his
18 extended answer.
19 The Chairman. Any further discussion?
20 Senator Kyl. Always happy to oblige.
21 Senator Conrad. If I could just conclude the
22 thought, Mr. Chairman. Look, this is not paid for. In
23 the budget, we go to a $3.5 million exemption per person,
24 index it for inflation, and pay for it. This proposal is
25 not paid for, blows a hole in the budget. The first full

1 10 years that it is in effect, it costs over $650
2 billion. As a result, it violates pay-go, and this will
3 kill the farm bill.
4 If you want to kill the farm bill, if this is really
5 an attempt to kill the farm bill, this is the way to do
6 it because you violate pay-go, put it all subject to
7 multiple points of order, and it goes right down the
8 tubes. We have already, in the budget, provided going to
9 $3.5 million per person, $7 million a couple, index it
10 for inflation. I hope colleagues would support that and
11 not blow a hole in the budget and endanger the whole farm
12 bill.
13 Senator Kyl. Mr. Chairman, just 30 seconds here.
14 Senator Smith. Is there an offset on the AMT?
15 The Chairman. Well, we can always engage in
16 hypotheticals. We are not dealing with AMT right now.
17 Senator Smith. I just wanted to add that.
18 The Chairman. That is right. Senator Kyl?
19 Senator Smith. I want to join Senator Kyl in
20 saying I think we ought to deal with this.
21 Senator Kyl. Just two quick things. First of all,
22 the budget assumed a pay-for, but obviously, as we know,
23 that was not paid for either, nor was the vote that we
24 took and got 57 votes on in 2006. There was no pay-for
25 for that, and I think the reasons are pretty obvious.

1 With respect to this tax and the reform, it is not
2 something that we should have to penalize the very people
3 that are we trying to help by eliminating the threat of
4 the death tax.
5 Senator Lott. Mr. Chairman?
6 The Chairman. Senator Lott?
7 Senator Lott. Yes. Just briefly. I have got
8 about 20 minutes of remarks I would like to make on this.
9 However, I will not do that.
10 The Chairman. We are spellbound. We will hear
11 you.
12 Senator Lott. Look, there is a lot of support for
13 doing more in this area than we have done. You have
14 indicated you support that, Senator Grassley, Senator
15 Lincoln, a bunch of us. But I would rather this not come
16 up in a war zone, some way at the end of a session or
17 when we are trumping each other.
18 What I think we ought to do, and I think if you
19 could make just sort of commitment that, all right, look,
20 we are going to have a hearing on this, we are going to
21 think it through, and we are going to try to see if we
22 can find a way to do this, that would be a wise thing to
23 do.
24 The Chairman. I think that is very wise, Senator.
25 I would like to wrap up discussion on this if we could.

1 Senator Salazar. Mr. Chairman? Senator Baucus?
2 The Chairman. Senator Salazar?
3 Senator Salazar. Chairman Baucus, I want to echo
4 the comment that was just made by Senator Lott. Senator
5 Roberts and I have introduced legislation that was
6 focused in just on farms and ranches and eliminating the
7 estate tax when it is passed on as a working operation to
8 the next generation. I think it is the kind of issue
9 where we ought to have a discussion at some point in
10 time, and I hope that that happens.
11 Senator Lincoln. Mr. Chairman?
12 The Chairman. Senator Lincoln?
13 Senator Lincoln. I just think it is a reasonable
14 suggestion that we can set a goal for a proposal, a
15 hearing, a mark-up, and hope that we will. I agree that
16 this is not the place to do it and that there is much
17 time for discussion, and certainly work on this issue. I
18 would encourage us to do that as the committee, to set
19 those goals and stick by them.
20 The Chairman. Senator, I would urge you to
21 withdraw your amendment, with the understanding that this
22 committee will hold a hearing. A hearing is long
23 overdue. We have not had a hearing on this subject for
24 many years and it is definitely needed. We need to have
25 a hearing this year, frankly, also with the understanding

1 that we have as a goal a mark-up on this legislation in
2 the spring of next year. This is extremely important.
3 There are a lot of farmers, ranchers, small business
4 people who are very dependent upon reform. Given those
5 conditions and understanding, I urge the Senator to
6 withdraw.
7 Senator Kyl. Mr. Chairman, I know how much you
8 have tried over the years to find a way to get enough
9 support for estate tax reform that the Senate could pass.
10 Next year would seem to be a very propitious time in
11 which to get that done. If we could get started early
12 enough on it next year so it does not get caught up in
13 what Trent Lott called the "war zone", I think it could
14 have a very good chance at passing.
15 I would be happy to withdraw the amendment with the
16 understanding by the committee that it is our goal
17 sometime early next year to have a mark-up on a bill. We
18 are not, obviously, committed to any particular bill,
19 though I have got a really good one here.
20 The Chairman. All right. Thank you, Senator. All
21 right.
22 Mr. Kleinbard, I understand that you have spent some
23 time in working out some language on the Lincoln
24 amendment, and also Salazar #3 on cellulosic alcohol.
25 Mr. Kleinbard. Yes, sir. Senator Salazar's

1 amendment #3 relates to the provisions in the bill that
2 would comprise a tax credit for the production of
3 cellulosic alcohol. The amendment would further increase
4 those credits by 17 cents per gallon. We have now been
5 able to come up with a revenue estimate of about $135
6 million over 10 years. The offset for that is an
7 amendment to Section 1031 of the Code dealing with like-
8 kind exchanges, which would take out from the scope of
9 the tax-free like-kind exchange rule like-kind exchanges
10 of collectible assets. That raises about $175 million.
11 Senator Lincoln's amendment #3 would be an amendment
12 to encourage the introduction of small, energy-efficient
13 motors. It would be a credit of $15 per horsepower for
14 motors placed in service over the next three years. It
15 is estimated that that would cost about $129 million over
16 the 10-year budget window.
17 The offset to that is a clarification of Section
18 162(f) of the Code relating to the deductibility of fines
19 and penalties. Under the clarification, no deduction
20 would be permitted for any amount paid to, or at the
21 direction of, a government in relation to the violation
22 or governmental inquiry into the potential violation of
23 any law, and there would be exceptions for amounts that
24 have been explicitly identified as restitution payments,
25 remediation payments, or payments made to come into

1 compliance with the law. That raises $210 million.
2 The Chairman. Without objection, those two
3 amendments are agreed to, Senator Lincoln's and Senator
4 Salazar's.
5 [No response].
6 Senator Salazar. I want to thank the Chairman and
7 Ranking Member both. Thank you all. I especially want
8 to thank Senators Smith, Cantwell, Crapo, Kerry, and
9 Lincoln for this amendment. Let me just say, at the end
10 of the day, what this is all about is putting cellulosic
11 ethanol at the same level playing field as starch-based
12 ethanol, and it really will unlock the future, in my
13 view, of what we are going to do with biofuels.
14 The Chairman. Thank you, Senator.
15 Senator Lincoln. Mr. Chairman?
16 The Chairman. Senator Lincoln?
17 Senator Lincoln. Thank you very much. I think
18 these are the motors that go in our irrigation pumps, our
19 poultry farm fans, our grain elevators, timber saws, the
20 things that we are talking about here in this bill. So,
21 we appreciate it very much.
22 The Chairman. You bet.
23 Senator Stabenow?
24 Senator Stabenow. Thank you, Mr. Chairman. In the
25 same vein on cellulosic ethanol, I have an amendment #4 I

1 would like to modify that extends the small producer
2 credit for cellulosic ethanol. It expires December 31,
3 2012, or when we have reached $1 billion in production.
4 This would take the savings from the Lincoln amendment
5 and just extend the credit. We are not sure how long
6 that would be. It may be 10 months, it may be 12 months.
7 But this will allow us to extend out that important
8 credit.
9 The Chairman. So the understanding is that the
10 leftover would pay for any co-terminus.
11 Senator Stabenow. Yes. That is correct. That is
12 right.
13 The Chairman. Without objection, so ordered.
14 [No response].
15 The Chairman. The amendment is agreed to.
16 Are there any further amendments?
17 Mr. Kleinbard. Mr. Chairman?
18 The Chairman. Mr. Kleinbard?
19 Mr. Kleinbard. Just a point of inquiry, sir.
20 Senator Salazar's amendment also is a net raiser now of
21 about $40 million.
22 Senator Stabenow. We will be happy to take that as
23 well. [Laughter].
24 Mr. Kleinbard. That was my question.
25 Senator Stabenow. We will include both of those,

1 Mr. Chairman, if that is acceptable to the Chair.
2 The Chairman. Hearing no objection, that is what
3 we will do.
4 Any further amendments? Senator Kerry is here. If
5 we could, Mr. Kleinbard, again, restate your
6 understanding of the agreement on coal-to-liquids. With
7 Senator Kerry here, we can wrap that up.
8 Mr. Kleinbard. All right. Senator Bunning's
9 amendment #4 would restore the Chairman's mark that
10 extends the alternative fuel credit available against
11 excise taxes through December 31, 2010, and it would
12 modify the Chairman's mark in the following respects:
13 first, it would include coal-to-liquid fuels in that
14 extension to December 31, 2010; second, it would require
15 that facilities producing coal-to-liquid fuels eligible
16 for the credit engage in carbon sequestration of at least
17 50 percent of their carbon output between now and
18 December 30, 2010, and 75 percent sequestration rate as
19 of the last day of the effective date, December 31, 2010,
20 unless an arbitration panel of three arbitrators
21 concludes that it is feasible to move to a 75 percent
22 sequestration carbon capture more quickly.
23 The arbitrators would consist of the National
24 Academy of Sciences, an arbitrator to be nominated from
25 independent experts by Senator Bunning, and a third

1 arbitrator to be chosen by the first two.

2 Senator Kerry. The only change I would insert, so

3 the record is clear on it, is that we have to agree that

4 the arbitrator named by Senator Bunning is a neutral

5 arbitrator. That was part of the agreement.

6 Senator Bunning. That is.

7 Mr. Kleinbard. That is what I meant by the term

8 "independent expert". Yes, sir.

9 Senator Bunning. And commercially feasible was

10 also part of that.

11 Senator Kerry. No. I think we said we could not

12 do commercially feasible because it was impossible to get

13 into the books to get the adequate access to the numbers,

14 so we talked about trying to have some sort of cost

15 analysis from the players, but that we could not actually

16 make a judgment. They cannot make a judgment without

17 access to the --

18 Senator Bunning. Could we let the arbitrators

19 decide that?

20 Senator Kerry. Well, what I would like to do, is

21 have a standard way -- I am perfectly happy to agree that

22 they should require a cost analysis. I think that is a

23 fair way to do it. Let them do their cost analysis. It

24 is without regard to the judgment, which is really

25 subjective. All right?

1 Senator Bunning. All right.
2 The Chairman. There is agreement. Good.
3 Senator Kerry. Technology cost.
4 The Chairman. All right.
5 Senator Crapo. Mr. Chairman?
6 The Chairman. Yes?
7 Senator Crapo. Could I just briefly make a
8 statement?
9 The Chairman. Yes.
10 Senator Crapo. Rather than offer an amendment. I
11 note that the Chairman and his staff did not accept my
12 amendment on tax credits for the bio gas, but that we did
13 in our discussions have agreement to continue working on
14 that and I appreciate the Chairman and his staff working
15 with me on that.
16 I also wanted to mention that I am strongly in
17 support of Senator Stabenow's efforts with regard to
18 specialty crops. And even though that amendment will not
19 be brought today, I appreciate the committee working with
20 us on that in our further efforts with the Agriculture
21 Committee to try to additionally strengthen support for
22 specialty crops.
23 The Chairman. Thank you, Senator.
24 I now offer an amendment. It is the Baucus-Grassley
25 amendment number --

1 Senator Bunning. Excuse me, Mr. Chairman.
2 The Chairman. Yes? Yes?
3 Senator Bunning. I just wanted to make sure that
4 that agreement is accepted.
5 The Chairman. I understand it is all the way
6 around. Yes. That is my understanding.
7 Senator Bunning. All right. Thank you.
8 The Chairman. All right. Thank you, Senator.
9 I offer, now, committee amendment #1. It is the
10 Baucus-Grassley amendment which codifies Economic
11 Substance. That is the pay-for here. I understand the
12 argument is made by the Senator from Arizona. We have
13 tailored this back so it does not catch people who should
14 not be caught.
15 Also, I think the point of all this is to get some
16 more clarity in the law. Our Circuit Courts have
17 different interpretations and it is just important, I
18 think, to get this codified so that taxpayers and
19 businessmen know what is and is not the Economic
20 Substance law, and I urge the adoption of the amendment.
21 Senator Kyl. Mr. Chairman, I think the point of it
22 is to raise revenue, and I will vote against it for the
23 reasons I articulated earlier.
24 The Chairman. All right. Good.
25 All those in favor of the amendment say "aye".

1 [Chorus of ayes].

2 The Chairman. Those opposed, "no".

3 [Chorus of nays].

4 The Chairman. A roll call has been requested on

5 the amendment. All those in favor will vote "aye", those

6 opposed, "no".

7 The Clerk. Mr. Rockefeller?

8 Senator Rockefeller. Aye.

9 The Clerk. Mr. Conrad?

10 Senator Conrad. Aye.

11 The Clerk. Mr. Bingaman?

12 Senator Bingaman. Aye.

13 The Clerk. Mr. Kerry?

14 Senator Kerry. Aye.

15 The Clerk. Mrs. Lincoln?

16 Senator Lincoln. Aye.

17 The Clerk. Mr. Wyden?

18 The Chairman. Aye by proxy.

19 The Clerk. Mr. Schumer?

20 The Chairman. Aye by proxy.

21 The Clerk. Ms. Stabenow?

22 Senator Stabenow. Aye.

23 The Clerk. Ms. Cantwell?

24 Senator Cantwell. Aye.

25 The Clerk. Mr. Salazar?

1 Senator Salazar. Aye.

2 The Clerk. Mr. Grassley?

3 Senator Grassley. Aye.

4 The Clerk. Mr. Hatch?

5 Senator Hatch. No.

6 The Clerk. Mr. Lott?

7 Senator Lott. No.

8 The Clerk. Ms. Snowe?

9 Senator Snowe. No.

10 The Clerk. Mr. Kyl?

11 Senator Kyl. No.

12 The Clerk. Mr. Smith?

13 Senator Smith. Aye.

14 The Clerk. Mr. Bunning?

15 Senator Bunning. No.

16 The Clerk. Mr. Crapo?

17 Senator Crapo. No.

18 The Clerk. Mr. Roberts?

19 Senator Roberts. No.

20 The Clerk. Mr. Ensign?

21 Senator Grassley. No by proxy.

22 The Clerk. Mr. Chairman?

23 The Chairman. Aye.

24 The Clerk. Mr. Chairman, the tally is 13 ayes, 8

25 nays.

1 The Chairman. The amendment is agreed to.
2 Are there further amendments?
3 [No response].
4 The Chairman. If there are no further amendments,
5 I would entertain a motion that the committee report the
6 Chairman's mark on the farm tax bill.
7 I would also remind Senators we have one other item
8 to conclude here, and that is the Peru agreement. That
9 should not take any time at all.
10 I would entertain that motion.
11 Senator Grassley. I move.
12 The Chairman. Does anyone require a recorded vote?
13 It is? A vote was requested. All those in favor vote
14 "aye", those opposed, "no".
15 The Clerk. Mr. Rockefeller?
16 Senator Rockefeller. Aye.
17 The Clerk. Mr. Conrad?
18 Senator Conrad. Aye.
19 The Clerk. Mr. Bingaman?
20 Senator Bingaman. Aye.
21 The Clerk. Mr. Kerry?
22 Senator Kerry. Aye.
23 The Clerk. Mrs. Lincoln?
24 Senator Lincoln. Aye.
25 The Clerk. Mr. Wyden?

1 The Chairman. Aye by proxy.

2 The Clerk. Mr. Schumer?

3 The Chairman. Aye by proxy.

4 The Clerk. Ms. Stabenow?

5 Senator Stabenow. Aye.

6 The Clerk. Ms. Cantwell?

7 Senator Cantwell. Aye.

8 The Clerk. Mr. Salazar?

9 Senator Salazar. Aye.

10 The Clerk. Mr. Grassley?

11 Senator Grassley. Aye.

12 The Clerk. Mr. Hatch?

13 Senator Hatch. Aye.

14 The Clerk. Mr. Lott?

15 Senator Lott. No.

16 The Clerk. Ms. Snowe?

17 Senator Snowe. No.

18 The Clerk. Mr. Kyl?

19 Senator Kyl. No.

20 The Clerk. Mr. Smith?

21 Senator Smith. Aye.

22 The Clerk. Mr. Bunning?

23 Senator Bunning. Aye.

24 The Clerk. Mr. Crapo?

25 Senator Crapo. Aye.

1 The Clerk. Mr. Roberts?

2 Senator Roberts. Aye.

3 The Clerk. Mr. Ensign?

4 Senator Grassley. No by proxy.

5 The Clerk. Mr. Chairman?

6 The Chairman. Aye.

7 The Clerk. Mr. Chairman, the tally of members
8 present is 15 ayes, 3 nays. The final tally including
9 proxies is 17 ayes, 4 nays.

10 The Chairman. The ayes have it. The mark is
11 agreed to.

12 I might say, Senator Schumer is not here and was
13 going to offer an amendment and then withdraw it having
14 to do with ethanol duties, and asked me, in a colloquy,
15 to keep working with him on it, and I will do that. I
16 make that pledge to Senator Schumer, and it is my
17 understanding that Senator Grassley will do the same.

18 Senator Conrad. Mr. Chairman?

19 The Chairman. Senator Conrad?

20 Senator Conrad. Mr. Chairman, might I just thank
21 the Chairman and the Ranking Member for what is really a
22 critically important achievement for rural America, to
23 have disaster aid built into the next farm bill so that
24 every time there is a natural disaster around the country
25 that affects our producers, they do not have to come and

1 get a whole new disaster bill authorized.

2 I, for one, deeply appreciate the incredible work

3 that the Chairman and Ranking Member have put into this.

4 An awful lot of people are going to benefit around the

5 country, and I believe ultimately taxpayers will do

6 better, they will save money rather than having ad hoc

7 disaster bills every year, because this is going to

8 encourage people to buy crop insurance.

9 The Chairman. I appreciate that, Senator. Also,

10 it is tailored to actual losses. In lots of ways, this

11 is going to be a much more efficient way of giving

12 disaster assistance to farmers as opposed to the old way,

13 the ad hoc congressional which, which is pretty broad

14 brush. It helped in many ways, but maybe in ways it

15 should not have been applied. So, I thank you very much,

16 Senator. We have worked hard to accomplish that

17 objective.

18 Senator Grassley. I want to make a point, Mr.

19 Chairman, on economic substance. Obviously I am just

20 talking to my friends on this side. It is not a case of

21 raising money, as far as I am concerned. It is not a

22 case of having an offset. We have got four different

23 Circuit Courts of Appeal that have issued four different

24 decisions on what economic substance is, and they have

25 told the Congress to make a definition of economic

1 substance. So when are we going to assume our
2 responsibility of defining economic substance so the
3 taxpayers know what the law is?
4 The Chairman. Thank you, Senator. All right.
5 The next order of business is to consider the Peru
6 mark. In the meantime, I ask consent that staff have
7 authority to make changes for technical, conforming, and
8 budgetary reasons. Without objection.
9 [No response].
10 The Chairman. All right.
11 The next order of business is the Peru mark. As we
12 considered the exact same mark two weeks ago, we will
13 dispense with a staff description.
14 Do Senators have any further questions regarding the
15 mark?
16 Senator Hatch. Mr. Chairman?
17 The Chairman. Senator Hatch?
18 Senator Hatch. Mr. Chairman, I would like to put
19 my statement in the record explaining why I am going to
20 vote for it this time. But I am still concerned about
21 the amendments that I lost in front of this committee,
22 because I think that we are going to rue the day that we
23 did that on all future treaties.
24 But be that as it may, I will just put my statement
25 in the record.

1 [The prepared statement of Senator Hatch appears in
2 the appendix.]
3 Senator Kyl. Mr. Chairman, might I just associate
4 myself with the remarks of Senator Hatch?
5 The Chairman. Absolutely.
6 Senator Grassley. I move the legislation to
7 implement the bilateral agreement.
8 The Chairman. All those in favor say "aye".
9 [Chorus of ayes].
10 The Chairman. Those opposed, "no".
11 [Chorus of nays].
12 The Chairman. The ayes seem to have it. The ayes
13 do have it, and it is agreed to.
14 I think we are done. I want to thank Senators.
15 This has been really an interesting procedure here, and I
16 thank you very, very much. Thank you all very much.
17 The committee is adjourned.
18 [Whereupon, at 5:56 p.m. the meeting was concluded.]
19
20
21
22
23
24
25

UNITED STATES SENATE
COMMITTEE ON FINANCE

Max Baucus, Chairman

Thursday, October 4, 2007

215 Dirksen Senate Office Building

Agenda for Business Meeting

I. An original bill entitled "The Heartland, Habitat, Harvest, and Horticulture Act of 2007".

II. Legislation Implementing the U.S.-Peru Trade Promotion Agreement

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

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

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

October 2, 2007
JCX-94-07

CONTENTS

Page

INTRODUCTION 1

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

A. Crop Disaster Assistance Program and other Disaster Assistance 2

II. CONSERVATION PROVISIONS 6

A. Provide Tax Credit for Eligible Farmland Enrolled in the Conservation Reserve Program 6
B. Exclusion of Conservation Reserve Program Payments From SECA Tax For Individuals Receiving Social Security Retirement or Disability Payments 8
C. Make Permanent the Special Rule Encouraging Contributions of Capital Gain Real Property for Conservation Purposes 9
D. Provide Tax Credit for Recovery and Restoration of Endangered Species 13
E. Allow Deduction for Endangered Species Recovery Expenditures 17
F. Provide Exclusion for Certain Payments and Programs Relating to Fish and Wildlife 18
G. Provide Tax Credit for Easements Made Pursuant to Certain U.S.D.A. Conservation Programs 20
H. Provide for Tax-Exempt Facility Bonds for Forest Conservation Activities 22

III. ENERGY PROVISIONS 27

A. Credit for Residential Wind Property 27
B. Landowner Incentive to Encourage Electric Transmission Build-Out 29
C. Small Producer Credit for Cellulosic Alcohol 30
D. Extension of Small Ethanol Producer Credit 32
E. Extension of Credits for Biodiesel 34
F. Small Fossil-Free Alcohol Producer Credit 37
G. Expansion of Special Depreciation Allowance for Cellulosic Biomass Ethanol Plant Property 39
H. Extension and Modification of Renewable Diesel Incentives 41
I. Extension and Modification of Alternative Fuel Excise Tax Credit 43
J. Extension of Credit for Installation of Alternative Fuel Refueling Property 45
K. Extension of Temporary Duty on Ethyl Alcohol 47
L. Elimination of Certain Refunds of Duty Imposed on Ethanol 48
M. Modification of the Incentives Relating to Alcohol Fuels 49
N. Treatment of Qualified Fuel Mixtures as Taxable Fuel 51
O. Excluding Volume of Denaturants from the Alcohol Fuels Credit 53

IV. AGRICULTURAL PROVISIONS 54

A. Qualified Small Issue Bonds for Farming 54
B. Modification of Installment Sale Rules for Certain Farm Property 55
C. Allowance of Section 1031 Treatment for Exchanges Involving Certain Mutual Ditch, Reservoir, or Irrigation Company Stock 56
D. Rural Renaissance Tax Credit Bonds 57
E. Agricultural Business Security Tax Credit 63
F. Credit for Drug Safety and Effectiveness Testing for Minor Species 65

V. REVENUE RAISING PROVISIONS 67

A. Limitation on Farming Losses of Certain Taxpayers 67
B. Increase and Index Dollar Thresholds for Farm Optional Method and Nonfarm Optional Method for Computing Net Earnings from Self-Employment 68
C. Information reporting for Commodity Credit Corporation transactions 71
D. Modification of Section 1031 Treatment for Certain Real Estate 72
E. Modification of Effective Date of Leasing Provisions of the American Jobs Creation Act of 2004 73

INTRODUCTION

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

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

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

A. Crop Disaster Assistance Program and other Disaster Assistance

Present Law

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

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

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

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

---

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

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

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

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

Description of Proposal

In general

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

Permanent Crop Disaster Assistance Program ("PCDP")

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

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

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

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

Permanent Livestock Indemnity Program

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

Tree Assistance Program

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

Buy-up NAP Coverage

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

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

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

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

Limitations

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

Pest and Disease Management and Disaster Prevention

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

Sunset of proposal

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

Effective Date

The proposal is effective on the date of enactment.

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

II. CONSERVATION PROVISIONS

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

Present Law

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

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

Description of Proposal

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

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

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

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

---

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

Effective Date

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

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

Present Law

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

Description of Proposal

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

Effective Date

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

[6] Sec. 1402.

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

Present Law

Charitable contributions generally

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

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

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

Capital gain property

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

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

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

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

Qualified conservation contributions

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

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

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

In general

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

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

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

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

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

Farmers and ranchers

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

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

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

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

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

---

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

Termination

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

Description of Proposal

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

Effective Date

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

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

Present Law

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

Description of Proposal

In general

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

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

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

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

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

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

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

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

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

Definitions

Eligible taxpayer

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

Qualified agreements

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

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

Habitat management plan

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

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

Qualified species

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

Taking

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

Appropriate Secretary

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

Effective Date

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

E. Allow Deduction for Endangered Species Recovery Expenditures

Present Law

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

Description of Proposal

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

Effective Date

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

---

[10] Sec. 175.

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

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

Present Law

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

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

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

Description of Proposal

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

---

[12] Sec. 126.

Effective Date

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

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

Present Law

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

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

Description of Proposal

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

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

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

---

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

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

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

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

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

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

Effective Date

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

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

Present Law

Tax-exempt bonds

In general

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

Qualified private activity bonds

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

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

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

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

Taxation of income from timber harvesting

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

Description of Proposal

Overview

In general

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

Qualified organizations

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

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

Qualified forest conservation bonds

In general

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

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

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

Qualified project costs

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

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

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

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

Exclusion of certain qualified harvesting activity income from tax

Income from qualified harvesting activities

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

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

---

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

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

Qualified conservation plan

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

Recapture taxes

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

Effective Date

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

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

III. ENERGY PROVISIONS

A. Credit for Residential Wind Property

Present Law

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

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

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

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

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

Description of Proposal

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

---

[18] Sec. 25D.

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

Effective Date

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

B. Landowner Incentive to Encourage Electric Transmission Build-Out

Present Law

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

Description of Proposal

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

Effective Date

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

[19] Sec. 61.

C. Small Producer Credit for Cellulosic Alcohol

Present Law

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

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

Description of Proposal

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

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

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

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

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

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

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

Effective Date

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

D. Extension of Small Ethanol Producer Credit

Present Law

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

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

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

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

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

Description of Proposal

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

---

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

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

Effective Date

The proposal is effective on the date of enactment.

E. Extension of Credits for Biodiesel

Present Law

Income tax credit

Overview

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

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

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

Biodiesel mixture credit

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

---

[22] Sec. 40A.

[23] Treasury Notice 2005-62.

Biodiesel credit

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

Small agri-biodiesel producer credit

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

Biodiesel mixture excise tax credit

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

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

Payments with respect to biodiesel fuel mixtures

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

[24] Sec. 6426(c).

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

[26] Sec. 6427(e).

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

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

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

F. Small Fossil-Free Alcohol Producer Credit

Present Law

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

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

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

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

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

Description of Proposal

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

---

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

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

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

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

The credit terminates after December 31, 2012.

Effective Date

The proposal is effective after December 31, 2007.

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

Present Law

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

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

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

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

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

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

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

Description of Proposal

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

Effective Date

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

H. Extension and Modification of Renewable Diesel Incentives

Present Law

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

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

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

Description of Proposal

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

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

---

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

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

Effective Date

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

I. Extension and Modification of Alternative Fuel Excise Tax Credit

Present Law

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

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

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

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

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

Description of Proposal

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

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

Effective Date

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

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

Present Law

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

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

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

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

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

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

[33] Sec. 30C.

Description of Proposal

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

Effective Date

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

K. Extension of Temporary Duty on Ethyl Alcohol

Present Law

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

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

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

L. Elimination of Certain Refunds of Duty Imposed on Ethanol

Present Law

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

Description of Proposal

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

Effective Date

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

M. Modification of the Incentives Relating to Alcohol Fuels

Income tax credit

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

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

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

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

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

Excise tax credit and payment provision for alcohol fuel mixtures

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

---

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

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

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

Renewable Fuels Standard Program

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

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

N. Treatment of Qualified Fuel Mixtures as Taxable Fuel

Present Law

An excise tax is imposed upon (1) the removal of any taxable fuel from a refinery or terminal, (2) the entry of any taxable fuel into the United States, or (3) the sale of any taxable fuel to any person who is not registered with the IRS to receive untaxed fuel, unless there was a prior taxable removal or entry.[36] The tax does not apply to any removal or entry of taxable fuel transferred in bulk by pipeline or vessel to a terminal or refinery if the person removing or entering the taxable fuel, the operator of such pipeline or vessel (excluding deep draft vessels) and the operator of such terminal or refinery are registered with the Secretary.[37] The term "taxable fuel" means gasoline, diesel fuel, and kerosene.[38]

Diesel fuel is (1) any liquid suitable for use in a diesel powered highway vehicle or diesel powered train, (2) transmix, and (3) diesel fuel blendstocks identified by the Secretary.[39] By regulation, diesel fuel does not include kerosene, gasoline, No. 5 and No. 6 fuel oils (as described in ASTM Specification D 396), or F-76 (Fuel Naval Distillates MIL-F-16884) any liquid that contains less than four percent normal parafins, or any liquid that has a distillation range of 125 degrees Fahrenheit or less, sulfur content of 10 ppm or less and minimum color of +27 Saybolt.[40]

Biodiesel is not a taxable fuel because it has less than four percent paraffin content. Ethanol and other fuel alcohols also are not treated as taxable fuel. However, such fuels are subject to the backup tax under section 4041 if sold for use or used as a fuel in a diesel powered highway vehicle or diesel powered train and not for a nontaxable use.

In addition, such fuels are taxable if used in the production of a blended taxable fuel.[41]

The Code provides per-gallon tax incentives relating to biodiesel fuel used in a qualified mixture. The taxpayer has the option of taking the credit amount as an income tax credit, excise tax credit against the tax imposed on taxable fuels ("section 4081 liability") or as a payment from the Secretary in the amount of the credit. The credit is 50 cents for each gallon of biodiesel used

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

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

[38] Sec. 4083(a).

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

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

[41] Under Treas. Reg. sec. 48.4081-1(c), blended taxable fuel generally means any taxable fuel that (1) is produced outside the bulk transfer/terminal system and (2) by mixing taxable fuel with respect to which tax has been imposed under sec. 4081(a) (gasoline, diesel fuel or kersosene) with any other liquid on which tax has not been imposed under sec. 4081.

by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of the taxpayer. In the case of agri-biodiesel, the credit is $1.00 per gallon.

A qualified biodiesel mixture is a mixture of biodiesel and diesel fuel that is (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) is used as a fuel by the taxpayer producing such mixture. Pursuant to Treasury Notice, a mixture of 99.9 percent biodiesel and diesel fuel is considered a mixture but such mixture is not a blended taxable fuel because it contains less than four percent paraffin content. Thus, while eligible for the biodiesel fuel mixture tax credit and payment provisions, such fuel would not be subject to tax until put in a motor vehicle for a taxable use.

The Code also provides per-gallon tax incentives relating to alcohol used in a qualified mixture. A qualified mixture means a mixture of alcohol and gasoline, (or of alcohol and a special fuel) sold by the taxpayer as fuel, or used as fuel by the taxpayer producing such mixture. The credit is 51 cents if the alcohol is ethanol (60 cents in the case of other alcohols).

Description of Proposal

The proposal adds qualified alcohol fuel mixtures and qualified biodiesel fuel mixtures to the definition of taxable fuel.

Effective Date

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

O. Excluding Volume of Denaturants from the Alcohol Fuels Credit

Present Law

The Code provides a per-gallon credit for the volume of alcohol used as a fuel or in a qualified mixture. For purposes of determining the number of gallons of alcohol with respect to which the credit is allowable, the volume of alcohol includes any denaturant, including gasoline.[42] The denaturant must be added under a formula approved by the Secretary and the denaturant cannot exceed five percent of the volume of such alcohol (including denaturants).

Description of Proposal

The proposal provides that the volume of alcohol eligible for the credit does not include the volume of any denaturant.

Effective Date

The proposal is effective January 1, 2008.

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

IV. AGRICULTURAL PROVISIONS

A. Qualified Small Issue Bonds for Farming

Present law

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

Description of Proposal

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

Effective Date

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

B. Modification of Installment Sale Rules for Certain Farm Property

Present Law

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

Description of Proposal

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

Effective Date

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

---

[43] Sec. 453.

[44] Sec. 453(i).

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

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

Present Law

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

Description of Proposal

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

Effective Date

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

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

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

D. Rural Renaissance Tax Credit Bonds

Present law

Tax-exempt bonds

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

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

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

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

---

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

[49] Sec. 148.

[50] Sec. 149(e).

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

[52] Sec. 148.

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

Tax Credit Bonds

In general

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

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

Clean renewable energy bonds

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

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

---

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

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

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

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

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

Qualified zone academy bonds

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

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

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

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

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

Gulf tax credit bonds

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

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

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

Description of Proposal

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

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

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

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

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

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

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

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

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

Effective Date

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

E. Agricultural Business Security Tax Credit

Present Law

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

Description of Proposal

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

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

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

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

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

---

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

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

Effective Date

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

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

Present Law

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

Description of Proposal

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

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

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

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

---

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

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

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

Effective Date

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

V. REVENUE RAISING PROVISIONS

A. Limitation on Farming Losses of Certain Taxpayers

Present Law

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

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

Description of Proposal

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

Effective Date

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

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

Present Law

In general

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

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

Farm optional method

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

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

Nonfarm optional method

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

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

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

Other rules applicable to farm optional and nonfarm optional methods

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

Social Security benefit eligibility

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

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

Description of Proposal

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

Effective Date

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

C. Information reporting for Commodity Credit Corporation transactions

Present law

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

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

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

Description of Proposal

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

Effective Date

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

---

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

[60] 2007-33 IRB.

D. Modification of Section 1031 Treatment for Certain Real Estate

Present Law

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

Description of Proposal

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

Effective Date

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

---

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

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

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

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

Present Law

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

Description of Proposal

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

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

Effective Date

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

JOINT COMMITTEE ON TAXATION
October 2, 2007
JCX-95-07

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MARK OF THE "HEARTLAND, HABITAT, HARVEST AND HORTICULTURE ACT OF 2007," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON OCTOBER 4, 2007

Fiscal Years 2008 - 2017

[Millions of Dollars]

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
I. Supplemental Agricultural Disaster Assistance from the Agricultural Disaster Relief Trust Fund [1] [2]	**DOE**	**-830**	**-1,196**	**-1,287**	**-1,362**	**-1,435**	**---**	**---**	**---**	**---**	**---**	**-6,108**	**-6,108**
II. Conservation Provisions													
1. Provide an option to elect tax credits in lieu of payments under Conservation Reserve Programs [3] [4] [5] [6]	DOE	-924	-952	-971	-1,001	-1,024	---	---	---	---	---	-4,870	-4,870
2. Exclusion of Conservation Reserve Program Payments from SECA tax for individuals receiving Social Security retirement or disability benefits [6]	pma 12/31/07	[7]	-21	-22	-22	-22	-23	-24	-24	-24	-24	-87	-206
3. Make permanent the special rule for contributions of qualified conservation contributions	cmi tyba 12/31/07	-36	-46	-57	-69	-83	-86	-90	-94	-98	-102	-291	-761
4. Provide a tax credit for recovery and restoration of endangered species	tyba 12/31/07	-13	-79	-122	-201	-250	-262	-202	-135	-67	-33	-665	-1,364
5. Allow a deduction for endangered species recovery expenditures	epoia DOE	-14	-21	-24	-29	-35	-40	-47	-54	-63	-73	-122	-399
6. Provide an exclusion for certain payments and programs relating to fish and wildlife	pra DOE	-3	-5	-6	-6	-6	-6	-6	-6	-6	-6	-26	-55
7. Provide an option to elect tax credits in lieu of payments under conservation programs:													
a. Wetlands Reserve Program	[8]	*Negligible Revenue Effect*											
b. Working Grasslands Program	[8]	-15	-15	-15	-15	-15	---	---	---	---	---	-75	-75
8. Forest conservation bonds	[9]	-3	-10	-19	-27	-32	-33	-33	-33	-33	-33	-92	-257
Total of Conservation Provisions		**-1,008**	**-1,149**	**-1,236**	**-1,370**	**-1,467**	**-450**	**-402**	**-346**	**-291**	**-271**	**-6,228**	**-7,987**
III. Energy Provisions													
1. Credit for residential wind property - provide 30% credit, capped at $4,000, for residential applications of small wind (sunset 12/31/08)	ea 12/31/07	-1	-2	---	---	---	---	---	---	---	---	-3	-3
2. Landowner incentive to encourage electric transmission build-out of section 45 facilities (exclusion applies only to payments received related to transmission lines and equipment used to transmit electricity at 230 or more kilovolts)	pra DOE	-5	-16	-17	-18	-18	-19	-20	-21	-23	-23	-74	-179
3. Small producer credit for up to 60 million gallons of cellulosic alcohol fuel production [10]	apa 12/31/07	---	-2	-19	-80	-139	-210	-294	-85	---	---	-239	-828
4. Extend for two years the small ethanol producer credit (sunset 12/31/12)	DOE	---	---	---	-15	-43	-41	-28	-30	-15	---	-57	-172

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
5. Extend for two years the $1.00 and 50 cent production credits for biodiesel (sunset 12/31/10) and extend for four years the 10 cent credit for small agri-biodiesel producers (sunset 12/31/12), add camelina to the nonexclusive list of sources for agri-biodiesel	DOE	---	-84	-128	-42	-10	-3	---	---	---	---	-264	-267
6. 25 cent small producer credit for fossil-free producers of alcohol (sunset 12/31/12)	apa 12/31/07	-9	-18	-35	-70	-110	-36	---	---	---	---	-242	-278
7. Expansion of special depreciation allowance for cellulosic biomass ethanol plant property	[11]	---	-1	-1	-1	-2	---	1	1	1	1	-4	-1
8. Extension and modification of renewable diesel incentives (sunset 12/31/10)	DOE & fsoua DOE	25	-59	-132	-44	---	---	---	---	---	---	-211	-211
9. Extension and modification of alternative fuels excise tax credit, excluding CTL (sunset 12/31/10 for non-hydrogen fuels)	DOE & fsoua DOE	---	---	-267	-65	---	---	---	---	---	---	-332	-332
10. Extension of credit for installation of alternative fuel refueling property (sunset 2010 for non-hydrogen refueling property)	DOE	---	---	-49	-42	-15	-11	-7	[7]	2	2	-107	-119
11. Extension of temporary duty on ethyl alcohol through 12/31/10 [1] [12]	DOE	---	9	13	3	---	---	---	---	---	---	25	25
12. Elimination of certain refunds of duty imposed on ethanol [1]	[13]	6	1	[14]	[14]	[14]	[14]	[14]	[14]	[14]	[14]	8	10
13. Modification of the incentives relating to alcohol fuels (VEETC)	DOE	---	294	438	121	---	---	---	---	---	---	854	854
14. Treatment of qualified fuel mixtures as taxable fuel	freosa 12/31/07	4	1	1	1	1	-6	---	---	---	---	8	2
15. Exclude volume of denaturants from the alcohol fuels credit	fsoua 12/31/07	59	91	102	32	---	---	---	---	---	---	284	284
Total of Energy Provisions		**79**	**214**	**-94**	**-220**	**-336**	**-326**	**-348**	**-135**	**-35**	**-20**	**-354**	**-1,215**
IV. Agricultural Provisions													
1. Qualified small issue bonds for farming - increase loan limit from $250,000 to $450,000 and index; and eliminate the dollar limitation in definition of substantial farmer	bia DOE	[7]	[7]	-1	-1	-2	-2	-3	-3	-4	-4	-4	-19
2. Modification of installment sale rules for certain farm property	sa DOE	-8	-31	-30	-29	-28	-27	-25	-24	-23	-22	-125	-246
3. Allowance of section 1031 treatment for exchanges involving certain mutual ditch, reservoir, or irrigation company stock	eca DOE	[7]	[7]	[7]	[7]	[7]	[7]	[7]	[7]	[7]	[7]	-1	-2
4. Rural renaissance tax credit bonds	bia DOE & before 12/31/08	-6	-18	-23	-22	-20	-19	-17	-16	-14	-13	-89	-168
5. Agricultural business security tax credit	DOE	-2	-3	-3	-3	-3	-1	[14]	[14]	[14]	[14]	-14	-14
6. Credit for drug safety and effectiveness testing for minor species	eia DOE	-1	-5	-9	-12	-13	-15	-15	-16	-16	-17	-41	-121
Total of Agricultural Provisions		**-17**	**-57**	**-66**	**-67**	**-66**	**-64**	**-60**	**-59**	**-57**	**-56**	**-274**	**-570**
V. Revenue Raising Provisions													
1. Limitation on farming losses of certain taxpayers	tyba 12/31/07	40	64	60	59	56	51	44	35	27	19	279	456
2. Increase and index dollar threshold for farm optional method and nonfarm optional method for computing net earnings from self-employment [6]	tyba 12/31/07	5	10	10	11	11	11	12	13	13	14	46	110

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
3. Information reporting for Commodity Credit Corporation transactions	lro/a 1/1/07	No Revenue Effect											
4. Modification of section 1031 treatment for certain real estate	eca DOE	3	3	2	2	2	2	3	3	3	3	12	27
5. Modify the effective date for the application of the AJCA 2004 leasing (SILO) provision - apply loss limitation to leases with foreign entities regardless of when the lease was entered into	tyba 12/31/06	2,680	896	407	290	288	260	135	-239	-629	-854	4,561	3,235
Total of Revenue Raising Provisions		**2,728**	**973**	**479**	**362**	**357**	**324**	**194**	**-188**	**-586**	**-818**	**4,898**	**3,828**
NET TOTAL		**952**	**-1,215**	**-2,204**	**-2,657**	**-2,947**	**-516**	**-616**	**-728**	**-969**	**-1,165**	**-8,066**	**-12,052**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is assumed to be December 1, 2007.

Legend for "Effective" column:

apa = alcohol produced after
bia = bonds issued after
cmi = contributions made in
DOE = date of enactment
ea = expenditures after
eca = exchanges contracted after
eia = expenses incurred after
epoia = expenditures paid or incurred after
freosa= fuels removed, entered, or sold after
fsoua = fuel sold or used after
lro/a = loans repaid on or after
pma = payments made after
pra = payments received after
sa = sales after
spa = services performed after
tyba = taxable years beginning after

[1] Estimate provided by the Congressional Budget Office and is preliminary and subject to change.

[2] Reduction in funds available to the general fund of the U.S. Government. The proposal will also result in an increase in outlays of the following amounts

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
227	1,040	1,113	1,156	1,167	893	---	---	---	---	4,703	5,597

[3] Tax credits would be excludable from income for income and SECA tax purposes.

[4] The proposal will also result in a decrease in outlays of the following amounts.

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
742	763	777	791	808	---	---	---	---	---	3,881	3,881

[5] Estimate includes a reduction in SECA taxes of $548 million over the fiscal years 2008 through 2012.

[6] Revenue estimate does not include any resulting effects on Social Security and Medicare outlays. These will be estimated by the Congressional Budget Office.

[7] Loss of less than $500,000.

[8] Effective for easements granted after September 30, 2007, in taxable years ending after such date.

[9] Effective for obligations issued on or after the date which is 180 days after the enactment of this Act.

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

[11] Effective for property placed in service after the date of enactment in taxable years ending after the date of enactment.

[12] The estimate contains interaction with the provision to eliminate certain refunds of duty imposed on ethanol.

[13] Effective for goods exported on or after the date that is 15 days after the date of enactment.

[14] Gain of less than $500,000.

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

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

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

October 4, 2007
JCX-96-07

CONTENTS

Page

INTRODUCTION 1

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

A. Modifications to Item I.A. of the Chairman's Mark Relating to the Permanent Crop Disaster Assistance Program and Other Disaster Assistance 2

II. CONSERVATION PROVISIONS 3

A. Modification to Item II.A. of the Chairman's Mark Relating to Providing a Tax Credit for Eligible Farmland Enrolled in the Conservation Reserve Program 3
B. Modification to Item II.F. of the Chairman's Mark Relating to Providing an Exclusion for Certain Payments and Programs Relating to Fish and Wildlife 3
C. Deduction for Qualified Timber Gain and Timber REIT Provisions 3

III. ENERGY PROVISIONS 10

A. Modification to Item III.A. of the Chairman's Mark Relating to the Credit for Residential Wind Property 10
B. Modification to Item III.I. of the Chairman's Mark Relating to the Extension and Modification of the Alternative Fuel Excise Tax Credit 10
C. Modification to Item III.N. of the Chairman's Mark Relating to the Treatment of qualified Mixtures as Taxable Fuel 10
D. Modification of the Credit for the Production of Electricity from Renewable Resources 10

IV. AGRICULTURAL PROVISIONS 17

A. Farm Equipment Treated as Five-Year Property 17
B. Expensing of Broadband Internet Access Expenditures 18

V. REVENUE PROVISIONS 21

A. Modifications to Corporate Estimated Tax Payments 21

INTRODUCTION

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

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

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

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

The Chairman's Modification decreases the funding of the Agriculture Disaster Relief Trust Fund from 4.0 percent to 3.34 percent of the amounts received in the general fund of the Treasury that are attributable to the duties collected on articles entered, or withdrawn from warehouse, for consumption under the Harmonized Tariff Schedule.

The Chairman's Modification decreases the amount of payments under the Permanent Crop Disaster Assistance Program from 55 percent to 52 percent of the difference between the disaster program guarantee and the sum of total farm revenue.

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

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

---

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

II. CONSERVATION PROVISIONS

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

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

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

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

C. Deduction for Qualified Timber Gain and Timber REIT Provisions

Present Law

Treatment of certain timber gain

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

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

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

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

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

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

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

---

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

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

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

Other REIT provisions

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

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

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

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

---

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

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

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

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

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

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

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

---

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

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

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

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

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

Explanation of Provision

Elective deduction for 60 percent of qualified timber gain

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

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

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

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

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

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

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

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

Additional REIT provisions

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

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

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

REIT prohibited transaction safe harbor for timber property

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

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

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

Special rules for Timber REITs

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

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

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

Effective Date

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

III. ENERGY PROVISIONS

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

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

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

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

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

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

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

Present Law

In general

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

[18] Sec. 45.

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

Credit amounts and credit period

In general

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

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

Reduced credit amounts and credit periods

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

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

Credit applicable to refined coal

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

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

Credit applicable to Indian coal

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

Special rules and other limitations on credit claimants and credit amounts

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

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

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

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

---

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

Qualified facilities

Wind energy facility

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

Closed-loop biomass facility

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

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

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

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

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

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

In the case of an open-loop biomass facility that uses agricultural livestock waste nutrients, a qualified facility is one that was originally placed in service after October 22, 2004,

and before January 1, 2009, and has a nameplate capacity rating which is not less than 150 kilowatts. In the case of any other open-loop biomass facility, a qualified facility is one that was originally placed in service before January 1, 2009.

Geothermal facility

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

Solar facility

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

Small irrigation facility

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

Landfill gas facility

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

Trash combustion facility

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

Hydropower facility

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

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

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

Refined coal facility

A qualifying refined coal facility is a facility producing refined coal that is placed in service after October 22, 2004 and before January 1, 2009. Refined coal is a qualifying liquid, gaseous, or solid fuel produced from coal (including lignite) or high-carbon fly ash, including such fuel used as a feedstock. A qualifying fuel is a fuel that when burned emits 20 percent less nitrogen oxides and either SO_2 or mercury than the burning of feedstock coal or comparable coal predominantly available in the marketplace as of January 1, 2003, and if the fuel sells at prices at least 50 percent greater than the prices of the feedstock coal or comparable coal. In addition, to be qualified refined coal the fuel must be sold by the taxpayer with the reasonable expectation that it will be used for the primary purpose of producing steam.

Indian coal facility

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

Summary of credit rate and credit period by facility type

Table 1.–Summary of Section 45 Credit

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

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

Description of Proposal

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

Effective Date

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

IV. AGRICULTURAL PROVISIONS

A. Farm Equipment Treated as Five-Year Property

Present Law

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

Description of Proposal

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

Effective Date

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

---

[21] Sec. 168.

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

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

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

B. Expensing of Broadband Internet Access Expenditures

Present Law

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

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

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

Description of Proposal

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

---

[25] Sec. 168.

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

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

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

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

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

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

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

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

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

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

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

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

Effective Date

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

V. REVENUE PROVISIONS

A. Modifications to Corporate Estimated Tax Payments

Present Law

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

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

Description of Proposal

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

Effective Date

The proposal is effective on the date of enactment.

JOINT COMMITTEE ON TAXATION
October 4, 2007
JCX-97-07

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MARK , AS MODIFIED, OF THE "HEARTLAND, HABITAT, HARVEST AND HORTICULTURE ACT OF 2007," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON OCTOBER 4, 2007

Fiscal Years 2008 - 2017

[Millions of Dollars]

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
I. Supplemental Agricultural Disaster Assistance from the Agricultural Disaster Relief Trust Fund (the authority provided by the provision expires at the same time as the 2007 Farm Bill) [1] [2] [3]	**DOE**	**-693**	**-998**	**-1,074**	**-1,137**	**-1,198**	**---**	**---**	**---**	**---**	**---**	**-5,100**	**-5,100**
II. Conservation Provisions													
1. Provide an option to elect tax credits in lieu of payments under Conservation Reserve Program [4] [5] [6] [7]	DOE	---	-935	-937	-949	-950	---	---	---	---	---	-3,771	-3,771
2. Exclusion of Conservation Reserve Program Payments from SECA tax for individuals receiving Social Security retirement or disability benefits [7]	pma 12/31/07	[8]	-21	-22	-22	-22	-23	-24	-24	-24	-24	-87	-206
3. Make permanent the special rule for contributions of qualified conservation contributions	cmi tyba 12/31/07	-36	-46	-57	-69	-83	-86	-90	-94	-98	-102	-291	-761
4. Provide a tax credit for recovery and restoration of endangered species	tyba 12/31/07	-13	-79	-122	-201	-250	-262	-202	-135	-67	-33	-665	-1,364
5. Allow a deduction for endangered species recovery expenditures	epoia DOE	-14	-21	-24	-29	-35	-40	-47	-54	-63	-73	-122	-399
6. Provide an exclusion for certain payments and programs relating to fish, wildlife, forest protection and pest management	pra DOE	-4	-7	-7	-7	-7	-7	-7	-7	-7	-7	-32	-69
7. Provide an option to elect tax credits in lieu of payments under conservation programs:													
a. Wetlands Reserve Program	[9]	*Negligible Revenue Effect*											
b. Working Grasslands Program	[9]	-15	-15	-15	-15	-15	---	---	---	---	---	-75	-75
8. Forest conservation bonds	[10]	-3	-10	-19	-27	-32	-33	-33	-33	-33	-33	-92	-257
9. Deduction for qualified timber gain and timber REIT provisions (sunset one year after the date of enactment)	tyba DOE	-173	-102	-17	-14	-12	-6	-2	-2	-2	-2	-318	-332
Total of Conservation Provisions		**-258**	**-1,236**	**-1,220**	**-1,333**	**-1,406**	**-457**	**-405**	**-349**	**-294**	**-274**	**-5,453**	**-7,234**
III. Energy Provisions													
1. Credit for wind property - provide 30% credit, capped at $4,000, for residential and commercial applications of small wind (sunset 12/31/08)	ea 12/31/07	-2	-3	[8]	[8]	[8]	[11]	[11]	---	---	---	-5	-5
2. Landowner incentive to encourage electric transmission build-out of section 45 facilities (exclusion applies only to payments received related to transmission lines and equipment used to transmit electricity at 230 or more kilovolts)	pra DOE	-5	-16	-17	-18	-18	-19	-20	-21	-23	-23	-74	-179

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
3. Small producer credit for up to 60 million gallons of cellulosic alcohol fuel production [12]	apa 12/31/07	---	-2	-19	-80	-139	-210	-294	-85	---	---	-239	-828
4. Extend for two years the small ethanol producer credit (sunset 12/31/12)	DOE	---	---	---	-15	-43	-41	-28	-30	-15	---	-57	-172
5. Extend for two years the $1.00 and 50 cent production credits for biodiesel (sunset 12/31/10) and extend for four years the 10 cent credit for small agri-biodiesel producers (sunset 12/31/12), add camelina to the nonexclusive list of sources for agri-biodiesel	DOE	---	-84	-128	-42	-10	-3	---	---	---	---	-264	-267
6. 25 cent small producer credit for fossil-free producers of alcohol (sunset 12/31/12)	apa 12/31/07	-9	-18	-35	-70	-110	-36	---	---	---	---	-242	-278
7. Expansion of special depreciation allowance for cellulosic biomass ethanol plant property	[13]	---	-1	-1	-1	-2	---	1	1	1	1	-4	-1
8. Extension and modification of renewable diesel incentives (sunset 12/31/10)	DOE & fsoua DOE	25	-59	-132	-44	---	---	---	---	---	---	-211	-211
9. Include biobased liquid propane and compressed natural gas in alternative fuels excise tax credit definition	DOE & fsoua DOE	[8]	[8]	[8]	---	---	---	---	---	---	---	[8]	[8]
10. Extension of credit for installation of alternative fuel refueling property (sunset 2010 for non-hydrogen refueling property)	DOE	---	---	-49	-42	-15	-11	-7	[8]	2	2	-107	-119
11. Extension of temporary duty on ethyl alcohol through 12/31/10 [1] [14]	DOE	---	9	13	3	---	---	---	---	---	---	25	25
12. Elimination of certain refunds of duty imposed on ethanol [1]	[15]	6	1	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	8	10
13. Modification of the incentives relating to alcohol fuels (VEETC)	DOE	---	294	438	121	---	---	---	---	---	---	854	854
14. Treatment of qualified fuel mixtures as taxable fuel with additional reporting requirements	freosa 12/31/07	4	1	1	1	1	-6	---	---	---	---	8	2
15. Exclude volume of denaturants from the alcohol fuels credit	fsoua 12/31/07	59	91	102	32	---	---	---	---	---	---	284	284
16. Modify treatment of certain USDA energy grants/loans used for renewable power facilities	fpisa DOE	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-6	-14
Total of Energy Provisions		**77**	**212**	**172**	**-156**	**-337**	**-327**	**-349**	**-136**	**-36**	**-21**	**-30**	**-899**
IV. Agricultural Provisions													
1. Qualified small issue bonds for farming - increase loan limit from $250,000 to $450,000 and index; and eliminate the dollar limitation in definition of substantial farmer	bia DOE	[8]	[8]	-1	-1	-2	-2	-3	-3	-4	-4	-4	-19
2. Modification of installment sale rules for certain farm property	sa DOE	-8	-31	-30	-29	-28	-27	-25	-24	-23	-22	-125	-246
3. Allowance of section 1031 treatment for exchanges involving certain mutual ditch, reservoir, or irrigation company stock	eca DOE	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	-1	-2
4. Rural renaissance tax credit bonds	bia DOE & bio/b 12/31/08	-6	-18	-23	-22	-20	-19	-17	-16	-14	-13	-89	-168
5. Agricultural business security tax credit	DOE	-2	-3	-3	-3	-3	-1	[11]	[11]	[11]	[11]	-14	-14
6. Credit for drug safety and effectiveness testing for minor species	eia DOE	-1	-5	-9	-12	-13	-15	-15	-16	-16	-17	-41	-121

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
7. Reduce the recovery period for certain farming business machinery or equipment from seven to five years (sunset 12/31/09)........	ppisa DOE	-160	-327	-383	-320	-287	-62	415	652	390	82	-1,477	[16]
8. Expensing of broadband internet access expenditures (sunset 12/31/10)........	eia DOE	-117	-175	-234	28	98	76	67	62	64	58	-399	-72
Total of Agricultural Provisions		**-294**	**-559**	**-683**	**-359**	**-255**	**-50**	**422**	**655**	**397**	**84**	**-2,150**	**-642**
V. Revenue Provisions													
1. Limitation on farming losses of certain taxpayers........	tyba 12/31/07	40	64	60	59	56	51	44	35	27	19	279	456
2. Increase and index dollar threshold for farm optional method and nonfarm optional method for computing net earnings from self-employment [7]........	tyba 12/31/07	5	10	10	11	11	11	12	13	13	14	46	110
3. Information reporting for Commodity Credit Corporation transactions........	lro/a 1/1/07	------------ *No Revenue Effect* ------------											
4. Modification of section 1031 treatment for certain real estate........	eca DOE	3	3	2	2	2	2	3	3	3	3	12	27
5. Modify the effective date for the application of the AJCA 2004 leasing (SILO) provision - apply loss limitation to leases with foreign entities regardless of when the lease was entered into........	tyba 12/31/06	2,680	896	407	290	288	260	135	-239	-629	-854	4,561	3,235
6. Increase by 6.75 Percentage Points the Required Corporate Estimated Tax Payments Factor for Corporations with Assets of at Least $1 Billion for Payments Due in July, August, and September 2012........	DOE	---	---	---	---	4,181	-4,181	---	---	---	---	4,181	---
Total of Revenue Provisions		**2,728**	**973**	**479**	**362**	**4,538**	**-3,857**	**194**	**-188**	**-586**	**-818**	**9,079**	**3,828**
NET TOTAL		**1,560**	**-1,608**	**-2,326**	**-2,623**	**1,342**	**-4,691**	**-138**	**-18**	**-519**	**-1,029**	**-3,654**	**-10,047**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is assumed to be December 1, 2007.

Legend for "Effective" column:

apa = alcohol produced after
bia = bonds issued after
bio/b = bonds issued on or before
cmi = contributions made in
DOE = date of enactment
ea = expenditures after
eca = exchanges contracted after
eia = expenses incurred after
epoia = expenditures paid or incurred after
fpisa = facilities placed in service after
freosa= fuels removed, entered, or sold after
fsoua = fuel sold or used after
lro/a = loans repaid on or after
pma = payments made after
ppisa = property placed in service after
pra = payments received after
sa = sales after
spa = services performed after
tyba = taxable years beginning after

[Footnotes for JCX-97-07 appear on the following page]

Footnotes for JCX-97-07:

[1] Estimate provided by the Congressional Budget Office and is preliminary and subject to change.

[2] Reduction in funds available to the general fund of the U.S. Government.

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
The proposal will also result in an increase in outlays of the following amounts............	872	978	1,021	1,034	1,046	69	---	---	---	---	4,949	5,019

[3] Estimate provided by the Congressional Budget Office and includes clarification of the definition of farm-raised fish to include the propagation and rearing of aquatic species in controlled or selected environments and the expansion of the definition of livestock to include horses. The Congressional Budget Office also estimates that the provision will have a negligible effect on outlays.

[4] Tax credits would be excludable from income for income and SECA tax purposes.

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
[5] The proposal will also result in a decrease in outlays of the following amounts.	---	750	750	750	750	---	---	---	---	---	3,000	3,000

[6] Estimate includes a reduction in SECA taxes of $425 million over the fiscal years 2008 through 2012.

[7] Revenue estimate does not include any resulting effects on Social Security and Medicare outlays. These will be estimated by the Congressional Budget Office.

[8] Loss of less than $500,000.

[9] Effective for easements granted after September 30, 2007, in taxable years ending after such date.

[10] Effective for obligations issued on or after the date which is 180 days after the enactment of this Act.

[11] Gain of less than $500,000.

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

[13] Effective for property placed in service after the date of enactment in taxable years ending after the date of enactment.

[14] The estimate contains interaction with the provision to eliminate certain refunds of duty imposed on ethanol.

[15] Effective for goods exported on or after the date that is 15 days after the date of enactment.

[16] Negligible revenue effect

Amendment List

The Heartland, Habitat, Harvest and Horticulture Act of 2007

October 4, 2007

Committee Number	Senator	Summary	Offset
1	Baucus/Grassley #1	Clarification of the Economic Substance Doctrine	This provision raises approximately $10.0 billion over 10 years.
2	Baucus #2	Add algae to the list of qualified feedstocks for the purposes of Section 40A of the Internal Revenue Code	To be provided
3	Rockefeller #1	Expand Section 45 to include refined coal from a qualified coal waste sludge recycling process. This refined coal is a fuel made from coal and "coal waste sludge" used as a feedstock from the production of coke.	To be provided
4	Rockefeller/Hatch #2	Extends section 6426(d)(2)(E) any liquid fuel derived from coal (including peat) through the Fischer-Tropsch process through December 31, 2010. The tax credit would only be available for fuel produced from a facility that separate and sequester 75% of its total carbon dioxide emissions.	To be provided
5	Rockefeller/Baucus/ Snowe #3	Creates a two-tiered tax incentive to stimulate new investment in broadband technology and infrastructure.	To be provided
6	Kerry #1	Expands the assistance for livestock, honey bees, and farm-raised fish to include fishery disasters	
7	Kerry #2	Clarifies the definition of farm-raised fish to include the propagation and rearing of aquatic species in controlled or selected environments.	
8	Lincoln/Smith #1	Timber Revitalization and Economic Enhancement (TREE) Act	Increase information return penalties.
9	Lincoln/Smith #2	Sec 45G Railroad Track Maintenance Credit Extension	To be provided
10	Lincoln/Smith #3	Energy Efficient Motors Incentives Act	Fines and penalties $263 million
11	Lincoln #4	Farm and Ranch Estate Tax Modernization	To be provided
12	Lincoln/Snowe #5	Asset Exclusion for Savings and Nutrition	To be provided
13	Lincoln #6	Bio-based Feedstock Credit	To be provided
14	Schumer #1	Ethanol duty drawbacks	
15	Schumer #2	Clarification of the Open-loop biomass facility credit	
16	Stabenow #1	Creation of Specialty Crop Trust Fund	Approximately 1.5 billion/10.
17	Stabenow #2	Cellulosic Ethanol Amendment	
18	Stabenow #3	E85 Blenders Credit	To be provided once cost is determined

Amendment List

The Heartland, Habitat, Harvest and Horticulture Act of 2007

October 4, 2007

19	Stabenow #4	Extending the Cellulosic Expiration Date	
20	Cantwell #1	Application of Biodiesel Tax Credits	
21	Cantwell #2	Add "qualified small businesses" as eligible for Permanent Crop Disaster Assistance Program (PCDP) payments	To be determined
22	Salazar #1	To provide tax-exempt financing for qualified renewable energy facilities	Repeal Section 1031 tax treatment for collectibles
23	Salazar/Smith/Kerry/ Crapo #2	An amendment to eliminate the restriction to residential property on the small wind tax credit and to eliminate the $500 per half-kW limitation on the amount of the credit.	To be provided
24	Salazar/Smith/ Cantwell/ Crapo/Kerry/Lincoln #3	An amendment to increase the tax credit for the production of cellulosic alcohol.	Repeal Section 1031 tax treatment for collectibles
25	Salazar #4	To provide tax incentives for the reduction of hazardous fuels.	To be provided
26	Grassley/Baucus #1	Expand the exclusion for certain payments and programs relating to fish and wildlife	
27	Grassley #2	USDA Renewable Energy Grants for the production of electricity	
28	Hatch #1	Add the provisions of S. 2002, the Real Estate Investment Trust Investment Diversification and Empowerment Act of 2007	To be provided
29	Hatch #2	Increase the Emergency Assistance for livestock, honey bees, and farm-raised fish from the $25,000,000 annual amount in the Chairman's mark to $50,000,000.	To be provided
30	Snowe #1	Milk Import Tariff Equity Act	This amendment would raise revenue
31	Kyl/Lott/Smith/ Ensign 1	Family Farm, Ranch, and Business Preservation - Estate Tax Reform	
32	Smith/Wyden #1	Exemption of Youth Wooden Arrows from the Arrow Excise Tax	To be provided
33	Smith #2	Section 45 credit Rate Equity for Open-Loop Biomass Facilities	To be provided
34	Bunning #1	Strike Title I of the bill - Ag Disaster Relief Trust Fund	
35	Bunning #2	To extend the existing alternative fuel tax credit for coal-derived fuels	
36	Bunning #3	To expand the definition of livestock to horses	Expect to be revenue neutral
37	Bunning #4	Require sequestration for all fuels under section 6426.	
38	Bunning #5	To extend the existing alternative fuel tax credit for coal-derived fuels produced at a facility with 50% carbon capture	

Amendment List

The Heartland, Habitat, Harvest and Horticulture Act of 2007

October 4, 2007

39	Bunning #6	Treat farming business machinery and equipment as 5-year property for purposes of depreciation	To be provided.
40	Crapo #1	To increase the tax credit for the production of biogas	Clarify penalty for sale of fuel failing EPA regulations.

1

Baucus-Grassley Amendment #1 to the Heartland, Habitat, Harvest and Horticulture Act of 2007

Short Title: Clarification of the Economic Substance Doctrine.

Description of Amendment:

Clarification of the Economic Substance Doctrine and Penalty for Understatements Attributable to Transactions Lacking Economic Substance. This provision clarifies the application of the economic substance doctrine but does not change current-law standards used by courts in determining when to utilize an economic substance analysis. Under the provision, in any case in which a court determines that the economic substance doctrine is relevant to a transaction, the economic substance doctrine would be satisfied only if (1) the transaction changes in a meaningful way (apart from federal income tax consequences) the taxpayer's economic position, and (2) the taxpayer has a substantial non-Federal tax purpose for entering into such transaction. The provision also imposes a 30 percent penalty on understatements attributable to a non-economic substance transaction (unless the transaction was disclosed, in which case the penalty is 20 percent). This provision becomes effective for transactions entered into after the date of enactment.

Denial of Deduction for Interest on Underpayments Attributable to Non-Economic Substance Transactions. This provision denies any deduction for interest on unpaid taxes attributable to any non-economic substance transaction understatement. This provision becomes effectives for transactions entered into after the date of enactment.

This provision raises approximately $10.0 billion over 10 years.

A more detailed description of the amendment is attached hereto.

Contact Name and Phone Number: Joshua Odintz and Chris Javens, ext. 4-4515.

The penalty is applied to the amount of any understatement attributable to the listed or reportable avoidance transaction without regard to other items on the tax return. For purposes of this provision, the amount of the understatement is determined as the sum of: (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return);[40] and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item.

Except as provided in regulations, a taxpayer's treatment of an item shall not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of when the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.[41]

Strengthened reasonable cause exception

A penalty is not imposed with respect to any portion of an understatement if it is shown that there was reasonable cause for such portion and the taxpayer acted in good faith. Such a showing requires: (1) adequate disclosure of the facts affecting the transaction in accordance with the regulations under section 6011;[42] (2) that there is or was substantial authority for such treatment; and (3) that the taxpayer reasonably believed that such treatment was more likely than not the proper treatment. For this purpose, a taxpayer will be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief: (1) is based on the facts and law that exist at the time the tax return (that includes the item) is filed; and (2) relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that (a) a return will not be audited, (b) the treatment will not be raised on audit, or (c) the treatment will be resolved through settlement if raised.[43]

A taxpayer may (but is not required to) rely on an opinion of a tax advisor in establishing its reasonable belief with respect to the tax treatment of the item. However, a taxpayer may not rely on an opinion of a tax advisor for this purpose if the opinion (1) is provided by a "disqualified tax advisor" or (2) is a "disqualified opinion."

Disqualified tax advisor

[40] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income. Sec. 6662A(b).

[41] Sec. 6662A(e)(3).

[42] See the previous discussion regarding the penalty for failing to disclose a reportable transaction.

[43] Sec. 6664(d).

A disqualified tax advisor is any advisor who: (1) is a material advisor[44] and who participates in the organization, management, promotion, or sale of the transaction or is related (within the meaning of section 267(b) or 707(b)(1)) to any person who so participates; (2) is compensated directly or indirectly[45] by a material advisor with respect to the transaction; (3) has a fee arrangement with respect to the transaction that is contingent on all or part of the intended tax benefits from the transaction being sustained; or (4) as determined under regulations prescribed by the Secretary, has a disqualifying financial interest with respect to the transaction.

A material advisor is considered as participating in the "organization" of a transaction if the advisor performs acts relating to the development of the transaction. This may include, for example, preparing documents: (1) establishing a structure used in connection with the transaction (such as a partnership agreement); (2) describing the transaction (such as an offering memorandum or other statement describing the transaction); or (3) relating to the registration of the transaction with any federal, state, or local government body.[46] Participation in the "management" of a transaction means involvement in the decision-making process regarding any business activity with respect to the transaction. Participation in the "promotion or sale" of a transaction means involvement in the marketing or solicitation of the transaction to others. Thus, an advisor who provides information about the transaction to a potential participant is involved in the promotion or sale of a transaction, as is any advisor who recommends the transaction to a potential participant.

Disqualified opinion

An opinion may not be relied upon if the opinion: (1) is based on unreasonable factual or legal assumptions (including assumptions as to future events); (2) unreasonably relies upon representations, statements, finding or agreements of the taxpayer or any other person; (3) does not identify and consider all relevant facts; or (4) fails to meet any other requirement prescribed by the Secretary.

[44] The term "material advisor" means any person who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, or carrying out any reportable transaction, and who derives gross income in excess of $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons ($250,000 in any other case). Sec. 6111(b)(1).

[45] This situation could arise, for example, when an advisor has an arrangement or understanding (oral or written) with an organizer, manager, or promoter of a reportable transaction that such party will recommend or refer potential participants to the advisor for an opinion regarding the tax treatment of the transaction.

[46] An advisor should not be treated as participating in the organization of a transaction if the advisor's only involvement with respect to the organization of the transaction is the rendering of an opinion regarding the tax consequences of such transaction. However, such an advisor may be a "disqualified tax advisor" with respect to the transaction if the advisor participates in the management, promotion, or sale of the transaction (or if the advisor is compensated by a material advisor, has a fee arrangement that is contingent on the tax benefits of the transaction, or as determined by the Secretary, has a continuing financial interest with respect to the transaction).

defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1). The penalty imposed under the provision will not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Effective Date

The provision applies to transactions entered into after the date of enactment.

3. Denial of deduction for interest on underpayments attributable to noneconomic substance transactions

Present Law

No deduction for interest is allowed for interest paid or accrued on any underpayment of tax which is attributable to the portion of any reportable transaction understatement with respect to which the relevant facts were not adequately disclosed.[50] The Secretary of the Treasury is authorized to define reportable transactions for this purpose.[51]

Description of Proposal

The provision extends the disallowance of interest deductions to interest paid or accrued on any underpayment of tax which is attributable to any noneconomic substance underpayment (whether or not disclosed).

Effective Date

The provision applies to transactions entered into after the date of enactment

[50] Sec. 162(m). Under section 6664(d)(2)(A), in such a case of nondisclosure, the taxpayer also is not entitled to the "reasonable cause and good faith" exception to the section 6662A penalty for a reportable transaction understatement.

[51] See the description of present law under the immediately preceding proposal, "Penalty for understatements attributable to transactions lacking economic substance, etc."

The penalty is applied to the amount of any understatement attributable to the listed or reportable avoidance transaction without regard to other items on the tax return. For purposes of this provision, the amount of the understatement is determined as the sum of: (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return);[40] and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item.

Except as provided in regulations, a taxpayer's treatment of an item shall not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of when the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.[41]

Strengthened reasonable cause exception

A penalty is not imposed with respect to any portion of an understatement if it is shown that there was reasonable cause for such portion and the taxpayer acted in good faith. Such a showing requires: (1) adequate disclosure of the facts affecting the transaction in accordance with the regulations under section 6011;[42] (2) that there is or was substantial authority for such treatment; and (3) that the taxpayer reasonably believed that such treatment was more likely than not the proper treatment. For this purpose, a taxpayer will be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief: (1) is based on the facts and law that exist at the time the tax return (that includes the item) is filed; and (2) relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that (a) a return will not be audited, (b) the treatment will not be raised on audit, or (c) the treatment will be resolved through settlement if raised.[43]

A taxpayer may (but is not required to) rely on an opinion of a tax advisor in establishing its reasonable belief with respect to the tax treatment of the item. However, a taxpayer may not rely on an opinion of a tax advisor for this purpose if the opinion (1) is provided by a "disqualified tax advisor" or (2) is a "disqualified opinion."

Disqualified tax advisor

[40] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income. Sec. 6662A(b).

[41] Sec. 6662A(e)(3).

[42] See the previous discussion regarding the penalty for failing to disclose a reportable transaction.

[43] Sec. 6664(d).

A disqualified tax advisor is any advisor who: (1) is a material advisor[44] and who participates in the organization, management, promotion, or sale of the transaction or is related (within the meaning of section 267(b) or 707(b)(1)) to any person who so participates; (2) is compensated directly or indirectly[45] by a material advisor with respect to the transaction; (3) has a fee arrangement with respect to the transaction that is contingent on all or part of the intended tax benefits from the transaction being sustained; or (4) as determined under regulations prescribed by the Secretary, has a disqualifying financial interest with respect to the transaction.

A material advisor is considered as participating in the "organization" of a transaction if the advisor performs acts relating to the development of the transaction. This may include, for example, preparing documents: (1) establishing a structure used in connection with the transaction (such as a partnership agreement); (2) describing the transaction (such as an offering memorandum or other statement describing the transaction); or (3) relating to the registration of the transaction with any federal, state or local government body.[46] Participation in the "management" of a transaction means involvement in the decision-making process regarding any business activity with respect to the transaction. Participation in the "promotion or sale" of a transaction means involvement in the marketing or solicitation of the transaction to others. Thus, an advisor who provides information about the transaction to a potential participant is involved in the promotion or sale of a transaction, as is any advisor who recommends the transaction to a potential participant.

Disqualified opinion

An opinion may not be relied upon if the opinion: (1) is based on unreasonable factual or legal assumptions (including assumptions as to future events); (2) unreasonably relies upon representations, statements, finding or agreements of the taxpayer or any other person; (3) does not identify and consider all relevant facts; or (4) fails to meet any other requirement prescribed by the Secretary.

[44] The term "material advisor" means any person who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, or carrying out any reportable transaction, and who derives gross income in excess of $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons ($250,000 in any other case). Sec. 6111(b)(1).

[45] This situation could arise, for example, when an advisor has an arrangement or understanding (oral or written) with an organizer, manager, or promoter of a reportable transaction that such party will recommend or refer potential participants to the advisor for an opinion regarding the tax treatment of the transaction.

[46] An advisor should not be treated as participating in the organization of a transaction if the advisor's only involvement with respect to the organization of the transaction is the rendering of an opinion regarding the tax consequences of such transaction. However, such an advisor may be a "disqualified tax advisor" with respect to the transaction if the advisor participates in the management, promotion, or sale of the transaction (or if the advisor is compensated by a material advisor, has a fee arrangement that is contingent on the tax benefits of the transaction, or as determined by the Secretary, has a continuing financial interest with respect to the transaction).

defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1). The penalty imposed under the provision will not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Effective Date

The provision applies to transactions entered into after the date of enactment.

3. Denial of deduction for interest on underpayments attributable to noneconomic substance transactions

Present Law

No deduction for interest is allowed for interest paid or accrued on any underpayment of tax which is attributable to the portion of any reportable transaction understatement with respect to which the relevant facts were not adequately disclosed.[50] The Secretary of the Treasury is authorized to define reportable transactions for this purpose.[51]

Description of Proposal

The provision extends the disallowance of interest deductions to interest paid or accrued on any underpayment of tax which is attributable to any noneconomic substance underpayment (whether or not disclosed).

Effective Date

The provision applies to transactions entered into after the date of enactment

[50] Sec. 162(m). Under section 6664(d)(2)(A), in such a case of nondisclosure, the taxpayer also is not entitled to the "reasonable cause and good faith" exception to the section 6662A penalty for a reportable transaction understatement.

[51] See the description of present law under the immediately preceding proposal, "Penalty for understatements attributable to transactions lacking economic substance, etc."

2

BAUCUS AMENDMENT #2
The Heartland, Habitat, Harvest and Horticulture Act of 2007

Description: Add algae to the list of qualifying feedstocks for purposes of Section 40A of the Internal Revenue Code.

Offset: To be provided

Contact: Ryan (4-7558)

3

ROCKEFELLER #1

Rockefeller Amendment #1 to the Heartland, Habitat, Harvest and Horticulture Act of 2007

Description: Expand Section 45 to include refined coal from a qualified coal waste sludge recycling process. This refined coal is a fuel made from coal and "coal waste sludge" used as a feedstock for the production of coke.

Offset: To be provided

Contact: Jorge Castro (4-9843)

[NOTE – Amendment sponsors reserve the right to modify the amendment for technical, revenue-neutrality, or other purposes.]

——

(4)

ROCKEFELLER/HATCH AMENDMENT #2 to The Heartland, Habitat, Harvest and Horticulture Act of 2007

Description: Extends section 6426(d)(2)(E) any liquid fuel derived from coal (including peat) through the Fischer-Tropsch process through December 31, 2010. The tax credit would only be available for fuel produced from a facility that separate and sequester 75% of its total carbon dioxide emissions.

Offset: To be provided

Contact: Jorge Castro (4-9843)

[NOTE – Amendment sponsors reserve the right to modify the amendment for technical, revenue-neutrality, or other purposes.]

(5)

ROCKEFELLER/BAUCUS/SNOWE AMENDMENT #3 to The Heartland, Habitat, Harvest and Horticulture Act of 2007

Description: Creates a two-tiered tax incentive to stimulate new investment in broadband technology and infrastructure. Specifically, it would provide:

> a) 50% expensing for investment in "current-generation" broadband infrastructure (5 megabits per second download, 1 megabit per second upload) in rural and underserved areas that is not a saturated market, and
>
> b) Full expensing for "next generation" broadband investments (100 megabits per second download, 20 megabits per second upload) in rural, underserved and other residential areas.

Any provider meeting these speed thresholds would be eligible, whether the service is provided over copper telephone wire, cable modem, optical fiber, wireless, satellite, or other media. To encourage timely investment, the incentive would sunset after 4 years.

Offset: To be provided

Contact: Jorge Castro (4-9843)

[NOTE – Amendment sponsors reserve the right to modify the amendment for technical, revenue-neutrality, or other purposes.]

6

Kerry Amendment #1 to Heartland, Habitat, Harvest, and Horticulture Act of 2007

Short Title: Modify Emergency Assistance for livestock, honey bees, and farm-raised fish

Description of Amendment: The amendment expands the assistance for livestock, honey bees, and farm-raised fish to include fishery disasters. The Secretary of Agriculture will determine eligible fishery disasters in consultation with the Secretary of Commerce. To be eligible for consideration a fishery disaster has to have been declared by the Secretary of Commerce under the Interjurisdictional Fisheries Act or the Magnuson Stevens Fishery Conservation and Management Act. The payments made from the fund would be for purposes consistent with the Interjurisdictional Fisheries Act or the Magnuson Stevens Fishery Conservation and Management Act. The amendment increases the amount allowed for emergency relief from $25 million to $50 million.

Contact: Kathy Kerrigan 4-7242

7

Kerry Amendment #2 to Heartland, Habitat, Harvest, and Horticulture Act of 2007

Short Title: Modify Emergency Assistance for livestock, honey bees, and farm-raised fish

Description of Amendment: The amendment clarifies the definition of farm-raised fish to include the propagation and rearing of aquatic species (including any species of finfish, mollusk, crustacean, or other aquatic invertebrate, amphibian, reptile, or aquatic plant) in controlled or selected environments. This language clarifies that shellfish, finfish and aquatic plants are eligible for emergency assistance under this Act.

Contact: Kathy Kerrigan 4-7242

(8)

Lincoln-Smith Amendment #1
to the Heartland, Habitat, Harvest and Horticulture Act of 2007

Cosponsors: Cantwell, Lott, Wyden, Crapo, Snowe

Short Title: Timber Revitalization and Economic Enhancement (TREE) Act

Description of Amendment: This amendment would allow a tax deduction for up to 60% of gains from certain sales or exchanges of timber. It would also provide for modernization of real estate investment trust (REIT) rules for timber property.

Offset: Increase information return penalties.

Contact: Anna Taylor (4-1050)

(9)

Lincoln-Smith Amendment #2
to the Heartland, Habitat, Harvest and Horticulture Act of 2007

Cosponsors: Roberts, Snowe, Kerry

Short Title: Sec. 45G Railroad Track Maintenance Credit Extension

Description of Amendment: This amendment would extend the Code Sec. 45G credit for three additional years (through 2010). It would also allow the credit to be used against alternative minimum tax liabilities.

Offset: To be provided

Contact: Anna Taylor (4-1050)

(10)

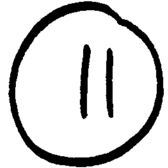
Lincoln-Smith Amendment #3
to the Heartland, Habitat, Harvest and Horticulture Act of 2007

Short Title: Energy Efficient Motors Incentives Act

Description of Amendment: This amendment would provide a tax credit for the purchase of qualified energy efficient motors that meet or exceed certain energy efficiency standards. The credit would equal $15 per horsepower and the aggregate amount of credit that a taxpayer may claim for any taxable year shall not exceed $1,250,000. It defines a "qualifying energy efficient motor" as any that is: (a) a general- or definite-purpose electric motor of 500 horsepower or less that meets or exceeds the efficiency levels specified in Tables 12-12 or 12-13 of the National Electrical Manufacturers Association MG-1 (2006); (b) the original use begins with the taxpayer; and (c) is placed in service in the United States. The proposal shall apply to energy efficient motors placed in service after the date of enactment and would expire 36 months from date of enactment.

Offset: Denial of deduction for certain fines, penalties and other amounts. $263 million/10.

Contact: Anna Taylor (4-1050)



Lincoln Amendment #4
to the Heartland, Habitat, Harvest and Horticulture Act of 2007

Short Title: Farm and Ranch Estate Tax Modernization

Description of Amendment: This amendment would adjust the cap under Code Sec. 2032A regarding valuation of qualifying farm and ranch property. The cap amount would be raised (and made equal) to the exemption level. Effective DOE.

Offset: To be provided

Contact: Anna Taylor (4-1050)

(12)

Lincoln-Snowe Amendment #5
to the Heartland, Habitat, Harvest and Horticulture Act of 2007

Cosponsor: Roberts

Short Title: Asset Exclusion For Savings and Nutrition

Description of Amendment: This amendment would exclude assets in tax-preferenced retirement savings accounts and education savings accounts from countable financial resources when determining eligibility for the Food Stamp program.

This amendment is based on Sections 3 and 4 of the Food Stamp Personal Savings and Investment Act (S. 591).

Offset: To be provided

Contact: Anna Taylor (4-1050)

13

Lincoln Amendment #6
to the Heartland, Habitat, Harvest and Horticulture Act of 2007

Short Title: Bio-based Feedstock Credit

Description of Amendment: This amendment would encourage businesses to reduce the petroleum-based feedstocks used in existing manufacturing processes by allowing a temporary credit against income tax of 7 cents for each pound of bio-based feedstocks which replace petroleum-based feedstocks in such process.

Offset: To be provided

Contact: Todd Wooten (4-7499) or Anna Taylor (4-1050)

14

Schumer Amendment #1 to the "Heartland, Habitat, Harvest, and Horticulture Act of 2007"

Background

The Chairman's Mark contains a provision related to ethanol duty drawbacks which says that the drawback is eliminated for any products EXPORTED on or after the fifteenth day after enactment. The provision thus applies retroactively to ethanol that has been (or will be) imported into the country in reliance on the current-law ability to obtain drawback on imports. (The impact is retroactive because the language includes current or pending imports that have been contracted for based on the financial analysis that included the availability of drawback under current law.)

Amendment

The Schumer Amendment would change the provision to apply to any IMPORTS contracted for after the date of enactment. This treatment would be consistent with the effective date generally used when tax laws are modified (i.e., transactions already under contract at the time of enactment or the time of committee action may continue to utilize current law).

Revenue Impact

Less than $10 million – this is a timing issue rather than a policy change.

Contact: Jeff Hamond, 4-4422

15

Schumer Amendment #2 to the "Heartland, Habitat, Harvest, and Horticulture Act of 2007"

Background

While tax credits for production of many sources of renewable energy automatically go to the production facility's owner, subsection 45(d) assigns credits to the lessee or operator of an open-loop biomass facility. The way the current language is drafted can have the effect of slowing investment in such facilities for a variety of reasons, and may not be in line with Congressional intent.

Amendment

Section 45(d) may discourage new private investment in agricultural livestock waste nutrient-fired open-loop facilities by denying credits to the owners, who frequently help to protect against investment risk. Then Schumer amendment would amend Section 45(d)3)(B) so that the credit is allocated to a lessee/operator only if the owner is a tax-exempt governmental entity or rural electric cooperative; otherwise the person eligible for the credit shall be the owner. The amendment would be effective with respect to facilities placed in service after the date of enactment of the American Jobs Creation Act of 2004 (October 22, 2004) and only for credits on production which occurs after the date of enactment of the proposed amendment. Section 45 credits previously claimed by the lessee/operator of such open loop biomass facilities would be unaffected.

Revenue Impact

Very small, if any. The amendment does not increase any credits – it simply clarifies who may qualify for them.

Contact: Jeff Hamond, 4-4422

16

Stabenow Amendment #1 to the Heartland, Habitat, Harvest, and Horticulture Act of 2007

Short Title: Specialty Crop Amendment

Description of Amendment: To amend the Trade Act of 1974, by establishing a permanent appropriation equal to 1% of the tariffs collected. The appropriation would be collected in a separate fund in Treasury and the Secretary of Agriculture shall use the funds for specified specialty crop programs. Programs would be Specialty Crop Competitive Grants, Trade Technical Assistance for Specialty Crops, and Specialty Crop National Research Grants.

While specialty crops are approximately one-half of the country's gross agricultural receipts, they receive minimal aid from the federal government. Specialty crop programs would help American farmers produce more competitive fruits and vegetable and allow consumers more accessible healthy foods at a time when diabetes and obesity rates are rising.

It raises approximately $1.5 billion over 10 years.

Contact: Chris Adamo 4-8807

17

Stabenow Amendment #2 to the Heartland, Habitat, Harvest, and Horticulture Act of 2007

Short Title: Cellulosic Ethanol Amendment

Description of Amendment: To amend the Small Producer Credit for Cellulosic Alcohol, so that it clearly includes "pulp mill residue".

Pulp mill residue has the potential to fuel a process that would turn black liquor into cellulosic ethanol. Black liquor is a byproduct of paper mill operation and it is the combination of the lignin residue with water and chemicals used for extraction, thus it is a residue of the lignocellulosic material that began the process.

The black liquor technology is currently in use in Sweden and this incentive could encourage its use in paper mills in the United States.

Contact: Chris Adamo 4-8807

(18)

Stabenow Amendment #3 to the Heartland, Habitat, Harvest, and Horticulture Act of 2007

Short Title: E85 Blenders Credit

Description of Amendment: A qualified alternative fuel blender will continue to receive the full 51 cents per gallon credit for ethanol that is blended into E85 after the 51-cent-per-gallon credit for ethanol is reduced to 46 cents. This alternative fuel blender credit will be extended to December 31, 2012.

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

Offset to be provided once cost is determined.

Contact: Chris Adamo 4-8807

19

Stabenow Amendment #4 to the Heartland, Habitat, Harvest, and Horticulture Act of 2007

Short Title: Extending the Cellulosic Expiration Date

Description of Amendment: Extend the sunset provision of the Small Producer Credit for Cellulosic Ethanol to December 31, 2015.

The Small Producer Credit for Cellulosic Ethanol expires the later of December 31, 2012 or December 31 of the calendar year in which the Secretary, in consultation with the Environmental Protection Agency, certifies that one billion gallons of cellulosic alcohol have been produced or imported into the United States. Joint Tax says that will be 2016 right now. Our hope is that we get to one billion gallons before 2016.

Contact: Chris Adamo 4-8807

20

Cantwell/Smith Amendment #1 – Application of Biodiesel Tax Credits

This amendment clarifies the tax treatment of biodiesel eligible for the per-gallon tax incentives. This proposal would add to the provisions in the chairman's mark extending the credits for biodiesel and treating qualified fuel mixtures as taxable fuel the following conditions:

Taxpayers claiming the biodiesel mixture excise tax credit are required to register with the IRS, and registrants are deemed to be IRS registered fuel terminals. The Secretary is instructed to promulgate rules establishing reporting requirements for terminals that blend biodiesel. The Secretary is also instructed to issue regulations to certify that only biodiesel meeting ASTM D6751 fuel specifications qualifies for biodiesel income tax credits, excise tax credits and payment provisions. Taxpayers claiming biodiesel tax incentives are also required to remit documentation, consistent with rules issued by the Secretary, certifying that fuel for which credits are claimed meets ASTM D6751 specifications.

Taxpayers are required to remit the diesel fuel excise tax on exported biodiesel blends that are taxable fuels. Taxpayers can claim refunds on excise taxes paid. The customs process for "finished motor fuel" will apply. Thus, the following certificates must be provided in order for a refund on the 24.4 cent excise tax paid to be claimed: (1) U.S. Customs Export Documents for finished motor fuel, and (2) landing documents required from destination country.

As under current law, (Sec. 4083(a)(1)), dyed fuels are taxable fuels that have been exempted from tax.

Effective date: Effective for fuels sold or used after December 31, 2007.

Revenue Cost: TBD – This should raise revenue relative to the mark because it shuts down instances of inappropriate, multiple credit claims.

Contact: Lauren Bazel 4-5506 (Cantwell), Valerie West 4-3753 (Smith)

21

Cantwell Amendment #2 – Add "qualified small businesses" as eligible for Permanent Crop Disaster Assistance Program (PCDP) payments

The amendment would make certain qualified small businesses eligible for Permanent Crop disaster Assistance Program payments.

These eligible small businesses must be located in the qualified "disaster counties" as defined in the Chairman's mark, and (i) have less than $15,000,000 in average annual gross income from all business activities, at least 75 percent of which shall be directly related to agriculture production or agriculture support industries; (ii) verify the amount of economic loss attributable to weather-related agricultural losses using such documentation as required by the PCDP; (iii) have suffered losses attributable to weather-related agricultural disasters that equal at least 50 percent of the total economic loss of the small business for each year a payment is requested; and (iv) demonstrate that the grant will materially improve the likelihood the business will recover from the disaster and continue to service and support production agriculture.

This eligibility criteria is similar to that included in Title II of S. 284, the Emergency Farm Relief Act of 2007. It also was included in the Senate version of the emergency supplemental appropriations act of 2007 (S. 965), but stripped from conference.

Revenue Estimate: TBD

Contact: Lauren Bazel 4-5506 (Cantwell)

22

SALAZAR Amendment #1 to the 4-H Act of 2007

Short Title: An amendment to provide tax-exempt financing for qualified renewable energy facilities.

Description of Amendment: The Amendment would provide incentives for investment in community owned wind and other renewable energy projects up to 40 megawatts in size by giving private developers access to tax-exempt bond markets (identical to S. 672).

Offset: Repeal Section 1031 tax treatment for collectibles.

Contact: Steve Black (8-5033)

23

SALAZAR (SMITH-KERRY-CRAPO) Amendment #2 to the 4-H Act of 2007

Short Title: An amendment to eliminate the restriction to residential property on the small wind tax credit and to eliminate the $500 per half-kW limitation on the amount of the credit.

Description of Amendment: The Amendment would eliminate the requirement, except in the case of an individual, that qualifying wind turbines be used to generate electricity for use in a dwelling unit used as a residence by the taxpayer. The Amendment would also eliminate the redundant (in light of the $4,000 cap) $500 per half-kW limitation on the amount of the credit.

Offset: Repeal Section 1031 tax treatment for collectibles.

Contact: Steve Black (8-5033)

24

SALAZAR (SMITH-CANTWELL-CRAPO-KERRY-LINCOLN) Amendment #3 to the 4H Act of 2007

Short Title: An amendment to increase the tax credit for the production of cellulosic alcohol.

Description of Amendment: This amendment would provide the small producer tax credit of 10 cents per gallon for up to 60 million gallons per year of qualified cellulosic fuel production, and increase the income tax credit for qualified cellulosic fuel production from 50 cents per gallon to 67 cents per gallon.

Offset: Repeal Section 1031 tax treatment for collectibles.

Contact: Steve Black (8-5033)

25

SALAZAR Amendment #4 to the 4H Act of 2007

Short Title: An amendment to reduce the risks to communities and water supplies from severe wildfires, especially in areas affected by insect infestations.

Description of Amendment: This amendment would provide a number of tax incentives for the reduction of hazardous fuels:

- **Extension of Tax Credit for Electricity Produced From Biomass** – It would extend an existing biomass electricity production tax credit (now scheduled to expire on January 1, 2009) until January 1, 2030.

- **Partial Exclusion from Gross Income Payments Received for Certain Hazardous Fuel Reduction Projects** – It would allow a taxpayer to exclude from taxable income money received from the Federal Government as compensation for hazardous fuel reduction work. The exclusion would be for up to $10,000 for a single return $20,000 for a joint return.

- **Deduction of Certain Expenditures in Connection with Implementation of Community Wildfire Protection Plans** – It would allow individuals to deduct funds they expend for hazardous fuel reductions that are done as part of a wildfire protection plan from their income taxes. It allows for the exclusion of up to $10,000 for a single return or $20,000 for a joint return.

Offset: To be provided.

Contact: Brendan McGuire (8-5436)

Grassley/Baucus Amendment #1
to
"The Heartland, Habitat, Harvest, and Horticulture Act of 2007"

26

Short Title: Expand the exclusion for certain payments and programs relating to fish and wildlife

Description of Amendment: The proposal modifies Section II, Part F of the Chairman's Mark by expanding the exclusion for certain payments and programs relating to fish and wildlife to include the Forest Health Protection Program and Section 8(i)(1)(A) of the Cooperative Forestry Assistance Act of 1978. Revenue estimate is negligible.

Contact: Elizabeth Paris, 4-7388

27

Grassley Amendment #2
to
"The Heartland, Habitat, Harvest, and Horticulture Act of 2007"

Short Title: USDA Renewable Energy Grants for the production of electricity

Description of Amendment: Exclude USDA grants described under the current Farm Bill as Section 9006 from Section 45(b)(3), which reduces the PTC for the grant amount. Revenue estimate is pending.

Contact: Elizabeth Paris, 4-7388

28

HATCH AMENDMENT #1

to

The Heartland, Habitat, Harvest, and Horticulture Act of 2007

Add the provisions of S. 2002, the Real Estate Investment Trust Investment Diversification and Empowerment Act of 2007
(Cosponsored by Senator Salazar)

Description of Amendment

The REIT Investment Diversification and Empowerment Act of 2007 (RIDEA) includes the following provisions to help modernize the tax rules governing Real Estate Investment Trusts to permit REITs to better meet the challenges of evolving market conditions and opportunities:

Title I: Foreign Currency and Other Qualified Activities

The Internal Revenue Service (IRS) has long recognized that U.S. REITs can and do invest outside the U.S., essentially recognizing that any income generated from REIT-permissible sources outside of the U.S. should not jeopardize the REIT's tax status. However, the treatment of foreign currency gains directly attributable to overseas real estate investment is not wholly clear, and its correct characterization is becoming increasingly important as U.S. REITs strengthen their positions in foreign markets.

As U.S. REITs continue to expand their overseas investments, the correct characterization of foreign currency gains and other types of non-specified income and assets has become even more important. To ensure that foreign currency gains do not harm a REIT's tax status, the IRS has provided a short-term solution by allowing certain REITs to establish a subsidiary REIT in each currency zone in which a REIT invests. However, the use of subsidiary REITs, each of which must satisfy the complex myriad of REIT rules or risk disqualification of the parent REIT, is a cumbersome and unmanageable solution in the long term. Accordingly, RIDEA would clarify existing law by characterizing foreign currency gains generated by a REIT outside the U.S. as "good" REIT income so long as the REIT focuses on commercial real estate, as measured by specific objective rules. Despite the IRS' authority to prescribe similar rules, the absence of such guidance necessitates legislative clarification to provide certainty to REIT management and their shareholders within a more administrable framework.

RIDEA also would delegate to the IRS the express authority to issue guidance with respect to whether any other item of income should satisfy the REIT gross income tests or should not be taken into account in calculating these tests. While the IRS often has been willing to grant such rulings to specific taxpayers, these rulings cannot be relied on by other taxpayers and in any event do not cover all circumstances.

Accordingly, RIDEA would: (1) characterize foreign currency gains attributable to a REIT's ownership and operation of overseas real estate assets as qualifying income under REIT gross income tests; (2) conform the current REIT hedging rule to also apply to foreign currency gains and to apply those rules for purposes of the both REIT gross income tests under current law; (3) specifically provide the Department of the Treasury with the authority to issue guidance on other items of income to either qualify under the REIT gross income tests or to provide that items of income are not taken into account in computing those tests; (4) treat foreign currency as a qualifying real estate asset; and (5) make conforming changes to other REIT provisions reflecting foreign currency gains.

Title II: Taxable REIT Subsidiaries

As originally introduced in 1999, the REIT Modernization Act (RMA) limited a REIT's ownership in taxable REIT subsidiaries (TRS) to 25 percent of a REIT's gross assets. However, the limit was reduced to 20 percent when Congress ultimately enacted the RMA as part of the Ticket to Work Incentives Improvement Act of 1999.

RIDEA would increase the limit on TRS securities from 20 percent to 25 percent of a REIT's gross assets. The rationale for a 25 percent limit on TRSs that was contained in the RMA remains the same today. The dividing line for testing a concentration on commercial real estate in the REIT rules has long been set at 25 percent, and even the mutual fund rule uses a 25 percent test. An IRS study shows increasing amounts of taxes paid by new TRSs, and common sense tells us that permitting increased activities in a double tax regime should increase revenues to the fisc compared to a single tax regime.

Title III: Dealer Sales

The Internal Revenue Code imposes a 100 percent excise tax on profits generated on sales of property in which a REIT is acting as a dealer rather than an investor. Because of the confiscatory nature of this 100 percent excise tax, the Code provides a "safe harbor" under which a REIT can be assured that the excise tax does not apply if it satisfies a number of requirements. RIDEA would make two changes to the dealer safe harbor.

One requirement under current law is that the REIT not either make seven sales in a taxable year or sell more than 10 percent of its portfolio each year. However, the test as currently constructed penalizes many REITs that have owned their properties for a long period of time. This is because the test is geared to the property's "tax basis," an amount that diminishes over time due to tax depreciation, rather than "fair market value", an amount that generally increases over time. Second, the current test requires that a REIT hold a property for at least four years, three years longer than the general holding period required to distinguish between an "investor" and a "dealer" in property.

RIDEA would update this safe harbor to test "fair market" value instead of "tax basis" to allow REITs that have owned their properties for longer periods not be penalized and thereby prevented from prudently managing the timing and extent of

asset dispositions. As part of the REIT Modernization Act of 1999, Congress adopted a provision that utilizes fair market value rules for purposes of calculating personal property rents associated with the rental of real property. Thus, there is an analogous precedent for a fair value approach.

The safe harbor also would be amended to replace the four-year holding period with a two-year holding period. The four-year requirement is not consistent with other Code provisions that define whether property is held for long term investments, such as the one-year holding period to determine long-term capital gains treatment, and the two-year holding period to distinguish whether the sale of a home is taxable because it is held for investment purposes.

Title IV: Health Care REITs

Generally, rental payments made from a subsidiary owned by a REIT to that REIT are not considered qualified rental income for REIT purposes under the "related party rules". However, as part of the REIT Modernization Act of 1999 (RMA), a lodging REIT is allowed to establish a taxable REIT subsidiary (TRS) that can lease lodging facilities from a REIT holding a controlling interest, with the payments to the REIT considered qualified income under the REIT rules. The RMA also created a rule under which a TRS is not allowed to operate or manage lodging or health care facilities.

At the time the RMA was considered, it was not clear that health care REITs would be interested in such treatment, so health care facilities do not qualify for the RMA exception to the related party rules. Today, many operators of health care assets such as assisted living facilities do not want to bear the financial risks of being a lessee of such facilities and would rather act purely as an independent operator of the facilities. Health care REITs now believe that the TRS restriction is interfering with their ability to manage their operations in the most efficient manner.

RIDEA would conform the treatment of health care facilities to that of lodging facilities by treating as qualifying income rental payments attributable to a health care facility made to a REIT from a taxable REIT subsidiary. Under this proposal, a TRS would still be required to use an independent contractor to manage or operate health care facilities, but payments collected by a REIT from its TRS renting health care facilities would be qualified income under the REIT tests.

Title V: Foreign REITs

Since imitation is the sincerest form of flattery, Congress should be proud that about 20 countries have enacted legislation paralleling the U.S. REIT rules after observing the benefits brought to the United States as a result of a vibrant REIT market. The number of countries that have adopted REIT-like legislation this past decade has greatly accelerated, with Israel being the latest country to do so and legislation in the United Kingdom going into effect on January 1, 2007. Although the tax code treats stock in a U.S. REIT as a real estate asset, so that it is a qualified asset that generates qualifying income, current law does not afford the same treatment to the stock of non-U.S. REITs.

A U.S. REIT might want to invest in another country through a REIT organized in that country. A company could lose its status as a U.S. REIT if it owns more than 10 percent of the foreign REIT's securities, even though the foreign company looks and acts like a U.S. REIT. A REIT should not be discouraged from investing in an entity that engages in the same activities that a U.S. REIT is allowed to undertake if it invests directly in another country.

RIDEA would amend the REIT rules to provide that income from, and interests in, foreign-qualified REITs would be treated as qualifying REIT income and assets under the U.S. REIT rules provided that under the laws of another country: (1) at least 75 percent of the foreign company's assets must be invested in real estate assets; (2) the foreign REIT either receives a dividends paid deduction or is exempt from corporate level tax; and (3) the foreign REIT is required to distribute at least 85% of its taxable income to shareholders on an annual basis.

Revenue Effect

Around $534 million over ten years.

Offset

To be provided.

Evan Liddiard, 4-0619

29

HATCH AMENDMENT #2

to

The Heartland, Habitat, Harvest, and Horticulture Act of 2007

Increase the Emergency Assistance for livestock, honey bees, and farm-raised fish from the $25,000,000 annual amount in the Chairman's mark to $50,000,000.

Description of Amendment

The Chairman's mark provides for a permanent Agriculture Disaster Relief Trust Fund that would provide payments to farmers and ranchers who suffer losses in areas that are declared disaster areas by the USDA. As part of the provision, the mark provides up to $25,000,000 annually from the trust fund to provide emergency relief to producers of livestock, honey bees, and farm-raised fish due to losses from adverse weather or other environmental conditions, such as blizzards and wildfires, as determined by the Secretary, that are not covered under the authority of the Secretary to make qualifying natural disaster declarations.

The amendment would double the amount to up to $50,000,000 annually.

Offset

To be provided.

J.J. Brown, 4-9858
Evan Liddiard, 4-0619

Snowe Amendment #1 to the Heartland, Habitat, Harvest, and Horticulture Act of 2007

Short Title:

Milk Import Tariff Equity Act

Description of Amendment:

Imposes tariff-rate quotas on certain casein and milk protein concentrates, as set forth in S. 1485, the Milk Import Tariff Equity Act, with any revenue collected to go toward deficit reduction. The current duty of $0.0037 per kilogram would rise to $1.56 per kilogram for Milk Protein Concentrate, and to $2.16 per kilogram for casein, for all over-quota imports of those products.

Offset:

This amendment would raise revenue.

Contact Name and Phone Number:

Dylan Williams, 4-5097

(31)

Kyl with Lott, Smith, Ensign Amendment #1
To the
Heartland, Habitat, Harvest and Horticulture Act of 2007

Short Title: Family Farm, Ranch, and Business Preservation Amendment.

Description of the Amendment: The amendment would eliminate the current-law estate tax repeal in 2010 and replace it with permanent estate tax reform. The reform would be comprised of a $5 million per estate exclusion amount that is both indexed for inflation and is portable; amounts over the exclusion would be taxed at a flat long-term capital gains rate through $25 million (indexed for inflation); amounts over $25 million would be taxed at a flat 30 percent rate.

Contact: Lisa Wolski
4-4521

32

SMITH-WYDEN AMENDMENT #1
THE HEARTLAND, HABITAT, HARVEST AND HORTICULTURE ACT OF 2007

Smith-Wyden Amendment #1 to the Heartland, Habitat, Harvest and Horticulture Act of 2007, for himself and Mr. Wyden.

Short Title: Exemption of Youth Wooden Arrows from the Arrow Excise Tax

Description of Amendment: The amendment would exempt youth wooden arrows from the arrow excise tax (Code Section 4161(b)(2)(A)).

Senators Smith and Wyden move to include this provision in the Heartland, Habitat, Harvest and Horticulture Act of 2007.

Offset: To be provided.

Contact: Kara Getz, Senator Smith (4-2444) and Josh Sheinkman, Senator Wyden (4-5244)

33

SMITH AMENDMENT #2
THE HEARTLAND, HABITAT, HARVEST AND HORTICULTURE ACT OF 2007

Short Title: Section 45 Credit Rate Equity for Open-Loop Biomass Facilities

Description of Amendment: Current law reduces the Section 45 production tax credit by half for electricity produced by certain qualifies facilities. The amendment would eliminate this reduction in the credit rate for electricity produced after 2007 from open-loop biomass facilities.

Offset: To be provided.

Contact Name and Phone Number: Valerie West, 48328

34

BUNNING AMENDMENT #1

Bunning Amendment #1 to the Heartland, Habitat, Harvest and Horticultural Act of 2007

Short Title: Strike Title I of the Bill

Description of Amendment:

The amendment would strike the proposal to create a permanent Agricultural Disaster Relief Trust Fund with borrowing authority.

Offset: The amendment raises $6.108 billion

Contact: Payson Peabody x4-8802 or Sarah Timoney x4-4343

35

BUNNING AMENDMENT #2

Bunning Amendment #2 to Title III
Cosponsors **Lott, Hatch**

Short Title: To extend the existing alternative fuel tax credit for coal-derived fuels

Description of Amendment: This amendment would extend the existing alternative fuel tax credit for coal-derived fuel as it is extended for renewable fuels until December 31, 2010.

Contact Name and Phone Number: Bill Beaver 224-6857, cell 202-714-7190
Payson Peabody 224-8802

36

Bunning Amendment # 3

Short Title: To Expand the Definition of Livestock to Horses.

Description of Amendment: Makes horses eligible for the same federal assistance that other livestock is eligible for under federal programs. The current definition of livestock in the underlying bill includes cattle, bison, poultry sheep swine and other livestock as determined by the Secretary. This amendment expands the definition to include horses used for commercial production agriculture.

LIVESTOCK ASSISTANCE.

(a) IN GENERAL.—In carrying out a livestock assistance, compensation, or feed program, the Secretary of Agriculture shall include horses within the definition of ''livestock'' covered by the program.

(b) DEFINITION – horses shall be defined as horses used for commercial production agriculture including – stallions, mares, foals, yearlings and such horses being prepared for breeding, sale, or use.

(c) APPLICABILITY.—

(1) IN GENERAL.—This section and the amendments made by this section apply to losses resulting from a disaster that occurs after the date of enactment of the underlying bill.

(2) PRIOR LOSSES.—This section and the amendments made by this section do not apply to losses resulting from a disaster that occurred before the date of enactment of this Act.

Offset: Expect to be revenue neutral

Contact Name and Phone Number: Sarah Timoney 224-4343
Payson Peabody 224-8802

37

BUNNING AMENDMENT #4

Bunning Amendment #4 to Title III

Short Title: To provide a level playing field for all alternative fuels eligible for the alternative fuel excise tax credit.

Description of Amendment: This amendment would change the eligibility requirements for the alternative fuel tax credit by requiring all eligible fuels be produced at a facility that captures at least 75% of carbon emissions.

Contact Name and Phone Number: Bill Beaver 224-6857, cell 202-714-7190
Payson Peabody 224-8802

38

BUNNING AMENDMENT #5

Bunning Amendment #5 to Title III

Short Title: To extend the existing alternative fuel tax credit for coal-derived fuels produced at a facility with 50% carbon capture.

Description of Amendment: This amendment would extend the existing alternative fuel tax credit for coal-derived fuel as it is extended for renewable fuels under December 31, 2010 with a requirement for 50% carbon capture.

Contact Name and Phone Number: Bill Beaver 224-6857, cell 202-714-7190
Payson Peabody 224-8802

39

BUNNING AMENDMENT #6

Bunning Amendment #6 to the Heartland, Habitat, Harvest and Horticultural Act of 2007

Co-Sponsors: Sen. Conrad, Sen. Roberts

Short Title: Treat farming business machinery and equipment as 5-year property for purposes of depreciation

Description of Amendment: Add the text of S. 1621 as an amendment to the bill.

Offset: To be provided.

Contact: Payson Peabody x4-8802 or Sarah Timoney x4-4343

40

CRAPO Amendment to the 4H Act of 2007

Short Title: An amendment to increase the tax credit for the production of biogas.

Description of Amendment: This amendment would provide $4.27 per million British thermal units (mmBtu) of biogas produced and either sold or used by the taxpayer with an overall cap for the first 100 million mmbtu's. This rewards the first adapters and caps the spending at $427 million.

Offset: Clarify penalty for sale of fuel failing EPA regulations – >$500,000 over 10 years

Contact: Craig Ferguson (4-3048)

DESCRIPTION OF THE REVENUE RAISING PROVISIONS OF PROPOSED LEGISLATION IMPLEMENTING THE UNITED STATES - PERU TRADE PROMOTION AGREEMENT

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

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

October 2, 2007
JCX-92-07

CONTENTS

Page

INTRODUCTION 1

A. Extension of Customs User Fees 2

B. Modifications to Corporate Estimated Tax Payments 3

INTRODUCTION

The Senate Committee on Finance has scheduled a markup on October 4, 2007. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the revenue raising provisions of proposed legislation implementing the United States - Peru trade promotion agreement.

---

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Revenue Raising Provisions of Proposed Legislation Implementing the United States - Peru Trade Promotion Agreement,* (JCX-92-07), October 2, 2007. This document can also be found on the web at www.house.gov/jct.

A. Extension of Customs User Fees

Present Law

Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA")[2] authorized the Secretary of the Treasury to collect certain service fees. Section 412 of the Homeland Security Act of 2002[3] authorized the Secretary of the Treasury to delegate such authority to the Secretary of Homeland Security. Provided for under 19 U.S.C. 58c, these fees include: processing fees for air and sea passengers, commercial trucks, rail cars, private aircraft and vessels, commercial vessels, dutiable mail packages, barges and bulk carriers, merchandise, and Customs broker permits. COBRA was amended on several occasions. The current authorization for the collection of the passenger and conveyance processing fees is through October 7, 2014. The current authorization for the collection of the merchandise processing fees is through October 21, 2014.[4]

Description of Proposal

The proposal extends the passenger and conveyance processing fees and the merchandise processing fees authorized under COBRA through December 13, 2014.

Effective Date

The proposal is effective on the date of enactment.

---

[2] Pub. L. No. 99-272.

[3] Pub. L No. 107-296.

[4] For fiscal years after September 30, 2005, the Secretary is to charge fees in amounts that are reasonably related to the costs of providing customs services in connection with the activity or item for which the fee is charged.

B. Modifications to Corporate Estimated Tax Payments

Present Law

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

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

Description of Proposal

The proposal increases the otherwise applicable percentage (115.00 percent) by 0.75 percentage points.

Effective Date

The proposal is effective on the date of enactment.

ECONOMIC SUBSTANCE DOCTRINE

1. Clarification of the economic substance doctrine

Present Law

In general

The Code provides detailed rules specifying the computation of taxable income, including the amount, timing, source, and character of items of income, gain, loss, and deduction. These rules permit both taxpayers and the government to compute taxable income with reasonable accuracy and predictability. Taxpayers generally may plan their transactions in reliance on these rules to determine the federal income tax consequences arising from the transactions.

In addition to the statutory provisions, courts have developed several doctrines that can be applied to deny the tax benefits of tax motivated transactions, notwithstanding that the transaction may satisfy the literal requirements of a specific tax provision. The common-law doctrines are not entirely distinguishable, and their application to a given set of facts is often blurred by the courts and the IRS. Although these doctrines serve an important role in the administration of the tax system, they can be seen as at odds with an objective, "rule-based" system of taxation.

A common-law doctrine applied with increasing frequency is the "economic substance" doctrine. In general, this doctrine denies tax benefits arising from transactions that do not result in a meaningful change to the taxpayer's economic position other than a purported reduction in federal income tax.[1]

Economic substance doctrine

Courts generally deny claimed tax benefits if the transaction that gives rise to those benefits lacks economic substance independent of tax considerations – notwithstanding that the purported activity actually occurred. The Tax Court has described the doctrine as follows:

---

[1] *See, e.g., ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998), *aff'g* 73 T.C.M. (CCH) 2189 (1997), *cert. denied* 526 U.S. 1017 (1999). Closely related doctrines also applied by the courts (sometimes interchangeable with the economic substance doctrine) include the "sham transaction doctrine" and the "business purpose doctrine." *See, e.g., Knetsch v. United States*, 364 U.S. 361 (1960) (denying interest deductions on a "sham transaction" whose only purpose was to create the deductions). Certain "substance over form" cases involving tax-indifferent parties, in which courts have found that the substance of the transaction did not comport with the form asserted by the taxpayer, have also involved examination of whether the change in economic position that occurred, if any, was consistent with the form asserted, and whether the claimed business purpose supported the particular tax benefits that were claimed. *See, e.g., Klamath Strategic Investment Fund, LLC v. United States,* 472 F. Supp. 2d 885 (E.D. Texas 2007); *TIFD- III-E, Inc. v. United States*, 459 F. 3d 220 (2d Cir. 2006); *BB&T Corporation v. United States*, __F. Supp. 2d __, 2007-1 USTC P 50,130 (M.D.N.C. 2007).

The tax law . . . requires that the intended transactions have economic substance separate and distinct from economic benefit achieved solely by tax reduction. The doctrine of economic substance becomes applicable, and a judicial remedy is warranted, where a taxpayer seeks to claim tax benefits, unintended by Congress, by means of transactions that serve no economic purpose other than tax savings.[2]

Business purpose doctrine

A common law doctrine that often is considered together with the economic substance doctrine is the business purpose doctrine. The business purpose doctrine involves a subjective inquiry into the motives of the taxpayer – that is, whether the taxpayer intended the transaction to serve some useful non-tax purpose. In making this determination, some courts have bifurcated a transaction in which independent activities with non-tax objectives have been combined with an unrelated item having only tax-avoidance objectives in order to disallow the tax benefits of the overall transaction.[3]

Application by the courts

Elements of the doctrine

There is a lack of uniformity regarding the proper application of the economic substance doctrine.[4] Some courts apply a conjunctive test that requires a taxpayer to establish the presence of both economic substance (i.e., the objective component) and business purpose (i.e., the subjective component) in order for the transaction to survive judicial scrutiny.[5] A narrower approach used by some courts is to conclude that either a business purpose or economic substance is sufficient to respect the transaction.[6] A third approach regards economic substance

[2] *ACM Partnership v. Commissioner*, 73 T.C.M. at 2215.

[3] *See, ACM Partnership v. Commissioner*, 157 F.3d at 256 n.48.

[4] "The casebooks are glutted with [economic substance] tests. Many such tests proliferate because they give the comforting illusion of consistency and precision. They often obscure rather than clarify." *Collins v. Commissioner*, 857 F.2d 1383, 1386 (9th Cir. 1988).

[5] *See, e.g., Pasternak v. Commissioner*, 990 F.2d 893, 898 (6th Cir. 1993) ("The threshold question is whether the transaction has economic substance. If the answer is yes, the question becomes whether the taxpayer was motivated by profit to participate in the transaction.").

[6] *See, e.g., Rice's Toyota World v. Commissioner*, 752 F.2d 89, 91-92 (4th Cir. 1985) ("To treat a transaction as a sham, the court must find that the taxpayer was motivated by no business purposes other than obtaining tax benefits in entering the transaction, and, second, that the transaction has no economic substance because no reasonable possibility of a profit exists."); *IES Industries v. United States,* 253 F.3d 350, 358 (8th Cir. 2001) ("In determining whether a transaction is a sham for tax purposes [under the Eighth Circuit test], a transaction will be characterized as a sham if it is not motivated by any economic purpose out of tax considerations (the business purpose test), and if it is without economic substance because no real potential for profit exists (the economic substance test)."). As noted earlier, the economic substance doctrine and the sham transaction doctrine are similar and sometimes are applied

and business purpose as "simply more precise factors to consider" in determining whether a transaction has any practical economic effects other than the creation of tax benefits.[7]

Recently, the Court of Federal Claims questioned the continuing viability of the doctrine. That court also stated that "the use of the 'economic substance' doctrine to trump 'mere compliance with the Code' would violate the separation of powers" though that court also found that the particular case did not lack economic substance. The Court of Appeals for the Federal Circuit ("Federal Circuit Court") overruled the Court of Federal Claims decision, reiterating the viability of the economic substance doctrine and concluding that the transaction in question violated that doctrine.[8] The Federal Circuit Court stated that "[w]hile the doctrine may well also apply if the taxpayer's sole subjective motivation is tax avoidance even if the transaction has economic substance, [footnote omitted], a lack of economic substance is sufficient to disqualify the transaction without proof that the taxpayer's sole motive is tax avoidance."[9]

Nontax economic benefits

There also is a lack of uniformity regarding the type of non-tax economic benefit a taxpayer must establish in order to satisfy economic substance. Some courts have denied tax benefits on the grounds that a stated business benefit of a particular structure was not in fact obtained by that structure.[10] Several courts have denied tax benefits on the grounds that the

---

interchangeably. For a more detailed discussion of the sham transaction doctrine, see, e.g., Joint Committee on Taxation, *Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998 (including Provisions Relating to Corporate Tax Shelters)* (JCS-3-99) at 182.

[7] *See, e.g., ACM Partnership v. Commissioner*, 157 F.3d at 247; *James v. Commissioner*, 899 F.2d 905, 908 (10th Cir. 1995); *Sacks v. Commissioner*, 69 F.3d 982, 985 (9th Cir. 1995) ("Instead, the consideration of business purpose and economic substance are simply more precise factors to consider . . . We have repeatedly and carefully noted that this formulation cannot be used as a 'rigid two-step analysis'.").

[8] *Coltec Industries, Inc. v. United States*, 62 Fed. Cl. 716 (2004) (slip opinion at 123-124, 128); *vacated and remanded*, 454 F.3d 1340 (Fed. Cir. 2006), *cert. denied*, 127 S. Ct. 1261 (Mem.) (2007).

[9] The Federal Circuit Court stated that "when the taxpayer claims a deduction, it is the taxpayer who bears the burden of proving that the transaction has economic substance." The Federal Circuit Court quoted a decision of its predecessor court, stating that "*Gregory v. Helvering* requires that a taxpayer carry an unusually heavy burden when he attempts to demonstrate that Congress intended to give favorable tax treatment to the kind of transaction that would never occur absent the motive of tax avoidance." The Court also stated that "while the taxpayer's subjective motivation may be pertinent to the existence of a tax avoidance purpose, all courts have looked to the objective reality of a transaction in assessing its economic substance." *Coltec Industries, Inc. v. United States*, 454 F.3d at 1355, 1356.

[10] *See, e.g., Coltec Industries v. United States*, 454 F.3d 1340 (Fed. Cir. 2006). The court analyzed the transfer to a subsidiary of a note purporting to provide high stock basis in exchange for a purported assumption of liabilities, and held these transactions unnecessary to accomplish any business purpose of using a subsidiary to manage asbestos liabilities. The court also held that the purported

subject transactions lacked profit potential.[11] In addition, some courts have applied the economic substance doctrine to disallow tax benefits in transactions in which a taxpayer was exposed to risk and the transaction had a profit potential, but the court concluded that the economic risks and profit potential were insignificant when compared to the tax benefits.[12] Under this analysis, the taxpayer's profit potential must be more than nominal. Conversely, other courts view the application of the economic substance doctrine as requiring an objective determination of whether a "reasonable possibility of profit" from the transaction existed apart from the tax benefits.[13] In these cases, in assessing whether a reasonable possibility of profit exists, it may be sufficient if there is a nominal amount of pre-tax profit as measured against expected net tax benefits.

Financial accounting benefits

In determining whether a taxpayer had a valid business purpose for entering into a transaction, at least one court has concluded that financial accounting benefits arising from tax savings do not qualify as a non-tax business purpose.[14] However, based on court decisions that recognize the importance of financial accounting treatment, taxpayers have asserted that financial accounting benefits arising from tax savings can satisfy the business purpose test.[15]

---

business purpose of adding a barrier to veil-piercing claims by third parties was not accomplished by the transaction. 454 F.3d at 1358-1360 (Fed. Cir. 2006).

[11] *See, e.g., Knetsch*, 364 U.S. at 361; *Goldstein v. Commissioner*, 364 F.2d 734 (2d Cir. 1966) (holding that an unprofitable, leveraged acquisition of Treasury bills, and accompanying prepaid interest deduction, lacked economic substance).

[12] *See, e.g., Goldstein v. Commissioner*, 364 F.2d at 739-40 (disallowing deduction even though taxpayer had a possibility of small gain or loss by owning Treasury bills); *Sheldon v. Commissioner*, 94 T.C. 738, 768 (1990) (stating that "potential for gain . . . is infinitesimally nominal and vastly insignificant when considered in comparison with the claimed deductions").

[13] *See, e.g., Rice's Toyota World v. Commissioner,* 752 F. 2d 89, 94 (4th Cir. 1985) (the economic substance inquiry requires an objective determination of whether a reasonable possibility of profit from the transaction existed apart from tax benefits); *Compaq Computer Corp. v. Commissioner*, 277 F.3d 778, 781 (5th Cir. 2001)(applied the same test, citing *Rice's Toyota World*); *IES Industries v. United States*, 253 F.3d 350, 354 (8th Cir. 2001).

[14] *See American Electric Power, Inc. v. UnitedStates*, 136 F. Supp. 2d 762, 791-92 (S.D. Ohio 2001); *aff'd* 326 F.3d.737 (6th Cir. 2003).

[15] *See, e.g.,* Joint Committee on Taxation, *Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations* (JSC-3-03) February, 2003 ("Enron Report"), Volume III at C-93, 289. Enron Corporation relied on *Frank Lyon Co. v. United States*, 435 U.S. 561, 577-78 (1978), and *Newman v. Commissioner*, 902 F.2d 159, 163 (2d Cir. 1990), to argue that financial accounting benefits arising from tax savings constitute a good business purpose.

Tax-indifferent parties

A number of cases have involved transactions structured to allocate income for Federal tax purposes to a tax-indifferent party, with a corresponding deduction, or favorable basis result, to a taxable person. The income allocated to the tax-indifferent party for tax purposes was structured to exceed any actual economic income to be received by the tax indifferent party from the transaction. Courts have sometimes concluded that a particular type of transaction did not satisfy the economic substance doctrine.[16] In other cases, courts have indicated that the substance of the transaction did not support the form of income allocations asserted by the taxpayer, and have questioned whether asserted business purpose or other standards were met.[17]

Description of Proposal

The provision clarifies and enhances the application of the economic substance doctrine. Under the provision, in a case in which a court determines that the economic substance doctrine is relevant to a transaction (or a series of transactions), such transaction (or series of transactions) has economic substance (and thus satisfies the economic substance doctrine) only if the taxpayer establishes that (1) the transaction changes in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position, and (2) the taxpayer has a substantial non-Federal-tax purpose for entering into such transaction. The provision provides a uniform definition of economic substance, but does not alter the flexibility of the courts in other respects.

If the tax benefits are clearly consistent with all applicable provisions of the Code and the purposes of such provisions, it is not intended that such tax benefits be disallowed if the only reason for such disallowance is that the transaction fails the economic substance doctrine as defined in this provision. Thus, the provision does not change current law standards used by courts in determining *when* to utilize an economic substance analysis.[18]

The provision is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages. Among[19] these basic decisions are (1) the choice between capitalizing a business enterprise with debt or equity; (2) the choice between foreign

---

[16] *See, e.g., ACM Partnership v. Commissioner,* 157 F.3d 231 (3d Cir. 1998), *aff'g* 73 T.C.M. (CCH) 2189 (1997), *cert. denied* 526 U.S. 1017 (1999).

[17] *See, e.g., TIFD- III-E, Inc. v. United States,* 459 F.3d 220 (2d Cir. 2006).

[18] *See, e.g.,* Treas. Reg. sec. 1.269-2, stating that characteristic of circumstances in which a deduction otherwise allowed will be disallowed are those in which the effect of the deduction, credit, or other allowance would be to distort the liability of the particular taxpayer when the essential nature of the transaction or situation is examined in the light of the basic purpose or plan which the deduction, credit, or other allowance was designed by the Congress to effectuate.

[19] The examples are illustrative and not exclusive.

corporations and domestic corporations; (3) the treatment of a transaction or series of transactions as a corporate organization or reorganization under subchapter C; and (4) the ability to respect a transaction between related parties provided that the arm's length standard of section 482 is satisfied. Leasing transactions, like all other types of transactions, will continue to be analyzed in light of all the facts and circumstances.[20] As under present law, whether a particular transaction meets the requirements for specific treatment under any of these provisions can be a question of facts and circumstances. Also, the fact that a transaction does meet the requirements for specific treatment under any provision of the Code is not determinative of whether a transaction or series of transactions of which it is a part has economic substance.

The provision does not alter the court's ability to aggregate, disaggregate, or otherwise recharacterize a transaction when applying the doctrine. For example, the provision reiterates the present-law ability of the courts to bifurcate a transaction in which independent activities with non-tax objectives are combined with an unrelated item having only tax-avoidance objectives in order to disallow those tax motivated benefits.[21]

Conjunctive analysis

The provision clarifies that the economic substance doctrine involves a conjunctive analysis – there must be a judicial inquiry regarding the objective effects of the transaction on the taxpayer's economic position as well as an inquiry regarding the taxpayer's subjective motives for engaging in the transaction. Under the provision, a transaction must satisfy both tests, i.e., the transaction must change in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and the taxpayer must have a substantial non-Federal-tax purpose[22] for entering into such transaction, in order to satisfy the economic substance doctrine. This clarification eliminates the disparity that exists among the circuits regarding the application of the doctrine, and modifies its application in those circuits in which either a change in economic position or a non-tax business purpose (without having both) is sufficient to satisfy the economic substance doctrine.

---

[20] *See, e.g., Frank Lyon v. Commissioner*, 435 U.S. 561 (1978); *Coltec Industries v. United States*, 454 F.3d 1340 (Fed. Cir. 2006), *cert. denied* 127 S. Ct. 1261 (Mem) (2007).

[21] *See, e.g., Coltec Industries, Inc. v. United States*, 454 F.3d 1340 (Fed. Cir. 2006), *cert. denied* 127 S. Ct. 1261 (Mem.) (2007) ("the first asserted business purpose focuses on the wrong transaction--the creation of Garrison as a separate subsidiary to manage asbestos liabilities. . . . [W]e must focus on the transaction that gave the taxpayer a high basis in the stock and thus gave rise to the alleged benefit upon sale...") 454 F.3d 1340, 1358 (Fed. Cir. 2006). *See also ACM Partnership v. Commissioner*, 157 F.3d at 256 n.48; *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 613 (1938) ("A given result at the end of a straight path is not made a different result because reached by following a devious path.").

[22] A purpose of reducing non-Federal taxes is not a non-Federal-tax business purpose if (i) the transaction will effect a reduction in both Federal and non-Federal taxes because of similarities between Federal tax law and the law of the other jurisdiction and (ii) the reduction of Federal taxes is greater than or substantially coextensive with the reduction of non-Federal taxes.

Non-Federal-tax business purpose

Under the provision, a taxpayer's non-Federal-tax purpose for entering into a transaction (the second prong in the analysis) must be "substantial."[23]

An objective of achieving a favorable accounting treatment for financial reporting purposes will not itself be treated as a substantial non-Federal-tax purpose if the origin of such financial accounting benefit is a reduction of Federal income tax.[24] For example, a transaction that is expected to increase financial accounting income as a result of generating tax deductions or losses without a corresponding financial accounting charge (i.e., a permanent book-tax difference)[25] should not be considered to have a substantial non-Federal-tax purpose unless a substantial non-Federal-tax purpose exists apart from the financial accounting benefits.[26]

Profit potential

---

[23] See, e.g., Treas. Reg. sec. 1.269-2(b) (stating that a distortion of tax liability indicating the principal purpose of tax evasion or avoidance might be evidenced by the fact that "the transaction was not undertaken for reasons germane to the conduct of the business of the taxpayer"). Similarly, in *ACM Partnership v. Commissioner*, 73 T.C.M. (CCH) 2189 (1997), the court stated:

> Key to [the determination of whether a transaction has economic substance] is that the transaction must be rationally related to a useful nontax purpose that is plausible in light of the taxpayer's conduct and useful in light of the taxpayer's economic situation and intentions. Both the utility of the stated purpose and the rationality of the means chosen to effectuate it must be evaluated in accordance with commercial practices in the relevant industry. A rational relationship between purpose and means ordinarily will not be found unless there was a reasonable expectation that the nontax benefits would be at least commensurate with the transaction costs. [citations omitted]

[24] However, if the tax benefits are clearly contemplated and expected by the language and purpose of the relevant authority, such tax benefits should not be disallowed solely because the transaction results in a favorable accounting treatment. An example is the repealed foreign sales corporation rules.

[25] This includes tax deductions or losses that are anticipated to be recognized in a period subsequent to the period the financial accounting benefit is recognized. For example, FAS 109 in some cases permits the recognition of financial accounting benefits prior to the period in which the tax benefits are recognized for income tax purposes.

[26] Claiming that a financial accounting benefit constitutes a substantial non-tax purpose fails to consider the origin of the accounting benefit (i.e., reduction of taxes) and significantly diminishes the purpose for having a substantial non-tax purpose requirement. See, e.g., *American Electric Power, Inc. v. United States*, 136 F. Supp. 2d 762, 791-92 (S.D. Ohio 2001) ("AEP's intended use of the cash flows generated by the [corporate-owned life insurance] plan is irrelevant to the subjective prong of the economic substance analysis. If a legitimate business purpose for the use of the tax savings 'were sufficient to breathe substance into a transaction whose only purpose was to reduce taxes, [then] every sham tax-shelter device might succeed,'") (citing *Winn-Dixie v. Commissioner*, 113 T.C. 254, 287 (1999)); *aff'd*, 326 F3d 737 (6th Cir. 2003).

Under the provision, a taxpayer may rely on factors other than profit potential to demonstrate that a transaction results in a meaningful change in the taxpayer's economic position or that the taxpayer has a substantial non-Federal-tax purpose for entering into such transaction. The provision does not require or establish a specified minimum return that will satisfy the profit potential test. However, if a taxpayer relies on a profit potential, the present value of the reasonably expected pre-Federal tax profit must be substantial in relation to the present value of the expected net Federal tax benefits that would be allowed if the transaction were respected.[27] In addition, in determining pre-Federal-tax profit, foreign taxes are treated as expenses to the extent provided in regulations.[28]

<u>**Other rules**</u>

The Secretary may prescribe regulations that provide (1) exemptions from the application of the provision, and (2) other rules as may be necessary or appropriate to carry out the purposes of the provision.

No inference is intended as to the proper application of the economic substance doctrine under present law. In addition, the provision shall not be construed as altering or supplanting any other common law doctrine; and the provision shall be construed as being additive to any such other doctrine.

Effective Date

The provision applies to transactions entered into after the date of enactment.

2. Penalty for understatements attributable to transactions lacking economic substance, etc.

Present Law

<u>**General accuracy-related penalty**</u>

An accuracy-related penalty under section 6662 applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement. If the correct income tax liability exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 (or, in the case of corporations, by the lesser of (a) 10 percent of the correct tax (or

---

[27] Thus, a "reasonable possibility of profit" alone will not be sufficient to establish that a transaction has economic substance.

[28] There is no intention to restrict the ability of the courts to consider the appropriate treatment of foreign taxes in particular cases, as under present law. However, the Treasury Department may, in addition, choose to require treatment of foreign taxes as expenses as provided in regulations.

$10,000 if greater) or (b) $10 million), then a substantial understatement exists and a penalty may be imposed equal to 20 percent of the underpayment of tax attributable to the understatement.[29] Except in the case of tax shelters,[30] the amount of any understatement is reduced by any portion attributable to an item if (1) the treatment of the item is supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment. The Treasury Secretary may prescribe a list of positions which the Secretary believes do not meet the requirements for substantial authority under this provision.

The section 6662 penalty generally is abated (even with respect to tax shelters) in cases in which the taxpayer can demonstrate that there was "reasonable cause" for the underpayment and that the taxpayer acted in good faith.[31] The relevant regulations provide that reasonable cause exists where the taxpayer "reasonably relies in good faith on an opinion based on a professional tax advisor's analysis of the pertinent facts and authorities [that] . . . unambiguously concludes that there is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged" by the IRS.[32]

Listed transactions and reportable avoidance transactions

In general

A separate accuracy-related penalty under section 6662A applies to "listed transactions" and to other "reportable transactions" with a significant tax avoidance purpose (hereinafter referred to as a "reportable avoidance transaction"). The penalty rate and defenses available to avoid the penalty vary depending on whether the transaction was adequately disclosed.

Both listed transactions and reportable transactions are allowed to be described by the Treasury department under section 6707A(c), which imposes a penalty for failure adequately to report such transactions under section 6011. A reportable transaction is defined as one that the Treasury Secretary determines is required to be disclosed because it is determined to have a potential for tax avoidance or evasion.[33] A listed transaction is defined as a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified

---

[29] Sec. 6662.

[30] A tax shelter is defined for this purpose as a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement if a significant purpose of such partnership, other entity, plan, or arrangement is the avoidance or evasion of Federal income tax. Sec. 6662(d)(2)(C).

[31] Sec. 6664(c).

[32] Treas. Reg. sec. 1.6662-4(g)(4)(i)(B); Treas. Reg. sec. 1.6664-4(c).

[33] Sec. 6707A(c)(1).

by the Secretary as a tax avoidance transaction for purposes of the reporting disclosure requirements.[34]

Disclosed transactions

In general, a 20-percent accuracy-related penalty is imposed on any understatement attributable to an adequately disclosed listed transaction or reportable avoidance transaction.[35] The only exception to the penalty is if the taxpayer satisfies a more stringent reasonable cause and good faith exception (hereinafter referred to as the "strengthened reasonable cause exception"), which is described below. The strengthened reasonable cause exception is available only if the relevant facts affecting the tax treatment are adequately disclosed, there is or was substantial authority for the claimed tax treatment, and the taxpayer reasonably believed that the claimed tax treatment was more likely than not the proper treatment.

Undisclosed transactions

If the taxpayer does not adequately disclose the transaction, the strengthened reasonable cause exception is not available (i.e., a strict-liability penalty generally applies), and the taxpayer is subject to an increased penalty equal to 30 percent of the understatement.[36] However, a taxpayer will be treated as having adequately disclosed a transaction for this purpose if the IRS Commissioner has separately rescinded the separate penalty under section 6707A for failure to disclose a reportable transaction.[37] The IRS Commissioner is authorized to do this only if the failure does not relate to a listed transaction and only if rescinding the penalty would promote compliance and effective tax administration.[38]

A public entity that is required to pay a penalty for an undisclosed listed or reportable transaction must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).[39]

Determination of the understatement amount

---

[34] Sec. 6707A(c)(2).

[35] Sec. 6662A(a).

[36] Sec. 6662A(c).

[37] Sec. 6664(d).

[38] Sec. 6707A(d).

[39] Sec. 6707A(e).

The penalty is applied to the amount of any understatement attributable to the listed or reportable avoidance transaction without regard to other items on the tax return. For purposes of this provision, the amount of the understatement is determined as the sum of: (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return);[40] and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item.

Except as provided in regulations, a taxpayer's treatment of an item shall not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of when the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.[41]

Strengthened reasonable cause exception

A penalty is not imposed with respect to any portion of an understatement if it is shown that there was reasonable cause for such portion and the taxpayer acted in good faith. Such a showing requires: (1) adequate disclosure of the facts affecting the transaction in accordance with the regulations under section 6011;[42] (2) that there is or was substantial authority for such treatment; and (3) that the taxpayer reasonably believed that such treatment was more likely than not the proper treatment. For this purpose, a taxpayer will be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief: (1) is based on the facts and law that exist at the time the tax return (that includes the item) is filed; and (2) relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that (a) a return will not be audited, (b) the treatment will not be raised on audit, or (c) the treatment will be resolved through settlement if raised.[43]

A taxpayer may (but is not required to) rely on an opinion of a tax advisor in establishing its reasonable belief with respect to the tax treatment of the item. However, a taxpayer may not rely on an opinion of a tax advisor for this purpose if the opinion (1) is provided by a "disqualified tax advisor" or (2) is a "disqualified opinion."

Disqualified tax advisor

[40] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income. Sec. 6662A(b).

[41] Sec. 6662A(e)(3).

[42] See the previous discussion regarding the penalty for failing to disclose a reportable transaction.

[43] Sec. 6664(d).

A disqualified tax advisor is any advisor who: (1) is a material advisor[44] and who participates in the organization, management, promotion,or sale of the transaction or is related (within the meaning of section 267(b) or 707(b)(1)) to any person who so participates; (2) is compensated directly or indirectly[45] by a material advisor with respect to the transaction; (3) has a fee arrangement with respect to the transaction that is contingent on all or part of the intended tax benefits from the transaction being sustained; or (4) as determined under regulations prescribed by the Secretary, has a disqualifying financial interest with respect to the transaction.

A material advisor is considered as participating in the "organization" of a transaction if the advisor performs acts relating to the development of the transaction. This may include, for example, preparing documents: (1) establishing a structure used in connection with the transaction (such as a partnership agreement); (2) describing the transaction (such as an offering memorandum or other statement describing the transaction); or (3) relating to the registration of the transaction with any federal, state,or local government body.[46] Participation in the "management" of a transaction means involvement in the decision-making process regarding any business activity with respect to the transaction. Participation in the "promotion or sale" of a transaction means involvement in the marketing or solicitation of the transaction to others. Thus, an advisor who provides information about the transaction to a potential participant is involved in the promotion or sale of a transaction, as is any advisor who recommends the transaction to a potential participant.

Disqualified opinion

An opinion may not be relied upon if the opinion: (1) is based on unreasonable factual or legal assumptions (including assumptions as to future events); (2) unreasonably relies upon representations, statements, finding or agreements of the taxpayer or any other person; (3) does not identify and consider all relevant facts; or (4) fails to meet any other requirement prescribed by the Secretary.

---

[44] The term "material advisor" means any person who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, or carrying out any reportable transaction, and who derives gross income in excess of $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons ($250,000 in any other case). Sec. 6111(b)(1).

[45] This situation could arise, for example, when an advisor has an arrangement or understanding (oral or written) with an organizer, manager, or promoter of a reportable transaction that such party will recommend or refer potential participants to the advisor for an opinion regarding the tax treatment of the transaction.

[46] An advisor should not be treated as participating in the organization of a transaction if the advisor's only involvement with respect to the organization of the transaction is the rendering of an opinion regarding the tax consequences of such transaction. However, such an advisor may be a "disqualified tax advisor" with respect to the transaction if the advisor participates in the management, promotion,or sale of the transaction (or if the advisor is compensated by a material advisor, has a fee arrangement that is contingent on the tax benefits of the transaction, or as determined by the Secretary, has a continuing financial interest with respect to the transaction).

Coordination with other penalties

To the extent a penalty on an understatement is imposed under section 6662A, that same amount of understatement is not also subject to the accuracy-related penalty under section 6662(a) or to the valuation misstatement penalties under section 6662(e) or 6662(h). However, such amount of understatement is included for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1) and for purposes of identifying an underpayment under the section 6663 fraud penalty.

The penalty imposed under section 6662A does not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Description of Proposal

The provision imposes a new, stronger penalty for an understatement attributable to any transaction that lacks economic substance (referred to in the statute as a "noneconomic substance transaction understatement").[47] The penalty rate is 30 percent (reduced to 20 percent if the taxpayer adequately discloses the relevant facts in accordance with regulations prescribed under section 6011). No exceptions (including the reasonable cause or rescission rules) to the penalty are available (i.e., the penalty is a strict-liability penalty). Under the provision, outside opinions or in-house analysis would not protect a taxpayer from imposition of a penalty if it is determined that the transaction lacks economic substance or is not respected as described below.

A "noneconomic substance transaction" means any transaction if (1) the transaction lacks economic substance (as defined in the provision regarding the clarification of the economic substance doctrine).[48] For this purpose, a transaction is one that lacks economic substance if it is disregarded as a result of the application of the same factors and analysis that is required under the provision for an economic substance analysis, even if a court uses a different term to describe the doctrine.

For purposes of the bill, the calculation of an "understatement" is made in the same manner as in the present law provision relating to accuracy-related penalties for listed and reportable avoidance transactions (sec. 6662A). Thus, the amount of the understatement under the provision would be determined as the sum of (1) the product of the highest corporate or

---

[47] Thus, unlike the present-law accuracy-related penalty under section 6662A (which applies only to listed and reportable avoidance transactions), the new penalty under the provision applies to any transaction that lacks economic substance.

[48] That provision generally provides that in any case in which a court determines that the economic substance doctrine is relevant, a transaction has economic substance only if: (1) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (2) the taxpayer has a substantial non-Federal-tax purpose for entering into such transaction. Specific other rules also apply. See "Explanation of Provision" for the immediately preceding provision, "Clarification of the economic substance doctrine."

individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return),[49] and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item. In essence, the penalty will apply to the amount of any understatement attributable solely to a non-economic substance transaction.

As in the case of the understatement penalty for reportable and listed transactions under present law section 6662A(e)(3), except as provided in regulations, the taxpayer's treatment of an item will not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of the date the taxpayer is first contacted regarding an examination of such return or such other date as specified by the Secretary.

As in the case of the understatement penalty for undisclosed reportable transactions under present law section 6707A, a public entity that is required to pay a penalty under the provision (but in this case, regardless of whether the transaction was disclosed) must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

Regardless of whether the transaction was disclosed, a penalty under the provision cannot be asserted until there has been a review and approval by the Chief Counsel of the Internal Revenue Service (or, if so delegated, a branch chief within the office of Chief Counsel) and the taxpayer has had the opportunity to submit a written statement in connection with that review. Once the penalty has been asserted following such National Office review, the penalty cannot be compromised for purposes of a settlement without approval of the Chief Counsel (or, if so delegated, a branch chief within the office of Chief Counsel). The penalty can be compromised in such event only to the extent the underlying understatement with respect to which it was asserted is also compromised. Furthermore, the IRS is required to keep records summarizing the application of this penalty and providing a description of each penalty compromised under the provision and the reasons for the compromise. If a final adjudication of a court determines that the economic substance doctrine does not apply, then a noneconomic substance penalty asserted by the IRS in that case would not apply.

Any understatement on which a penalty is imposed under the provision will not be subject to the accuracy-related penalty under section 6662 or under 6662A (accuracy-related penalties for listed and reportable avoidance transactions). However, an understatement under the provision is taken into account for purposes of determining whether any understatement (as

---

[49] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses that would (without regard to section 1211) be allowed for such year, would be treated as an increase in taxable income.

defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1). The penalty imposed under the provision will not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Effective Date

The provision applies to transactions entered into after the date of enactment.

3. Denial of deduction for interest on underpayments attributable to noneconomic substance transactions

Present Law

No deduction for interest is allowed for interest paid or accrued on any underpayment of tax which is attributable to the portion of any reportable transaction understatement with respect to which the relevant facts were not adequately disclosed.[50] The Secretary of the Treasury is authorized to define reportable transactions for this purpose.[51]

Description of Proposal

The provision extends the disallowance of interest deductions to interest paid or accrued on any underpayment of tax which is attributable to any noneconomic substance underpayment (whether or not disclosed).

Effective Date

The provision applies to transactions entered into after the date of enactment

---

[50] Sec. 162(m). Under section 6664(d)(2)(A), in such a case of nondisclosure, the taxpayer also is not entitled to the "reasonable cause and good faith" exception to the section 6662A penalty for a reportable transaction understatement.

[51] See the description of present law under the immediately preceding proposal, "Penalty for understatements attributable to transactions lacking economic substance, etc."

THE UNITED STATES – PERU TRADE PROMOTION AGREEMENT IMPLEMENTATION ACT

STATEMENT OF ADMINISTRATIVE ACTION

This Statement of Administrative Action ("Statement") is submitted to the Congress in compliance with section 2105(a)(1)(C)(ii) of the Bipartisan Trade Promotion Authority Act of 2002 ("TPA Act") and accompanies the implementing bill for the free trade agreement that the United States has concluded with Peru. The bill approves and makes statutory changes necessary or appropriate to implement the Agreement, which the United States Trade Representative signed on April 12, 2006, and amended through a Protocol signed in Washington, D.C. on June 24, 2007 and Lima on June 25, 2007.

As is the case with earlier Statements of Administrative Action submitted to the Congress in connection with fast-track bills, this Statement represents an authoritative expression by the Administration concerning its views regarding the interpretation and application of the Agreement, both for purposes of U.S. international obligations and domestic law. The Administration understands that it is the expectation of the Congress that future administrations will observe and apply the interpretations and commitments set out in this Statement. In addition, since this Statement will be approved by the Congress at the time it approves the implementing bill for this Agreement, the interpretation of the Agreement included in this Statement carries particular authority.

This Statement describes significant administrative actions proposed to implement U.S. obligations under the Agreement.

In addition, incorporated into this Statement are two other statements required under section 2105(a) of the TPA Act: (1) an explanation of how the implementing bill and proposed administrative action will change or affect existing law; and (2) a statement setting forth the reasons why the implementing bill and proposed administrative action are necessary or appropriate to carry out the Agreement. The Agreement does not change the provisions of any agreement the United States has previously negotiated with Peru.

For ease of reference, this Statement generally follows the organization of the Agreement, with the exception of grouping the general provisions of the Agreement (Chapters One and Nineteen through Twenty-Three) at the beginning of the discussion.

For each chapter of the Agreement, the Statement describes the pertinent provisions of the implementing bill, explaining how the bill changes or affects existing law, and stating why those provisions are necessary or appropriate to implement the Agreement. The Statement then describes the administrative action proposed to implement the particular chapter of the Agreement, explaining how the proposed action changes existing administrative practice or authorizes further action and stating why such actions are necessary or appropriate to implement the Agreement.

It should be noted that this Statement does not, for the most part, discuss those many instances in which U.S. law or administrative practice will remain unchanged under the Agreement. In many cases, U.S. laws and regulations are already in conformity with the obligations assumed under the Agreement.

Finally, references in this Statement to particular sections of U.S. statutes are based on those statutes in effect as of the date this Statement was submitted to the Congress.

Chapters:
One (Initial Provisions and General Definitions)
Nineteen (Transparency)
Twenty (Administration of the Agreement and Trade Capacity Building)
Twenty-One (Dispute Settlement)
Twenty-Two (Exceptions)
Twenty-Three (Final Provisions)

1. Implementing Bill

a. Congressional Approval

Section 101(a) of the implementing bill provides Congressional approval for the Agreement and this Statement, as required by sections 2103(b)(3) and 2105(a)(1) of the TPA Act.

b. Entry into Force

Article 23.4 requires the United States and Peru to exchange written notifications that their respective legal requirements for the entry into force of the Agreement have been fulfilled. The exchange of notifications is a necessary condition for the Agreement's entry into force. Section 101(b) of the implementing bill authorizes the President to exchange notes with Peru to provide for the Agreement to enter into force for the United States on or after January 1, 2008. The exchange of notes is conditioned on a determination by the President that Peru has taken measures necessary to comply with those of its obligations that are to take effect at the time the Agreement enters into force.

Certain provisions of the Agreement become effective after the Agreement enters into force. For example, the Agreement provides Peru up to three years to comply with certain provisions relating to customs administration. Likewise, the Agreement allots Peru 18 months to begin carrying out certain transparency provisions governing financial services measures. In addition, the Agreement's obligations regarding intellectual property rights, specifically those governing the ratification of certain international agreements, patent restoration, and the enforcement of certain copyright protections apply to Peru at prescribed times after the Agreement enters into force.

c. Relationship to Federal Law

Section 102(a) of the bill establishes the relationship between the Agreement and U.S. law. The implementing bill, including the authority granted to federal agencies to promulgate implementing regulations, is intended to bring U.S. law fully into compliance with U.S. obligations under the Agreement. The bill accomplishes that objective with respect to federal legislation by amending existing federal statutes that would otherwise be inconsistent with the Agreement and, in certain instances, by creating entirely new provisions of law.

Section 102(a) clarifies that no provision of the Agreement will be given effect under

domestic law if it is inconsistent with federal law, including provisions of federal law enacted or amended by the bill. Section 102(a) will not prevent implementation of federal statutes consistent with the Agreement, where permissible under the terms of such statutes. Rather, the section reflects the Congressional view that necessary changes in federal statutes should be specifically enacted rather than provided for in a blanket preemption of federal statutes by the Agreement.

The Administration has made every effort to include all laws in the implementing bill and to identify all administrative actions in this Statement that must be changed in order to conform with the new U.S. rights and obligations arising from the Agreement. Those include both regulations resulting from statutory changes in the bill itself and changes in laws, regulations, rules, and orders that can be implemented without a change in the underlying U.S. statute.

Accordingly, at this time it is the expectation of the Administration that no changes in existing federal law, rules, regulations, or orders other than those specifically indicated in the implementing bill and this Statement will be required to implement the new international obligations that the United States will assume under the Agreement. This is without prejudice to the President's continuing responsibility and authority to carry out U.S. law and agreements. As experience under the Agreement is gained over time, other or different administrative actions may be taken in accordance with applicable law to implement the Agreement. If additional action is called for, the Administration will seek legislation from Congress or, if a change in regulation is required, follow normal agency procedures for amending regulations.

d. Relationship to State Law

The Agreement's rules generally cover state and local laws and regulations, as well as those at the federal level. There are a number of exceptions to, or limitations on, this general rule, however, particularly in the areas of government procurement, labor and environment, investment, and cross-border trade in services and financial services.

The Agreement does not automatically "preempt" or invalidate state laws that do not conform to the Agreement's rules, even if a dispute settlement panel were to find a state measure inconsistent with the Agreement. The United States is free under the Agreement to determine how it will conform with the Agreement's rules at the federal and non-federal level. The Administration is committed to carrying out U.S. obligations under the Agreement, as they apply to the states, through the greatest possible degree of state-federal consultation and cooperation.

Section 102(b)(1) of the bill makes clear that only the United States is entitled to bring an action in court in the event that there is an unresolved conflict between a state law, or the application of a state law, and the Agreement. The authority conferred on the United States under this paragraph is intended to be used only as a "last resort," in the unlikely event that efforts to achieve consistency through consultations have not succeeded.

The reference in section 102(b)(2) of the bill to the business of insurance is required by virtue of section 2 of the McCarran-Ferguson Act (15 U.S.C. 1012). That section states that no federal statute shall be construed to supersede any state law regulating or taxing the business of

insurance unless the federal statute "specifically relates to the business of insurance." Certain provisions of the Agreement (for example, Chapter Twelve, relating to financial services) do apply to state measures regulating the insurance business, although "grandfathering" provisions in Chapter Twelve exempt existing inconsistent (*i.e.*, "non-conforming") measures.

Given the provision of the McCarran-Ferguson Act, the implementing act must make specific reference to the business of insurance in order for the Agreement's provisions covering the insurance business to be given effect with respect to state insurance law. Insurance is otherwise treated in the same manner under the Agreement and the implementing bill as other financial services under the Agreement.

e. Private Lawsuits

Section 102(c) of the implementing bill precludes any private right of action or remedy against a federal, state, or local government, or against a private party, based on the provisions of the Agreement. A private party thus could not sue (or defend a suit against) the United States, a state, or a private party on grounds of consistency (or inconsistency) with the Agreement. The provision also precludes a private right of action attempting to require, preclude, or modify federal or state action on grounds such as an allegation that the government is required to exercise discretionary authority or general "public interest" authority under other provisions of law in conformity with the Agreement.

With respect to the states, section 102(c) represents a determination by the Congress and the Administration that private lawsuits are not an appropriate means for ensuring state compliance with the Agreement. Suits of this nature may interfere with the Administration's conduct of trade and foreign relations and with suitable resolution of disagreements or disputes under the Agreement.

Section 102(c) does not preclude a private party from submitting a claim against the United States to arbitration under Chapter Ten (Investment) of the Agreement or seeking to enforce an award against the United States issued pursuant to such arbitration. The provision also would not preclude any agency of government from considering, or entertaining argument on, whether its action or proposed action is consistent with the Agreement, although any change in agency action would have to be consistent with domestic law.

f. Implementing Regulations

Section 103(a) of the bill provides the authority for new or amended regulations to be issued, and for the President to proclaim actions implementing the provisions of the Agreement, as of the date the Agreement enters into force. Section 103(b) of the bill requires that, whenever possible, all federal regulations required or authorized under the bill and those proposed in this Statement as necessary or appropriate to implement immediately applicable U.S. obligations under the Agreement are to be developed and promulgated within one year of the Agreement's entry into force. In practice, the Administration intends, wherever possible, to amend or issue the other regulations required to implement U.S. obligations under the Agreement at the time the Agreement enters into force. The process for issuing regulations pursuant to this authority will

comply with the requirements of the Administrative Procedures Act, including requirements to provide notice of and an opportunity for public comment on such regulations. If issuance of any regulation will occur more than one year after the date provided in section 103(b), the officer responsible for issuing such regulation will notify the relevant committees of both Houses of Congress of the delay, the reasons for such delay, and the expected date for issuance of the regulation. Such notice will be provided at least 30 days prior to the end of the one-year period.

g. Dispute Settlement

Section 105(a) of the bill authorizes the President to establish within the Department of Commerce an office responsible for providing administrative assistance to dispute settlement panels established under Chapter Twenty-One of the Agreement. This provision enables the United States to implement its obligations under Article 20.3.1 of the Agreement. This office will not be an "agency" within the meaning of 5 U.S.C. 552, consistent with treatment provided under other U.S. free trade agreements, including the North American Free Trade Agreement ("NAFTA") and free trade agreements with Australia, Chile, and Singapore, Morocco, Bahrain, and Oman. Thus, for example, the office will not be subject to the Freedom of Information Act or the Government in the Sunshine Act. Since they are international bodies, panels established under Chapter Twenty-One are not subject to those acts.

Section 105(b) of the bill authorizes the appropriation of funds to support the office established pursuant to section 105(a).

h. Effective Dates

Section 107(b) of the bill provides that the first three sections of the bill as well as Title I of the bill go into effect on the date of enactment of the bill.

Section 107(a) provides that the other provisions of the bill and the amendments to other statutes made by the bill take effect on the date on which the Agreement enters into force. Section 107(c) provides that the provisions of the bill (other than section 107(c) itself) and the amendments to other statutes made by the bill will cease to have effect on the date on which the Agreement terminates.

2. <u>Administrative Action</u>

No administrative changes will be necessary to implement Chapters One, Twenty, Twenty-Two, and Twenty-Three.

Article 19.1.1 of the Agreement requires each government to designate a contact point to facilitate communications regarding the Agreement. The Office of the United States Trade Representative ("USTR") will serve as the U.S. contact point for this purpose.

The Agreement calls for the United States and Peru to develop rosters of independent experts willing to serve as panelists to settle disputes between the parties that may arise under the Agreement. One roster will be available for most types of disputes, while a specialized roster

will be established to address disputes regarding the Agreement's financial services provisions. USTR will consult with the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate ("Trade Committees") as it develops rosters of panelists. USTR will provide the Trade Committees with the names of the experts it is considering, and detailed background information on each, at least 30 days before submitting the names of any nominees to Peru.

Chapter Two (National Treatment and Market Access for Goods)

1. Implementing Bill

a. Proclamation Authority

Section 201(a)(1) of the bill grants the President authority to implement by proclamation U.S. rights and obligations under Chapter Two of the Agreement through the application or elimination of customs duties and tariff-rate quotas ("TRQs"). Section 201(a)(1) authorizes the President to:

- modify or continue any duty;
- keep in place duty-free or excise treatment; or
- impose any duty

that the President determines to be necessary or appropriate to carry out or apply Articles 2.3, 2.5, 2.6, 3.3.13, and Annex 2.3 of the Agreement.

The proclamation authority with respect to Article 2.3 authorizes the President to provide for the continuation, phase-out, and elimination, according to the Schedule of the United States to Annex 2.3 of the Agreement, of customs duties on imports from Peru that meet the Agreement's rules of origin.

The proclamation authority with respect to Articles 2.5 and 2.6 authorizes the President to provide for the elimination of duties on particular categories of imports from Peru. Article 2.5 pertains to the temporary admission of certain goods, such as commercial samples, goods intended for display at an exhibition, and goods necessary for carrying out the business activity of a person who qualifies for temporary entry into the United States. Article 2.6 pertains to the importation of goods: (i) returned to the United States after undergoing repair or alteration in Peru; or (ii) sent from Peru for repair or alteration in the United States.

Sections 201(a)(2) of the bill address the status of Peru as a designated beneficiary country under the Generalized System of Preferences.

Section 201(a)(2) of the bill requires the President to withdraw beneficiary country status under the Generalized System of Preferences from Peru on the date the Agreement takes effect.

Section 201(b) of the bill authorizes the President, subject to the consultation and layover provisions of section 104 of the bill, to:

- modify or continue any duty;
- modify the staging of any duty elimination set out in Annex 2.3, pursuant to an agreement with Peru under Article 2.3.4;
- keep in place duty-free or excise treatment; or
- impose any duty

by proclamation whenever the President determines it to be necessary or appropriate to maintain the general level of reciprocal and mutually advantageous concessions with respect to Peru provided by the Agreement.

Section 104 of the bill sets forth consultation and layover steps that must precede the President's implementation of any duty modification by proclamation. This would include, for example, modifications of duties under section 201(b) of the bill. Under the consultation and layover provisions, the President must obtain the advice of the appropriate private sector advisory committees (pursuant to section 135 of the Trade Act of 1974) and the ITC on the proposed action. The President must submit a report to the Trade Committees setting forth the action proposed, the reasons for the proposed action, and the advice of the private sector and the ITC. The bill sets aside a 60-day period following the date of transmittal of the report for the President to consult with the Trade Committees on the action. Following the expiration of the 60-day period, the President may proclaim the action.

The President may initiate the consultation and layover process under section 104 of the bill on enactment of the bill. However, under section 103(a), any modifying proclamation cannot take effect until the Agreement enters into force. In addition to modifications of customs duties, these provisions apply to other Presidential proclamation authority provided in the bill that is subject to consultation and layover, such as authority to implement a proposal to modify the Agreement's specific rules of origin pursuant to an agreement with Peru under Article 4.14 of the Agreement.

Section 201(c) of the bill provides for the conversion of existing specific or compound rates of duty for various goods to *ad valorem* rates for purposes of implementing the Agreement's customs duty reductions. (A compound rate of duty for a good would be a rate of duty stated, for example, as the sum of X dollars per kilogram plus Y percent of the value of the good.)

Section 201(d) of the bill directs the President to take such action as may be necessary to ensure that imports of goods subject to TRQs do not disrupt the orderly marketing of commodities in the United States. This provision will be implemented consistent with Article

2.15 of the Agreement. Any agency action pursuant to this provision will be taken in accordance with regulations promulgated after providing notice and opportunity for public comment.

b. Agricultural Safeguard

Section 202 of the bill implements the agricultural safeguard provisions of Article 2.18 and Annex 2.18 of the Agreement. Article 2.18 permits the United States to impose an "agricultural safeguard measure," in the form of additional duties, on imports of certain goods of Peru specified in the Schedule of the United States to Annex 2.18 of the Agreement that exceed the volume thresholds set out in that annex.

Section 202(a) of the bill provides the overall contour of the agricultural safeguard rules, including definitions of terms used in the agricultural safeguard provisions. Section 202(a)(1) defines the applicable normal trade relations (most-favored-nation) ("NTR (MFN)") rate of duty for purposes of the agricultural safeguard. Under the Agreement, the sum of the duties assessed under an agricultural safeguard and the applicable rate of duty in the Schedule of the United States to Annex 2.3 of the Agreement may not exceed the general NTR (MFN) rate of duty.

Section 202(a)(2) of the bill defines the "schedule rate of duty" for purposes of the agricultural safeguard as the rate of duty for a good set out in the Schedule of the United States to Annex 2.3 of the Agreement.

Section 202(a)(3) of the bill specifies the products that may be subject to an agricultural safeguard measure. These goods must qualify as originating goods under section 203, except that operations performed in or material obtained from the United States will be considered as if the operations were performed in, and the material was obtained from, a country that is not a party to the Agreement.

Section 202(b) of the bill provides for the Secretary of the Treasury (the "Secretary") to impose agricultural safeguard duties and explains how the additional duties are to be calculated. The additional duties are triggered in any year when the volume of imports of the good from Peru exceeds 130 percent of the in-quota quantity allocated to Peru for the good in that calendar year in the Schedule of the United States to Annex 2.3 of the Agreement. (The in-quota quantities for goods are set out in the Schedule of the United States to Annex 2.3 of the Agreement on a calendar-year basis beginning with "year one." Year one refers to the calendar year in which the Agreement enters into force.) The additional duties remain in effect only until the end of the calendar year in which they are imposed.

Section 202(b)(3) of the bill implements Article 2.18.6 of the Agreement by directing the Secretary within 60 days of the date on which the Secretary first assesses an agricultural safeguard duty on a good to notify Peru and provide it with supporting data.

Section 202(c) of the bill implements Article 2.18.4 of the Agreement by establishing that no additional duty may be applied on a good if, at the time of entry, the good is subject to a safeguard measure under the procedures set out in Subtitle A of Title III of the bill or under the safeguard procedures set out in chapter 1 of Title II of the Trade Act of 1974.

Section 202(d) of the bill provides that the agricultural safeguard provision ceases to apply with respect to a good on the date on which duty-free treatment must be provided to that good under the Schedule of the United States to Annex 2.3 of the Agreement.

c. Customs User Fees

Section 204 of the bill implements U.S. commitments under Article 2.10.4 of the Agreement, regarding customs user fees on originating goods, by amending section 13031(b) of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(b)). The amendment provides for the immediate elimination of the merchandise processing fee for goods qualifying as originating goods under Article 3.3, Annex 3-A or Chapter Four of the Agreement. Customs processing of goods qualifying as originating goods under the Agreement will be financed by money from the General Fund of the Treasury. This is necessary to ensure that the United States complies with obligations under the General Agreement on Tariffs and Trade 1994 by limiting fees charged for the processing of non-originating imports to amounts commensurate with the processing services provided. That is, fees charged on such non-originating imports will not be used to finance the processing of originating imports.

2. Administrative Action

a. Temporary Admission of Goods and Goods Entered After Repair or Alteration

As discussed above, section 201(a)(1) of the bill authorizes the President to proclaim duty-free treatment for certain goods to carry out Article 2.5 (temporary admission of certain goods) and Article 2.6 (repair or alteration of certain goods) of the Agreement. The Secretary will issue regulations to carry out this portion of the proclamation.

b. Agricultural Safeguard

The Secretary will issue regulations implementing the agricultural safeguard provisions of section 202. It is the Administration's intent that agricultural safeguard measures will be applied whenever the volume thresholds specified in the Agreement have been met.

Chapter Three (Textiles and Apparel)

1. Implementing Bill

a. Handloomed, Handmade, or Folklore Articles

The proclamation authority granted to the President under section 201(a)(1) includes authority to implement Article 3.3.13 of the Agreement by providing duty-free treatment for Peruvian textile or apparel articles that the United States and Peru agree are handloomed,

handmade, or folklore articles, and are certified as such by Peru's competent authority.

b. Textile or Apparel Safeguard

Article 3.1 of the Agreement makes remedies available to domestic textile and apparel industries that have sustained or are threatened by serious damage from imports of textile or apparel goods for which duties have been reduced or eliminated under the Agreement. It also sets forth procedures for obtaining such remedies. The Administration does not anticipate that the Agreement will result in injurious increases in textile or apparel imports from the other Agreement countries. Nevertheless, the Agreement's textile or apparel safeguard procedure will ensure that relief is available if needed.

The safeguard mechanism applies when, as a result of the reduction or elimination of a customs duty under the Agreement, textile or apparel goods of Peru are being imported into the United States in such increased quantities, in absolute or relative terms, and under such conditions as to cause serious damage or actual threat thereof to a U.S. industry producing like or directly competitive goods. In these circumstances, Article 3.1 permits the United States to increase duties on the imported goods to a level that does not exceed the lesser of the prevailing U.S. NTR (MFN) duty rate for the good or the U.S. NTR (MFN) duty rate in effect at the time the Agreement entered into force.

Subtitle B of Title III of the bill (sections 321 through 328) implements the Agreement's textile and apparel safeguard.

Section 321(a) establishes that an interested party may file a request for a textile or apparel safeguard measure with the President, who must review the request to determine whether to commence consideration of the request on its merits. Under section 321(b), if the President determines that the request contains information necessary to warrant consideration on the merits, the President must provide notice in the *Federal Register* stating that the request will be considered and seeking public comments on the request. The notice will contain a summary of the request itself and the dates by which comments and rebuttals must be received. Subject to protection of confidential business information, if any, the full text of the request will be made available on the Department of Commerce, International Trade Administration's website.

Section 322 sets out the procedures to be followed in considering the request. Section 322(a)(1) of the bill provides for the President to determine whether, as a result of the reduction or elimination of a duty provided for under the Agreement, a "Peruvian textile or apparel article" is being imported into the United States in such increased quantities, in absolute terms or relative to the domestic market for that article, and under such conditions that imports of the article cause serious damage, or actual threat thereof, to a domestic industry producing an article that is like, or directly competitive with, the imported article. Section 301(2) of the bill defines "Peruvian textile or apparel article" to mean an article listed in the Annex to the World Trade Organization ("WTO") Agreement on Textiles and Clothing (other than a good listed in Annex 3-C of the Agreement) that qualifies as an originating good under section 203(b) of the bill. The President's determination corresponds to the determination required under Article 3.1.1 of the

Agreement. Section 322(a)(2) of the bill includes criteria for determining serious damage or actual threat thereof, consistent with Article 3.1.2 of the Agreement.

Section 322(b) of the bill identifies the relief that the President may provide to a U.S. industry that the President determines is facing serious damage or actual threat thereof. Such relief may consist of an increase in tariffs to the lesser of: (i) the NTR (MFN) duty rate in place for the textile or apparel article at the time the relief is granted; or (ii) the NTR (MFN) duty rate for that article on the day before the Agreement entered into force.

Section 323 of the bill provides that the maximum period of relief under the textile or apparel safeguard shall be three years in the aggregate. The initial period of import relief may be up to two years. The President may extend the relief for up to one year, however, if he determines that continuation is necessary to remedy or prevent serious damage and to facilitate adjustment, and that the domestic industry is, in fact, adjusting to import competition.

Section 324 of the bill provides that relief may not be granted to an article under the textile and apparel safeguard if: (i) relief previously has been granted to that article under the textile and apparel safeguard; or (ii) the article is subject, or becomes subject, to a safeguard measure under (a) Chapter Eight of the Agreement (corresponding to Subtitle A of Title III of the bill), or (b) chapter 1 of Title II of the Trade Act of 1974.

Section 325 of the bill provides that on the date import relief terminates, imports of the textile or apparel article that was subject to the safeguard action will be subject to the rate of duty that would have been in effect on that date in the absence of the relief.

Section 326 of the bill provides that authority to provide relief under the textile and apparel safeguard will expire five years after the date on which the Agreement enters into force.

Under Article 3.1.7 of the Agreement, if the United States provides relief to a domestic industry under the textile and apparel safeguard, it must provide Peru "mutually agreed trade liberalizing compensation in the form of concessions having substantially equivalent trade effects or equivalent to the value of the additional duties expected to result from the [safeguard]." If the United States and Peru are unable to agree on trade liberalizing compensation, that country may increase tariffs equivalently on U.S. goods. The obligation to provide compensation (and the right to increase tariffs absent agreement on compensation) terminates when the safeguard relief ends.

Section 123 of the Trade Act of 1974 (19 U.S.C. 2133), as amended, authorizes the President to provide trade compensation for global safeguard measures taken pursuant to chapter 1 of title II of the Trade Act of 1974. Section 327 of the implementing bill extends that authority to measures taken pursuant to the Agreement's textile or apparel safeguard provisions.

Finally, section 328 of the bill provides that confidential business information submitted in the course of consideration of a request for a textile or apparel safeguard may not be released absent the consent of the party providing the information. It also provides that a party submitting

confidential business information in a textile or apparel safeguard proceeding must submit a non-confidential version of the information or a summary of the information.

c. Enforcement of Textile and Apparel Rules of Origin

In addition to lowering barriers to trade in textile and apparel goods, the Agreement includes anti-circumvention provisions designed to ensure the accuracy of claims of origin and to prevent circumvention of laws, regulations, and procedures affecting such trade. Article 3.2 of the Agreement provides for verifications to determine the accuracy of claims of origin for textile or apparel goods, and to determine that exporters and producers are complying with applicable laws, regulations, and procedures regarding trade in textile or apparel goods.

Under Articles 3.2.3 and 3.2.4 of the Agreement, at the request of the United States, the government of Peru must conduct a verification. The object of a verification under Article 3.2.3(a)(i) is to determine whether a claim of origin for a textile or apparel good is accurate. The object of a verification under Article 3.2.3(a)(ii) is to determine whether an exporter or producer is complying with applicable customs laws, regulations, and procedures regarding trade in textile or apparel goods, including those implementing international agreements. The United States may assist in the verification or, at the request of the government of Peru, conduct the verification itself. A verification may entail visits by officials of Peru and the United States to the premises of a textile or apparel exporter or producer in Peru.

Pursuant to Article 3.2.7 of the Agreement, the United States may take appropriate action during and after a verification, including, depending on the nature of the verification, by suspending or denying preferential tariff treatment for textile or apparel goods exported or produced by the person subject to the verification, detaining the goods, or denying them entry into the United States.

Section 208 of the bill implements Article 3.2 of the Agreement. Under section 208(a), the President may direct the Secretary to take "appropriate action" while a verification that the Secretary has requested is being conducted. Section 208(b) provides that, depending on the nature of the verification, the action may include: (i) suspending preferential tariff treatment for textile or apparel goods that the person subject to the verification has produced or exported if the Secretary believes there is insufficient information to sustain a claim for such treatment; (ii) denying preferential tariff treatment to such goods if the Secretary decides that a person has provided incorrect information to support a claim for such treatment; (iii) detaining such goods if the Secretary considers there is not enough information to determine their country of origin; and (iv) denying entry to such goods if the Secretary determines that a person has provided incorrect information on their origin.

Under section 208(c), the President may also direct the Secretary to take "appropriate action" after a verification has been completed. Under section 208(d), depending on the nature of the verification, the action may include: (i) denying preferential tariff treatment under the Agreement to textile or apparel goods that the person subject to the verification has exported or produced if the Secretary considers there is insufficient information to support a claim for such treatment or determines that a person has provided incorrect information to support a claim for

such treatment; and (ii) denying entry to such goods if the Secretary decides that a person has provided incorrect information regarding their origin or that there is insufficient information to determine their origin. Unless the President sets an earlier date, any such action may remain in place until the Secretary obtains enough information to decide whether the exporter or producer that was subject to the verification is complying with applicable customs rules or whether a claim that the goods qualify for preferential tariff treatment or originate in an Agreement country is accurate.

Under section 208(e), the Secretary may publish the name of a person that the Secretary has determined: (i) is engaged in circumvention of applicable laws, regulations, or procedures affecting trade in textile or apparel goods; or (ii) has failed to demonstrate that it produces, or is capable of producing, textile or apparel goods.

d. Fabrics, Yarns, or Fibers Not Available in Commercial Quantities

Under the specific rules of origin for textile and apparel goods set out in Annex 3-A of the Agreement, fabrics, yarns, or fibers that are not available in commercial quantities in a timely manner in the United States and Peru are treated as if they originate in the United States or Peru, regardless of their actual origin, when used as inputs in the production of textile or apparel goods. Annex 3-B lists certain fabrics, yarns, and fibers that the governments of the United States and Peru have agreed are unavailable in the region.

In addition, Article 3.3.5 of the Agreement provides that the United States may add fabrics, yarns, or fibers to the list in certain circumstances. First, Article 3.3.5(e) of the Agreement provides that the United States may, after consultations with Peru add any fabrics or yarns that it has determined under its regional trade preference programs before the Agreement enters into force to be unavailable in the United States in commercial quantities in a timely manner. These regional trade preference program provisions are set out in: section 112(b)(5)(B) of the African Growth and Opportunity Act (19 U.S.C. § 3721(b)), section 204(b)(3)(B)(ii) of the Andean Trade Preference Act (19 U.S.C. § 3203(b)(3)(B)(ii)), and section 213(b)(2)(A)(v)(II) of the Caribbean Basin Economic Recovery Act (19 U.S.C. § 2703(b)(2)(A)(v)(II)).

Second, if the United States determines, at the request of an "interested entity" (a potential or actual purchaser or seller, or the government of Peru), that a fabric, yarn, or fiber is unavailable in commercial quantities in a timely manner in Peru and the United States, or if it determines that no interested entity objects to the request, the United States will add the material to the list – in a restricted or unrestricted quantity. In addition, within six months of adding a material to the list in Annex 3-B, the United States may remove any restriction it has imposed on the product.

Article 3.3.6 authorizes the United States, in response to a request from an interested entity, either to remove a material from the list or impose a restriction on any material it has added to the list in an unrestricted quantity. The United States may take this action beginning six months after it determines, in response to a request, that the material has become commercially available in Peru or the United States.

Section 203(o)(2) of the bill provides authority for the President to carry out the provision in Article 3.3.5(e) of the Agreement pursuant to which the United States may, after consultations with Peru, add materials to the list that it has determined are unavailable in commercial quantities in a timely manner in the United States under its regional trade preference programs (the African Growth and Opportunity Act, the Andean Trade Preference Act, and the Caribbean Basin Economic Recovery Act) before the Agreement enters into force.

Section 203(o)(4) of the bill implements those provisions of Article 3.3 that provide for the United States to modify the list of materials in Annex 3-B after the Agreement enters into force.

Specifically, subparagraph (C)(i) provides that an interested entity may request the President to determine that a fabric, yarn, or fiber is not available in commercial quantities in Peru and the United States and to proclaim that the material is included in the list in Annex 3-B.

Subparagraph (C)(ii) authorizes the President to determine whether the material is commercially available in a timely manner in Peru or the United States. Subparagraph (C)(iii) provides that if the President determines that the material is not commercially available in a timely manner in Peru and the United States, or if no interested entity has objected, he may issue a proclamation adding the fabric, yarn, or fiber to the Annex 3-B list in a restricted or unrestricted quantity. The President normally must issue the proclamation within 30 business days of receiving a request. However, subparagraph (C)(iv)(II) provides that the President may take up to 44 business days if the President decides he lacks sufficient information to make the determination within 30 business days. Subparagraph (C)(v) provides for proclamations to take effect when published in the *Federal Register*.

Subparagraph (C)(vi) provides that within six months after adding a fabric, yarn, or fiber to the list in Annex 3-B in a restricted quantity, the President may eliminate the restriction if he determines that the fabric, yarn, or fiber is not available in commercial quantities in a timely manner in Peru and the United States.

Subparagraph (D) implements Article 3.3.5(c) of the Agreement. It provides that in the unlikely event that the President takes no action in response to a request to add a material to the list, the material is automatically added in an unrestricted quantity beginning 45 business days after the request was submitted, or 60 days after the request was submitted if the President has determined under subparagraph (C)(iv) that he lacks sufficient information to make the determination within 30 business days.

Under subparagraph (E)(i), an interested entity may request the President to limit the amount of any fabric, yarn, or fiber that the United States has included on the list in Annex 3-B in an unrestricted quantity, or to remove such a material from the list entirely. Under subparagraph (E)(ii), an interested entity may submit such a request beginning six months after the product was placed on the list in an unrestricted amount. Subparagraph (E)(iii) provides for the President to issue a proclamation carrying out a request if he determines within 30 business days after the request is submitted that the material is available in commercial quantities in a timely manner in Peru or the United States. Subparagraph (E)(iv) provides that this type of

proclamation may take effect no earlier than six months after it is published in the *Federal Register*.

Subparagraph (F) calls for the President to establish procedures for interested entities to submit requests for changes in the Annex 3-B list and to submit comments and supporting evidence before the President determines whether to change the list.

2. Administrative Action

a. Handloomed, Handmade, or Folklore Articles

The President will authorize the Committee for the Implementation of Textile Agreements ("CITA") to consult with Peru to determine which, if any, textile or apparel goods from Peru will be treated as handloomed, handmade, or folklore articles. CITA is an interagency entity created by Executive Order 11651 that carries out U.S. textile trade policies, as directed by the President. The President will delegate to CITA his authority under the bill to provide duty-free treatment for these articles.

b. Textile and Apparel Safeguard

CITA will perform the function of receiving requests for textile or apparel safeguard measures under section 321 of the bill, making determinations of serious damage or actual threat thereof under section 322(a), and providing relief under section 322(b). CITA will issue procedures for requesting such safeguard measures, for making its determinations under section 322(a), and for providing relief under section 322(b). CITA will perform these functions pursuant to a delegation of the President's authority under the bill.

c. Enforcement of Textile and Apparel Rules of Origin

Section 208 of the bill provides that the Secretary may request Peru to initiate verifications in order to determine whether claims of origin for textile or apparel goods are accurate or whether exporters and producers are complying with applicable laws, regulations, and procedures regarding trade in textile or apparel goods. The President will delegate to CITA his authority under the bill to direct appropriate U.S. officials to take an action described in section 208(b) of the bill while such a verification is being conducted. The President will also authorize CITA to direct pertinent U.S. officials to take an action described in section 208(d) after a verification is completed. If CITA decides that it is appropriate to deny preferential tariff treatment or deny entry to particular goods, CITA will issue an appropriate directive to U.S. Customs and Border Protection (CBP).

Section 208 of the bill provides the exclusive basis in U.S. law for CITA to direct appropriate action implementing Article 3.2 of the Agreement.

d. Fabrics, Yarns, or Fibers Not Available in Commercial Quantities

The President will delegate to CITA his authority under section 203(o)(4) of the bill, which establishes procedures for changing the list of fabrics, yarns, or fibers not available in commercial quantities in a timely manner in Agreement countries set out in Annex 3-B of the Agreement.

CITA will publish procedures under which interested entities may request that CITA: (i) add a fabric, yarn, or fiber to the list in Annex 3-B; (ii) eliminate a restriction on a fabric, yarn, or fiber within six months after the item was added to the list in a restricted quantity; (iii) remove a fabric, yarn, or fiber from the list; or (iv) restrict the quantity of a fabric, yarn, or fiber that was added to the list in an unrestricted quantity or with respect to which CITA previously eliminated a restriction. These procedures will set out the information required to be submitted with a request. CITA will publish notice of requests that meet these requirements. CITA will provide an opportunity for interested entities to submit comments and evidence regarding a request, and to rebut evidence that other interested entities have submitted, before CITA makes a determination.

CITA will make determinations under section 203(o)(4) on a case-by-case basis taking into account factors relevant to the request. Such factors ordinarily would include the physical and technical specifications of the fabric, yarn, or fiber that is the subject of the request, as well as evidence demonstrating the extent to which manufacturers in Peru or the United States are able to supply the item in commercial quantities in a timely manner. CITA will provide public notice of its determinations.

Chapter Four (Rules of Origin)

1. Implementing Bill

a. General

Section 203 of the implementing bill codifies the general rules of origin set forth in Chapter Four of the Agreement. These rules apply only for the purposes of this bill and for the purposes of implementing the customs duty treatment provided under the Agreement. An originating good for the purposes of this bill would not necessarily be a good of or import from Peru for the purposes of other U.S. laws or regulations.

Under the general rules, there are three basic ways for a good of Peru to qualify as an "originating" good, and therefore be eligible for preferential treatment when it is imported into the United States. First, a good is originating if it is "wholly obtained or produced entirely in the territory of Peru, the United States, or both." The term "good wholly obtained or produced entirely in the territory of Peru, the United States, or both" is defined in section 203(n)(5) of the bill and includes, for example, minerals extracted from the territory of Peru, the United States, or both, animals born and raised in the territory of Peru, the United States, or both, and waste and scrap derived from production of goods that takes place in the territory of Peru, the United

States, or both.

The term "good wholly obtained or produced entirely in the territory of Peru, the United States, or both" includes "recovered goods." These are parts resulting from the disassembly of used goods that are brought into good working condition in order to be combined with other recovered goods and other materials to form a "remanufactured good." The term "remanufactured good" is separately defined in section 203(n)(20) to mean an industrial good assembled in the territory of Peru or the United States, or both, and falling within Chapter 84, 85, 87 or 90 of the HTS or heading 9402 (with the exception of goods under heading 8418 or 8516) that: (i) is entirely or partially comprised of recovered goods; and (ii) has a similar life expectancy and enjoys a factory warranty similar to such a good that is new.

Second, the general rules of origin provide that a good is "originating" if the good is produced in the territory of Peru, the United States, or both, and the materials used to produce the good that are not themselves originating goods are transformed in such a way as to cause their tariff classification to change and to meet other requirements, as specified in Annex 3-A or Annex 4.1 of the Agreement. Such additional requirements include, for example, performing certain processes or operations related to textile or apparel goods in the territory of Peru, the United States, or both, or meeting regional value content requirements, sometimes in conjunction with changes in tariff classification.

Third, the general rules of origin provide that a good is "originating" if the good is produced entirely in the territory of Peru, the United States, or both, exclusively from materials that themselves qualify as originating goods.

The remainder of section 203 of the implementing bill sets forth specific rules related to determining whether a good meets the Agreement's specific requirements to qualify as an originating good. For example, section 203(c) implements provisions in Annex 4.1 of the Agreement that require certain goods to have at least a specified percentage of "regional value content" to qualify as originating goods. It prescribes alternative methods for calculating regional value content, as well as a specific method that must be used in the case of certain automotive goods. Section 203(f) provides that a good is not disqualified as an originating good if it contains *de minimis* quantities of non-originating materials that do not undergo a change in tariff classification. Other provisions in section 203 address how materials are to be valued, how to determine whether fungible goods and materials qualify as originating or non-originating, as well as a variety of other matters.

Section 203(l) allows a good to be shipped through a third country without losing its status as an originating good, provided certain conditions are met. While in a third country, the good may not be further produced, except that it may be unloaded, reloaded, or preserved, if necessary. Whether the good is unloaded, reloaded, or preserved in a third country, or is simply shipped through the third country, the good must, while in that country, remain under customs control.

Section 203(l) recognizes that, in modern commerce, a good may not be directly shipped from Peru to the United States, or vice versa; for example, shipments may be consolidated at an

interim port. At the same time, in order to ensure that the preferential tariff treatment under the Agreement inures to producers in Peru and the United States, rather than producers in third countries, an originating good may not be further produced in a country that is not a party to the Agreement. Requiring the good to remain under customs control provides greater traceability of the good to ensure that no further production occurred.

b. Proclamation Authority

Section 203(o)(1) of the bill authorizes the President to proclaim the specific rules of origin in Annex 3-A and Annex 4.1 of the Agreement, as well as any additional subordinate rules necessary to carry out the customs duty provisions of the bill consistent with the Agreement. In addition, section 203(o)(3) gives authority to the President to modify certain of the Agreement's specific origin rules by proclamation, subject to the consultation and layover provisions of section 104 of the bill. (See item 1.a of Chapter Two, above.)

Various provisions of the Agreement expressly contemplate that Peru and the United States may agree to modify the Agreement's rules of origin. Article 4.14 calls for two governments to consult regularly after the Agreement's entry into force to discuss proposed modifications to Annex 4.1. Article 20.1.3(b) of the Agreement authorizes the Free Trade Commission to approve proposed modifications to any of the Agreement's origin rules. Such modifications are to be implemented in accordance with each country's applicable legal procedures. In addition, Article 3.3.2 of the Agreement calls for the Parties to consult at either Party's request to consider whether rules of origin for particular textile or apparel goods should be modified.

Section 203(o)(3) of the bill expressly limits the President's authority to modify by proclamation specific rules of origin pertaining to textile or apparel goods (listed in Chapters 50 through 63 of the HTS and identified in Annex 3-A of the Agreement). Those rules of origin may be modified by proclamation within one year of enactment of the implementing bill, to correct typographical, clerical, or other non-substantive technical errors. However, Section 203(o)(4), discussed above, provides the President with authority to proclaim modifications to the rules of origin for textile or apparel articles that are not available in commercial quantities in the United States and Peru.

c. Disclosure of Incorrect Information and Denial of Preferential Treatment

Article 4.19.3 of the Agreement provides that a Party may not impose a penalty on an importer who makes an invalid claim for preferential tariff treatment under the Agreement if the importer did not engage in negligence, gross negligence, or fraud in making the claim or, after discovering that the claim is invalid, promptly and voluntarily corrects the claim and pays any customs duty owing. Article 4.18.5 of the Agreement provides if an importing country determines through verification that an importer, exporter, or producer has engaged in a pattern of conduct in providing false or unsupported certifications or other representations that a good qualifies as originating, it may suspend preferential tariff treatment under the Agreement for identical goods covered by any subsequent certifications or other representations that that person may make. The suspension may continue until the importing country determines that the

importer, exporter, or producer is in compliance with applicable laws and regulations governing claims for preferential tariff treatment under the Agreement.

Section 205(a) of the bill implements Article 4.19.3 for the United States by amending section 592(c) of the Tariff Act of 1930 (19 U.S.C. 1592(c)). Section 205(b) of the bill implements Article 4.18.5 for the United States by amending section 514 of the Tariff Act of 1930 (19 U.S.C. 1514).

d. Claims for Preferential Tariff Treatment

Article 4.19.5 of the Agreement provides that an importer may claim preferential tariff treatment for an originating good within one year of importation, even if no such claim was made at the time of importation. In seeking a refund for excess duties paid, the importer must provide to the customs authorities information substantiating that the good was in fact an originating good at the time of importation.

Section 206 of the bill implements U.S. obligations under Article 4.19.5 of the Agreement by amending section 520(d) of the Tariff Act of 1930 (19 U.S.C. 1520(d)) to allow an importer to claim preferential tariff treatment for originating goods within one year of their importation.

e. Exporter and Producer Certifications

Article 4.15 of the Agreement provides that an importer may base a claim for preferential tariff treatment on either (i) a written or electronic certification by the importer, exporter, or producer, or (ii) the importer's knowledge that the good is an originating good, including through reasonable reliance on information in the importer's possession that the good is an originating good. (The Agreement allows certain exceptions, for example, for goods with a customs value less than or equal to $1,500.) If an exporter issues a certification, it must either be based on the person's knowledge that the good is originating or supported by a separate certification issued by the producer.

Article 4.20 of the Agreement sets out rules governing incorrect certifications of origin issued by exporters or producers. Where an exporter or producer becomes aware that a certification of origin contains or is based on incorrect information, it must promptly and voluntarily notify in writing every person to whom the exporter or producer issued the certification of any change that could affect the accuracy or validity of the certification. If it does so, the United States may not impose a penalty.

Section 205(a) of the bill implements U.S. obligations under Article 4.20 by amending section 592 of the Tariff Act of 1930 (19 U.S.C. 1592). New subsection (i) of section 592, as added by section 205(a), imposes penalties on exporters and producers that issue false PTPA certifications of origin through fraud, gross negligence, or negligence. These penalties do not apply where an exporter or producer corrects an error in the manner described above.

f. Recordkeeping Requirements

Article 4.17 of the Agreement sets forth record keeping requirements that each government must apply to its importers. U.S. obligations under Article 4.17 regarding importers are satisfied by current law, including the record keeping provisions in section 508 of the Tariff Act of 1930 (19 U.S.C. 1508).

Article 4.17 also sets forth record keeping requirements that each government must apply to exporters and producers issuing certifications of origin for goods exported under the Agreement. Section 207 of the bill implements Article 4.17 for the United States by amending the customs record keeping statute (section 508 of the Tariff Act of 1930).

As added by section 207 of the bill, subsection (h) of section 508 of the Tariff Act of 1930 defines the terms "PTPA certification of origin" and "records and supporting documents." It then provides that a U.S. exporter or producer that issues a PTPA certification of origin must make, keep, and, if requested pursuant to rules and regulations promulgated by the Secretary, render for examination and inspection a copy of the certification and such records and supporting documents. The exporter or producer must keep these records and supporting documents for five years from the date it issues the certification. New subsection (h) of section 508 of the Tariff Act of 1930 sets forth penalties for violations of this record keeping requirement.

2. Administrative Action

The rules of origin in Chapter Four of the Agreement are intended to direct the benefits of customs duty elimination under the Agreement principally to firms producing or manufacturing goods in Peru and the United States. For this reason, the rules ensure that, in general, a good is eligible for benefits under the Agreement only if it is: (i) wholly produced or obtained in the territory of Peru, the United States, or both; or (ii) undergoes substantial processing in the territory of Peru, the United States, or both.

a. Claims for Preferential Treatment

Section 209 of the bill authorizes the Secretary to prescribe regulations necessary to carry out the tariff-related provisions of the bill, including the rules of origin and customs user fee provisions. The Secretary will use this authority in part to promulgate any regulations necessary to implement the Agreement's provisions governing claims for preferential treatment. Under Article 4.15 of the Agreement, an importer may claim preferential treatment for a good based on either (i) a written or electronic certification by the importer, exporter, or producer, or (ii) the importer's knowledge, including through reasonable reliance on information in the importer's possession, that the good is originating. A certification need not be in a prescribed format, but must include the elements set out in Article 4.15.2 of the Agreement. Under Article 4.19 of the Agreement, an importing Party must grant a claim for preferential tariff treatment unless its customs officials issue a written determination that the claim is invalid as a matter of law or fact.

b. Verification

Under Article 4.18 of the Agreement, customs officials may use a variety of methods to verify claims that goods imported from the other Party satisfy the Agreement's rules of origin. Article 3.2 sets out special procedures for verifying claims that textile or apparel goods imported from the other Party meet the Agreement's origin rules. (See item 1.c of Chapter Three, above.) U.S. officials will carry out verifications under Articles 4.18 and 3.2 of the Agreement pursuant to authorities under current law. For example, section 509 of the Tariff Act of 1930 (19 U.S.C. 1509) provides authority to examine records and issue summonses to determine liability for duty and ensure compliance with U.S. customs laws.

Chapter Five (Customs Administration and Trade Facilitation)

1. Implementing Bill

No statutory changes will be required to implement Chapter Five.

2. Administrative Action

a. Inquiry Point

Article 5.1.2 of the Agreement requires each government to designate an inquiry point for inquiries from interested persons on customs matters. CBP will serve as the U.S. inquiry point for this purpose. Consistent with Article 5.1.2, CBP will post information on the Internet at "www.cbp.gov" on how interested persons can make customs-related inquiries.

b. Advance Rulings

Treasury regulations for advance rulings under Article 5.10 of the Agreement (including on classification, valuation, origin, and qualification as an originating good) will parallel in most respects existing regulations in Part 177 of the Customs Regulations for obtaining advance rulings. For example, a ruling may be relied on provided that the facts and circumstances represented in the ruling are complete and do not change. The regulations will make provision for modifications and revocations as well as for delaying the effective date of a modification where the firm in question has relied on an existing ruling. Advance rulings under the Agreement will be issued within 150 days of receipt of all information reasonably required to process the application for the ruling.

Chapter Six (Sanitary and Phytosanitary Measures)

No statutory or administrative changes will be required to implement Chapter Six.

Chapter Seven (Technical Barriers to Trade)

1. Implementing Bill

No statutory changes will be required to implement Chapter Seven.

2. Administrative Action

Article 7.7 of the Agreement establishes an inter-governmental Committee on Technical Barriers to Trade ("TBT"). A USTR official responsible for TBT matters or trade relations with Peru will serve as the U.S. coordinator for the committee.

Chapter Eight (Trade Remedies)

1. Implementing Bill

Subtitle A of Title III of the bill implements in U.S. law the safeguard provisions set out in Chapter Eight of the Agreement. Subtitle C of Title III of the bill implements the global safeguard provisions set out in Chapter Eight of the Agreement. (As discussed under Chapter Three, above, Subtitle B of Title III of the bill implements the textile or apparel safeguard provisions of the Agreement.)

a. Safeguard Measures

Subtitle A of Title III of the bill, sections 311 through 316, authorizes the President, after an investigation and affirmative determination by the ITC (or a determination that the President may consider to be an affirmative determination), to suspend duty reductions or impose duties temporarily up to NTR (MFN) rates on a "Peruvian article" when, as a result of the reduction or elimination of a duty under the Agreement, the article is being imported into the United States in such increased quantities and under such conditions as to be a substantial cause of serious injury or threat of serious injury to a domestic industry that produces a like or directly competitive good. The standards and procedures set out in these provisions closely parallel the procedures set forth in sections 201 through 204 of the Trade Act of 1974 (19 U.S.C. 2251 – 2254).

Section 301(1) defines the term "Peruvian article" to mean a good that qualifies as an originating good under section 203(b) of the bill.

Section 311 of the bill provides for the filing of petitions with the ITC and for the ITC to conduct safeguard investigations initiated under Subtitle A. Section 311(a) provides that a petition requesting a safeguard action may be filed with the ITC by an entity that is "representative of an industry." As under section 202(a)(1) of the Trade Act of 1974, the term "entity" is defined to include a trade association, firm, certified or recognized union, or a group of workers.

Section 311(b) sets out the standard to be used by the ITC in undertaking an investigation and making a determination in Subtitle A safeguard proceedings.

Section 311(c) makes applicable by reference several provisions of the Trade Act of 1974. These are the definition of "substantial cause" in section 202(b)(1)(B), the factors listed in section 202(c) applied in making determinations, the hearing requirement of section 202(b)(3), and the provisions of section 202(i) permitting confidential business information to be made available under protective order to authorized representatives of parties to a safeguard investigation.

Section 311(d) exempts from investigation under this section Peruvian articles that have previously been the basis for according relief under Subtitle A to a domestic industry.

Section 312(a) establishes deadlines for ITC determinations following an investigation under section 311(b). The ITC must make its injury determination within 120 days of the date on which it initiates an investigation.

Section 312(b) makes applicable the provisions of section 330(d) of the Tariff Act of 1930, which will apply when the ITC Commissioners are equally divided on the question of injury or remedy.

Under section 312(c), if the ITC makes an affirmative determination, or a determination that the President may consider to be an affirmative determination, under section 312(a), it must find and recommend to the President the amount of import relief that is necessary to remedy or prevent the serious injury and to facilitate the efforts of the domestic industry to make a positive adjustment to import competition. The relief that the ITC may recommend is limited to that authorized in section 313(c). Similar to procedures under the global safeguards provisions in current law, section 312(c) of the bill provides that only those members of the ITC who agreed to the affirmative determination under section 312(a) may vote on the recommendation of relief under section 312(c).

Under section 312(d), the ITC is required to transmit a report to the President not later than 30 days after making its injury determination. The ITC's report must include: (i) the ITC's determination(s) under section 312(a) and the reasons supporting the determination(s); (ii) if the determination under section 312(a) is affirmative or may be considered to be affirmative by the President, any findings and recommendations for import relief and an explanation of the basis for each recommendation; and (iii) any dissenting or separate views of ITC Commissioners. Section 312(e) requires the ITC to publish its report promptly and to publish a summary of the report in the *Federal Register*.

Section 313(a) of the bill directs the President, subject to section 313(b), to take action not later than 30 days after receiving a report from the ITC containing an affirmative determination or a determination that the President may consider to be an affirmative determination. The President must provide import relief to the extent that the President determines is necessary to remedy or prevent the injury the ITC has found and to facilitate the efforts of the domestic industry to make a positive adjustment to import competition. Under

section 313(b), the President is not required to provide import relief if the President determines that the relief will not provide greater economic and social benefits than costs.

Section 313(c)(1) sets forth the nature of the relief that the President may provide. In general, the President may take action in the form of:

- a suspension of further reductions in the rate of duty to be applied to the articles in question; or

- an increase in the rate of duty on the articles in question to a level that does not exceed the lesser of the existing NTR (MFN) rate or the NTR (MFN) rate of duty imposed on the day before the Agreement entered into force.

Under section 313(c)(2), if the relief the President provides has a duration greater than one year, the relief must be subject to progressive liberalization at regular intervals over the course of its application.

Section 313(d) provides that the period for import relief under a Subtitle A safeguard may not exceed four years in the aggregate. The initial period of import relief may be of up to two years. The President may extend the period of import relief provided by up to two years, however, if he determines that continuation of relief is necessary to remedy or prevent serious injury and to facilitate adjustment to import competition, and that there is evidence that the industry is making a positive adjustment to import competition. That determination must follow an affirmative determination (or a determination that the President may consider to be an affirmative determination) by the ITC to the same effect.

Section 313(e) specifies the duty rate to be applied to Peruvian articles after termination of a safeguard action. On the termination of relief, the rate of duty for the remainder of the calendar year is to be the rate that was scheduled to have been in effect one year after the initial provision of import relief. For the rest of the duty phase-out period, the President may set the duty:

- at the rate called for under the Schedule of the United States to Annex 2.3 of the Agreement; or

- in a manner that eliminates the duty in equal annual stages ending on the date set out in that Schedule.

Section 313(f) exempts from relief any article that is: (i) subject to import relief under the global safeguard provisions in U.S. law (chapter 1 of Title II of the Trade Act of 1974); (ii) subject to import relief under subtitle B; or (iii) subject to an assessment of additional duty under subsection (b) of section 202.

Section 314 provides that the President's authority to take action under Subtitle A expires ten years after the date on which the Agreement enters into force, unless the period for

elimination of duties on a good exceeds ten years. In such case, relief may be provided until the expiration of the period for elimination of duties.

Section 315 allows the President to provide trade compensation to Peru, as required under Article 8.5 of the Agreement, when the United States imposes relief through a Subtitle A safeguard action. Section 315 provides that for purposes of section 123 of the Trade Act of 1974, which allows the President to provide compensation for global safeguards, any relief provided under section 313 will be treated as an action taken under the global safeguard provisions of U.S. law (sections 201 through 204 of the Trade Act of 1974).

Section 316 amends section 202(a) of the Trade Act of 1974 to provide that the procedures in section 332(g) of the Tariff Act of 1930 with respect to the release of confidential business information are to apply to Subtitle A safeguard investigations.

The Administration has not provided classified information to the ITC in past safeguard proceedings and does not expect to provide such information in future proceedings. In the unlikely event that the Administration provides classified information to the ITC in such proceedings, that information would be protected from publication in accordance with Executive Order 12958.

b. Global Safeguard Measures

Section 331 of the bill implements the global safeguard provisions of Article 8.6.2 of the Agreement. It authorizes the President, in granting global import relief under sections 201 through 204 of the Trade Act of 1974, to exclude imports of originating articles from the relief when certain conditions are present.

Specifically, section 331(a) provides that if the ITC makes an affirmative determination, or a determination that the President may consider to be an affirmative determination, in a global safeguard investigation under section 202(b) of the Trade Act of 1974, the ITC must find and report to the President whether imports of the article from Peru considered individually that qualify as originating goods under section 203(b) are a substantial cause of serious injury or threat thereof. Under section 331(b), if the ITC makes a negative finding under section 331(a) the President may exclude any imports that are covered by the ITC's finding from the global safeguard action.

2. <u>Administrative Action</u>

No administrative changes will be required to implement Chapter Eight.

Chapter Nine (Government Procurement)

1. Implementing Bill

Chapter Nine of the Agreement establishes rules that certain government entities, listed in Annex 9.1 of the Agreement, must follow in procuring goods and services. The Chapter's rules will apply whenever these entities undertake procurements valued above thresholds specified in Annex 9.1.

In order to comply with its obligations under Chapter Nine, the United States must waive the application of certain federal laws, regulations, procedures and practices that ordinarily treat foreign goods and services and suppliers of such goods and services less favorably than U.S. goods, services, and suppliers. Section 301(a) of the Trade Agreements Act of 1979 (19 U.S.C. 2511(a)) authorizes the President to waive the application of such laws, regulations, procedures, and practices with respect to "eligible products" of a foreign country designated under section 301(b) of that Act. By virtue of taking on the procurement-related obligations in Chapter Nine, Peru is eligible to be designated under section 301(b) of the Trade Agreements Act and will be so designated.

The term "eligible product" in section 301(a) of the Trade Agreements Act is defined in section 308(4)(A) of that Act for goods and services of countries and instrumentalities that are parties to the WTO Agreement on Government Procurement and countries that are parties to the NAFTA and other recent free trade agreements. Section 401 of the bill amends the definition of "eligible product" in section 308(4)(A) of the Trade Agreements Act. As amended, section 308(4)(A) will provide that, for Peru, an "eligible product" means a product or service of Peru that is covered under the Agreement for procurement by the United States. This amended definition, coupled with the President's exercise of his authority under section 301(a) of the Trade Agreements Act, will allow U.S. government entities covered by the Agreement to purchase products and services from Peru.

2. Administrative Action

As noted above, Annex 9.1 of the Agreement provides that U.S. government entities subject to Chapter Nine must apply the Chapter's rules to goods and services from Peru when they make purchases valued above certain dollar thresholds. USTR will notify the Federal Acquisition Regulatory Council ("FAR Council") of the thresholds that pertain to Peru under the Agreement. The FAR Council will then incorporate those thresholds into the Federal Acquisition Regulation in accordance with applicable procedures under the Office of Federal Procurement Policy Act.

Article 9.6.7 clarifies that a procuring entity is not precluded from preparing, adopting, or applying "technical specifications" to promote the conservation of natural resources and the environment, or to require a supplier to comply with generally applicable laws regarding fundamental principles and rights at work and acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health, in the territory in which the

good is produced or the service is performed. Thus, for example, a procuring entity is permitted to require a foreign producer to comply with laws guaranteeing freedom of association and protecting collective bargaining rights that generally apply in the territory in which the good is produced, even if that law does not apply to that foreign producer based on its location in an export processing zone.

Finally, neither this provision nor any other provision of Chapter Nine will affect application of the Davis-Bacon Act and related Acts (40 U.S.C. 3141 - 48 and 29 C.F.R. 5.1).

Chapter Ten (Investment)

1. Implementing Bill

Section 106 of the bill authorizes the United States to use binding arbitration to resolve claims by investors of Peru under Article 10.16.1(a)(i)(C) or Article 10.16.1(b)(i)(C) of the Agreement. Those articles concern disputes over certain types of government contracts, and section 106 of the bill clarifies that the United States consents to the arbitration of such disputes. No statutory authorization is required for the United States to engage in binding arbitration for other claims covered by Article 10.16. Provisions allowing arbitration of certain contract claims have regularly been included in U.S. bilateral investment treaties over recent decades, and were included in the free trade agreements with Chile, Singapore, Morocco, Central America and the Dominican Republic, and Oman.

2. Administrative Action

No administrative changes will be required to implement Chapter Ten.

Chapter Eleven (Cross-Border Trade in Services)

No statutory or administrative changes will be required to implement Chapter Eleven.

Chapter Twelve (Financial Services)

No statutory or administrative changes will be required to implement Chapter Twelve.

Chapter Thirteen (Competition Policy, Designated Monopolies, and State Enterprises)

No statutory or administrative changes will be required to implement Chapter Thirteen.

Chapter Fourteen (Telecommunications)

No statutory or administrative changes will be required to implement Chapter Fourteen.

Chapter Fifteen (Electronic Commerce)

No statutory or administrative changes will be required to implement Chapter Fifteen.

Chapter Sixteen (Intellectual Property Rights)

No statutory or administrative changes will be required to implement Chapter Sixteen.

For pharmaceutical products, Article 16.10.2(e)(i) provides an exception to the data exclusivity obligations for measures to protect public health in accordance with the Declaration on the TRIPS Agreement and Public Health (WT/MIN(01)/DEC/2) (the "Doha Declaration"). Thus, where a Party issues a compulsory license in accordance with Article 31 of the TRIPS Agreement and the Doha Declaration, the data exclusivity obligations in Chapter Sixteen will not prevent the adoption or implementation of such a public health measure. In addition, in a case in which there is no patent on the pharmaceutical product, and, therefore, no need to issue a compulsory license, the data exclusivity obligations in Chapter Sixteen will not prevent the adoption or implementation of such a measure.

Chapter Seventeen (Labor)

1. Implementing Bill

No statutory changes will be required to implement Chapter Seventeen.

2. Administrative Action

Article 17.4.1 of the Agreement establishes a Labor Affairs Council comprising cabinet-level officials from each Party. Article 17.4.5 of the Agreement calls for each government to designate an office to serve as a contact point with the other country and the public and to assist the Council in carrying out the Agreement's Labor Cooperation and Capacity Building Mechanism. The Department of Labor's Bureau of International Labor Affairs (ILAB) will serve as the U.S. contact point for this purpose.

Chapter Eighteen (Environment)

1. Implementing Bill

Annex 18.3.4 of the Agreement calls on Peru to take certain actions to enhance its forest sector governance and promote legal trade in timber products. In addition, the Annex authorizes

the United States to take steps to ensure that timber products of Peru that are exported to the United States comply with Peruvian law governing harvest of, and trade in, those products. Among other things, the United States may request Peruvian officials to conduct audits or on-site inspections of harvesting operations and timber producers in Peru and to permit U.S. compliance officers to accompany them on the inspections. The Annex authorizes the United States to detain or bar imports from a Peruvian producer under certain circumstances, such as when a producer knowingly provides false information to Peruvian or U.S. officials.

Section 501 of the bill establishes an interagency committee to oversee implementation of Annex 18.3.4. In particular, section 501 describes requests and determinations the committee may make relating to audits and verifications pursuant to the Annex. Section 501 also provides authority to the committee to request verifications and take appropriate enforcement measures, including directing CBP to apply import measures of the type and in the circumstances contemplated under the Annex.

Section 502 of the bill provides that no later than the beginning of the second and third years after the Agreement enters into force, and periodically thereafter, USTR will report to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives on steps the United States and Peru have taken to carry out Annex 18.3.4 and on activities related to forest sector governance carried out under the Environmental Cooperation Agreement entered into between the United States and Peru.

2. Administrative Action

USTR and other agencies will monitor progress of Peru in implementing the broad range of obligations contained in Annex 18.3.4, including those designed to further improve Peru's governance in the forest sector over the period of 18 months from the date of entry-into-force of the Agreement. In particular, USTR will work with the State Department, and other appropriate agencies, to identify specific areas in which Peru requires assistance, through capacity building, in pursuing the improvements specified in the Annex. The State Department will coordinate the interagency effort to address these specific areas under the Environmental Cooperation Agreement, as provided for in Article 18.10. Areas already identified in the Annex for possible capacity-building initiatives include: strengthening the legal, policy, and institutional framework governing the forest estate and the international trade in forest products; building institutional capacity for forest law enforcement and the international trade in forest products; improving the performance of the forest concession system in meeting economic, social, and ecological objectives; and increasing public participation and improving transparency in forest resource planning and management decision-making.

No later than 90 days after the Agreement enters into force, the President will establish the interagency committee provided for in section 501(a) and will direct the appropriate authorities in the executive branch, in consultation with USTR, to issue those measures, including agency regulations, that may be necessary to implement Annex 18.3.4. The committee, which USTR will coordinate, will comprise agencies with relevant authorities or expertise, including the Forest Service, the Animal and Plant Health Inspection Service (APHIS), the Fish and Wildlife Service (FWS), CBP, the Department of State, and other agencies, as appropriate.

Especially in the context of verifications, the Forest Service will bring to the committee, its long history of developing and implementing policies to protect and manage forest resources, particularly on government-owned and -managed lands, in a manner that enhances both resource productivity and sound environmental stewardship. The experience of APHIS and FWS in ensuring compliance with the Endangered Species Act and the Lacey Act, and in particular in making use of the enforcement tools available under those statutes, will serve to inform the committee as it determines whether particular producers or exporters are complying with Peru's laws governing its forest sector and what compliance measures, if any, may be appropriate. The State Department, through its Bureau of Oceans and International Environmental and Scientific Affairs, has worked extensively with other governments, including Peru, to address concerns relating to local and cross-border wildlife and forest issues. It is also the lead agency for administering the Environmental Cooperation Agreement with Peru, which calls for the two governments to undertake capacity-building initiatives, including in the area of sustainable management of forest resources. Finally, because the Annex contemplates enforcement measures that may include actions relating to U.S. imports, CBP's participation in the committee will be critical.

USTR will coordinate with the Forest Service, APHIS, FWS, CBP, the Department of State, and other agencies, as appropriate, in developing the report required under section 502 of the bill.

Article 18.5.1 of the Agreement establishes an Environmental Affairs Council, comprising senior-level officials with environmental responsibilities from each Party, and provides that each government will designate a contact point for carrying out the Council's work. The Department of State (Bureau of Oceans and International Environmental and Scientific Affairs), in consultation with USTR, will serve as the U.S. contact point.

JOINT COMMITTEE ON TAXATION
October 2, 2007
JCX-93-07

ESTIMATED REVENUE EFFECTS OF PROPOSED LEGISLATION IMPLEMENTING THE UNITED STATES - PERU TRADE PROMOTION AGREEMENT SCHEDULED FOR MARKUP BY THE SENATE COMMITTEE ON FINANCE ON OCTOBER 4, 2007

Fiscal Years 2008 - 2017

[Millions of Dollars]

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
1. Extend Customs User Fees (sunset 12/13/14) [1]................	DOE	---	---	---	---	---	---	---	485	---	---	---	485
2. Increase by 0.75 Percentage Points the Required Corporate Estimated Tax Payments Factor for Corporations with Assets of at Least $1 Billion for Payments Due in July, August, and September 2012.........	DOE	---	---	---	---	465	-465	---	---	---	---	465	---
NET TOTAL		---	---	---	---	**465**	**-465**	---	**485**	---	---	**465**	**485**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is assumed to be October 1, 2007.

Legend for "Effective" column: DOE = date of enactment

[1] Estimate provided by the Congressional Budget Office.

FINANCE COMMITTEE MARKUP – OCTOBER 4, 2007

COLLOQUY ON ETHANOL DRAWBACK PROVISION

STATEMENT BY SENATOR SCHUMER

Mr. Chairman, I have filed an amendment, which I will not offer, to modify the effective date of a provision in the Chairman's Mark dealing with duty drawback on ethanol imports. The provision in the bill would effectively eliminate the ability of ethanol importers to claim duty drawback on ethanol that is subsequently exported. While I oppose the underlying provision in its entirety, my amendment would merely seek to ensure that any modifications to current law approved by the Committee are done on a *prospective*, rather than a retroactive, basis.

The duty drawback rules have been a feature of the trade law since the 1700s. In essence, they allow import duties on products, substitutable products, or products manufactured with such imports which are later exported to be *drawn back* or returned from the Treasury. The rules permit a three-year period between the import and the manufacture of the product and a further six month period between the manufacture and export of the product.

The mark currently ends duty drawback on ethanol exports that occur 15 days after enactment. The problem is that ethanol imports which have already been received in this country and blended into gasoline would lose their ability to claim drawback. These imports were shipped and priced based on the importers' right to claim drawback by matching up with exports within three years of the importation. My view is that the Chairman's Mark treats importers of this one product unfairly, because it would not allow them to receive a benefit that they have been expecting under current law.

The northeast, including my state of New York, is a major importer of ethanol for two reasons: First, because we are what is referred to as "non-attainment" area, and required to burn cleaner fuel under the Clean Air Act; and second, because it is cheaper for us to obtain imported ethanol from Brazil by water than to obtain ethanol by rail from the Midwest. As the Chairman and Ranking Member know, ethanol cannot be shipped by pipeline.

There are many companies in New York and others in the region who would be affected by the retroactive nature of this provision. They brought ethanol into the country and priced the ethanol in reliance on the law that permits them to later claim drawback, and they will be out millions of dollars if this provision is not changed. They have done nothing wrong, and it is not right to change the rules in the middle of the game.

I could have filed an amendment to try to strike the provision, but I recognize that the Committee has been helpful on many other matters of importance to me and my state. Therefore, I chose to file an amendment that simply altered the effective date of the

provision to *imports* contracted for after the date of enactment, rather than *exports* shipped 15 days after enactment.

The entire provision in the Mark raises only $10 million, and almost all of that is raised in 2008, which means almost all the revenue comes from the retroactive application it to imports that have already been received in this country. That is simply unfair.

I can understand why the Senator from Iowa does not like ethanol imports, but they are important to my state. And as the Congress enacts a new, much higher, renewable fuels standard, imports will continue to play a role. In fact, the Secretary of Energy, Samuel Bodman, has said that the new RFS will make ethanol imports even more important.

I believe that the Chairman and Ranking Member, while they may not entirely agree with my point of view, understand that my arguments have some merit. While the provision is remaining in the Mark today, they have both agreed to work closely with me and my staff to see if a reasonable compromise can be reached before this bill (or the energy bill, which contains the same provision) are dealt with on the Senate floor. I thank both of them for their attention to this matter.

Opening Statement by Senator Orrin G. Hatch

Before the

Senate Committee Finance

October 4, 2007

Markup of the Heartland, Habitat, Harvest, and Horticulture Act of 2007

Mr. Chairman, thank you for holding this important mark-up this afternoon.

I know there are many important issues the Committee needs to address today but I wanted to take just a moment to address the May 10th trade deal the Administration negotiated with Peru. The amendments that I offered at the September 20th Mock Markup on Intellectual Property and Labor were important and will, I fear, become more relevant when we as a nation begin to negotiate future free trade agreements with other nations.

I will not ask the Committee members to indulge me at this time, to again restate the concerns my two amendments would have fixed. I would merely ask those interested to review the transcript of that mock markup to see the substantial concerns I outlined. Unfortunately, a majority of members on this committee were not in a position where they could support my amendments at the time and I understand the difficult decisions they had to make.

The Peruvian Agreement stands to dramatically increase the $7.7 million worth of goods that Utah businesses export to Peru every year and that amount is abundantly helpful to the Utah economy. While I am confident that my concerns remain valid, I have done what I can to address them. Now we are voting on the final implementing language and I am faced with the prospect of whether I am willing to vote in favor of the agreement and support the enormous trade benefits Utah businesses, consumers, and employees stand to gain from the agreement or whether I will vote against the agreement because the important amendments I offered were not agreed to by the Committee.

In an effort to err on the side of economic expansion and growth for all Utahns, I have decided I will vote in favor of the implementing language before us today. However, I will not give

up on improving future trade agreements in the critical areas of labor and Intellectual Property Rights.

I am grateful to you and Senator Grassley for your work on the Heartland, Habitat, Harvest, and Horticulture Act. I think it's appropriate that the Senate Finance Committee participate in the development of the Farm Bill, and I think that, overall, what we have before us is a very good proposal.

In particular, I want to thank you for your leadership in establishing a permanent disaster fund for farmers and ranchers. It would be a good thing to end the annual circus of trying to legislate a response every year to the various agriculture disasters faced by our farmers. For farmers and ranchers in Utah, our disaster relief proposals come too little, too late, and sometimes not at all.

As you know, Mr. Chairman, I filed an amendment to add $25 million to the Emergency Assistance for Livestock, Honey Bees, and Farm-raised Fish. Too often, livestock producers face disasters not covered completely by other programs, such as the Permanent Livestock Indemnity Program, which only covers livestock losses. I want to thank you very much for working with me on this amendment and helping to add an extra $15 million each year for this program.

I want to express my support for other provisions in the Mark, as well, such as the improvements and extensions of the conservation programs and the effort to promote drugs for minor species such as sheep and lambs,

I also support a number of the energy provisions included in the Mark. I am particularly supportive of the extension of the tax credit for the installation of alternative refueling property. As you know, that provision was part of the CLEAR Act, which promotes the greater use of alternative fuels and hybrid vehicles in our transportation sector. I sponsored that legislation, but it became law as part of the Energy Policy Act of 2005, only with the tremendous work and support of you and Senator Grassley, who was Chairman at the time.

Overall, Mr. Chairman, I am pleased with the 4H bill. However, I do not support some of the revenue raisers which fund the bill. As I mentioned at the last markup, I do not believe we should be raising taxes in a retroactive manner, as the SILO provision does. I also oppose the economic

substance codification provision. However, I understand that revenue raisers are hard to come by, and I will support reporting this bill today despite these revenue raisers. Thank you, Mr. Chairman.