1 EXECUTIVE COMMITTEE MEETING TO CONSIDER THE ENERGY POLICY
2 TAX INCENTIVES ACT OF 2005
3 THURSDAY, JUNE 16, 2005
4 U.S. Senate,
5 Committee on Finance,
6 Washington, DC.
7 The meeting was convened, pursuant to notice, at
8 10:46 a.m., in room SD-628, the Dirksen Senate Office
9 Building, Hon. Charles E. Grassley (chairman of the
10 committee) presiding.
11 Also present: Senators Hatch, Lott, Snowe, Kyl,
12 Thomas, Santorum, Bunning, Crapo, Baucus, Rockefeller,
13 Conrad, Jeffords, Kerry, Lincoln, Wyden, and Schumer.
14 Also present: Kolan Davis, Republican Staff Director
15 and Chief Counsel; Russ Sullivan, Democratic Staff
16 Director; Carla Martin, Chief Clerk; and Amber Williams,
17 Assistant Clerk.
18 Also present: Elizabeth Paris and Matt Jones, Tax
19 Counsel, Finance Committee; Thomas Barthold, Deputy Chief
20 of Staff, Joint Committee on Taxation; Robert Carroll,
21 Deputy Assistant Secretary for Tax Analysis, Treasury
22 Department; Christy Mistr, Mark Prather, Bill Dauster,
23 and Ryan Abraham.
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1 The Chairman. I appreciate very much members
2 getting here as early as they did on a very important
3 piece of legislation that is necessary to get out this
4 week, and join with the Energy bill on the floor next
5 week. So, I call the committee to order.
6 I hope that we can be done here by the noon hour. In
7 light of time constraints, Senator Baucus and I discussed
8 yesterday that we would just simply put our statements in
9 the record.
10 [The prepared statements of Chairman Grassley and
11 Senator Baucus appear in the appendix.]
12 The Chairman. I would turn to today's business,
13 then, and call up the Chairman's mark, which is an
14 original bill entitled, "The Energy Policy Tax Incentives
15 Act of 2005."
16 The Finance Committee staff will walk through the
17 modifications to the Chairman's mark. I would note that
18 we have Elizabeth Paris and Matt Jones, who are Tax
19 Counsels for the Finance Committee, to do that.
20 We also have Thomas Barthold, Deputy Chief of Staff
21 for the Joint Committee on Taxation, and Robert Carroll,
22 the Deputy Assistant Secretary for Tax Analysis in the
23 Treasury Department.
24 So, I would ask Mr. Barthold to make a few short
25 comments--and "short" is capitalized--on the

1 modifications. Would you please go ahead, Mr. Barthold?
2 Mr. Barthold. Thank you, Mr. Chairman.
3 The modification makes three different kinds of
4 changes to the Chairman's mark: there are some
5 modifications that directly affect provisions already in
6 the mark, there are some additional new energy tax
7 incentives added, and then there is a brief list of
8 revenue-raising provisions.
9 Would you like me to highlight a few of the
10 significant, more substantive changes?
11 The Chairman. I would like to have the five most
12 significant touched on, shortly.
13 Mr. Barthold. Five. All right.
14 Senator Baucus. Use your judgment. The most
15 important.
16 The Chairman. Or six or seven. But not 110.
17 Mr. Barthold. I will try to be judicious.
18 The modification to the Chairman's mark makes changes
19 to the Section 45 Production Tax Credit for electricity
20 from renewable energy by providing parity in the credit
21 period for all different energy resources.
22 Under present law, some have a 5-year period, some
23 have a 10-year period. The modification would make them
24 all a 5-year period. The Chairman's modification also
25 adds a new qualifying facility and resource of

1 incremental hydro power. I misspoke. It is all a 10-
2 year period. Parity at 10 years. Forgive me.
3 The modification also increases the allocation of the
4 investment credit applicable to clean coal facilities
5 from 6,500 megawatts allocated nationally to 7,500
6 megawatts allocated nationally.
7 The modification makes further addition to the
8 enhanced Oil Recovery Credit by adding deep gas wells as
9 an element of the enhanced Oil Recovery Credit.
10 Among the new energy tax incentives provided in the
11 Chairman's modification is a 10-year recovery period for
12 underground natural gas storage facilities. There is an
13 expansion of the present law Small Producer Ethanol
14 Credit and creation of a parallel credit for small
15 producers of agri-bio diesel.
16 The Chairman's modification provides an investment
17 credit for recycling equipment. The Chairman's
18 modification also provides a limited five-year carry-back
19 period for the net operating losses of certain electric
20 utility companies, which reinvest the equivalent amount
21 of the loss in electric transmission or pollution control
22 equipment.
23 In terms of the revenue raising provisions, the
24 majority of items listed in the Chairman's modification
25 have been previously passed by the Senate and they are

1 part of the Senate's Fuel Fraud Initiative. In addition,
2 the Chairman's modification would reinstate the Oil Spill
3 Liability Trust Fund tax beginning April 1, 2007 and
4 running through December 31, 2014.
5 In addition, the Chairman's modification would
6 provide that dyed fuels are subject to the Leaking
7 Underground Storage Trust Fund tax.
8 I am happy, as always, to elaborate in further detail
9 on any item in the underlying Chairman's mark or in the
10 modification, but that, I believe, is a summary of maybe
11 the most substantive items in the modification, Mr.
12 Chairman.
13 The Chairman. Now we are ready for questions on the
14 modification.
15 Senator Baucus. Mr. Chairman?
16 The Chairman. Or questions on any subject.
17 Senator Baucus?
18 Senator Baucus. Mr. Chairman, Senator Bingaman is
19 unable to be here. He is managing the energy bill on the
20 floor. He is concerned about merging the definitions of
21 "incremental hydro power" with respect to Section 45 in
22 this bill and also the definition of "incremental hydro
23 power" in the energy bill. He wants to make sure that
24 those are compatible, or work together, and we do not
25 have different definitions.

1 He wants to get assurance from this committee that,
2 between now and the floor, we will work to get a similar
3 definition for "incremental hydro power" in both cases.
4 I do not know if you are aware of this, or others are
5 aware of this. Senator Smith is not here, but he is
6 interested in the same subject.
7 The Chairman. I am not aware of it. But why do we
8 not ask Ms. Paris to comment. Can you do that?
9 Ms. Paris. I was not aware that there was a
10 diversity in the two definitions, but I am sure, as we
11 have tried to do for the last several years, as we keep
12 doing this energy bill, we have tried very hard to make
13 sure that the energy policy and the energy tax stands
14 well together and we have made similar changes to the
15 biomass provisions and similar changes to clean coal
16 incentives to make them match up. So, I do not know what
17 the problem is, but we have a history of trying to make
18 those two work well together.
19 Senator Baucus. I appreciate that. Speaking for
20 Senator Smith and Senator Bingaman, I just want to make
21 sure we can try the best we can between now and the
22 floor. Thank you.
23 The Chairman. All right. This is some policy then,
24 Senator Baucus, that needs to be worked out. Is that
25 what you are saying?

1 Senator Baucus. Right. It is just to make sure the
2 definitions are not inconsistent with each other.
3 The Chairman. All right.
4 And along that line, though, the explanation that Ms.
5 Paris gave of that sort of general approach, is the same
6 approach that is implied we take here?
7 Senator Baucus. Yes. Yes. Right. Thank you.
8 The Chairman. All right.
9 Now, further questions?
10 [No response]
11 The Chairman. All right.
12 If there are no questions, I would now move to modify
13 the Chairman's mark.
14 [No response]
15 The Chairman. Without objection, the Chairman's
16 mark is modified.
17 Now, there were 56 amendments filed. We have worked
18 very hard to accommodate committee members' concerns. In
19 light of the modified mark, are there any members wishing
20 to speak or to offer amendments?
21 Senator Rockefeller. Mr. Chairman?
22 The Chairman. Senator Rockefeller?
23 Senator Rockefeller. Mr. Chairman, I have to go in
24 five minutes, which is very embarrassing. On the other
25 hand, I was here at 10:00.

1 The Chairman. You were. [Laughter]. But it did
2 not start until 10:30.
3 Senator Rockefeller. I know. [Laughter]. But I
4 thought you would appreciate the effort.
5 The Chairman. All right.
6 Senator Rockefeller. This is simply to do two
7 things. One, is to really thank you and Senator Baucus
8 and your staffs for working very, very hard, both on
9 clean coal, on coal mine methane, the capturing thereof,
10 and the oil and gas, so-called Section 29. Replacement
11 was not granted, but there was a way around that.
12 I want to really thank you for that because, one you
13 have included, and the other two you have said that we
14 will work out before it comes up. I trust you both and
15 accept that, and am enormously grateful for it. I really
16 mean that, because energy bills do not usually work this
17 way.
18 The other thing I want to say to Mr. Barthold, on
19 Joint Tax, is that in the Section 29, as well as on the
20 coal mine methane, your scoring has come in
21 extraordinarily high. I mean, it is way out of sight of
22 what we would have expected.
23 What I would just simply ask, with all respect and
24 earnestness, is that you work with us and with the
25 leadership of the committee to try and look at those

1 figures once again. I mean, they are very, very high
2 scores. They came in at a very, very late time, which
3 made it very difficult, obviously, for us.
4 Mr. Barthold. I apologize for any delay that we may
5 have caused. As always, we are happy to work with any
6 member and meet with outsiders that might be able to
7 provide information that we can then coordinate with
8 information that we get from the Department of Energy and
9 other sources.
10 Senator Rockefeller. Thank you.
11 Thank you, Mr. Chairman.
12 The Chairman. Did you have something else?
13 Senator Rockefeller. No. This was about Rick
14 Santorum. It was just another flattering comment about
15 him. [Laughter].
16 The Chairman. Now I would call on Senator Hatch.
17 Senator Hatch. Well, thank you, Mr. Chairman. I am
18 going to thank you and Senator Baucus for the good work
19 that you have done on this, the way you have helped all
20 of us. You really, I think, deserve a lot of credit. It
21 is not an easy thing to do.
22 But I call up my Amendment #2 dealing with tax
23 incentives for oil shale and oil sands production. Now,
24 I do not intend to ask for a vote on this amendment
25 because I understand we are still waiting for a score one

1 part of it, and that we may be able to get clarification
2 from Treasury on the other part.
3 But I want to make it clear that once we are able to
4 receive a score on this amendment, I will continue to
5 work to have it included in the Energy Tax package.
6 Now, this may not yet be common knowledge, but right
7 here in the United States we have more recoverable oil
8 from oil shale and tar sands than there is in the entire
9 Middle East. This is, in fact, well known by geologists
10 and energy experts, but it has not been counted among our
11 Nation's oil reserve because it is not yet being
12 developed commercially.
13 Yesterday's *Washington Post* featured a front-page
14 article on Canada's recent experiment with producing oil
15 from tar sands, also known as oil sands. The article
16 stated that, based on their new production of oil sands,
17 "Canada's proven oil reserves are reported to be 180
18 billion barrels, second only to Saudi Arabia."
19 In Colorado, Utah, and Wyoming, we also have a very
20 significant oil sands resource. But if you factor in our
21 oil shale, we could have a reserve of upwards of 1 to 3
22 trillion barrels, which is equal to the entire world's
23 known resources.
24 The *Washington Post* article also reports that the oil
25 sands production is not profitable when a barrel of oil

1 sells in the low $20s, far below the current and recent
2 $55 range.
3 The problem, is overcoming the barriers to new
4 development in the U.S. By the way, Utah, which has a
5 great many of the tar sands and oil shale acreage, is
6 importing oil from Canadian tar sands in a significant
7 quantity so it can be refined in Utah.
8 Now, in just a few years Canada went from a small
9 player to an international oil-producing powerhouse, and
10 the key to this happened to be tax incentives. This
11 amendment looks to the Alberta model to help the United
12 States move towards greater energy independence.
13 Now, I want to thank Senator Thomas for co-sponsoring
14 the amendment, which I mentioned has two parts. The
15 first part would clarify that a new technology for
16 developing oil shale, known as the In-Situ Conversion
17 Process, ICP, qualifies for a percentage depletion
18 allowance. The ICP process uses drilling rather than
19 mining and is much better for the environment.
20 I would like to ask for a commitment from the
21 Treasury Department that we could get a speedy
22 determination of whether the current law's percentage
23 depletion allowance would cover this process. Could I
24 ask Mr. Carroll to give me that commitment?
25 Mr. Carroll. Certainly. We would be happy to look

1 into that issue to see whether that qualifies.

2 Senator Hatch. You have agreed, then, that Treasury
3 will take a look at this new technology and see, if a
4 regulatory clarification can be made, that this process
5 does qualify for a percentage depletion. You agree with
6 that?

7 Mr. Carroll. Yes. We will certainly look into
8 that.

9 Senator Hatch. All right.

10 Now, Mr. Chairman, I would like, if there is any
11 difficulty on this at all, for you to work with me to
12 change the law to ensure that this new technique does
13 qualify for the same tax treatment, which I am told is
14 available for other types of oil shale production. So,
15 if you would, I would appreciate that.

16 The Chairman. The answer is yes. We will be
17 working with you on that. I also have a comment on the
18 second part of the amendment, allowing companies involved
19 in oil shale and oil sand production to expense
20 immediately any qualified oil shale and oil sand
21 technology expenditures.

22 As I understand it, the staff of the Joint Committee
23 on Taxation was not able to get an estimate of the
24 revenue cost of this provision, which is a new one.

25 Senator Hatch. That is my understanding. Mr.

1 Chairman, I understand any hesitancy to support an
2 amendment when we do not know the cost.
3 However, I am asking for the Chairman's commitment to
4 work with me in finding a way to enact strong incentives
5 to get the production of oil shale and oil sands off the
6 ground as soon as possible in our country, which would
7 certainly alleviate an awful lot of the dependency that
8 we have.
9 The Chairman. We agree to work with you on that.
10 Senator Hatch. Well, thank you, Mr. Chairman. I
11 really appreciate it.
12 With that, I withdraw the amendment and we will work
13 together to try and resolve these problems.
14 The Chairman. Yes.
15 The Chair recognizes Senator Conrad.
16 Senator Conrad. I thank the Chair. I thank the
17 Chair for the very productive attitude that he has
18 brought to this process. We have genuinely enjoyed
19 working with the Chairman and the Chairman's staff on the
20 amendments that we offered, and we very much appreciate
21 how many of them were included in the mark.
22 Mr. Chairman, there are a number of issues still
23 unresolved that are really beyond our ability to work
24 out, and I wanted to just raise two of them with you, if
25 I could, at this moment.

1 The first, involves Conrad-Lincoln-Bunning Amendment
2 #1 that involves bio-diesel. As the Chairman knows, in
3 order to claim this tax credit, bio-diesel blenders must
4 obtain a certificate from bio-diesel producers. However,
5 many blenders do not buy directly from the producers, but
6 rather from wholesalers who are not authorized to issue
7 the required certificate.
8 Under the IRS interim ruling, certificates cannot be
9 passed through wholesalers to the blenders. Now, the IRS
10 has the authority to do it and they have the authority to
11 issue guidance that would make the certificates
12 transferrable. Issuing such guidance would be consistent
13 with the committee's intent in creating the tax credit in
14 last year's legislation.
15 I would ask the IRS to issue a notice by August 1 of
16 this year to address this chain of custody issue. I have
17 also heard from many constituents in my State, and from
18 other States as well--by the way, I have heard from
19 people in Minnesota, South Dakota, and Wisconsin--on this
20 issue that are missing out on the credits, worth nearly
21 $100,000, because they do not buy directly from bio-
22 diesel producers.
23 In addition, the credit should be awarded
24 retroactively to blenders that bought through
25 wholesalers, provided the blender was acting in good

1 faith and following normal industry practice. I request
2 that the IRS allow these credits and pay these claims.
3 Again, I ask that a notice for awarding credits
4 retroactively be issued by August 1 of 2005.
5 Mr. Chairman, I know that you have a view on this as
6 well.
7 The Chairman. Yes. Well, first of all, let me
8 clarify with you on, I think, the first point you made.
9 I think I agree with you, but I just want to make sure.
10 You are asking me whether or not it is this committee's
11 intent, under existing law, that the IRS has the
12 authority to issue guidance that would make certificates
13 transferrable, and the fact that they are not doing it is
14 inconsistent with the committee's intent in creating the
15 tax credit in last year's bill.
16 Senator Conrad. That is exactly right.
17 The Chairman. So the Senator from North Dakota is
18 not only correct, but let me say, beyond what I just
19 said, it is my understanding that over the period of time
20 of writing this legislation last year, that we had very
21 close working relationships with people in Treasury,
22 where they were at the table as the law was being
23 written. So, it is ludicrous now that we would have a
24 process come out of Treasury that nullifies the purpose
25 of the legislation.

1 Senator Conrad. I could not agree with the Chairman
2 more. If I could just say, it was very clear that the
3 intent here was to permit those who do not buy directly
4 from producers, but rather from wholesalers, to qualify.
5 Senator Bunning. Mr. Chairman, may I comment?
6 The Chairman. Do you ask him to yield? Because he
7 was not done yet.
8 Senator Bunning. Oh. Finish.
9 Senator Conrad. I would just say, Mr. Chairman,
10 there are really two issues that we have got to get
11 resolved. One, is that the IRS issue a notice by August
12 1 to address this chain of custody issue, and second,
13 that they issue a notice for awarding credits
14 retroactively, and that be issued by August 1 as well. I
15 think it was clearly the intent. I think everybody
16 understood and agreed to that. How this got off the
17 track, I do not think I will ever understand.
18 The Chairman. Particularly considering the fact
19 that they seemed to be involved in the drafting of the
20 legislation, in other words, working with our committee
21 staff to make sure that something was doable. Surely,
22 congressional intent ought to have been very clear under
23 that sort of atmosphere of working together.
24 So I want to assure the Senator from North Dakota
25 that I agree with him. The IRS needs to provide a clear

1 guidance that will enable blenders to claim the tax
2 credit, as Congress intended, and August 1, or earlier.
3 Like, tomorrow would be an ideal time to do it.
4 [Laughter].
5 Senator Conrad. I thank the Chairman very much.
6 The Chairman. Yes.
7 The Senator from Kentucky?
8 Senator Bunning. Thank you, Mr. Chairman.
9 I have been very concerned when we went through this
10 process. I was very active in the bio-diesel credit to
11 start with. I am hearing from constituents and others
12 that this lack of clarity and guidance from Treasury is
13 making it not only difficult, but almost impossible to
14 participate in the bio-diesel market.
15 The goal is to get bio-diesel to the consumer, and we
16 need this guidance sooner rather than later to allow this
17 to happen. I urge the Treasury to act immediately to
18 establish a reasonable certification process for the bio-
19 diesel blenders, and I could not support Senator Conrad
20 or my Chairman more. Thank you.
21 The Chairman. Senator Thomas?
22 Senator Thomas. Thank you, Mr. Chairman.
23 I wanted to call up an amendment that I think has an
24 important potential on this business of coal conversion
25 and the IGCC technology. This has to do with the coal

1 technology. We have, I think, in there a very good
2 arrangement in which to get into the IGCC technology.
3 I think the integration of gassification, combined
4 with this technology, is important because coal is, after
5 all, certainly in the short term, our most available and
6 plentiful resource.
7 So the amendment that I filed would simply ensure--it
8 is already in here to do that--that the development of
9 this technology would continue in all kinds of coal,
10 rather than prematurely favoring one kind of coal over
11 another. I visited with Senator Baucus. Perhaps you
12 would like to comment, sir.
13 Senator Baucus. Mr. Chairman?
14 The Chairman. Yes. Senator Baucus?
15 Senator Baucus. Mr. Chairman, this is a new
16 technology which should, clearly, apply equally to coal
17 around the country, different parts of the country. We
18 all have been very involved in discussions of western
19 coal versus eastern coal, BTU content, moisture content,
20 calorie content, whatever, you name it, we have had all
21 these discussions.
22 So, the whole point of this amendment by the Senator
23 from Wyoming is just to make sure that there is parity
24 here so that western coal is treated equally and fairly
25 compared with eastern coal.

1 There may be a couple of technical provisions or
2 wrinkles in writing this amendment, and discretion might
3 be the better part of valor here. If the Senator is
4 trying to withdraw the amendment right now, with the
5 understanding that when we mark the bill up on the floor,
6 the Chairman's mark will include language that, in good
7 faith, works out the issue here and makes sure there is
8 balance.
9 Senator Thomas. If we can work with the Chairman
10 and you to make sure it is balanced, why, I certainly
11 will withdraw my amendment.
12 The Chairman. Well, the answer is, first of all, I
13 would associate myself with what Senator Baucus has said,
14 and that responds, evidently, precisely to the point that
15 you want, and the cooperation that you expected from the
16 leadership of this committee. I will try to work with
17 you on that.
18 Is this on the same subject?
19 Senator Conrad. This is on a related subject.
20 The Chairman. All right.
21 Senator Santorum, I promised you.
22 Senator Thomas. Let me thank you. I guess we are
23 through with mine.
24 The Chairman. You withdraw your amendment?
25 Senator Thomas. Yes, sir.

1 The Chairman. All right.

2 Senator Conrad, then I will get Senator Santorum.
3 Well, maybe I had better --

4 Senator Conrad. Whatever you want to do.

5 The Chairman. Senator Santorum?

6 Senator Santorum. Thank you, Mr. Chairman. I do
7 want to thank you for your cooperation on the amendments,
8 many of the amendments that I offered, and working them
9 out with us. I appreciate those changes in the
10 modification.

11 I did want to pick up on just a couple of things that
12 Senator Rockefeller said. I, too, was concerned about
13 the scoring of the coal bed methane proposal, and
14 certainly look forward to working with Joint Tax and
15 trying to discover what possibly could have resulted in a
16 scoring that was so many multiples more than what anyone
17 anticipated. Again, we hope to be able to deal with that
18 and maybe come back on the floor with some modifications
19 to address those issues.

20 What Senator Rockefeller alluded to in his closing
21 comment was his first amendment, which is an amendment
22 clarifying Section 29. I know there are no Section 29
23 amendments, and I understand that and certainly support
24 the Chairman in his desire not to fuss with that section
25 of the Code.

1 The amendment that Senator Rockefeller offered that I
2 am a co-sponsor of was an amendment that was a
3 clarification to Section 29 as a result of the Treasury
4 taking a stance, which I think is, frankly, an
5 indefensible stance, which is that they are not going to
6 issue any more private letter rulings on any new
7 processes under Section 29, this particular provision of
8 Section 29, starting, I think, in 2000, going forward.
9 The only processes that were qualified before 2000,
10 or some derivation of those processes, would be given
11 this credit. Anything new, any innovations, sorry. You
12 want to talk about contrary to congressional intent, that
13 is about as contrary to congressional intent as I can
14 possibly imagine. It is indefensible.
15 I think we need to clarify that Congress did not give
16 a credit for, I think, up until 2007, to have only
17 processes they were qualified up to 2000 to be qualified
18 for that credit.
19 So, that is what this amendment was about. The
20 Chairman, I know, has expressed his sympathy with this
21 amendment, and I certainly look forward to working with
22 him to solve this at some point down the road.
23 The Chairman. I could clarify for you, in a sense,
24 about the Section 29 issue you brought up and my desire
25 not to deal with it. A lot of those items are going to

1 be conferenceable, as you probably know, from the House
2 legislation.
3 Are you done?
4 Senator Santorum. I have one final comment. This
5 is also an issue that is a conferenceable issue. That
6 is, an amendment that I had, my Amendment #4, which is on
7 Nuclear Decommissioning Trust Fund treatment, I
8 understand, Mr. Chairman, you do not have any provisions
9 in this mark on nuclear decommissioning, that the House
10 has several provisions. This is a provision that was not
11 included in the House language that I have concerns
12 about.
13 I would just ask you, Mr. Chairman, to keep this
14 amendment in mind for conference. It would be
15 appropriate in conference and I think it is something
16 that we have talked to your staff about, and hope that
17 you could advocate for us with me in conference.
18 The Chairman. Yes. And my staff and I have
19 discussed that very issue, and positively.
20 Senator Santorum. Thank you.
21 The Chairman. Senator Conrad?
22 Senator Lincoln. Mr. Chairman?
23 The Chairman. Then I will get Senator Lincoln.
24 Senator Lincoln. Thank you.
25 Senator Conrad. Mr. Chairman, this is a related

1 issue to the issue that Senator Thomas raised. I am very
2 supportive of the concern that he raised.
3 As we have looked at the language on the clean coal
4 technology--this involves my Amendment #1--our industry
5 tells us lignite would not qualify, even though,
6 ironically, they are included in the score, so there
7 would be no revenue effect of my amendment.
8 The technical description they have used would
9 preclude lignite from qualifying. This is what people
10 that I respect have told me is the case. That is clearly
11 not the intent. The fiscal estimate assumes they would
12 qualify, but the technical language precludes them from
13 qualifying.
14 So, your staff has told me they would like a little
15 more time to be certain, because it is very technical
16 language, to be able to work on this technical language.
17 Since there is no score involved, what I am asking is
18 if I have your commitment, Mr. Chairman and Ranking
19 Member, to work with me before we get to the floor to see
20 if we cannot resolve this to make certain that the
21 language actually accomplishes what we think it does,
22 what it is hoped it would do.
23 The Chairman. Before I respond to you, I would like
24 to call on Mr. Barthold to comment, and then let me speak
25 after he speaks.

1 Mr. Barthold?

2 Mr. Barthold. Thank you, Mr. Chairman.

3 The Chairman's modification, Senator Conrad, does
4 clarify that lignite is a qualifying fuel source for the
5 purpose of the Chairman's mark provision with respect to
6 clean coal investment incentives.

7 The Chairman. So you are saying his problem is
8 taken care of?

9 Mr. Barthold. Yes, sir.

10 The Chairman. Does the Senator from North Dakota
11 agree with that?

12 Senator Conrad. We have had the industry most
13 affected in my State review the language.

14 The Chairman. Even the modified language?

15 Senator Conrad. The modified language as well.
16 They tell us that, because of highly technical reasons,
17 they do not think it accomplishes what is intended to be
18 accomplished. That is why I am asking you, Mr. Chairman,
19 if we could work together.

20 The Chairman. All right.

21 Senator Conrad. And I understand that the staff is
22 not prepared to accept the language that I offered,
23 because it takes time to fully comprehend it. I
24 certainly respect that.

25 The Chairman. Then let me ask here, based upon what

1 Mr. Barthold said, there does not seem, either from the
2 fiscal standpoint or the policy standpoint, to be any
3 difference of opinion, it seems to me if we all agree
4 what we want to accomplish and it is just a question of
5 verbiage, we ought to be able to get there.
6 I want somebody to assure me that I can assure him.
7 Matt, can you help us? Mr. Jones, I mean. [Laughter].
8 Mr. Jones. Yes, Senator. I think that Senator
9 Conrad's concerns can be addressed. The language in the
10 mark does not specify what the levels of efficiency are
11 for lignite, for instance.
12 The amendment that was filed by Senator Conrad, I
13 think, was concerned about other legislative language
14 that had been introduced. So, there is sufficient leeway
15 within the parameters of the Chairman's modification to
16 address Senator Conrad's concerns.
17 The Chairman. Based on what he said, we will work
18 something out.
19 Senator Conrad. Good. I appreciate it.
20 Senator Thomas. Can you assure me that you are
21 assured? [Laughter].
22 The Chairman. You know, maybe I am too cautious,
23 because I am around so many of you lawyers. [Laughter].
24 Senator Conrad. Not me.
25 The Chairman. All right.

1 Now I think I promised Senator Lincoln, right?
2 Senator Lincoln. Thank you, Mr. Chairman. And I am
3 not a lawyer, just a farmer's daughter.
4 I wanted to make sure that I was clear on the number
5 36, which was the amendment that Senator Bunning and
6 Senator Conrad spoke on.
7 The Chairman. You and I have very much an interest
8 in that.
9 Senator Lincoln. Yes, sir. Was it accepted or do
10 we move forward? Are we going to fix it on the floor?
11 The Chairman. Well, here is what we are asking. We
12 are dealing with a statute that, it is my understanding,
13 that the Treasury was at the table as we were trying to
14 write the right language. I do not know how much greater
15 cooperation you can have between the executive branch and
16 the legislative branch.
17 Then you have got a process put in place that neuters
18 the whole thing, so all the legislation we get passed
19 does not do the good that we thought it was going to do,
20 at a time when we have got bio-diesel that can fill in a
21 big hole, particularly with the sulphur requirements that
22 are going to be put on petroleum diesel, and the
23 lubricity that you need in diesel now that can come from
24 bio-diesel. In five or six years, we can have a bio-
25 diesel industry where ethanol is after 25 years. We do

1 not need some bureaucrat standing in the way of getting
2 done what Congress already decided we need to get done.
3 Senator Lincoln. I am with you. [Laughter].
4 The Chairman. Well, if I have got you on my side, I
5 am a winner.
6 Senator Lincoln. I do have an amendment. Is this
7 an appropriate time?
8 The Chairman. Senator Baucus?
9 Senator Baucus. No, no. Go ahead.
10 The Chairman. All right. Go ahead.
11 Senator Conrad. Before we do that, could I just say
12 that I wanted to associate myself with every word of the
13 Chairman.
14 Senator Lincoln. Me, too.
15 Is it still my turn?
16 The Chairman. Yes.
17 Senator Lincoln. All right. Great.
18 The Chairman. And when you are done in a half hour,
19 I am going to call on Senator Baucus. [Laughter].
20 Senator Lincoln. It is Amendment #25 that Senator
21 Smith, myself, and Senator Hatch offered. The new EPA
22 regulations for our diesel trucks are going to be phased
23 in beginning in 2007.
24 This amendment was a bill that we actually worked on
25 that is out there. These new regulations are going to

1 certainly require dramatic reductions in emission, and
2 will certainly result in diesel engines having near zero
3 emissions when they are fully phased in and implemented
4 by 2010.
5 Some of our concern, is what we have seen in the
6 past. That is, when you have those new requirements,
7 particularly on vehicles, because we know that Federal
8 regulation can require manufacturers and suppliers to
9 produce emission-compliant products, but we cannot
10 mandate that the public purchase those engines.
11 We want to encourage the purchasing of the new
12 engines as opposed to waiting and seeing happen what has
13 happened in the past, and that is, that people will
14 purchase, retrofit, or repair older engines where we do
15 not actually meet the objective of what we are trying to
16 do with the newer engines, with better emissions
17 outcomes.
18 So what we are proposing in our bill, and certainly
19 in this amendment, Mr. Chairman, is a 10 percent, which
20 we derive from the economics of what happened in October
21 of 2002 from the introduction of lower-emission diesel
22 trucks, but the ability to give some credit to those that
23 do purchase these new vehicles and these new engines.
24 I just want to make sure that I made you aware of it,
25 in hopes that you, as well as the staff, might be willing

1 to work with us as we move towards the floor to look at
2 what we can do with this amendment to move it forward as
3 we go to the floor, and hopefully be able to offer
4 something when we get there.
5 The Chairman. Yes.
6 Senator Lincoln. Thank you, sir. I am finished.
7 The Chairman. Senator Kerry? If it is on this
8 subject, I will let you speak. I promised Senator
9 Baucus.
10 Senator Baucus. No, it was just a very small
11 matter, Mr. Chairman. Senator Schumer would like Senator
12 Snowe added as a co-sponsor to his Amendments #53 and
13 #54.
14 The Chairman. All right.
15 Senator Kerry?
16 Senator Kerry. Mr. Chairman, I just wanted to thank
17 you at this point, both you, Senator Baucus, and the
18 staffs. I think that this process has been sort of the
19 exception to the rule of late around here. It has been
20 extraordinarily cooperative and very open.
21 I think that no one is going to agree with every
22 component of this, obviously, but I think, all in all, it
23 represents a very significant step forward, a lot of tax
24 credit innovations on renewables and alternatives, as
25 well as a good balance, some thoughtful things with

1 respect to even the fossil fuel piece for how to make it
2 more efficient and do some of the things we ought to be
3 doing.
4 So, I just wanted to thank you. I appreciate the
5 acceptance of the five amendments, in addition to the
6 other things we worked on jointly. I think it has been a
7 terrific product, and I congratulate both of you.
8 The Chairman. Yes. And I congratulate your staff
9 for working with us, because we had to modify, to some
10 extent, your proposals. So, you were very cooperative as
11 well.
12 Anybody else? Senator Kyl?
13 Senator Kyl. Is this the time to offer some
14 amendments, Mr. Chairman?
15 The Chairman. We are offering amendments, yes. But
16 did you want to follow up, Senator Thomas, or did you
17 have an amendment, too?
18 Senator Thomas. Mr. Chairman, I just simply wanted
19 to say that we had an amendment on reducing the allowable
20 appreciation time, and several of us were sponsors. I
21 just wanted to thank you for putting that in. I think
22 that is very important if we are going to get a
23 transmission system. So, just thank you.
24 The Chairman. All right.
25 Now, Senator Kyl?

1 Senator Kyl. Thank you, Mr. Chairman. I will be
2 very brief, since I think this year I am the Lone Ranger,
3 with Senator Nickles having departed the committee.
4 The Chairman. His former staff is all outside the
5 door. [Laughter].
6 Senator Kyl. And the entities that they may be
7 working for may no longer have the same point of view as
8 the good Senator.
9 But the last time we did this bill, Senator Nickles
10 and I reluctantly opposed its passage because of a
11 significant amount of subsidies, and the fact that we did
12 not think that those subsidies would achieve the purpose,
13 as well-expressed as that purpose was that was expressed.
14 As a result, we could not support it.
15 I have got four amendments. I would simply like to
16 tell you what they are, see if there is any expression of
17 interest in supporting them, and if there is not, quickly
18 move on, Mr. Chairman, in deference to your needs and
19 desires.
20 The Chairman. I have read them all.
21 Senator Kyl. Yes. And there is no point, I think,
22 in you --
23 The Chairman. No. I am being facetious. Proceed,
24 please.
25 Senator Kyl. They are the same, basically, as what

1 we did before.

2 By the way, I did have one question, which perhaps I

3 could just ask right now, and then move to these

4 amendments. I will be very, very brief.

5 I note that in Section 45, you take the Solar Energy

6 Credit out of that. There is a credit added back in at

7 another place, and I do not know whether that is intended

8 to substitute for the solar credit in Section 45 or not.

9 I just wondered what the explanation of that was.

10 The Chairman. Can either Elizabeth or Matt respond

11 to that, please?

12 Mr. Jones. Yes. Staff had extensive conversations

13 with the solar industry and their preference unanimously,

14 from the folks that we talked to, was to eliminate solar

15 as an eligible resources under Section 45 and enhance the

16 investment tax credit for solar technology.

17 Senator Kyl. All right. I assumed that was the

18 case, and I appreciate that.

19 Mr. Chairman, the basic line here is that, frequently

20 when you produce a subsidy for something, the price of

21 that commodity is simply raised by the amount of the

22 subsidy, and the subsidy does not, in fact, change

23 behavior.

24 I note that a lot of the subsidies here are to

25 support very popular programs, which, because of their

1 popularity, will occur without the subsidy, alternative
2 fuel or hybrid vehicles being the best example.
3 I have an amendment to strike the alternative fuel
4 section. We discussed last time the problems with that
5 program and how, in my own State of Arizona, it was
6 repealed shortly after it was adopted because of those
7 significant problems.
8 Is there any interest in supporting the removal of
9 that section from the bill?
10 [No response]
11 Senator Kyl. Hearing none, I will move on to my
12 second amendment.
13 The billions of dollars in Section 45--$4.2 billion
14 over 10 years, for example--from the so-called renewable
15 sources, I think, is an interference with the free market
16 in terms of wind. There was testimony on wind. I do not
17 recall exactly when it was, but this was in 2001.
18 The American Wind Energy Associated noted that the
19 cost for wind had fallen by 80 percent with the credit,
20 that wind is comparative with fossil fuels, and that the
21 cost of wind energy will continue to be reduced until
22 wind can compete head-to-head with fossil fuels without
23 the need for any incentives. Has that time arrived?
24
25 The Chairman. It is my understanding that it is

1 4.3, and it needs to be down to 3.5 kilowatt hours.
2 Senator Kyl. Well, obviously it is getting so
3 close.
4 The Chairman. Now, we started out at 7.5 cents per
5 hour 15 years ago.
6 Senator Kyl. Yes.
7 The Chairman. So we are making progress. Some day,
8 we probably will not need the tax credit.
9 Senator Kyl. Someday.
10 The Chairman. It could be tomorrow, but I am not
11 going to say it.
12 Senator Lott. Will the Senator yield?
13 Senator Kyl. Sure.
14 Senator Lott. I am just feeling sympathy for the
15 loneliness of your position. I just wished to say that I
16 share your concerns, but, as you well know, the fix is
17 in. But this is just the beginning of the process, to do
18 not get too uptight about it. Hopefully, we will fix it
19 in the end.
20 Senator Kyl. I hope I did not appear to be too
21 uptight.
22 Senator Lott. Well, no. You have been very calm
23 and very accepting. But this is just to get us to the
24 point where we can actually get a bill. I have a lot of
25 sympathy with what you are saying, and I just wanted to

1 be on the record about that.

2 Senator Kyl. Well, I am one of those people who
3 will be trying to move this thing along next week on the
4 floor.

5 The Chairman. Further clarification of the fix
6 being in, what we are trying to do is get the United
7 States a little less dependent upon oil from other
8 countries that you cannot count on. That is sort of a
9 fix we all agree with, right?

10 Senator Baucus. Right.

11 Senator Lott. But I would like for us to have more
12 of our own oil, too.

13 The Chairman. And I voted with you on every one of
14 those.

15 Go ahead.

16 Senator Kyl. Mr. Chairman, the four amendments that
17 I have here are not going to be adopted. I will simply
18 put a little statement in the record with respect to each
19 of them.

20 [The prepared statement of Senator Kyl appears in the
21 appendix.]

22 Senator Kyl. But I really do ask my colleagues, it
23 is very easy for us to spend taxpayer money, and whether
24 it is a credit, a deduction, or a subsidy, it all amounts
25 to the same thing because we are foregoing revenue or we

1 are providing direct cash assistance.

2 We are very concerned about foregoing revenue in
3 other things that we want to do, like reducing taxes. We
4 are then concerned about the cost to the Treasury and the
5 size of the deficit.

6 Here, it almost seems to me like folks think it is
7 free money, and it seems like it is a good cause, so let
8 us do it. But I really wonder whether there is a
9 cost/benefit relationship here and whether anybody can
10 tell us whether the cost of the vehicles are simply
11 raised by the price of the subsidy, as a result of which
12 there is really no benefit in terms of modifying human
13 behavior. That is what we are trying to do with the Tax
14 Code here.

15 Here is my last question. Maybe I could get one vote
16 from my colleague from Mississippi on this one proposal,
17 just to ask this question. We have got this Alternative
18 Motor Vehicle Credit that applies to all vehicles, and
19 the amount of the credit depends upon the size of the
20 vehicle. In fact, I think for the large vehicles the
21 amount of the credit can go up to $50,000 for larger
22 vehicles.

23 I just wonder if my colleagues would be willing to
24 put some kind of limit on that. I have an amendment, for
25 example, that would deny the credit for light trucks or

1 automobiles that have a final price or sales price of
2 $35,000 or more.
3 In other words, it would apply to the Ford Escape,
4 for example, at a price of $25,000, but the luxury Lexus
5 that has an MSRP of over $45,000, or a Porsche, would not
6 be eligible for the credit for the Alternative Motor
7 Vehicle Credit in the legislation. Would anybody be
8 interested in supporting that amendment so that we are
9 not just subsidizing the acquisition of these very
10 expensive vehicles?
11 The Chairman. If I could, on that point, for
12 Senator Hatch, because he is so involved in what is
13 referred to as the CLEAR Act, a principal goal of that
14 Act is to stimulate market acceptance of hybrid vehicles,
15 because hybrid vehicles bring our Nation greater energy
16 security, they bring us cleaner air, and hybrid
17 technologies bring us closer to the President's goal of
18 fuel cell vehicles.
19 Limiting new technologies to small, inexpensive
20 vehicles is not a good way to create widespread market
21 acceptance of hybrids. Let us not forget that the new
22 Lexus hybrid is an SUV. We all benefit when a new
23 hybrid, especially SUV hybrids, hit the road. By
24 limiting the CLEAR Act credits to small, inexpensive
25 cars, we limit the opportunity for widespread consumer

1 acceptance of better technology.

2 Senator Thomas. Mr. Chairman, I just want to say
3 that I generally support it. But keep in mind, when we
4 did this before we had some $30 billion involved. Now we
5 are down to $11 billion. But we still need to look at
6 some things.

7 The Chairman. Let me suggest to the Senator that,
8 considering what we did, as the Senator from Wyoming
9 said, maybe in an absent-minded way four or five years
10 ago and we corrected it in the FSC/ETI bill last year, I
11 would be willing to take a look at this. But I think we
12 need to involve Senator Hatch as well, and I cannot
13 commit him to that. But we want to be fiscally
14 responsible in this approach.

15 Senator Kyl. I will not propose the amendment at
16 this time.

17 The Chairman. All right.

18 We have got a situation where we have got exactly 11
19 people here. Would it be possible for us to approve this
20 bill, and I will stay around to hear everybody out?
21 Could I put the question, please?

22 Senator Baucus. I so move.

23 The Chairman. All right.

24 First of all, I would ask acceptance of the
25 Chairman's mark, as amended, and that it be adopted.

1 Those in favor, say aye.

2 [A chorus of ayes]

3 The Chairman. Those opposed, say no.

4 [No response]

5 The Chairman. The motion is carried.

6 I now ask that the committee favorably report the
7 Energy Policy Tax Incentives Act of 2005, as amended.
8 Those in favor, say aye.

9 [A chorus of ayes]

10 The Chairman. Those opposed, say no.

11 Senator Kyl. No.

12 The Chairman. The ayes seem to have it. The ayes
13 do have it. The bill is favorably reported.

14 I ask that the staff have the authority to draft
15 necessary technical and conforming language and any
16 changes to the Chairman's mark. I also want to thank
17 Senator Baucus, as I did in my opening statement which I
18 put in the record, for working so closely in processing
19 this very important bill.

20 The Senator from Oregon.

21 Senator Wyden. Mr. Chairman, I want to
22 particularly, while Senator Kyl is here, pick up on his
23 point about subsidies, because I have a lot of sympathy
24 for what he is saying. In the Energy Committee, the vote
25 was 21:1, and I was the one up there because of

1 essentially the argument you are making.

2 I think it is especially worth nothing that the

3 President said, back in April, "With $55 oil, we do not

4 need incentives to oil and gas companies to explore.

5 There are plenty of incentives." Today, oil is at $55 a

6 barrel. Of course, this legislation contains $2 billion

7 in additional fossil fuel incentives.

8 But the reason that I have been supportive, and I

9 particularly want to single out Senator Baucus, Senator

10 Grassley, and Senator Thomas here, is that, for the first

11 time, what we are looking at in the oil and gas area that

12 are approaches that will encourage getting more

13 production out of existing wells in a fashion that I

14 think is going to help us be energy secure, but also take

15 steps that will be environmentally sound.

16 For example, I commend Senator Baucus, in particular.

17 He talked with us, but it was really his idea, that the

18 approach that is being used in the oil area will

19 essentially use carbon dioxide to push more oil up so we

20 are going to get more per well, and we are also going to

21 reduce greenhouse gases. So, I am very pleased to be

22 able to support this legislation, having voted against

23 the earlier one.

24 I would say to Senator Kyl, who I basically agree

25 with on the subsidy question, that this time, as far as I

1 can tell, for the first time we are not just heaving
2 money out there, just not ladling out more at the
3 smorgasbord of buffets, but actually taking approaches
4 that are going to allow us to address our production
5 needs in an environmentally sound way.
6 That was why I was pleased to be able to support your
7 efforts and commend you both, Senator Baucus and Senator
8 Grassley. And Senator Thomas. I was a sponsor of what
9 he was doing in terms of the Deep Natural Gas Production
10 Credit, for exactly the same reason: we are going to get
11 more natural gas per well under what Senator Thomas is
12 talking about.
13 The Chairman. Senator Baucus?
14 Senator Baucus. Mr. Chairman, I think most in the
15 room have a lot of sympathy with what Senator Kyl was
16 saying, Senator Lott, and others about subsidies. I
17 appreciated, particularly, Senator Kyl's question about,
18 what is the cost benefit here?
19 What are we really getting for these additional
20 dollars that are going to help spur additional energy?
21 It is a very good question. Frankly, Mr. Chairman, I am
22 not sure that we do a sufficient job in this committee in
23 trying to answer that question and others like it.
24 We are trying to target incentives here, but it is
25 fairly imperfect. I think, on down the road, it behooves

1 us to be a little more careful in what we are doing here,
2 because it does not make sense just to enact a subsidy
3 because it sounds good, but it does make sense to enact a
4 credit or an incentive of some kind because it actually
5 does produce the desired effect, particularly if these
6 are sunsetted.

7 I have a lot of trouble with a lot of these
8 incentives that are there indefinitely, because times
9 change so quickly, the world is so volatile, and it is
10 just very important, I think, for us to just dig a little
11 deeper than we have in the past to try to address the
12 basic points that have been raised.

13 The Chairman. Senator Conrad?

14 Senator Conrad. Mr. Chairman, I just want to say, I
15 think Senator Kyl, to his credit, has been very
16 thoughtful in raising legitimate concerns. I think it
17 deserves a thoughtful response.

18 I would just say to my colleagues, I held an Energy
19 Security Summit at the Energy and Environmental Research
20 Center at the University of North Dakota. We had 22
21 company CEOs there. We had the environmental community
22 represented. We had the Deputy Secretary of Energy there
23 from this administration, the Deputy Secretary of Energy
24 from the previous Bush administration there.

25 We had two and a half days of the most intensive

1 discussions of the vulnerability of the United States
2 because we are importing 56 percent of the oil that we
3 use. Every projection says that we are headed for 70
4 percent dependence on foreign oil.
5 The question before that Energy Security Summit was,
6 what can we seriously do to reduce American dependence?
7 We also talked about the trade deficit. We have got a
8 record trade deficit. One-quarter of the trade deficit
9 is energy.
10 In going through a group, Senator Kyl, of people that
11 I think you respect, Linda Stuntz, from the previous Bush
12 administration, Secretary Sell from this administration,
13 we talked about the building blocks, the things that we
14 would need to do in a serious way to really make a
15 difference. Many of those elements are in this bill.
16 Let me just talk about one for a moment, and that is
17 bio-diesel. Right now, we are producing very little bio-
18 diesel in this country. They are producing a lot of it
19 overseas. In my State, we are going to use canola oil,
20 which is something we grow every year, as a substitute,
21 an additive, for diesel fuel.
22 That is urgently required because the sulphur
23 requirements are changing this next year. The result of
24 that change in sulphur requirements, is if you take 20
25 percent of the sulphur out of fuel, the engines do not

1 perform the way they are designed to perform. If you
2 then have an additive of bio-diesel, you recapture the
3 engine performance and you substitute a renewable fuel
4 for one that is not.
5 The economics of it are very clear. We are just
6 about to build the largest bio-diesel plant in North
7 America in North Dakota. I have gone over the economics
8 with the people who are investing in that plant. The
9 fact is, you have got to have a bit of a subsidy to make
10 it work economically.
11 The payoff is going to be, number one, we are going
12 to have better engine performance after the sulphur is
13 taken out of diesel fuel. Number two, we are going to
14 have a renewable in place of something that is not.
15 The economic impact is, they believe we will need to
16 build 30 bio-diesel plants, producing 30 million gallons
17 a year in this country, to meet the demand caused by the
18 change in the sulphur standard.
19 Senator Wyden, very thoughtfully, has reviewed oil.
20 On oil, we are going to get greater recovery out of
21 existing fields, and we have got major fields in North
22 Dakota. I know most people do not think of North Dakota
23 that way, but we are the ninth largest oil producer.
24 Those fields are in substantial production decline.
25 But if we inject CO_2, and we have got a massive coal

1 gassification plant in North Dakota that produces CO_2--
2 and by the way, Canada is already buying a lot of CO_2 to
3 re-inject in their fields--we are going to get much
4 greater recovery out of those depleted fields, and that
5 reduces our energy dependence.
6 On wind energy, my State is judged to have the
7 highest potential for wind energy. Senator Grassley said
8 it well. We have dramatically improved the economics of
9 wind energy. But we are still not quite there.
10 Most estimates are, we can produce it at 4.3 cents a
11 kilowatt, and we need to be at 3.5 to be completely
12 independent, viable, subsidy-free. But we have come down
13 from close to eight cents. So, the trajectory, the trend
14 line, is moving very well.
15 I would just say to my colleague, honestly, as I look
16 at this bill, I would say that the criticism I would levy
17 is, it is not aggressive enough. I do not think we are
18 doing nearly enough to dramatically reduce our
19 dependence. With that, I think you have done a
20 responsible thing in raising the issue, because it is
21 very easy to spend taxpayers' money.
22 Senator Kyl. Mr. Chairman, might I respond? I
23 obviously did not intend to take this much time, because
24 we needed to complete our process. But having done that,
25 I do appreciate the courteous and well thought out

1 presentations by all of my colleagues in response to my
2 point.
3 One thing we can do. Now, let me just make a point
4 that I have a couple of disagreements with my colleagues,
5 and I will just note a couple. But I do think that we
6 are in agreement that an analysis of the cost benefits
7 would be useful for us to see what really does work,
8 because these programs are, in many cases, programs that
9 we keep extending.
10 They did have a life to them. The Section 45
11 programs, for example. I am not aware that we have ever
12 done an analysis of the results of the Section 45
13 programs. Well, we probably ought to do that, if we have
14 not. I might be wrong on that.
15 I do not know whether GAO is the right party, or we
16 should do that as part of our committee, or it can be
17 done outside. But, clearly, with the cumulative effect
18 of the amount of money that we are spending here, I think
19 it would be useful.
20 For example, just to answer a question like this,
21 when we provide a rebate on a vehicle that we want people
22 to buy because it is a hybrid, or an alternative fuel
23 vehicle, or something like that, to what extent does the
24 manufacturer simply jack up the price so that the end
25 result is, it is costing the consumer the same amount of

1 money?

2 To what extent does that fact affect the consumer
3 behavior, or does the consumer still think he is getting
4 a good deal with the subsidy, so he buys it, and we are
5 really probably inefficiently promoting the behavior of
6 the individual by virtue of the rebate, which is
7 essentially going back into the pocket of the
8 manufacturer?

9 I do not know whether or to what extent that is true
10 or not. I suspect none of us know that. So this is the
11 kind of thing that probably could be studied and it
12 probably would be useful for us to get the answer to
13 that.

14 Maybe what we could do--not right now--is we could
15 get our heads together with you, the Ranking Member, and
16 those of the rest of us who are interested in an
17 evaluation of just how effective these programs are, to
18 find a way to study them and give us some objective
19 measurement. My guess is, we will find some are, some
20 are not, but at least that will give us a better
21 yardstick for the future.

22 Just one final point, and not to quibble. Wind and
23 solar, geothermal, water or hydro power, these are all
24 renewable sources. In a sense, you could say that
25 garbage is renewable, to the extent that we can make a

1 product out of that.

2 But something which requires energy to grow--and
3 ethanol is a good example here, some of the bio-diesel
4 additive products I think fit under this category--and if
5 it takes energy to reproduce this every year, it is used
6 up and then we have to grow some more, refine it, treat
7 it, or add it.

8 I do not technically think you can call that a
9 renewable energy source because, like other energy
10 sources, it has to each year be created, and once it is
11 created, it is used, it is gone, it is done and has to be
12 recreated at some expense. That may be a minor matter,
13 but I think using the term "renewable" to describe that
14 kind of product is, at least in my mind, not accurate.

15 The Chairman. We ought to call it solar, because of
16 photosynthesis.

17 Do you want to speak?

18 Senator Snowe. Yes, just briefly.

19 Senator Kyl. I do not need to pursue the point
20 further.

21 Senator Snowe. Thank you, Mr. Chairman.

22 I just would note about this mark, and I want to
23 thank you for including a number of initiatives that I
24 proposed with respect to energy efficiency and what is
25 unique, and in fact, I think, establishes a benchmark for

1 this legislation and for energy legislation, is that
2 these tax incentives that are provided and the subsidies
3 that are provided are based on performance and not cost.
4 So, the actual energy savings has to be verified
5 before they become eligible for the tax incentives. So,
6 the tax incentives range from anywhere from 30 to 50
7 percent, but what is unique about this legislation--in
8 fact, it is landmark--in the sense that we have now, for
9 the first time ever, are establishing performance-based
10 energy efficiency standards that have to be verified
11 before they can be eligible for the tax incentives
12 provided in this legislation.
13 So, that is something that I wanted to note to the
14 members of this committee, because it truly is landmark
15 in accomplishing this goal, because the cost-based
16 initiatives in the past have demonstrated that they have
17 failed.
18 So, it is not simply how much someone has invested in
19 energy efficiency, it is a question of whether or not
20 they actually achieve energy savings, and they have to
21 verify it before they can become eligible for these
22 incentives.
23 Senator Schumer. Mr. Chairman?
24 The Chairman. Senator Schumer?
25 Senator Schumer. Thank you, Mr. Chairman. I just

1 want to add my accolades to you and the Ranking Member.
2 I think this is an excellent package. It is, if you
3 will, a very green package.
4 I was personally disappointed in the bill that came
5 out of the House. It did not even to be the palest shade
6 of green. This is deep, forest green. Using all of
7 these kinds of renewable energy is really the way to the
8 future. So, I want to thank you for that, and thank
9 Senator Baucus for that as well. I also care
10 particularly about fuel cells, and we have done a very
11 good job on fuel cells.
12 The one extra point that I would make, is this. We
13 do have tax credits for hybrid vehicles to the consumer,
14 and it is a pretty extensive package. I think it is very
15 good.
16 I had an amendment, which I did not offer at the
17 request, I think, of both of you, which would have given
18 some tax credits for domestic manufacturing. Encouraging
19 hybrids is a great idea. As you know, they have reduced
20 our gasoline consumption and there is a great demand for
21 them.
22 But the worry I have is, if we just give the credits
23 for the consumer, a lot of the manufacturing that is done
24 could end up being overseas and we would not get the
25 double bang for the buck. It is always good to have

1 hybrids, period. They save on energy. But it would be a
2 shame if things were not made in America, or companies
3 that were not from America, would get the major benefit
4 of this.
5 So, I was prepared to offer something that would give
6 a tax credit for domestic manufacturing of hybrids, and
7 you would get it on both ends, one from the consumer, not
8 to take away from what we did for the consumer, and one
9 for the manufacturer.
10 I did not offer it because I know this is full and
11 you have had to come up with some kind of set-off against
12 it, and I know the care that the Chairman and Ranking
13 Member put into this package.
14 But I hope, between now and going to the floor, and
15 as we wend our way through, we could continue to discuss
16 how we can make sure that the benefit of the credit for
17 hybrids falls more to domestic manufacturing than to
18 foreign manufacturing, along the lines of the credit that
19 I was going to propose.
20 Would that be something we could continue to discuss,
21 Mr. Chairman?
22 The Chairman. Well, we can always talk about
23 everything. Are you referring to imported cars, not cars
24 made by foreign manufacturers in the United States?
25 Senator Schumer. The credit that I proposed, as

1 long as they were made in the United States, it does not
2 matter if they were made by Toyota or General Motors, but
3 they should be made here.
4 The Chairman. Yes. Let us visit about it.
5 Senator Schumer. All right.
6 The Chairman. I do not say that to encourage,
7 because it is just a new thought that I have not spent a
8 lot of time on.
9 Senator Schumer. All right. I would just like to
10 have some time to be able to talk to you and the members
11 of the committee as we work our way to the floor. Thank
12 you, Mr. Chairman.
13 Senator Conrad. Mr. Chairman, again, I want to
14 thank you and the Ranking Member as well. I do not think
15 there is a better example of how, really, I think this
16 committee has worked in the past, in a way that is
17 collegial, bipartisan and productive. I want to thank
18 you for the leadership you have shown.
19 Just in answer to Senator Kyl on the question of
20 renewables, I would say this to Senator Kyl. Oil, gas,
21 and coal are finite resources. Once you have used what
22 is there, what was available in the world, it is gone.
23 To be able to produce a crop like canola, corn, or
24 wheat is something you can produce every year, and we
25 have expanded the ability to produce. Those really are

1 renewable. Those are things that we can produce here.
2 The oil reserves of the United States are being depleted.
3 We are on a downhill slope.
4 Moving over to renewable crop-based substances that
5 can reduce our dependence on foreign oil, I believe, is
6 in the national security interest of the United States.
7 I believe it is in the economic interests of the United
8 States, and that we are doing exactly the right thing in
9 promoting their development.
10 The Chairman. Well, just for the sake of the people
11 from the cities, you cannot grow corn without sun.
12 Senator Kyl. Or oil. There is an energy cost.
13 The Chairman. There is an energy cost. But if you
14 are quoting the professor from Cornell of 25 years ago,
15 in the meantime, instead of growing 50 bushels of corn to
16 the acre, we are growing 150 bushels of corn to the acre.
17 Instead of going across the fields 10 times to put a
18 crop in, we are going across once because of minimum
19 tillage or no tillage. We are making less trips across
20 the field when we harvest it. It is a much more
21 efficient product making it in the plant that actually
22 produces it than 25 years ago.
23 Senator Wyden. Mr. Chairman, I learned a while back
24 to duck this ethanol brawl.
25 Senator Conrad. This is bio-diesel. This is a bio-

1 diesel brawl.

2 Senator Wyden. Oh, good. The only point I wanted
3 to make, because, again, I am, by and large, very
4 sympathetic with Senator Kyl as it relates to subsidies,
5 and that is why I was the dissenter up in the energy
6 committee, is that when you look at the alternatives, for
7 example, the overall bill basically spends a boatload of
8 money on research and demonstration projects, projects
9 that are by and large being done, in my view, by private
10 industry.

11 What was appealing to me about what Chairman Grassley
12 and Senator Baucus were doing, for example, in the
13 hydrogen fuel cell area, they were taking some real steps
14 towards commercialization. Everybody says it is going to
15 be years and years before we get to commercialization.

16 When I look at hydrogen and fuel cells, what I would
17 like to see is the opportunity for people to have
18 incentives to set up hydrogen filling stations and
19 hydrogen repair shops, and the like, and we have got that
20 in this legislation.

21 So, you basically have a sympathizer as we go forward
22 in this discussion, and that is why I voted against the
23 other legislation. But I think this has been a
24 responsible job of targeting, both as it relates to oil
25 and natural gas.

1 It is different in terms of getting more production
2 per well, and even in the alternative area where, by and
3 large, government has heaved a ton of money at research
4 and demonstration projects that are generally going on in
5 the private sector, and have not done anywhere near
6 enough to jump-start commercialization. I think the
7 Grassley-Baucus package does that. Again, I appreciate
8 the work.
9 Senator Baucus. Mr. Chairman?
10 The Chairman. Senator Baucus?
11 Senator Baucus. Mr. Chairman, I deeply appreciate
12 your leadership and cooperation here and your willingness
13 to work together, in deeds, not words.
14 I, however, am a little concerned about all the
15 various ideas that everybody has about how to make this
16 country more self-sufficient. It is hard to know who is
17 right and who is not. I talk to experts; we all talk to
18 experts. Some say hydrogen is the future, others say no
19 way. There are lots of examples like that.
20 We are at the point where we have to stop, to some
21 degree--and do not misunderstand this--responding to
22 special interest entreaties to help their industry, help
23 their interests, and that kind of thing.
24 We certainly have to listen to them, and listen very
25 carefully, but we have to listen, I think, more carefully

1 than we have in the past and try to separate the wheat
2 from the chaff a little bit better than we have in the
3 past.
4 It gets a little bit to Senator Kyl's point about
5 some kind of a cost benefit analysis, what really does
6 work here? There are going to be many, many different
7 ideas.
8 We are at a stage in American history where we have
9 tried to wean ourselves from OPEC, where there are going
10 to be a lot of different ideas, lots of very innovative,
11 well-intended ideas. Some of them are going to work,
12 some of them not. We clearly have to experiment with
13 some to find out which ones work, which ones do not work.
14 But at the same time, I think we need to be a little
15 bit more discriminating when we address the basic
16 questions of how to help make our country more self-
17 sufficient, and that is just to be a little more careful
18 about which of these incentives, all very well intended,
19 really work better than some others. We cannot afford
20 the luxury of not doing that, in my judgment.
21 We have done a great job here. Mr. Chairman, you
22 have done a super job here.
23 The Chairman. Thank you.
24 Senator Baucus. I think we are at the stage right
25 now where we have done a super job, but next year we are

1 going to have to do a super job in a little bit different
2 direction, because I think that is where we are headed.
3 The Chairman. I have come to the conclusion that I
4 will listen to every idea about energy, except those
5 people that, for the last 25 years, have been coming
6 around telling me that there has been a carburetor
7 invented that will go 150 miles to the gallon, but
8 General Motors bought it up. [Laughter].
9 Senator Baucus. They tell you that in Iowa, too? I
10 hear that all the time. [Laughter].
11 Senator Conrad. I had the same thing said to me,
12 too.
13 The Chairman. And since there is so much bipartisan
14 congratulations going on here, just in case you folks on
15 that side of the aisle that have not wanted to talk about
16 Social Security--and I am not here to -- [Laughter]. I
17 am not here to harangue about Social Security. But for
18 the benefit of the Republicans, if you read the ninth
19 page of the *Washington Post*, it looks like the
20 Republicans are surrendering on Social Security. I want
21 you to know, I am not.
22 Senator Baucus. End on a high note of cooperation.
23 The Chairman. Yes. Well, I am speaking to the
24 Republicans, not to the Democrats. [Laughter]. I
25 thought it would be news for you.

1 Senator Conrad. Now speak to all of us and bring us
2 all back together.
3 The Chairman. We are in the process of doing that.
4 It just is going to take a lot longer on that issue.
5 Senator Conrad. No. But here, really, we should
6 not lose this moment without saying to the Chairman, you
7 have really done an extraordinary job of leadership, and
8 we appreciate it.
9 The Chairman. Thank you. I guess we are done.
10 Thank you.
11 [Whereupon, at 12:00 p.m. the meeting was concluded.]
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UNITED STATES SENATE
COMMITTEE ON FINANCE

Charles E. Grassley, Chairman

Thursday, June 16, 2005

628 Dirksen Senate Office Building

10:30 a.m.

Agenda for Business Meeting

Energy Policy Tax Incentives Act of 2005

JOINT COMMITTEE ON TAXATION
June 14, 2005
JCX-45-05

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MARK OF THE "ENERGY POLICY TAX INCENTIVES ACT OF 2005," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON JUNE 16, 2005

Fiscal Years 2005 - 2015

[Millions of Dollars]

Provision	Effective	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2005-10	2005-15
I. Electricity Infrastructure														
1. Extend and modify section 45 credit through 12/31/08 [1]	esfqfa 12/31/05	---	-19	-97	-279	-460	-534	-558	-554	-555	-558	-563	-1,389	-4,177
2. Clean renewable energy bonds ($1 billion aggregate issuance limitation through 12/31/08)	bia 12/31/05	---	-9	-25	-43	-56	-60	-60	-60	-60	-60	-60	-193	-493
3. Treatment of certain income of electric cooperatives	tyba 12/31/06	---	---	-14	-24	-26	-29	-32	-34	-37	-39	-42	-93	-277
4. Dispositions of transmission property to implement FERC restructuring policy (applies to sales or dispositions completed prior to 1/1/08)	DOE	-37	-105	-237	-73	43	43	44	45	82	150	64	-366	19
5. Credit for production from advanced nuclear power facilities	tyba DOE	---	---	---	---	---	---	---	---	-41	-83	-155	---	-278
6. Investment incentives for production of electricity and gasification from advanced clean coal	DOE	---	-32	-72	-136	-203	-279	-318	-313	-276	-193	-134	-722	-1,955
7. Clean energy bonds for certified coal property ($1 billion aggregate issuance limitation through 12/31/10)	bia 12/31/05	---	-7	-22	-35	-45	-50	-55	-60	-60	-60	-60	-159	-454
Total of Electricity Infrastructure		**-37**	**-172**	**-467**	**-590**	**-747**	**-909**	**-979**	**-976**	**-947**	**-843**	**-950**	**-2,922**	**-7,615**
II. Domestic Fossil Fuel Security														
1. Credit for investment in coke/cogeneration manufacturing facilities (sunset 12/31/09)	ppisa DOE	-3	-26	-32	-25	-17	-13	-11	-6	-2	[2]	---	-116	-135
2. Incentives to expand refining capacity														
a. Temporary expensing for equipment used in the refining of liquid fuels (and allow pass through to coop patrons) [3]	ppisa DOE	---	-22	-58	-268	-95	-735	-611	355	285	231	191	-1,178	-727
b. Pass through low sulfur diesel expensing to coop patrons [4]	[5]	-42	-13	5	4	4	4	4	4	4	4	4	-37	-16
3. Enhanced oil recovery credit modification for new/expanded CO2 recoveries (sunset 12/31/09)	ppisa 12/31/05	---	-12	-31	-57	-97	-133	-166	-155	-143	-143	-143	-330	-1,078
4. Gas distribution property treated as 15 year MACRS property, no AMT conformity (sunset after 2007) [3]	ppisa DOE	-1	-13	-43	-65	-63	-52	-42	-36	-39	-47	-51	-237	-452
Total of Domestic Fossil Fuel Security		**-46**	**-86**	**-159**	**-411**	**-268**	**-929**	**-826**	**162**	**105**	**45**	**1**	**-1,898**	**-2,408**

Provision	Effective	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2005-10	2005-15
III. Conservation and Energy Efficiency														
1. Allowance of deduction for certain energy efficient commercial building property (sunset 12/31/09)	ppisa DOE	-37	-138	-175	-203	-211	-62	16	14	12	10	8	-826	-766
2. Business credit for construction of new energy efficient homes (30% credit sunsets 12/31/07; 50% credit sunsets 12/31/09)	hpa DOE	-23	-104	-181	-126	-80	-63	-49	-40	-30	-10	-3	-576	-706
3. Incentive for certain energy efficient property used in business (HV/AC et al.) (sunset 12/31/08)	ppisa DOE	-15	-45	-62	-74	-28	---	---	---	---	---	---	-223	-223
4. Credit for certain non-business energy property (HV/AC et al.) (sunset 12/31/08)	ppisa 12/31/05	---	-69	-341	-352	-291	---	---	---	---	---	---	-1,053	-1,053
5. Energy credit for combined heat and power system property (sunset 12/31/07)	ppisa DOE	-27	-72	-72	-42	-22	-15	-13	-8	-1	5	5	-249	-261
6. Credit for energy efficient appliances (sunsets 12/31/07 for dishwashers and 12/31/10 for clothes washers and refrigerators) [6]	apa DOE	-8	-76	-86	-65	-41	-20	-5	---	---	---	---	-295	-300
7. 30% credit for residential purchases/installations of solar (pv and hot water) and fuel cells (sunset 12/31/09)	ppisa 12/31/05	---	-2	-13	-21	-25	-24	---	---	---	---	---	-85	-85
8. Business tax incentives for qualifying fuel cells and microturbines (sunset 12/31/09 for fuel cells and 12/31/08 for microturbines)	ppisa 12/31/05	---	-5	-10	-15	-12	-6	-4	-2	-1	[2]	[2]	-47	-54
9. Modify investment tax credit for solar energy (sunset 12/31/09)	ppisa 12/31/05	---	-4	-7	-8	-8	-6	-4	-3	-2	-1	[2]	-33	-43
Total of Conservation and Energy Efficiency		**-110**	**-515**	**-947**	**-906**	**-718**	**-196**	**-59**	**-39**	**-22**	**4**	**10**	**-3,387**	**-3,491**
IV. Alternative Motor Vehicles and Fuels Incentives														
1. Alternative motor vehicle credit (sunset 12/31/09 for hybrid vehicles, 12/31/10 for alternative fuel vehicles, and 12/31/14 for fuel cell vehicles)	ppisa DOE	-3	-428	-362	-395	-420	-19	-11	-10	-13	-17	-8	-1,628	-1,686
2. Modification and extension of credit for electric vehicles (sunset 12/31/09)	ppisa DOE	-4	-25	-35	-38	-40	-8	7	5	3	1	[7]	-149	-133
3. Credit for installation of alternative fueling stations credit for property placed in service before 1/1/10 (before 1/1/15 for hydrogen property)	ppisa 12/31/05	[2]	-3	-8	-13	-21	-17	-8	-6	-3	-1	1	-62	-78
4. Credit for retail sale of and imposition of tax on alternative fuels [8]	fsa 9/30/06	---	---	-165	-180	-189	30	39	42	44	47	49	-505	-284
5. Extend excise tax provisions and income tax credit for biodiesel (credit sunset 12/31/10)	DOE	---	---	-56	-88	-104	-120	-33	---	---	---	---	-368	-402
Total of Alternative Motor Vehicle Fuels Incentives		**-7**	**-456**	**-626**	**-714**	**-774**	**-134**	**-6**	**31**	**31**	**30**	**42**	**-2,712**	**-2,583**
V. Section 45 Technicals	[9]	***No Revenue Effect***												
NET TOTAL		**-200**	**-1,229**	**-2,199**	**-2,621**	**-2,507**	**-2,168**	**-1,870**	**-822**	**-833**	**-764**	**-897**	**-10,919**	**-16,097**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. Date of enactment is assumed to be August 1, 2005

[Legend and Footnotes for JCX-45-05 appear on the following page]

Legend and Footnotes for JCX-45-05:

Legend for "Effective" column:

apa = appliances produced after
bia = bonds issued after
DOE = date of enactment
esfqfa = electricity sold from qualifying facilities after
fsa = fuel sold after
hpa = homes purchased after
ppisa = property placed in service after
tyba = taxable years beginning after

[1] Estimates include interaction effect with the clean energy bond provision (item I.2.).
[2] Loss of less than $500,000.
[3] Excluding assets subject to binding contracts on June 14, 2005 and is restricted to original-use property.
[4] Revenue estimate is preliminary and subject to change pending further specification of proposal.
[5] Effective for expenses qualifying for the deduction under section 179B.
[6] Estimate is based upon proposed Energy Star standards for 2007 and indeterminate Energy Star standards for 2010.
[7] Gain of less than $500,000.
[8] The credit generally expires September 30, 2009. However, for hydrogen, the credit expires after December 31, 2014.
[9] Effective as if included in the American Jobs Creation Act of 2004.

DESCRIPTION OF THE CHAIRMAN'S MODIFICATION TO THE PROVISIONS OF THE "ENERGY POLICY TAX INCENTIVES ACT OF 2005"

Scheduled for Markup
By the
SENATE COMMITTEE ON FINANCE
on June 16, 2005

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

June 16, 2005
JCX-46-05

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's modification to the provisions of the "Energy Policy Tax Incentives Act of 2005," which is to be marked up by the Senate Committee on Finance on June 16, 2005.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Modification to the Provisions of the "Energy Policy Tax Incentives Act of 2005"* (JCX-46-05), June 16, 2005.

A. Provisions Modifying the Proposals in the Chairman's Mark

1. Modifications to item A.1 of the Chairman's Mark relating to the renewable electricity production tax credit

The Chairman's modification extends the credit period from five years to 10 years for electricity produced from qualifying open-loop biomass facilities (including agricultural livestock waste nutrient facilities), geothermal facilities, solar facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities placed in service after the date of enactment. The modification extends the credit period from five years to 10 years for electricity produced from qualifying fuel cell facilities placed in service after December 31, 2005.

The Chairman's modification clarifies that a qualifying trash combustion facility includes a new unit that increases electricity production capacity placed in service after October 22, 2004, at an existing trash combustion facility.

The Chairman's modification also includes hydropower as a qualified energy resource and permits taxpayers to claim a credit at one-half the 1.5 cents-per-kilowatt-hour (indexed for inflation rate) for electricity attributable to "incremental hydropower" produced at qualified hydroelectric facilities during the 10-year period commencing when the facility is placed in service. A qualified hydroelectric facility is a facility that produces incremental hydropower placed in service after the date of enactment and before January 1, 2009. "Incremental hydropower" is additional electricity generation achieved from increased efficiency or additions of capacity at an existing hydroelectric facility. A "qualified hydroelectric facility" is a FERC-licensed minor diversion structure less than 10 feet in height or an existing non-hydro dam to which turbines or other generating devices are added to produce energy and that does not require enlargement of the impoundment or diversion structures in connection with the installation of the turbine or other generating device. All such facilities are subject to all applicable environmental laws and licensing and regulatory requirements.

2. Modification to item A.6 of the Chairman's Mark relating to the credit for investment in clean coal facilities

The Chairman's modification increases to 7,500 megawatts the amount of power generation capacity the Secretary of Treasury, in consultation with the Secretary of Energy, is authorized to allocate to qualified clean coal projects. The Secretary of Treasury must allocate 55 percent of the total power generation capacity to credit-eligible projects that use an integrated gasification combined cycle technology and 45 percent to credit-eligible projects that use other advanced coal-based technologies. The Chairman's modification also clarifies that lignite is a qualifying coal for a clean coal facility under the proposal.

3. Modification to item B.2 of the Chairman's Mark relating to temporary expensing for equipment used in the refining of liquid fuels

The Chairman's modification requires that as a condition of eligibility for the expensing of equipment used in the refining of liquid fuels, a refinery must report to the IRS concerning its refinery operations (e.g., production and output).

4. Modification to item B.4 of the Chairman's Mark relating to the enhanced oil recovery credit for carbon dioxide injections

The Chairman's modification expands the definition of qualified enhanced oil recovery project to include "deep gas" well projects. Deep gas is natural gas produced from onshore formations deeper than 20,000 feet. Under the modified proposal, the credit phases out using a barrel of oil equivalent for natural gas calculated based on Btu content. The modified proposal also requires that other conforming modifications to the credit be made. The credit for enhanced oil recovery with respect to deep gas wells expires after December 31, 2009.

5. Modification to item C.2 in the Chairman's Mark relating to energy efficient new homes

The modification clarifies that duct sealing and infiltration reduction measures qualify as an energy-efficient building envelope component.

6. Modification to item C.3 in the Chairman's Mark relating to business energy property

The modification clarifies that an oil, natural gas, or propane furnace or hot water boiler that achieves at least 95 percent annual fuel utilization efficiency is eligible for a deduction of $450. The modification further clarifies that a natural gas, propane, or oil water heater must have an energy factor of at least 0.80 to qualify for any deduction.

7. Modification to item C.4 in the Chairman's Mark relating to nonbusiness energy property

The modification clarifies that an oil, natural gas, or propane furnace or hot water boiler that achieves at least 95 percent annual fuel utilization efficiency is eligible for a credit of $150. The modification further clarifies that a natural gas, propane, or oil water heater must have an energy factor of at least 0.80 to qualify for any credit.

The modification also allows certified home inspectors to be eligible to provide certifications of the energy efficiency performance of principal residences.

8. Modification to item C.8 in the Chairman's Mark relating to business investment tax credit for fuel cells and microturbines

For purposes of the fuel cell and microturbine investment tax credit, the modification removes the restriction that prohibits telecommunication utilities from claiming the credit.

9. Modification to item C.9 in the Chairman's Mark relating to business solar investment tax credit

The modification makes hybrid solar lighting systems eligible solar energy property for purposes of the section 48 energy credit.

10. Modification to item D.1 of the Chairman's Mark relating to the alternative vehicle credit

The Chairman's modification changes the applicable emissions standards for a hybrid vehicle with a gross vehicle weight rating greater than 6,000 pounds and less than or equal to 8,500 pounds from Bin 8 Tier II to Bin 5 Tier II.

B. Additional Energy Tax Incentives

1. Ten-year recovery period for underground natural gas storage facilities and cushion gas

Present Law

Under present law, depreciation allowances for property used in a trade or business generally are determined under the Modified Accelerated Cost Recovery System ("MACRS"). Under MACRS, natural gas storage facilities and related equipment have a class life of 22 years and a recovery period of 15 years.

Cushion gas is the minimum volume of natural gas necessary to provide the pressure to facilitate the flow of gas from a storage reservoir to a pipeline. Recoverable cushion gas will be available for sale or other use upon abandonment of the storage reservoir, while nonrecoverable cushion gas will become obsolete with that abandonment. Under present law, the tax treatment of cushion gas depends on whether such gas is recoverable. The quantity of cushion gas that is recoverable is not subject to depreciation because it is not subject to exhaustion, wear, tear, or obsolescence. Conversely, non-recoverable cushion gas is subject to obsolescence and is therefore subject to tax depreciation. The depreciable life of non-recoverable cushion gas is also 15 years.

Description of Proposal

The proposal reclassifies underground natural gas storage facilities and nonrecoverable cushion gas as ten-year MACRS property. The present law treatment of recoverable cushion gas remains unchanged.

Effective Date

The proposal applies to property placed in service after the date of enactment, the original use of which commences with the taxpayer.

2. Modify research credit for research relating to energy

Present Law

General rule

Section 41 provides for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenses for a taxable year exceed its base amount for that year. The research tax credit is scheduled to expire and generally will not apply to amounts paid or incurred after December 31, 2005.

A 20-percent research tax credit also applies to the excess of (1) 100 percent of corporate cash expenses (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-

base period, as adjusted for inflation. This separate credit computation is commonly referred to as the university basic research credit (see sec. 41(e)).

Alternative incremental research credit regime

Taxpayers are allowed to elect an alternative incremental research credit regime. If a taxpayer elects to be subject to this alternative regime, the taxpayer is assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise is reduced. Under the alternative credit regime, a credit rate of 2.65 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of one percent (i.e., the base amount equals one percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 3.2 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of two percent. A credit rate of 3.75 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of two percent. An election to be subject to this alternative incremental credit regime may be made for any taxable year beginning after June 30, 1996, and such an election applies to that taxable year and all subsequent years unless revoked with the consent of the Secretary of the Treasury.

Eligible expenses

Qualified research expenses eligible for the research tax credit consist of: (1) in-house expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid or incurred by the taxpayer to certain other persons for qualified research conducted on the taxpayer's behalf (so-called contract research expenses). In the case of amounts paid to a research consortium, 75 percent of amounts paid for qualified research is treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer.

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 for the deduction for research expenses, but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and substantially all of the activities of which must constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component.

Description of Proposal

The proposal modifies the present-law research credit as it applies to qualified energy research. In particular, the proposal provides that the taxpayer may claim a credit equal to 20 percent of the taxpayer's expenditures on qualified energy research undertaken by an energy research consortium. The amount of credit claimed is determined only by regard to such expenditures by the taxpayer within the taxable year. Unlike the general rule for the research credit, the 20-percent credit for research by an energy research consortium applies to all such expenditures, not only those in excess of a base amount however determined. An energy research consortium is a qualified research consortium as under present law that also is organized and operated primarily to conduct energy research and development in the public interest and to which at least five unrelated persons paid, or incurred amounts, to such organization within the calendar year. In addition, to be a qualified energy research consortium, no single person shall pay or incur more than 50 percent of the total amounts received by the research consortium during the calendar year.

The proposal also provides that 100 percent of amounts paid or incurred by the taxpayer to eligible small businesses, universities, and the Federal government for qualified energy research would constitute qualified research expenses as contract research expenses, rather than 65 percent of qualified research expenditures allowed under present law. An eligible small business for this purpose is a business in which the taxpayer does not own a 50 percent or greater interest and the business has employed, on average, 500 or fewer employees in the two preceding calendar years.

Qualified energy research expenditures are expenditures that would otherwise qualify for the research credit under present law and relate to the production, supply, and conservation of energy, including otherwise qualifying research expenditures related to alternative energy sources or the use of alternative energy sources. For example, research relating to hydrogen fuel cell vehicles would qualify under this proposal, if the research expenditures otherwise satisfy the criteria of present-law section 41. Likewise, otherwise qualifying research undertaken to improve the energy-efficiency of lighting would qualify under this proposal.

Effective Date

The proposal is effective for amounts paid or incurred after the date of enactment in taxable years ending after such date.

3. Create small agri-biodiesel producer credit

Present Law

Biodiesel income tax credit

The Code provides an income tax credit for biodiesel and qualified biodiesel mixtures, the biodiesel fuels credit. The biodiesel fuels credit is the sum of the biodiesel mixture credit plus the biodiesel credit and is treated as a general business credit. The amount of the biodiesel fuels credit is includible in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the biodiesel excise tax credit and payment provisions created by the Act.

The credit may not be carried back to a taxable year ending before or on December 31, 2004. The provision does not apply to fuel sold or used after December 31, 2006.

Biodiesel is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the EPA 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.

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.

The biodiesel income tax credit does not contain any incentives for small producers.

Small ethanol producer credit

Present law provides several tax benefits for ethanol and methanol produced from renewable sources that are used as a motor fuel or that are blended with other fuels (e.g., gasoline) for such a use. In the case of ethanol, a separate 10-cents-per-gallon credit for up to 15 million gallons per year for small producers, defined generally as persons whose production does not exceed 15 million gallons per year and whose production capacity does not exceed 30 million gallons per year. The alcohol fuels tax credits are includible in income. The alcohol fuels tax credit is scheduled to expire after December 31, 2010.

Description of Proposal

The proposal adds to the biodiesel fuels credit a small agri-biodiesel producer credit. The credit is a 10-cents-per-gallon credit for up to 15 million gallons of biodiesel produced by small producers, defined generally as persons whose production capacity does not exceed 60 million gallons per year.

Effective Date

The proposal is effective for taxable years ending after the date of enactment.

4. Modification to the small ethanol producer credit

Present Law

Present law provides several tax benefits for ethanol and methanol that are used as a fuel or that are blended with other fuels (e.g., gasoline) for such a use. For example, the Code provides an income tax credit for alcohol and alcohol-blended fuels. In the case of ethanol, the

Code provides an additional 10-cents-per-gallon credit for small producers, defined generally as persons whose production capacity does not exceed 30 million gallons per year.[2]

Description of Proposal

The proposal increases the limit on production capacity for small ethanol producers from 30 million gallons to 60 million gallons per year.

Effective Date

The proposal is effective for taxable years ending after the date of enactment.

5. Qualified recycling equipment credit

Present Law

There is no present law credit for qualified recycling equipment.

Description of Proposal

The proposal provides a 15-percent business tax credit for the cost of qualified recycling equipment placed in service or leased by the taxpayer. Qualified recycling equipment means equipment, including connecting piping, employed in sorting or processing residential and commercial qualified recyclable materials for the purpose of converting such materials for use in manufacturing tangible consumer products, including packaging. Such term includes equipment that is utilized at commercial or public venues, including recycling collection centers, where the equipment is utilized to sort or process qualified recyclable materials for such purpose. Such term does not include rolling stock or other equipment used to transport recyclable materials.

Qualified recyclable materials are any packaging or printed material which is glass, paper, plastic, steel, or aluminum generated by an individual or business and which has been separated from solid waste for the purposes of collection and recycling.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2005.

6. Five-year carryback of net operating losses of certain electric utility companies

Present Law

A net operating loss ("NOL") is, generally, the amount by which a taxpayer's allowable deductions exceed the taxpayer's gross income. A carryback of an NOL generally results in the

[2] Secs. 40(b)(4) and (g)(1). The alcohol fuels tax credit (which is comprised of the small ethanol producer credit, the alcohol mixture credit, and the alcohol credit) is scheduled to expire after December 31, 2010 (sec. 40(e)(1)).

refund of Federal income tax for the carryback year. A carryforward of an NOL reduces Federal income tax for the carryforward year.

In general, an NOL may be carried back two years and carried forward 20 years to offset taxable income in such years.[3] Different rules apply with respect to NOLs arising in certain circumstances. For example, a three-year carryback applies with respect to NOLs (1) arising from casualty or theft losses of individuals, or (2) attributable to Presidentially declared disasters for taxpayers engaged in a farming business or a small business. A five-year carryback period applies to NOLs from a farming loss (regardless of whether the loss was incurred in a Presidentially declared disaster area). Special rules also apply to real estate investment trusts (no carryback), specified liability losses (10-year carryback), and excess interest losses (no carryback to any year preceding a corporate equity reduction transaction).

Section 202 of the Job Creation and Worker Assistance Act of 2002[4] ("JCWAA") provided a temporary extension of the general NOL carryback period to five years (from two years) for NOLs arising in taxable years ending in 2001 and 2002. In addition, the five-year carryback period applies to NOLs from these years that qualify under present law for a three-year carryback period (i.e., NOLs arising from casualty or theft losses of individuals or attributable to certain Presidentially declared disaster areas).

A taxpayer can elect to forgo the five-year carryback period. The election to forgo the five-year carryback period is made in the manner prescribed by the Secretary of the Treasury and must be made by the due date of the return (including extensions) for the year of the loss. The election is irrevocable. If a taxpayer elects to forgo the five-year carryback period, then the losses are subject to the rules that otherwise would apply under section 172 absent the provision.

Description of Proposal

The proposal provides a temporary extension of the NOL carryback period to five years for NOLs of certain electric utility companies arising in taxable years ending in 2003, 2004, and 2005 ("eligible NOLs"). Regardless of the taxable year in which an eligible NOL arose, refund claims resulting from the extended carryback period can be made during any taxable year ending after December 31, 2005, and before December 31, 2008. However, the amount of the refund claimed during any one taxable year may not exceed the electric utility company's investment in electric transmission property and pollution control facilities in the preceding taxable year. Taxpayers may elect to forgo the five-year carryback period provided under the proposal if an election is filed before December 31, 2008.

Effective Date

The proposal is effective for refund claims resulting from net operating losses generated in taxable years ending in 2003, 2004, and 2005.

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[3] Sec. 172.

[4] Pub. Law No. 107-147.

7. Qualifying pollution control equipment credit

Present Law

The investment credit is the sum of the rehabilitation credit, and the energy credit. The investment credit is part of the general business credit.

Description of Proposal

The proposal adds a credit for qualifying pollution control equipment to the investment credit. The qualifying pollution control equipment credit provides a 15-percent tax credit for qualifying pollution control equipment placed in service at a qualifying facility during the taxable year. Qualifying pollution control equipment means any technology that is installed in or on a qualifying facility to reduce air emissions of any pollutant regulated by the EPA under the Clean Air Act, including thermal oxidizers, scrubber systems, vapor recovery systems, low nitric oxide burners, flare systems, bag houses, cyclones, and continuous emission monitoring systems. A qualifying facility is a facility that produces not less than 1 million gallons of ethanol during the taxable year. For depreciation purposes, the basis of qualifying pollution control equipment would be reduced by 50 percent of the value of the credit.

Effective Date

The credit is available for property placed in service after date of enactment.

8. Credit for production of Indian country coal

Present Law

Present law provides two income tax incentives for businesses operating within Indian reservations: (1) accelerated depreciation with respect to certain non-gaming property used in a trade or business within an Indian reservation (sec. 168(j)); and (2) a nonrefundable income tax credit to employers on the first $20,000 of qualified wages and health care costs paid to certain members of Indian tribes (or their spouses) who work on or near an Indian reservation and who earn less than $30,000 per year (adjusted for inflation beginning in 1993) (sec. 45A). Both credits expire after December 31, 2005.

Present law does not provide a credit for the production of coal from coal reserves owned by an Indian tribe.

Description of Proposal

The proposal establishes a nontransferable credit (indexed for inflation after 2006) for "Indian Country Coal" sold to a utility or other entity that operates a utility unit. Indian Country Coal is defined as coal delivered to a purchaser by common carrier railroad or highway truck, that is produced from coal reserves owned by a Federally recognized tribe of Indians, including coal held in trust by the United States for the tribe or its members. The amount of the credit equals $1.50 per ton for coal sold in 2006 through 2010 and $2.00 per ton for coal sold after

2010. No credit is allowed for sales after 2012. The credit is allowed against the alternative minimum tax.

Effective Date

The proposal applies to Indian Country Coal sold to a utility or utility unit after December 31, 2005.

9. Wood stoves for EPA non-attainment areas

Present Law

There is no present-law tax credit related to wood stoves.

Description of Proposal

The proposal provides a $500 credit for the replacement of a non-compliant wood stove with a stove that complies with Environmental Protection Agency ("EPA") emission performance standards. In general, a non-compliant wood stove is any wood stove purchased prior to June 30, 1992. Stoves produced after June 30, 1992 must comply with EPA's "Standards of Performance for Residential Wood Heaters." The credit is only available for replacements that occur in areas designated by the EPA as non-attainment areas for particulate matter less than 2.5 micrometers in diameter or non-attainment areas for particulate matter less than 10 micrometers in diameter.

Effective Date

The credit applies to wood stoves purchased after the date of enactment and before January 1, 2009.

10. Exemption of bulk beds for farm crops from the Federal excise tax on heavy trucks and trailers

The Code imposes a 12-percent excise tax on the first retail sale of heavy trucks and trailers (chassis and bodies.[5] Under present law, the tax on the first retail sale of automobile truck bodies does not apply to any body primarily designed (1) to process or prepare seed, feed, or fertilizer for use on farms, (2) to haul feed, seed, or fertilizer to and on farms, (3) to spread feed, seed, or fertilizer on farms, (4) to load or unload feed, seed, or fertilizer on farms, or (5) for any combination of the foregoing.[6]

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[5] Sec. 4051(a).

[6] Sec. 4053(2).

Description of Proposal

The proposal exempts bulk beds used for transporting farm crops to and on farms from the excise tax on the retail sale heavy trucks and trailers if sold to a person who certifies to the seller that such person is actively engaged in the trade or business of farming and the primary use of the bulk bed is to haul to and on farms farm crops grown in connection with such trade or business. The proposal provides for the recapture of the tax from the purchaser upon resale of within two years of the first retail sale, or if such purchaser makes substantial nonexempt use of the article.

Effective Date

The proposal is effective for sales after September 30, 2005.

11. National Academy of Sciences study

Present Law

Present law does not provide for a study of the health, environmental, security, and infrastructure external costs that may be associated with the use and production of energy.

Description of Proposal

The proposal requires the Secretary of Treasury to enter into an agreement, within 60 days, with the National Academy of Sciences to conduct a study to define and evaluate the health, environmental, security, and infrastructure external costs and benefits associated with energy activities that are not or may not be fully incorporated into the price of such activities, or into the Federal tax or fee or other applicable revenue measure related to such activities. The results of the study are to be submitted to Congress within two years of the agreement.

Effective Date

The proposal is effective on the date of enactment.

C. Revenue Raising Provisions

1. Treatment of kerosene for use in aviation

Present Law

In general, aviation-grade kerosene is taxed at a rate of 21.8 cents per gallon upon removal of such fuel from a refinery or terminal (or entry into the United States).[7] Aviation-grade kerosene may be removed at a reduced rate, either 4.3 or zero cents per gallon, if the aviation fuel is removed directly into the fuel tank of an aircraft for use in commercial aviation[8] or for a use that is exempt from the tax imposed by section 4041(c) (other than by reason of a prior imposition of tax),[9] or is removed or entered as part of an exempt bulk transfer.[10] These taxes are credited to the Airport and Airway Trust Fund.[11] If taxed aviation-grade kerosene is used for a nontaxable use, a claim for credit or refund may be made.[12] Such claims are paid from the Airport and Airway Trust Fund to the general fund of the Treasury.[13] All other removals and entries of kerosene used for surface transportation are taxed at the diesel tax rate of 24.3 cents per gallon,[14] and these taxes are credited to the Highway Trust Fund.[15] If aviation-grade

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[7] Sec. 4081(a)(2)(A)(iv). (An additional 0.1 cent is imposed on aviation-grade kerosene and credited to the Leaking Underground Storage Tank ("LUST" Trust Fund). Sec. 4081(a)(2)(B). The LUST Trust Fund tax is set to expire after September 30, 2005. Sec. 4081(d)(3).

[8] Sec. 4081(a)(2)(C).

[9] Sec. 4082(e). Exempt uses include use in commercial aviation as supplies for vessels or aircraft, which includes use by certain foreign air carriers and for the international flights of domestic carriers. Secs. 4082(e), 6427(l)(2), and 4221(d)(3),

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

[11] Sec. 9502(b)(1)(C).

[12] Sec. 6427(l)(4). Nontaxable uses include: (1) use other than as fuel in an aircraft (such as use in heating oil); (2) use on a farm for farming purposes; (3) use in a military aircraft owned by the United States or a foreign country; (4) use in a domestic air carrier engaged in foreign trade or trade between the United States and any of its possessions; (5) use in a foreign air carrier engaged in foreign trade or trade between the United States and any of its possessions (but only if the foreign carrier's country of registration provides similar privileges to United States carriers); (6) exclusive use of a State or local government; (7) sales for export, or shipment to a United States possession; (8) exclusive use by a nonprofit educational organization; (9) use by an aircraft museum exclusively for the procurement, care, or exhibition of aircraft of the type used for combat or transport in World War II; and (10) use as a fuel in a helicopter or a fixed-wing aircraft for purposes of providing transportation with respect to which certain requirements are met. Secs. 4041(f)(2), 4041(g), 4041(h), 4041(l), and 6427(l)(2)(B)(i).

[13] Sec. 9502(d)(2).

[14] Sec. 4081(a)(2)(iii).

[15] Sec. 9503(b)(1)(D).

kerosene is taxed upon removal or entry but used for surface transportation, the taxes remain in the Airport and Airway Trust Fund, and the Highway Trust Fund is not credited for the taxes on such fuel.

Description of Proposal

The proposal imposes the diesel tax rate of 24.3 cents per gallon upon the entry or removal of aviation-grade kerosene. The present law reduced-rates for removals of aviation-grade kerosene directly into the fuel tank of an aircraft apply,[16] except that in addition, under the proposal, if kerosene is removed directly into the fuel tank of an aircraft for use in aviation other than commercial aviation, the rate of tax is 21.8 cents per gallon. The rate is also 21.8 cents per gallon for the removal of aviation-grade kerosene at the following airports: Miami International Airport (T-65-FL-2159), LaGuardia (T-11-NY-1335), and Cleveland North (T-34-OH-3175).

The proposal provides that amounts may be claimed as credits or refunds for kerosene that is used for aviation purposes. If kerosene is used for noncommercial aviation, the amount is 2.5 cents; if kerosene is used for commercial aviation, the amount is 20 cents; if kerosene is used for a use that is exempt from tax (as determined under present law), the amount is 24.3 cents. Present law rules with respect to claims apply, except for claims with respect to kerosene used in noncommercial aviation, which are payable to the ultimate vendor only. To be eligible to receive a payment, a vendor must be registered and must show either that the price of the fuel did not include the tax and the tax was not collected from the purchaser, the amount of tax was repaid to the ultimate purchaser, or the written consent of the purchaser to the making of the claim was filed with the Secretary.

Under the proposal, all taxes collected at the 24.3 cents per gallon rate (under section 4081) initially are credited to the Highway Trust Fund. The proposal requires the Secretary to transfer at least monthly from the Highway Trust Fund into the Airport and Airway Trust Fund amounts equivalent to 21.8 cents per gallon for claims made with respect to kerosene used for noncommercial aviation purposes and 4.3 cents per gallon for claims made with respect to kerosene used for commercial aviation purposes. The proposal requires that transfers be made on the basis of estimates by the Secretary, with proper adjustments to be made subsequently to the extent prior estimates were in excess of or less than the amounts required to be transferred. Transfers are required to be made with respect to taxes received on or after October 1, 2005, and before October 1, 2011.

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[16] For example, for kerosene removed directly into the fuel tank of an aircraft for use in commercial aviation by a person registered for such use, the rate of tax is 4.3 cents per gallon. Kerosene removed directly into the fuel tank of an aircraft for an exempt use is not taxed. For purposes of these reduced rates, it is intended that the following airports be included on the Secretary's expanded list of airports that include a secured area in which a terminal is located: Los Angeles International Airport (T-95-CA-4812) and Federal Express Corporation Memphis (T-62-TN-2220).

Effective Date

The provision is effective for fuels or liquids removed, entered, or sold after September 30, 2005.

2. Repeal of ultimate vendor refund claims with respect to diesel and kerosene used for farming purposes

Present Law

Ultimate purchaser refunds for nontaxable uses

In general, the Code provides that if diesel fuel or kerosene on which tax has been imposed is used by any person in a nontaxable use, the Secretary is to refund (without interest) to the ultimate purchaser the amount of tax imposed.[17] The refund is made to the ultimate purchaser of the taxed fuel by either income tax credit or refund payment.[18] Not more than one claim may be filed by any person with respect to fuel used during its taxable year. However, there are exceptions to this rule.

An ultimate purchaser may make a claim for a refund payment for any quarter of a taxable year for which the purchaser can claim at least $750.[19] If the purchaser cannot claim at least $750 at the end of quarter, the amount can be carried over to the next quarter to determine if the purchaser can claim at least $750. If the purchaser cannot claim at least $750 at the end of the taxable year, the purchaser must claim a credit on the person's income tax return.

As discussed below, these ultimate purchaser refund rules do not apply to diesel fuel or kerosene used on a farm. The Code precludes the ultimate purchaser from claiming a refund for such use. Instead, the refund claims are made by registered ultimate vendors as described below.

Special ultimate vendor rule for fuel used on a farm for farming purposes

In the case of diesel fuel or kerosene used on a farm for farming purposes refund payments are paid to the ultimate, registered vendors ("registered ultimate vendor") of such fuels. Thus a registered ultimate vendor that sells undyed diesel fuel or undyed kerosene to any of the following may make a claim for refund: (1) the owner, tenant, operator of a farm for use by that person on a farm for farming purposes; and (2) a person other than the owner, tenant, or operator of a farm for use by that person on a farm in connection with cultivating, raising or harvesting. The registered ultimate vendor is the only person who may make the claim with

[17] Sec. 6427(l)(1).

[18] Generally, refund payments are only made to governmental units and tax-exempt organizations. Sec. 6427(k). The quarterly payment claim rules for ultimate purchasers are an exception to this rule.

[19] Sec. 6427(i)(2).

respect to diesel fuel or kerosene used on a farm for farming purposes. The purchaser of the fuel cannot make the claim for refund.

Registered ultimate vendors may make weekly claims if the claim is at least $200 ($100 or more in the case of kerosene).[20] If not paid within 45 days (20 days for an electronic claim), the Secretary is to pay interest on the claim.

Description of Proposal

The proposal repeals ultimate vendor refund claims in the case of diesel fuel or kerosene used on a farm for farming purposes. Thus, refunds for taxed diesel fuel or kerosene used on a farm for farming purposes are paid to the ultimate purchaser under the rules applicable to nontaxable uses of diesel fuel or kerosene.

Effective Date

The proposal is effective for sales after September 30, 2005.

3. Refunds of excise taxes on exempt sales of taxable fuel by credit card

Present Law

Under the rules in effect prior to 2005, in the case of gasoline on which tax had been paid and sold to a State or local government, to a nonprofit educational organization, for supplies for vessels or aircraft, for export, or for the production of special fuels, the wholesale distributor that sold such gasoline was treated as the only person who paid the tax and thereby was the proper claimant for a credit or refund of the tax paid. A "wholesale distributor" included any person, other than an importer or producer, who sold gasoline to producers, retailers, or to users who purchased in bulk quantities and accepted delivery into bulk storage tanks. A wholesale distributor also included any person who made retail sales of gasoline at 10 or more retail motor fuel outlets.

Under a special administrative exception to these rules, a sale of gasoline charged on an oil company credit card issued to an exempt person described above is not considered a direct sale by the person actually selling the gasoline to the ultimate purchaser if the seller receives a reimbursement of the tax from the oil company (or indirectly from an intermediate vendor). Thus, the person that actually paid the tax, in most cases the oil company, is treated as the only person eligible to make the refund claim.[21]

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[20] Sec. 6427(i)(4)(A).

[21] Notice 89-29, 1989-1 C.B. 669.

The American Jobs Creation Act of 2004 ("AJCA")[22] modified the pre-existing statutory rules with respect to certain sales. Under AJCA, if a registered ultimate vendor purchases any gasoline on which tax has been paid and sells such gasoline to a State or local government or to a nonprofit educational organization, for its exclusive use, such ultimate vendor is treated as the only person who paid the tax and thereby is the proper claimant for a credit or refund of the tax paid.[23] However, AJCA did not change the special administrative oil company credit card rule described above.[24]

In addition, under AJCA, refund claims made by such an ultimate vendor may be filed for any period of at least one week for which $200 or more is payable. Any such claim must be filed on or before the last day of the first quarter following the earliest quarter included in the claim. The Secretary must pay interest on refunds unpaid after 45 days. If the refund claim was filed by electronic means, and the ultimate vendor has certified to the Secretary for the most recent quarter of the taxable year that all ultimate purchasers of the vendor are certified for highway exempt use as a State or local government or a nonprofit educational organization, refunds unpaid after 20 days must be paid with interest.[25]

In the case of diesel fuel or kerosene used in a nontaxable use, the ultimate purchaser is generally the only person entitled to claim a refund of excise tax.[26] However, in the case of diesel fuel or kerosene used on a farm for farming purposes or by a State or local government, aviation-grade kerosene, and certain nonaviation-grade kerosene, an ultimate vendor may claim the refund if the ultimate vendor is registered and bears the tax (or receives the written consent of the ultimate purchaser to claim the refund).[27]

Description of Proposal

The proposal replaces the oil company credit card rule with a new set of rules applicable to certain credit card sales. The new rules apply to gasoline, diesel fuel, and kerosene. Under the proposal, if a purchase of taxable fuel is made by means of a credit card issued to an ultimate purchaser that is either a State or local government or, in the case of gasoline, a nonprofit educational organization, for its exclusive use, a credit card issuer who is registered and who

[22] Pub. L. No. 108-357.

[23] AJCA, sec. 865(a), effective January 1, 2005. See Code sec. 6416(a)(4)(A).

[24] In Notice 2005-4, 2005-2 I.R.B. 289, the Treasury Department confirmed that it would continue to apply the oil company credit card rule until March 1, 2005. On February 28, 2005, the Treasury Department issued Notice 2005-24, 2005-12 I.R.B. 1, modifying Notice 2005-4. Notice 2005-24 stated that the oil company credit card rule will remain in effect until it is modified by a statutory change or by future guidance.

[25] Sec. 6146(a)(4)(B).

[26] Sec. 6427(l)(1).

[27] See secs. 6427(l)(4)(B), (l)(5)(B), and (l)(5)(C), and sec. 6416(a)(1)(A), (B), and (D).

extends such credit to the ultimate purchaser with respect to such purchase shall be the only person entitled to apply for a credit or refund if the following two conditions are met: (1) such registered person has not collected the amount of the tax from the purchaser, or has obtained the written consent of the ultimate purchaser to the allowance of the credit or refund; and (2) such registered person has either repaid or agreed to repay the amount of the tax to the ultimate vendor, has obtained the written consent of the ultimate vendor to the allowance of the credit or refund, or has otherwise made arrangements that directly or indirectly assure the ultimate vendor of reimbursement of such tax. It is anticipated that such indirect arrangements may consist of the contractual undertaking of the relevant oil company to the credit card company that it will cover over the tax to the ultimate vendor, and the corresponding contractual undertaking of the oil company to the ultimate vendor.

If a credit card issuer is not registered, or if either condition (1) or (2) above is not met, then the credit card issuer must collect an amount equal to the tax from the ultimate purchaser, and only the ultimate purchaser may claim a credit or payment from the IRS.[28] Thus, tax-paid fuel must not be sold tax free to an exempt entity by means of a credit card unless the credit card issuer is registered. An unregistered credit card issuer that does not collect an amount equal to the tax from the exempt entity is liable for present-law penalties for failure to register.[29] It is intended that the IRS will review the registration of a registered credit card issuer that has engaged in multiple violations of the requirements of the proposal.

A credit card issuer entitled to claim a refund under the proposal is responsible for supplying all the appropriate documentation currently required from ultimate vendors. The present-law refund amount and timing rules applicable to ultimate vendors, including the special rules for electronic claims, apply to refunds to credit card issuers under the proposal.[30]

The proposal also conforms present-law penalty provisions to the new rules.

The proposal does not change the present-law rules applicable to non-credit card purchases.

Effective Date

The proposal is effective for sales after December 31, 2005.

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[28] See sec. 6421(c).

[29] See secs. 6719, 7232, and 7272.

[30] See sec. 6416(a)(4)(B). Present law would continue to apply to the timing of ultimate purchaser claims. Under present law, claims by an ultimate purchaser are generally made on an annual basis. However, claims aggregating over $750 may be made quarterly. See secs. 6421(d) and 6427(i)(2).

4. Recertification of exempt status

Present Law

If gasoline is sold to any person for an exempt use, an ultimate purchaser that has borne the tax is entitled to claim a refund.[31] However, a registered ultimate vendor is the appropriate person to claim a refund of Federal excise taxes on gasoline sold to a State or local government or to a nonprofit educational organization.[32]

In general, in order to claim a refund of Federal excise taxes on gasoline (and on other articles subject to manufacturers excise taxes under Chapter 32 of the Code) sold to a State or local government or to a nonprofit educational organization, for its exclusive use, a claimant must submit a statement indicating that it possesses evidence of the exempt use giving rise to the overpayment of tax.[33] Such evidence consists of a certificate executed and signed by the ultimate purchaser. The ultimate purchaser certificate must be signed by the ultimate purchaser and must identify the article, show the name and address of the ultimate purchaser, and state the exempt use made or to be made of the article. In the case where the certificate sets forth the use to be made of the article, rather than its actual use, it must show that the ultimate purchaser has agreed to notify the claimant if the article is not in fact used as specified in the certificate.[34]

However, if the article to which the claim relates has passed through a chain of sales from the claimant to the ultimate purchaser, a certificate from the ultimate vendor is sufficient. The ultimate vendor certificate contains the exempt sales information, and a statement that it possesses the ultimate purchaser certificates and will forward them to the claimant within three years from the date of the statement. An ultimate vendor statement may be made covering no more than 12 consecutive calendar quarters.[35]

In general, an ultimate purchaser is the proper party to claim a refund of Federal excise tax on diesel fuel or kerosene used by any person in a nontaxable use.[36] However, in the case of diesel or kerosene used by a State or local government, the ultimate vendor is the proper person

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[31] Sec. 6421(c).

[32] Sec. 6416(a)(4)(A).

[33] Treas. Reg. sec. 48.6416(b)(2)-3(a)(5).

[34] Treas. Reg. sec. 48.6416(b)(2)-3(b)(1)(i) and (ii). The certificate must also contain a statement that the ultimate purchaser understands that it and any other party may, for fraudulent use of the certificate, be subject under section 7201 to a fine of not more than $10,000, or imprisonment for not more than five years, or both, together with the costs of prosecution.

[35] Treas. Reg. sec. 48.6416(b)(2)-3(b)(1)(i) and (iii).

[36] Sec. 6427(l)(1). In the case of diesel fuel or kerosene, a nontaxable use is any use which is exempt from the tax imposed by section 4041(a)(1) other than by reason of a prior imposition of tax. Sec. 6427(l)(2).

if such vendor is registered and has borne the tax.[37] A registered ultimate vendor claiming a refund under this provision must provide a statement that it has in its possession an unexpired exemption certificate of the purchaser and that the claimant has no reason to believe any information in the certificate is false.[38]

A State or local government includes any political subdivision of a State, or the District of Columbia.[39] A nonprofit educational organization means an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on, and which is either exempt from income tax under section 501(a) or is a school operated as an activity of an organization described in section 501(c)(3) which is exempt from income tax under section 501(a).[40]

Description of Proposal

Under the proposal, additional documentation requirements are imposed with respect to purchases of taxable fuel and certain other articles on a nontaxable basis by State or local governments and nonprofit educational organizations, and with respect to refunds or credits by any person with respect to such purchases. The proposal covers Federal excise taxes on sales of gasoline, diesel fuel, kerosene, compressed natural gas (except if sold for use on school buses or intracity buses), heavy trucks and trailers, and tires (except for tires sold for use on qualified buses). The proposal does not cover Federal excise taxes on sales of coal, recreational equipment (bows and arrows, sport fishing equipment and firearms), and vaccines.

In addition to present-law documentation requirements, in order for a State or local governmental entity to claim exemption from tax on sales of such covered articles, or for any person to claim a credit or refund based upon the State or local governmental status of the purchaser of such articles, the State must certify that the article is sold to a State or local government for the exclusive use of a State or local government. In the case of articles sold to a qualified volunteer fire department, as defined in section 150(e)(2),[41] the State must so certify, and the article must be sold for the exclusive use of the qualified volunteer fire department.

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[37] Sec. 6427(l)(5)(C).

[38] Treas. Reg. sec. 48.6427-9(e)(1)(vi).

[39] Sec. 4221(d)(4); Treas. Reg. sec. 48.6416(b)(2)-2(d).

[40] Sec. 4221(d)(5); Treas. Reg. sec. 48.6416(b)(2)-2(e).

[41] In general, as defined in section 150(e)(2), a qualified volunteer fire department is any organization organized and operated to provide firefighting or emergency medical services for persons in an area that is not provided with any other firefighting services, and which is required by written agreement with the political subdivision to furnish firefighting services in such area.

In order for a nonprofit educational organization to claim exemption from tax on such articles, or for any person to claim a credit or refund of tax on such articles based upon the nonprofit educational status of an organization, the State in which such organization is providing educational services must certify that such organization is in good standing.

The Secretary may prescribe forms for such certifications.

Effective Date

The proposal is effective for sales after December 31, 2005.

5. Reregistration in event of change in ownership

Present Law

Blenders, enterers, pipeline operators, position holders, refiners, terminal operators, and vessel operators are required to register with the Secretary with respect to fuels taxes imposed by sections 4041(a)(1) and 4081.[42] An assessable penalty for failure to register is $10,000 for each initial failure, plus $1,000 per day that the failure continues.[43] A non-assessable penalty for failure to register is $10,000.[44] A criminal penalty of $10,000, or imprisonment of not more than five years, or both, together with the costs of prosecution also applies to a failure to register and to certain false statements made in connection with a registration application.[45] Treasury regulations require that a registrant notify the Secretary of any change (such as a change in ownership) in the information a registrant submitted in connection with its application for registration within 10 days of the change.[46] The Secretary has the discretion to revoke the registration of a noncompliant registrant.

Description of Proposal

The proposal requires that upon a change in ownership of a registrant, the registrant must reregister with the Secretary, as provided by the Secretary. A change in ownership means that after a transaction (or series of related transactions), more than 50 percent of the ownership interests in, or assets of, a registrant are held by persons other than persons (or persons related thereto) who held more than 50 percent of such interests or assets before the transaction (or series of related transactions). The proposal does not apply to companies, the stock of which is regularly traded on an established securities market. The penalties for failure to reregister are the

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[42] Sec. 4101; Treas. Reg. sec. 48.4101-1(a) and (c)(1).

[43] Sec. 6719.

[44] Sec. 7272(a).

[45] Sec. 7232.

[46] Treas. Reg. sec. 48.4101-1(h)(1)(v).

same as the present law penalties for failure to register. The proposal applies to changes in ownership occurring prior to the date of enactment.

Effective Date

The proposal is effective for actions or failures to act after the date of enactment.

6. Registration of operators of deep-draft vessels

Present Law

Blenders, enterers, pipeline operators, position holders, refiners, terminal operators, and vessel operators are required to register with the Secretary with respect to fuels taxes imposed by sections 4041(a)(1) and 4081.[47] Treasury regulations define a vessel operator as any person that operates a vessel within the bulk transfer/terminal system, excluding deep-draft ocean-going vessels.[48] Accordingly, operators of deep-draft ocean-going vessels are not required to register. A deep-draft ocean-going vessel is a vessel that is designed primarily for use on the high seas that has a draft of more than 12 feet.[49]

An assessable penalty for failure to register is $10,000 for each initial failure, plus $1,000 per day that the failure continues.[50] A non-assessable penalty for failure to register is $10,000.[51] A criminal penalty of $10,000, or imprisonment of not more than five years, or both, together with the costs of prosecution also applies to a failure to register and to certain false statements made in connection with a registration application.[52]

In general, gasoline, diesel fuel, and kerosene ("taxable fuel") are taxed upon removal from a refinery or a terminal.[53] Tax also is imposed on the entry into the United States of any taxable fuel for consumption, use, or warehousing. The tax does not apply to any removal or entry of a taxable fuel transferred in bulk (a "bulk transfer") by pipeline or vessel to a terminal or refinery if the person removing or entering the taxable fuel, the operator of such pipeline or

[47] Sec. 4101; Treas. Reg. sec. 48.4101-1(a) and (c)(1).

[48] Treas. Reg. sec. 48.4101-1(b)(8).

[49] Sec. 4042(c)(1).

[50] Sec. 6719.

[51] Sec. 7272(a).

[52] Sec. 7232.

[53] Sec. 4081(a)(1)(A).

vessel, and the operator of such terminal or refinery are registered with the Secretary as required by section 4101.[54] Transfer to an unregistered party subjects the transfer to tax.

Description of Proposal

In general, the proposal provides that a deep-draft ocean-going vessel is a vessel for purposes of the registration requirements. Under the proposal, operators of deep-draft ocean-going vessels are required to register and, if a deep-draft ocean-going vessel is used as part of a bulk transfer, the operator of such vessel must be registered in order for the bulk transfer exemption to apply. An operator of a deep-draft ocean-going vessel is not required to register under the proposal for purposes of section 4101, including for purposes of the bulk transfer exemption, to the extent such vessel is used to enter taxable fuel into the United States for consumption, use, or warehousing.

Effective Date

The proposal is effective on the date of enactment.

7. Reconciliation of on-loaded cargo to entered cargo

Present Law

The Trade Act of 2002 directed the Secretary to promulgate regulations pertaining to the electronic transmission to the Bureau of Customs and Border Protection ("Customs") of information pertaining to cargo destined for importation into the United States or exportation from the United States, prior to such importation or exportation.[55] The Department of the Treasury issued final regulations on October 31, 2002. The regulations require the advance and accurate presentation of certain manifest information prior to lading at the foreign port and encourage the presentation of this information electronically. Customs must receive from the carrier the vessel's Cargo Declaration (Customs Form 1302) or the electronic equivalent within 24 hours before such cargo is laden aboard the vessel at the foreign port.[56]

Certain carriers of bulk cargo, however, are exempt from these filing requirements. Such bulk cargo includes that composed of free flowing articles such as oil, grain, coal, ore and the like, which can be pumped or run through a chute or handled by dumping.[57] Thus, taxable fuels are not required to file the Cargo Declaration within 24 hours before such cargo is laden aboard

[54] Sec. 4081(a)(1)(B). The sale of a taxable fuel to an unregistered person prior to a taxable removal or entry of the fuel is subject to tax. Sec. 4081(a)(1)(A).

[55] Sec. 343(a) of Pub. L. No. 107-210 (2002).

[56] 19 CFR sec. 4.7(b)(2).

[57] 19 CFR sec. 4.7(b)(4)(i)(A).

the vessel at the foreign port. Instead the Cargo Declaration must be filed within 24 hours prior arrival in the United States.

Description of Proposal

The proposal provides that not later than one year after the date of enactment of this paragraph, the Secretary of Homeland Security, together with the Secretary of the Treasury, is to establish an electronic data interchange system through which Customs shall transmit to the Internal Revenue Service information pertaining to cargoes of taxable fuels (as defined in section 4083) that Customs has obtained electronically under its regulations adopted to carry out the Trade Act of 2002 requirement. For this purpose, not later than one year after the date of enactment, all filers of required cargo information for such taxable fuels, as defined, must provide such information to Customs through its approved electronic data interchange system.

Effective Date

The proposal is effective upon date of enactment.

8. Gasoline blend stocks and kerosene

Present Law

Gasoline blend stocks

In general

A "taxable fuel" is gasoline, diesel fuel (including any liquid, other than gasoline, which is suitable for use as a fuel in a diesel-powered highway vehicle or train), and kerosene.[58] Under the regulations, "gasoline" includes all products commonly or commercially known or sold as gasoline and are suitable for use as a motor fuel, and that have an octane rating of 75 or more. Gasoline also includes, to the extent provided in regulations, gasoline blend stocks and products commonly used as additives in gasoline. By regulation, the Treasury has identified certain products as gasoline blend stocks,[59] however, the term "gasoline blend stocks" does not include any product that cannot be blended into gasoline without further processing or fractionation ("off-spec gasoline").

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[58] Sec. 4083(a).

[59] Treas. Reg. sec. 48.4081-1(c)(3)(ii). The term "gasoline blend stocks" means alkylate; butane; catalytically cracked gasoline; coker gasoline; ethyl tertiary butyl ether (ETBE); hexane; hydrocrackate; isomerate; methyl tertiary butyl ether (MTBE); mixed xylene (not including any separated isomer of xylene); natural gasoline; pentane; pentane mixture; polymer gasoline; raffinate; reformate; straight-run gasoline; straight-run naphtha; tertiary amyl methyl ether (TAME); tertiary butyl alcohol (gasoline grade) (TBA); thermally cracked gasoline; and toluene. Treas. Reg. sec. 48.4081-1(c)(3)(i). Effective January 1, 2005, transmix containing gasoline was removed from the definition of gasoline blend stocks. Internal Revenue Service, Notice 2005-4 (December 15, 2004).

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.[60] The tax does not apply to any removal or entry of taxable fuel transferred in bulk to a terminal or refinery if the person removing or entering the taxable fuel the operator of such pipeline or vessel, and the operator of such terminal or refinery are registered with the Secretary.[61]

Gasoline blend stock exemptions

If certain conditions are met, the removal, entry, or sale of gasoline blend stocks is not taxable. Generally, the exemption from tax applies if a gasoline blend stock (1) is not used to produce finished gasoline (2) is received at an approved terminal or refinery (3) or in bulk transfer to an industrial user.[62]

Gasoline blend stocks not used to produce finished gasoline.–Pursuant to Treasury regulation, no tax is imposed on nonbulk removals from a terminal or refinery, or nonbulk entries into the United States of any gasoline blend stocks if (1) the person liable for the tax is a taxable fuel registrant, and (2) such person does not use the gasoline blend stocks to produce finished gasoline. In connection with a sale, no tax is imposed on the nonbulk removal or entry if (1) the person liable for the tax is a gasoline registrant and (2) at the time of sale such party has an unexpired certificate from the buyer, and knows of no false information in the certificate.[63]

Any sale (or resale) of a gasoline blend stock that was not subject to tax on nonbulk removal or entry is taxable unless the seller has an unexpired certificate from the buyer and has no reason to believe that any information in the certificate is false.

The certificate to be provided by a buyer of gasoline blend stocks contains a statement that the gasoline blend stocks covered by the certificate will not be used to produce finished gasoline, identifies the type (or types of blend stocks) covered by the certificate and provides that the buyer will not claim a credit or refund for any gasoline covered by the certificate. The certificate is signed under penalties of perjury by a person with authority to bind the buyer. The certificate expires on the earliest of one year from the effective date of the certificate, the date a new certificate is provided to the seller or the date the seller is notified by the IRS or the buyer that the buyer's right to provide a certificate has been withdrawn.

Gasoline blend stocks received at an approved terminal or refinery.–Treasury regulations provide that tax is not imposed on the removal or entry of gasoline blend stocks that are received

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

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

[62] Treas. Reg. sec. 48.4081-4.

[63] Treas. Reg. sec. 48.4081-4(b)(1) and (2).

at a terminal or refinery if the person liable for tax is a taxable fuel registrant, has an unexpired notification certificate from the operator of the terminal or refinery where the gasoline blend stocks are received; and has no reason to believe that any information in the certificate is false.[64] A notification certificate is used to notify another person of the taxable fuel registrant's registration status.

Bulk transfer to an industrial user.–Tax is not imposed if upon removal of the gasoline blend stocks from a pipeline or vessel, the gasoline blend stocks are received by a taxable fuel registrant that is an industrial user.[65] An industrial user means any person that receives gasoline blend stocks by bulk transfer for its own use in the manufacture of any product other than finished gasoline.

Refunds or credits for tax imposed on gasoline blend stocks not used for producing gasoline

If any gasoline blend stock or additive is not used by a person to produce gasoline and that person establishes that the ultimate use of the gasoline blend stock or additive is not used to produce gasoline, then the Secretary is to pay (without interest) to such person, an amount equal to the aggregate amount of tax imposed on such person with respect to such gasoline or blend stock.[66]

If gasoline is used in an off-highway business use, the ultimate purchaser of the gasoline is entitled to a credit or refund for the excise taxes imposed on the fuel. "Off-highway business use" means any use by a person in a trade or business of such person otherwise than as a fuel in a highway vehicle that meets certain requirements.[67] Gasoline for this purpose includes gasoline blend stocks.[68]

The Code also provides for a refund of tax for tax-paid fuel sold to a subsequent manufacturer or producer if the subsequent manufacturer or producer uses the fuel, for nonfuel purposes, as a material in the manufacture or production of any other article manufactured or produced by him.[69]

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[64] Treas. Reg. sec. 48.4081-4(b)(1)

[65] Treas. Reg. sec. 48.4081-4(d).

[66] Sec. 6427(h)(1).

[67] Sec. 6421(a) and (e).

[68] Sec. 6421(e)(1) and sec. 4083(a)(2)(B).

[69] Sec. 6416(b)(3)(B).

Kerosene

Definition of kerosene

By regulation, kerosene is defined as the kerosene described in ASTM Specification D 3699 (No. 1-K and No. 2-K), ASTM Specification D 1655 (kerosene-type jet fuel), and military specifications MIL-DTL-5624T (Grade JP-5) and MIL-DTL-83133E (Grade JP-8). Kerosene does not include any liquid that is an excluded liquid.[70]

An "excluded liquid" is (1) any liquid that contains less than four percent normal paraffins, or (2) 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. These liquids are commonly known as "mineral spirits" and are obtained by distillation of crude oil. Mineral spirits are used for a wide variety of purposes, such as in dry-cleaning fluids, paint thinners, varnishes, photocopy toners, inks, adhesives, and as general purpose cleaners and degreasers.

Exemptions

Diesel fuel and kerosene that is to be used for a nontaxable purpose will not be taxed upon removal from the terminal if it is dyed to indicate its nontaxable purpose. Kerosene received by pipeline or vessel to satisfy a feedstock purpose is exempt from the dyeing requirement.[71] Pursuant to Treasury regulations, nonbulk removals of kerosene for a feedstock purpose by a registered feedstock user also are exempt.[72] The person receiving the kerosene must be registered with the IRS and provide a certificate noting that the kerosene will be used for a feedstock purpose in order for the exemption to apply. Pursuant to the Treasury regulations, tax also does not apply upon the removal or entry of kerosene if the person otherwise liable for tax is a taxable fuel registrant and such person uses the kerosene for a feedstock purpose.[73]

"Feedstock purpose" means the use of kerosene for nonfuel purposes in the manufacture or production of any substance (other than gasoline, diesel fuel or special fuels subject to tax).[74] Thus, for example, kerosene is used for a feedstock purpose when it is used as an ingredient in the production of paint and is not used for a feedstock purpose when it is used to power machinery at a factory where paint is produced.

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[70] Treas. Reg. sec. 48.4081-1(b).

[71] Sec. 4082(d)(1).

[72] Treas. Reg. sec. 48.4082-7(c).

[73] Treas. Reg. sec. 48.4082-7(c).

[74] Treas. Reg. sec. 48.4082-7(b).

Refunds and payments for nontaxable uses of kerosene

If tax-paid kerosene is used by any person in a nontaxable use, the Secretary is required to pay (without interest) to the ultimate purchaser of such fuel an amount equal to the aggregate amount of tax imposed on such fuel. For this purpose, a nontaxable use is any use which is exempt from the tax imposed by section 4041(a)(1) other than by reason of prior imposition of tax. Claims relating to kerosene used on a farm for farming purposes and by a State are made by registered ultimate vendors. Claims relating to undyed kerosene sold from a blocked pump[75] or sold for blending with heating oil to be used during periods of extreme or unseasonable cold are also made by registered ultimate vendors. Special rules apply with respect to aviation-grade kerosene.

The Code also provides for a refund of tax for tax-paid fuel sold to a subsequent manufacturer or producer if the subsequent manufacturer or producer uses the fuel, for nonfuel purposes, as a material in the manufacture or production of any other article manufactured or produced by him.[76]

Description of Proposal

Gasoline blend stocks

The proposal partially repeals exemptions provided in Treas. Reg. sec. 48.4081-4, which, under certain conditions, exempts from tax gasoline blend stocks that are not used to produce finished gasoline or that are received at an approved terminal or refinery. Under the proposal, tax is imposed on all nonbulk entries and removals of gasoline blend stocks, regardless of whether they will be used to produce finished gasoline or received at an approved terminal or refinery. The proposal does not change the exemption for bulk transfers to registered industrial users.

Kerosene and mineral spirits

The proposal requires that with respect to fuel entered or removed after September 30, 2005, the Secretary include mineral spirits in the definition of kerosene. Thus, for entries and removals after September 30, 2005, mineral spirits are taxed and exempt from tax in the same manner as kerosene.

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[75] A blocked pump is a fuel pump that is used to dispense undyed kerosene that is sold at retail for use by the buyer in any nontaxable use; is at a fixed location; is identifed with a legible and conspicuous notice stating "Undyed Untaxed Kerosene, Nontaxable Use Only," and cannot reasonably be used to dispense fuel directly into the fuel supply tank of a diesel-powered highway vehicle or diesel-powered train; or is locked by the vendor after each sale and unlocked only in response to a request by a buyer for undyed kerosene for use other than as a fuel in a diesel-powered highway vehicle or diesel-powered train.

[76] Sec. 6416(b)(3)(B).

Effective Date

The proposal is effective for fuel removed or entered after September 30, 2005.

9. Nonapplication of export exemption to delivery of fuel to motor vehicles removed from United States

Present Law

A manufacturer's 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 for consumption, use or warehousing; or
3. The sale of any taxable fuel to any person who is not registered, unless there was a prior taxable removal or entry.[77]

The term "taxable fuel" means gasoline, diesel fuel and kerosene.

Special provisions under the Code provide for a refund of tax to any person who sells gasoline to another for exportation.[78] Section 6421(c) provides "If gasoline is sold to any person for any purpose described in paragraph (2), (3), (4), or (5) of section 4221(a), the Secretary shall pay (without interest) to such person an amount equal to the product of the number of gallons so sold multiplied by the rate at which tax was imposed on such gasoline by section 4081." Section 4221 provides, in pertinent part, "Under regulations prescribed by the Secretary, no tax shall be imposed under this chapter. . . on the sale by the manufacturer. . . of an article–. . . for export, or for resale by the purchaser to a second purchaser for export. . . but only if such exportation or use is to occur before any other use . . .."

It is the IRS administrative position that the exemption from manufacturers excise tax by reason of exportation does not apply to the sale of motor fuel pumped into a fuel tank of a vehicle that is to be driven, or shipped, directly out of the United States.[79]

A duty-free sales facility that meets certain conditions may sell and deliver for export from the customs territory of the United States duty-free merchandise. Duty-free merchandise is merchandise sold by a duty-free sales facility on which neither Federal duty nor Federal tax has been assessed pending exportation from the customs territory of the United States. The statutes covering duty-free facilities do not contain any limitation on what goods may qualify for duty-free treatment.

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

[78] Secs. 6421(c) and 4221(a)(2).

[79] Rev. Rul. 69-150, 1969-1 C.B. 286.

The issue of whether fuel sold from a duty-free facility and placed into the tank of an automobile that is then driven out of the country is exported fuel has been litigated in the courts.[80] The cases involved the same operator of a duty-free facility seeking a refund of excise tax. The facility is near the Canadian border and is configured in such a way that anyone leaving the facility must depart the United States and enter into Canada. Both the Federal Circuit and the Sixth Circuit of Appeals are in accord with the IRS position and ruled that the operator of the duty-free facility did not have standing to pursue a claim for refund.[81]

Description of Proposal

The proposal reaffirms the long-standing IRS position taken in Rev. Rul. 69-150 and restates present law by amending the Code definition of export to exclude the delivery of a taxable fuel into a fuel tank of a motor vehicle that is shipped or driven out of the United States. It also imposes a tax on the sale of taxable fuel at a duty-free sales enterprise unless there was a prior taxable removal, or entry of such fuel.

Effective Date

The proposal applies to sales or deliveries made after the date of enactment.

10. Impose assessable penalty on dealers of adulterated fuel

Present Law

Diesel fuel, gasoline, and kerosene are taxable fuels. Diesel fuel is defined as (1) any liquid (other than gasoline) which is suitable for use as a fuel in a diesel-powered highway vehicle or a diesel powered train, (2) transmix, and (3) diesel fuel blend stocks identified by the Secretary.[82] As a defense to Federal and State excise tax liability, some taxpayers have contended that certain diesel fuel mixtures or additives do not meet the requirements of (1) above because they are not approved as additives or mixtures by the EPA. In addition, under present law, untaxed fuel additives, including certain contaminants, may displace taxed diesel fuel in a mixture.

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[80] See, *Ammex Inc. v. United States*, 52 Fed. Cl. 303 (2002) (on cross-motions for summary judgment, the court found that plaintiff established standing to proceed to trial pursuant to sec. 6421(c) respecting its gasoline purchases only); and *Ammex Inc. v. United States*, 2002 U.S. Dist. LEXIS 25771 (E.D. Mich. July 31, 2002) (granting defendant's motion for summary judgment), reconsideration denied, *Ammex, Inc. v. United States*, 2002 U.S. Dist. LEXIS 22893 (E.D. Mich. Oct. 22, 2002). Although the Claims Court ruled that Ammex had standing to challenge the excise tax on gasoline, it subsequently held that Ammex was not entitled to a payment pursuant to sec. 6421(c) because it failed to prove at trial that it did not pass the tax on to its customers. *Ammex Inc. v. United States*, 2003 U.S. Claims LEXIS 63 (Fed. Cl. Mar. 26, 2003). The Claims Court finding that the plaintiff had standing was reversed on appeal.

[81] See, *Ammex Inc. v. United States*, 384 F.3d 1368 (Fed. Cir. 2004) *cert. denied* 125 S.Ct. 1697 (2005); and *Ammex Inc. v. United States*, 367 F.3d 530 (6th Cir. 2004) *cert. denied* 125 S.Ct. 1695 (2005).

[82] Sec. 4083(a)(3)(A).

The Code provides that any person who, in connection with a sale or lease (or offer for sale or lease) of an article, knowingly makes any false statement ascribing a particular part of the price of the article to a tax imposed by the United States, or intended to lead any person to believe that any part of the price consists of such a tax, is guilty of a misdemeanor.[83] Another Code provision provides that any person who has in his custody or possession any article on which taxes are imposed by law, for the purpose of selling the article in fraud of the internal revenue laws or with design to avoid payment of the taxes thereon, is liable for "a penalty of $500 or not less than double the amount of taxes fraudulently attempted to be evaded."[84]

Description of Proposal

The proposal adds a new assessable penalty. Under the proposal, any person other than a retailer who knowingly transfers for resale, sells for resale, or holds out for resale for use in a diesel-powered highway vehicle (or train) any liquid that does not meet applicable EPA regulations (as defined in section 45H(c)(3))[85] is subject to a penalty of $10,000 for each such transfer, sale or holding out for resale, in addition to the tax on such liquid, if any. Any retailer who knowingly holds out for sale (other than for resale) any such liquid, is subject to a $10,000 penalty for each such holding out for sale, in addition to the tax on such liquid, if any.

The penalty is dedicated to the Highway Trust Fund.

Effective Date

The proposal is effective for any transfer, sale, or holding out for sale or resale occurring after the date of enactment.

11. Oil Spill Liability Trust Fund

Present Law

In general, a five-cent-per-barrel tax was imposed on crude oil received at a United States refinery and imported petroleum products received for consumption, use, or warehousing. The Fund's tax applied after December 31, 1989, and before January 1, 1995. The tax was effective only if the unobligated balance in the Fund was less than $1 billion.

Description of Proposal

The proposal reinstates the Oil Spill Liability Trust Fund tax. The tax applies on April 1, 2007, or if later, the last day of any calendar quarter for which the Secretary estimates that, as of

[83] Sec. 7211. Such a violation is punishable by a fine not to exceed $1,000, or by imprisonment for not more than one year, or both.

[84] Sec. 7268.

[85] Section 45H(c)(3) refers to "the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency."

the close of that quarter, the unobligated balance in the Oil Spill Liability Trust fund is less that $2 billion.

The tax will be suspended during a calendar quarter if the Secretary estimates that, as of the close of the preceding calendar quarter, the unobligated balance in the Oil Spill Liability Trust Fund exceeds $3 billion. The tax terminates after December 31, 2014.

Effective Date

The proposal is generally effective on April 1, 2007.

12. Leaking Underground Storage Tank Trust Fund

Present Law

The Code imposes an excise tax, generally at a rate of 0.1 cents per gallon, on gasoline, diesel, kerosene, and special motor fuels (other than liquefied petroleum gas and liquefied natural gas).[86] The taxes are deposited in the Leaking Underground Storage Tank ("LUST") Trust Fund. The tax expires on October 1, 2005.

Diesel fuel and kerosene that is to be used for a nontaxable purpose will not be taxed upon removal from the terminal if it is dyed to indicate its nontaxable purpose.

The Code requires the LUST Trust Fund to reimburse the General Fund for certain refund and credit claims related to the nontaxable use of fuel (only to the extent attributable to the LUST Trust fund financing rate).[87]

Description of Proposal

Under the proposal, the LUST Trust Fund tax is extended at the current rate through September 30, 2011. Further, dyed fuel is subject to the LUST tax and without refund. Under the proposal, the LUST Trust Fund is no longer required to reimburse the General Fund for claims and credits related to the nontaxable use of fuel.

[86] For qualified methanol and ethanol fuel the rate is 0.05 cents per gallon (sec. 4041(b)(2)(A)(ii). Qualified methanol or ethanol fuel is any liquid at least 85 percent of which consists of methanol, ethanol or other alcohol produced from coal (including peat) (sec. 4041(b)(2)(B)).

[87] Specifically, section 9508(c)(2) requires the LUST Trust Fund to reimburse the General Fund from time to time for claims paid pursuant to sections 6420 (relating to amounts paid in respect of gasoline used on farms), section 6421 (relating to amounts paid in respect of gasoline used for certain nonhighway purposes or by local transit systems), and section 6427 (relating to fuels not used for taxable purposes) and income credits allowed under section 34 for the purposes previously mentioned. No income tax credit is allowed for any amount payable under section 6421 or 6427 if a claim for such amount is timely filed and is payable under such section (sec. 34(b)).

Effective Date

The extension of the trust fund is effective October 1, 2005. The taxation of dyed fuel is effective for fuel entered or removed after December 31, 2005.

DESCRIPTION OF THE "ENERGY POLICY TAX INCENTIVES ACT OF 2005"

Scheduled for Markup
by the
SENATE COMMITTEE ON FINANCE
June 16, 2005

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

June 14, 2005
JCX-44-05

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup on June 16, 2005, of the "Energy Policy Tax Incentives Act of 2005." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of provisions of the "Energy Policy Tax Incentives Act of 2005.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the "Energy Policy Tax Incentives Act of 2005,"* (JCX-44-05) June 14, 2005.

A. Electricity Infrastructure

1. Extension and modification of renewable electricity production tax credit

Present Law

In general

An income tax credit is allowed for the production of electricity from qualified facilities sold by the taxpayer to an unrelated person (sec. 45). Qualified facilities comprise wind energy facilities, closed-loop biomass facilities, open-loop biomass (including agricultural livestock waste nutrients) facilities, geothermal energy facilities, solar energy facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities. In addition, an income tax credit is allowed for the production of refined coal.

Credit amounts and credit period

In general

The base amount of the credit is 1.5 cents per kilowatt-hour (indexed for inflation) of electricity produced. The amount of the credit is 1.9 cents per kilowatt-hour for 2005. A taxpayer may claim credit for 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.

Reduced credit amounts and credit periods

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 is placed in service. In general, for eligible pre-existing facilities and other facilities placed in service prior to January 1, 2005, the credit 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, and trash combustion facilities, the otherwise allowable credit amount is 0.75 cent per kilowatt-hour, indexed for inflation measured after 1992.

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 $5.481 per ton for 2005).

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 in the case of the refined coal production credit) to an unrelated party. Also, in general, the amount of credit a taxpayer may claim is reduced by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits. The reduction cannot exceed 50 percent of the otherwise allowable credit.[2]

The credit for electricity produced from renewable sources is a component of the general business credit (sec. 38(b)(8)). Generally, the general business credit for any taxable year may not exceed the amount by which the taxpayer's net income tax exceeds the greater of the tentative minimum tax or so much of the net regular tax liability as exceeds $25,000. Excess credits may be carried back one year and forward up to 20 years.

A taxpayer's tentative minimum tax is treated as being zero for purposes of determining the tax liability limitation with respect to the section 45 credit for electricity produced from a facility (placed in service after October 22, 2004) during the first four years of production beginning on the date the facility is placed in service.

[2] 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.

Summary of credit rate and credit period by facility type

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

Electricity produced from renewable resources	Credit amount for 2005 (cents per kilowatt-hour; dollars per ton)	Credit period (years from placed-in-service date)[1]
Wind	1.9	10
Closed-loop biomass	1.9	10
Open-loop biomass (including agricultural livestock waste nutrient facilities)	0.9	5
Geothermal	1.9	5
Solar	1.9	5
Small irrigation power	0.9	5
Municipal solid waste (including landfill gas facilities and trash combustion facilities)	0.9	5
Refined Coal	**5.481**	**10**

[1] For eligible pre-existing facilities and other facilities placed in service prior to January 1, 2005, the credit period commences on January 1, 2005. In the case of certain co-firing closed-loop facilities, the credit period begins no earlier than October 22, 2004.

Periods for which credit allowable

In order to be a qualified facility–

Wind energy facility

A wind energy facility must be placed in service after December 31, 1993, and before January 1, 2006.

Closed-loop biomass facility

A closed-loop biomass facility must be placed in service after December 31, 1992, and before January 1, 2006. 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, 2006.

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

An open-loop biomass facility must be placed in service after October 22, 2004 and before January 1, 2006, in the case of a facility using agricultural livestock waste nutrients and

must be placed in service at any time prior to January 1, 2006 in the case of a facility using other open-loop biomass.

Geothermal, solar, small irrigation, landfill gas, and trash combustion facilities

To be a qualifying facility, a geothermal, solar, small irrigation, landfill gas, or trash combustion facility must be placed in service after October 22, 2004 and before January 1, 2006.

Refined coal facility

A refined coal facility must be placed in service after October 22, 2004 and before January 1, 2009.

Description of Proposal

The proposal extends the placed-in-service date by three years (through December 31, 2008) for the following qualifying facilities: wind facilities; closed-loop biomass facilities (including a facility co-firing the closed-loop biomass with coal, other biomass, or coal and other biomass); open-loop biomass facilities; geothermal facilities; small irrigation power facilities; landfill gas facilities; and trash combustion facilities. The proposal does not extend the placed-in-service date for solar facilities (December 31, 2005) or refined coal facilities (December 31, 2008).

The proposal adds one new qualifying energy resource, fuel cells. A qualifying fuel cell facility is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that convert a fuel into electricity using electrochemical means, and which has an electricity-only generation efficiency of greater than 30 percent and generates at least 0.5 megawatts of electricity, and which is placed in service after December 31, 2005, and before January 1, 2009. The taxpayer can claim the 1.5 cents-per-kilowatt-hour (indexed for inflation) credit for a five-year period commencing on the date the facility is placed in service.

Effective Date

The proposal is effective on the date of enactment.

2. Clean renewable energy bonds

Present law

Tax-exempt bonds

Interest on State and local government bonds generally is excluded from gross income for Federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. Activities that can be financed with these tax-exempt bonds include the financing of electric power facilities (i.e., generation, transmission, distribution, and retailing).

Interest on State or local bonds to finance activities of private persons ("private activity bonds") is taxable unless a specific exception is contained in the Code (or in a non-Code provision of a revenue Act). The term "private person" generally includes the Federal Government and all other individuals and entities other than States or local governments. The Code includes exceptions permitting States or local governments to act as conduits providing tax-exempt financing for certain private activities. In most cases, the aggregate volume of these tax-exempt private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2005, the State volume cap is the greater of $80 per resident or $239 million. The Code imposes several additional restrictions on tax-exempt private activity bonds that do not apply to bonds for governmental activities.

The tax exemption for State and local bonds does not apply to any arbitrage bond.[3] A bond is defined as an arbitrage bond 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.[4] 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 State or local bonds must file with the IRS certain information about the bonds in order for such bonds to be tax-exempt.[5] Generally, this information return is required to be filed no later than the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments may issue "qualified zone academy bonds."[6] "Qualified zone academy bonds" are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds. A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located

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

[4] Sec. 148.

[5] Sec. 149(e).

[6] Sec. 1397E.

in an empowerment zone or enterprise community designated under the Code, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

Financial institutions that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate multiplied by the face amount of the bond. The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer. The credit is includable in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and AMT liability. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond.

There is an annual limitation of $400 million on the amount of qualified zone academy bonds that may be issued in calendar years 1998 through 2005. The $400 million aggregate bond cap is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

Tax credits for production of electricity from renewable sources

An income tax credit is allowed for the production of electricity from qualified facilities sold by the taxpayer to an unrelated person.[7] The base amount of the credit is 1.5 cents per kilowatt-hour (indexed for inflation) of electricity produced. The amount of the credit is 1.9 cents per kilowatt-hour for 2005. A taxpayer may claim credit for 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.

Qualified facilities comprise wind energy facilities, closed-loop biomass facilities, open-loop biomass (including agricultural livestock waste nutrients) facilities, geothermal energy facilities, solar energy facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities. In addition, an income tax credit is allowed for the production of refined coal.

To be a qualified facility, a wind energy facility must be placed in service after December 31, 1993, and before January 1, 2006. A closed-loop biomass facility must be placed in service after December 31, 1992, and before January 1, 2006. 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, 2006. An open-loop biomass facility must be

[7] Sec. 45.

placed in service after October 22, 2004 and before January 1, 2006, in the case of facility using agricultural livestock waste nutrients, and must be placed in service at any time prior to January 1, 2006 in the case of a facility using other open-loop biomass. Geothermal, solar, small irrigation, landfill gas, and trash combustion facilities all must be placed in service after October 22, 2004 and before January 1, 2006. In addition, 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.

Description of Proposal

The proposal creates a new category of tax credit bonds, "Clean Renewable Energy Bonds." Clean Renewable Energy Bonds 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 facilities that qualify for the tax credit under section 45 ("qualified projects"), without regard to the placed in service date requirements of that section.

Like qualified zone academy bonds, Clean Renewable Energy Bonds are not interest-bearing obligations. Rather, the taxpayer holding a Clean Renewable Energy Bond on a credit allowance date would be 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 holder's bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits issuance of Clean Renewable Energy 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.

The proposal also imposes a maximum maturity limitation on any Clean Renewable Energy Bond. The maximum maturity is the term which the Secretary estimates will result in the present value of the obligation to repay the principal on a Clean Renewable Energy Bond being equal to 50 percent of the face amount of such bond.

For purposes of the proposal, "qualified issuers" include governmental bodies; the Tennessee Valley Authority; mutual or cooperative electric companies (either 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 clean energy bond lenders. A clean energy bond lender means a cooperative lending organization which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and was in existence on February 1, 2002. The term "qualified borrower" includes a governmental body (including an Indian tribal government), the Tennessee Valley Authority, and a mutual or cooperative electric company.

Under the proposal, Clean Renewable Energy Bonds are subject to the arbitrage requirements of section 148 that apply to traditional tax-exempt bonds. In addition, to qualify as Clean Renewable Energy Bonds, 95 percent or more of the proceeds of such bonds must be spent on qualified projects 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 projects during the five-year spending period, bonds will continue to qualify as Clean Renewable Energy Bonds if

unspent proceeds are used within 90 days from the end of such five-year period to redeem an amount of outstanding bonds to satisfy the 95 percent expenditure test. The five-year spending period also may be extended by the Secretary upon the qualified issuer's request.

Unlike qualified zone academy bonds, the proposal requires issuers of Clean Renewable Energy Bonds to report issuance to the IRS in a manner similar to the information returns required for traditional tax-exempt bonds. Under the proposal, there is a national limitation of $1 billion of Clean Renewable Energy Bonds that the Secretary may allocate, in the aggregate, to qualified projects. The authority to issue Clean Renewable Energy Bonds expires December 31, 2008.

Effective Date

The proposal is effective for bonds issued after December 31, 2005.

3. Treatment of income of certain electric cooperatives

Present Law

In general

Under present law, an entity must be operated on a cooperative basis in order to be treated as a cooperative for Federal income tax purposes. Although not defined by statute or regulation, the two principal criteria for determining whether an entity is operating on a cooperative basis are: (1) ownership of the cooperative by persons who patronize the cooperative; and (2) return of earnings to patrons in proportion to their patronage. The IRS requires that cooperatives must operate under the following principles: (1) subordination of capital in control over the cooperative undertaking and in ownership of the financial benefits from ownership; (2) democratic control by the members of the cooperative; (3) vesting in and allocation among the members of all excess of operating revenues over the expenses incurred to generate revenues in proportion to their participation in the cooperative (patronage); and (4) operation at cost (not operating for profit or below cost).[8]

In general, cooperative members are those who participate in the management of the cooperative and who share in patronage capital. As described below, income from the sale of electric energy by an electric cooperative may be member or non-member income to the cooperative, depending on the membership status of the purchaser. A municipal corporation may be a member of a cooperative.

For Federal income tax purposes, a cooperative generally computes its income as if it were a taxable corporation, with one exception--the cooperative may exclude from its taxable income distributions of patronage dividends. In general, patronage dividends are the profits of the cooperative that are rebated to its patrons pursuant to a pre-existing obligation of the

[8] Announcement 96-24, "Proposed Examination Guidelines Regarding Rural Electric Cooperatives," 1996-16 I.R.B. 35.

cooperative to do so. The rebate must be made in some equitable fashion on the basis of the quantity or value of business done with the cooperative.

Except for tax-exempt farmers' cooperatives, cooperatives that are subject to the cooperative tax rules of subchapter T of the Code[9] are permitted a deduction for patronage dividends from their taxable income only to the extent of net income that is derived from transactions with patrons who are members of the cooperative.[10] The availability of such deductions from taxable income has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative.

Cooperatives that qualify as tax-exempt farmers' cooperatives are permitted to exclude patronage dividends from their taxable income to the extent of all net income, including net income that is derived from transactions with patrons who are not members of the cooperative, provided the value of transactions with patrons who are not members of the cooperative does not exceed the value of transactions with patrons who are members of the cooperative.[11]

Taxation of electric cooperatives exempt from subchapter T

In general, the cooperative tax rules of subchapter T apply to any corporation operating on a cooperative basis (except mutual savings banks, insurance companies, other tax-exempt organizations, and certain utilities), including tax-exempt farmers' cooperatives (described in sec. 521(b)). However, subchapter T does not apply to an organization that is "engaged in furnishing electric energy, or providing telephone service, to persons in rural areas."[12] Instead, electric cooperatives are taxed under rules that were generally applicable to cooperatives prior to the enactment of subchapter T in 1962. Under these rules, an electric cooperative can exclude patronage dividends from taxable income to the extent of all net income of the cooperative, including net income derived from transactions with patrons who are not members of the cooperative.[13]

Tax exemption of rural electric cooperatives

Section 501(c)(12) provides an income tax exemption for rural electric cooperatives if at least 85 percent of the cooperative's income consists of amounts collected from members for the sole purpose of meeting losses and expenses of providing service to its members. The IRS takes the position that rural electric cooperatives also must comply with the fundamental cooperative

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[9] Sec. 1381, et seq.

[10] Sec. 1382.

[11] Sec. 521.

[12] Sec. 1381(a)(2)(C).

[13] See Rev. Rul. 83-135, 1983-2 C.B. 149.

principles described above in order to qualify for tax exemption under section 501(c)(12).[14] The 85-percent test is determined without taking into account any income from: (1) qualified pole rentals; (2) open access electric energy transmission services; (3) open access electric energy distribution services; (4) any nuclear decommissioning transaction; (5) any asset exchange or conversion transaction.[15]

Income from open access transactions

Income received or accrued by a rural electric cooperative (other than income received or accrued directly or indirectly from a member of the cooperative) from the provision or sale of electric energy transmission services or ancillary services on a nondiscriminatory open access basis under an open access transmission tariff approved or accepted by Federal Energy Regulations Commission ("FERC") or under an independent transmission provider agreement approved or accepted by FERC (including an agreement providing for the transfer of control–but not ownership–of transmission facilities) is excluded in determining whether a rural electric cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12).

In addition, income is excluded for purposes of the 85-percent test if it is received or accrued by a rural electric cooperative (other than income received or accrued directly or indirectly from a member of the cooperative) from the provision or sale of electric energy distribution services or ancillary services, provided such services are provided on a nondiscriminatory open access basis to distribute electric energy not owned by the cooperative: (1) to end-users who are served by distribution facilities not owned by the cooperative or any of its members; or (2) generated by a generation facility that is not owned or leased by the cooperative or any of its members and that is directly connected to distribution facilities owned by the cooperative or any of its members.

The exclusion for income from open access transactions does not apply to taxable years beginning after December 31, 2006.

Income from nuclear decommissioning transactions

Income received or accrued by a rural electric cooperative from any "nuclear decommissioning transaction" also is excluded in determining whether a rural electric cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12). The term "nuclear decommissioning transaction" is defined as—

1. any transfer into a trust, fund, or instrument established to pay any nuclear decommissioning costs if the transfer is in connection with the transfer of the cooperative's interest in a nuclear powerplant or nuclear powerplant unit;

[14] Rev. Rul. 72-36, 1972-1 C.B. 151.

[15] Sec. 501(c)(12)(C).

2. any distribution from a trust, fund, or instrument established to pay any nuclear decommissioning costs; or

3. any earnings from a trust, fund, or instrument established to pay any nuclear decommissioning costs.

The exclusion for income from nuclear decommissioning transactions does not apply to taxable years beginning after December 31, 2006.

Income from asset exchange or conversion transactions

Gain realized by a tax-exempt rural electric cooperative from a voluntary exchange or involuntary conversion of certain property is excluded in determining whether a rural electric cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12). This provision only applies to the extent that: (1) the gain would qualify for deferred recognition under section 1031 (relating to exchanges of property held for productive use or investment) or section 1033 (relating to involuntary conversions); and (2) the replacement property that is acquired by the cooperative pursuant to section 1031 or section 1033 (as the case may be) constitutes property that is used, or to be used, for the purpose of generating, transmitting, distributing, or selling electricity or natural gas.

The exclusion for income from asset exchange or conversion transactions does not apply to taxable years beginning after December 31, 2006.

Treatment of income from load loss transactions

Tax-exempt rural electric cooperatives

Under present law, income received or accrued by a tax-exempt rural electric cooperative from a "load loss transaction" is treated under 501(c)(12) as income collected from members for the sole purpose of meeting losses and expenses of providing service to its members.[16] Therefore, income from load loss transactions is treated as member income in determining whether a rural electric cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12). In addition, income from load loss transactions does not cause a tax-exempt electric cooperative to fail to be treated for Federal income tax purposes as a mutual or cooperative company under the fundamental cooperative principles described above.

The term "load loss transaction" is generally defined as any wholesale or retail sale of electric energy (other than to a member of the cooperative) to the extent that the aggregate amount of such sales during a seven-year period beginning with the "start-up year" does not exceed the reduction in the amount of sales of electric energy during such period by the cooperative to members. The "start-up year" is defined as the first year that the cooperative offers nondiscriminatory open access or, if later and at the election of the cooperative, 2004.

[16] Sec. 501(c)(12)(H).

Present law also excludes income received or accrued by rural electric cooperatives from load loss transactions from the tax on unrelated trade or business income.

The special rule for income received or accrued by a tax-exempt rural electric cooperative from a load loss transaction does not apply to taxable years beginning after December 31, 2006.

Taxable electric cooperatives

The receipt or accrual of income from load loss transactions by taxable electric cooperatives is treated as income from patrons who are members of the cooperative.[17] Thus, income from a load loss transaction is excludible from the taxable income of a taxable electric cooperative if the cooperative distributes such income pursuant to a pre-existing contract to distribute the income to a patron who is not a member of the cooperative. In addition, income from load loss transactions does not cause a taxable electric cooperative to fail to be treated for Federal income tax purposes as a mutual or cooperative company under the fundamental cooperative principles described above.

The special rule for income received or accrued by a taxable electric cooperative from a load loss transaction does not apply to taxable years beginning after December 31, 2006.

Description of Proposal

The proposal eliminates the sunset date for the rules excluding income received or accrued by tax-exempt rural electric cooperatives from open access electric energy transmission or distribution services, any nuclear decommissioning transaction, and any asset exchange or conversion transaction for purposes of the 85-percent test under section 501(c)(12). The proposal also eliminates the sunset date for the rule that allows income from load loss transactions to be treated as member income in determining whether a rural electric cooperative satisfies the 85-percent test. In addition, the proposal eliminates the sunset date for the rule that permits taxable electric cooperatives to treat the receipt or accrual of income from load loss transactions as income from patrons who are members of the cooperative.

Effective Date

The proposal is effective on the date of enactment.

4. Dispositions of transmission property to implement FERC restructuring policy

Present Law

Generally, a taxpayer selling property recognizes gain to the extent the sales price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain

[17] Sec. 501(c)(12)(H).

is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

One such special tax provision permits taxpayers to elect to recognize gain from qualifying electric transmission transactions ratably over an eight-year period beginning in the year of sale if the amount realized from such sale is used to purchase exempt utility property within the applicable period[18] (the "reinvestment property"). If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain is recognized to the extent of such excess in the year of the qualifying electric transmission transaction.

A qualifying electric transmission transaction is the sale or other disposition of property used by the taxpayer in the trade or business of providing electric transmission services, or an ownership interest in such an entity, to an independent transmission company prior to January 1, 2007. In general, an independent transmission company is defined as: (1) an independent transmission provider[19] approved by the FERC; (2) a person (i) who the FERC determines under section 203 of the Federal Power Act (or by declaratory order) is not a "market participant" and (ii) whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider before the close of the period specified in such authorization, but not later than January 1, 2007; or (3) in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, (i) a person which is approved by that Commission as consistent with Texas State law regarding an independent transmission organization, or (ii) a political subdivision, or affiliate thereof, whose transmission facilities are under the operational control of an organization described in (i).

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

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

Description of Proposal

The proposal extends the deferral provision to sales or dispositions to an independent transmission company prior to January 1, 2008.

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

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

Effective Date

The proposal is effective for transactions occurring after the date of enactment. However, because the proposal is an extension of a present law provision which expires on December 31, 2006, only transactions occurring after December 31, 2006 and prior to January 1, 2008 will be affected.

5. Credit for production of electricity from advanced nuclear power facilities

Present Law

An income tax credit is allowed for production of electricity from qualified facilities sold by the taxpayer to an unrelated person (sec. 45). Qualified facilities comprise wind energy facilities, closed-loop biomass facilities, open-loop biomass (including agricultural livestock waste nutrients) facilities, geothermal energy facilities, solar energy facilities, small irrigation power facilities, landfill gas facilities, and trash combustion facilities. The base amount of the credit is 1.5 cents per kilowatt-hour (indexed for inflation) of electricity produced. The amount of the credit is 1.9 cents per kilowatt-hour for 2005. However, electricity produced at open-loop biomass, small irrigation power, and municipal solid waste facilities receives only 50 percent of the credit, or 0.9 cents per kilowatt-hour for 2005. Generally, wind and closed-loop biomass facilities may claim this credit for 10 years from the placed-in-service date of the facility. Other qualified facilities may claim the credit for only five years from the placed-in-service date.

Present law does not provide a credit for electricity produced at advanced nuclear power facilities.

Description of Proposal

The proposal permits a taxpayer producing electricity at a qualifying advanced nuclear power facility to claim a credit equal to 1.8 cents per kilowatt-hour of electricity produced for the eight-year period starting when the facility is placed in service.[20] The aggregate amount of credit that a taxpayer may claim in any year during the eight-year period is subject to limitation based on allocated capacity and an annual limitation as described below.

A qualifying advanced nuclear facility is an advanced nuclear facility for which the taxpayer has received an allocation of megawatt capacity from the Secretary of Treasury, in consultation with the Secretary of Energy, and is placed in service before January 1, 2021. The taxpayer may only claim credit for production of electricity equal to the ratio of the allocated capacity that the taxpayer receives from the Secretary of Treasury to the rated nameplate capacity of the taxpayer's facility. For example, if the taxpayer receives an allocation of 750 megawatts of capacity from the Secretary and the taxpayer's facility has a rated nameplate

[20] The 1.8-cents credit amount is reduced, but not below zero, if the annual average contract price per kilowatt-hour of electricity generated from advanced nuclear power facilities in the preceding year exceeds eight cents per kilowatt-hour. The eight-cent price comparison level is indexed for inflation after 1992.

capacity of 1,000 megawatts, then the taxpayer may claim three-quarters of the otherwise allowable credit, or 1.35 cents per kilowatt-hour, for each kilowatt-hour of electricity produced at the facility (subject to the annual limitation described below). The Secretary of Treasury may allocate up to 6,000 megawatts of capacity.

A taxpayer operating a qualified facility may claim no more than $125 million in tax credits per 1,000 megawatts of allocated capacity in any one year of the eight-year credit period. If the taxpayer operates a 1,350 megawatt rated nameplate capacity system and has received an allocation from the Secretary for 1,350 megawatts of capacity eligible for the credit, the taxpayer's annual limitation on credits that may be claimed is equal to 1.35 times $125 million, or $168.75 million. If the taxpayer operates a facility with a nameplate rated capacity of 1,350 megawatts, but has received an allocation from the Secretary for 750 megawatts of credit eligible capacity, then the two limitations apply such that the taxpayer may claim a credit equal to 1.35 cents per kilowatt-hour of electricity produced (as described above) subject to an annual credit limitation of $93.75 million in credits (three-quarters of $125 million).

An advanced nuclear facility is any nuclear facility for the production of electricity, the reactor design for which was approved after 1993 by the Nuclear Regulatory Commission. For this purpose, a qualifying advanced nuclear facility does not include any facility for which a substantially similar design for a facility of comparable capacity was approved before 1994.

In addition, the credit allowable to the taxpayer is reduced by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits, but such reduction cannot exceed 50 percent of the otherwise allowable credit. The credit is treated as part of the general business credit and, under a special transition rule may not be carried back to a taxable year ending before or on the effective date of the provision.

Effective Date

The proposal applies to electricity produced in taxable years beginning after the date of enactment.

6. Credit for investment in clean coal facilities

Present Law

Present law does not provide an investment credit for electricity production facilities property that uses coal as a fuel or for the gasification of coal or other materials. However, a nonrefundable, 10-percent investment tax credit ("energy credit") is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) that is used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage (sec. 48). The energy credit is a component of the general business credit (sec. 38(b)(1)).

Description of Proposal

The proposal adds two new 20-percent investment tax credits to the energy credit. Both credits are available only to projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. Certifications are issued using a competitive bidding process.

With respect to the first investment tax credit, the proposal establishes a 10-year program to produce 6,500 megawatts of power generation capacity using integrated gasification combined cycle and other advanced coal-based electricity generation technologies. Qualified projects must be economically feasible and use the appropriate clean coal technologies. In determining which qualified projects to certify, the Secretary of Treasury shall give priority to projects that include carbon capture capability, increased by-product utilization and other benefits. The Secretary of Treasury, in consultation with the Secretary of Energy, must allocate up to 3,575 megawatts of power generation capacity to credit-eligible projects using an integrated gasification combined cycle technology. The remaining 2,925 megawatts of power generation capacity must be allocated to credit-eligible projects that use other advanced coal-based technologies.

With respect to the second investment tax credit, the proposal authorizes the certification of certain gasification projects. Qualified gasification projects convert coal, petroleum residue, biomass, or other materials recovered for their energy or feedstock value into a synthesis gas composed primarily of carbon monoxide and hydrogen for direct use or subsequent chemical or physical conversion. Under the proposal, certified gasification projects are eligible for the new 20 percent investment tax credit. The total value of credit-eligible expenditures on all certified gasification projects may not exceed $4 billion. In addition, no single project may claim a gasification investment tax credit in excess of $200 million.

Effective Date

The proposal applies to projects certified after the date of enactment.

7. Clean energy bonds for certified coal property

Present law

Tax-exempt bonds

Interest on State and local government bonds generally is excluded from gross income for Federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. Activities that can be financed with these tax-exempt bonds include the financing of electric power facilities (i.e., generation, transmission, distribution, and retailing).

Interest on State or local bonds to finance activities of private persons ("private activity bonds") is taxable unless a specific exception is contained in the Code (or in a non-Code provision of a revenue Act). The term "private person" generally includes the Federal Government and all other individuals and entities other than States or local governments. The Code includes exceptions permitting States or local governments to act as conduits providing tax-exempt financing for certain private activities. In most cases, the aggregate volume of these

tax-exempt private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2005, the State volume cap is the greater of $80 per resident or $239 million. The Code imposes several additional restrictions on tax-exempt private activity bonds that do not apply to bonds for governmental activities.

The tax exemption for State and local bonds does not apply to any arbitrage bond.[21] A bond is defined as an arbitrage bond 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.[22] 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 State or local bonds must file with the IRS certain information about the bonds in order for such bonds to be tax-exempt.[23] Generally, this information return is required to be filed no later than the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments may issue "qualified zone academy bonds."[24] "Qualified zone academy bonds" are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds. A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community designated under the Code, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

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

[22] Sec. 148.

[23] Sec. 149(e).

[24] Sec. 1397E.

Financial institutions that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate multiplied by the face amount of the bond. The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer. The credit is includable in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and AMT liability. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond.

There is an annual limitation of $400 million on the amount of qualified zone academy bonds that may be issued in calendar years 1998 through 2005. The $400 million aggregate bond cap is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

Description of Proposal

The proposal creates a new category of tax credit bonds, "Clean Energy Coal Bonds." Clean Energy Coal Bonds 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 "certified coal property." Certified coal property is defined as any property that is part of a qualifying advanced coal project certified by the Secretary of Energy.

Like qualified zone academy bonds, Clean Energy Coal Bonds are not interest-bearing obligations. Rather, the taxpayer holding a Clean Energy Coal Bond on a credit allowance date would be 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 holder's bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits issuance of Clean Energy Coal Bonds without discount and interest cost to the qualified issuer. The credit is includible 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.

For purposes of the proposal, "qualified issuers" include governmental bodies; the Tennessee Valley Authority; mutual or cooperative electric companies (either 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 clean energy bond lenders. A clean energy bond lender means a cooperative lending organization which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and was in existence on February 1, 2002. The term "qualified borrower" includes a governmental body (including an Indian tribal government), the Tennessee Valley Authority, and a mutual or cooperative electric company.

Under the proposal, Clean Energy Coal Bonds are subject to the arbitrage requirements of section 148 that apply to traditional tax-exempt bonds. In addition, to qualify as Clean Energy Coal Bonds, 95 percent or more of the proceeds of such bonds must be spent on certified coal 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 projects during the five-year spending period, bonds will continue to qualify as Clean Energy Coal Bonds if unspent proceeds are used within 90 days from the end of such five-year period to redeem an amount of outstanding bonds to satisfy the 95 percent expenditure test. The five-year spending period also may be extended by the Secretary upon the qualified issuer's request.

The proposal also imposes a maximum maturity limitation on any Clean Energy Coal Bond. The maximum maturity is the term which the Secretary estimates will result in the present value of the obligation to repay the principal on a Clean Energy Coal Bond being equal to 50 percent of the face amount of such bond.

Unlike qualified zone academy bonds, the proposal requires issuers of Clean Energy Coal Bonds to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds. Under the proposal, there is a national limitation of $1 billion of Clean Energy Coal Bonds that the Secretary may allocate, in the aggregate, to certified coal property projects. The authority to issue Clean Energy Coal Bonds expires December 31, 2010.

Effective Date

The proposal is effective for bonds issued after December 31, 2005.

B. Domestic Fossil Fuel Security

1. Credit for investment in clean coke/cogeneration manufacturing facilities

Present Law

Present law does not provide a credit for investment in clean coke/cogeneration manufacturing facilities property.

Description of Proposal

The proposal provides a 20-percent investment tax credit for qualified investments in clean coke/cogeneration facilities property. The proposal defines clean coke/cogeneration manufacturing facilities property as depreciable real and tangible personal property located in the United States that meets certain emission limitations and is used for the manufacture of metallurgical coke or for the production of steam or electricity from waste heat generated during the production of metallurgical coke.

The qualified investment for any taxable year is the basis of each coke/cogeneration facilities property placed in service by the taxpayer during such taxable year. The proposal excludes the credit from the basis adjustment rules for investment credit property set out in section 50(c) of the Code. Under the basis adjustment rules, the basis in investment credit property is generally reduced by the amount of the investment credit.

Effective Date

The proposal applies to property placed in service after the date of enactment and before December 31, 2009.

2. Temporary expensing for equipment used in the refining of liquid fuels

Present Law

Depreciation of refinery assets

Under present law, depreciation allowances for property used in a trade or business generally are determined under the Modified Accelerated Cost Recovery System ("MACRS") of section 168 of the Internal Revenue Code. Under MACRS, petroleum refining assets are depreciated for regular tax purposes over a 10-year recovery period using the double declining balance method. Petroleum refining assets are assets used for distillation, fractionation, and catalytic cracking of crude petroleum into gasoline and its other components. Present law also provides a special expensing rule for small refiners for capital costs incurred in complying with Environmental Protection Agency sulfur regulations.

Taxation of cooperatives and their patrons

For Federal income tax purposes, a cooperative generally computes its income as if it were a taxable corporation, with one exception–the cooperative may exclude from its taxable

income distributions of patronage dividends. In general, patronage dividends are the profits of the cooperative that are rebated to its patrons pursuant to a pre-existing obligation of the cooperative to do so. The rebate must be made in some equitable fashion on the basis of the quantity or value of business done with the cooperative.

Except for tax-exempt farmers' cooperatives, cooperatives that are subject to the cooperative tax rules of subchapter T of the Code[25] are permitted a deduction for patronage dividends from their taxable income only to the extent of net income that is derived from transactions with patrons who are members of the cooperative.[26] The availability of such deductions from taxable income has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative.

Cooperatives that qualify as tax-exempt farmers' cooperatives are permitted to exclude patronage dividends from their taxable income to the extent of all net income, including net income that is derived from transactions with patrons who are not members of the cooperative, provided the value of transactions with patrons who are not members of the cooperative does not exceed the value of transactions with patrons who are members of the cooperative.[27]

Description of Proposal

The proposal provides a temporary election to expense qualified refinery property. Qualified refinery property includes assets used in the refining of liquid fuels: (1) with respect to the construction of which there is a binding construction contract before January 1, 2008; (2) which is placed in service before January 1, 2012; (3) which increases the capacity of an existing refinery by at least five percent or increases throughput of qualified fuels (as defined in section 29(c)) by at least 25 percent; and (4) which meets all applicable environmental laws in effect when the property is placed in service.

The proposal also allows cooperatives to pass through to patrons the deduction permitted for qualified refinery property. To the extent the deduction for qualified refinery property is passed through to patrons, the cooperative is denied the deduction for such property or any depreciation deductions under sections 167 or 168 with respect to such property.

Effective Date

The proposal is effective for property placed in service after the date of enactment, the original use of which begins with the taxpayer, provided the property is not subject to a binding contract for construction as of June 14, 2005.

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[25] Sec. 1381, et seq.

[26] Sec. 1382.

[27] Sec. 521.

3. Pass through to patrons the deduction for capital costs incurred by cooperative for complying with environmental protection agency sulfur regulations for small refiners

Present Law

Expensing and credit for small refiners

Taxpayers generally may recover the costs of investments in refinery property through annual depreciation deductions. In addition, the Code permits small business refiners to immediately deduct as an expense up to 75 percent of the costs paid or incurred for the purpose of complying with the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency ("EPA"). Costs qualifying for the deduction are those costs paid or incurred with respect to any facility of a small business refiner during the period beginning on January 1, 2003 and ending on the earlier of the date that is one year after the date on which the taxpayer must comply with the applicable EPA regulations or December 31, 2009.

The Code also provides that a small business refiner may claim credit equal to five cents per gallon for each gallon of low sulfur diesel fuel produced during the taxable year that is in compliance with the Highway Diesel Fuel Sulfur Control Requirements. The total production credit claimed by the taxpayer is limited to 25 percent of the capital costs incurred to come into compliance with the EPA diesel fuel requirements. As with the deduction permitted under present law, costs qualifying for the credit are those costs paid or incurred with respect to any facility of a small business refiner during the period beginning on January 1, 2003 and ending on the earlier of the date that is one year after the date on which the taxpayer must comply with the applicable EPA regulations or December 31, 2009. The taxpayer's basis in property with respect to which the credit applies is reduced by the amount of production credit claimed.

For these purposes a small business refiner is a taxpayer who is within the business of refining petroleum products, employs not more than 1,500 employees directly in refining, and has less than 205,000 barrels per day (average) of total refinery capacity. The deduction is reduced, *pro rata*, for taxpayers with capacity in excess of 155,000 barrels per day.

In the case of a qualifying small business refiner that is owned by a cooperative, the cooperative is allowed to elect to pass any production credits to patrons of the organization. Present law does not permit cooperatives to pass through to members the deduction permitted for the costs paid or incurred for the purpose of complying with the Highway Diesel Fuel Sulfur Control Requirements.

Taxation of cooperatives and their patrons

For Federal income tax purposes, a cooperative generally computes its income as if it were a taxable corporation, with one exception--the cooperative may exclude from its taxable income distributions of patronage dividends. In general, patronage dividends are the profits of the cooperative that are rebated to its patrons pursuant to a pre-existing obligation of the cooperative to do so. The rebate must be made in some equitable fashion on the basis of the quantity or value of business done with the cooperative.

Except for tax-exempt farmers' cooperatives, cooperatives that are subject to the cooperative tax rules of subchapter T of the Code[28] are permitted a deduction for patronage dividends from their taxable income only to the extent of net income that is derived from transactions with patrons who are members of the cooperative.[29] The availability of such deductions from taxable income has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative.

Cooperatives that qualify as tax-exempt farmers' cooperatives are permitted to exclude patronage dividends from their taxable income to the extent of all net income, including net income that is derived from transactions with patrons who are not members of the cooperative, provided the value of transactions with patrons who are not members of the cooperative does not exceed the value of transactions with patrons who are members of the cooperative.[30]

Description of Proposal

The proposal allows cooperatives to pass through to patrons the deduction permitted under section 179B for costs paid or incurred for the purpose of complying with the Highway Diesel Fuel Sulfur Control Requirements. To the extent the deduction is passed through to patrons, the cooperative is denied the deduction it would otherwise be entitled under section 179B or for depreciation deductions under sections 167 or 168 with respect to costs attributable to calculation of the patrons' allowable section 179B deduction.

Effective Date

The proposal is effective for costs paid or incurred with respect to any facility of a small business refiner during the period beginning on January 1, 2003, and ending on the earlier of the date that is one year after the date on which the taxpayer must comply with the applicable EPA regulations or December 31, 2009.

4. Enhanced oil recovery credit for carbon dioxide injections

Present Law

Taxpayers may claim a credit equal to 15 percent of enhanced oil recovery ("EOR") costs. Qualified EOR costs include the following costs associated with an EOR project: (1) amounts paid for depreciable tangible property; (2) intangible drilling and development expenses; (3) tertiary injectant expenses; and (4) construction costs for certain Alaskan natural gas treatment facilities. The EOR credit is phased out when oil prices exceed a threshold amount.

[28] Sec. 1381, et seq.

[29] Sec. 1382.

[30] Sec. 521.

Description of Proposal

The proposal modifies the EOR credit to increase the credit rate to 20 percent with respect to any new EOR project or substantial expansion of an existing EOR project that occurs after the effective date and that uses carbon dioxide flooding or injection as an oil recovery method. The increased credit is available only for qualified EOR projects that use carbon dioxide that is (1) from a man-made, industrial source or (2) separated from natural gas and natural gas liquids at a natural gas processing plant.

Effective Date

The proposal applies to property placed in service after December 31, 2005, and before January 1, 2010.

5. Natural gas distribution lines treated as fifteen-year property

Present Law

The applicable recovery period for assets placed in service under the Modified Accelerated Cost Recovery System is based on the class life of the property. The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[31] Natural gas distribution pipelines are assigned a 20-year recovery period and a class life of 35 years.

Description of Proposal

The proposal establishes a statutory 15-year recovery period and a statutory class life of 35 years for natural gas distribution lines placed in service before January 1, 2008.

Effective Date

The proposal is effective for property placed in service after the date of enactment, the original use of which commences with the taxpayer and which is not subject to a binding contract for acquisition by the taxpayer as of June 14, 2005.

[31] 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

C. Conservation and Energy Efficiency Provisions

1. Energy efficient commercial building deduction

Present Law

No special deduction is currently provided for expenses incurred for energy-efficient commercial building property.

Description of Proposal

In general

The proposal provides a deduction equal to energy-efficient commercial building property expenditures made by the taxpayer. Energy-efficient commercial building property expenditures is defined as property: (1) which is installed on or in any building located in the United States, (2) which is installed as part of (i) the interior lighting systems, (ii) the heating, cooling, ventilation, and hot water systems, or (iii) the building envelope, and (3) which is certified as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more in comparison to a reference building which meets the minimum requirements of Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America ("ASHRAE/IESNA"). The deduction is limited to an amount equal to $2.25 per square foot of the property for which such expenditures are made. The deduction is allowed in the year in which the property is placed in service.

Eligible buildings may include any residential rental property, including any low-rise multifamily structure or single family housing property which is not within the scope of Standard 90.1-2001.

Certain certification requirements must be met in order to qualify for the deduction. The Secretary, in consultation with the Secretary of Energy, will promulgate regulations that describe methods of calculating and verifying energy and power costs using qualified computer software based on the provisions of the 2005 California Nonresidential Alternative Calculation Method Approval Manual or, in the case of residential property, the 2005 California Residential Alternative Calculation Method Approval Manual. The methods for calculation shall be fuel neutral, such that the same energy efficiency features shall qualify a building for the deduction under this subsection regardless of whether the heating source is a gas or oil furnace or boiler or an electric heat pump. The calculation methods shall provide appropriate calculated energy savings for design methods and technologies not otherwise credited in either Standard 90.1-2001 or in the 2005 California Nonresidential Alternative Calculation Method Approval Manual, including the following: (i) Natural ventilation, (ii) Evaporative cooling, (iii) Automatic lighting controls such as occupancy sensors, photocells, and timeclocks, (iv) Daylighting, (v) Designs utilizing semi-conditioned spaces which maintain adequate comfort conditions without air conditioning or without heating, (vi) Improved fan system efficiency, including reductions in static pressure, (vii) Advanced unloading mechanisms for mechanical cooling, such as multiple

or variable speed compressors, (viii) The calculation methods may take into account the extent of commissioning in the building, and allow the taxpayer to take into account measured performance which exceeds typical performance, (ix) On-site generation of electricity, including combined heat and power systems, fuel cells, and renewable energy generation such as solar energy, and (x) Wiring with lower energy losses than wiring satisfying Standard 90.1-2001 requirements for building power distribution systems.

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

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

Partial allowance of deduction

In the case of a building that does not meet the overall building requirement of a 50-percent energy savings, a partial deduction is allowed with respect to each separate building system that comprises energy efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system-specific savings targets established by the Secretary of the Treasury. The applicable system-specific savings targets to be established by the Secretary are those that would result in a total annual energy savings with respect to the whole building of 50 percent, if each of the separate systems met the system specific target. The separate building systems are (1) the interior lighting system, (2) the heating, cooling, ventilation and hot water systems, and (3) the building envelope. The maximum allowable deduction is $0.75 per square foot for each separate system.

In the case of system-specific partial deductions, in general no deduction is allowed until the Secretary establishes system-specific targets. However, in the case of lighting system retrofits, until such time as the Secretary issues final regulations, the system-specific energy savings target for the lighting system is deemed to be met by a reduction in Lighting Power Density of 40 percent (50 percent in the case of a warehouse) of the minimum requirements in Table 9.3.1.1 or Table 9.3.1.2 of ASHRAE/IESNA Standard 90.1-2001. Also, in the case of a lighting system that reduces lighting power density by 25 percent, a partial deduction of 37.5 cents per square foot is allowed. A pro-rated partial deduction is allowed in the case of a lighting system that reduces lighting power density between 25 percent and 40 percent. Certain lighting level and lighting control requirements must also be met in order to qualify for the partial lighting deductions.

Effective Date

The proposal is effective for property placed in service after the date of enactment and prior to January 1, 2010.

2. Energy efficient new homes

Present Law

A nonrefundable, 10-percent business energy credit is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage.

The business energy tax credits are components of the general business credit (sec. 38(b)(1)). The business energy tax credits, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of (1) 25 percent of net regular tax liability above $25,000 or (2) the tentative minimum tax. For credits arising in taxable years beginning after December 31, 1997, an unused general business credit generally may be carried back one year and carried forward 20 years (sec. 39).

A taxpayer may exclude from income the value of any subsidy provided by a public utility for the purchase or installation of an energy conservation measure. An energy conservation measure means any installation or modification primarily designed to reduce consumption of electricity or natural gas or to improve the management of energy demand with respect to a dwelling unit (sec. 136).

There is no present-law credit for the construction of new energy-efficient homes.

Description of Proposal

The proposal provides a credit to an eligible contractor of an amount equal to the aggregate adjusted bases of all energy-efficient property installed in a qualified new energy-efficient home during construction. The credit cannot exceed $1,000 ($2,000) in the case of a new home that has a projected level of annual heating and cooling costs that is 30 percent (50 percent) less than a comparable dwelling constructed in accordance with the standards of chapter 4 of the 2003 International Energy Conservation Code as in effect (including supplements) on the date of enactment, and any applicable Federal minimum efficiency standards for equipment. With respect to homes that meet the 30-percent standard, 1/3 of such 30 percent savings must come from the building envelope, and with respect to homes that meet the 50-percent standard, 1/5 of such 50 percent savings must come from the building envelope.

The eligible contractor is the person who constructed the home, or in the case of a manufactured home, the producer of such home. Energy efficiency property is any energy-efficient building envelope component (insulation materials or system specifically and primarily designed to reduce heat loss or gain, and exterior windows, including skylights, and doors) and any energy-efficient heating or cooling equipment or system that can, individually or in combination with other components, meet the standards for the home.

To qualify as an energy-efficient new home, the home must be: (1) a dwelling located in the United States, (2) substantially completed after the date of enactment, and (3) certified in

accordance with guidance prescribed by the Secretary to have a projected level of annual heating and cooling energy consumption that meets the standards for either the 30-percent or 50-percent reduction in energy usage.

Manufactured homes certified by a method prescribed by the Administrator of the Environmental Protection Agency under the Energy Star Labeled Homes program are eligible for the $1,000 credit provided criteria (1) and (2) are met.

The credit is part of the general business credit. No credits attributable to energy efficient homes can be carried back to any taxable year ending on or before the effective date of the credit. No deduction is allowed for that portion of expenses for a qualifying new home otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit for such taxable year. If a credit is allowed for any expenditure, the basis of such property is reduced by the amount of the credit.

Effective Date

The credit applies to homes whose construction is substantially completed after the date of enactment, and which are purchased during the period beginning on the date of enactment and ending on December 31, 2009 (December 31, 2007 in the case of the $1,000 credit).

3. Deduction for business energy property

Present Law

There is no special deduction provided for energy-efficient property.

Description of Proposal

The proposal provides a deduction for the purchase of qualified energy property. The allowable deduction for each energy property is (1) $150 for each advanced main air circulating fan or a Tier 1 natural gas, propane, or oil water heater, and (2) $900 for each Tier 2 energy-efficient building property.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace originally placed in service by the taxpayer during the taxable year, including a fan which uses a brushless permanent magnet motor or another type of motor which achieves similar or higher efficiency at full and half speed, as determined by the Secretary.

A Tier 1 natural gas, propane, or oil water heater is a natural gas, propane, or oil water heater with an energy factor of at least 0.65.

Tier 2 energy-efficient building property is: (1) an electric heat pump water heater which yields an energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which has a heating seasonal performance factor (HSPF) of at least 9, a seasonal energy efficiency ratio (SEER) of at least 15, and an energy efficiency ratio (EER) of at least 13, (3) a geothermal heat pump which (i) in the case of a closed loop product, has an energy efficiency ratio (EER) of at least 14.1 and a heating coefficient of performance (COP) of at least

3.3, (ii) in the case of an open loop product, has an energy efficiency ratio (EER) of at least 16.2 and a heating coefficient of performance (COP) of at least 3.6, and (iii) in the case of a direct expansion (DX) product, has an energy efficiency ratio (EER) of at least 15 and a heating coefficient of performance (COP) of at least 3.5, (4) a central air conditioner which has a seasonal energy efficiency ratio (SEER) of at least 15 and an energy efficiency ratio (EER) of at least 13, and (5) a natural gas, propane, or oil water heater which has an energy factor of at least 0.80.

The proposal also provides a deduction for energy efficient residential rental building property. The deduction with respect to each dwelling unit is $6,000 if the building achieves a 50 percent reduction in energy costs relative to the original condition of the building. In the case of a building that achieves a reduction in energy costs between 20 and 50 percent, the allowable deduction is $12,000 times the percentage reduction. No deduction is allowed in the case of energy cost savings of less than 20 percent. With respect to property potentially eligible for the specific deductions delineated above or for the residential rental building property deduction, the taxpayer must elect which deduction the property is eligible for. In order to be eligible for the credit, the building's energy savings must be certified according to regulations established by the Secretary that follow various rules and procedures. In the case of energy efficient residential rental building property which is public property, the Secretary shall promulgate a regulation to allow the allocation of the deduction to the person primarily responsible for designing the improvements to the property in lieu of the public entity which is the owner of such property.

If a deduction is allowed under this proposal with respect to any property, the basis of such property is reduced by the amount of the deduction so allowed.

Effective Date

The credit applies to property placed in service after the date of enactment and prior to January 1, 2009.

4. Credit for non-business energy property

Present Law

There is no credit provided for non-business energy-efficient property.

Description of Proposal

The proposal provides a credit for the purchase of qualified energy property. The allowable credit is (1) $50 for each advanced main air circulating fan or Tier 1 natural gas, propane, or oil water heater, and (2) $300 for each Tier 2 energy efficient property.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace originally placed in service by the taxpayer during the taxable year, including a fan which uses a brushless permanent magnet motor or another type of motor which achieves similar or higher efficiency at full and half speed, as determined by the Secretary.

A Tier 1 natural gas, propane, or oil water heater is a natural gas, propane, or oil water heater with an energy factor of at least 0.65.

Tier 2 energy-efficient property is: (1) an electric heat pump water heater which yields an energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which has a heating seasonal performance factor (HSPF) of at least 9, a seasonal energy efficiency ratio (SEER) of at least 15, and an energy efficiency ratio (EER) of at least 13, (3) a geothermal heat pump which (i) in the case of a closed loop product, has an energy efficiency ratio (EER) of at least 14.1 and a heating coefficient of performance (COP) of at least 3.3, (ii) in the case of an open loop product, has an energy efficiency ratio (EER) of at least 16.2 and a heating coefficient of performance (COP) of at least 3.6, and (iii) in the case of a direct expansion (DX) product, has an energy efficiency ratio (EER) of at least 15 and a heating coefficient of performance (COP) of at least 3.5, (4) a central air conditioner which has a seasonal energy efficiency ratio (SEER) of at least 15 and an energy efficiency ratio (EER) of at least 13, and (5) a natural gas, propane, or oil water heater which has an energy factor of at least 0.80.

The proposal also provides a credit for highly energy efficient principal residences. The credit with respect to a principal residence is $2,000 if the principal residence achieves a 50 percent reduction in energy costs relative to the original condition of the building. In the case of a principal residence that achieves a reduction in energy costs between 20 and 50 percent, the allowable credit is $4,000 times the percentage reduction. No credit is allowed in the case of energy cost savings of less than 20 percent. With respect to property potentially eligible for the specific credits delineated above or for the principal residence credit, the taxpayer must elect which credit the property is eligible for. In order to be eligible for the credit, the residence's energy savings must be certified according to regulations established by the Secretary that follow various rules and procedures.

Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. Certain restrictions and limitations apply with respect to property financed by subsidized energy financing or obtained through grant programs. 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. If a credit is allowed under this proposal with respect to any property, the basis of such property is reduced by the amount of the credit so allowed.

<u>**Effective Date**</u>

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

5. Energy credit for combined heat and power system property

<u>**Present Law**</u>

A nonrefundable, 10-percent business energy credit is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a

structure, or to provide solar process heat, or (2) used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage.

The business energy tax credits are components of the general business credit (sec. 38(b)(1)). The business energy tax credits, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of (1) 25 percent of net regular tax liability above $25,000 or (2) the tentative minimum tax. For credits arising in taxable years beginning after December 31, 1997, an unused general business credit generally may be carried back one year and carried forward 20 years (sec. 39).

A taxpayer may exclude from income the value of any subsidy provided by a public utility for the purchase or installation of an energy conservation measure. An energy conservation measure means any installation or modification primarily designed to reduce consumption of electricity or natural gas or to improve the management of energy demand with respect to a dwelling unit (sec. 136).

There is no present-law credit for combined heat and power ("CHP") property.

Description of Proposal

The proposal provides a 10-percent credit for the purchase of CHP property.

CHP property is property: (1) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) that has an electrical capacity of not more than 15 megawatts or a mechanical energy capacity of no more than 2000 horsepower or an equivalent combination of electrical and mechanical energy capacities; (3) that produces at least 20 percent of its total useful energy in the form of thermal energy that is not used to produce electrical or mechanical power, and produces at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof); and (4) the energy efficiency percentage of which exceeds 60 percent. CHP property does not include property used to transport the energy source to the generating facility or to distribute energy produced by the facility.

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

Effective Date

The credit applies to property placed in service after the date of enactment and before January 1, 2008.

6. Energy efficient appliances

Present Law

A nonrefundable, 10-percent business energy credit is allowed for the cost of new property that is equipment: (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat; or (2) used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage.

The business energy tax credits are components of the general business credit (sec. 38(b)(1)). The business energy tax credits, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of: (1) 25 percent of net regular tax liability above $25,000 or (2) the tentative minimum tax. For credits arising in taxable years beginning after December 31, 1997, an unused general business credit generally may be carried back one year and carried forward 20 years (sec. 39).

A taxpayer may exclude from income the value of any subsidy provided by a public utility for the purchase or installation of an energy conservation measure. An energy conservation measure means any installation or modification primarily designed to reduce consumption of electricity or natural gas or to improve the management of energy demand with respect to a dwelling unit (sec. 136).

There is no present-law credit for the manufacture of energy-efficient appliances.

Description of Proposal

The proposal provides a credit for the eligible production of certain energy-efficient dishwashers, clothes washers and refrigerators.

The credit for dishwashers applies to dishwashers produced in 2006 and 2007 that meet the Energy Star standards for 2007. The credit amount equals $3 multiplied by the percentage by which the efficiency of the 2007 standards (not yet known) exceeds that of the 2005 standards. The credit may not exceed $100 per dishwasher.

The credit for clothes washers equals (1) $50 for clothes washers manufactured in 2005 that have a modified energy factor (MEF) of at least 1.42, (2) $100 for clothes washers manufactured in 2005-2007 that meet the requirements of the Energy Star program which are in effect for clothes washers in 2007, or (3) the minimum of (i) $200 or (ii) $10 multiplied by the average of the energy and water savings percentages of the 2010 Energy Star standards relative to the 2007 Energy Star standards, for clothes washers manufactured in 2008-2010 that meet the requirements of the Energy Star program which are in effect for clothes washers in 2010.

The credit for refrigerators is based on energy savings and year of manufacture. The energy savings are determined relative to the energy conservation standards promulgated by the Department of Energy that took effect on July 1, 2001. Refrigerators that achieve a 15 to 20 percent energy saving and that are manufactured in 2005 or 2006 receive a $75 credit.

Refrigerators that achieve a 20 to 25 percent energy saving receive a (i) $125 credit if manufactured in 2005-2007, or (ii) $100 credit if manufactured in 2008. Refrigerators that achieve at least a 25 percent energy saving receive a (i) $175 credit if manufactured in 2005-2007, or (ii) $150 credit if manufactured in 2008-2010.

Appliances eligible for the credit include only those that exceed the average amount of production from the 3 prior calendar years for each category of appliance. In the case of refrigerators, eligible production is production that exceeds 110 percent of the average amount of production from the three prior calendar years. Proration rules apply in the case of credits for 2005 production.

A dishwasher is any a residential dishwasher subject to the energy conservation standards established by the Department of Energy. A refrigerator must be an automatic defrost refrigerator-freezer with an internal volume of at least 16.5 cubic feet to qualify for the credit. A clothes washer is any residential clothes washer, including a residential style coin operated washer that satisfies the relevant efficiency standard.

The taxpayer may not claim credits in excess of $75 million for all taxable years, and may not claim credits in excess of $20 million with respect to clothes washers eligible for the $50 credit and refrigerators eligible for the $75 credit. A taxpayer may elect to increase the $20 million limitation described above to $25 million provided that the aggregate amount of credits with respect to such appliances, plus refrigerators eligible for the $100 and $125 credits, is limited to $50 million for all taxable years.

Additionally, the credit allowed for all appliances may not exceed two percent of the average annual gross receipts of the taxpayer for the three taxable years preceding the taxable year in which the credit is determined.

The credit is part of the general business credit.

Effective Date

The credit applies to appliances produced after the date of enactment and prior to January 1, 2011 (January 1, 2008 in the case of dishwashers).

7. Residential solar hot water, photovoltaics and fuel cell property

Present Law

There is no present-law personal tax credit for energy efficient residential property.

Description of Proposal

The proposal provides a personal tax credit for the purchase of qualified photovoltaic property and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs. The credit is equal to 30 percent of qualifying expenditures, with a maximum credit for each of these systems of property of $2,000. The

provision also provides a 30 percent credit for the purchase of qualified fuel cell power plants. The credit for any fuel cell may not exceed $500 for each 0.5 kilowatt of capacity.

Qualifying solar water heating property means an expenditure for property to heat water for use in a dwelling unit located in the United States and used as a residence if at least half of the energy used by such property for such purpose is derived from the sun. Qualified photovoltaic 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 converts a fuel into electricity using electrochemical means, and which has an electricity-only generation efficiency of greater than 30 percent and that generates at least 0.5 kilowatts of electricity. The qualified fuel cell power plant must be installed on or in connection with a dwelling unit located in the United States and used by the taxpayer as a principal residence.

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

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

Effective Date

The credit applies to equipment installed after December 31, 2005, and prior to January 1, 2010.

8. Credit for business installation of qualified fuel cells and stationary microturbine power plants

Present Law

A nonrefundable, 10-percent business energy credit is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage.

The business energy tax credits are components of the general business credit (sec. 38(b)(1)). The business energy tax credits, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of (1) 25 percent of net regular tax liability above $25,000 or (2) the tentative minimum tax. For credits arising in taxable years beginning after December 31, 1997, an unused general business credit generally may be carried back one year and carried forward 20 years (sec. 39).

There is no present-law credit for fuel cell or microturbine power plant property.

Description of Proposal

The proposal provides a 30 percent business energy credit for the purchase of qualified fuel cell power plants for businesses. A qualified fuel cell power plant is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that converts a fuel into electricity using electrochemical means, and which has an electricity-only generation efficiency of greater than 30 percent and generates at least 0.5 kilowatts of electricity. The credit for any fuel cell may not exceed $500 for each 0.5 kilowatts of capacity.

Additionally, the proposal provides a 10 percent credit for the purchase of qualifying stationary microturbine power plants. A qualified stationary microturbine power plant is an integrated system comprised of a gas turbine engine, a combustor, a recuperator or regenerator, a generator or alternator, and associated balance of plant components which converts a fuel into electricity and thermal energy. Such system also includes all secondary components located between the existing infrastructure for fuel delivery and the existing infrastructure for power distribution, including equipment and controls for meeting relevant power standards, such as voltage, frequency and power factors. Such system must have an electricity-only generation efficiency of not less that 26 percent at International Standard Organization conditions and a capacity of less than 2,000 kilowatts. The credit is limited to the lesser of 10 percent of the basis of the property or $200 for each kilowatt of capacity.

The credit is nonrefundable. The taxpayer's basis in the property is reduced by the amount of the credit claimed.

Effective Date

The credit for businesses applies to property placed in service after December 31, 2005, and before January 1, 2010 (January 1, 2009 in the case of microturbines), under rules similar to rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990).

9. Business solar investment tax credit

Present Law

A nonrefundable, 10-percent business energy credit is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage.

The business energy tax credits are components of the general business credit (sec. 38(b)(1)). The business energy tax credits, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of (1) 25 percent of net regular tax liability above $25,000 or (2) the tentative minimum tax. For credits arising in taxable years beginning after

December 31, 1997, an unused general business credit generally may be carried back one year and carried forward 20 years (sec. 39).

Description of Proposal

The proposal increases the 10-percent credit to 30 percent in the case of solar energy property placed in service after December 31, 2005 and before January 1, 2010.

Effective Date

The credit applies to solar energy property placed in service after December 31, 2005 and before January 1, 2010.

D. Alternative Motor Vehicles and Fuels Incentives

1. Alternative vehicle credit

Present Law

Certain costs of qualified clean-fuel vehicle may be expensed and deducted when such property is placed in service (sec. 179A). Qualified clean-fuel vehicle property includes motor vehicles that use certain clean-burning fuels (natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity and any other fuel at least 85 percent of which is methanol, ethanol, any other alcohol or ether).[32] The maximum amount of the deduction is $50,000 for a truck or van with a gross vehicle weight over 26,000 pounds or a bus with seating capacities of at least 20 adults; $5,000 in the case of a truck or van with a gross vehicle weight between 10,000 and 26,000 pounds; and $2,000 in the case of any other motor vehicle. Qualified electric vehicles do not qualify for the clean-fuel vehicle deduction. The deduction is reduced to 25 percent of the otherwise allowable deduction in 2006 and is unavailable for purchases after December 31, 2006.

Description of Proposal

Alternative motor vehicle credits

The proposal provides a credit for the purchase of a new qualified fuel cell motor vehicle, a new qualified hybrid motor vehicle, and a new qualified alternative fuel motor vehicle. In general the proposal provides that the buyer claims the credit, unless the buyer is a tax-exempt entity in which case the seller or lessor of the vehicle may claim the credit. The taxpayer may carry forward unused credits for 20 years or carry unused credits back for three years (but not to any taxable year beginning before the date of enactment). Qualified vehicles fuel cell motor vehicles are vehicles placed in service before 2015. Qualified hybrid motor vehicles are vehicles placed in service before 2010. Qualified alternative fuel motor vehicles are vehicles placed in service before 2011. Any deduction otherwise allowable under sec. 179A is reduced by the amount of credit allowable.

Fuel cell vehicles

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

[32] A hybrid-electric vehicle may qualify as a clean-fuel vehicle under present law.

Table 2.–Base Credit Amount for Fuel Cell Vehicles

Vehicle Gross Weight Rating in Pounds	Credit Amount
Vehicle ≤ 8,500	$8,000
8,500 < vehicle ≤ 14,000	$10,000
14,000 < vehicle ≤ 26,000	$20,000
26,000 < vehicle	$40,000

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

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

Table 3.–Credit for Qualifying Fuel Cell Vehicles

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

Hybrid motor vehicles

A qualifying hybrid vehicle is a motor vehicle that draws propulsion energy from on-board sources of stored energy which include both an internal combustion engine or heat engine using combustible fuel and a rechargeable energy storage system (e.g., batteries). A qualifying hybrid motor vehicle must be placed in service before January 1, 2010.

In the case of an automobile or light truck (vehicles weighing 8,500 pounds or less), the amount of credit for the purchase of a hybrid vehicle is the sum of two components: a fuel economy credit amount that varies with the rated fuel economy of the vehicle compared to a 2002 model year standard and a conservation credit based on the estimated lifetime fuel savings of a qualifying vehicle compared to a comparable 2002 model year vehicle. A qualifying hybrid automobile or light truck must have a maximum available power from the rechargeable energy storage system of at least five percent. In addition, the vehicle must meet or exceed certain EPA emissions standards. For a vehicle with a gross vehicle weight rating of 6,000 pounds or less the applicable emissions standards are the Bin 5 Tier II emissions standards. For a vehicle with a gross vehicle weight rating greater than 6,000 pounds and less than or equal to 8,500 pounds, the applicable emissions standards are the Bin 8 Tier II emissions standards.

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

Table 4.–Fuel Economy Credit

Credit	If Fuel Economy of the Fuel Cell Vehicle Is:	
	At least	but less than
$400	125% of base fuel economy	150% of base fuel economy
$800	150% of base fuel economy	175% of base fuel economy
$1,200	175% of base fuel economy	200% of base fuel economy
$1,600	200% of base fuel economy	225% of base fuel economy
$2,000	225% of base fuel economy	250% of base fuel economy
$2,400	250% of base fuel economy	

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

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

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

Alternative fuel vehicle

The credit for the purchase of a new alternative fuel vehicle would be 50 percent of the incremental cost of such vehicle, plus an additional 30 percent if the vehicle meets certain emissions standards, but not more than between $4,000 and $32,000 depending upon the weight of the vehicle. Table 5, below, shows the maximum permitted incremental cost for the purpose of calculating the credit for alternative fuel vehicles by vehicle weight class.

Table 5.–Maximum Allowable Incremental Cost for Calculation of Alternative Fuel Vehicle Credit

Vehicle Gross Weight Rating in Pounds	Maximum Allowable Incremental Cost
Vehicle ≤ 8,500	$5,000
8,500 < vehicle ≤ 14,000....................................	$10,000
14,000 < vehicle ≤ 26,000..................................	$25,000
26,000 < vehicle	$40,000

Alternative fuels comprise compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, and any liquid fuel that is at least 85 percent methanol. Qualifying alternative fuel motor vehicles are vehicles that operate only on qualifying alternative fuels and are incapable of operating on gasoline or diesel (except in the extent gasoline or diesel fuel is part of a qualified mixed fuel, described below).

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

Base fuel economy

The base fuel economy is the 2002 model year city fuel economy for vehicles by inertia weight class by vehicle type. The "vehicle inertia weight class" is that defined in regulations prescribed by the Environmental Protection Agency for purposes of Title II of the Clean Air Act. Table 6, below, shows the 2002 model year city fuel economy for vehicles by type and by inertia weight class.

Table 6.–2002 Model Year City Fuel Economy

Vehicle Inertia Weight Class Pounds	Passenger Automobile (miles per gallon)	Light Truck (miles per gallon)
1,500	45.2	39.4
1,750	45.2	39.4
2,000	39.6	35.2
2,250	35.2	31.8
2,500	31.7	29.0
2,750	28.8	26.8
3,000	26.4	24.9
3,500	22.6	21.8
4,000	19.8	19.4

Vehicle Inertia Weight Class Pounds	Passenger Automobile (miles per gallon)	Light Truck (miles per gallon)
4,500	17.6	17.6
5,000	15.9	16.1
5,500	14.4	14.8
6,000	13.2	13.7
6,500	12.2	12.8
7,000	11.3	12.1
8,500	11.3	12.1

Effective Date

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

2. Electric vehicle credit

Present Law

A 10-percent tax credit is provided for the cost of a qualified electric vehicle, up to a maximum credit of $4,000. A qualified electric vehicle generally is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electrical current. The full amount of the credit is available for purchases prior to 2006. The credit is reduced to 25 percent of the otherwise allowable amount for purchases in 2006 and is unavailable for purchases after December 31, 2006.

Description of Proposal

The proposal repeals the phaseout of the credit under present law. The proposal also modifies present law to provide for a credit equal to the lesser of $1,500 or 10 percent of the manufacturer's suggested retail price of certain vehicles that conform to the Motor Vehicle Safety Standard 500. For all other electric vehicles, Table 7, below describes the credit.

Table 7.–Credit for Qualifying Battery Electric Vehicles

Vehicle Gross Weight Rating in Pounds	Credit Amount
Vehicle ≤ 8,500	$4,000
8,500 < vehicle ≤ 14,000	$10,000
14,000 < vehicle ≤ 26,000	$20,000
26,000 < vehicle	$40,000

If an electric vehicle weighing not more than 8,500 pounds has an estimated driving range of at least 100 miles on a single charge of the vehicle's batteries or if it is capable of a payload capacity of at least 1,000 pounds, then the credit amount in Table 7 is $6,000.

In the case of property purchased by tax-exempt persons, the seller may claim the credit. The proposal allows taxpayers to carry forward unused credits for 20 years or carry unused credits back for three (but not to any taxable year before the date of enactment).

<u>Effective Date</u>

The proposal is effective for property placed in service after the date of enactment and before January 1, 2010.

3. Alternative fuel refueling property credit

<u>Present Law</u>

Clean-fuel vehicle refueling property may be expensed and deducted when such property is placed in service (sec. 179A). Clean-fuel vehicle refueling property comprises property for the storage or dispensing of a clean-burning fuel, if the storage or dispensing is the point at which the fuel is delivered into the fuel tank of a motor vehicle. Clean-fuel vehicle refueling property also includes property for the recharging of electric vehicles, but only if the property is located at a point where the electric vehicle is recharged. Up to $100,000 of such property at each location owned by the taxpayer may be expensed with respect to that location. The deduction is unavailable for costs incurred after December 31, 2006.

For the purpose of sec. 179A clean fuels comprise natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity, and any other fuel at least 85 percent of which is methanol, ethanol, or any other alcohol or ether.

Description of Proposal

The proposal permits taxpayers to claim a 50-percent credit for the cost of installing 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. In the case of retail clean-fuel vehicle refueling property the allowable credit may not exceed $30,000. In the case of residential clean-fuel vehicle refueling property the allowable credit may not exceed $1,000.

Under the proposal clean 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, and hydrogen.

The taxpayer's basis in the property is reduced by the amount of the credit and the taxpayer may not claim deductions under section 179A with respect to property for which the credit is claimed. In the case of refueling property installed on property owned or used by a tax-exempt person, the taxpayer that installs the property may claim the credit. To be eligible for the credit, the property must be placed in service before January 1, 2010. The credit allowable for any taxable year cannot exceed the amount by which the taxpayer's regular tax (reduced by certain other credits) exceeds the taxpayer's tentative minimum tax. The taxpayer may carry forward unused credits for 20 years.

In the case of hydrogen fuel refueling property, to be eligible for the credit, the property must be placed in service before January 1, 2015.

Effective Date

The proposal is effective for property placed in service after the December 31, 2005.

4. Volumetric excise tax credit for alternative fuels

Present Law

A 24.3-cents-per-gallon excise tax is imposed on diesel fuel to finance the Highway Trust Fund. Gasoline and most special motor fuels are subject to tax at 18.3 cents per gallon for the Trust Fund.[33] The statutory rates for certain special motor fuels and compressed natural gas are determined on an energy equivalent basis, as follows:

[33] Sec. 4041(a)(2)(A)(i). An additional 0.1 cent per gallon tax is imposed for the Leaking Underground Storage Tank Trust Fund on the sale or use of any liquid (other than liquefied petroleum gas and other than liquefied natural gas) if any tax was applicable under section 4041(a)(1) (relating to diesel fuel and kerosene) or 4041(a)(2) (relating to special motor fuels). See sec. 4041(d).

Liquefied petroleum gas (propane)	13.6 cents per gallon
Liquefied natural gas	11.9 cents per gallon
Methanol derived from petroleum or natural gas	9.15 cents per gallon
Compressed natural gas	48.54 cents per MCF

Under section 4041, tax is imposed on special motor fuels (any liquid other than gas oil, fuel oil or any product taxable under section 4081) when there is a taxable sale by any person to an owner, lessee or other operator of a motor vehicle or motorboat, for use as fuel in the motor vehicle or motorboat or used by any person as a fuel in a motor vehicle or motorboat unless there was a prior taxable sale. No excise tax credit is provided for the sale or use of those fuels.

Liquid hydrogen, when sold or used as fuel in a motor vehicle or motorboat, is a special motor fuel for purposes of the tax on special motor fuels and would be subject to tax at 18.4 cents per gallon.[34] Compressed hydrogen gas used or sold as a fuel is not subject to tax.

Prior to the American Jobs Creation Act of 2004, gasohol and gasoline to be blended into gasohol was taxed at a reduced rate based on the amount of ethanol contained in the mixture (e.g., 10 percent, 7.7 percent or 5.5 percent alcohol in the mixture). The Act eliminated reduced rates of excise tax for most alcohol-blended fuels. In place of the reduced rates, the Act amended the Code to create two new excise tax credits: the alcohol fuel mixture credit and the biodiesel mixture credit.[35] The sum of these credits may be taken against the tax imposed on taxable fuels (by section 4081). A person may also file a claim for payment equal to the amount of these credits for biodiesel or alcohol used to produce an eligible mixture.[36] The credits and payments are paid out of the General Fund. If the alcohol is ethanol with a proof of 190 or greater, the credit or payment amount is 51 cents per gallon. For agri-biodiesel, the credit or payment amount is $1.00 per gallon; for biodiesel other than agri-biodiesel, the credit or payment amount is 50 cents per gallon. Under the Code's coordination rules, a claim may be taken only once with respect to any particular gallon of alcohol or biodiesel.

Description of Proposal

Under the proposal, the liquefied petroleum gas, and P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)) are taxed at 18.3 cents per gallon under section 4041. Compressed natural gas is taxed at 18.3 cents per energy equivalent of a gallon of gasoline, and liquefied natural gas, any liquid fuel derived from coal and liquid hydrocarbons

[34] This includes an additional 0.1 imposed by section 4041(d) for the Leaking Underground Storage Tank Trust Fund.

[35] Sec. 6426. The Act also created an income tax credit for biodiesel and biodiesel mixtures. Sec. 40A.

[36] Sec. 6427(e).

derived from biomass would be taxed at 24.3 cents per gallon under section 4041. Under the proposal, hydrogen (whether in liquid or gas form) is exempt from the tax imposed by section 4041, however, persons selling hydrogen as fuel for motor vehicles or motorboats are required to register with the Secretary. Collectively, these fuels (including hydrogen) are referred to as "alternative fuels."

In addition, the proposal creates two new excise tax credits, the alternative fuel credit, and the alternative fuel mixture credit. The credits are allowed against section 4041 liability. The alternative fuel credit is 50 cents per gallon of alternative fuel or gasoline gallon equivalents of nonliquid alternative fuel sold by the taxpayer for use as a motor fuel in a highway vehicle. 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 for use as a fuel in a highway vehicle or used by the taxpayer for use as a fuel in a highway vehicle. Liquid fuel derived from coal would only qualify for the credits if derived from the Fischer-Tropsch process. The credits generally expire after September 30, 2009. The proposal also allows persons to 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. Both credits and payments are made out of the General Fund. 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.

With respect to hydrogen, the credit and payment provisions expire after December 31, 2014.

Effective Date

The proposal is effective for any sale, use or removal for any period after September 30, 2006.

5. Extend excise tax provisions and income tax credit for biodiesel

Present Law

Biodiesel income tax credit

Overview

The Code provides an income tax credit for biodiesel and qualified biodiesel mixtures, the biodiesel fuels credit.[37] The biodiesel fuels credit is the sum of the biodiesel mixture credit plus the biodiesel credit and 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 may not be carried back to a taxable year ending before or on December 31, 2004. The provision does not apply to fuel sold or used after December 31, 2006.

[37] Sec. 40A.

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.

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

Biodiesel credit

The biodiesel credit is 50 cents for each gallon of biodiesel 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.

Biodiesel mixture excise tax credit

The Code also provides an excise tax credit for biodiesel mixtures.[38] 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.[39]

[38] Sec. 6426(c).

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

The credit is not available for any sale or use for any period after December 31, 2006. 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.[40] To the extent the biodiesel fuel mixture credit exceeds any 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.[41] Thus, if the person has no section 4081 liability, the credit is refundable. The payment provision does not apply with respect to biodiesel fuel mixtures sold or used after December 31, 2006.

Description of Proposal

The proposal extends the income tax credit, excise tax credit, and payment provisions through December 31, 2010.

Effective Date

The proposal is effective on the date of enactment.

[40] Sec. 6427(e).

[41] Sec. 6427(e)(2). See also, Internal Revenue Service, *Notice 2005-4*, 2005-2 I.R.B. (December 15, 2004).

E. Energy Related Technical Corrections

1. Technical corrections relating to the expansion of the credit for electricity produced from certain renewable resources

The technical correction provides that the five-year credit period applicable to open-loop biomass facilities that were originally placed in service before the date of enactment begins on January 1, 2005.

The technical correction clarifies that open-loop biomass resources include both cellulosic and lignin waste material.

The technical correction strikes as deadwood the credit eligibility rule for government-owned poultry waste facilities, as such facilities placed in service after the date of enactment are provided for under the rules for agricultural livestock waste nutrient facilities.

The technical correction clarifies that, for the purpose of section 45, a qualified landfill gas facility does not include a facility that uses gas that was produced at a facility, the production from which is, or was previously, allowed a credit under section 29 for the production of landfill gas.

The technical correction clarifies that the Act did not change the determination of whether property is eligible for a five-year recovery period under section 168(e)(3)(B)(vi)(I).

The technical correction provides that the poultry waste facilities placed in service on or before the date of enactment are unaffected by the new provision relating to agricultural livestock waste nutrient facilities.

U.S. SENATE COMMITTEE ON

Finance

SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

http://finance.senate.gov

Opening Statement of Chairman Grassley
Committee Consideration of the Energy Policy Tax Incentives Act of 2005
Thursday, June 16, 2005

On Tuesday, June 14th, I put forward the chairman's mark on the Energy Policy Tax Incentives Act of 2005. This mark was a bipartisan product formulated with Senator Baucus, after consultation with all members of the Finance Committee. This package, once reported out of the Finance Committee, will be offered as an amendment to the underlying energy bill. In my estimation, the Energy Policy Tax Incentives Act reflects a fair balance of the interests of the members and effectively supports the development of energy production from renewable and environmentally beneficial sources. I'd like to briefly describe these tax incentives that will become part of the energy bill. For years, I have worked to decrease our reliance on foreign sources of energy and accelerate and diversify domestic energy production. I believe public policy ought to promote renewable domestic production that uses renewable energy and fosters economic development.

Specifically, the development of alternative energy sources should alleviate domestic energy shortages and insulate the United States from the Middle East-dominated oil supply. In addition, the development of renewable energy resources conserves existing natural resources and protects the environment. Finally, alternative energy development provides economic benefits to farmers, ranchers and forest land owners, such as those in Iowa who have launched efforts to diversify the state's economy and to find creative ways to extract a greater return from abundant natural resources.

Section 45 of the Internal Revenue Code currently provides a production tax credit for electricity produced from renewable sources including wind, biomass, and other renewables. The Energy Policy Tax Incentives Act extends the section 45 credit for three years. I have been a constant advocate of alternative energy sources. Since the inception 13 years ago of the wind energy tax credit, wind energy production has grown considerably. In addition, wind represents an affordable and inexhaustible source of domestically produced energy. Extending the wind energy tax credit through 2008 would support the tremendous continued development of this clean, renewable energy source.

The Finance Committee's amendment supports a maturing green energy source. Experts have established wind energy's valuable contributions to maintaining cleaner air and a cleaner environment. Every 10,000 megawatts of wind energy produced in the United States can reduce carbon monoxide emissions by 33 million metric tons by replacing the combustion of fossil fuels.

In addition, this proposal helps to empower our rural communities to reap continued economic benefits. The installation of wind turbines has a stimulative economic effect because it requires significant capital investment which results in the creation of jobs and the injection of capital into often rural economic areas.

In addition, for each wind turbine, a farmer or rancher can receive more than $2,000 per year for 20 years in direct lease payments. Iowa's major wind farms currently pay more than $640,000 per year to land owners, and

the development of 1,000 megawatts of capacity in California, for example, would result in annual payments of approximately $2 million to farm and forest landowners in that state.

Environmentally-friendly biomass energy production is a proven, effective technology that generates numerous waste management public benefits across the country. The biomass definition covers open loop biomass. Open loop biomass includes organic, non-hazardous materials such as saw dust, tree trimmings, agricultural byproducts and untreated construction debris. The development of a local industry to convert biomass to electricity has the potential to produce enormous economic benefits and electricity security for rural America. In addition, studies show that biomass crops could produce between $2 billion and $5 billion in additional farm income for American farmers. As an example, over 450 tons of turkey and chicken litter are under contract to be sold for an electricity plant using poultry litter being built in Minnesota. This is a win-win; not only do the farmers not have to pay to dispose of this stuff, they get paid to sell the litter. You could find similar examples throughout the Midwest and other farm regions across America. Finally, marginal farmland incapable of sustaining traditional yearly production is often capable of generating native grasses and organic materials that are ideal for biomass energy production. Turning tree trimmings and native grasses into energy provides an economic gain and serves an important public interest.

I am very proud of a long history of supporting new alternative energy concepts in the production of electricity. The chairman's mark, as modified, continues that commitment. By using animal waste as an energy source, an American livestock producer can reduce or eliminate monthly energy purchases from electric and gas suppliers and provide excess energy for distribution to other members of the community.

Swine and bovine energy is truly green electricity, as it also furthers environmental objectives. Specifically, anaerobic digestion of manure improves air quality because it eliminates as much as 90 percent of the odor from feedlots and improves soil and water quality by dramatically reducing problems with waste run-off. Maximizing farm resources in such a manner may prove essential to remain competitive in today's livestock market. In addition, the technology used to create the electricity results in the production of a fertilizer product that is of a higher quality than unprocessed animal waste.

The Energy Policy Tax Incentives Act is important to agriculture, rural economies and small business, and it is also important for domestic supply and energy independence. Rural America can play an important part in energy independence and domestic supply. In addition to the production of electricity, this amendment includes additional tax incentives for the production of alternative fuels from renewable resources. We continue the small producers credit for the production of ethanol. We continue the incentive for the production of biodiesel. Biodiesel is a natural substitute for diesel fuel and can be made from almost all vegetable oils and animal fats. Modern science is allowing us to slowly substitute natural renewable agricultural sources for traditional petroleum. It gives us choices for the future and it can relieve the strain on the domestic oil production to fulfill those important needs that agricultural products cannot serve.

Renewable fuels like ethanol and biodiesel will improve air quality, strengthen national security, reduce the trade deficit, decrease dependence on the Middle East for oil, and expand markets for agricultural products. The Energy Policy Tax Incentives Act amendment is a balanced package. I would like to note, with some satisfaction, that today we have the opportunity to do the people's business in the way they want us to do business. This energy tax incentives amendment was crafted in a bipartisan way on an important initiative in a way that reflects the diversity of our views and the diversity of our nation.

Energy Bill Markup
Statement of Senator Max Baucus
June 16, 2005

Mr. Chairman, thank you for scheduling this markup.

Energy is critical to our Nation's economy and security. Today, however, we import three-fifths of the oil that we consume. Our continuing dependance on foreign oil increasingly threatens our vital national interests.

The world's demand for oil is growing at a record pace. Experts expect the world's oil consumption to grow by 60 percent in the next 25 years. Today, OPEC is pumping close to full capacity, but refined products — especially diesel — remain scarce.

The price of oil has soared to more than $55 a barrel. The price of gas at the pump is a daily reminder of the scarcity of energy. These increasing energy prices stifle our economic growth.

And our dependence on imported oil makes our Country more vulnerable to terrorism. Without warning, a single act of terrorism could disrupt the flow of oil to our nation, and could send gas prices to more than $3 a gallon.

We can and must reduce our dependance on foreign oil. While we cannot do so overnight, we can do more to provide reliable energy from domestic sources. The energy tax incentives included in the proposal before us today take significant steps in the right direction.

The tax provisions before us today differ from those contained in this year's House bill. The House bill heavily favors conventional sources of energy, such as oil, gas, and electricity. The House bill also ignores the important contributions of conservation efforts, improved energy efficiency, and expanded use of alternative-fuel vehicles.

The Chairman's mark provides a more balanced approach. It provides tax incentives needed to support and develop renewable energy sources. In Judith Gap, Montana, wind whips across the wheat plains. Wind is a great and promising resource in Montana. But future development of wind projects needs support, like that provided in the Chairman's mark.

The bill before us today also rewards energy conservation and efficiency, and encourages the use of

clean-fuel vehicles and technologies. These incentives are environmentally responsible. They reduce pollution. And they improve people's health.

In addition, the Chairman's mark recognizes the value of coal and oil to our economy. The mark provides tax incentives for cleaner-burning coal and much-needed expansion of refinery capacity.

The lack of refinery capacity is driving the price of oil up. And our lack of domestic capacity increases our vulnerabilities. A new refinery has not been built in the U.S. since 1976. The Chairman's mark allows expensing of costs to develop additional refinery capacity domestically.

The Chairman's mark would make meaningful progress toward energy independence. It is a balanced product. I encourage my colleagues to support this legislation.

STATEMENT OF SENATOR JON KYL
THE ENERGY POLICY TAX INCENTIVES ACT OF 2005
SENATE FINANCE COMMITTEE
JUNE 16, 2005

I know that many of my colleagues on the committee strongly support the Energy Policy Tax Incentives Act of 2005—a bill that has been in the works for several years. I must, however, express my own profound disappointment with the legislation. We are proposing to approve over $16 billion of credits and incentives for what I think will be very questionable results; therefore I oppose this legislation.

My primary concern is that Congress continues to try to set an industrial policy—a failed strategy of "government knows best"—on the strongest and most dynamic economy in the developed world.

Almost exactly two years ago Congress, working with President Bush, approved one of the most important and best-designed tax cuts in recent memory: the Jobs and Growth tax bill. Quite simply, it cut tax rates on income and on dividends and capital gains. We know from widely-accepted economic studies—most recently from our 2004 Nobel Prize winning economist, Dr. Prescott from Arizona State University—that high tax rates discourage work, savings and investment. And that to encourage these favorable economic activities, the best thing we can do is keep tax rates low and get out of the way.

Government should not try to force taxpayers into one favored type of investment by providing tax subsidies for that investment. If an investment is not economically viable without a government subsidy, then perhaps it is not an activity that ought to be encouraged with taxpayer dollars. I filed an amendment that I will not offer at today's markup that would have stripped the provisions extending and modifying section 45, which I believe falls into this category of subsidizing technologies that are not economically viable.

And if a technology is already viable without a taxpayer-financed subsidy, then we should not devote scare resources to encourage what is already happening in the free market.

In this regard, the alternative fuel vehicle provisions are a good example. As much as we all support the goal of cleaner air, we must be careful not to create more problems than we solve. In my own state of Arizona, an alternative-fuels subsidy program had to be repealed when its many scandalous deficiencies were exposed. Nor has there been any evidence that the vehicles to which the subsidy applies aren't simply priced higher by the amount of the subsidy. I have filed an amendment to strike these provisions from the bill because I have serious questions about whether the incentives are necessary and whether it is appropriate to use the tax code to persuade taxpayers to purchase one type of vehicle over another.

I know hybrid cars and alternative fuel cars are very popular, so Senators may hesitate to stand in the way of tax incentives for people to buy them. But I believe their very popularity argues that there is no need for the tax incentives. People are buying them today without being coaxed by the federal government. Again, I filed several amendments to eliminate or modify the alternative fuel vehicles provisions from the Chairman's mark, but I will not offer those amendments today.

Finally, I believe that the scarce tax-cutting dollars available to this Congress should be used exclusively for provisions that will maintain our strong economy, including making the individual income tax rates, the dividend and capital gains rates, repeal of the death tax, and many of the depreciation changes permanent.

For these reasons, Mr. Chairman, I plan to vote against the Energy Policy Tax Incentives Act.

STATEMENT FOR SENATOR BUNNING
FINANCE COMMITTEE HEARING
ENERGY TAX INCENTIVES ACT OF 2005 MARKUP
JUNE 16, 2005

THANK YOU, MR. CHAIRMAN.

I'M GLAD THAT WE ARE MOVING FORWARD WITH THE ENERGY TAX BILL AGAIN THIS YEAR. THE UNITED STATES NEEDS A SOUND ENERGY POLICY, WHICH INCLUDES TAX INCENTIVES, TO ENSURE A STRONGER ENVIRONMENT, ECONOMY, AND NATIONAL SECURITY.

WE ALL KNOW THE PRICE OF ENERGY HAS RISEN SHARPLY IN THE LAST FEW YEARS. AND IT IS ONLY GOING TO KEEP RISING.

GASOLINE, NATURAL GAS, COAL, AND OTHER FUELS HAVE ALL SEEN LARGE PRICE INCREASES THIS YEAR.

WITH OIL AT OVER $50 A BARREL, I FEEL STRONGLY THAT WE NEED TO INCREASE OUR REFINING CAPACITY IN THIS COUNTRY AND I AM GLAD THAT THIS BILL RECOGNIZES THIS NEED BY PROVIDING TAX CREDITS TO ENCOURAGE THE EXPANSION OF REFINERIES.

I AM ALSO PLEASED THAT THIS BILL ATTEMPTS TO STRIKE A BALANCE WITH A BOOST IN DOMESTIC ENERGY PRODUCTION AS WELL AS PROMOTION OF CONSERVATION AND SMARTER ENERGY USE.

I'M HAPPY THAT AN IMPORTANT CONSERVATION ISSUE – ENERGY EFFICIENT APPLIANCES – WAS INCLUDED IN THE BILL THIS YEAR.

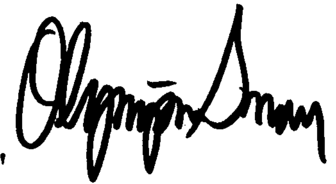
I ALSO WANT TO THANK THE CHAIRMAN FOR THE INCLUSION OF CLEAN COAL TAX INCENTIVES. I BELIEVE THAT MORE INCENTIVES SHOULD BE INCLUDED, HOWEVER, BECAUSE COAL IS A VITAL ENERGY SOURCE FOR OUR COUNTRY PROVIDING OVER 50% OF ENERGY FOR OUR ELECTRICITY GENERATION. I HOPE THAT WE CAN INCREASE THE CLEAN COAL PROVISIONS TO HELP SPUR INVESTMENT IN CLEANER TECHNOLOGIES, CREATE JOBS, AND ENSURE COAL'S FUTURE.

I HOPE THE ENERGY TAX INCENTIVES ACT WILL HELP IMPROVE OUR NATION'S USE OF DOMESTIC ENERGY IN THE TWENTY-FIRST CENTURY.

PASSING AN ENERGY BILL IS IMPORTANT FOR OUR FUTURE. I HOPE THAT WE CAN SIGN THE BILL INTO LAW THIS YEAR.

THANK YOU.

Statement of Olympia J. Snowe
Before the Senate Finance Committee
Mark-Up of "Energy Policy Tax Incentives Act of 2005"
June 16, 2005



Thank you Mr. Chairman. Let me start out by commending you for holding this mark up today and for putting together a much needed package of energy tax incentives that provide a vital component of our energy policy. These incentives will spur the development of new and promising technologies for sources of energy and energy efficiencies.

The United States has a long history of creativity and innovation when comes to energy. But, somehow we cannot seem to break away from our dependency on foreign oil as the dominant energy source. It is clear that we must begin a new chapter for energy use as we begin the 21st century through new sources and new means of both generating and saving energy. Fuel cell technology is just one example of this ingenuity – offering a clean, secure, efficient and dependable source of energy. I am pleased that the Lieberman-Snowe fuel cell bill is part of this bill and it should be part of our national energy strategy.

New sources of energy and energy efficiencies can and *must* be developed and launched in the marketplace for the benefit of both our own national security as well as the American consumer. At the same time, conservation and small energy consumption is also a necessity.

Mr. Chairman, I want to commend you for putting forward a balanced and fair bill that attempts to look broadly at our energy needs and at new technologies. Innovation has been the bedrock of this nation's economic growth and it will be essential once again in transforming the way energy is produced and consumed, not only in the United States but around the world.

I am particularly pleased that the Chairman's mark before us today contains a number of tax incentives I have championed and that will benefit my state of Maine as well as many others.

Specifically, this mark provides important tax incentives for the construction of energy efficient commercial buildings, and renovation of old existing buildings – including schools and other public buildings – as well as residential buildings that produce a 50 percent reduction in energy costs to the owner or tenant – as compared to a national model code that was part of S. 680, Efficient Energy Through Certified Technologies and Electricity Reliability, or EFFECTER, Act that I introduced with Senators Feinstein, McCain, and Durbin.

The mark also contains a tax credit for new energy-efficient homes that save as much as 30 to 50 percent of the heating and cooling energy costs, as well as tax credits for efficient heating, cooling and water heating equipment – including air conditioners – that reduce consumer energy costs.

Notably, these incentives are based on performance, not cost, in order to foster competition between suppliers of different technologies to produce products that meet the proposed target and conserve the most energy. And we know that competition will not only improve these technologies, but help make them more widely available.

In my State of Maine, we have a company, the Nyle Company in Bangor, that makes heat pump hot water heaters, the installation of which is easy, low cost and requires no change in lifestyle. These heat pump heaters can reduce electric usage for hot water heating by more than 50 percent. These heaters extract heat and humidity from the surrounding area, thus reducing the need for dehumidifiers and reducing air conditioning loads, which saves even more energy. Even a small percentage of the market

represents a huge reduction in demand and usage – and a small tax credit, as contained in the mark, could greatly jumpstart this market.

Finally, the mark extends the section 45 tax credit for electricity production from renewable sources. In the JOBS bill enacted last fall, this credit was modified to allow categories of waste materials from forest-related activities – biomass, which is a critical industry in Maine – to qualify. This has been a boost to the struggling forest products industry and will take a step towards smart energy production. It is vital that we extend this effective tax credit.

Mr, Chairman, I believe our task is to help make it more attractive, through the tax code, for our U.S. manufacturers to get the most promising and cost-effective technologies to the U.S. and global marketplace as quickly as possible. Through the tax code, we can also incentives great energy savings though energy efficiencies. We should help increase the American public's awareness of the benefits to our health and our national security of encouraging the shift away from foreign oil and toward domestic renewable and alternative energy sources that help curb our voracious thirst for fossil fuels.

My performance-based targeted incentives included in the Chairman's mark will reduce natural gas prices and electricity prices by cutting the demand for natural gas and electricity in th near term, as well as in the longer term.

The bottom line is, we have the opportunity to raise the bar for our future domestic energy systems and energy efficiencies. Solutions exist in available and developing technologies, and most of all in the entrepreneurial spirit of the American people.

I would like included in the record, performance-based provisions from my bill, S. 680, the Efficient Energy Through Certified Technologies and Electricity Reliability, or EFFECTER, Act, that are included in the Chairman's mark, the "Energy Tax Incentives Act of 2005", and I thank the Chair.

Provisions included from S. 680, of the "Efficient Energy Through Certified Technologies and Electric Reliability, or EFFECTER, Act of 2005":

- **New and existing commercial buildings (including schools and other public buildings and rental housing owned by corporations) with 50% reductions in annual energy costs to the owner or tenant compared to a national model code;**

- **Efficient new residential buildings, saving 30% or 50% of energy compared to national model codes, with a higher incentive for the higher savings. The incentive is provided to the builder.**

- **Efficient heating, cooling and water heating equipment that reduces consumer energy costs and, for air conditioners, reduces peak electric power demand, by about 20% (lower incentives) and 30%-50% (higher incentives) compared to national standards; also incentives for solar hot water and photovoltaic systems.**

- **Retrofits of existing homes that save up to 50% of the heating and cooling energy cost compared to the condition of the home as-is, including retrofits of rental property and multi-family dwellings undertaken by either the tenant or the landlord.**

- **Combined heat and power (CHP) systems up to 15 megawatts that meet specified efficiency specifications. CHP technologies produce both**

electricity and steam from a single fuel at a facility located near the consumer. These efficient systems recover heat that normally would be wasted in an electricity generator, and save the fuel that would otherwise be used to produce heat or steam in a separate unit.