110TH CONGRESS } *2nd Session* }	HOUSE OF REPRESENTATIVES	{ REPORT { 110-??

HEARTLAND, HABITAT, HARVEST, AND HORTICULTURE ACT OF 2008

CONFERENCE REPORT

TO ACCOMPANY

H.R. 2419

May __ (legislative day, May __), 2008.—Ordered to be printed

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Mr. RANGEL, from the committee of conference,
submitted the following

CONFERENCE REPORT

[To accompany H.R. 2419]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2419), having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the State amendment, insert the following:

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I. DISASTER ASSISTANCE TRUST FUND[1]
(sec. 12101 of the Senate amendment, sec. 901 of the Trade Act of 1974 and sec. 15101 of the conference agreement)

Present Law

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

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

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

DSA is available to those producers who are borrowers from the Farm Service Agency in primary or contiguous counties that have been declared by the President or designated by the Secretary of Agriculture ("Secretary") as a disaster area. When borrowers affected by natural disasters are unable to make their scheduled payments on any debt, FSA is authorized to consider the set-aside of some payments to allow the farming operation to continue. After a disaster designation is made, FSA will notify borrowers of the availability of the DSA. Borrowers who are notified have eight months from the date of designation to apply. FSA borrowers may also request a release of income proceeds to meet current operating and family living expenses or

[1] The statement of managers does not contain descriptions of the provisions in the House bill and Senate amendment that were not agreed to by the conferees.

may request special servicing provisions from their local FSA county offices to explore other options.

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

House Bill

No provision.

Senate Amendment

In general

The provision amends the Trade Act of 1974 to create a permanent Agriculture Disaster Relief Trust Fund ("PADTF") that would provide payments to farmers and ranchers who suffer losses in areas that are declared disaster areas by the USDA. The trust fund will be funded by an amount equal to 3.34 percent of the amounts received in the general fund of the Treasury that are attributable to the duties collected on articles entered, or withdrawn from warehouse, for consumption under the Harmonized Tariff Schedule. The PADTF could make payments under four new disaster assistance programs: the permanent crop disaster assistance program, the permanent livestock indemnity program, the tree assistance program, and the emergency assistance program for livestock, honey bees, and farm raised fish. In addition, the PADTF will also fund a new pest and disease management and disaster prevention program. Amounts not required to meet current withdrawals may be invested in U.S. Treasury obligations with interest credited to the PADTF. The PADTF may also borrow, with interest, as repayable advances sums necessary to carry out the purposes of the fund.

Permanent Crop Disaster Assistance Program ("PCDP")

Generally, PCDP payments will be paid to producers located in disaster counties on 52 percent of the difference between the disaster program guarantee and the sum of total farm revenue. Disaster counties include counties receiving disaster declarations by the Secretary due to production losses resulting directly or indirectly from adverse weather, counties contiguous to such counties, and any farm whose production due to weather was less than 50 percent of normal production. To be eligible for PCDP payments, the producer must have purchased or enrolled in both crop insurance for insurable crops at a minimum of 50 percent of yield at 55 percent of price and NAP for uninsurable crops. The Secretary may waive this requirement under certain conditions.

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

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

Permanent Livestock Indemnity Program

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

Tree Assistance Program

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

Buy-up NAP Coverage

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

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

The Secretary shall use up to $35,000,000 annually from the trust fund to provide emergency relief to producers of livestock (including horses), honey bees, and farm-raised fish due to losses from adverse weather or other environmental conditions, such as blizzards and wildfires, as determined by the Secretary, that are not covered under the authority of the

Secretary to make qualifying natural disaster declarations. For purposes of the provision, farm-raised fish includes the propagation and rearing of aquatic species (including any species of finfish, mollusk, crustacean, or other aquatic invertebrate, amphibian, reptile, or aquatic plant) in controlled or semi-controlled environments.

Limitations

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

Pest and Disease Management and Disaster Prevention

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

Sunset of provision

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

Conference Agreement

Supplemental Agricultural Disaster Assistance Program Description and Provisions

(For crop years 2008-2011)

The provision amends the Trade Act of 1974 to create a Supplemental Agricultural Disaster Assistance trust fund ("Trust Fund") that would provide payments to farmers and ranchers who suffer losses in areas that are designated disaster areas by the USDA. The Trust Fund could make payments under five new disaster assistance programs: the Supplemental Revenue Program ("SURE"), the Livestock Forage Disaster Program ("LFP"), the Livestock Indemnity Program ("LIP"), the Tree Assistance Program ("TAP"), and the Emergency Assistance Program for Livestock, Honey bees, and Farm raised fish.

Supplemental Revenue Assistance Payments (SURE)

Section 901(b) SURE Assistance will be available to eligible producers on farms in disaster determined and contiguous counties that have incurred crop production losses and/or crop quality losses.

901(a)(5) For purposes of the supplemental revenue assistance program, disaster counties are counties that received Secretarial Disaster declarations due to production losses resulting directly or indirectly from adverse weather. However, Secretarial designations are waived for farms with greater than 50% production losses.

901(b)(2)(A) SURE Assistance payments will be issued on 60% of the difference between the disaster assistance program guarantee AND total farm revenue (as defined).

The conferees expect that when payments are calculated, USDA will not discount any final payments for any activity that has already been deducted as an adjustment to a crop insurance indemnity or noninsured assistance payment such as harvest costs, packing, or transportation.

901(b)(3) The SURE Assistance Program Guarantee is the sum obtained by adding:

For each insurable commodity, the product obtained by multiplying: the higher of the Adjusted APH yield, or the counter-cyclical program payment yield the percentage of crop insurance yield guarantee, the crop insurance price election, the acres planted or prevented from being planted, and 115%, AND for each non-insurable commodity on the farm, the product obtained by multiplying: the higher of the adjusted noninsured assistance program yield guarantee or the counter-cyclical program payment yield, 100% of the NAP established price, the acres planted or prevented from being planted, and 120%.

The conferees intend the price election for revenue products to be the price the crop insurance indemnity would be calculated for the plan of insurance obtained by the producer.

901(a)(2) The Adjusted APH Yield and Section 901(a)(3) the Adjusted Noninsured Crop Disaster Assistance Yield are determined by dropping replacement yields for producers with at least four years of actual production history. For producers with four years or less, one replacement yield may be dropped from the calculation.

The SURE Assistance guarantee will be adjusted in the following manners. 901(b)(2)(B) The guarantee may not exceed 90% of the expected revenue for the whole farm. 901(b)(3)(B)&(C) Where crop insurance or the NAP makes adjustments for prevented planting or un-harvested production, the adjusted guarantee will be the basis for calculating the SURE Assistance guarantee.

901(b)(3)(D) The Secretary is also charged with the responsibility to establish equitable treatment for non-standard crop insurance products like AgriLite.

901(b)(4) The total Farm Revenue for the farm shall be equal to the sum obtained by adding: the estimated actual value of the production for each crop produced by multiplying the actual crop acreage harvested; the estimated actual yield; the national average market price for the marketing year for each commodity, as determined by the Secretary; the crop insurance or NAP indemnities accruing to the farm; the value of any other natural disaster assistance payments provided by the federal government on a farm for the same loss; 15% of direct payments accruing to the farm; all marketing loan proceeds (including certificate gains); and all counter-cyclical or average crop revenue payments

The conferees encourage the Secretary to accept Loss Adjustment yields to determine estimated actual yield when available with the understanding that all of the units for the crop on the farm would need to be adjusted to arrive at total farm production.

When loss adjusted yields are not available, the conferees expect the Secretary to obtain APH certified yields submitted to the Risk Management Agency through participating crop insurance companies.

901(b)(4)(B) The Secretary shall adjust the average market price received to reflect average quality discounts applied to the local or regional market price of the crop during the year of production. The Secretary shall also account for crop value reduced due to excess moisture resulting from a disaster related condition.

The conferees expect the Secretary, assisted by Farm Service Agency State and County committees, will determine local or regional discounts for the marketing year in a manner similar to what has been used to administer recent ad hoc quality loss programs.

The conferees encourage the Secretary to consider salvage values when quality factors prevent the commodity from being marketed for its originally intended purpose.

901(b)(5) Expected crop revenue is used to calculate the 90% limit of the SURE Assistance Guarantee and is equal to the sum obtained by adding:

For each insured commodity, the product obtained by multiplying: the higher of the Actual Production History (APH) yield, the Adjusted APH yield, or the counter-cyclical program payment yield; the acreage planted or prevented from being planted; and the insurance price guarantee, AND for each noninsured crop, the product obtained by multiplying: the adjusted non-insurable assistance program (NAP) yield, the adjusted Actual Production History (APH) NAP yield; the acreage planted or prevented from being planted; and 100% of the NAP protection price.

The entire farm constitutes unit structure for this program including all crops in all counties in the farming operation and shared production.

Livestock Indemnity Program (LIP)

901(c)(1) The Trust Fund may also make payments under the Livestock Indemnity program (LIP) to eligible producers on farms that have incurred livestock death losses in excess of normal mortality rates during the calendar year due to adverse weather, as determined by the Secretary.

901(c)(2) Indemnity payments are made at a rate of 75 percent of the fair market value of the livestock on the day before the date of death of the livestock as determined by the Secretary.

It is the intent of the conferees that the Secretary shall make LIP payments based upon individual producers' eligible losses. No state, county, or other trigger shall be used by the Secretary to define an eligible LIP area.

It is expected that the Secretary, through the State Farm Service Agency Committee will obtain recommendations from applicable state livestock organizations, state Cooperative Extension Service, and other knowledgeable and credible sources to establish the normal mortality rate for each type of livestock on a state-by-state basis.

When determining the market value of applicable livestock in order to determine payment rates for LIP, the Secretary shall establish market values for each type of livestock from credible livestock markets. Credible livestock markets include sale barns, local sales as well as terminal market centers or slaughtering facilities.

Livestock Forage Disaster Program (LFP)

901(d) The Livestock Forage Program provides ranchers assistance for forage losses due to drought. Ranchers in counties with droughts designated by the Drought Monitor as severe, extreme or exceptional qualify for assistance. Producers in a severe drought will receive one month's payment. Producers experiencing extreme drought will get two month's payment and producers in a county with an exceptional drought will receive three month's payment. The payment is 60 percent of either 1) the monthly feed cost for the total number of livestock covered or, 2) the monthly feed cost calculated by using the normal carrying capacity of the eligible grazing land, whichever is smaller.

901(d)(4) LFP also covers losses to ranchers whose livestock utilize federal grazing permits. Payments are available to eligible livestock producers whose livestock are prohibited by a Federal agency from grazing due to fire. Payments will be made for the time period beginning on the date the Federal Agency excludes the eligible livestock producer and ending on the last day of the eligible producer's the Federal lease. The payment rate is 50 percent of the monthly feed costs for the total number of livestock covered by the Federal lease.

The conferees intend this section to also apply to trust property and range units managed under the authority of the Department of Interior through the Bureau of Indian Affairs.

901(d)(1)(D) In order to disallow excessive payments to livestock producers who overgraze pasture and grazing lands the Secretary shall calculate the normal carrying capacity of the eligible livestock producer's grazing and pasture land and issue payments based on the lesser of the actual number of the livestock producer's eligible livestock or the maximum carrying capacity of the eligible livestock producer's pasture and grazing land for the type and weight of the eligible producer's livestock.

901(d)(5) One of the eligibility requirements for the LFP is that a livestock producer shall have timely applied for and obtained, if available, either crop insurance, including pilot programs implemented by the Risk Management Agency such as the Pastureland Rangeland Forage Program; or coverage under the NAP on the pasture or grazing land which suffered an eligible loss. Producers are not required to purchase any pilot program if they purchase NAP.

901(d)(5)(C) For the 2008 crop year only, if a livestock producer had not timely obtained either crop insurance or NAP coverage, if it was available, the Secretary shall waive this requirement if the livestock producer pays any fee that would have been required to enroll in either crop insurance or NAP.

901(d)(5)(D) For any year after 2008, the Secretary may on a case-by-case basis provide equitable relief for producers who the county Farm Service Agency Committee determines unintentionally failed to obtain crop insurance or NAP coverage on applicable grazing and pasture land.

The conferees recommend that for LFP applications for which payment would be less than $25,000, the State Farm Service Agency Committee may provide equitable relief; and that for LFP applications for which payments exceed $25,000 the Secretary or designee shall review a recommendation from the county and state Farm Service Agency committees and determine whether equitable relief applies.

Emergency Assistance for Livestock, Honey Bees, and Farm-Raised Fish

901(e)(1) The Secretary shall use up to $50,000,000 annually from the Trust Fund to provide emergency relief to producers of livestock (including horses), honey bees, and farm-raised fish due to losses from adverse weather or other conditions, such as blizzards and wildfires, as determined by the Secretary.

The conferees wish to clarify that program is intended to cover disasters that are not adequately covered by any other disaster program.

Tree Assistance Program (TAP)

901(f) The Secretary shall make payments to eligible orchardists and nursery tree growers as follows. Assistance is in the form of 1) 70 percent reimbursement for the cost of replanting trees lost due to a natural disaster if tree mortality is in excess of 15 percent, adjusted for normal mortality, or sufficient seedlings to reestablish a stand; and 2) 50 percent reimbursement of the cost of pruning, removal, and other costs incurred to salvage existing trees or to prepare land to replant trees lost due to a natural disaster in excess of 15 percent damage and/or mortality adjusted for normal tree damage and/or mortality.

The conferees wish to clarify that the insurance requirement for TAP eligibility refers to insurance on the crop and not on the underlying vines or trees.

Rick Management Purchase Requirements

901(g) To be eligible for SURE Assistance, the producer must have purchased or be enrolled in (at a minimum) the Catastrophic crop insurance (CAT) for insurable crops and the Noninsured Assistance Program (NAP) for uninsurable crops.

901(g)(4) For the 2008 crop year, the Secretary will waive the purchase requirement if producers pay a fee equal to the administrative fees for CAT and NAP on crops for which no coverage has been purchased within 90 days after the enactment of this subtitle.

The conferees intend that participation in pilot crop insurance programs may establish linkage, but pilot participation would not be necessary to establish linkage if CAT or NAP coverage is secured.

901(g)(5) The Secretary may provide equitable relief to producers who unintentionally fail to meet the crop insurance or NAP purchase requirements for one or more crops on a farm on a case-by-case basis. For 2008, the Secretary will have additional authority for producers who failed purchase requirements of this subtitle.

The conferees that the Secretary will use equitable relief provisions in circumstances where severe weather events result in revised planting intentions for crops for which the producer had not obtained a minimum CAT or NAP coverage.

901(g)(3) The Secretary may waive the crop insurance purchase requirement for limited resource, minority and/or beginning farmers and provide disaster assistance benefits at a level deemed appropriate by the Secretary.

The conferees do not expect the Secretary to conduct an annual signup to participate in the SURE Assistance program. The conferees anticipate an effective public information effort will be conducted by USDA with the cooperation of the Farm Service Agency, the Natural Resources Conservation Service, the Risk Management Agency (including crop insurance companies), the Cooperative State Research, Education, and Extension Service, and State Departments of Agriculture.

Limitations

901(h) No eligible producer may receive more than $100,000 annually in total disaster assistance under this section, excluding subsection 901(f). A producer is not eligible for benefits under the provision if, as determined by the Secretary, such producer's adjusted gross income (as defined in section 1001D(a) of the Food Security Act of 1985 or any successor provision) . Direct attribution of benefits as described in subsection (e) and (f) of Section 1001 of the Food Security Act of 1985 (7 U.S.C. 1308) or any successor provision shall apply.

The conferees anticipate that the AGI limit would be consistent with limitations for the noninsured assistance program.

The conferees note that the Tree Assistance Program (TAP) has a separate $100,000 annual limitation.

Period of Effectiveness

Section 901(i) states that the Supplemental Agricultural Disaster Assistance program shall cover disaster related losses occurring on or before September 30, 2011.

The conferees expect the Secretary to cover all losses for which disaster conditions were evident on or before September 30, 2011.

Duplicate Payments

Section 901(j) instructs the Secretary to prevent duplicative payments.

The conferees expect Emergency Conservation Programs (ECP), or any other similar program not directed to production or revenue losses of the farm, are not intended to be covered by this section.

Agricultural Disaster Relief Trust Fund (Trust Fund)

902(b) The Trust Fund will be funded by an amount equal to 3.08 percent of the amounts received in the general fund of the Treasury that are attributable to the duties collected on articles entered, or withdrawn from warehouse, for consumption under the Harmonized Tariff Schedule. Amounts not required to meet current withdrawals may be invested in U.S. Treasury obligations with interest credited to the trust fund. The Trust Fund may also borrow, with interest, as repayable advances sums necessary to carry out the purposes of the fund.

902(b)(3) Funds will not be appropriated to the Trust Fund if any changes are made to the operation of the programs within the Trust Fund that are not permitted by the Trust Fund.

Jurisdiction

Section 903 requires legislation in the Senate of the United States that amends section 901 or section 902 be referred to the Committee on Finance of the Senate.

II. REVENUE PROVISIONS FOR AGRICULTURE PROGRAMS

A. Extension of Custom User Fees (sec. 15201 of the conference agreement)

Present Law

Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c) ("COBRA") authorizes the Secretary of the Treasury to collect certain customs services fees. Section 412 of the Homeland Security Act of 2002 authorizes the Secretary of the Treasury to delegate such authority to the Secretary of Homeland Security. Customs user fees include passenger and conveyance processing fees (e.g., fees for processing air and sea passengers, commercial trucks, rail cars, private aircraft and vessels, commercial vessels, dutiable mail packages, barges and bulk carriers, cargo, and Customs broker permits) and merchandise processing fees. Congress has authorized collection of the passenger and conveyance processing fees through December 27, 2014. The current authorization for the collection of the merchandise processing fees is through December 27, 2014.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement amends Section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 to extend the passenger and conveyance processing fees through September 30, 2017, and extend the merchandise processing fees through November 14, 2017. The conference agreement would require remittance, by no later than September 25, 2017, of passenger and conveyance fees for the period July 1, 2017 though September 20, 2017. It would also require an estimated prepayment of the merchandise processing fees no later than September 25, 2017 for merchandise entered on or after October 1, 2017 and before November 15, 2017. The estimated prepayment will be based on the amount paid in the equivalent period of the previous year, as determined by the Secretary of the Treasury. The conference agreement also holds service users harmless for overpayments or underpayments of merchandise processing fees by requiring the Secretary of Treasury to reconcile the fees paid with the actual fees incurred for services rendered. The Secretary of Treasury must then refund any overpayments with interest, and make adjustments for any underpayments of such merchandise processing fees.

Effective Date

The provision is effective on the date of enactment.

B. Modifications to Corporate Estimated Tax Payments (sec. 15202 of the conference agreement)

Present Law

In general

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

Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA")

TIPRA provided the following special rules:

In case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, shall be increased to 106.25 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

In case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2013, shall be increased to 100.75 percent of the payment otherwise due and the next required payment shall be reduced accordingly.

Subsequent legislation

Several public laws have been enacted since TIPRA which further increase the percentage of payments due under each of the two special rules enacted by TIPRA described above.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The provision makes a modification to the corporate estimated tax payment rules.

In case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012, are increased by 7 3/4 percentage points of the payment otherwise due and the next required payment shall be reduced accordingly.

Effective Date

The provision is effective on the date of enactment.

III. TAX PROVISIONS

A. Conservation

1. Exclusion of Conservation Reserve Program Payments from SECA tax for individuals receiving Social Security retirement or disability payments (sec. 12202 of the Senate amendment, sec. 15301 of the conference agreement and sec. 1402(a) of the Code)

Present Law

Generally, the Self-Employment Contributions Act ("SECA") tax is imposed on an individual's net earnings from self-employment income within the Social Security wage base. Net earnings from self-employment generally mean gross income (including the individual's net distributive share of partnership income) derived by an individual from any trade or business carried on by the individual less applicable deductions.[2]

House Bill

No provision.

Senate Amendment

The provision excludes conservation reserve program payments from self-employment income for purposes of the SECA tax in the case of individuals who are receiving Social Security retirement or disability benefits. The treatment of conservation reserve program payments received by other taxpayers is not changed.

Effective date.–The provision is effective for payments made after December 31, 2007.

Conference Agreement

The conference agreement follows the Senate amendment.

2. Make permanent the special rule encouraging contributions of capital gain real property for conservation purposes (sec. 12203 of the Senate amendment, sec. 15302 of the conference agreement and sec. 170 of the Code)

Present Law

Charitable contributions generally

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contributed

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[2] Sec. 1402.

property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.[3]

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

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

Capital gain property

Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property to a qualified charity are deductible at fair market value within certain limitations. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of capital gain property to charitable organizations described in section 170(b)(1)(B) (e.g., private non-operating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

For purposes of determining whether a taxpayer's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property

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

are taken into account after other charitable contributions. Contributions of capital gain property that exceed the percentage limitation may be carried forward for five years.

Qualified conservation contributions

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

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

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

In general

Under a temporary provision that is effective for contributions made in taxable years beginning after December 31, 2005,[4] the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined under present law). Instead, individuals may deduct the fair market value of any qualified conservation contribution to an organization described in section 170(b)(1)(A) to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions.

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

For example, assume an individual with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions subject to the 50-percent limitation of $60. The individual is allowed a deduction

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

of $50 in the current taxable year for the non-conservation contributions (50 percent of the $100 contribution base) and is allowed to carryover the excess $10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire $80 qualified conservation contribution may be carried forward for up to 15 years.

Farmers and ranchers

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

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

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[5]

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

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

Termination

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

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

House Bill

No provision.

Senate Amendment

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

Effective date.–The provision is effective for contributions made in taxable years beginning after December 31, 2007.

Conference Agreement

The conference agreement follows the Senate amendment by extending the special rule regarding contributions of capital gain real property for conservation purposes. However, under the conference agreement, the special rule does not apply for contributions made in taxable years beginning after December 31, 2009.

3. Deduction for endangered species recovery expenditures (sec. 12205 of the Senate amendment, sec. 15303 of the conference agreement and sec. 175 of the Code)

Present Law

Under present law, a taxpayer engaged in the business of farming may treat expenditures that are paid or incurred by him during the taxable year for the purpose of soil or water conservation in respect of land used in farming, or for the prevention of erosion loss of land used in farming, as expenses that are not chargeable to capital account. Such expenditures are allowed as a deduction, not to exceed 25 percent of the gross income derived from farming during the taxable year.[6] Any excess above such percentage is deductible for succeeding taxable years, not to exceed 25 percent of the gross income derived from farming during such succeeding taxable year.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that expenditures paid or incurred by a taxpayer engaged in the business of farming for the purpose of achieving site-specific management actions pursuant to the Endangered Species Act of 1973[7] are to be treated the same as expenditures for the purpose of soil or water conservation in respect of land used in farming, or

[6] Sec. 175.

[7] 16 U.S.C. 1533(f)(B).

for the prevention of erosion of land used in farming, i.e., such expenditures are treated as not chargeable to capital account and are deductible subject to the limitation that the deduction may not exceed 25 percent of the farmer's gross income derived from farming during the taxable year.

Effective date.–The provison is effective for expenditures paid or incurred after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, except that the conference agreement provision is effective for expenditures paid or incurred after December 31, 2008.

4. Temporary reduction in corporate tax rate for qualified timber gain; timber REIT provisions (secs. 12212-12217 of the Senate amendment, secs. 15311-15315 of the conference agreement and secs. 856, 857, and 1201 of the Code)

Present Law

Treatment of certain timber gain

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

Under present law, for taxable years beginning before January 1, 2011, the maximum rate of tax on long term capital gain ("net capital gain")[8] of an individual, estate, or trust is 15 percent. Any net capital gain that otherwise would be taxed at a 10- or 15-percent rate is taxed at a zero-percent rate. These rates apply for purposes of both the regular tax and the alternative minimum tax.[9]

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

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

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

The net capital gain of a corporation is taxed at the same rates as ordinary income, up to a maximum rate of 35 percent.[10]

Real estate investment trusts ("REITs") are subject to a special taxation regime. Under this regime, a REIT is allowed a deduction for dividends paid to its shareholders.[11] As a result, REITs generally do not pay tax on distributed income, but the income is taxed to the REIT shareholders. A REIT that has long-term capital gain can declare a dividend that shareholders are entitled to treat as long-term capital gain.

REITs generally are required to distribute 90 percent of their taxable income (other than net capital gain). A REIT generally must pay tax at regular corporate rates on any undistributed income. However, a REIT that has net capital gain can retain that gain without distributing it, and the shareholders can report the net capital gain as if it were distributed to them. In that case the REIT pays a C corporation tax on the retained gain, but the shareholders who report the income are entitled to a credit or refund for the difference between the tax that would be due if the income had been distributed and the 35-percent rate paid by the REIT.[12] In effect, net capital gain of a REIT (including but not limited to timber gain) can be taxed as net capital gain of the shareholders, whether or not the gain is distributed.

<u>Other REIT provisions</u>

A REIT is also subject to a four-percent excise tax to the extent it does not distribute specified percentages of its income within any calendar year. The required distributed percentage is 85 percent in the case of the REIT ordinary income, and 95 percent in the case of

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[10] Secs. 11 and 1201.

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

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

the REIT capital gain net income (as defined).[13] The amount of the excess of the required distribution over the actual distribution is subject to the 4-percent tax.

A REIT generally is restricted to earning certain types of passive income. Among other requirements, at least 75 percent of the gross income of a REIT in a taxable year must consist of certain types of real estate related income, including rents from real property, income from the sale or exchange of real property (including interests in real property) that is not stock in trade, inventory, or held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, and interest on mortgages secured by real property or interests in real property.[14] Interests in real property are specifically defined to exclude mineral, oil, or gas royalty interests.[15] A REIT will not qualify as a REIT, and will be taxable as a C corporation, for any taxable year if it does not meet this income test.

Some REITs have been formed to hold land on which trees are grown. Upon maturity of the trees, the standing trees are sold by the REIT. The Internal Revenue Service has issued private letter rulings in particular instances stating that the income from the sale of the trees under section 631(b) can qualify as REIT real property income because the uncut timber and the timberland on which the timber grew is considered real property and the sale of uncut trees can qualify as capital gain derived from the sale of real property.[16]

A REIT is subject to a 100-percent excise tax on gain from any sale that is a "prohibited transaction," defined as a sale of property that is stock in trade, inventory, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.[17] This determination is based on facts and circumstances. However, a safe-harbor provides that no excise tax is imposed if certain requirements are met. In the case of timber property, the safe harbor is met, regardless of the number of sales that occur during the taxable year, if (i) the REIT has held the property for not less than four years in connection with the trade or business of producing timber; (ii) the aggregate adjusted bases of the property sold (other than foreclosure property) during the taxable year does not exceed 10 percent of the aggregate bases of all the assets of the REIT as of the beginning of the taxable year, and if certain other requirements are met. These include requirements that limit the amount of expenditures the REIT can make during

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

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

[15] Section 856(c)(5)(C).

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

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

the 4-year period prior to the sale that are includible in the adjusted basis of the property,[18] that require marketing to be done by an independent contractor, and that forbid a sales price that is based on the income or profits of any person.[19] There is a similar but separate safe harbor for sales of non-timber property, with similar rules, including a 4-year holding period requirement and a limit on the percentage of the aggregate adjusted basis of property that can be sold in one taxable year.[20]

A REIT is not generally permitted to hold securities representing more than 10 percent of the voting power or value of the securities of any one issuer; nor may more than 5 percent of the fair market value of REIT assets be securities of any one issuer.[21] However, under an exception, a REIT may hold any amount of securities of one or more "taxable REIT subsidiary" (TRS) corporations, provided that such TRS securities do not represent more than 20 percent of the fair market value of REIT assets at the end of any quarter. A TRS is a C corporation that is subject to regular corporate tax on its income and that meets certain other requirements. A taxable REIT subsidiary may conduct activities that would produce disqualified non-passive or non-real estate income that could disqualify the REIT if conducted by a REIT itself. Such business could include business relating to processing timber, or holding timber products or other assets for sale to customers in the ordinary course of business. Such income would be subject to regular corporate rates of tax as income of the TRS.[22]

House Bill

No provision.

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

[19] Section 857(b)(6)(D).

[20] Section 857(b)(6)(C).

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

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

Senate Amendment

Elective deduction for 60 percent of qualified timber gain

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

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

If a taxpayer elects the deduction, the 40 percent of the gain subject to tax is taxed at ordinary income tax rates.[23]

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

In the case of a REIT, the election to take the 60-percent deduction is made by the REIT. If a REIT makes the election, then the timber gain is excluded from the computation of capital gain or loss of the REIT and can no longer be designated as a capital gain dividend to shareholders. Instead, the gain is treated as ordinary income for purposes of applying the REIT income distribution requirements, but for this purpose 60-percent of the amount of the gain is deductible by the REIT in computing its income. REIT earnings and profits also exclude the portion of the timber gain that is deductible. Thus, 40 percent of the gain is subject to the REIT distribution requirements,[24] and 40 percent of the gain increases REIT earnings and profits. Accordingly, because REIT earnings and profits have been increased by the 40-percent amount, there is sufficient earnings and profits that a distribution of that 40-percent amount that otherwise qualifies as a dividend would be treated as an ordinary dividend distribution to shareholders. Since this dividend is from a REIT and is not derived from an entity that was taxed as a C corporation, it would not qualify for the current 15-percent qualified dividend rates and would be taxed at the ordinary income rates of the shareholders.

REIT shareholders obtain an upward basis adjustment in their REIT interests, equal to the 60 percent of the timber gain that is deductible by the electing REIT. Because the 60 percent of timber gain that was deductible by the REIT does not increase REIT earnings and profits, a distribution of such 60 percent to the shareholder generally will not be treated as a dividend (in the absence of other retained earnings) but as a return of basis under the general rules of section

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

[24] For purposes of the section 4981 excise tax on undistributed REIT income, the amount treated as subject to the 95 percent distribution requirement is the 40 percent of timber gain income that remains after allowing the deduction.

301(c). Because the shareholders' basis has been increased by this 60 percent, this distribution would not exceed the shareholders' basis and thus would be nontaxable return of basis, rather than capital gain in excess of basis. However, if a REIT shareholder has obtained such an upward basis adjustment for a REIT interest and disposes of the interest before having held the interest for at least 6 months, then any loss on disposition of the interest is disallowed to the extent of such upward basis adjustment.

Additional REIT provisions

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

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

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

REIT prohibited transaction safe harbor for timber property

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

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

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

Special rules for Timber REITs

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

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

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

Effective Date

The provision applies to taxable years beginning after the date of enactment, but does not apply after the last day of the first taxable year beginning after the date of enactment.

Conference Agreement

Corporate rate reduction for qualified timber gain

The conference agreement provides a 15-percent alternative tax rate for corporations on the portion of a corporation's taxable income that consists of qualified timber gain (or, if less, the net capital gain) for a taxable year.[25]

The alternative 15-percent tax rate applies to both the regular tax and the alternative minimum tax.

Qualified timber gain means the net gain described in section 631(a) and (b) for the taxable year, determined by taking into account only trees held more than 15 years.

Effective date.–The provision applies to taxable years ending after the date of enactment and beginning on or before the date which is one year after the date of enactment. In the case of a taxable year that includes the date of enactment, qualified timber gain may not exceed the qualified timber gain properly taken into account for the portion of the year after that date. In the case of a taxable year that includes the date that is one year after the date of enactment, qualified timber gain may not exceed the qualified timber gain properly taken into account for the portion of the year on or before that date.

[25] The conference agreement does not contain the 60 percent deduction for qualified timber income that was contained in the Senate amendment, nor does it make any change to section 4981.

Additional REIT provisions

The conference agreement follows the additional REIT provisions in the Senate amendment.

Effective date.–The additional REIT provisions apply only for the first taxable year of the REIT that begins after the date of enactment and before the date that is one year after the date of enactment. The provisions terminate after that time.

5. Qualified forestry conservation bonds (sec. 12808 of the Senate amendment, and sec. 15316 of the conference agreement and new secs. 54A and 54B of the Code)

Present Law

Tax-exempt bonds

In general

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

Private activity bond tests

Present law provides two tests for determining whether a State or local bond is in substance a private activity bond, the private business test and the private loan test.[26]

Private business tests

Private business use and private payments result in State and local bonds being private activity bonds if both parts of the two-part private business test are satisfied–

1. More than 10 percent of the bond proceeds is to be used (directly or indirectly) by a private business (the "private business use test"); and

[26] Sec. 141(b) and (c).

2. More than 10 percent of the debt service on the bonds is secured by an interest in property to be used in a private business use or to be derived from payments in respect of such property (the "private payment test").[27]

Private business use generally includes any use by a business entity (including the Federal government), which occurs pursuant to terms not generally available to the general public. For example, if bond-financed property is leased to a private business (other than pursuant to certain short-term leases for which safe harbors are provided under Treasury regulations), bond proceeds used to finance the property are treated as used in a private business use, and rental payments are treated as securing the payment of the bonds. Private business use also can arise when a governmental entity contracts for the operation of a governmental facility by a private business under a management contract that does not satisfy Treasury regulatory safe harbors regarding the types of payments made to the private operator and the length of the contract.[28]

Private loan test

The second standard for determining whether a State or local bond is a private activity bond is whether an amount exceeding the lesser of (1) five percent of the bond proceeds or (2) $5 million is used (directly or indirectly) to finance loans to private persons. Private loans include both business and other (e.g., personal) uses and payments by private persons; however, in the case of business uses and payments, all private loans also constitute private business uses and payments subject to the private business test. Present law provides that the substance of a transaction governs in determining whether the transaction gives rise to a private loan. In general, any transaction which transfers tax ownership of property to a private person is treated as a loan.

Qualified private activity bonds

As stated, interest on private activity bonds is taxable unless the bonds meet the requirements for qualified private activity bonds. Qualified private activity bonds permit States or local governments to act as conduits providing tax-exempt financing for certain private activities. The definition of qualified private activity bonds includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond (sec. 141(e)). The definition of exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain

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[27] The 10-percent private business use and payment threshold is reduced to five percent for private business uses that are unrelated to a governmental purpose also being financed with proceeds of the bond issue. In addition, as described more fully below, the 10-percent private business use and private payment thresholds are phased-down for larger bond issues for the financing of certain "output" facilities. The term output facility includes electric generation, transmission, and distribution facilities.

[28] See Treas. Reg. sec. 1.141-3(b)(4) and Rev. Proc. 97-13, 1997-1 C.B. 632.

private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities (sec. 142(a)).

In most cases, the aggregate volume of 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 2007, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $256.24 million, if greater.

Arbitrage restrictions

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[29] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[30] 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.

Indian tribal governments

Indian tribal governments are provided with a tax status similar to State and local governments for specified purposes under the Code.[31] Among the purposes for which a tribal government is treated as a State is the issuance of tax-exempt bonds. However, bonds issued by tribal governments are subject to limitations not imposed on State and local government issuers. Tribal governments are authorized to issue tax-exempt bonds only if substantially all of the proceeds are used for essential governmental functions or certain manufacturing facilities.[32]

Clean renewable energy bonds

As an alternative to traditional tax-exempt bonds, States and local governments may issue clean renewable energy bonds ("CREBs"). CREBs are defined as any bond issued by a qualified issuer if, in addition to the requirements discussed below, 95 percent or more of the proceeds of such bonds are used to finance capital expenditures incurred by qualified borrowers for qualified projects. "Qualified projects" are facilities that qualify for the tax credit under section 45 (other than Indian coal production facilities), without regard to the placed-in-service date requirements

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

[30] Sec. 148.

[31] Sec. 7871.

[32] Sec. 7871(c).

of that section.[33] The term “qualified issuers” includes (1) governmental bodies (including Indian tribal governments); (2) mutual or cooperative electric companies (described in section 501(c)(12) or section 1381(a)(2)(C), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act); and (3) clean renewable energy bond lenders. The term “qualified borrower” includes a governmental body (including an Indian tribal government) and a mutual or cooperative electric company. A clean renewable energy bond lender means a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002.

Unlike tax-exempt bonds, CREBs are not interest-bearing obligations. Rather, the taxpayer holding CREBs on a credit allowance date is entitled to a tax credit. The amount of the credit is determined by multiplying the bond’s credit rate by the face amount on the holder’s bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits issuance of CREBs without discount and interest cost to the qualified issuer. The credit accrues quarterly and 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.

CREBs are subject to a maximum maturity limitation. 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 CREBs being equal to 50 percent of the face amount of such bond. In addition, the Code requires level amortization of CREBs during the period such bonds are outstanding.

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

In addition to the above requirements, at least 95 percent of the proceeds of CREBs must be spent on qualified projects within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified projects during the five-year spending period, bonds will continue to qualify as CREBs if unspent proceeds are used within 90 days from the end of such five-year period to redeem any “nonqualified bonds.” The five-year spending period may be extended by the Secretary upon the qualified issuer’s request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

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

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

House Bill

No provision

Senate Amendment

The Senate amendment creates a new category of tax-credit bonds, qualified forestry conservation bonds. Qualified forestry conservation bonds are bonds issued by qualified issuers to finance qualified forestry conservation projects. The term "qualified issuer" means a State or a section 501(c)(3) organization. The term "qualified forestry conservation project" means the acquisition by a State or section 501(c)(3) organization from an unrelated person of forest and forest land that meets the following qualifications: (1) some portion of the land acquired must be adjacent to United States Forest Service Land; (2) at least half of the land acquired must be transferred to the United States Forest Service at no net cost and not more than half of the land acquired may either remain with or be donated to a State; (3) all of the land must be subject to a habitat conservation plan for native fish approved by the United States Fish and Wildlife Service; and (4) the amount of acreage acquired must be at least 40,000 acres.

There is a national limitation on qualified forestry conservation bonds of $500 million. Allocations of qualified forestry conservation bonds are among qualified forestry conservation projects in the manner the Secretary determines appropriate so as to ensure that all of such limitation is allocated before the date that is 24 months after the date of enactment. The Senate amendment also requires the Secretary to solicit applications for allocations of qualified forestry conservation bonds no later than 90 days after the date of enactment.

The Senate amendment requires 100 percent of the available project proceeds of qualified forestry conservation bonds to be used within the three-year period that begins on the date of issuance. The Senate amendment defines available project proceeds as proceeds from the sale of the issue less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds. To the extent less than 100 percent of the available project proceeds are used to finance qualified forestry conservation purposes during the three-year spending period, bonds will continue to qualify as qualified forestry conservation bonds if unspent proceeds are used within 90 days from the end of such three-year period to redeem bonds. The three-year spending period may be extended by the Secretary upon the issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Qualified forestry conservation bonds generally are subject to the arbitrage requirements of section 148. However, available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (2) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified forestry conservation bonds are issued.

The maturity of qualified forestry conservation bonds is the term that the Secretary estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified forestry conservation bonds are issued.

As with present-law tax credit bonds, the taxpayer holding qualified forestry conservation bonds on a credit allowance date is entitled to a tax credit. The credit rate is set by the Secretary at 70 percent of the rate that would permit issuance of qualified forestry conservation bonds without discount and interest cost to the issuer. The amount of the tax credit to the holder is determined by multiplying the bond's credit rate by the face amount on the holder's bond. The credit accrues quarterly, 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. Unused credits in one year may be carried forward to succeeding taxable years. In addition, credits may be separated from the ownership of the underlying bond similar to how interest coupons can be stripped for interest-bearing bonds.

Issuers of qualified forestry conservation bonds are required to certify that the financial disclosure requirements that apply to State and local bonds offered for sale to the general public are satisfied with respect to any Federal, State, or local government official directly involved with the issuance of such bonds. The Senate amendment authorizes the Secretary to impose additional financial reporting requirements by regulation.

Effective date.–The provision is effective for bonds issued after the date of enactment.

Conference Agreement

The conference agreement includes the Senate amendment with modifications. Under the conference agreement, the credit rate on qualified forestry conservation bonds is determined by the Secretary at the rate that permits issuance of such bonds without discount and interest cost to the qualified issuer.

The conference agreement also provides that a qualified issuer receiving an allocation to issue qualified forestry conservation bonds may, in lieu of issuing bonds, elect to treat such allocation as a deemed payment of tax (regardless of whether the issuer is subject to tax under chapter 1 of the Code) that is equal to 50 percent of the amount of such allocation. An election to treat an allocation of qualified forestry conservation bonds as a deemed payment is not valid unless the qualified issuer certifies to the Secretary that any payment of tax refunded to the issuer will be used exclusively for one or more qualified forestry conservation purposes. The deemed tax payment may not be used as an offset or credit against any other tax and shall not accrue interest. In addition, if the qualified issuer fails to use any portion of the overpayment for qualified forestry conservation purposes, the issuer shall be liable to the United States in an amount equal to such portion, plus interest, for the period from the date such portion was refunded to the date such amount is paid.

Effective date.–The provision is effective for bonds issued after the date of enactment.

B. Energy Provisions

1. Credit for production of cellulosic biofuel (sec. 12312 of the Senate amendment, sec. 15321 of the conference agreement and sec. 40 of the Code)

Present Law

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

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

House Bill

No provision.

Senate Amendment

The Senate amendment provides an income tax credit for each gallon of qualified cellulosic fuel production of the producer for the taxable year. The amount of the credit per gallon is $1.25 less the credit amount for alcohol fuel and the credit amount for small ethanol producers as of the date the cellulosic biofuel fuel is produced. This credit is in addition to any credit that may be available under section 40 of the Code.

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

Cellulosic biofuel means any alcohol, ether, ester, or hydrocarbon that is produced in the United States and is derived from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis. However, it does not include any alcohol with a proof of less than 150. Examples of lignocellulosic or hemicellulosic matter that is available of a renewable or recurring basis include dedicated energy crops and trees, wood and wood residues, plants, grasses, agricultural residues, fibers, animal wastes and other waste materials, and municipal solid waste. A qualified cellulosic biofuel mixture is a mixture of cellulosic biofuel and any petroleum fuel product which is sold by the person producing such mixture to any person for use as a fuel, or is used as a fuel by the person producing such mixture.

The credit terminates on April 1, 2015.

The Senate amendment waives the 15 million gallon limitation of the small ethanol producer credit for cellulosic biofuel that is ethanol.

Effective date.–The provision is effective for fuel produced after December 31, 2007.

Conference Agreement

The conference agreement adds a new component to section 40 of the Code, the "cellulosic biofuel producer credit." This credit is a nonrefundable income tax credit for each gallon of qualified cellulosic fuel production of the producer for the taxable year. The amount of the credit per gallon is $1.01, except in the case of cellulosic biofuel that is alcohol. In the case of cellulosic biofuel that is alcohol, the $1.01 credit amount is reduced by (1) the credit amount applicable for such alcohol under the alcohol mixture credit as in effect at the time cellulosic biofuel is produced and (2) in the case of cellulosic biofuel that is ethanol, the credit amount for small ethanol producers as in effect at the time the cellulosic biofuel fuel is produced. The reduction applies regardless of whether the producer claims the alcohol mixture credit or small ethanol producer credit with respect to the cellulosic alcohol. When the alcohol mixture credit and small ethanol producer credit expire after December 31, 2010, cellulosic biofuel will receive the $1.01 without reduction.

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

"Cellulosic biofuel" means any liquid fuel that (1) is produced in the United States and used as fuel in the United States,[34] (2) is derived from any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis and (3) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency under section 211 of the Clean Air Act. Thus, to qualify for the credit the fuel must be approved by the Environmental Protection Agency. Cellulosic biofuel does not include any alcohol with a proof of less than 150. Examples of lignocellulosic or hemicellulosic matter that is available of a renewable or recurring basis include dedicated energy crops and trees, wood and wood

[34] For this purpose, "United States" includes any possession of the United States.

residues, plants, grasses, agricultural residues, fibers, animal wastes and other waste materials, and municipal solid waste.

A "qualified cellulosic biofuel mixture" is a mixture of cellulosic biofuel and a special fuel or of cellulosic biofuel and gasoline, which is sold by the person producing such mixture to any person for use as a fuel, or is used as a fuel by the person producing such mixture. The term "special fuel" includes any liquid fuel (other than gasoline) which is suitable for use in an internal combustion engine.

The cellulosic biofuel producer credit terminates on December 31, 2012. The conference agreement requires cellulosic biofuel producers to be registered with the IRS. The cellulosic biofuel producer credit cannot be claimed unless the taxpayer is registered with the IRS as a producer of cellulosic biofuel.

With respect to the small ethanol producer credit, the conference agreement also waives the 15 million gallon limitation for cellulosic biofuel that is ethanol. Thus the small ethanol producer credit may be claimed for cellulosic ethanol in excess of 15 million gallons. The other requirements for the small ethanol producer credit continue to apply for ethanol other than cellulosic ethanol, including the 15 million gallon limitation.

Under the conference agreement, cellulosic biofuel and alcohols cannot qualify as biodiesel, renewable diesel, or alternative fuel for purposes of the credit and payment provisions relating to those fuels.

Effective date.–The provision is effective for fuel produced after December 31, 2008.

2. Comprehensive study of biofuels (sec. 15322 of the conference agreement)

Present Law

The National Academy of Sciences serves to investigate, examine, experiment and report upon any subject of science whenever called upon to do so by any department of the government. The National Research Council is part of the National Academies. The National Research Council was organized by the National Academy of Sciences in 1916 and is its principal operating agency for conducting science policy and technical work.

House Bill

No provision.[35]

Senate Amendment

No provision.

[35] A provision requiring a comprehensive study on biofuels was included in section 402 of H.R. 5351, passed by the House on February 27, 2008.

Conference Agreement

The conference agreement requires the Secretary, in consultation with the Department of Energy and the Department of Agriculture and the Environmental Protection Agency, to enter into an agreement with the National Academy of Sciences to produce an analysis of current scientific findings to determine:

1. Current biofuels production, as well as projections for future production;

2. The maximum amount of biofuels production capable on U.S. forests and farmlands, including the current quantities and character of the feedstocks and including such information as regional forest inventories that are commercially available, used in the production of biofuels;

3. The domestic effects of a increase in biofuels production on, for example, (a) the price of fuel, (b) the price of land in rural and suburban communities, (c) crop acreage and other land use, (d) the environment, due to changes in crop acreage, fertilizer use, runoff, water use, emissions from vehicles utilizing biofuels, and other factors, (e) the price of feed, (f) the selling price of grain crops, and forest products, (g) exports and imports of grains and forest products, (h) taxpayers, through cost or savings to commodity crop payments, and (i) the expansion of refinery capacity;

4. The ability to convert corn ethanol plants for other uses, such as cellulosic ethanol or biodiesel;

5. A comparative analysis of corn ethanol versus other biofuels and renewable energy sources, considering cost, energy output, and ease of implementation;

6. The impact of the credit for production of cellulosic biofuel (as established by this Act) on the regional agricultural and silvicultural capabilities of commercially available forest inventories; and

7. The need for additional scientific inquiry, and specific areas of interest for future research.

The Secretary shall submit an initial report of the findings to the Congress not later than six months after the date of enactment, and a final report not later than 12 months after the date of enactment. In the case of information relating to the impact of the tax credits established by the Act on the regional agricultural and silvicultural capabilities of commercially available forest inventories, the initial report is due 36 months after the date of enactment and the final report is due 42 months after the date of enactment.

Effective date.–The provision is effective on the date of enactment.

3. Modification of alcohol credit (sec. 12315 of the Senate amendment, and sec. 15331 of the conference agreement and secs. 40 and 6426 of the Code)

Present Law

Income tax credit

The alcohol fuels credit is the sum of three credits: the alcohol mixture credit, the alcohol credit, and the small ethanol producer credit. Generally, the alcohol fuels credit expires after December 31, 2010.[36]

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

Taxpayers may reduce their income taxes by 51 cents for each gallon of ethanol, which is not in a mixture with gasoline or other special fuel, that they sell at the retail level as vehicle fuel or use themselves as a fuel in their trade or business ("the alcohol credit"). For alcohol other than ethanol, the rate is 60 cents per gallon.[37]

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

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

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

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

Excise tax credit and payment provision for alcohol fuel mixtures

The Code also provides an excise tax credit and payment provision for alcohol fuel mixtures. Like the income tax credit, the amount of the credit is 60 cents per gallon of alcohol used as part of a qualified mixture (51 cents in the case of ethanol). For purposes of the excise tax credit and payment provisions, alcohol includes methanol and ethanol but does not include (1) alcohol produced from petroleum, natural gas, or coal (including peat), or (2) alcohol with a proof of less than 190. Such term also includes an alcohol gallon equivalent of ethyl tertiary butyl either or other ethers produced from alcohol. In lieu of a tax credit, a person making a qualified mixture eligible for the credit may seek a payment from the Secretary in the amount of the credit. The payment provisions and credits are coordinated such that the incentive is not claimed more than once for each gallon of alcohol used as part of qualified mixture.

Renewable Fuels Standard Program

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

House Bill

No provision.

Senate Amendment

Under the Senate amendment, the 51-cent-per-gallon incentive for ethanol is adjusted to 46 cents per gallon beginning with the first calendar year after the year in which 7.5 billion gallons of ethanol (including cellulosic ethanol) have been produced in or imported into the United States after the date of enactment, as certified by the Secretary in consultation with the Administrator of the Environmental Protection Agency.

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

Under the conference agreement, the 51-cent-per-gallon incentive for ethanol is adjusted to 45 cents per gallon for the calendar year 2009 and thereafter.[38] If the Secretary makes a determination, in consultation with the Administrator of the Environmental Protection Agency, that 7,500,000,000 gallons of ethanol (including cellulosic ethanol) were not produced in or imported into the United States in 2008, the reduction in the credit amount will be delayed. If a determination is made that the threshold was not reached in 2008, the reduction for 2010 also will be delayed if the Secretary determines 7,500,000,000 gallons were not produced or imported

[38] The low-proof blender amount is adjusted accordingly to 33.33 cents.

in 2009. In the absence of a determination, the reduction remains in effect. In the event the determination is made subsequent to the start of a calendar year, those persons claiming the reduced amount prior to the Secretary's determination will be entitled to the difference between the correct credit amount for that year and the credit amount claimed, e.g. between 51 cents per gallon and 45 cents per gallon.

Effective date.–The provision is effective on the date of enactment.

4. Calculation of volume of alcohol for fuel credits (sec. 12316 of the Senate amendment, and sec. 15332 of the conference agreement and sec. 40 of the Code)

Present Law

The Code provides a per-gallon credit for the volume of alcohol used as a fuel or in a qualified mixture. For purposes of determining the number of gallons of alcohol with respect to which the credit is allowable, the volume of alcohol includes any denaturant, including gasoline.[39] The denaturant must be added under a formula approved by the Secretary and the denaturant cannot exceed five percent of the volume of such alcohol (including denaturants).

House Bill

No provision.

Senate Amendment

The Senate amendment reduces the amount of allowable denaturants to two percent of the volume of the alcohol.

Effective date.–The provision is effective for fuel sold or used after December 31, 2007.

Conference Agreement

The conference agreement follows the Senate amendment.

Effective date.–The provision is effective for fuel sold or used after December 31, 2008.

5. Ethanol tariff extension (sec. 12317 of the Senate amendment and sec. 15333 of the conference agreement)

Present Law

Heading 9901.00.50 of the Harmonized Tariff Schedule of the United States imposes a cumulative general duty of 14.27 cents per liter (approximately 54 cents per gallon) to imports of ethyl alcohol, and any mixture containing ethyl alcohol, if used as a fuel or in producing a mixture to be used as a fuel, that are entered into the United States prior to January 1, 2009.

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

Taxpayers who blend ethanol with gasoline are eligible to claim an alcohol fuels tax credit of 51 cents per gallon, irrespective of whether the ethanol used is produced domestically or imported. Heading 9901.00.50 applies a temporary duty to ethanol imports that offsets the benefit of the alcohol fuels tax credit to imported ethanol.

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

House Bill

No provision.

Senate Amendment

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

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

Effective date.–The provision is effective on the date of enactment.

6. Limitations on duty drawback on certain imported ethanol (sec. 12318 of the Senate amendment and sec. 15334 of the conference agreement)

Present Law

Subheading 9901.00.50 of the Harmonized Tariff Schedule of the United States ("HTSUS"), imposes an additional duty on ethanol that is used as fuel or used to make fuel. Subsection (b) of Section 313 of the Tariff Act of 1930 permits the refund of duty if the duty-paid good, or a substitute good, is used to make an article that is exported. Subsection (j)(2) of Section 313 permits the refund of duty if the duty-paid good, or a substitute good, is exported. Subsection (p) of section 313 permits the substitution on exportation for drawback eligibility of one motor fuel for another motor fuel. A person who manufactures or acquires gasoline with ethanol subject to the duty imposed by subheading 9901.00.50, HTSUS, can export jet fuel (which does not involve the use of ethanol) and obtain a refund of the duty paid under subheading 9901.00.50, HTSUS.

House Bill

No provision.

Senate Amendment

The Senate amendment eliminates the ability to obtain a refund of the duty imposed by subheading 9901.00.50, HTSUS, by substitution of ethanol not subject to the duty under 9901.00.50 of the HTSUS for ethanol subject to the duty imposed under subheading 9901.00.50, HTSUS, for drawback purposes. Also, under the provision, an exported article that does not contain ethyl alcohol or a mixture of ethyl alcohol shall not be treated as the same kind and quality as a qualified article that does contain ethyl alcohol or a mixture of ethyl alcohol, for substitution duty drawback purposes under section 313(p) of the Tariff Act of 1930. In particular, this eliminates the ability to export jet fuel as a substitute for motor fuel made with imports of ethyl alcohol or a mixture of ethyl alcohol, and receive duty drawback based upon the import duty paid under subheading 9901.00.50, HTSUS.

Effective date.–Effective for articles exported on or after the date that is 15 days after the date of enactment.

Conference Agreement

Under the conference agreement, any duty paid under subheading 9901.00.50, HTSUS, on imports of ethyl alcohol or a mixture of ethyl alcohol may not be refunded if the exported article upon which a drawback claim is based does not contain ethyl alcohol or a mixture of ethyl alcohol. In particular, the provision eliminates the ability to export jet fuel as a substitute for motor fuel made with imports of ethyl alcohol or a mixture of ethyl alcohol, and then receive duty drawback based upon the import duty paid on the ethyl alcohol or the mixture of ethyl alcohol under subheading 9901.00.50, HTSUS.

Effective date.– The provision applies to imports of ethyl alcohol or a mixture of ethyl alcohol entered for consumption, or withdrawn from warehouse for consumption, on or after October 1, 2008. With respect to claims for substitution duty drawback that are based upon imports of ethyl alcohol or a mixture of ethyl alcohol entered for consumption, or withdrawn from warehouse for consumption, before October 1, 2008, such claims must be filed not later than September 30, 2010; otherwise, such claims are disallowed.

C. Agricultural Provisions

1. Qualified small issue bonds for farming (sec. 12401 of the Senate amendment, sec. 15341 of the conference agreement and sec. 144 of the Code)

Present Law

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

House Bill

No provision.

Senate Amendment

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

Effective date.–The provision is effective for bonds issued after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

2. Allowance of section 1031 for exchanges involving certain mutual ditch, reservoir, or irrigation company stock (sec. 12403 of the Senate amendment, sec. 15342 of the conference agreement and sec. 1031 of the Code)

Present Law

An exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like-kind" which is to be held for productive use in a trade or business or for investment.[40] If section 1031 applies to an exchange of properties, the basis of

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

the property received in the exchange is equal to the basis of the property transferred, decreased by any money received by the taxpayer, and further adjusted for any gain or loss recognized on the exchange. In general, section 1031 does not apply to any exchange of stock in trade or other property held primarily for sale; stocks, bonds or notes; other securities or evidences of indebtedness or interest; interests in a partnership; certificates of trust or beneficial interests; or choses in action.[41]

House Bill

No provision.

Senate Amendment

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

Effective date.–The provision is effective for transfers after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

3. Agricultural chemicals security tax credit (sec. 12405 of the Senate amendment, sec. 15343 of the conference agreement and new sec. 45O of the Code)

Present Law

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

House Bill

No provision.

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

Senate Amendment

The Senate amendment establishes a 30 percent credit for qualified chemical security expenditures for the taxable year with respect to eligible agricultural businesses. The credit is a component of the general business credit.[42]

The credit is limited to $100,000 per facility, this amount is reduced by the aggregate amount of the credits allowed for the facility in the prior five years. In addition, each taxpayer's annual credit is limited to $2,000,000.[43] The credit only applies to expenditures paid or incurred before December 31, 2012. The taxpayer's deductible expense is reduced by the amount of the credit claimed.

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

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

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

Effective date.–The provision is effective for expenses paid or incurred after date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

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

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

4. Three-year depreciation for all race horses (sec. 12509(a) of the Senate amendment, and sec. 15344 of the conference agreement and sec. 168 of the Code)

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[44] The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[45] Any race horse that is more than two years old at the time it is placed in service is assigned a three-year recovery period.[46] A seven year recovery period is assigned to any race horse that is two years old or younger at the time it is placed in service.[47]

House Bill

No provision.

Senate Amendment

The Senate amendment provides a three year recovery period for any race horse.

Effective date.–The provision applies to property placed in service on or after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, except that the provision applies to any race horse that is two years old or younger at the time that it is placed in service after December 31, 2008 and before January 1, 2014.

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[44] Sec. 168.

[45] 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

[46] Sec. 168(e)(3)(A)(i).

[47] Rev. Proc. 87-56, 1987-2 C.B. 674, asset class 01.225.

5. Temporary relief for Kiowa County, Kansas and surrounding area[48]

(a) Suspension of certain limitations on personal casualty losses (sec.12701 of the Senate amendment, sec. 15345 of the conference agreement and sec. 1400S(b) of the Code)

Present Law

Under present law, a taxpayer may generally claim a deduction for any loss sustained during the taxable year and not compensated by insurance or otherwise (sec. 165). For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Personal casualty or theft losses are deductible only if they exceed $100 per casualty or theft (the "$100 limitation") (sec. 165(h)). In addition, aggregate net casualty and theft losses are deductible only to the extent they exceed 10 percent of an individual taxpayer's adjusted gross income (the "AGI limitation") (sec. 165(h)).

House Bill

No provision.

Senate Amendment

The Senate amendment removes two limitations on personal casualty or theft losses to the extent those losses arose from such events in the Kansas disaster area after May 4, 2007, and are attributable to the disaster occurring at that time. For purposes of the provisions of this Act, the term "Kansas disaster area" means an area with respect to which a major disaster has been declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (FEMA-1699-DR, as in effect on the date of enactment of this Act) by reason of severe storms and tornados beginning on May 4, 2007, and determined by the President to warrant individual or individual and public assistance from the Federal Government under such Act with respect to damages attributable to storms and tornados. These personal casualty or theft losses are deductible without regard to either the $100 limitation or the AGI limitation. For purposes of applying the AGI limitation to other personal casualty or theft losses, losses deductible under this provision are disregarded. Thus, the provision has the effect of treating personal casualty or theft losses from the disaster separate from all other casualty losses.

Effective date.–The provision is effective for losses arising on or after May 4, 2007.

Conference Agreement

The conference agreement follows the Senate amendment.

[48] The provisions of this Act generally provide tax relief similar to certain other disaster areas. They do not modify the otherwise applicable tax relief to those other disaster areas.

(b) Extension of replacement period for nonrecognition of gain (sec. 12701 of the Senate amendment, and sec. 15345 of the conference agreement)

Present Law

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

Under section 1033, gain realized by a taxpayer from an involuntary conversion of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within the applicable period. The taxpayer's basis in the replacement property generally is the cost of such property, reduced by the amount of gain not recognized.

The applicable period for the taxpayer to replace the converted property begins with the date of the disposition of the converted property (or if earlier, the earliest date of the threat or imminence of requisition or condemnation of the converted property) and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized (the "replacement period").

Special rules extend the replacement period for certain real property[49] and principal residences damaged by a Presidentially declared disaster[50] to three years and four years, respectively, after the close of the first taxable year in which gain is realized. Similarly, the replacement period for livestock sold on account of drought, flood, or other weather-related conditions is extended from two years to four years after the close of the first taxable year in which any part of the gain on conversion is realized.[51]

House Bill

No provision.

Senate Amendment

The Senate amendment extends from two to five years the replacement period in which a taxpayer may replace converted property, in the case of property that is in the Kansas disaster area and that is compulsorily or involuntarily converted on or after May 4, 2007, by reason of the May 4, 2007, storms and tornados. Substantially all of the use of the replacement property must be in this area.

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[49] Sec. 1033(g)(4).

[50] Sec. 1033(h)(1)(B).

[51] Sec. 1033(e)(2).

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

(c) Employee retention credit (sec. 12701 of the Senate amendment, sec. 15345 of the conference agreement and sec. 1400R(a) of the Code)

Present Law

For employers affected by Hurricanes Katrina, Rita, or Wilma, section 1400R provides a credit of 40 percent of the qualified wages (up to a maximum of $6,000 in qualified wages per employee) paid by an eligible employer to an eligible employee.

Hurricane Katrina

An eligible employer is any employer (1) that conducted an active trade or business on August 28, 2005, in the GO Zone and (2) with respect to which the trade or business described in (1) is inoperable on any day after August 28, 2005, and before January 1, 2006, as a result of damage sustained by reason of Hurricane Katrina.

An eligible employee is, with respect to an eligible employer, an employee whose principal place of employment on August 28, 2005, with such eligible employer was in the GO Zone. An employee may not be treated as an eligible employee for any period with respect to an employer if such employer is allowed a credit under section 51 with respect to the employee for the period.

Qualified wages are wages (as defined in section 51(c)(1) of the Code, but without regard to section 3306(b)(2)(B) of the Code) paid or incurred by an eligible employer with respect to an eligible employee on any day after August 28, 2005, and before January 1, 2006, during the period (1) beginning on the date on which the trade or business first became inoperable at the principal place of employment of the employee immediately before Hurricane Katrina, and (2) ending on the date on which such trade or business has resumed significant operations at such principal place of employment. Qualified wages include wages paid without regard to whether the employee performs no services, performs services at a different place of employment than such principal place of employment, or performs services at such principal place of employment before significant operations have resumed.

The credit is a part of the current year business credit under section 38(b) and therefore is subject to the tax liability limitations of section 38(c). Rules similar to sections 51(i)(1) and 52 apply to the credit.

Hurricane Rita and Wilma

The credit for employers affected by Hurricanes Rita and Wilma is subject to the same rules as Katrina, except the reference dates for affected employers, comparable to the August 28, 2005 date for Katrina, are September 23, 2005, and October 23, 2005, respectively.

House Bill

No provision.

Senate Amendment

The Senate amendment extends the retention credit, as modified to include an employer size limitation, for employers affected by the Kansas storms and tornados. The reference dates for these employers, comparable to the August 28, 2005 and January 1, 2006 dates of present law for employers affected by Hurricane Katrina, are May 4, 2007, and January 1, 2008, respectively.

The retention credit for employers affected by the Kansas storms and tornados includes an employer size limitation. The credit only applies to eligible employers who employed an average of not more than 200 employees on business days during the taxable year before May 4, 2007.

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

(d) Special depreciation allowance (sec. 12701 of the Senate amendment, sec. 15345 of the conference agreement and sec. 1400N(d) of the Code)

Present Law

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS").[52] Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

For qualified Gulf Opportunity Zone property, the Code provides an additional first-year depreciation deduction equal to 50 percent of the adjusted basis.[53] In order to qualify, property generally must be placed in service on or before December 31, 2007 (December 31, 2008 in the case of nonresidential real property and residential rental property).

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[52] Sec. 168.

[53] Sec. 1400N(d).

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

In order for property to qualify for the additional first-year depreciation deduction, it must meet all of the following requirements. First, the property must be property to which the general rules of the Modified Accelerated Cost Recovery System ("MACRS") apply with (1) an applicable recovery period of 20 years or less, (2) computer software other than computer software covered by section 197, (3) water utility property (as defined in section 168(e)(5)), (4) certain leasehold improvement property, or (5) certain nonresidential real property and residential rental property. Second, substantially all of the use of such property must be in the Gulf Opportunity Zone and in the active conduct of a trade or business by the taxpayer in the Gulf Opportunity Zone. Third, the original use of the property in the Gulf Opportunity Zone must commence with the taxpayer on or after August 28, 2005.[54] Finally, the property must be acquired by purchase (as defined under section 179(d)) by the taxpayer on or after August 28, 2005 and placed in service on or before December 31, 2007 (December 31, 2008, for qualifying nonresidential real property and residential rental property). Property does not qualify if a binding written contract for the acquisition of such property was in effect before August 28, 2005. However, property is not precluded from qualifying for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to August 28, 2005.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after August 27, 2005, and before January 1, 2008, and the property is placed in service on or before December 31, 2007 (and all other requirements are met). In the case of qualified nonresidential real property and residential rental property, the property must be placed in service on or before December 31, 2008. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

[54] Used property may constitute qualified property so long as it has not previously been used within the Gulf Opportunity Zone. In addition, it is intended that additional capital expenditures incurred to recondition or rebuild property the original use of which in the Gulf Opportunity Zone began with the taxpayer would satisfy the "original use" requirement. See Treasury Regulation sec. 1.48-2, Example 5.

The special allowance for Gulf Opportunity Zone property was extended for certain nonresidential real property and residential rental property, and certain personal property if substantially all of the use of such property is in such building,[55] placed in service in specified portions of the GO Zone by the taxpayer on or before December 31, 2010.[56] The extension only applies to nonresidential real property and residential rental property to the extent of the adjusted basis attributable to manufacture, construction, or production before January 1, 2010.[57]

House Bill

No provision.

Senate Amendment

The Senate amendment provides an additional first-year depreciation deduction equal to 50 percent of the adjusted basis for qualified Recovery Assistance property. In order for property to qualify for the additional first-year depreciation deduction, it must meet all of the following requirements: (1) The property must be property to which the general rules of the MACRS apply with (a) an applicable recovery period of 20 years or less, (b) computer software other than computer software covered by section 197, (c) water utility property (as defined in section 168(e)(5)), (d) certain leasehold improvement property, or (e) certain nonresidential real property and residential rental property; (2) substantially all of the use of such property must be in the Kansas Disaster Zone and in the active conduct of a trade or business by the taxpayer in the Kansas Disaster Zone. Third, the original use of the property in the Kansas Disaster Zone must commence with the taxpayer on or after May 5, 2007.[58] Finally, the property must be acquired by purchase (as defined under section 179(d)) by the taxpayer on or after May 5, 2007 and placed in service on or before December 31, 2008 (December 31, 2009, for qualifying nonresidential real property and residential rental property). Property does not qualify if a binding written contract for the acquisition of such property was in effect before May 5, 2007. However, property is not precluded from qualifying for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to May 5, 2007.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the

[55] Such personal property must be placed in service by the taxpayer not later than 90 days after such building is placed in service.

[56] Sec. 1400N(d)(6).

[57] Sec. 1400N(d)(6)(D).

[58] Used property may constitute qualified property so long as it has not previously been used within the Kansas Disaster Zone. In addition, it is intended that additional capital expenditures incurred to recondition or rebuild property the original use of which in the Kansas Disaster Zone began with the taxpayer would satisfy the "original use" requirement. See Treasury Regulation sec. 1.48-2, Example 5.

property after May 4, 2007, and before January 1, 2009, and the property is placed in service on or before December 31, 2008 (and all other requirements are met). In the case of qualified nonresidential real property and residential rental property, the property must be placed in service on or before December 31, 2009. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

(e) Increase in expensing under section 179 (sec. 12701 of the Senate amendment, sec. 15345 of the conference agreement and sec. 1400N(e) of the Code)

Present Law

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under section 179. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2007 through 2010, is \$125,000 of the cost of qualifying property placed in service for the taxable year.[59] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2010 is treated as qualifying property. The \$125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$500,000. The \$125,000 and \$500,000 amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[60]

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

[60] Sec. 179(c)(1). Under Treas. Reg. sec. 1.179-5, applicable to property placed in service in taxable years beginning after 2002 and before 2008, a taxpayer is permitted to make or revoke an election under section 179 without the consent of the Commissioner on an amended Federal tax return for that

For taxable years beginning in 2011 and thereafter (or before 2003), the following rules apply. A taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner.[61]

For qualified section 179 Gulf Opportunity Zone property, the maximum amount that a taxpayer may elect to deduct is increased by the lesser of $100,000 or the cost of qualified section 179 Gulf Opportunity Zone property for the taxable year.[62] The provision applies with respect to qualified section 179 Gulf Opportunity Zone property acquired on or after August 28, 2005, and placed in service on or before December 31, 2007. This placed in service date was extended to December 31, 2008 for property substantially all of the use of which is in one or more specified portions of the GO Zone. The threshold for reducing the amount expensed is computed by increasing the $500,000 present-law amount by the lesser of (1) $600,000, or (2) the cost of qualified section 179 Gulf Opportunity Zone property placed in service during the taxable year. Neither the $100,000 nor $600,000 amounts are indexed for inflation.

Qualified section 179 Gulf Opportunity Zone property means section 179 property (as defined in section 179(d)) that also meets the following requirements: (1) The property must be property to which the general rules of the MACRS apply with (a) an applicable recovery period of 20 years or less, (b) computer software other than computer software covered by section 197, (c) water utility property (as defined in section 168(e)(5)), (d) certain leasehold improvement property; (2) substantially all of the use of which is in the Gulf Opportunity Zone and is in the active conduct of a trade or business by the taxpayer in that Zone; (3) the original use of which commences with the taxpayer on or after August 28, 2005; (4) which is acquired by the taxpayer by purchase on or after August 28, 2005, but only if no written binding contract for the acquisition was in effect before August 28, 2005; and (5) which is placed in service by the taxpayer on or before December 31, 2007.

<u>House Bill</u>

No provision.

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taxable year. This amended return must be filed within the time prescribed by law for filing an amended return for the taxable year. T.D. 9209, July 12, 2005.

[61] Sec. 179(c)(2).

[62] Sec. 1400N(e).

Senate Amendment

The Senate amendment increases the amount that a taxpayer may elect for qualified section 179 Recovery Assistance property. The maximum amount that a taxpayer may elect to deduct under section 179 is increased by the lesser of $100,000 or the cost of qualified section 179 Recovery Assistance property for the taxable year. The provision applies with respect to qualified section 179 Recovery Assistance property acquired on or after May 5, 2007, and placed in service on or before December 31, 2008. The threshold for reducing the amount expensed is computed by increasing the $500,000 present-law amount by the lesser of (1) $600,000, or (2) the cost of qualified section 179 Recovery Assistance property placed in service during the taxable year. Neither the $100,000 nor $600,000 amounts are indexed for inflation.

Qualified section 179 Recovery Assistance property means section 179 property (as defined in section 179(d)) that also meets the following requirements: (1) The property must be property to which the general rules of the MACRS apply with (a) an applicable recovery period of 20 years or less, (b) computer software other than computer software covered by section 197, (c) water utility property (as defined in section 168(e)(5)), or (d) certain leasehold improvement property; (2) substantially all of the use of which is in the Kansas Disaster Zone and is in the active conduct of a trade or business by the taxpayer in that Zone; (3) the original use of which commences with the taxpayer on or after May 5, 2007; (4) which is acquired by the taxpayer by purchase on or after May 5, 2007, but only if no written binding contract for the acquisition was in effect before May 5, 2007; and (5) which is placed in service by the taxpayer on or before December 31, 2008.

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

(f) Expensing for certain demolition and clean-up costs (sec. 12701 of the Senate amendment, sec. 15345 of the conference agreement and sec. 1400N(f) of the Code)

Present Law

Under present law, the cost of demolition of a structure is capitalized into the taxpayer's basis in the land on which the structure is located.[63] Land is not subject to an allowance for depreciation or amortization.

The treatment of the cost of debris removal depends on the nature of the costs incurred. For example, the cost of debris removal after a storm may in some cases constitute an ordinary and necessary business expense which is deductible in the year paid or incurred. In other cases, debris removal costs may be in the nature of replacement of part of the property that was damaged. In such cases, the costs are capitalized and added to the taxpayer's basis in the

[63] Sec. 280B.

property.   For example, Revenue Ruling 71-161[64] permits the use of clean-up costs as a measure of casualty loss but requires that such costs be added to the post-casualty basis of the property.

Under section 1400N(f), a taxpayer is permitted a deduction for 50 percent of any qualified Gulf Opportunity Zone clean-up cost paid or incurred during the period beginning on August 28, 2005, and ending on December 31, 2007. The remaining 50 percent is capitalized and treated as described above. A qualified Gulf Opportunity Zone clean-up cost is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the Gulf Opportunity Zone to the extent that the amount would otherwise be capitalized. In order to qualify, the property must be held for use in a trade or business, for the production of income, or as inventory.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, a taxpayer is permitted a deduction for 50 percent of any qualified Recovery Assistance clean-up cost paid or incurred during the period beginning on May 4, 2007, and ending on December 31, 2009. The remaining 50 percent is treated as under present law. A qualified Recovery Assistance clean-up cost is an amount paid or incurred for the removal of debris from, or the demolition of structures on, real property located in the Kansas disaster area to the extent that the amount would otherwise be capitalized. In order to qualify, the property must be held for use in a trade or business, for the production of income, or as inventory.

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

(g) Treatment of public utility property disaster losses (sec. 12701 of the Senate amendment, sec. 15345 of the conference agreement and sec. 1400N(o) of the Code)

Present Law

Under section 165(i), certain losses attributable to a disaster occurring in a Presidentially declared disaster area may, at the election of the taxpayer, be taken into account for the taxable year immediately preceding the taxable year in which the disaster occurred.

[64] 1971-1 C.B. 76.

Section 6411 provides a procedure under which taxpayers may apply for tentative carryback and refund adjustments with respect to net operating losses, net capital losses, and unused business credits.

Section 1400N(o) provides an election for taxpayers who incurred casualty losses attributable to Hurricane Katrina with respect to public utility property located in the Gulf Opportunity Zone. Under the election, such losses may be taken into account in the fifth taxable year (rather than the 1st taxable year) immediately preceding the taxable year in which the loss occurred. If the application of this provision results in the creation or increase of a net operating loss for the year in which the casualty loss is taken into account, the net operating loss may be carried back or carried over as under present law applicable to net operating losses for such year.

For purposes of section 1400N(o), public utility property is property used predominantly in the trade or business of the furnishing or sale of electrical energy, water, or sewage disposal services; gas or steam through a local distribution system; telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962; or transportation of gas or steam by pipeline. Such property is eligible regardless of whether the taxpayer's rates are established or approved by any regulatory body.

A taxpayer making the election under the provision is eligible to file an application for a tentative carryback adjustment of the tax for any prior taxable year affected by the election. As under present law with respect to tentative carryback and refund adjustments, the IRS generally has 90 days to act on the refund claim. Under the provision, the statute of limitations with respect to such a claim can not expire earlier than one year after the date of enactment. Also, a taxpayer making the election with respect to a loss is not entitled to interest with respect to any overpayment attributable to the loss.

House Bill

No provision.

Senate Amendment

The Senate amendment provides an election for taxpayers who incurred casualty losses attributable to the Kansas storms and tornados with respect to public utility property located in the Kansas Disaster Zone. Under the election, such losses may be taken into account in the fifth taxable year (rather than the 1st taxable year) immediately preceding the taxable year in which the loss occurred. If the application of this provision results in the creation or increase of a net operating loss for the year in which the casualty loss is taken into account, the net operating loss may be carried back or carried over as under present law applicable to net operating losses for such year. The other definitions and rules that apply under section 1400N(o) shall apply to the losses claimed in the Kansas Disaster Zone.

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

(h) Treatment of net operating losses attributable to storm losses (sec. 12701 of the Senate amendment, sec. 15345 of the conference agreement and sec. 1400N(k) of the Code)

Present Law

Under present law, a net operating loss ("NOL") is, generally, the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[65] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[66]

Different rules apply with respect to NOLs arising in certain circumstances. 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 applies to NOLs (1) arising from a farming loss (regardless of whether the loss was incurred in a Presidentially declared disaster area), or (2) certain amounts related to Hurricane Katrina and the Gulf Opportunity Zone. 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). Additionally, a special rule applies to certain electric utility companies.

House Bill

No provision.

Senate Amendment

The Senate amendment provides rules in connection with certain net operating losses similar to the rules provided for Gulf Opportunity Zone losses under section 1400N(k). The rules, as applied to qualified Recovery Assistance losses, are as follows:

In general

The provision provides a special five-year carryback period for NOLs to the extent of certain specified amounts related to the Kansas storms and tornados. The amount of the NOL which is eligible for the five year carryback ("eligible NOL") is limited to the aggregate amount of the following deductions: (i) qualified Recovery Assistance casualty losses; (ii) certain moving expenses; (iii) certain temporary housing expenses; (iv) depreciation deductions with

[65] Sec. 172(b)(1)(A).

[66] Sec. 172(b)(2).

respect to qualified Recovery Assistance property for the taxable year the property is placed in service; and (v) deductions for certain repair expenses resulting from the Kansas storms and tornados. The provision applies for losses paid or incurred after May 3, 2007, and before January 1, 2010; however, an irrevocable election not to apply the five-year carryback under the provision may be made with respect to any taxable year.

Qualified Recovery Assistance casualty losses

The amount of qualified Gulf Opportunity Zone casualty losses which may be included in the eligible NOL is the amount of the taxpayer's casualty losses with respect to (1) property used in a trade or business, and (2) capital assets held for more than one year in connection with either a trade or business or a transaction entered into for profit. In order for a casualty loss to qualify, the property must be located in the Kansas Disaster Zone and the loss must be attributable to Kansas storms or tornados. As under present law, the amount of any casualty loss includes only the amount not compensated for by insurance or otherwise. In addition, the total amount of the casualty loss which may be included in the eligible NOL is reduced by the amount of any gain recognized by the taxpayer from involuntary conversions of property located in the Kansas Disaster Zone caused by the Kansas storms or tornados.

To the extent that a casualty loss is included in the eligible NOL and carried back under the provision, the taxpayer is not eligible to also treat the loss as having occurred in the prior taxable year under section 165(i). Similarly, the five year carryback under the provision does not apply to any loss taken into account for purposes of the ten-year carryback of public utility casualty losses which is provided under another provision in the Act.

Moving expenses

Certain employee moving expenses of an employer may be included in the eligible NOL. In order to qualify, an amount must be paid or incurred after May 3, 2007, and before January 1, 2010 with respect to an employee who (i) lived in the Kansas Disaster Zone before May 4, 2007, (ii) was displaced from their home either temporarily or permanently as a result of the Kansas storms or tornados, and (iii) is employed in the Kansas Disaster Zone by the taxpayer after the expense is paid or incurred.

For this purpose, moving expenses are defined as under present law to include only the reasonable expenses of moving household goods and personal effects from the former residence to the new residence, and of traveling (including lodging) from the former residence to the new place of residence. However, for purposes of the provision, the former residence and the new residence may be the same residence if the employee initially vacated the residence as a result of the Kansas storms or tornados. It is not necessary for the individual with respect to whom the moving expenses are incurred to have been an employee of the taxpayer at the time the expenses were incurred. Thus, assuming the other requirements are met, a taxpayer who pays the moving expenses of a prospective employee and subsequently employs the individual in the Kansas Disaster Zone may include such expenses in the eligible NOL.

Temporary housing expenses

Any deduction for expenses of an employer to temporarily house employees who are employed in the Kansas Disaster Zone may be included in the eligible NOL. It is not necessary for the temporary housing to be located in the Kansas Disaster Zone in order for such expenses to be included in the eligible NOL; however, the employee's principal place of employment with the taxpayer must be in the Kansas Disaster Zone. So, for example, if a taxpayer temporarily houses an employee at a location outside of the Kansas Disaster Zone, and the employee commutes into the Kansas Disaster Zone to the employee's principal place of employment, such temporary housing costs will be included in the eligible NOL (assuming all other requirements are met).

Depreciation of Gulf Opportunity Zone property

The eligible NOL includes the depreciation deduction (or amortization deduction in lieu of depreciation) with respect to qualified Recovery Assistance property placed in service during the year. The special carryback period applies to the entire allowable depreciation deduction for such property for the year in which it is placed in service, including both the regular depreciation deduction and the additional first-year depreciation deduction, if any. An election out of the additional first-year depreciation deduction for qualified Recovery Assistance property does not preclude eligibility for the five-year carryback.

Repair expenses

The eligible NOL includes deductions for repair expenses (including the cost of removal of debris) with respect to damage caused by the Kansas storms or tornados. In order to qualify, the amount must be paid or incurred after May 3, 2007 and before January 1, 2010, and the property must be located in the Kansas Disaster Zone.

Other rules

The amount of the NOL to which the five-year carryback period applies is limited to the amount of the corporation's overall NOL for the taxable year. Any remaining portion of the taxpayer's NOL is subject to the general two-year carryback period. Ordering rules similar to those for specified liability losses apply to losses carried back under the provision.

In addition, the general rule which limits a taxpayer's NOL deduction to 90 percent of AMTI does not apply to any NOL to which the five-year carryback period applies under the provision. Instead, a taxpayer may apply such NOL carrybacks to offset up to 100 percent of AMTI.

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

(i) Representations regarding income eligibility for purposes of qualified residential rental project requirements (sec. 12701 of the Senate amendment, sec. 15345 of the conference agreement and sec. 1400N(n) of the Code)

Present Law

In general

Under present law, gross income does not include interest on State or local bonds (sec. 103). State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes ("qualified private activity bonds").

Qualified private activity bonds

The definition of a qualified private activity bond includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond. The definition of exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities.

Subject to certain requirements, qualified private activity bonds may be issued to finance residential rental property or owner-occupied housing. Residential rental property may be financed with exempt facility bonds if the financed project is a "qualified residential rental project." A project is a qualified residential rental project if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income (the "20-50 test"). Alternatively, a project is a qualified residential rental project if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income (the "40-60 test"). The issuer must elect to apply either the 20-50 test or the 40-60 test. Operators of qualified residential rental projects must annually certify that such project meets the requirements for qualification, including meeting the 20-50 test or the 40-60 test.

House Bill

No provision

Senate Amendment

Under the provision, the operator of a qualified residential rental project may rely on the representations of prospective tenants displaced by reason of the severe storms and tornados in the Kansas disaster area beginning on May 4, 2007 for purposes of determining whether such individual satisfies the income limitations for qualified residential rental projects and, thus, the project is in compliance with the 20-50 test or the 40-60 test. This rule only applies if the individual's tenancy begins during the six-month period beginning on the date when such individual was displaced.

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

The conference agreement includes the Senate amendment provision.

(j) Use of retirement funds from retirement plans relating to the Kansas Disaster Zone (sec. 12701 of the Senate amendment, sec. 15345 of the conference agreement and sec. 1400Q of the Code)

Present Law

In general

Withdrawals from retirement plans

Under present law, a distribution from a qualified retirement plan under section 401(a), a qualified annuity plan under section 403(a), a tax-sheltered annuity under section 403(b) (a "403(b) annuity"), an eligible deferred compensation plan maintained by a State or local government under section 457 (a "governmental 457 plan"), or an individual retirement arrangement under section 408 (an "IRA") generally is included in income for the year distributed (secs. 402(a), 403(a), 403(b), 408(d), and 457(a)). (These plans are referred to collectively as "eligible retirement plans".) In addition, a distribution from a qualified retirement or annuity plan, a 403(b) annuity, or an IRA received before age 59-½, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount includible in income, unless an exception applies (sec. 72(t)).

An eligible rollover distribution from a qualified retirement or annuity plan, a 403(b) annuity, or a governmental 457 plan, or a distribution from an IRA, generally can be rolled over within 60 days to another plan, annuity, or IRA. The IRS has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual. Any amount rolled over is not includible in income (and thus also not subject to the 10-percent early withdrawal tax).

Distributions from a qualified retirement or annuity plan, 403(b) annuity, a governmental 457 plan, or an IRA are generally subject to income tax withholding unless the recipient elects otherwise. An eligible rollover distribution from a qualified retirement or annuity plan, 403(b) annuity, or governmental 457 plan is subject to income tax withholding at a 20-percent rate unless the distribution is rolled over to another plan, annuity or IRA by means of a direct transfer. Any distribution is an eligible rollover distribution unless specifically excepted. Exceptions include a distribution that is part of a series of substantially equal periodic payments made at least annually for the life of the employee

Certain amounts held in a qualified retirement plan that includes a qualified cash-or-deferred arrangement (a “401(k) plan”) or in a 403(b) annuity may not be distributed before severance from employment, age 59-½, death, disability, or financial hardship of the employee. Amounts deferred under a governmental 457 plan may not be distributed before severance from employment, age 70-½, or an unforeseeable emergency of the employee.

Loans from retirement plans

An individual is permitted to borrow from a qualified plan in which the individual participates (and to use his or her accrued benefit as security for the loan) provided the loan bears a reasonable rate of interest, is adequately secured, provides a reasonable repayment schedule, and is not made available on a basis that discriminates in favor of employees who are officers, shareholders, or highly compensated.

Subject to certain exceptions, a loan from a qualified employer plan to a plan participant is treated as a taxable distribution of plan benefits. A qualified employer plan includes a qualified retirement plan under section 401(a), a qualified annuity plan under section 403(a), a tax-deferred annuity under section 403(b), and any plan that was (or was determined to be) a qualified employer plan or a governmental plan.

An exception to this general rule of income inclusion is provided to the extent that the loan (when added to the outstanding balance of all other loans to the participant from all plans maintained by the employer) does not exceed the lesser of (1) $50,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or (2) the greater of $10,000 or one half of the participant’s accrued benefit under the plan (sec. 72(p)). This exception applies only if the loan is required, by its terms, to be repaid within five years. An extended repayment period is permitted for the purchase of the principal residence of the participant. Plan loan repayments (principal and interest) must be amortized in level payments and made not less frequently than quarterly, over the term of the loan.

Plan amendments

Present law provides a remedial amendment period during which, under certain circumstances, a plan may be amended retroactively in order to comply with the qualification requirements (sec. 401(b)). In general, plan amendments required to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer’s taxable year in which the change in law occurs. The Secretary of the Treasury may extend the time by which plan amendments need to be made.

Use of retirement funds related to disaster relief for Hurricanes Katrina, Rita, and Wilma

In general

Section 1400Q provides exceptions to certain rules regarding distributions from retirement plans, for loans from retirement plans, and for plan amendments to retirement plans. [67]

Tax favored withdrawals from retirement plans

Section 1400Q(a) provides an exception to the 10-percent early withdrawal tax in the case of a qualified hurricane distribution from a qualified retirement or annuity plan, a 403(b) annuity, or an IRA. In addition, as discussed more fully below, income attributable to a qualified hurricane distribution may be included in income ratably over three years, and the amount of a qualified hurricane distribution may be recontributed to an eligible retirement plan within three years.

A qualified hurricane distribution includes certain distributions from an eligible retirement plan related to Hurricanes Katrina, Wilma, and Rita. Specifically, qualified hurricane distributions include the following distributions from an eligible retirement plan: any distribution made on or after August 25, 2005, and before January 1, 2007, to an individual whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss by reason of Hurricane Katrina; any distribution made on or after September 23, 2005, and before January 1, 2007, to an individual whose principal place of abode on September 23, 2005, is located in the Hurricane Rita disaster area and who has sustained an economic loss by reason of Hurricane Rita; and any distribution made on or after October 23, 2005, and before January 1, 2007, to an individual whose principal place of abode on October 23, 2005, is located in the Hurricane Wilma disaster area and who has sustained an economic loss by reason of Hurricane Wilma.

The total amount of qualified hurricane distributions that an individual can receive from all plans, annuities, or IRAs is $100,000. Thus, any distributions in excess of $100,000 during the applicable periods are not qualified hurricane distributions.

Any amount required to be included in income as a result of a qualified hurricane distribution is included in income ratably over the three-year period beginning with the year of distribution unless the individual elects not to have ratable inclusion apply.

Any portion of a qualified hurricane distribution may, at any time during the three-year period beginning the day after the date on which the distribution was received, be recontributed to an eligible retirement plan to which a rollover can be made. Any amount recontributed within the three-year period is treated as a rollover and thus is not includible in income. For example, if

[67] The relief with respect to Hurricane Katrina was initially provided in the Katrina Emergency Relief Act of 2005 (Pub. L. No. 109-73). The IRS provided guidance on those relief provisions in Notice 2005-92, 2005-2 CB 1165. The relief was codified in section 1400Q and was expanded to the Hurricanes Rita and Wilma Disaster areas in the Gulf Opportunity Zone Act of 2005 (Pub. L. No. 109-135)

an individual receives a qualified hurricane distribution in 2005, that amount is included in income, generally ratably over the year of the distribution and the following two years, but is not subject to the 10-percent early withdrawal tax. If, in 2007, the amount of the qualified hurricane distribution is recontributed to an eligible retirement plan, the individual may file an amended return (or returns) to claim a refund of the tax attributable to the amount previously included in income. In addition, if, under the ratable inclusion provision, a portion of the distribution has not yet been included in income at the time of the contribution, the remaining amount is not includible in income.

A qualified hurricane distribution is a permissible distribution from a 401(k) plan, 403(b) annuity, or governmental 457 plan, regardless of whether a distribution would otherwise be permissible. A plan is not treated as violating any Code requirement merely because it treats a distribution as a qualified hurricane distribution, provided that the aggregate amount of such distributions from plans maintained by the employer and members of the employer's controlled group does not exceed $100,000. A plan is not treated as violating any Code requirement merely because an individual might receive total distributions in excess of $100,000, taking into account distributions from plans of other employers or IRAs.

Qualified hurricane distributions are subject to the income tax withholding rules applicable to distributions other than eligible rollover distributions. Thus, 20-percent mandatory withholding does not apply.

Recontributions of withdrawals for home purchases

Section 1400Q(b) generally provides that a distribution received from a 401(k) plan, 403(b) annuity, or IRA in order to purchase a home in the Hurricane Katrina, Rita, or Wilma disaster areas may be recontributed to such a plan, annuity, or IRA in certain circumstances.

The ability to recontribute applies to an individual who receives a qualified distribution. A qualified distribution is a hardship distribution from a 401(k) plan or 403(b) annuity, or a qualified first-time homebuyer distribution from an IRA, that is a qualified Katrina distribution, a qualified Rita distribution, or a qualified Wilma distribution.

A qualified Katrina distribution is a distribution: (1) that is received after February 28, 2005, and before August 29, 2005; and (2) that was to be used to purchase or construct a principal residence in the Hurricane Katrina disaster area, but the residence is not purchased or constructed on account of Hurricane Katrina. Any portion of a qualified Katrina distribution may, during the period beginning on August 25, 2005, and ending on February 28, 2006, be recontributed to a plan, annuity or IRA to which a rollover is permitted.

A qualified Hurricane Rita distribution is a distribution: (1) that is received after February 28, 2005, and before September 24, 2005; and (2) that was to be used to purchase or construct a principal residence in the Hurricane Rita disaster area, but the residence is not purchased or constructed on account of Hurricane Rita. Any portion of a qualified Hurricane Rita distribution may, during the period beginning on September 23, 2005, and ending on February 28, 2006, be recontributed to a plan, annuity or IRA to which a rollover is permitted.

A qualified Hurricane Wilma distribution is a distribution: (1) that is received after February 28, 2005, and before October 24, 2005; and (2) that was to be used to purchase or construct a principal residence in the Hurricane Wilma disaster area, but the residence is not purchased or constructed on account of Hurricane Wilma. Any portion of a qualified Hurricane Wilma distribution may, during the period beginning on October 23, 2005, and ending on February 28, 2006, be recontributed to a plan, annuity or IRA to which a rollover is permitted.

Any amount recontributed is treated as a rollover. Thus, that portion of the qualified distribution is not includible in income (and also is not subject to the 10-percent early withdrawal tax).

Loans from qualified plans to individuals sustaining an economic loss

Section 1400Q(c) provides an exception to the income inclusion rule for loans from a qualified employer plan related to Hurricanes Katrina, Rita, and Wilma made to a qualified individual during an applicable period and provides a repayment delay for loans that are outstanding on or after a qualified beginning date if the due date for any repayment with respect to such loan occurs after the qualified beginning date and December 31, 2006.

The exception to the general rule of income inclusion is provided to the extent that the loan (when added to the outstanding balance of all other loans to the participant from all plans maintained by the employer) does not exceed the lesser of (1) $100,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or (2) the greater of $10,000 or the participant's accrued benefit under the plan.

In the case of a qualified individual with an outstanding loan on or after the qualified beginning date from a qualified employer plan, if the due date for any repayment with respect to such loan occurs during the period beginning on the qualified beginning date, and ending on December 31, 2006, such due date is delayed for one year. Any subsequent repayments with respect to such loan shall be appropriately adjusted to reflect the delay in the due date and any interest accruing during such delay. The period during which required repayment is delayed is disregarded in complying with the requirements that the loan be repaid within five years and that level amortization payments be made.

A qualified individual entitled to this plan loan relief includes a qualified Katrina individual, a qualified Rita individual, or a qualified Wilma individual. A qualified Hurricane Katrina individual is an individual whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss by reason of Hurricane Katrina. The qualified beginning date for a qualified Katrina individual is August 25, 2005 and the applicable period is the period beginning on September 24, 2005, and ending December 31, 2006.

A qualified Hurricane Rita individual is an individual whose principal place of abode on September 23, 2005, is located in a Hurricane Rita disaster area and who has sustained an economic loss by reason of Hurricane Rita. The qualified beginning date for a qualified

Hurricane Rita individual is September 23, 2005, and the applicable period is the period beginning on September 23, 2005, and ending on December 31, 2006.

A qualified Hurricane Wilma individual is an individual whose principal place of abode on October 23, 2005, is located in a Hurricane Wilma disaster area and who has sustained an economic loss by reason of Hurricane Wilma. The qualified beginning date for a qualified Hurricane Wilma individual is October 23, 2005, and the applicable period is the period beginning on October 23, 2005, and ending on December 31, 2006.

An individual cannot be a qualified individual with respect to more than one hurricane.

Plan amendments relating to Hurricanes Katrina, Rita, and Wilma

Section 1400Q(d) permits certain plan amendments made pursuant to any provision in section 1400Q, or regulations issued thereunder, to be retroactively effective. If the plan amendment meets the requirements of section 1400Q, then the plan will be treated as being operated in accordance with its terms. In order for this treatment to apply, the plan amendment is required to be made on or before the last day of the first plan year beginning on or after January 1, 2007, or such later date as provided by the Secretary of the Treasury. Governmental plans are given an additional two years in which to make required plan amendments. If the amendment is required to be made to retain qualified status as a result of the changes made by section1400Q (or regulations), the amendment is required to be made retroactively effective as of the date on which the change became effective with respect to the plan, and the plan is required to be operated in compliance until the amendment is made. Amendments that are not required to retain qualified status but that are made pursuant to section 1400Q may be made retroactively effective as of the first day the plan is operated in accordance with the amendment. A plan amendment will not be considered to be pursuant to section 1400Q (or regulations) if it has an effective date before the effective date of the provision (or regulations) to which it relates.

House Bill

No provision.

Senate Amendment

The Senate amendment provides relief similar to the relief provided in section 1400Q with respect to use of retirement funds in connection with the tornadoes and storms that occurred in the Kansas disaster area.

Effective date.–The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

6. Modification of the advanced coal project credit and the gasification project credit (sec. 15346 of the conference agreement and secs. 48A and 48B of the Code)

Present Law

Advanced coal project credit

An investment tax credit is available for power generation projects that use integrated gasification combined cycle ("IGCC") or other advanced coal-based electricity generation technologies.[68] The credit amount is 20 percent for investments in qualifying IGCC projects and 15 percent for investments in qualifying projects that use other advanced coal-based electricity generation technologies.

To qualify, an advanced coal project must be located in the United States and use an advanced coal-based generation technology to power a new electric generation unit or to retrofit or repower an existing unit. Generally, an electric generation unit using an advanced coal-based technology must be designed to achieve a 99 percent reduction in sulfur dioxide and a 90 percent reduction in mercury, as well as to limit emissions of nitrous oxide and particulate matter.[69]

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

Credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. Certifications are issued using a competitive bidding process. The Secretary of Treasury must establish a certification program no later than 180 days after August 8, 2005,[70] and each project application must be submitted during the three-year period beginning on the date such certification program is established. An applicant for certification has two years from the date the Secretary accepts the application to provide the Secretary with evidence that the requirements for certification have been met. Upon certification, the applicant has five years from the date of issuance of the certification to place the project in service.

[68] Sec. 48A.

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

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

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

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

Gasification project credit

A 20-percent investment tax credit is also available for investments in certain qualifying coal gasification projects.[71] Only property which is part of a qualifying gasification project and necessary for the gasification technology of such project is eligible for the gasification credit.

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

Credits are available only for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy. Certifications are issued using a competitive bidding process. The Secretary of Treasury must establish a certification program no later than 180 days after August 8, 2005,[72] and each project application must be submitted during the three-year period beginning on the date such certification program is established. The Secretary of Treasury may not allocate more than $350 million in credits. In addition, the Secretary may certify a maximum of $650 million in qualified investment as eligible for credit with respect to any single project.

House Bill

No provision.

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[71] Sec. 48B.

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

Senate Amendment

In implementing either section 48A (relating to the credit described above) or section 48B (relating to the coal gasification credit), the Senate amendment directs the Secretary to modify the terms of any competitive certification award and any associated closing agreements in certain cases. Specifically, modification is required when it (1) is consistent with the objectives of such section, (2) is requested by the recipient of the award, and (3) involves moving the project site to improve the potential to capture and sequester carbon dioxide emissions, reduce costs of transporting feedstock, and serve a broader customer base. However, no modification is required if the Secretary determines that the dollar amount of tax credits available to the taxpayer under the applicable section would increase as a result of the modification or such modification would result in such project not being originally certified. In considering any such modification, the Secretary must consult with other relevant Federal agencies, including the Department of Energy.

Effective date.–The Senate amendment is effective for credit allocation awards issued before, on, or after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

D. Other Revenue Provisions

1. Limitation on farming losses of certain taxpayers (sec. 12501 of the Senate amendment, sec. 15351 of the conference agreement and sec. 461 of the Code)

Present Law

For taxpayers who materially participate (as defined in section 469(h)) in a farming activity, net farming losses are reported in full as a reduction to income from both passive and nonpassive sources. For taxpayers who do not materially participate in a farming activity, the passive activity rules of section 469 limit the ability to use such losses to reduce income from nonpassive sources.

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

Present law (section 263A(e)(4))[73] defines a farming business as the trade or business of farming, including the trade or business of operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees (excluding evergreen trees that are more than six years old at the time severed from the roots). Treasury regulation section 1.263A-4(a)(4) further provides that a farming business generally means a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity. The raising, shearing, feeding, caring for, training, and management of animals are included in this definition. For example, the raising of cattle for sale is considered a farming business. However, the mere buying and reselling of plants or animals grown or raised entirely by another is not considered to be raising an agricultural or horticultural commodity. While a farming business does include processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products (e.g., harvesting, washing, inspecting, and packing fruits and vegetables for sale), it does not include the processing of commodities or products beyond those activities that are normally incident to the growing, raising, or harvesting of such products.

House Bill

No provision.

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[73] This is the same definition of "farming business" used for averaging of farm income under section 1301.

Senate Amendment

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

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

Conference Agreement

The conference agreement follows the Senate amendment with modifications. The conference agreement limits the farming loss of a taxpayer, other than a C corporation, for any taxable year in which any applicable subsidies are received to the greater of (1) $300,000 ($150,000 in the case of a married person filing a separate return), or (2) the taxpayer's total net farm income for the prior five taxable years. For purposes of the provision, applicable subsidies are (1) any direct or counter-cyclical payments under title I of the Food, Conservation, and Energy Act of 2008 (or any payment elected in lieu of any such payment), or (2) any CCC loan. Total net farm income is an aggregation of all income and loss from farming businesses for the prior five taxable years.

The following examples illustrate the operation of this provision:

Example 1.–Assume an individual taxpayer has $1 million of net income from a farming business in each taxable year 2010 to 2014, and incurs a $5 million farming loss in 2015. For purposes of this provision, the farming loss in 2015 is limited to the greater of (1) $300,000 or (2) $5 million (total net farm income for the prior five taxable years). Thus, the farming loss is allowable in full in 2015. Assuming the taxpayer had no other income or deductions in any of the taxable years 2010 to 2015, the $5 million net operating loss for 2015 is carried back to the prior five taxable years under the present-law net operating loss carryback rules and reduces the taxpayer's taxable income in each of those years to zero.[74]

Example 2.–Assume an individual taxpayer has $300,000 of net farm income and $700,000 of non-farm income in 2010, and $1 million of net farm income in each taxable year 2011 to 2014. In 2015, the taxpayer incurs a $7 million farming loss. For purposes of this provision, the farming loss in 2015 is limited to the greater of (1) $300,000 or (2) $4.3 million (total net farm income for the prior five taxable years). Thus, $2.7 million of the farming loss is disallowed under the provision and will be treated as a deduction attributable to a farming business in 2016. The $4.3 million farming loss allowed for 2015 is carried back to the prior five taxable years and allowed as a deduction under present-law rules. The taxpayer's taxable

[74] Under section 172(b)(1)(G), farming losses may be carried back to each of the five taxable years preceding the taxable year of the loss.

income in each of the years 2010[75] to 2013 is reduced to zero and taxable income in 2014 is reduced by the remaining farm loss of $300,000 to $700,000.

For purposes of calculating total net farm income for the prior five years, losses that are limited under the provision are taken into account in the year in which they are allowed as a deduction. For example, if a taxpayer has a $500,000 excess farm loss in 2010 that is not allowed as a deduction until 2012, the calculation in 2011 of total net farm income for the prior five years does not take into account the $500,000 as a farm loss. Instead, the $500,000 loss would be included in the calculation of prior year's total net farm income for taxable years 2013 through 2017. In the case where the filing status of the taxpayer is not the same for the taxable year and each of the taxable years in the five-year period, the Treasury Department is authorized to provide guidance for the computation of total net farm income.

In the case of a partnership or S corporation, the limit is applied at the partner or shareholder level.[76] Therefore, each partner or shareholder takes into account its proportionate share of income, gain, or deduction from farming businesses of a partnership or S corporation, and any applicable subsidies received by a partnership or S corporation during the taxable year (regardless of whether such items are treated as income for Federal tax purposes).

For purposes of the provision, the term "farming business" has the meaning provided in present-law section 263A(e)(4), with a modification for certain processing activities. Thus, for purposes of this provision, the conference agreement broadens the definition of "farming business" to include the processing of commodities, without regard to whether such activity is incidental, by a taxpayer otherwise engaged in a farming business with respect to such commodities. The farming activities of a cooperative are attributed to each member for purposes of this rule. Thus, a member of a cooperative who raises a commodity and sells it to the cooperative for processing is considered to be the processor of such commodity. In this case, patronage dividends received from a cooperative that is engaged in a farming business are considered to be income from a farming business for purposes of this provision.

As under the Senate amendment, any loss that is disallowed under the provision in a particular year is carried forward to the next taxable year and treated as a deduction attributable to farming businesses in that year.

Farming losses arising by reason of fire, storm, or other casualty, or by reason of disease or drought, are disregarded for purposes of calculating the limitation.

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[75] The loss carryback to 2010 reduces both the $300,000 of net farm income and $700,000 of non-farm income to zero.

[76] The Treasury Department may provide guidance for the application of this provision to any other pass-thru entity to the extent necessary to carry out the purposes of this provision. In the case of tiered partnership or pass-thru entity structures, the Treasury Department may provide guidance as necessary to carry out the purposes of this provision.

Treasury regulatory authority is provided to prescribe such additional reporting requirements as appropriate to carry out the purposes of this provision.

Effective date.–The provision is effective for taxable years beginning after December 31, 2009.

2. Increase and index dollar thresholds for farm optional method and nonfarm optional method for computing net earnings from self-employment (sec. 12502 of the Senate amendment, sec. 15352 of the conference agreement and sec. 1402(a) of the Code)

Present Law

In general

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

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

Farm optional method

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

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

Nonfarm optional method

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

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

Other rules applicable to farm optional and nonfarm optional methods

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

Social Security benefit eligibility

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

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

House Bill

No provision.

Senate Amendment

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

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

Conference Agreement

The conference agreement follows the Senate amendment.

3. Information reporting for commodity credit corporation transactions (sec. 12503 of the Senate amendment, sec. 15353 of the conference agreement and new sec. 6039J of the Code)

Present Law

The Farm Security and Rural Investment Act of 2002[77] authorizes a marketing assistance loan program through the Commodity Credit Corporation ("CCC"). Under such program, the CCC may make loans for eligible commodities at a specified rate per unit of commodity (the original loan rate). The repayment amount for such a loan secured by an eligible commodity generally is based on the lower of the original loan rate or the alternative repayment rate, as determined by the CCC, as of the date of repayment. The alternative repayment rate may be adjusted to reflect quality and location for each type of commodity. A taxpayer receiving a CCC loan can use cash to repay such a loan, purchase CCC certificates for use in repayment of the loan, or deliver the pledged collateral as full payment for the loan at maturity.

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

If a farmer uses cash instead of certificates, the farmer will receive a Form CCC-1099-G Information Return showing the market gain realized. For transactions prior to January 1, 2007, however, if a farmer uses CCC certificates to facilitate repayment of a CCC loan, the farmer will not receive an information return. For loans repaid on or after January 1, 2007, IRS Notice 2007-63 provides that the CCC reports market gain associated with the repayment of a CCC loan

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

whether the taxpayer repays the loan with cash or uses CCC certificates in repayment of the loan.[78] The CCC reports the market gain on Form 1099-G, Certain Government Payments.

House Bill

No provision

Senate Amendment

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

Effective date.–The provision is effective for loans repaid on or after January 1, 2007.

Conference Agreement

The conference agreement includes the Senate amendment provision.

[78] 2007-33 IRB.

E. Protection of Social Security (sec. 15361 of the conference agreement)

To ensure that the assets of the trust funds established under section 201 of the Social Security Act are not reduced as the result of the enactment of this Act, the Secretary of the Treasury shall transfer certain amounts annually from the general revenues of the Federal Government to those trust funds.

IV. TRADE PROVISIONS

A. Extension of Certain Trade Benefits (secs. 15401-15407 and 15410-15411 of the conference agreement)

Present Law

Sec. 213A of the Caribbean Basin Recovery Act (19 U.S.C. 2703a) establishes the Haitian Hemispheric Opportunity through Partnership Encouragement Act of 2006 ("HOPE I"). HOPE I extended preferences to Haiti for apparel meeting certain rules of origin, and for certain automotive wire harnesses.

With respect to apparel, HOPE I extended preferential treatment to three categories of apparel: (1) apparel meeting a value-added rule of origin; (2) limited quantities of woven apparel wholly assembled in Haiti; and (3) brassieres meeting a cut and sew requirement.

HOPE I (in section 213A(d)) conditions Haiti's eligibility for these preferences on the President determining and certifying that Haiti has either established, or is making continual progress towards establishing, protection of internationally recognized worker rights. These rights include the right of association, the right to organize and bargain collectively, a prohibition on the use of any form of forced or compulsory labor, a minimum age of employment of children, and acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health.

The use of the HOPE I preference program has been very limited to date.

In fact, just 1.6% of Haiti's apparel exports in 2007 were under the HOPE I program. The Conferees believe that the limited use of the program is largely attributable to HOPE I's complex value-added rule of origin. As a result, the economic benefits – namely, new investment and significant new job creation – that the preference program was intended to spread widely to foster stability and security in Haiti have not been forthcoming.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

To address the deficiencies in HOPE I, the conference report includes the Haitian Hemispheric Opportunity through Partnership Encouragement Act of 2008 (HOPE II), which provides additional ways (under simplified rules) that Haitian apparel can qualify for duty-free treatment, as well as authorizing a new apparel sector labor capacity building and monitoring program (the Technical Assistance Improvement and Compliance Needs Assessment and Remediation Program or "TAICNAR program") to ensure the benefits of the new preferences are spread widely. The Conferees intend HOPE II to help Haitian industry attract new investment and create immediate jobs, generate income for workers to cover increased food costs and pay for other necessities, and continue to provide incentives to encourage the use of inputs manufactured by U.S. companies.

Key aspects of the HOPE II apparel provisions are outlined below. The Conferees note that HOPE II creates six discrete stand alone rules for apparel (and some textile) products to qualify for preferential treatment: (1) the value-added rule (as provided for in HOPE I, subject to a change in the cap); (2) a capped benefit for woven apparel meeting a wholly assembled/knit-to-shape rule; (3) a capped benefit for certain knit apparel meeting a wholly assembled/knit-to-shape rule; (4) an uncapped benefit for certain types of apparel meeting a wholly assembled/knit-to-shape rule; (5) an uncapped benefit for apparel meeting a wholly assembled/knit-to-shape rule under the "3 for 1" Earned Import Allowance Program; and (6) an uncapped benefit for apparel meeting a wholly assembled/knit-to-shape rule, where the apparel is made from "short supply" yarns or fabrics. The Conferees note that if a capped benefit is filled in a given year, an importer can still use one or more of the other rules. In addition, apparel from Haiti may also qualify for preferential access to the U.S. market under the United States-Caribbean Basin Trade Partnership Act (Title II of Public Law 106-200) (CBTPA).

Ten Year Duration.–The conference report extends most apparel preferences, including all apparel preferences created under HOPE II, for 10 years, until September 30, 2018. The ten year duration is aimed at fostering a more stable investment climate for businesses seeking to use HOPE I or II preferences.

Expanded Preferences for Woven Apparel.–The conference report expands the HOPE I "woven apparel cap" to 70 million square meters equivalents ("SMEs"), and extends the benefit for 10 years. Apparel exported under this provision can qualify for preferences if the apparel is "wholly assembled" or knit-to-shape, or both, in Haiti, without regard to the origin of the fabric (or fabric components, or components knit to shape, or yarn) comprising the apparel article. The definition of "wholly assembled" is taken from existing Customs regulations.

New Knit Apparel Cap.–HOPE II creates a new "knit apparel cap" of 70 million SMEs, with exclusions for men's/boys' cotton t-shirts, men's/boys' mmf t-shirts, certain men's/boys' sweatshirts/pullovers, and certain men's/boy's cotton-blend sweatshirts. Apparel exported under this provision can qualify for preferences if the apparel is "wholly assembled" or knit-to-shape, or both, in Haiti, without regard to the origin of the fabric (or fabric components, or components knit to shape, or yarn) comprising the apparel article.

Modified Single Transformation Rule for Certain Apparel and Certain Luggage.–HOPE II extends preferential treatment to certain apparel articles wholly assembled, or knit to shape, or both, in Haiti, without regard to the origin of the fabric (or fabric components, or components knit to shape, or yarn) comprising the apparel article. The apparel articles covered by this provision are: (1) brassieres; (2) those apparel articles covered by the Central America-Dominican Republic-United States Free Trade Agreement (CAFTA-DR) "single transformation" rule; (3) headgear; and (4) certain sleepwear.

With regard to covered sleepwear, HOPE II extends preferences to women's and girls' pajama bottoms (i.e., sleep pants), regardless of whether such bottoms are a separate garment or are part of a set.

HOPE II also extends preferential treatment to luggage and handbags wholly assembled in Haiti, without regard to the source of the fabric, materials or components. The Conferees did not include the concept of knit-to-shape in this provision, because such processing does not typically occur for such luggage/handbags.

"3 for 1" EIA Program for Knit or Woven Apparel.–HOPE II creates a "3 for 1" earned import allowance program (EIA) to be developed and administered by the Secretary of Commerce. Under the "3 for 1" EIA, Haitian producers or entities controlling production that purchase qualifying fabric for apparel production in Haiti may export other apparel to the United States duty-free, and not subject to quantitative limitations, regardless of the origin of the fabric (or fabric components, components knit to shape, or yarns) from which the apparel product is made. Specifically, for every 3 SMEs of qualifying fabric purchased, a producer or entity controlling production receives a "credit" for 1 SME that can be used in the manufacture of apparel using non-qualifying fabric (e.g., Taiwanese fabric). The Secretary of Commerce is to establish electronic "accounts" for producers or entities controlling production where such "credits" can be deposited. A producer or entity controlling production can then withdraw these credits for an "earned import allowance certificate" that reflects the requested number of credits. Apparel wholly assembled, or knit to shape, or both, in Haiti using non-qualifying fabric may enter the United States duty-free, if the apparel is accompanied by such an "earned import allowance certificate" that reflects the number of credits equal to the SMEs of the apparel for which preferential treatment is sought.

An example may help illustrate the process: Producer A in Haiti purchases 300 SMEs of denim fabric woven in the United States using U.S. yarns in order to manufacture jeans in Haiti. Producer A, upon submission of documentation supporting the purchase of the U.S. denim (such documentation can include information submitted by the U.S. textile mill that exported the fabric), will receive 100 credits in Producer A's Commerce Department account. If Producer A subsequently wants to export jeans that are wholly assembled in Haiti to the United States duty-free and such jeans are wholly assembled in Haiti from Italian denim, Producer A would redeem all or part of the accrued 100 credits for the requisite earned import allowance certificate. For instance, if the jeans made with the Italian fabric account for 50 SMEs, Producer A would request a certificate that equaled 50 credits.

In HOPE II, the Conferees have established principles for the "3 for 1" EIA program. The Conferees expect and intend the Secretary of Commerce to establish additional requirements in order to make the program efficient, workable, and administrable, and have provided the Secretary with the authority to promulgate and enforce such requirements. In addition, the Conferees urge the Secretary of Commerce to establish the "3 for 1" EIA program as an electronic program, including with respect to the EIA certificate.

The Conferees note that woven and knit fabrics are treated differently under the HOPE II-created EIA program. Specifically, qualifying woven fabric must be wholly formed in the United States, from U.S. yarns (subject to some limited exceptions). Qualifying knit fabric may be wholly formed or knit to shape in the United States, U.S. free trade agreement (FTA) partner country or U.S. preference partner country (e.g., a beneficiary country under the African Growth and Opportunity Act), or any combination, from U.S. yarns (subject to some limited exceptions).

Modified Single Transformation Rule for Apparel Made from "Short Supply" Fabrics/Yarns.–HOPE II also includes a provision to extend duty-free treatment to any apparel article wholly assembled or knit to shape, or both, in Haiti where the apparel article is made from fabrics or yarns designated as not being available in commercial quantities under any U.S. preference program or FTA, or is covered by certain provisions of Annex 401 of the NAFTA (i.e., those provisions which extend duty-free treatment to apparel notwithstanding the origin of fabric or yarns). The Conferees note that the entire apparel article need not be made from a "short supply" fabric or yarn – only the fabric, fabric components, components knit to shape, or yarns that make up the component that determines the tariff classification of the article need be made of "short supply" fabrics or yarns for entry under this rule.

Transition Value-Added Rule.–HOPE II preserves the existing value-added rule of origin from HOPE I, but freezes the cap for exports qualifying for this rule at the 2008 level (i.e., 1.25% of U.S. apparel imports). Under HOPE II, the value-added rule retains the termination date provided for in HOPE I (five years from enactment of HOPE I). The Conferees chose to sunset this provision as provided for in HOPE I and not extend the rule for an additional ten years, because Haitian exports under the value-added rule have been minimal, reflecting the complexity of the rule. The conferee notes that more flexible value-added rules applied to apparel in other preferential trade arrangements (e.g., the United States-Jordan Free Trade Agreement) have been effective in increasing trade.

Allow Direct Shipment from and Co-production in the Dominican Republic.–HOPE II recognizes the unique situation of Haiti and the Dominican Republic, the two sovereign nations that share the Caribbean island of Hispaniola, and the ties between the textile and apparel industries of both countries. The Conferees believe that existing ties between the textiles and apparel industries of both countries should be maintained and strengthened. Toward that end, HOPE II allows direct shipment from the Dominican Republic of apparel qualifying under section 213A, as amended by HOPE II. The direct shipment provision will minimize transit times and costs when apparel wholly assembled or knit to shape in Haiti is sent to the Dominican Republic for packaging or post-assembly operations.

The Conferees have included direction to the Commissioner responsible for U.S. Customs and Border Protection to provide technical and other assistance to Haiti and the Dominican Republic to develop procedures to prevent unlawful transshipment and use of counterfeit documents. The Conferees intend that assistance to be provided expeditiously and in a manner that facilitates trade, and to include assisting Haiti and the Dominican Republic in developing a secure, electronic system to combat unlawful transshipment and use of counterfeit documents.

The Conferees also expect the processing requirement necessary for an apparel article to qualify under HOPE II – that is, that apparel be wholly assembled or knit to shape, or both, in Haiti – to facilitate co-production between Haiti and the Dominican Republic. The HOPE II processing requirement does not preclude assembly or other operations from occurring outside

Haiti. Co-production operations performed in the Dominican Republic could include, but are not limited to, activities such as minor assembly, repair, embellishment, and finishing.

Clarifications on Administration of Caps.–HOPE II clarifies that exports qualifying for preferences under apparel provisions not subject to quantitative limitations (e.g., the apparel qualifying under the rules contained in section 213A(b)(3), as amended by HOPE II) should not be included in the calculation of any quantitative limitations contained in HOPE II. In addition, apparel qualifying under a rule subject to a particular cap (e.g., the woven or knit apparel caps in section 213A(b)(2), as amended by HOPE II), should not be counted against another cap (e.g., the value–added cap, included in section 213A(b)(1), as amended by HOPE II). Finally, the legislation clarifies that HOPE II benefits are *in addition* to preferences extended to Haitian exports under the Caribbean Basin Economic Recovery Act (CBERA), including apparel preferences under section 213(b)(2) of the CBERA, as amended, and that apparel exports qualifying for preferences under 213(b)(2) should not be counted against the quantitative limitations established in HOPE II.

Labor Provisions. The conference agreement amends Section 213A of the Caribbean Basin Recovery Act to include new provisions to promote compliance with core labor standards, as enumerated in the legislation, and to improve working conditions, in particular in the textile and apparel sector. The Conferees recognize that the core labor standards defined in the legislation refer to the rights as listed in the 1998 International Labor Organization Declaration on Fundamental Principles and Rights at Work and its Follow Up. Specifically, HOPE II requires that the President certify, within 16 months of enactment, that Haiti has created an independent Labor Ombudsman's Office responsible for performing the functions set forth in the conference agreement and established, with the assistance of the International Labor Organization ("ILO"), the TAICNAR Program. Unless the President extends the period for meeting these requirements, which is permitted under certain limited conditions set out in the conference agreement, the President is required to terminate Haiti's eligibility for preferential treatment under the section.

The functions of the Labor Ombudsman include overseeing the implementation of the TAICNAR Program, maintaining a registry of the textile and apparel producers that may seek preferential treatment and coordinating a committee comprised of representatives of government agencies, employers, and workers to consult on the implementation of the TAICNAR Program and other matters of common concern. The Labor Ombudsman is also responsible for receiving comments from interested parties about the labor conditions in the facilities of the registered producers and, where such comments are submitted in good faith and supported with evidence, directing the comments to the ILO or the appropriate Haitian government official. Further, where registered producers are found to have deficiencies, the Labor Ombudsman also shares responsibility for assisting them in complying with core labor standards and national labor laws directly relating to the standards and acceptable conditions of work with respect to minimum wages, hours of work, and occupational health and safety. In performing its functions, the Labor Ombudsman is expected to coordinate and consult with other appropriate Haitian government officials (e.g., in the Ministry of Labor).

The TAICNAR Program is comprised of two elements. The first element of the program is technical assistance from the ILO to build Haiti's own capacity to inspect the facilities of registered textile and apparel producers, enforce its labor laws, and resolve labor disputes. The scope of such assistance is broad, including ILO assistance in reviewing national labor laws and regulations and bringing them into compliance with core labor standards, increasing awareness of worker rights, and on-the-job training for labor inspectors, judicial officers, and other government officials.

The second element of the TAICNAR Program is ILO assessment of compliance with core labor standards and national labor laws in the facilities of the producers registered with the Labor Ombudsman and, where necessary, assistance with remediating deficiencies. Consistent with existing practice under its Better Factories Cambodia and Better Works programs, the ILO has a number of tools to perform such assessments, including unannounced site visits and confidential interviews with management and workers. The results of the assessment are reported, confidentially in the first instance, to the management and workers (or, where there is union representation, worker representatives) together with suggestions for remediation of deficiencies. Under the program, the ILO then aids the producer in remediating any deficiencies, with assistance, if necessary, from the Labor Ombudsman or other parties. Every six months, following implementation of the TAICNAR Program by Haiti, the ILO is expected to publish a public report on the assessments it has conducted during the preceding six-month. Such reports will identify the specific factories assessed and the conditions in these factories.

To encourage compliance with core labor standards and national labor laws directly related to core labor standards, the conference agreement provides for preferential treatment to be denied in certain circumstances. Specifically, the conference agreement directs the President to identify (on a biennial basis, beginning in the second year after implementation) producers who are failing to comply with these compliance conditions. The President is directed to offer assistance to any such producers in meeting the compliance conditions and, if the assistance is refused or if the producer otherwise fails to come into compliance, to withdraw, suspend, or limit preferential treatment to articles of the producer. The preferential treatment may be reinstated if the President later determines that the producer has come into compliance with core labor standards and national labor laws directly related to core labor standards. In making both the initial identification of non-compliant producers and any later reinstatement determination, the President is to consider the reports of the ILO.

B. Extension of CBTPA
(sec. 15408-15409 of the conference agreement)

Present law

The Caribbean Basin Economic Recovery Act (19 U.S.C. 2703(b)), as amended by the United States-Caribbean Basin Trade Partnership Act (Title II of Public Law 106-200) (CBTPA), provides that eligible textile and apparel articles of a designated CBTPA beneficiary country shall enter the United States free of duty and free of quantitative limitations, provided that the President determines that the country has implemented the necessary procedures and requirements. These preference program provisions expire on September 30, 2008.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement amends section 213(b) of the Caribbean Basin Economic Recovery Act to extend the Caribbean Basin Trade Partnership Act, including the textile and apparel preference program provisions, through September 30, 2010.

C. Unused Merchandise Drawback (sec. 15421 of the conference agreement)

<u>Present law</u>

Section 313(j) of the Tariff Act of 1930 (19 U.S.C. 1313(j)) currently provides for unused merchandise drawback. Unused drawback is permitted if imported merchandise is exported or destroyed within 3 years of import without being used in the United States. Pursuant to section 313(j)(2) of the Tariff Act of 1930 (19 U.S.C. 1313(j)(2)), domestic or imported merchandise that is commercially interchangeable with the imported merchandise may be substituted for the imported merchandise and drawback granted on the export or destruction of the substituted merchandise within the 3-year period beginning on the date of importation. The drawback is limited to 99% of the duty, tax and fee imposed under Federal law on the imported merchandise upon entry or importation.

Section 313(j)(2) of the Tariff Act of 1930 does not contain a definition of ‘‘commercially interchangeable.’’ From late 2001 to May 2007, U.S. Customs and Border Protection (CBP) paid drawback claims on wine based on white domestic and imported table wine being commercially interchangeable with relatively valued imported white table wine. Red domestic and imported table wine was also considered to be commercially interchangeable with relatively valued imported red table wine. Relatively valued wine was considered to be wine within a price range of 50%.

CBP informed wine drawback claimants in May 2007 that, effective immediately, the above standard for commercial interchangeability was no longer applicable. CBP did not provide a definitive new standard but stated that the criterion of the varietal wine should have been a determining factor in determining commercial interchangeability.

The new provision carries forward the standard used for commercial interchangeability from 2001 to May 2007, and provides certainty for the filing and processing of unused drawback claims for imported and exported wine.

<u>House Bill</u>

No provision.

<u>Senate Amendment</u>

No provision.

<u>Conference Agreement</u>

The conference agreement amends section 313(j)(2) of the Tariff Act of 1930, to provide a standard for what is considered to be ‘‘commercially interchangeable’’ for purposes of unused merchandise drawback for wine. The provision is effective for claims filed for drawback on or after the date of enactment.

D. Requirements Relating to Determination of Transaction Value of Imported Merchandise (sec. 15422 of the conference agreement)

Present Law

No provision.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The Conference agreement includes an importer declaration requirement for one year to assist in gathering information on the valuation of goods imported into the United States.

The value of merchandise imported into the United States is determined primarily under transaction value. Transaction value is defined in section 402(b) of the Tariff Act of 1930 (19 U.S.C. 1401a(b)(1)) as the price actually paid or payable for the merchandise when sold for exportation to the United States. Import transactions can involve one sale of the imported goods prior to importation or a series of sales. In the multiple sale scenario, Customs and Border Protection ("CBP") currently permits importers to base transaction value on the price paid by the buyer in the first or earlier sale (e.g. the sale between the manufacturer and the intermediary), provided the importer can establish by sufficient evidence that the sale was at arm's length and that at the time of such sale, the merchandise was clearly destined for exportation to the United States.

On January 24, 2008, CBP published in the Federal Register a proposed interpretation of the expression "sold for exportation to the United States." 73 Fed. Reg. 4254 (Jan. 24, 2008). In the publication, CBP proposed that when imported merchandise has been subject to a series of sales prior to importation, the price actually paid or payable for the imported goods when sold for exportation is the price paid in the last sale occurring prior to the introduction of the goods into the United States.

Congress has serious concerns that CBP did not provide Congress or the importing community with any notice about its proposed interpretation. Congress also has serious concerns that CBP proposed its new interpretation without conducting adequate analysis of the proposed impact of such interpretation. Moreover, Congress has received several concerns and questions about CBP's proposed interpretation, including questions of the number and value of importations that would be impacted by the change. CBP informed Congress that it does not keep records indicating which importers are basing transaction value on the price paid by the buyer in the first or earlier sale. Therefore, there is no information available to assess which sectors are using this provision, the extent of its use, and probable impact on the United States.

The Conferees through section (a) require Customs to collect adequate information regarding the impact of such proposal by requiring that importers declare whether the transaction value of the imported merchandise is determined on the basis of the price paid in the first or earlier sale occurring prior to introduction of the merchandise into the United States. The term "first or earlier sale" as used in subsection (a)(2) is intended to refer to the current CBP interpretation expressed in the January 24, 2008 Federal Register Notice.

Subsection (b) requires CBP to provide the collected information to the United States International Trade Commission ("ITC") on a monthly basis. The Conferees intend for CBP and ITC to mutually agree on the format in which CBP will submit the data for ITC use. Subsection (c) requires the ITC to submit a report to the House Ways and Means Committee and the Senate Finance Committee within ninety days of receipt of CBP's last monthly report.

In subsection (d), the Conferees express a sense of Congress that CBP should not before January 1, 2011, implement a change of interpretation of the expression "sold for exportation to the United States" for purposes of applying the transaction value of the imported merchandise in a series of sales. It is the sense of Congress that after January 1, 2011, CBP may propose to change or change its interpretation only if CBP: (1) consults with and provides notice to the appropriate committees not less than 180 days prior to proposing a change and not less than 90 days prior to publishing a change; (2) consults with, provides notice to, and takes into consideration views expressed by the Commercial Operations Advisory Committee not less than 120 days prior to proposing a change and not less than 60 days prior to publishing a change; and (3) receives the explicit approval of the Secretary of Treasury prior to publishing a change. The term "publishing", as used in subsection (d), includes any notice CBP may provide to the regulated community through a public notice.

Through subsection (d)(3), the Conferees express a sense of Congress that CBP should take into consideration the ITC report as referenced in subsection (b) before publishing any change to the expression "sold for exportation to the United States."

V. TAX COMPLEXITY ANALYSIS

Section 4022(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code (the "Code") and has widespread applicability to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that have "widespread applicability" to individuals or small businesses.