EXECUTIVE COMMITTEE MEETING ON THE ENERGY TAX INCENTIVES ACT OF 2003; THE CLEAN DIAMOND TRADE ACT; THE TAX COURT MODERNIZATION ACT; AND TO CONSIDER THE NOMINATIONS OF MARK EVERSON, TO BE COMMISSIONER OF INTERNAL REVENUE; DIANE L. KROUPA, TO BE JUDGE OF THE U.S. TAX COURT; HARRY A. HAINES, TO BE JUDGE OF THE U.S. TAX COURT; ROBERT ALLEN WHERRY, JR., TO BE JUDGE OF THE U.S. TAX COURT; JOSEPH ROBERT GOEKE, TO BE JUDGE OF THE U.S. TAX COURT; AND RAYMOND T. WAGNER, JR., TO BE MEMBER OF THE OVERSIGHT BOARD, U.S. DEPARTMENT OF TREASURY

WEDNESDAY, APRIL 2, 2003

U.S. Senate,

Committee on Finance,

Washington, DC.

The meeting was convened, pursuant to notice, at 10:21 a.m., in room 215, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the committee) presiding.

Also present: Senators Hatch, Nickles, Lott, Snowe, Kyl, Thomas, Santorum, Smith, Bunning, Baucus, Rockefeller, Daschle, Breaux, Conrad, Jeffords, Bingaman, and Lincoln.

Also present: Kolan Davis, Staff Director and Chief Counsel; Theodore Totman, Deputy Staff Director; Jeff A. Forbes, Democrat Staff Director; and Carla Martin, Chief

Clerk.

Also present: Pam Olson, Assistant Secretary for Tax Policy, Department of Treasury; Tom Barthold, Joint Committee on Taxation; Elizabeth Paris and Matt Jones, Tax Counsel.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON FINANCE

The Chairman. I thank everybody for their patience while our committee wrapped up final preparation for this meeting.

Today we meet to mark up the very important Energy and Conservation Tax Relief Act. I am pleased that today we offer a very bipartisan energy tax incentive package for this Congress.

I would like to note with some satisfaction that today we are doing the people's business in the way they want us to do it. We are going to act in a bipartisan way on an important initiative in a way that reflects the diversity of our views and the diversity of our Nation.

In this wartime climate, this is what the people of the United States expect of the Congress. What a relief it is to have this sort of climate to work in on a very important bill, particularly at a time of war when energy is always a central issue.

The Finance Committee has a distinct history in the area of energy-related tax policy. Almost one decade ago, this committee put its imprint on comprehensive energy-related tax policy. Then, as now, the bill the committee produced strikes a balance between conventional

energy sources, alternative energy, and conservation of energy.

I must, as I have the privilege of doing so often, thank Ranking Member Max Baucus for all of our ongoing conferences. We have tried to consult every member of this committee on their priorities.

As we move through this mark-up process of the Energy Tax Incentive Act of 2003, I would like to remind our members to fully respect the committee's independence and tradition. Specifically, our committee product should be considered as a freestanding amendment. This is a bipartisan consensus product that should be debated on its own when the basic energy bill comes to the floor.

Now I would turn to some specifics in the Chairman's mark. First and foremost, we have an extension and expansion of the Production Credit for wind energy. Back in 1992, I was the first to offer this proposal in the Senate.

I was pleased to work with the Majority Leader and others to conclude this provision in the Internal Revenue Code. Now we have an important expansion of this Production Credit to cover biomass, including agricultural waste nutrients, geothermal wells, and solar energy.

As the President has wisely said, as a matter of

national security we need to reduce our dependence upon foreign oil. That means all domestic energy sources, green or otherwise, are fair game.

Along those lines, we have a new tax credit for bio-diesel fuels that will be included in this bill. I am pleased that Senator Lincoln, along with Senator Baucus, me, and several other fellow committee members have advanced this new credit of bio-diesel. This is obviously good news across several fronts of our economy, including the farmers, the consumers, and the environment.

Let me point out that the Chairman's mark contains a provision that enhances tax incentive for ethanol production. Ethanol is a clean-burning fuel that will be continued as a necessary element of our transportation fuels policy.

Today we will consider a tripartisan proposal offered by me as Chairman, Max Baucus as Ranking Member, and our Minority Leader Tom Daschle, Jim Jeffords, the Ranking Member of EPW, to reshape the ethanol excise tax exemption so that ethanol-blended fuels make the same contribution to the Highway Trust Fund as regular gasoline, while also retaining the important incentive to promote the use of domestic renewable fuel.

It makes common sense for ethanol taxes to contribute

just as much to building highways as traditional gasoline taxes. It is not logical for a smaller portion of ethanol taxes to contribute to highways than taxes from traditional gasoline.

All types of vehicle fuel taxes should contribute equally. Our highway needs are great. Our dependence on imported fuel should decrease. This restructuring of ethanol excise taxes contributes to both of these priorities.

At the same time, it preserves all incentive to use clean-burning, renewable, domestically-produced ethanol, the fuel of the future. Renewable fuels like ethanol and bio-diesel will improve air quality, strengthen national security, reduce trade deficits, decrease dependence on people like Saddam Hussein for oil, and expand markets for agricultural products.

There are a number of other very good proposals in this mark, and I am not going to go into them, but they may be discussed.

I also want to briefly talk about offsets. I am pleased that at this stage we have not offset the revenue loss in this mark. We have worked together in a bipartisan fashion to try to limit the mark to an amount allocated in our budget proposal. This decision was seen as a constructive gesture by many on my side of the

aisle, and I thank all committee members for cooperating with that.

It is also good that committee members agreed to stay within the reasonable bounds in terms of the overall revenue loss in this modified mark, which we have chosen to fully offset. Like all of you, I do not want the good policy in this bill brought down on a Budget Act point of order.

So to sum up, we are doing what we should do. We are responding to our national priority, energy security, which it is, in a balanced and comprehensive way.

I would now turn to Senator Baucus for opening comments.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator Baucus. Thank you, Mr. Chairman.

Mr. Chairman, at the outset I want to thank you very much for the civility, and cooperation, and grace with which you have been working with this side of the aisle.

I can remember other mark-ups where that was not always the case, not when you were Chairman, but in other situations, other circumstances, where one of the two parties would have their little pow-wow in the back room, and march out here and, in effect, just tell the rest of the committee what the legislation would be without any input from the other side.

I deeply appreciate the manner and approach that you have taken as Chairman of the committee. I know it is appreciated, more particularly, by the American people. It is a truism, people do want us working together. If any Senator works with others more than you, I would like to know who it is, because you do a good job. Thank you. I deeply appreciate it.

The Chairman. Thank you.

Senator Baucus. I also commend you for holding today's mark-up on various pieces of legislation which I think are pretty important. Clearly, the Energy Tax

Incentives Act, which you described, help make us less dependent upon foreign sources for oil.

We all know that generally the trend is not good. That is, the number of barrels of imported oil we consume in the United States daily is not going down, it is going up, certainly as a percent of the total amount of oil that we consume in the United States, and it is not a good situation to be in. Clearly, it tends to restrict our national policy, our foreign policy.

The more we can get away from that, the better it will be. We will never be completely self-sufficient, but the more we can work towards self-sufficiency, the stronger we are going to be as a country and the more options we are going to have as a country.

I highly commend you for bringing up this legislation, even though the energy bill has not yet been brought up and passed on the floor. We are still proceeding, nevertheless, on the energy tax provisions, and I think that is the proper, responsible thing to do.

The Clean Diamonds Trade Act is also very important to ensure that the profits from trade in diamonds does not go to unscrupulous folks who then use it for terrorism or for whatnot. It is very important, because diamonds are such an important commodity, and I thank you for that.

Mr. Chairman, very generally, because of the black-out in California last year and energy chaos, frankly, last year, we worked hard to get this bill passed. Those situations have not entirely changed this year, but there are other geopolitical forces which demand us to move quickly in passing an energy bill, and I hope we move quickly and get that passed.

In addition, I might point out, as you have, that our bill starts with the premise that we can accomplish certain policy goals by targeting market incentives and certain investments, that is, in the form of tax deductions and credits, as we do think we can help stimulate production and conservation, conventional and unconventional, by using the Tax Code. I think that is an assumption, a premise, which has proved valid time and time again.

We are also striking a balance between conservation and production, something that is very important to the American people. As the world gets more complicated, we need to move to be more creative in helping sever that link with OPEC through both production and conservation.

We also must move to reward new, further technological development and advancement. Technology is probably the main driver in modern civilization. The more we can move toward developing still new

technologies, we are going to be certainly in better shape.

Just a word about the Highway Trust Fund provisions. Some time ago, it became apparent to me that when we take up the next highway bill, that is, this year, we are going to have to find new ways to raise revenue, that is, to grow the program.

As you well know, Mr. Chairman, six years ago we passed a new highway program, T-21. We found new revenue to grow the program. Essentially, it was the gasoline tax that was dedicated to the general fund. We transferred it over to the Highway Trust Fund and that enabled us in the Congress to work out an agreement, an allocation of dollars, among the various States.

At that time, as there are today, there are many donor States, States that contributed more money in federal gasoline taxes to the Highway Trust Fund than they get back in funds to build highways.

Those donor States do not like being donor States. They want to be even at least, and to be less of a donor. To be more even, they want more money. They are able to get more money with the additional transfer to the Highway Trust Fund.

We do not have additional sources of money this year when we are bringing up the new highway program, and

those donor States will want to be made whole again in addition to just growing the program. So I felt that it would make good sense for the ethanol subsidy to be reworked so that it can go not to the general fund, that is, 2.5 cents, but rather to the Highway Trust Fund. The same with the 5.2 gasohol subsidy that is now in effect.

In effect, that program is subsidized by the Highway Trust Fund. My view is that that should be subsidized rather by the general fund, not the trust fund, because after all gasohol cars drive on the highways just as much as non-gasohol cars. They are both using the highway. And other measures, too.

We, in this bill--and I thank you very much, Mr. Chairman--address that issue. I thank you for it. It is not going to solve all the problems that we have as we are trying to grow the program, but it is going to be a healthy first step. I have worked hard on this provision for over a year and I am very glad to see that it is getting favorable recognition.

Mr. Chairman, just a couple of other points. One, I am glad that we are adding some modernization provisions for the Tax Court, and also that we will be confirming several new judges to the Tax Court. We set up the Tax Court, as you know, about 20 years ago, roughly, as a need to show a little independence. Also, these

provisions just recognize the important work that the Tax Court does.

It is a very important adjunct, separate from Article 3 District Court cases and tax litigation, because generally the Tax Court handles, as you well know, cases where the taxpayers just cannot afford to pay the tax and then ask for a refund, as is the case in District Court. Rather, these are middle-income taxpayers, by and large. They are disputing the tax, they do not think it is fair. I do not think it is fair that they should always have to pay and get a refund.

In the Tax Court, as you know, you do not have to pay the taxes unless the Tax Court tells you you have to pay the taxes at a later date. So, I am glad that we are modernizing the Tax Court, and also are going to be nominating several extra judges the court.

Thank you, Mr. Chairman.

The Chairman. Thank you.

[The prepared statement of Senator Hatch appears in the appendix.]

Senator Lott. Mr. Chairman?

The Chairman. Yes.

Senator Lott. I do not know how you wish to proceed, but if I could just be heard briefly, just in general.

The Chairman. All right.

OPENING STATEMENT OF HON. TRENT LOTT, A U.S. SENATOR FROM MISSISSIPPI

Senator Lott. I just want to take a minute to commend you and the Ranking Member for going forward with this. You can debate about the substance of it, and I am sure there will be some amendments. But I think it is so important for the committee to not fall behind the curve.

The Energy Committee is going to be working on this. I think this is one of the most important issues we face as a Nation, the need for national energy policy. Obviously, the tax section of the energy bill is critical.

I wanted, right out of the gate, to say I appreciate the fact that you all went ahead and scheduled it and are moving forward, when there are a lot of other things that you also are working on. Thank you.

The Chairman. Thank you.

I would now like to call up the Energy Tax Incentive Act. I think, in the process of doing that, I need to thank Senator Domenici, Senator Bingaman, and also Senator Baucus for their leadership on this package of tax incentives for the production and conservation of energy.

Committee staff had an opportunity, through the 48

hours of notice on this bill and the time to offer amendments, to work their way through amendments last night, and they prepared a modification of the Chairman's mark.

We believe the modification addresses priorities of the members in a balanced and efficient way. We have a dedicated staff at the table that can answer any questions members might have.

Elizabeth Paris, of the Republican staff, Matt Jones of the Democratic staff, Tom Barthold of the Joint Tax staff. I thank all of you for your hard work and being up late last night getting prepared for this. I would as, Mr. Barthold, if you would briefly describe modifications in my mark.

Mr. Barthold. Thank you, Mr. Chairman. You have before you Joint Committee documents, JCX 28 and 29. JCX 28 is a description of the modification to the Chairman's mark. 29 is the revenue table which shows the Chairman's mark as modified, the revenue effects of that.

I will briefly highlight some of the changes that are described in JCX 28. The first modification is to the provision relating to Section 45 in the Chairman's mark. The Chairman's mark had provided a credit rate after 2003 of 1.5 cents per kilowatt hour. The modification would change that credit rate to 1.8 cents per kilowatt hour.

Senator Nickles. Before you move on, the Chairman's mark was 1.5. It goes up to 1.8. So it increases the cost of this, what, from 2.1 something to 2.6?

Mr. Barthold. Yes, that seems to be the change. It is 2.3 to 2.6, so roughly $300 million, Senator.

Senator Nickles. Now, correct me if I am wrong, but the price of electricity is about three cents, wholesale?

Mr. Barthold. Four cents, three cents. It varies by region of the country.

Senator Nickles. Well, Mr. Chairman, I do not know why you made this change, but this is a big subsidy, about 50 or 60 percent of the price of electricity. It distorts markets. It is a big subsidy.

Let me ask you a question. Does this apply to existing facilities or only new facilities?

Mr. Barthold. The 1.8 cent rate, which would be frozen for all production by facilities placed in service after the date of enactment. As you know, under current law the credit rate is indexed for inflation.

Facilities that are pre-effective data facilities that were placed in service with the understanding that they would get an indexed credit would continue to receive a credit that is indexed.

We have projected, given modest inflation rates, that the country is fortunately experiencing, that perhaps by

around the end of the budget period the credit amount might be 2 cents per kilowatt hour. That is for existing facilities.

Senator Nickles. I thought existing facilities had that credit for a specific period of time.

Mr. Barthold. Ten years.

Senator Nickles. Ten years. Are you extending that 10 years?

Mr. Barthold. No. It is 10 years for any facility placed in service. But a facility placed in service last year, for example, would be receiving 1.8 cents per kilowatt hour for production last year, and probably this year, but 9 years from now they might be receiving 2 cents per kilowatt hour.

But for facilities placed in service after the date of enactment, under the Chairman's mark, as modified, all production for the 10-year life of the credit would be at a rate of 1.8 cents per kilowatt hour.

Senator Nickles. Mr. Chairman, I am not a big fan of the credit, and I am probably less a fan at 1.8 cents indexed than I am at 1.5 cents. So I was at least hopeful that we were not going to continue, I think, distorting markets. But, anyway, please proceed with your explanation.

Mr. Barthold. Senator, I may have confused you a

little bit. The 1.8 cents for facilities placed in service after the date of enactment is not indexed.

Senator Nickles. I understand. All right.

The Chairman. It is not indexed.

Senator Nickles. I would be more pleased if it were 1.5 cents and not indexed. [Laughter]. I mean, I think we are grossly distorting markets. People think that this energy is not free. When you have a subsidy that is as much as 60 percent of the wholesale cost of power, that is a big distortion. I will let it go, Mr. Chairman.

Senator Breaux. Mr. Chairman?

The Chairman. Senator Breaux has asked for the floor.

Senator Breaux. I would just mention, we have got tax credits for chicken poop. I mean, that distorts markets.

Senator Nickles. You may have an amendment or two on some of these as well.

The Chairman. All right. Would you proceed?

Mr. Barthold. Yes. The second provision to the Chairman's mark relates to the provisions of affecting alternative motor vehicles and alternative fuel incentives.

In general, the modification to the Chairman's mark

restores the Clear Act rates of credit. I will not detail all of the changes we have included in our document, the credit rate amounts that were changed in the Chairman's modification. But, in general, it restores all credit rates to those rates that were in the Clear Act. I would be happy to describe any particular change, if that would be helpful.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. I am trying to better understand this. So if you have a vehicle in excess of 26,000 pounds, the credit amount, if it is a fuel cell vehicle, is $40,000?

Mr. Barthold. The credit, as in the Chairman's mark, actually has two components, Senator. There is a base credit amount and then there is a credit amount for early adoption of the credit or, in some cases, for meeting fuel economy standards. But for fuel cell vehicles, yes, you are correct. There is just a base credit amount of $40,000.

Senator Nickles. Now, I do not have a clue. How much would a vehicle that weighs 26,000 pounds cost?

Mr. Barthold. This can include things like Greyhound buses an the like that would be over a quarter million dollars.

Senator Hatch. About $300,000.

Senator Nickles. So if it has fuel cells, we are going to give them a credit. Now, if it is a school bus, they do not pay taxes.

Mr. Barthold. Well, the Chairman's mark provides that tax-exempt organizations, such as an exempt organization or a State or local government, may purchase qualified vehicles and permit the seller of the vehicle to claim credits in lieu of the buyer. In general, it is the buyer that is claiming these credits.

Senator Hatch. Could I add something there, Mr. Chairman?

The Chairman. Senator Hatch has the floor.

Senator Hatch. I will let you know, tax credits are needed for early market introduction of new technologies to accelerate consumer acceptance, and of course provide a volume base for sustainable development.

Consumers must overcome incremental costs, which are partially offset by tax credits here, as well as limited infrastructure, that is, alternative fueled vehicles for them, lack of familiarity regarding maintenance and repair.

Now, increased acceptance by consumers will lead to larger scale production, which will lead to lower prices and the credits will no longer be needed. But, more

importantly, we will be saving energy and we will be making our country less energy dependent. So, that is the reason for these tax credits.

The Chairman. All right. Would you proceed, Mr. Barthold?

Mr. Barthold. Yes. The third change to the Chairman's mark is a minor change relating to residential energy-efficient property. The Chairman's modification provides that oil and propane furnaces and water heaters meeting certain efficiency standards would also qualify for the same credit as natural gas appliances in the Chairman's mark.

The fourth change relates to the so-called Smart Meters for monitoring energy usage, and it is really by nature of a clarification in terms of the data that the meter is supposed to report to the taxpayer in order to be a qualifying meter.

The fifth change to the Chairman's mark affects the provisions on advanced clean coal technology, both the investment credits and the production credits.

In short, the modification provides that fluidized bed combustion technology would be a qualifying advanced clean coal technology, and the Chairman's modification changes the national allocation of the credit from less than or equal to 3,500 megawatts of electricity capacity

to 4,000 megawatts of capacity.

The Chairman's modification also changes the amortization provision for geological and geophysical expenditures. The Chairman's mark had provided for four-year amortization. The modification would reduce the amortization period to two years.

The Chairman. That would be an example of our distorting the market in Senator Nickles' favor. [Laughter].

Senator Nickles. I would not quite agree with that.

The Chairman. All right. You do not have to. I did not agree with your statement about our distortions. [Laughter]. Would you proceed, Mr. Barthold?

Mr. Barthold. The next modification relates to the Section 29 alternative, non-conventional fuels production credit. It provides for a $3 credit for certain fuels that the original market provided a $2 credit for.

Senator Nickles. Wait a minute. Yesterday's market, you had it at $2 and you went to $3 for Section 29?

Mr. Barthold. For shale, tar sands, gas from geopressurized brine, Devonian shale, coal seams-type formation, biomass, the Chairman's mark had provided a $2, non-indexed credit and the modification makes that $3. That is, for the most part, where the committee's

bill was in the last Congress.

Senator Nickles. I will have an amendment dealing with that in a minute, Mr. Chairman.

The Chairman. Proceed, Mr. Barthold.

Mr. Barthold. In addition, the Chairman's modification has several new provisions. One, the ethanol fuels tax credit provides that, in lieu of the present law reduced excise tax rates on gasoline, that an excise tax credit would be provided and the credit could be taken against excise tax liability, also coordinated with the existing income tax credit.

In addition, this proposal eliminates the requirement that the 2.5 cents and 2.8 cents per gallon of excise taxes are currently retained in the general fund, so that the full amount of tax is credited to the Highway Trust Fund.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. To make sure I understand this, present law is, 2.8 cents of ethanol tax goes to the general revenue fund, not to the Highway Trust Fund. You have that money going to the Highway Trust Fund. Is that correct?

Mr. Barthold. Yes. The motor fuels tax would now go to the Highway Trust Fund.

Senator Nickles. I do not know why it was ever going to general revenue fund, but I concur with that.

The other part of the proposal would have general revenue fund making up the--what is it? Right now, all gasoline pays 18.3 cents, ethanol pays, what, 13 cents? Gasohol pays 13.

Mr. Barthold. Yes.

Senator Nickles. So you would have general revenue funds making up the 5.3 cents per gallon difference to the Highway Trust Fund. Is that correct?

Ms. Paris. Senator, the difference would be, in this proposal, is that right now, 18.4 cents is the amount of tax collected on gasoline and paid in on the return. Only 13.2 cents, that would be the smallest amount--it actually can ramp up to about 15.6 cents--is paid in on the current return. We never collect the money right now.

What this changes it to, is that a full 18.4 will be collected on every gallon of everything, and an excise tax credit can be taken for the number of gallons that are actually blended with gasoline. So the difference is, currently, we never collect the money. Now we will collect the money.

Senator Nickles. You mean, the gasohol money is not collected?

Ms. Paris. The primary way of blending ethanol is above-the-rack, and that money is not collected. It is a tax of excise tax exemption. The gasoline is at 18.4 cents, and you have an exemption between the spread of 13.2. That money never comes to the Treasury, ever. What this proposal does, is it says that everybody pays 18.4 on everything.

Senator Nickles. Going into the Highway Trust Fund.

Ms. Paris. Going to the U.S. Treasury. Everybody pays 18.4 on everything. The regular mechanism in the Internal Revenue Code currently, is everything comes to the general fund, it is paid over to the Highway Trust Fund.

Under the current law, we never get the money. Now we are saying you have to put the money in. Everybody pays 18.4, whether it is ethanol or gasoline, and then they can file for a credit on the same excise tax return for the number of gallons that they actually purchase.

This is a combination of a simplification, this is a combination of some fraud issues that we are trying to address, because there is a provision that if you blend below the rack with a promise to blend later, you only have to pay 14.4 cents in gasoline tax. That is one of the provisions that we are taking care of. Now everybody pays 18.4 no matter what they intend to do with it.

Senator Nickles. And the Highway Trust Fund will be credited for the 18.4.

Ms. Paris. Yes, sir.

Mr. Barthold. The Highway Trust Fund will get its 18.3 cents and the lust fund will get its one-tenth of one cent.

Senator Nickles. Yes. So the Highway Trust Fund is going to come out much better.

Ms. Paris. Correct. The estimate on the modified mark is that there will be a $415 million revenue raiser because of this change.

Senator Nickles. Well, the 2.8 cents credit, if I remember from wrestling with this issue on the budget a week ago, was like 600 or 700----

Ms. Paris. I am sorry, Senator. I stepped on your statement. I apologize. That is the amount of the money that is being transferred. This is $415 million worth of new money we have never collected before.

Senator Nickles. All right. You are talking about catching some inefficiencies.

Mr. Barthold. Fraud.

Ms. Paris. Fraud.

Senator Nickles. In the past, the trust fund did not receive the 5 cents on ethanol/gasohol, the blend.

Ms. Paris. And the general fund did not receive the

5 cents.

Senator Nickles. And the general fund did not. Now we are saying, general fund, you are not going to receive it, but since the Highway Trust Fund is going to receive it, general fund will be minus that 5 cents per gallon.

There is going to be a tax credit for the producers of ethanol that in the past--because the gasoline trust fund is going to be credited with 18.4 cents or 18.3 and there is a tax credit, so general revenue is going to be making up that difference for that 5.3 cents of ethanol blend.

Ms. Paris. But under this proposal, what had originally been requested by the highway community was that the general fund make up the 5.2 cents on money they had never collected. Now in this situation they know they will be collecting it and that will be adjusted subject to future auditable trails on gallons actually purchased of ethanol. Part of the problem was, there is strong evidence in our fuel fraud hearings that Senator Grassley and Senator Baucus had and they are not----

Senator Nickles. I am all for cleaning up the fraud.

Ms. Paris. Right.

Senator Nickles. I just want to make sure I am understanding correctly, that the general fund is going

to be making up the balance on that 5.3 cents.

Ms. Paris. Yes, sir.

Senator Nickles. That is correct?

Ms. Paris. The general fund will receive the 5.3 and it will transfer it to the Highway Trust Fund. Yes, sir.

Senator Nickles. All right. I just wanted to make sure that we were aware of that, because we have a problem in highways and everybody needs to know it. We are not getting nearly enough money into the highway funds to build the highways that Congress and others are demanding, and a lot of people are demanding a lot of general revenue fund money to pay for it, which we have not done in the past because highways have been built by user fees.

I think that is the right way to build highways. We will have to debate whether the user fees are high enough. But, in effect, what we have here, is we offer ethanol a 5.3 cent advantage for producing ethanol, and now we are saying that that advantage is going to be basically from general revenues transferred into the Highway Trust Fund. That is a significant change, and we ought to at least acknowledge it.

Ms. Paris. Senator, I misspoke. It is currently 5.2 cents, and it is in the President's proposal and in

this proposal that is scaled down to 5.1, and then it stays steady.

Senator Nickles. Ms. Olson, did the administration request that general revenues be supplementing the Highway Trust Fund to make up the balance?

Ms. Olson. No, we did not.

Senator Nickles. I was just wondering. Thank you.

The Chairman. Mr. Barthold, continue, please. How much more do you have, please?

Mr. Barthold. Just a very little bit.

The Chairman. All right.

Mr. Barthold. The next proposal modifies the income and excise tax rules for ETBE to conform to the provision that we just discussed. There is then a provision which creates a safe harbor exception under tax-exempt bond rules to permit municipal gas utilities to enter into long-term purchase contracts and finance those contracts with tax-exempt bonds.

The next proposal involves inversion legislation and it is substantially similar to that that was reported by this committee last year. It has four parts that I will very briefly describe.

For the normal case, the full inverter, they are treated as a U.S. corporation. For certain companies that are between 50 and 80 percent owned, it would not

permit toll charges to be offset by net operating losses or foreign tax credits. There are some enhanced disclosure requirements and tightened anti-earnings stripping legislation.

There is also a clarification relating to reinsurance and application of 482. Lastly, an excise tax on stock at a rate of 20 percent on stock compensation of certain corporate managers and insiders in inverted corporations. As I said, this is substantially similar to the legislation reported by the committee last year.

I skipped one item in the document. The modification of the mark also changes slightly the treatment of duty-free sales of gasoline.

Senator Nickles. Can I ask you a question on that?

Mr. Barthold. Certainly.

Senator Nickles. Since I am interested in gasoline for some unknown reason. Does that have the same effect? Are we doing ETB in the same way that we are with gasohol?

Mr. Barthold. The provision on ETBE gives it the same treatment as ethanol, yes.

Senator Nickles. So basically we are going to have general revenue subsidize that differential.

Mr. Barthold. It works the same way.

Senator Nickles. How much money does that cost?

Mr. Barthold. It was a negligible effect. ETBE is not significant in the market at present.

The Chairman. Are you done, then?

Mr. Barthold. The last two items are provisions relating to Alaskan natural gas. The first item provides a production credit for gas that would enter a pipeline in Alaska. The second item provides for a seven-year life for Alaska pipeline property, but only if the property is placed in service after the year 2014.

The Chairman. All right.

Senator Nickles. Mr. Chairman?

Mr. Barthold. I was reminded, I forgot, the Chairman's modification also extends the statutory authorization for IRS user fees through September 30 of 2013.

The Chairman. Senator Nickles, you had a question?

Senator Nickles. Mr. Chairman, I am interested in the Alaska provision. So you have only two Alaska provisions? Because I have seen a lot of different provisions floating around in the last couple of days.

Mr. Barthold. The Chairman's modification has the credit for gas entering a pipeline and seven-year deprecation for pipeline property.

Senator Nickles. I understand the seven. The credit. Is that 52 cents?

Mr. Barthold. Yes, it is, Senator. It is 52 cents, indexed for inflation. That is 52 cents per million BTU of gas. It is phased out as well head prices rise above 83 cents per million BTU.

The Chairman. Can we proceed now?

Senator Nickles. Can I ask another question?

The Chairman. You can ask one more question.

Senator Nickles. Only one?

The Chairman. No, you can ask all you want to ask.

Senator Hatch. But we hope it is only one. [Laughter].

Senator Nickles. At one point there was discussion of having a floor price for gas at 325, and having a tax credit differential. Is that in the Chairman's mark?

Mr. Barthold. The proposal on the credit for Alaska natural gas does act in a manner similar to a floor, because you only receive the credit if the price is below $1.35 per million BTU.

Senator Nickles. My question is, you are not doing both.

Mr. Barthold. Correct.

Senator Nickles. There was one provision that said we would have a credit price below 325, and that is not in the Chairman's mark, but it was discussed. I am just trying to figure out what is in the mark.

Mr. Barthold. That is correct.

Senator Nickles. Thank you for answering that question.

The Chairman. All right.

Now I would like to have the committee make a decision on this modification. Without objection, I would modify----

Senator Baucus. Mr. Chairman?

Senator Kyl. Mr. Chairman? Excuse me, Mr. Chairman?

The Chairman. All right. Yes, Senator Kyl?

Senator Kyl. I did not understand. Were you proposing to modify with the 1.5 to 1.8 kilowatt per hour?

The Chairman. Yes.

Senator Kyl. I object, if that is what you were proposing.

The Chairman. My parliamentarian says that the Chairman has the right to modify. You obviously would have the right to amend whatever you want to of that modification.

Senator Kyl. Thank you, Mr. Chairman. I just wanted to confirm that because, since it was not filed until late, no amendment was filed in opposite. If I can do that, then that would be fine. Thank you.

The Chairman. All right.

Senator Lincoln. Mr. Chairman?

The Chairman. The Senator from Arkansas?

Senator Lincoln. I just wanted to see if this is the appropriate time for me to ask of the counsel a question on my amendment. Is this the appropriate time?

The Chairman. If it is not in the mark, I would like to get the modification made. The Chairman modifies his mark.

Now we have the original bill, as modified by my mark, before us. Now the question is, are there any amendments? It would be appropriate for the Senator from Arkansas to ask a question at this point on any amendment you have, or any part of the bill you want to. Proceed.

Senator Lincoln. I just want to make sure that, in the Chairman's modification, there was an inclusion on the Section 29.

Ms. Paris. It needs to be offered as an amendment.

Senator Lincoln. So we will offer that as an amendment.

Is this an appropriate time to ask the staff about the scoring on the Section 45 and the Section 29?

The Chairman. Well, it would be appropriate for you to ask. But I wonder if I cannot help you out at this point. Well, would you comment, Ms. Olson? Proceed to

ask, please.

Senator Lincoln. On the two amendments that I had offered, and I think we reviewed them, and I want to say how much I appreciate the staff's attention, because they have worked long and hard and I am very appreciative of what we have agreed to do on the Section 29, particularly on the landfill gas.

My question is, and maybe during the course of the mark-up, we could get an answer or perhaps some kind of an idea of the difference in the cost, particularly, as I asked earlier, from the President's proposal, because the President's proposal has been supportive of our landfill gas initiatives, the difference in what it was scored last year and the scoring for this year, and if there is any idea in terms of what the scoring might be with the change in the definition that we have agreed to on Section 29.

It was my understanding that, with the changing of that definition and the securing of the definition in Section 9, it gives you a greater ability to give a scoring on the Section 45 amendment request that we have made.

Ms. Paris. Senator Lincoln, if I could interject.

Senator Lincoln. Sure.

Ms. Paris. The change of the definition needs to be

explained by Ms. Olson from the President's proposal, and it needs to be offered as an amendment.

Senator Lincoln. Once she defines that or describes that, then if I could just ask for the scoring on the municipal solid waste and on the Section 45, that would be great. Thank you.

The Chairman. Senator Lincoln, Senator Hatch would like to ask you a question.

Senator Lincoln. Yes, sir.

Senator Hatch. On your consideration there, how much additional power would come online if we were to provide an adequate tax credit to fund LFG projects?

Senator Lincoln. Well, I thank the Senator for his question, and certainly for his support. He has been tremendous as an advocate, a friend, and a colleague in working on this. According to the EPA data, 360 landfill gas projections nationwide currently produce 1,200 megawatts.

Furthermore, EPA has estimated that there are 600 to 700 additional landfill gas-to-energy projects that could be constructed nationwide with sufficient economic incentives. The landfill gas industry has estimated that an average of 55 new landfill gas projects each year could be brought online. So, I think it is a tremendous area of untapped energy source where we can really

encourage our communities to do a great deal.

Senator Hatch. Thank you.

Senator Lincoln. Thank you.

The Chairman. All right. Are there any further amendments? Senator Bingaman? Keep raising your hands, but let us go to one amendment here.

Senator Lott. And I would like to come after, whatever the order is.

Senator Bingaman. Mr. Chairman, let me ask. I filed an amendment, number one. I am not sure of the number of it on your list of amendments here. I think it is number 54 on your list related to research, payment for energy-related research made by qualified companies to small businesses, universities, and federal laboratories, making them eligible as expenses for the existing research credits that are already out there.

I would want to modify the amendment to limit it to the period up just through June 30 when the regular R&D credit expires, and also modify it to be sure that the credit would only be available in circumstances against income that has not been able to take advantage of any other credit, so that there is not a double dipping going on.

So, I think the staff is able to make those modifications, and I would offer that amendment with

those modifications, if it is acceptable.

The Chairman. Would that include a modification of no other federal funds being involved as well?

Senator Bingaman. No other federal funds.

The Chairman. Other subsidies, research subsidies, things of that nature.

Senator Bingaman. Right. Yes.

The Chairman. All right.

Senator Bingaman. So that there would be no other subsidy, so that there is not a double dipping going on by any companies.

The Chairman. Under those circumstances, we can accept the amendment.

Can I ask my Republican friends who want to offer amendments, I think that I have had an understanding with Senator Baucus that he could offer a series of amendments first, and I think I should give differential to that. Then we will be able to take care of everybody's amendment. I mean, we will be able to entertain everybody's amendment.

Senator Baucus. Well, thank you very much, Mr. Chairman. I thank my colleagues. Essentially, these are a couple, three amendments I think should be addressed and brought up earlier, and then we can deal with the other amendments later.

The real question, is the offsets. This bill is not offset. Last year's bill was not offset, but frankly I believe that with the much tighter budget problems we are facing this year, and with the proposed tax cut that will be later enacted along with other provisions, to say nothing of the additional cost of the war, that we should pay for these provisions. The provisions in this bill should be offset. I have an amendment, called Amendment 9.

The Chairman. All right. Amendment 29 is before us.

Senator Baucus. This is by Senator Graham of Florida and myself. It is to restore the taxes used to finance the Super Fund Trust Fund.

Mr. Chairman, this is pretty simple, and I think it is pretty basic and it is extremely important. The Super Fund Tax expired in 1995. Since then, the amount of dollars in the trust fund has declined precipitously. It makes sense. The tax expired in 1995, and there are a lot of abuses of the Super Fund Trust Fund, and the balance has declined.

It has declined from a high of $3.8 billion in 1996. Again, the tax expired in 1995. The current balance is $159 million. That is the balance projected by the President in his 2004 budget, from $3.8 billion to down

to $159 million.

Now, the administration has said that they will make up the difference in general revenue. That is, general revenue will pay for those clean-ups that the principal parties themselves do not clean up.

Under the law, as you know, the principal party, the person who caused the pollution, is the party that must clean up. If that person cannot clean up, or if they are something called orphan sites and you cannot find the polluter who actually caused the problem, then the Super Fund pays for the clean-up.

It is not that there are not a number of sites. There are a large number of sites. In fact, as of this year there are 1,230 national priority sites on the NPL list. The number is not declining. If anything, it is growing. So on the one hand, we are not providing the dollars any more because the Super Fund Trust expired in 1995, and there are not many dollars left.

On the other hand, the number of sites is not decreasing. They are still there. The administration has said that they will make up the difference with general revenue. We all know how iffy general revenue is.

Will Congress add general revenue to the Super Fund clean-up or not? As budget conditions get tighter all

the time, my guess is that it is less likely that, in fact, the Appropriations Committee is going to find the dollars for these Super Fund sites.

What is the effect of that? That passes the costs on to the States. That means the States have to clean up where Uncle Sam is not living up to its earlier promise when we passed Super Fund legislation years ago to clean up.

I also believe there is a very important principal here. The question is, who should pay for clean-up when the responsible party cannot be found, or has gone bankrupt, or is just not there? Who should pay? Should it be the general taxpayers that pay or should it be the polluter who should pay? Should it be the industry, generally, that causes most of this pollution that should pay?

The principle, I think, that makes the most sense, is the polluters should pay. If somebody causes a Super Fund site, generally, that person should have to be responsible for cleaning up, not the general taxpayer. Not somebody in another part of the country, a general taxpayer, who has had nothing to do with causing the pollution. That is just the basic principle of Super Fund legislation.

Now, as I said earlier, sometimes you cannot find the

polluter, or for whatever reason the polluter does not clean up and Uncle Sam has to bring an action forcing, in effect, the polluter to clean up, or the polluter cannot be found, or whatnot, and the fund itself will pay for the clean-up.

The fund is currently financed by various taxes on the oil and gas industry, the Super Fund tax. It is a little complicated. The reason is, that is the industry that generally causes the pollution. I have forgotten all who are taxed, but there was little dispute as to whether or not these are the industries that generally cause most of the pollution. That was not in dispute.

I think basically the administration has let this tax expire. I do not know why. But I think it is a false promise, an iffy promise, to say that general revenue is going to be there for these clean-ups, and will probably be pushed back on the States.

The Joint Tax has estimated that this provision, that is, to reinstate the Super Fund tax, will be enough revenue to offset the provisions in this bill. I think that is what we should do, given the geopolitical conditions, given all the additional constraints and all the additional demands on federal dollars, including demands that we reduce taxes.

Let us not forget. The CBO just recently said, with

dynamic scoring, with macro analysis, there is not going to be this huge dividend that some, earlier, thought would be the case with big tax cuts. CBO is very clear in saying that is not the case. We have got to rely on CBO. We have always relied on CBO. Others may have other theories, but CBO says that that is not the case. So, I would strongly urge that this be enacted.

The Chairman. Well, Senator Baucus----

Senator Baucus. And in the spirit of bipartisanship, Mr. Chairman.

The Chairman. I hope that I can convince you that the bipartisanship of a year ago would be the bipartisanship that we ought to continue this year on this specific issue and not anything broader than just your amendment at this point.

That is, I would like to have my friends think of the big picture that we have here. This committee, with this bill and other bills we have already done, is trying to complete the unfinished business of last session. Under Senator Baucus' leadership and Chairmanship, we produced four pieces of bipartisan tax legislation.

They were the Military bill, the CARE Act, the Pension Reform bill, and the Energy legislation. We have already produced two pieces from that unfinished list. They are the Military bill and the CARE Act. Obviously,

I thank Senator Baucus for working with us in a cooperative way to get that done.

The substance of today's bill, likewise, reflects bipartisan agreement. Obviously, we are divided on a very important subject of whether or not the bill should be offset. It takes both sides to make this place work.

Now the substance of this bill reflects the priorities for nearly all of us on this committee. I am kind of disappointed we are getting into this issue of offsetting. The budget resolution that was marked up in the committee included in its revenue assumptions room for tax relief for a package of tax incentives like we have in this bill.

The number is the same as the score in last year's Finance Committee bill. Keep in mind that last year's committee action did not rely on a budget resolution. In other words, we reported an un-offsetted bill without room in the budget.

The only other tax legislative items with room in this year's resolution were the growth package and extension of the current law provisions from the 2001 bipartisan Tax Relief bill. It is for this reason that we have asked members to offset amendments in excess of the amount that is in the budget resolution. If we do not have the budget resolution numbers in the conference

agreement on the budget, we will have to reexamine the issue at that time and offset if necessary.

So I think that we are trying to adhere in this legislation to the same policies and principles that were adopted with respect to each item of carry-over business from the 107th Congress, and along that line.

We did, in fact, offset the Military Tax bill and the CARE bill in a similar fashion to last year. The energy bill, however, was the only piece of tax legislation voted out of the Finance Committee last year without offsets. So, I am simply asking for the same courtesy with respect to this legislation as I afforded Chairman Baucus during the 107th Congress.

Now, some may argue the deficit is worse--that is the point that the distinguished Ranking Member made--so that somehow changes the picture for formerly un-offset legislation. Certainly the deficit is worse, but I do not see any concerns on the spending side when it comes to the deficit. If I saw spending proposals that were offset with spending cuts, then I would be more sympathetic to a turn-around that we are witnessing today. It is kind of inconsistent.

On the other hand, when we have consensus policy on the spending side, seldom is it offset with savings from the spending side. I think that we ought to follow the

consensus policy on the tax side. Yet, it is here where offsets then are being pushed. Again, it seems wholly inconsistent to me, and it is an inconsistency from where we were last year.

So I would ask members of this committee, I would even hope for withdrawal of the amendment. If it cannot be withdrawn, I would hope that we could defeat it.

Senator Hatch. Vote.

Senator Baucus. I am ready to vote, Mr. Chairman.

The Chairman. All right. The Clerk will call the roll.

The Clerk. Mr. Hatch?

Senator Hatch. No.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

Senator Lott. No.

The Clerk. Ms. Snowe?

Senator Snowe. Aye.

The Clerk. Mr. Kyl?

Senator Kyl. No.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

Senator Santorum. No.

The Clerk. Mr. Frist?
The Chairman. No, by proxy.
The Clerk. Mr. Smith?
Senator Smith. No.
The Clerk. Mr. Bunning?
Senator Bunning. No.
The Clerk. Mr. Baucus?
Senator Baucus. Aye.
The Clerk. Mr. Rockefeller?
Senator Rockefeller. Aye.
The Clerk. Mr. Daschle?
Senator Daschle. Aye.
The Clerk. Mr. Breaux?
Senator Breaux. No.
The Clerk. Mr. Conrad?
Senator Conrad. Aye.
The Clerk. Mr. Graham?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Jeffords?
Senator Jeffords. Aye.
The Clerk. Mr. Bingaman?
Senator Bingaman. Aye.
The Clerk. Mr. Kerry?
Senator Thomas. Aye, by proxy.
The Clerk. Mrs. Lincoln?

Senator Lincoln. No.

The Clerk. Mr. Chairman?

The Chairman. No.

The Clerk. Mr. Chairman, the tally is 9 ayes, 12 nays.

The Chairman. By that vote, the amendment is defeated.

I call on Senator Baucus.

Senator Baucus. Mr. Chairman, I have one more amendment. It is roughly a similar subject, that is, offsets. I call up my Amendment #28. This is co-sponsors by Senators Rockefeller, Daschle, Breaux, Conrad, Graham, Jeffords, Bingaman, Kerry, and Lincoln.

Essentially, we would use the Tax Shelter Transparency and Enforcement Act of 2003, that is, the tax shelter legislation that we passed out of this committee, to pay for this bill. My arguments are very similar to the arguments of the last amendment.

Joint Tax has scored this at $14 billion, which essentially pays for this. We will have to find some more. But a couple other points here. We have passed this legislation already overwhelmingly. We passed it with respect to the CARE Act.

Second, our committee's Enron hearings showed the need for this legislation, and the need for this

legislation to pass quickly. Lots of companies, accountants, and some lawyers are doing deals that frankly are designed to not pay taxes in a way that most American taxpayers would find totally repugnant.

Evidence in that hearing was overwhelming. I think it is imperative, therefore, that we get the tax shelter legislation passed so that many of these transactions that might otherwise occur in the future do not. It is only the right thing to do. Beyond that, the President needs this legislation, the tax shelter legislation, on his desk so that the appropriate law enforcement officials have the penalties that are needed to thwart some of these transactions to prevent them from occurring.

Without the penalties, without the enforcement, without greater enforcement powers, it is going to be very difficult for us just to stand here and say, do not do this. It is just not going to work. That is, people are going to proceed anyway.

So I would encourage the members of this committee to adopt this shelter legislation. It pays for the energy bill before us. We are at war. We need the offset. The budget situation is getting worse, not better. We are borrowing to pay for this bill right now and I feel that we should not pass greater borrowing off onto our

children, but rather pay for this bill in a way that we have all voted for already.

The Chairman. Senator Santorum?

Senator Santorum. Thank you, Mr. Chairman. As you know, this is the offset that we used for the CARE Act which is now on the floor. I think we are very close to getting the EC on that and passing it. I do not know how many times we use offsets around here.

Senator Baucus. Lots.

Senator Santorum. But I suspect that one that is going to hopefully pass the Senate here in the next week or so would not be used again in this fashion. I think we have good bipartisan agreement now and we should move forward. That is probably the quickest way to get it to the President's desk.

Senator Baucus. Well, I might say, Mr. Chairman, if we voted for this before, we ought to vote for it again. Just because it is on the CARE Act does not mean it is a bad idea now. As you all know, basically it is a race to the President's desk, these offsets.

Frankly, if the offset is on the CARE bill and the President signs it into law, then this offset no longer lies as unavailable. It is whoever who gets it first. So I think, if we passed it once, we might as well pass it again and see who gets there first.

The Chairman. I would ask my colleagues to vote against this amendment for reasons I have already given, plus associating myself with the remarks from the Senator from Pennsylvania. I will call for the ayes and nays.

Would the Clerk call the roll?

The Clerk. Mr. Hatch?

Senator Hatch. No.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

Senator Lott. No.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

Senator Kyl. No.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

Senator Santorum. No.

The Clerk. Mr. Frist?

The Chairman. No, by proxy.

The Clerk. Mr. Smith?

Senator Smith. No.

The Clerk. Mr. Bunning?

Senator Bunning. No.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Rockefeller?

Senator Rockefeller. Aye.

The Clerk. Mr. Daschle?

Senator Daschle. Aye.

The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Conrad?

Senator Conrad. Aye.

The Clerk. Mr. Graham?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Jeffords?

Senator Jeffords. Aye.

The Clerk. Mr. Bingaman?

Senator Bingaman. Aye.

The Clerk. Mr. Kerry?

Senator Baucus. Aye, by proxy.

The Clerk. Mrs. Lincoln?

Senator Lincoln. Aye.

The Chairman. Mr. Chairman, no.

The Clerk. The Chairman votes no. Mr. Chairman, the tally is 10 ayes, 11 nays.

The Chairman. The amendment is lost. I think what we will do on amendments here, since we have had Democrat

amendments, I will go to Senator Lott. Then if a Democrat has an amendment, we will go to the Democrat side, then back this way.

Senator Lott?

Senator Lott. Mr. Chairman, I do have an amendment that is truly bipartisan and is one of very fundamental fairness. This is identified as #9, Lott Amendment #1, but listed #9 on the list of amendments.

This amendment would amend the Internal Revenue Code of 1986 to repeal the 4.3 cent motor fuel excise taxes on railroads and inland waterway transportation, which remain in the general fund of the Treasury.

Everybody knows the history of this and I will not go into great detail, but a little bit of the history I think is justifiable. The deficit reduction fuel excise taxes were initially imposed on highway users, including trucks and the railroads, as a result of the 1999 Reconciliation Act. They were increased and expanded to include the inland waterway operators in 1993, and the commercial airlines in 1995.

In 1997, trucks and commercial airlines were relieved of their obligation to pay deficit reduction taxes into the general fund of the Treasury. Now, railroads and inland waterway operators are the only remaining transportation industries that continue to pay taxes

explicitly devoted to this proposition.

I do think this is a fundamental fairness question. Other parts of the economy of people that were paying into this tax, the 4.3 tax, had been pulled out, but the railroad and waterway operators have not been.

They clearly are an important part of our transportation system in America. They are struggling, in many ways. This is something that is not new. We have been talking about it, thinking about it, saying we ought to do it for a long time. I know that almost everybody on this committee has said that at one time or another. In fact, it was included in the House energy bill last year, which ultimately died, of course, in conference.

We do have co-sponsors, to include the principal co-sponsor, Senator Breaux, Senator Bunning, Senator Smith, Senator Thomas, Senator Lincoln, Senator Santorum, Snowe, and Hatch, as well as other Senators that are not a member of this committee.

There were rumors about what the cost impact would be. I thought they were excessive, so I did write to the Joint Taxation Committee and got the scoring, and it scored not at $4 or $5 billion, or even $2 billion, but $1.69 billion. So, it was much less than what some people had projected it would be.

I do have offsets that are available. I want to emphasize that on offsets you want to make sure they are legitimate and have not been used repeatedly, and that the Chairman and Ranking Member are comfortable with it.

So we do have offsets for this provision, but we will be glad to work with the Chairman and the Ranking Member to make sure that these are the best possible offsets.

I might also say that a lot of you are interested in Amtrak and are concerned about Amtrak. Amtrak is also impacted by this. In a time where we are struggling mightily to help find a way for them to keep staying in business, this would give some relief to that. So, I urge that we accept this and that we all finally do what we have been saying we wanted to do.

Senator Breaux. Mr. Chairman?

The Chairman. All right. I will call on you, then I will speak after you are done. Go ahead, Senator Breaux.

Senator Breaux. Thank you, Mr. Chairman. I would commend the Senator from Mississippi. I am a co-sponsor of this amendment. We had the 4.3 cent gasoline tax, fuel tax. Then we repealed it off of cars and automobiles, and it is still on barges and railroads. When you have a transportation tax that covers all segments of transportation, then it is fair and

equitable.

But if you repeal it for some and leave it on for others, then the equity just goes right out the window and you make it more difficult for one form of transportation to compete because they are paying 4.3 cents more than the rest of the industries are paying for transporting goods and services in this country.

So I think the repeal of this and paying for it is the right thing to do. Some have suggested that we consider saying, all right, put it into a railroad trust fund. Well, there is no railroad trust fund. This committee does not have jurisdiction over it if one is to be created.

The Environment and Public Works Committee would be involved in trying to maybe create a trust fund. How it is going to be handled, who knows? So I think the cleanest way of handling this is to do what we have already done for our highways, automobiles, and trucks, is to create a level playing field, and that is why I support the amendment.

The Chairman. Obviously, I am in no position to address anything against the substance of this legislation, because Senator Lott knows, and a lot of other people know, that I am very sympathetic to this, going back to not have voted for it in the very first

place, for the misuse of the power of taxation that is punitive to one industry.

But I would like to say why I think this is inappropriate at this time. I also know that Senator Jeffords would want to be recognized for an amendment to this amendment, just in case Senator Lott wants to proceed.

So, without a doubt, the justification for this amendment cannot be questioned. But I have been trying to put together a bill here that would be very broadly supported. In the process, I have had to say no to a lot of members of this committee wanting to do things similar to what Senator Lott is now doing.

So I would prefer that Senator Lott withhold. The question then is, why would I want Senator Lott to withhold an amendment that obviously I am sympathetic to? The answer is, we are preparing for a comprehensive reworking of the Motor Fuels Excise Tax in the mark-up of the highway bill.

I would further note, as I have already indicated, other Senators have accommodated the Chairman, and I think without too much problems on their part, to withhold their excise tax amendments. And if I do not embarrass people, I would like to mention some who have done it.

Senator Lincoln agreed to withhold a crop duster's amendment, which was in last year's bill, by the way. Likewise, Senator Breaux agreed to withhold a power take-off amendment. These Senators held off with the agreement that we would deal with their amendment in the highway bill where it is very appropriate to deal with it. These Senators are very much in the same position as my friend from Mississippi, having justification for their amendment.

So I do not know whether commitments are worth much around this place, and particularly maybe a commitment by Senator Grassley would be questioned. But I want to make a commitment, and it is all right to question it. That is, I would make a commitment not only to help the Senator from Mississippi get his amendment passed on the highway bill, but I would make a commitment that that would be in the Chairman's mark when we take up that highway bill.

So, I would respectfully ask the Senator from Mississippi to withdraw his amendment, and I would respectfully request that those people who are very much in favor of this amendment, representing industry or otherwise, to have some trust in the Chairman of this committee.

Senator Baucus?

Senator Baucus. Mr. Chairman, I appreciate that statement and I think the rest of us on the committee should honor it. You worked very hard to pull together a meaningful, orderly process here under which we could consider amendments and pass this bill. You have done a remarkable job and I think all of us deeply appreciate that.

I would just say to the other members of the committee, having worked personally with the Chairman so much, that he is a man of his word, clearly. When he says he is going to do something, he will do it. It is that simple.

I might also add that the offsets that are included in this amendment are already included in other legislation. It is in the CARE Act. [Laughter]. Maybe we should not take up pay-fors that have already been passed. [Laughter]. But in any event, the main point being that I think that we should defer to the Chairman, because he will find a way to deal with it. I know how hard the Senator from Mississippi has worked on this amendment. He deserves great, great credit for all of his work.

Senator Lott. Mr. Chairman, I would like to comment on that.

The Chairman. All right. Could I ask Senator

Breaux, since he is a major promoter of this and there is nothing wrong with being a major promoter of this, just as one example of me keeping my word. One of the bills on the agenda today is my word to you just one month ago that we would move your legislation just as soon as we had an opportunity to. I would hope that you would testify, not to members of this committee, but testify to people who are involved with the industry that I keep my word.

Senator Breaux. If I support the Lott amendment, does my section come out? [Laughter]. I am starting to see the merits of your argument much more clearly. [Laughter].

The Chairman. Your section will not come out if you support the Lott amendment.

Senator Breaux. Conference is a long ways off. Maybe I could just use this as an opportunity to ask a question. I think that Senator Lott and I are trying to get this accomplished. We are not that hung up on where it gets accomplished, just that it gets accomplished somewhere between now and a reasonable time which includes this year. I mean, I guess what you are saying is that there will be another opportunity to do the same thing.

The Chairman. Without a doubt, with the highway

bill and the strong interests that are pushing the highway bill, as well as the fact we all like to drive on good highways, there is going to be a highway bill up this year. There is going to be a revenue component to that and that is going to be up very shortly.

Senator Breaux. And this amendment would be germane to that, I take it?

The Chairman. My staff tells me it would be germane. I am not a lawyer. Beyond that, I have said I would include it in my mark.

Senator Breaux. That sounds pretty good.

The Chairman. Does that sound pretty good to Senator Lott?

Senator Lott. Mr. Chairman?

The Chairman. Go ahead, Senator Lott.

Senator Lott. First of all, we keep our word to each other. You have to me, and I have to you, for many, many years. There is not any question about you keeping your word. I know that.

But I also know that legislation has a way of coming and going and disappearing, and complications develop. It is very hard to sometimes keep your commitment because you have got to deal with those in the Senate, you have got to deal with the House of Representatives, and you have got to get it through conference.

So I have to weigh that. In this case, I was very careful to try to do it in the right way, Mr. Chairman. Mr. Chairman, we need to do this. It is overdue. Where would be the best place to put it? At that time, honestly, I was looking at the overall tax growth package for this and it was, I thought, understood that this would be the best place to do it.

So I went forward and did due diligence, got the amendment, sent out a letter asking for the co-sponsors, got co-sponsors on both sides, looked at getting the offset. People started working on the issue. So, here we are.

The question is, why not now, and why not here? Because it does include things that are not highway related. I guess it does have the inland waterways barge traffic covered, and also, of course, the railroads. If there was some substantive or other reason to delay it, I have asked for that and I do not get a response.

I think this is the right thing to do and I am just concerned that if we wait until later, that other things will intervene. I take the Chairman's word, and I have looked for a good reason to delay it. But I am just afraid. It was in the House last year, but yet it did not happen.

We may need to look for another vehicle for this bill

later on if we do not get an energy conference. I actually think this strengthens this bill and will help get some support from people that might have some questions about the tax provisions.

I learned a long time ago that you have got to work together, go along and get alone, and all of that. But I also have been burned in the past by having an opportunity and not taking advantage of it, and seeing the wheels come off later.

For one thing, offsets are going to be gobbled up as we go forward, and I would like for it to be offset. So for that reason, Mr. Chairman, I know that you support this, and I think just about every member of this committee does, and I really think we should go forward with it.

I want to make it clear, no offense to the senior members, from my standpoint. It is just that I cannot see any substantive or even political reason not to do this.

Senator Nickles. Mr. Chairman?

Senator Lott. The House is going to do it. Why would we want to make it subject to difference and leverage between the House and Senate? Why would the Senate want the House to do this on this bill, and the Senate not do it? So, I just think we ought to go

forward with it, Mr. Chairman.

The Chairman. Senator Nickles?

Senator Nickles. First, your word is as good as gold, and so is Senator Lott's and so is other members' in this committee, and I respect that. I do not know, on the highway bill. The highway bill is going to be going through EPW.

Senator Baucus. No, not the revenue portions. That is just the allocation only.

Senator Nickles. Then maybe it is a foregone conclusion that there is going to be a tax component to the highway bill. Does there have to be a tax component to the highway bill?

Senator Baucus. I might say, in order to accommodate the very points you were making earlier, to get more money in the highway program, by definition, therefore, that has to go through the Finance Committee.

Senator Nickles. Well, I understand if there is to be a tax increase. But I am not sure that is a foregone conclusion that there be.

The Chairman. Extension.

Senator Baucus. It has to be extended.

Senator Nickles. I appreciate the clarification. I think, obviously, the House is going to have this in their energy portion of their bill. It was last year and

I am sure it will be this year. They had a larger energy tax bill than we did last year, and this was part of it.

So, I think it makes sense to have it here. I understand your request. There may be a lot of interest in doing things on excise taxes, such as indexing, increasing, and so on for the highway program. Anyway, I did want to reiterate the statement that when you make a commitment, you are as solid as gold, as Senator Lott is as well.

The Chairman. Senator Baucus?

Senator Baucus. Yes. There is another consideration here, frankly. This bill is a nice, tight, compact energy bill now as it is. If we start adding on amendments, and Senator Lincoln certainly can offer hers, and lots of other Senators will have their amendments in committee.

And it is not just committee, it is the floor. We all know that the floor is a little bit dicey. It is a little hard to predict what is going to happen on the floor. To be honest, the highway bill is a stronger horse than the energy bill. The energy bill did not pass last year. The highway bill definitely will pass.

If the energy bill gets loaded up with amendments, then certainly the adoption of this amendment, if it is adopted--and I hope it is not offered on this bill--is

going to send a signal that, not necessarily that the door is wide open, but just that non-energy amendments are certainly in order on the energy bill. I just think it is a little dicey and it is something you have to think about.

Senator Lott. If I could make a comment on that. I have serious doubts about a lot of the things that are in this tax provision on the energy bill. I think a lot of this stuff is highly questionable and I am struggling with even going along with it.

This at least gives me some incentive to vote for the tax portion of the energy bill. I think that there is a lot of money that is going to be wasted in this tax provision of the energy bill. I think that there might be a few others that would feel like, well, at least we are doing this. It is overdue. It is a question of fairness.

So, I think you are underestimating how this might actually help you with the overall package. It may be tight, but it has got an awful lot of things in here of questionable value.

The Chairman. Does Senator Jeffords have an amendment?

Senator Jeffords. I have an amendment. This may make some people's minds out as to what we ought to do at

this time, and I would suggest it probably would end----

The Chairman. Before you offer your amendment then, is the Senator from Mississippi willing to withdraw his amendment?

Senator Lott. Mr. Chairman, I just do not feel like, other than your commitment that we will get it done, that there is no justification for delaying this. There is no substantive reason, there is no scoring reason.

I respect your position on it, but frankly I would just as soon not have this wrapped around the axle and around our neck for the next two, three, four, six months. We can state our position and get this done now instead of having it tangled up in the highway tax package or the highway process that is going to take us well into the fall. Well into the fall.

The Chairman. Before I go back to Senator Jeffords, the only thing I would say it, it is comity towards other members in the sense that other members withdrew their amendments for the highway bill because they dealt with excise taxes. This bill is about incentives for energy production and alternative energy and conservation, and your amendment does not fit into that category. What is your desire, to go ahead?

Senator Lott. I think we should go ahead.

The Chairman. Senator Jeffords?

Senator Jeffords. Mr. Chairman, I intend to offer an amendment to the amendment. I believe it is critically important that we take care of the transportation systems. That is where I do my major efforts.

I would like to see this amended to provide that it stays within the transportation area and is available for loans for the railroads, as other aspects of the transportation, to make sure that we can have a system which has the infrastructure repairs that both barges and railroads need now.

So, I would utilize these funds to try and improve the infrastructure of the railroads, which are in dire need, as well as the barge traffic. So, that is my intention if the amendment is offered.

The Chairman. All right. Senator Breaux?

Senator Breaux. I have a great deal of respect, obviously, for the Senator and the concept. But, number one, putting the 4.3 cents into something that does not exist does not make a lot of sense. There is no railroad trust fund. Another committee would have to have hearings and try to develop a railroad trust fund.

The second point, I am not sure, with the content of the railroad, how it would be handled. It would be

Environment and Public Works. It would not be this committee. The amount of money going into it, I think, would be--could we get a clarification on that?

Anyway, the point is, there is no railroad trust fund right now. You would have to create one. I think the other committee would do that. I do not want to give up jurisdiction if that is our jurisdiction, but there is no railroad trust fund.

The second point, I think, is probably more important. Railroads are run quite differently from highways. There is a Highway Trust Fund that the Federal Government determines where the money is going, where the money is going to be spent, which roads are priority, which roads are not priority roads. We do that in cooperation with the States.

Railroads do the infrastructure. The build the tracks, they build the railroads. The government does not do it. We would be fundamentally changing how railroads are developed and how infrastructure for railroads are going to be handled in this country by creating a railroad trust fund. It is quite different from highways and I think it is not the right thing to do.

Senator Smith. Mr. Chairman?

The Chairman. Senator Smith?

Senator Smith. I would like to echo what Senator Breaux has just said. The railroads know they need to make investments in infrastructure. There is a crying need. There is an incredible lack of investment in capital equipment in the railroad industry.

It does seem to me, if we are serious about that, rather than creating a new bureaucracy to centrally plan this, we ought to trust them to know where to place the capital that they earn in order to improve the system that they rely upon for return on investment, not just this year, but for the future.

Many people have complaints about railroads. I have had my share of them. But I am very concerned about the condition of the railroad industry in this country. I do not want to say we have to create some new system where we dictate to them the terms of where these things are invested. I trust the free market system to do that.

The Chairman. Could we vote on the amendment?

Senator Baucus. Mr. Chairman?

The Chairman. Senator Baucus?

Senator Baucus. Mr. Chairman, it is unfortunate that this debate is in this form, this context, because in many ways we are just not seeing the forest for the trees, in my judgment. The question is, in many respects, how do we encourage more and greater

infrastructure in America, whether it is highways, whether it is rail system, or whatever it is. That is really the question. We are talking generally about that subject, and certainly Senator Jeffords' amendment forces us to focus a little more on that subject.

I can see what is going to happen here. We are just going to, as we often do around here, think of things in the short term and amendments pass based upon short-term arguments, not thinking a little bit ahead down the road.

If I had my druthers--and I do not, it is not going to happen--it is that both of these amendments would be withdrawn and we think more clearly, solidly, creatively about ways to take this money--maybe it is directly with railroads, maybe it is a trust fund, I do not know--to help solve the problem here. I say that, because I can see what is going to happen.

When we take up the highway bill, the railroads are going to come to us and say, hey, we want some of that highway bill, too. They have already asked us. They have already asked us. Things like railyard improvements, at-grade crossings, State flexibility with highway funds. They are going to want States to have flexibility to give some of those funds to the railroads.

It is going to happen. So I am just saying to the railroads, if this amendment passes, I think it is unfair

for them to come back and say to those who travel on the highways, to take some of your money for the railroads. But I can see it happening now, and it is going to happen.

Senator Lott. Mr. Chairman, I will not drag this out.

The Chairman. Senator Lott?

Senator Lott. But a couple of points. I do not know what has happened in other States, but in my State this flexibility for some of that money to go to railroads has not produced very much. The money is going to other things, as I really think it should in many instances. But the highway bill, with the flexibility for railroads, has not helped.

Second, the best way to help improve infrastructure, I believe, is to allow these railroads--and by the way, this amendment is supported by the Transportation and Communications International Union--to keep more of their money, which they then can put into railroad bed improvement and other improvements. The companies, the private sector, have the greatest ability to do that.

If we really want to get this done, it seems to me, once again, it is a strong argument for going ahead and doing this, allow them to have that money that now is going into the general Treasury.

The Chairman. The Senator from North Dakota. Then I would like to vote, if we could.

Senator Conrad. Mr. Chairman, I, for one, am very sympathetic to the amendment from the Senator from Mississippi and the Senator from Louisiana, but it does strike me, it does not really fit on this bill. This bill is to encourage and provide incentives for energy development, and this amendment does not do that.

I would just hope our colleagues--and I would say this to Senator Jeffords as well--that they would withdraw these amendments and take the Chairman at his word that he is going to deal with this in a subsequent piece of legislation, because I think to do otherwise endangers the energy bill.

When we get to the floor, to the extent things are on here that are not part of energy incentives, it is Christmas tree time. You can see what is going to happen. The Chairman and the Ranking Member are going to have a hard enough time fending off things. If we start it here, I just think this whole thing could fall.

The Chairman. All right. It is a second degree amendment, right?

Senator Jeffords. Yes.

The Chairman. Proceed, Senator Jeffords.

Senator Jeffords. If we did not take it up now, I

think this is something that should be discussed in the future. I think there are ways to utilize these funds to ensure that the infrastructure for barges, as well as for railroads, are utilized in a way that would be most beneficial to the country rather than proceeding and just dumping it into the general revenue stream. I think that this is an area of great need in this Nation for infrastructure.

If we miss this opportunity to utilize these funds to help the barges and the railroads to be able to better service this Nation, it would be a mistake. So I would be happy to withdraw mine if the Senator from Mississippi withdraws his.

Senator Lott. Let us proceed to vote, Mr. Chairman.

The Chairman. We have the amendment.

Senator Jeffords. We are voting on Mr. Jeffords' amendment.

The Chairman. Yes, Mr. Jeffords' amendment. The Clerk would call the roll.

The Clerk. Mr. Hatch?

The Chairman. He would vote no, by proxy.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

Senator Lott. No.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

Senator Kyl. No.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

Senator Lott. No, by proxy.

The Clerk. Mr. Frist?

The Chairman. I have been notified that Mr. Frist would vote no, by proxy.

The Clerk. Mr. Smith?

Senator Smith. No.

The Clerk. Mr. Bunning?

Senator Bunning. No.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Rockefeller?

Senator Baucus. Rockefeller, aye by proxy.

The Clerk. Mr. Daschle?

Senator Daschle. No.

The Clerk. Mr. Breaux?

Senator Breaux. No.

The Clerk. Mr. Conrad?

Senator Conrad. No.

The Clerk. Mr. Graham?

Senator Baucus. No vote.

The Clerk. Mr. Jeffords?

Senator Jeffords. Aye.

The Clerk. Mr. Bingaman?

Senator Bingaman. No.

The Clerk. Mr. Kerry?

Senator Baucus. Aye, by proxy.

The Clerk. Mrs. Lincoln?

Senator Lincoln. No.

The Clerk. Mr. Chairman?

The Chairman. I vote no. I would ask those in favor of the Lott amendment to signify by voting aye.

Senator Jeffords. What was the announcement on the vote?

The Chairman. Oh, I am sorry.

The Clerk. Mr. Chairman, the tally is 4 ayes, 16 nays.

The Chairman. Give that to me again, please.

The Clerk. The tally is 4 ayes, 16 nays.

The Chairman. The Jeffords second-degree amendment is defeated.

The Clerk would call the roll on the Lott amendment.

Senator Baucus. Mr. Chairman, why do we not voice the Lott amendment?

The Chairman. All right. Those in favor say aye.

[A chorus of ayes]

The Chairman. Those opposed say no.

[A chorus of nays]

The Chairman. The ayes seem to have it. The ayes do have it. The Lott amendment is adopted.

The next amendment. The Senator from North Dakota.

Senator Conrad. Mr. Chairman, I would like to be very brief on this amendment. This amendment would replace Item 3D in the Chairman's mark, the Business and Tax Incentives for Fuel Cells, with Section 304 of S. 597, the Grassley-Baucus-Domenici-Bingaman Energy Tax Incentives bill introduced on March 11th of this year.

Section 304 would retain the tax incentives for fuel cells in the Chairman's mark and restore the tax incentive for stationary microturbines, which was part of the energy tax package included in the bill that passed the Senate in 2002.

Colleagues, microturbines are those small devices that are used to improve the reliability of electrical systems. We are seeing that these are being used in small businesses across the country, small restaurants, and other small businesses to improve reliability and efficiency.

I do not know why this was dropped. It has been part

of the bill passed last year, it was part of the larger energy bill put before the Congress just recently by the Chairmen and Ranking Members of both the Energy Committee and the Finance Committee.

The cost estimate last year was $39 million, and that was a five-year credit. This has been reduced to a four-year credit, so it would be even less than $39 million. It is strongly supported by many companies that are in this business.

The Chairman. We accept your amendment. [Laughter].

Senator Conrad. You cannot beat that! [Laughter].

The Chairman. Next amendment.

Senator Kyl. Mr. Chairman?

The Chairman. Senator Kyl?

Senator Kyl. Might you call the yeas and nays, not a roll call vote? I would like to register an objection to the amendment, that is all.

The Chairman. All right. There is one objection to the amendment, Senator Kyl.

The next amendment. Senator Hatch was next as a result of our going back and forth.

Senator Hatch. Thank you. Mr. Chairman, on behalf of Senator Lincoln and myself, I call up the Hatch-Lincoln Amendment #1. Now, this amendment is a major

step toward tax simplification for American families. It would establish a uniform definition of a child. Under the current law, there are five definitions of a child for purposes of each of the five different child-related tax benefits for individuals.

This amendment, Mr. Chairman, is identical to the uniform definition of a child bill you and Senator Baucus introduced yesterday. I want to congratulate you and Senator Baucus, along with your fine staffs, for your leadership in drafting this legislation. You deserve the credit for it. But we wanted to make sure that we do some simplification on this bill, and on every bill from here on in.

We recognize that this amendment is not germane to the energy bill that we are marking up today. However, we believe the time has come for the Finance Committee to begin dealing with the complexities of the Tax Code.

All of us say we are for simplification. We have all been telling our constituents that for years. Yet, every time we mark up another tax bill we do absolutely nothing but add to the complexity of the Internal Revenue Code.

This energy tax bill before us today is a great example. I do not know how many extra pages or how much extra complexity this bill will add to the Tax Code, but it will not be insignificant.

Please do not get me wrong here. I like this energy tax bill as much as anyone else on the committee. The Clear Act provisions it contains are very important to me personally, and I think to every Utahan, and every American.

The other provisions of the bill are also very important, and I support them. But let us face it, Mr. Chairman. We are adding a lot of complexity along with these tax credits. The Clear Act itself, which is my own bill, is almost 50 pages long by itself. It is a very complicated bill.

The problem is, I do not see us ever moving in the other direction towards simplicity. Even though we all agree that the tax system is way too complex, we are doing nothing to reverse the trend.

Well, Senator Lincoln and I think it is time to begin changing this way of doing things and we are proposing that every time this committee marks up a tax bill, that we include at least one tax simplification provision, starting today.

This is a small start, but it is a start. So we are offering this amendment today to begin simplifying the tax life of millions of American families. In the case of today's amendment to establish a uniform definition of a child, we are talking about simplifying the tax lives

of tens of millions of American families.

Mr. Chairman, as I mentioned, this amendment is identical to the bill you and Senator Baucus introduced yesterday. Obviously, it has bipartisan support. The only question before us, I think, is that of proper timing.

Well, I, for one, do not think the day is near at hand when we should all sit down on the Finance Committee and mark up a tax simplification bill. There are just too many other things on the agenda that are in line ahead of simplification.

Therefore, Senator Lincoln and I suggest that we simply make it a matter of committee policy, that every tax bill have at least one major tax simplification provision. I think this is the only way we are going to make progress on the complexity problem.

Now, I realize that you may be forced to rule this amendment out of order on germaneness grounds. This is fine, and we may very well lose on the appeal. But we want you and the committee to know that we are serious about this idea and we intend to keep offering simplification amendments to every bill.

I will add this. If the Chairman is willing to give us a commitment that he will include the uniform definition of a child provision in the next tax mark-up,

I think we might be willing to withdrawn the amendment today. But I would like to get in this mode of offering a tax simplification amendment to every tax bill from here on in.

Alternatively, if we could get his commitment to mark up this bill either by itself or with some other simplification items in the future, I think that would be fine with us.

The Chairman. Ms. Paris?

Ms. Paris. Senator Grassley, the ethanol excise tax proposal has been deemed to be a major simplification. It is going to take multiple pages out of the Internal Revenue Code and take six or seven different choices of ways to do things and streamline it.

Senator Grassley and Senator Baucus, because of the ability to not only simplify the Internal Revenue Code, increase enforcement, and collect more money, had used that as the major simplification process.

Senator Hatch. The only objection I have to that, and I do not disagree with that, is that that does not affect many families, in my view. This would affect every family with children. This really amounts to real simplification and I want to, again, commend the Chairman and the Ranking Member.

The Chairman. Before I call on Senator Lincoln,

what I would like to do, before we lose a quorum, subject to amendments as we have done so many times in this committee, vote the agenda of this committee out, then we will continue with amendments on various aspects of it. So, we will do that just as soon as we take care of this amendment.

Senator Lincoln?

Senator Lincoln. Thank you, Mr. Chairman. I certainly would like to start by thanking you and Senator Baucus, and certainly the entire staff of the Finance Committee, for providing the leadership.

In fact, I think the amendment that Senator Hatch and I have here, really the substance of this amendment, comes from much of the work that you all have done.

I want to compliment my colleague, Senator Hatch. He and I do very much agree that the call for tax reform is steady, it is necessary, and it is not something we can continue to ignore. It is often too easy for us to put good ideas aside, even though they are primed and ready.

I would just like to say to the Chairman, because he is one of the other farmers on this committee, like myself, my grandmother used to say, when there is something that needs to be done, particularly weeding your crops or weeding your garden, and you do not have the whole day to devote to it, oftentimes you have to

take it a little bit at a time, a row at a time.

I think that is what Senator Hatch and I have agreed to do, is to look at, if there are reforms that we can do that make good common sense, that we would like to move forward on them a little bit at a time, if that is what it takes, in the hopes that as we move forward we can see some comprehensive reform in the Tax Code.

So, Mr. Chairman, to you and the staff, the Joint Committee, Taxpayers Advocate, every member of the committee has identified several needed Tax Code reforms and simplifications.

As I said, Senator Hatch and I agree that whenever money is being allocated in this committee, a reform measure should at least be on the table and be something that we talk about, and that we are dedicated to doing.

So I appreciate his leadership in this, and I am certainly delighted to be working with him on that. We want to work with you, Mr. Chairman, to make it something we can achieve as a committee.

Senator Breaux. Mr. Chairman?

The Chairman. Senator Breaux?

Senator Breaux. I was just going to move the adoption of those other two bills.

The Chairman. All right. Just a moment. We will dispose of Senator Hatch's amendment. There are going to

be many opportunities, particularly on the growth package, where issues like this are very appropriate, very essential, in fact.

Even though this amendment is not germane to this bill, I would not rule it not germane because you have offered to withdraw it. I would accept your withdrawal, and we would make the commitment to you that we will work on it.

Senator Hatch. That is good enough. I think that is good enough for my colleague and myself, and I want to compliment her for her willingness to support on this.

The Chairman. I would ask that the Chairman's mark be adopted and that the committee favorably report the Energy Tax Incentives Act, subject to amendment.

Senator Nickles. Subject to amendments.

The Chairman. Yes, subject to amendments.

Senator Kyl. Mr. Chairman?

The Chairman. Senator Kyl?

Senator Kyl. Will you be affording us another opportunity at the conclusion of the amendments to vote yes or no on the entire bill?

The Chairman. That would be right now.

Senator Kyl. So without knowing whether or not--you see, I have got some amendments and I am disinclined to support the bill unless I can get some progress on my

amendments. So, I would be forced to vote no.

The Chairman. The other thing is, you will not have to worry about not supporting it, because in about five minutes we are going to lose a quorum.

Senator Kyl. Well, I will be afforded an opportunity to offer the amendments at a time when we have a quorum.

The Chairman. Yes, you will be. Yes, you will. The quorum on amendments is seven. The quorum on voting a bill out is 12, or 11.

Senator Kyl. To accommodate that, then I will simply register the fact that I have got to vote no, not knowing whether these are going to be accepted.

The Chairman. All right.

Senator Kyl. And I would ask the Chairman for an opportunity to explain why, without taking the time of the committee right now.

The Chairman. All right.

Would you call the roll, please?

The Clerk. Mr. Hatch?

Senator Hatch. Aye.

The Clerk. Mr. Nickles?

Senator Nickles. No.

The Clerk. Mr. Lott?

Senator Lott. Aye.

The Clerk. Ms. Snowe?

Senator Snowe. Aye.

The Clerk. Mr. Kyl?

Senator Kyl. No.

The Clerk. Mr. Thomas?

Senator Thomas. Aye.

The Clerk. Mr. Santorum?

The Chairman. Senator Santorum votes aye, by proxy.

The Clerk. Mr. Frist?

The Chairman. Aye, by proxy.

The Clerk. Mr. Smith?

Senator Smith. Aye.

The Clerk. Mr. Bunning?

Senator Bunning. Aye.

The Clerk. Mr. Baucus?

Senator Baucus. Aye.

The Clerk. Mr. Rockefeller?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Daschle?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Breaux?

Senator Breaux. Aye.

The Clerk. Mr. Conrad?

Senator Baucus. Aye, by proxy.

The Clerk. Mr. Graham?

Senator Baucus. I do not have it.
The Clerk. Mr. Jeffords?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Bingaman?
Senator Baucus. Aye, by proxy.
The Clerk. Mr. Kerry?
Senator Baucus. Aye, by proxy.
The Clerk. Mrs. Lincoln?
Senator Lincoln. Aye.
The Clerk. Mr. Chairman?
The Chairman. Aye.
The Clerk. Mr. Chairman, the tally is 18 ayes, 2 nays.
The Chairman. The amendment has received sufficient vote for passage out of committee, so that is done.
I would ask that the Clean Diamond Trade Act be voted out of committee. I would ask for a voice vote on that.
Those in favor, say aye.
[A chorus of ayes]
The Chairman. Those opposed, say no.
[No response]
The Chairman. The yeas seem to have it. The do have it. The Clean Diamond Trade Act is voted out of committee.
Now, the same for the Tax Court Modernization Act.

This is the one that I kept my promise to Senator Breaux that we would vote out of committee.

Senator Baucus. Mr. Chairman, I move the adoption of the act.

The Chairman. Thank you for moving the adoption of the act. I wanted to get the point made that I kept my word to Senator Breaux. [Laughter].

Those in favor, say aye.

[A chorus of ayes]

The Chairman. Those opposed, say no.

[No response]

The Chairman. The ayes seem to have it. The ayes do have it. The Tax Court Modernization Act is voted out of committee.

Now we would turn to the nominees. There are seven.

Senator Baucus. Move they be voted out en bloc.

The Chairman. The motion is made to vote these nominees out en bloc.

Those in favor, say aye.

[A chorus of ayes]

The Chairman. Those opposed, say no.

[No response]

The Chairman. The ayes seem to have it. The ayes do have it. The nominees are approved and will go to the floor of the Senate.

We return to the Energy Tax Incentives Act. Senator Kyl is recognized for an amendment.

Senator Kyl. Thank you, Mr. Chairman.

Let me start with Amendments #10 and 11. I would just ask unanimous consent to combine numbers 10 and 11, since we can more speedily deal with those at this time.

These have to do with the new alternative motor vehicle credits, is the first amendment. It is a subject that we talked about last year when we put this bill together.

I raised the concerns at that time that this kind of legislation had been adopted by the Arizona State legislature and they rued the day that they did it, and ultimately repealed it. It was fraught with problems. The costs were grossly underestimated.

The staff contacted people in Arizona, made some modifications in what was done, understanding a little bit better the concerns as a result of the experience that Arizona had. In my view, though, we still have not gone far enough.

Let me just see if I can very briefly describe the problem. In fact, here is one quotation from the *Arizona Republic* on the day the bill was repealed in Arizona: "Lawmakers gutted the disastrous alternative fuel program Monday in a volatile and dramatic House vote, ending a

debacle that outraged taxpayers, panicked buyers, and brought down one of the State's most powerful politicians."

That repealed law had provided tax incentives and rebates that paid more generously than this, but similarly. It was, in fact, up to 50 percent of the cost of a car that was equipped to burn the alternative fuels at that time.

It would have cost Arizonans about a half a billion dollars if it had not been repealed, which is about 11 percent of the State's budget. But when it was proposed, the cost was only estimated to be between $3 and $10 million, less than 10 percent of what turned out to be the true cost.

The first question I would have, is whether we are as confident of our revenue estimates here. Indeed, I suggest that we already have some reason to be concerned. Joint Tax estimates a revenue loss of $1.736 billion for this provision over 10 years, including the electric vehicle provisions.

But I understand that the estimated cost grew significantly over last year's estimates, and that the bill had to be scaled back as a result. I suspect that the reason for this is that the costs increased significantly because hybrid and alternative fuel

vehicles have become much more popular. People are, in fact, buying them.

Indeed, I would suggest that the very popularity of these cars argues that there is no need to give consumers an incentive for them to buy them.

There were also questions, and I will not get into the details here but there is evidence I can put into the record, about whether the alternative fuel vehicles would actually improve air quality enough to justify the cost of the expenditure that was being made here.

So while I am pleased, Mr. Chairman, that you have included the GAO study in your mark to look at these credits, what I fear is that we will find after a while that these fears that I am expressing today are justified, but we will have already spent the money and therefore have lost the benefit of a proper analysis of this before we put it in place.

So, in conclusion, I think experience shows that the true cost would far outpace what Joint Tax has projected. The benefits of alternative fuel vehicles over conventionally fueled vehicles are questionable, and consumers are buying the vehicles without the taxpayer subsidy. So, I suggest we should not be using the Tax Code, in effect, to bribe people to buy one type of car over another.

Senator Breaux. Would the Senator yield for a question? Does your amendment take out the whole thing, all the subsidies for all types of vehicles?

Senator Kyl. The amendment eliminates the entire subsidy and applies the savings to the deficit, and the total saving is about $2.5 billion.

Senator Breaux. It takes the whole Section 2 out, is that correct? The alternative vehicles and fuel incentives, the whole thing.

Senator Kyl. Yes.

Senator Breaux. All right.

Senator Hatch. Mr. Chairman?

The Chairman. Senator Hatch is recognized.

Senator Hatch. Let me respond to that. The Arizona legislation was much different than this proposal. For one thing, the incentive Arizona offered made alternative fuel vehicles less expensive than equivalent gasoline vehicles. This led to an unexpected demand and excessive cost to the State government.

This proposal's incentives are limited to a percentage of the incremental cost of the vehicle. Conventional vehicles will still cost less, even after the tax credits.

Moreover, Arizona's provision allowed incentives for vehicles that did not operate on alternative fuels, and

also allowed converted vehicles that did not have to operate exclusively on alternative fuels.

This proposal's incentives are limited to new vehicles that are built to operate only on alternative fuel. No incentive is provided for converting a gasoline or diesel engine to an alternative fuel vehicle.

So just so we understand this a little bit better, and it will perhaps save us some time, there were limited vehicle sales in 2002 from Japanese manufacturers on hybrid sales, Toyota's Prius was $18,000, Honda Insight, $7,000, Honda Civic, $16,000.

Our U.S. manufacturers are developing hybrid vehicles for introduction in the 2004 time frame. Increased vehicle costs and low fuel prices in the U.S. have limited demand expectations for market introduction. Japanese manufacturers have developed hybrids primarily for home market applications where fuel is $4 per gallon.

Now, the limited sales in 2002 from U.S. manufacturers, the 2002 sales for dedicated alternative fuel vehicles for the Big Three auto makers, were $3,500. In the case of the Japanese sales, they were very modest. There were hundreds of thousands of regular gasoline-driven cars sold.

Now, sales of hybrid and dedicated alternative fuel vehicles in 2002 represented 0.2 percent of total vehicle

sales. Frankly, if you take the Toyota Prius hybrid as an example, while Toyota sold more than 40,000 Priuses in the United States since its introduction here in the year 2000. That number pales in comparison to the sales of Camry, more than 400,000 annually, or Corolla, more than 200,000 annually.

So this is a completely different bill from what the Arizona legislature did, and it really is, I think, the one environmentally sound bill that we can put through this year, and it is time we do.

The Chairman. Senator Smith. Then I would like to vote, if we could.

Senator Smith. Mr. Chairman, a question to the Utah Senator.

Senator Hatch. Sure.

Senator Smith. Your bill is sunsetted as well. You are just trying to give these cars a jump start.

Senator Hatch. That is right. We are going to try to get a boost on them. We want to get to the point where we have hydrogen-driven cars.

Senator Smith. So it goes away, but it is certainly does encourage cleaner skies.

Senator Hatch. Right.

The Chairman. The Kyl amendment is before us.

Senator Kyl. Excuse me, Mr. Chairman. Mr.

Chairman, might I just clarify something? I said it was a savings of $2.3 billion. I misspoke. This, combined with the elimination of the phase-out for the credit for qualified electric vehicles, I am combining those two, with your approval, if I had consent to do that. The total savings for those two is $2.037 billion.

The Chairman. Are you modifying your amendment?

Senator Kyl. I had asked to do that originally.

The Chairman. All right. I am sorry.

Senator Kyl. There was no objection, I thought.

The Chairman. Those in favor of the Kyl amendment, say aye.

[A chorus of ayes]

The Chairman. Those opposed, say no.

[A chorus of nays]

The Chairman. The nays seem to have it. The nays do have it. The amendment is defeated.

The Senator from New Mexico?

Senator Bingaman. Thank you very much, Mr. Chairman. Amendment #55 on your list is an amendment that is identifical to legislation Senator Hutchison and I introduced yesterday to make it easier for publicly traded partnerships to sell their equity to mutual funds.

It is my understanding that the Treasury Department has some concerns about potential abuses that they

believe we need to deal with in the drafting of this. I know this has been a concern that you have raised as well.

I wanted to offer this today, but it is my understanding that you do have some concerns and that I should therefore hold off until we get to the Senate floor.

The Chairman. Could I express my concerns? And I appreciate very much your offer to do that. I have been briefed that the Treasury Department has some concerns, so I am going to just suggest that between now and the floor time, that our staffs work in trying to see if we can, and do, resolve Treasury's concerns.

If they are able to sort through these problems, then I will work with you to have your amendment included in the energy bill on the floor.

Senator Bingaman. Well, thank you very much. On that basis, I am glad to withdraw the amendment, Mr. Chairman.

The Chairman. Are we done with all amendments now?

Senator Lincoln. Mr. Chairman?

The Chairman. I will get to you. Senator Nickles?

Senator Nickles. Mr. Chairman, I have a couple of amendments I would like to offer. The first one I will offer will be #2. This would strike Section 29 extension

in the bill.

As you know, Mr. Chairman, I was disappointed in your mark amendment today because it increased the subsidy on Section 29 from $2 to $3. As you know, when this was originally passed, I believe, in 1980, we said several times it was going to expire.

In my State, I have some counties that qualify for tight sands gas. Why should they get $3 more than an adjacent county that does not quite meet that definition? I mean, it really is absurd. So, because of this section, we are telling people, well, drill here, not here. The economics are such, because Congress is making it that way. It really does not make sense.

I think the marketplace should really determine when we drill tight sands and when we drill conventional gas. So, we have stated in times past, we are going to let this sunset. We have heard members of the committee, bipartisan members of the committee, say, well, Section 29 expires. I believe it expires this year.

Now we are saying, well, wait a minute. Let us just continue it. We say we are going to continue it for another three years. We have extended it now four times. When is enough enough? It really does not make sense. Now we are extending it for all kinds of different new energy that we think, this is really going to make a

difference.

I am all for new alternative energies. I am all for them. But I think it is a lot better to have the marketplace determine when they are somewhat ready to be introduced into the market.

Right now, energy prices are high. High. This is saying, well, let us add 10 percent on top of them anyway for these sources that are--they are not even unconventional. I mean, there is a lot of energy produced under Section 29 that is very conventional production.

It may be a little more expensive. It might be tight sands or it may be coal-methane, or it may be something else. But there is a lot of energy that, frankly, will be produced when the marketplace should dictate it. Instead, we are using big subsidies, to the tune of billions of dollars under this. I am trying to see how you exchanged it. I believe a total of about $2.5 billion. So, I would just urge our colleagues to say, enough is enough.

I mentioned there are a lot of groups that are in support of this amendment, Mr. Chairman. I would hope that our colleagues would support it and not add to the cost of this bill by providing unnecessary, uneconomical subsidies for production that is not necessary.

The Chairman. Senator Thomas?

Senator Thomas. Thank you, Mr. Chairman. I guess I am a little surprised, my friend from Oklahoma. What we are talking about here is energy policy. We are talking about how we can increase domestic production to offset some of the problems that we have in this world. This is one of the things that is most important.

This gives an opportunity and an incentive for people to go into coal seams, tight formations, to do the things they would not otherwise do, and it has already been proven successful and it provides us a great deal of new production, not just simply old production. This is much more important than giving subsidies to small-production wells, and so on. This is a new opportunity.

Quite frankly, we see a lot of this in the west, particularly on public lands, that we are trying to get going, whether it is methane gas or whatever. We had this in last time, we had it at three.

I think this is a continuation of what we agreed upon last year. I certainly suggest that we ought to go on, and to remove this, I think, would be a great disadvantage to our efforts here and our purpose in having an energy policy. So, I am opposed to this amendment.

Senator Bunning. Mr. Chairman, I would just like to

be heard.

The Chairman. Senator Bunning, quickly.

Senator Bunning. Senator Nickles, what do you do with the money you save?

Senator Nickles. I just leave it be for deficit reduction, or it would not be added to the cost of the bill.

Senator Bunning. Thank you.

Senator Nickles. Mr. Chairman, could we have a roll call?

The Chairman. We can have a roll call.

Would the Clerk call the roll?

The Clerk. Mr. Hatch?

The Chairman. No, by proxy.

The Clerk. Mr. Nickles?

Senator Nickles. Aye.

The Clerk. Mr. Lott?

Senator Lott. Aye.

The Clerk. Ms. Snowe?

Senator Snowe. No.

The Clerk. Mr. Kyl?

Senator Kyl. Aye.

The Clerk. Mr. Thomas?

Senator Thomas. No.

The Clerk. Mr. Santorum?

The Chairman. No, by proxy.
The Clerk. Mr. Frist?
The Chairman. No, by proxy.
The Clerk. Mr. Smith?
Senator Smith. No.
The Clerk. Mr. Bunning?
Senator Bunning. Aye.
The Clerk. Mr. Baucus?
Senator Baucus. No.
The Clerk. Mr. Rockefeller?
Senator Baucus. No, by proxy.
The Clerk. Mr. Daschle?
Senator Baucus. No, by proxy.
The Clerk. Mr. Breaux?
Senator Breaux. No.
The Clerk. Mr. Conrad?
Senator Baucus. No, by proxy.
The Clerk. Mr. Graham?
Senator Baucus. No, by proxy.
The Clerk. Mr. Jeffords?
Senator Baucus. No, by proxy.
The Clerk. Mr. Bingaman?
Senator Baucus. No, by proxy.
The Clerk. Mr. Kerry?
Senator Baucus. No, by proxy.

The Clerk. Mrs. Lincoln?

Senator Lincoln. No.

The Clerk. Mr. Chairman?

The Chairman. No.

The Clerk. Mr. Chairman, the tally is 4 ayes, 17 nays.

The Chairman. The amendment is obviously defeated.

Senator Lincoln. Mr. Chairman?

The Chairman. Yes. The Senator from Arkansas.

Senator Lincoln. Mr. Chairman, thank you. I have got a couple of amendments, and I think they can be disposed with rather quickly because we have worked diligently with you and with the staff. The staff has just done a tremendous job. I know they were here until early in the morning trying to work out exact scores.

The Chairman. We accept your amendment. [Laughter].

Senator Nickles. Mr. Chairman?

Senator Lincoln. Thank you.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. I am just kind of wondering. Did we just accept her bio-diesel amendment?

Senator Lincoln. That was in the mark.

The Chairman. That was already in the bill.

Senator Nickles. All right. Mr. Chairman, I have an amendment.

The Chairman. Senator Nickles?

Senator Nickles. Mr. Chairman, this would be my Amendment #3, and it would strike the bio-diesel fuel credits.

Mr. Chairman, correct me if I am wrong, staff, the subsidy that we have for bio-diesel, one, this is new, it is not in current law. It is similar to ethanol, but it exceeds ethanol, almost double the ethanol credit. Is that correct?

Ms. Paris. The credit for the bio-diesel is 1 percent per percent up to 20 percent in bio-diesel for the income tax side. That equates to $1 per gallon. That is for agricultural bio-diesel, which is virgin vegetable oils and animal fats.

The subsidy for the recycled bio-diesel is a 0.5 percent per percent, up to 20 percent, which equates to 50 cents a gallon on the excise tax side. That would be for recycled oils, or virgin vegetable oils, or animal fats that mix with recycled oils. The excise tax credit for the agricultural bio-diesel is handled in the same format as the ethanol.

Senator Nickles. You have answered my question. It is $1.50. Some of it is 50 cents, some of it is $1.

Ms. Paris. Yes, sir.

Senator Nickles. The subsidy on ethanol is 52 cents, 53 cents, whatever.

Ms. Paris. Fifty-two cents.

Senator Nickles. So it is twice as much in some cases.

Let me ask another question. Are we also crediting the Highway Trust Fund as if they paid the full tax?

Ms. Paris. The agricultural bio-diesel does receive the excise tax provision. The recycled bio-diesel does not. It is under the same mechanism as what was just passed on the ethanol reform.

Senator Nickles. So a significant portion of this will fund the highway trust fund as if it paid the full tax, and since it does not, we are going to have general funds make up the balance to the Highway Trust Fund. Is that correct?

Ms. Paris. The mechanism would be the same.

Senator Nickles. Is that correct?

Ms. Paris. The full tax amount. Yes, sir.

Senator Nickles. That is my question.

Mr. Chairman, I think we are really making some serious mistakes unless this body decides we want to just have general revenue funds finance the Highway Trust Fund. So, we are creating, on the one hand, new, exotic

fuels, I guess. Not exotic, but soy diesel, or whatever.

We say they do not have to pay taxes, as much taxes, into the Highway Trust Fund, that we will make up the difference. So, we will be writing checks. I think that is terrible tax policy. That is the reason why I offered the amendment and I would urge our colleagues to support it.

The Chairman. The Senator from Arkansas?

Senator Lincoln. Thank you, Mr. Chairman.

Mr. Chairman, this language passed the committee 16 to 5 last year as an amendment that was offered by myself and Chairman Grassley. It provides partial exemption for the diesel excise tax for diesel blended with bio-diesel.

I would just like to encourage or impress upon my colleagues, bio-diesel is a fuel that has really far surpassed many of the other alternative fuels in a lot of different ways. It is a product that can be produced now, it can be burned.

If you drive a combustible diesel engine today, you can put 100 percent bio-diesel in that engine today, you can blend it, it can be piped, it can be blended at the pump, it can be blended before it is piped.

It is a tremendous alternative fuel that needs the encouragement of this Nation at a time when we need to be reflecting our direction towards alternative fuels and

looking for alternative fuels.

So I just would encourage the committee and the rest of my colleagues to recognize that the time is right to look for alternative fuels. Bio-diesel is one that is already in the marketplace and doing a great job. You do not have to pay a lot of expensive retrofitting to burn it in a vehicle today.

It is the way to go, and it is something that we should be doing. It is the diversity in our fuel economy that we need right now. So, I encourage my colleagues to vote for this.

Senator Nickles. Would the Senator from Arkansas yield? Is there any reason for it to have a subsidy double ethanol? Could we limit the subsidy to the cents per gallon that is in ethanol?

Senator Lincoln. Because we have not had the subsidy that ethanol has had for the many past years, and the cost right now in getting it up to speed with ethanol, even though it is plausibly equally as productive in a vehicle today as ethanol is, or could be.

Senator Nickles. But you can drink ethanol. You cannot drink bio-diesel. I would urge adoption.

Senator Lincoln. You can fry french fries in it, though. [Laughter].

Senator Breaux. We drink it in Louisiana.

[Laughter].

Senator Lincoln. Thank you, Mr. Chairman.

Senator Smith. Mr. Chairman?

The Chairman. Senator Smith?

Senator Smith. Mr. Chairman, a lot of the arguments that Senator Nickles makes are very appealing to me because they are a free market. But I also understand the public policy we are trying to drive is new sources of energy. But this also solves another very serious and growing problem in our country, and that is the problem with animal waste and what you do with it.

If you can get rid of it in this way, this is good for the environment, this is good public policy. While I am sympathetic to the Senator's arguments as to the marketplace, the predicate for this whole bill is how to get us less dependent on other sources of energy.

The Chairman. Those in favor of the Nickles amendment, say aye.

[A chorus of ayes]

The Chairman. Those opposed, say no.

[A chorus of nays]

The Chairman. The nays do have it. The amendment is defeated.

The Senator from Kentucky?

Senator Bunning. Thank you, Mr. Chairman. I have

an amendment, #25. It ties into the amendment that has just passed. I have filed an amendment that aims to provide tax parity for all types of bio-diesel used as an alternative renewable source of fuel.

There are many different types of bio-diesel, including animal fats, recycled cooking oils and restaurant greases, and vegetable oils made up of soybeans and many other seeds, and flax seeds.

The bio-diesel tax incentives section of the mark, however, provides one tax credit for bio-diesel from vegetable oils and animal fats, while providing a less generous tax incentive for recycled oils, greases, and non-virgin vegetable oils.

My amendment would return neutrality to the tax incentives by providing identical tax incentives to all bio-diesel, regardless of the source. It is important to provide an incentive to use the fuel itself instead of providing incentives for one type of bio-diesel over the other.

By providing the same tax incentives to all refiners of bio-diesel, we do not economically discriminate against one set of bio-diesel and void potential disruption in the emerging bio-diesel industry.

The amendment would level the playing field, from the smallest renderer to the largest soybean processor or co-

op. It also prevents federal dollars being used to tilt the marketplace to benefit one set of companies over another.

Kentucky has a large amount of soybean crops, so I support and encourage the use of vegetable oil as an alternative fuel. But bio-diesel is bio-diesel. Science has shown us this. The tax incentive for bio-diesel as an alternative renewable fuel source should be equally reflected in this.

Mr. Chairman, I was prepared to offer this amendment today. But, in recognition of the technical nature of this issue, I would like to forbear consideration at this time, with the understanding that our staffs will continue to work together on outstanding issues to prepare for possible consideration of this issue when we readdress this matter on the floor of the U.S. Senate.

The Chairman. We will work with you, Senator.

Senator Bunning. Thank you very much.

The Chairman. Thank you for your withdrawal.

Senator Kyl?

Senator Kyl. Thank you, Mr. Chairman. Let me, at this time, offer the amendment to remove the provision in Section 45, which increases the kilowatt hour on the wind and biomass to 1.8 cents, the amended that you added to the bill today. In view of the time, let me simply make

two points. I did not come fully prepared to argue this, because I was not aware it was going to be done.

But last year on the floor we had a fairly extensive debate in connection with renewable portfolio standard amendments, which verified at least two things, one of which was that the wind industry actually is not going to need a subsidy in the future. It is the closest to being in direct competition with the gas- and oil- and coal-produced electric energy in the country.

This comes from the industry itself. I cannot recall whether it was within two years, but it was within a very short period of time, the kilowatt per hour production costs were going to be essentially the same, with the result that even the industry was saying that this was a purely temporary tax incentive that could go away. Now we are increasing it.

The second point, is we also found, and the evidence was made clear in the debate on the floor, and I guess I will have to bring it out again, that this particular subsidy is really nothing more than a massive transfer of wealth from most of the electric customers in the country to a few places where wind energy, which is really the only thing that can compete with the fossil fuel-produced energy and nuclear, is produced.

Therefore, a few areas benefit to the loss of an

awful lot of electric customers in other parts of the country. So, I really wish that we had not done this, and I would like to strike it.

The Chairman. Senator Nickles?

Senator Nickles. Mr. Chairman, I concur with Senator Kyl. I remember when we debated this on renewable sources. Wind energy is competitive and it does not need the increase. Your amendment takes it from 1.8 to 1.5.

Senator Kyl. Yes.

Senator Nickles. I concur with that. I would urge its adoption.

Senator Breaux. Mr. Chairman?

The Chairman. The Senator from Louisiana.

Senator Breaux. Mr. Chairman, I would disagree. I would think that it is true that the cost of producing wind power is starting to come down. It is becoming more competitive. The tax credit has played a very important role in getting it to the point where it is, but it is not there yet.

I think that what you are looking at is an increase of, what is it, 1.5 now, to 1.8? Three-tenths of one cent, which is barely keeping up with what it would, with inflation, would cost. So I think it is one that is working.

It is not just narrowly utilized. It is utilized all over the United States. It is growing. Maybe eventually you are not going to need it, but you still need it now. I think this increase is just an inflationary adjustment.

Senator Baucus. Mr. Chairman, I suggest we vote.

The Chairman. All right. Those in favor of the Kyl amendment, say aye.

[A chorus of ayes]

The Chairman. Those opposed, say no.

[A chorus of nays]

The Chairman. The nays seem to have it. The nays do have it. The amendment is defeated.

Senator Kyl?

Senator Kyl. Mr. Chairman, if no one else has an amendment, let me, in the interest of time, combine three amendments so we can have a vote on all three. I think I understand what the result will be. [Laughter].

Well, I hope that is a friendly bit of laughter, because this is serious business. We are spending a lot of money here that we do not need to spend, and I am trying to accommodate my colleagues by combining these three.

Numbers 13, 14, and 15 in the material. They are my numbers 4, 5 and 6. Frankly, the explanation is pretty sufficient, I think, right in here. The savings in #13

is $288 million. The savings in $14 is $9 million. The savings in $15 is $134 million. You combine that up, and it amounts to pretty big money. We are talking half a billion dollars over 10 years, which could go to general deficit reduction.

I would just make a comment on the first amendment. By the way, this is a new subsidy. This is not a continuation of, or in addition to. This is a new subsidy. Now, this is for the energy-efficient clothes washers, refrigerators, and so on.

Remember when we did this with toilets, and everybody thought it was a great idea. Does anybody here agree that that was a great idea? I mean, you have to flush two or three times, so you end up not saving water. You end up using more water.

I mean, this is somebody's bright idea. The reality is, it is probably one of our wonderful special interests at work here. We love them all, and I join in the chorus of support for our wonderful special interest contributors. But the reality is that most of these benefit special interests and they do not add much in terms of cost benefit in terms of energy reduction or new production.

The Chairman. I would ask for a defeat of the amendment because this is well-balanced between energy

production, alternative energy, and energy conservation. These fall in the area of energy conservation, and I think we ought to promote energy conservation.

Those in favor of the Kyl amendment, say aye.

[A chorus of ayes]

The Chairman. Those opposed, say no.

[A chorus of nays]

The Chairman. The nays seem to have it. The nays do have it. The amendment is defeated.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. Mr. Chairman, I have an additional amendment I wish to bring to you attention, and that would be my first amendment.

This amendment would strike the provisions dealing with Section 45 and the ability to trade tax credits for non-taxable entities. Mr. Chairman, this is in the mark. I think you are going to be embarrassed if you keep it in the mark.

If my memory serves me correctly, we did something exactly like this called Safe Harbor Leasing. Senator Jeffords might remember that. It was back in the early 1980s. Basically, you allowed a lot of tax-exempt entities to be able to buy and trade tax credits.

Well, they did not pay taxes, so they did not get any

value from it. So they took it and they sold them to entities supposedly that did pay taxes. In effect, the entities that bought those did not pay taxes as a result of that.

So, we had a lot of profitable corporations that should have been paying taxes, but did not pay taxes because of safe harbor credits. We are going to do the same thing, I am afraid, under this provision.

You are going to give a lot of Section 45 credits that are going to be in the billions of dollars, ultimately, and allow entities that do not pay taxes to sell those credits to entities that do pay taxes. They will be traded, and there will be a market.

The net result is, you are going to be having a lot of taxable entities not paying taxes, and then we are going to be having hearings here years from now saying, wait a minute, why did that big company not pay taxes?

Oh, well, it is going to be because of this tradeable credit from non-taxable entities. Non-taxable entities already have an advantage: they do not pay taxes.

So, I would urge the adoption of the amendment to save us, I think, from a serious mistake and complicating the Tax Code, and also coming up with an end result of, I think ultimately, a licensed ability for a lot of entities not to pay taxes, period.

Senator Thomas. Mr. Chairman?

The Chairman. Senator Thomas?

Senator Thomas. May I ask a question of the Senator?

The Chairman. Yes.

Senator Thomas. I presume in many of these things, in taxes, we are seeking to provide an incentive for groups to do certain things. Is that not what this is for? You cannot give a tax incentive to a nonprofit, but if you do it this way you are giving an incentive for them. I believe that is the reason, is it not?

Senator Nickles. I think the net result will be, is you are going to have power marketing authorities, which we had last time, if you will remember, under Safe Harbor Leasing. You had co-ops. You will have co-ops.

A good example, would be co-ops could do a windmill farm. Then we have got credits. The credits are equal to, now, 60 percent of the wholesale price of electricity. They are valuable.

Since they do not pay taxes on those tax credits, now they will be able to sell those to another entity that possibly did pay taxes. Maybe it is a privately-owned utility. Maybe it is somebody else, and they will not pay taxes as a result of this.

So I think there is a domino impact that the co-op

already has tax advantages in the fact that they do not pay taxes. This will continue to make sure they have competitive advantages over taxable entities, and it will also make sure the Federal Government is going to receive a lot less revenue. I think it is terrible tax policy.

The Chairman. If you look at the history of providing electricity for everybody in the United States, you would have an appreciation of the roles of municipal utilities, and particularly rural electric cooperatives, along with public utilities, particularly at a time 60, 70 years ago when public utilities were not providing electricity in rural America.

This is to treat these three very viable entities, providing electricity to all Americans, to make sure that they are treated equal, not with some sort of advantage. The advantage was a tax incentive so all Americans could have electricity. So, let us remember that historical approach as we vote on this amendment. I would ask you to vote no on the amendment.

Senator Nickles. Mr. Chairman, if we want to treat them all equitably, let us tax them all identically.

The Chairman. We would still have farmers in the United States without electricity.

Those in favor, say aye.

[A chorus of ayes]

The Chairman. Those opposed, say no.

[A chorus of nays]

The Chairman. The nays seem to have it, do have it. The amendment is defeated.

Senator Santorum. Mr. Chairman?

The Chairman. The Senator from Pennsylvania.

Senator Santorum. Mr. Chairman, I want to call up my Amendment #21, which has to do with black lung trust assets. It is a very narrow issue. There are probably two companies right now who have reached their aggregate cap on what they can transfer from their black lung trust fund over to their liabilities under the Coal Act. There are two caps. One is a cap on how much they have annually they can put aside. The other, is an aggregate cap.

Frankly, I have no understanding in looking at this legislation. It had to be explained to me about 20 times, to figure out the reason that there is an aggregate cap on how much they can transfer once they already have 110 percent of what their expected liabilities are.

I think it was a floor amendment, my understanding was, years ago to the Coal Act. It really is going to have a negative impact on a couple of companies, one of whom happens to be in my State, number one.

Number two, this actually is a revenue raiser, so this is something that actually will raise $24 million in revenue because the company will transfer assets to pay their coal liability instead of paying it out of their profits, which would be a deduction for that. So, now they will be taxed on that income.

So it is a very reasonable thing. It does raise money. Senator Rockefeller, who as you know is one of the principal defenders of the Coal Act, has a statement here that says he supports it. I would hope that the Chairman would work with us to make sure that this is included in the bill.

The Chairman. Senator Santorum, I think it would be more appropriate if this were brought up when we bring up the pension bill. It is a controversial amendment, particularly where the revenue would transfer to, and all those things. We need to look at this more carefully than would be appropriate for right now in this amendment. I do not want to make any commitment, though, to you, because this is highly controversial.

Senator Santorum. The controversial part, I assume you are saying, is where the money goes, not the actual relieving of the burden.

The Chairman. That is right.

Senator Santorum. It is where you would want to

spend the $24 million, is what the problem is.

The Chairman. Partly, yes. And maybe mostly.

Senator Santorum. If I can get your commitment, I would be happy to work with you on the part of where the money goes. But I would like a commitment that we could relieve the burden of this aggregate cap, and then work with you on where that money goes.

I do not need a commitment on the second half, but I would like a commitment on the first half, that we are able to do this. As I said, Senator Rockefeller supports both aspects.

The Chairman. The answer is yes.

Senator Santorum. Thank you, Mr. Chairman.

The Chairman. Senator Kyl?

Senator Kyl. Mr. Chairman, I will not offer this amendment. You have already indicated a willingness to work with me. But it is Amendment #16, my #11. It would be the second step in the process that we began in the budget where we made room in the budget for accelerating the repeal of the death tax by one year.

We are going to have to find a vehicle in this committee to do that legislatively to take advantage of what we did in adopting the budget. I know Senator Baucus has been supportive, Senator Lincoln has been supportive, and others on this side have been supportive.

I know you will work with me to try to find that. This is probably not the right place to do it, so I will not offer this amendment at this time.

The Chairman. Thank you very much.

I think, now that we have all the amendments on this bill taken care of, before you speak, I want to take care of--well, we had better go with you.

Mr. Barthold. Mr. Chairman, the staff at the table is just unclear as to the amendments by Mrs. Lincoln that the committee accepted. Could we clarify the amendments?

The Chairman. Why do you not put it in writing?

Where are we now?

Senator Kyl. Mr. Chairman, might I ask you a question, please?

The Chairman. Yes.

Senator Kyl. When I voted no on the bill, I asked if I would have an opportunity, before we left, to briefly explain my reasons for that. I would like to do that.

The Chairman. Could I ask the courtesy to Senator Baucus that enough people stay so we can get his amendment adopted?

Senator Baucus. Of course. Thank you. It is a very perfunctory amendment. Basically, it is on the Diamond Act. It provides that the Treasury is the co-

chair of the Oversight Committee, which gives this committee jurisdiction over that issue. It is that simple.

The Chairman. All right. Without objection, the Baucus amendment to the Diamond legislation is adopted.

I should call on Senator Kyl, first, for his statement.

Senator Kyl. Thank you, Mr. Chairman. I will make this very, very brief. I think we all agree that we need an energy policy in this country. But I do disagree that the policy embodied in this legislation is one that can really meet any common sense cost benefit test, especially in view of other alternatives that exist to promote more energy development.

The bulk of this bill is subsidies, as we all acknowledge. In fact, Senator Breaux said it. They do distort the market. There was a judgment made by most people that that is acceptable, that that is desirable under the circumstances. I disagree.

One of the comments made by the Senator from Utah was that we have to have this in order to get these products to market. But the reality is, millions of products go to market every day without a subsidy. The Section 45 tax credit, I think, as I said, is a massive transfer of wealth. We are going to be increasing the deficit by $15

billion.

We seem to have sort of amnesia sometimes with regard to the deficit. We all talk about reducing the deficit, but then when we have an opportunity to spend money we end up doing that. I think there is no wonder some of our constituents have a rather jaundiced view of our commitment to reducing the deficit when we are willing to spend in this way.

This is a special interest bill. I do not say that in a pejorative way. A lot of the folks in the audience there who are special interests are friends. There is nothing, per se, wrong with special interests. But let us acknowledge that there are a few who benefit greatly from this legislation, at great cost to the majority.

I have in mind things like wind power and ethanol, and that is especially pernicious because there are some places where those things do not work very well. Ethanol does not work in Arizona. That is why we have to work MTEB, which also has its problems. I mentioned the alternative fuels experience. I do not think that is going to work well here. It certainly has not in Arizona.

We do need more energy, but I think we should try to get it in the traditional way and the most obvious way, which is more production. Yet, we are not willing to

support things like offshore development, like Anwar, and so on, which costs the government absolutely nothing, and in fact produces a lot of tax revenue.

Rather, we are trying to change people's behavior, help special interests, and force politically preferred products with costly taxpayer subsidies, which, as I say, at the end of the day, really cannot meet a sensible cost benefit analysis.

To conclude, the small savings in fuel and the small production that this bill provides comes at a huge cost for BTU. I submit it is not good energy policy, at least as compared with what we could do. That is why, Mr. Chairman, since my amendments were not adopted, I did have to vote no.

The Chairman. Senator Smith?

Senator Smith. Mr. Chairman, I think our friend from Arizona makes many good points, but I think it is a fact that we are paying a very high price as a Nation because of our dependence upon foreign sources of oil already. Those are not accounted for in an energy bill like this. But there are, nevertheless, costs incurred by the American taxpayer.

I want to thank you, sir, for your help on the Alaskan natural gas pipeline, which will substantially increase the availability of natural gas to the advantage

of Alaska, but also to the advantage of the lower 48.

I have two additional amendments that involve incremental hydropower and Section 48 tax credits, and another with respect to allowable tax credits for residential solar energy.

It is my understanding that we have not sufficiently refined the score on those, and I will work with you before we go to the floor, perhaps, that they can then be incorporated in the bill before it gets there.

But I thank you for your hearing this, and for your work on a very important bipartisan bill that furthers America's energy independence, at a price. But nothing is free, and we have got to get away from our dependence upon foreign sources of energy.

The Chairman. Thank you very much. We look forward to working with you on those two amendments.

The Senator from Arkansas?

Senator Lincoln. Thank you, Mr. Chairman. Once again, I would like to compliment your work on this energy bill. I think it does reflect the diversity of what we need in this country. I also want to compliment your staff. They have worked very hard.

I would like to clarify, if I may, the amendment there. Mr. Chairman, I, your staff and mine were working on the proposal, looking for a solution. The President's

change in the landfill gas definition for Section 29 seemed to be the appropriate place where we could come together, and I would like to make sure that that modification--I believe Ms. Olson can present that, if she would.

The Chairman. Is that a problem?

Ms. Paris. No, it is not. This is a clarification of Senator Lincoln's amendment that would conform it to the proposal in the President's budget regarding "placed in service," and when a landfill gas facility is considered placed in service. It clarifies that the credit applies to portions of facilities, so long as those portions of the facilities are placed in service after the effective date.

The Chairman. Thank you, Secretary Olson.

I would ask consent to provide authority to the staff to make technical and conforming changes, including changes to make the reported bill revenue neutral. That is applicable to the energy bill.

Senator Jeffords, did you want the floor?

Senator Jeffords. No. I just wanted to make sure that I am here before things end.

The Chairman. You are, all three of us.

Senator Jeffords. All right.

The Chairman. I ask also, I am going to put an

opening statement that I did not give on the Diamond bill as part of the record as well.

[The prepared statement of Senator Grassley appears in the appendix.]

The Chairman. The meeting is adjourned. Thanks to all my colleagues.

[Whereupon, at 12:59 p.m. the meeting was concluded.]

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UNITED STATES SENATE
COMMITTEE ON FINANCE

Charles E. Grassley, Chairman

Wednesday, April 2, 2003
10:00 a.m.
215 Dirksen Senate Office Building

Agenda for Business Meeting

I. **The Energy Tax Incentives Act of 2003;**

II. **The Clean Diamond Trade Act;**

III. **The Tax Court Modernization Act;**

IV. **The Committee may also consider any or all of the following nominees:**

- **Mark Everson, to be Commissioner of Internal Revenue;**
- **Mark Van Dyke Holmes, to be Judge of the United States Tax Court;**
- **Diane L. Kroupa, to be Judge of the United States Tax Court;**
- **Harry A. Haines, to be Judge of the United States Tax Court;**
- **Robert Allen Wherry, Jr., to be Judge of the United States Tax Court;**
- **Joseph Robert Goeke, to be Judge of the United States Tax Court; and,**
- **Raymond T. Wagner, Jr., to be Member of the Oversight Board, U.S. Department of Treasury.**

Senator Charles E. Grassley
Opening Statement
The Clean Diamond Trade Act

Today we will be considering the Clean Diamond Trade Act. We intially planned on considering an original Finance Commttee bill.

However, the bill was introduced last night by Senator Baucus and myself as S. 760. The bill is virtually identical to the original Chairman's mark. The bill now has eleven cosponsors, including Senators Snowe, Santorum, Bingaman, Rockefeller, and Kerry. S. 760 is the legislation we will be considering here today.

I understand Senator Baucus has an amendment he would like to offer that would strengthen the bill by establishing an executive branch coordinating committee to oversee implementation of the Act. I understand the amendment has been modified to include the Department of State as a co-chair of the implementing Committee along with other technical changes. With that modification, I will be prepared to accept the amendment.

Technically, this Act will implement a certification process for imports of rough diamonds. But, as many of you know, this bill goes far beyond technicalities. This bill will help put an end to trade in conflict diamonds. Conflict diamonds are diamonds mined and used by rebel movements in many African nations as a source of revenue to fuel armed conflict and the activities of rebel movements aimed at undermining or overthrowing legitimate governments in African countries. Millions of people have been driven from their homes by wars that have been fought for control of these diamonds. Families and entire countries have been torn apart.

That is why it is vitally important that we pass this legislation. Passage of this legislation would be a true bipartisan success and a significant step forward in stopping trade in conflict diamonds. And I would like to thank my colleagues for helping to develop the compromise legislation in this Act. I think our efforts paid off – last night we were able to introduce the bill we are considering today with over ten original cosponsors from both sides of the aisle.

Prior attempts to move similar bills have stalled in both the House and the Senate. So, as Chairman of the Finance Committee, I took great care to try and achieve the right balance so that we might implement a certification process that meets our international responsibilities, that can pass the House and the Senate, and most importantly, that works.

The Clean Diamond Trade Act will implement the Kimberley Process Certification Scheme. This is an international agreement establishing minimal acceptable international standards for national certification schemes relating to cross-border trade in rough diamonds. It represents over two years of negotiations among more than 50 countries, human rights advocacy groups, the diamond industry and non-government organizations.

The next plenary session of the Kimberley Process is scheduled to convene in Johannesburg, South Africa, from April 28 to the 30, 2003. The U.S. played a leadership role in crafting the

Kimberley Process Certification Scheme, and it is critical that we implement the certification process before April 28 if we are to retain this leadership. We also need to do this to ensure that the flow of legitimate diamonds into and out of the United States will continue without interruption. Most important, we need to do everything we can to stop trade in conflict diamonds as soon as possible.

I am pleased that we are able to mark-up this legislation in the Finance Committee today. I hope it will receive strong bipartisan support in committee and that we can pass this bill by unanimous consent in the full Senate before we adjourn for the April recess. The people and countries in Africa affected by the damage of conflict diamonds deserve our support. Passing this bill is the right thing to do.

Bob

NEWS RELEASE

ORRIN HATCH

United States Senator for Utah

FOR IMMEDIATE RELEASE

CONTACT: Peter Carr (202) 224-9854

Opening Statement of Senator Orrin G. Hatch
before the
Committee on Finance
Markup of Energy Tax Provisions
April 2, 2003

Thank you Mr. Chairman. I applaud you for holding this markup today. You and Senator Baucus deserve credit for putting forth an energy incentive tax package that is both broad in scope and bipartisan in nature. I am particularly pleased that your mark incorporates the CLEAR ACT, the most comprehensive legislation Congress has yet considered to promote the use of alternative fuel vehicles and advanced car technologies. Both of you and your staffs have been very helpful in finding a way to include this proposal in the Chairman's mark. As you know, among my partners on the CLEAR ACT are Senators Rockefeller, Jeffords, Snowe, Kerry, and Smith – all, important members of this committee.

Transportation accounts for about two-thirds of the oil consumed in the United States, and we are 97 percent dependent on oil for our transportation needs. If we want to clean our air and address our nation's energy dependency, we must increase the use of alternative fuels in our transportation sector.

President Bush has responded by making this an important focus of his energy strategy. Last year, the Department of Energy unveiled its FreedomCar program to promote research and development in the area of fuel cell vehicles. Recognizing that this goal necessitates a hydrogen-based infrastructure, early this year the President announced his Hydrogen Fuel initiative which has the goal of developing critical fueling technologies. I express my full support for these two initiatives which will help to promote a revolution in the transportation industry.

As important as these programs are, though, we must recognize that research and development alone will not bring us to a hydrogen future. The greatest economic power in the U.S. is the free market. Our future transportation system will be driven principally by what consumers want and what consumers can afford. The CLEAR ACT takes full advantage of the free market by focusing on the technologies needed for fuel cells that are in vehicles being purchased and driven by consumers as we speak, albeit on a relatively small scale. I might add that the President's energy strategy also includes many of the provisions found in the CLEAR ACT.

The CLEAR ACT also focuses on those alternative fuels that are readily available domestically and are easily transformed into hydrogen. A number of these fuels already have a tremendous infrastructure in place, but for the most part the infrastructure has not yet been adapted to the transportation sector.

In sum, if we are to get to a hydrogen future, we must focus first on those technologies and alternative fuels that are already available in the market. In recognizing this, the CLEAR ACT is the shortest and most direct path to a revolution in our transportation sector.

This legislation would lower the barriers that stand in the way of widespread consumer acceptance of these advanced technology and alternative fuel vehicles by providing a CLEAR Act Credit to consumers who purchase hybrid electric, fuel cell, battery electric, and dedicated alternative fuel vehicles. It would also provide tax incentives for the purchase of alternative fuels and the development of an alternative fuel infrastructure.

Without imposing any new mandates, the CLEAR ACT focuses on the very best emerging technologies to help our citizens to enjoy the health benefits of cleaner air sooner and to help us reduce our consumption of foreign oil sooner than would otherwise be possible.

A few years ago, a well-intentioned program to promote alternative fuel vehicles by the Arizona legislature experienced extreme cost overruns and failed to provide the promised energy and environmental benefits. I want to assure the members of this committee that we have studied the Arizona experience, we have identified the inherent weaknesses of that model, and we have been careful to avoid each one of them.

With the CLEAR ACT, until a new advanced vehicle is purchased, until new infrastructure has been installed, or until alternative fuel is placed in the tank of a dedicated alternative fuel vehicle, there will be no cost to the Treasury. And when a cost is incurred, it will be a small cost relative to the resulting environmental benefits and energy savings. I hope the members of this committee will give their full support for this plan.

In a different vein, Mr. Chairman, I also want to thank you and Senator Baucus for your cooperation and leadership in marking up the Tax Court Modernization Act today. The Tax Court plays a very important role in our tax system, and it is important that we do all we can to support the court, its judges and its employees. This bill will modernize the Court, and make it easier to attract and retain the talented judges and employees it needs to fulfill its heavy workload. Senator Breaux and I have been working for several years on this legislation, and it is gratifying to see it finally coming to fruition.

Let me also express my gratitude that today the committee will take steps to resolve the Kimberly Process Certification Scheme for cross border trade in rough diamonds. I know that this is an issue that both Chairman Grassley and Senator Baucus have worked very hard on to

craft the bipartisan bill that we will address today. This necessary change in Kimberly Scheme will undoubtedly help to prevent the flow of rough diamonds into the United States market from rebel-held conflict areas around the world. I support this important measure and anticipate voting for its passage.

Again, I thank the Chair and Senator Baucus for their leadership on these issues, and I look forward to the committee's action on them this morning.

###

Senate Finance Committee Mark-Up
"Energy Tax Incentives Act of 2003
Statement of Senator Snowe
April 2, 2003

Thank you, Mr. Chairman. First let me commend you for having this mark up today, as it is imperative that we reform our nation's energy policy. And, a vital component in this policy is a dynamic tax code that "incentivizes" new and promising technologies for energy.

The United States has had a long history of developing innovations and inventions with regard to oil use and production, nuclear power, and solar energy. New York's Pearl Station, designed by Thomas Edison in 1882, demonstrated the immense possibilities of large-scale electricity generation that would revolutionize our nation and the world.

As we begin our journey into the 21st century, we must begin a new chapter for energy use through the development of new sources of energy. Across the country, we are seeing research being transformed into previously-unseen products and industries. Fuel cell technology is just one example of this ingenuity – offering a clean, secure, efficient, and dependable source of energy that should be part of our national energy strategy to address our most pressing needs.

We all understand the concern about our country's dependence on foreign oil. New sources of energy can and *must* be developed and launched in the marketplace for the benefit of both our own national security as well as the American consumer. At the same time, conservation and smart energy consumption is *also* a necessity.

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

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

Specifically, this mark provides important tax incentives for the construction of energy efficient commercial buildings, and renovation of old existing buildings – including schools and other public buildings – as well as residential buildings that produce a 50 percent reduction in energy costs to the owner or tenant – as compared to a national model code that was part of S. 507 that I introduced with Senators Feinstein, Kerry, Smith and others.

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

Notably, these incentives are based on *performance*, not cost, in order to foster competition between suppliers of different technologies that can

meet the proposed target. And we know that competition will not only improve these technologies, but help make them more widely available.

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

Finally, the mark expands the categories of waste materials that qualify for the existing tax credit for the production of electricity to include waste from forest-related activities – a critical industry in Maine that continues to face difficult economic circumstances. This provision will both help the forest products industry and take a step towards smarter energy production.

Mr. Chairman, I believe our task is to help make it more attractive, through the tax code, for our U.S. manufacturers to get the most promising and cost-effective technologies to the U.S. and global marketplace with all due speed. We should also help to increase the American public's awareness of the benefits to our health and our national security of encouraging the shift away from foreign fossil fuel and toward domestic renewable and alternative energy sources.

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

I am pleased that the Finance Committee mark contains an array of energy tax provisions I have advocated and believe these measures will help guide our nation in crafting a responsible energy policy. The mark includes important legislation I have sponsored, principally the Efficient Energy through Certifiable Technology (EFFECT) Act and fuel cell tax legislation, S. 758, as well as additional renewable energy legislation I have cosponsored. These following provisions will serve the nation in meeting its energy needs.

- Energy Efficient New Homes: Following the Snowe-Feinstein comprehensive proposal for increasing building and residential energy efficiency, the Finance Committee mark provides a package of tax incentives that will stimulate significant energy savings in our nation's building and housing sector. The mark provides a tax incentive for constructing energy efficient new homes based on certain levels of energy savings. New homes that achieve a 30 percent or 50 percent energy savings will be eligible for a credit of $1,000 or $2,000 respectively. A similar performance-based standard is a center piece of the EFFECT Act. By including this in the mark, we are ensuring that energy efficiency will be part of the blueprint for many new houses.

- Energy Efficient Existing Homes: Under the mark, homeowners will also be able to take advantage of an energy efficiency credit offered for existing homes. Homeowners can receive a credit for retrofitting existing homes with efficient heating and cooling systems, energy efficient windows, and high efficiency insulation. This provision assures that energy tax incentives are available for both new and existing homes - as proposed in the EFFECT Act, too. The mark accomplishes the goal of addressing both new and existing homes.

- Energy Efficient Commercial Buildings: The mark adopts innovative language also included in the EFFECT Act with regard to energy efficient commercial buildings. New and existing commercial buildings that achieve a 50 percent reduction in energy costs compared to the national model code would qualify

for a deduction of $2.25 per square foot of the building. This ambitious level of energy savings would yield tremendous benefits to the reliability of our electricity grid.

- Fuel Cell Incentives: The mark promotes the expanded use of an environmentally sound and efficient energy technology - fuel cell power. The Finance mark parallels efforts of the Lieberman-Snowe Fuel Cell bill by providing both residential and commercial fuel cell users a tax credit. Fuel cells use electrochemical reactions to convert the energy from hydrogen-rich fuel sources into electricity.

- Alternative Fuel Vehicles and Highly Efficient Vehicles: The mark provides new tax credits for the purchase of three different types of advanced technology vehicles: Hybrid motor vehicles, alternative fuel motor vehicles, and fuel cell motor vehicles. This section is based on the CLEAR ACT, which I cosponsored. With the inclusion of the CLEAR Act, the mark advances the goals of encouraging the production and sale of energy efficient vehicles, while reducing emissions from vehicle exhaust and lessening our dependence on foreign oil.

- Alternative and Renewable Energy: I have cosponsored the Renewable Energy Incentives Act, introduced by Senator Reid, which extends credits for renewable energy production. As in this legislation, the mark ensures that incentives for alternative and renewable energy production will continue to be available over the next ten years. The mark does this by extending Section 45 Production Tax Credits for wind, biomass, geothermal, solar and incremental hydropower. Electricity generated from qualified renewable and alternative energy sources will be able to claim a tax credit of 1.5 cents per kilowatt-hour (cents/kWh). All ten of Maine's biomass plants will be covered by the tax credit extension.

- Transferable Renewable Energy Credit: The mark includes a mechanism to allow rural electric cooperatives and municipal power authorities to use the tax

credit for renewable and alternative energy. This provision is from the Renewable Energy Incentives Act, which I have cosponsored. Because these entities are tax exempt, the provision assures that these entities are also able to avail themselves of these credits.

STATEMENT FOR SENATOR BUNNING
FINANCE COMMITTEE HEARING
ENERGY TAX INCENTIVES ACT OF 2003 MARKUP
APRIL 2, 2003

Thank you, Mr. Chairman.

I'm glad that we are passing the Energy Tax Incentives Act. I think that tax incentives are important to promote technologies that will encourage conservation and the expanded use of cleaner burning fuels.

I am particularly pleased to see that clean coal technology tax provisions were provided in the bill. I am proud to come from a coal state and these provisions will particularly help Kentucky promote the use of clean coal technology. By providing tax incentives for those companies who implement clean coal technology, the provision will help spur investment, create jobs, and protect the environment. Further, clean coal tax incentives will encourage significant reductions of emissions of Sulfur Dioxide, Nitrogen Dioxide, and Carbon Dioxide in the future due to cleaner burning technologies and a sharp increase in the efficiency of turning coal into electricity.

I hope the Energy Tax Incentives Act will help to improve our nation's use of domestic energy in the twenty-first century.

Thank you.

DESCRIPTION OF
THE "ENERGY TAX INCENTIVES ACT OF 2003"

Scheduled for Markup
By the
SENATE COMMITTEE ON FINANCE
on April 2, 2003

Prepared by
the Staff of the
JOINT COMMITTEE ON TAXATION

March 31, 2003
JCX-21-03

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup on April 2, 2003, on the "Energy Tax Incentives Act of 2003." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the "Energy Tax Incentives Act of 2003.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the "Energy Tax Incentives Act of 2003"* (JCX-21-03), March 31, 2003.

I. RENEWABLE ENERGY

A. Extension and Modification of the Section 45 Electricity Production Credit

Present Law

An income tax credit is allowed for the production of electricity from either qualified wind energy, qualified "closed-loop" biomass, or qualified poultry waste facilities (sec. 45). The amount of the credit is 1.5 cents per kilowatt hour (indexed for inflation) of electricity produced. The amount of the credit was 1.8 cents per kilowatt hour for 2002. The credit is reduced for grants, tax-exempt bonds, subsidized energy financing, and other credits.

The credit applies to electricity produced by a wind energy facility placed in service after December 31, 1993, and before January 1, 2004, to electricity produced by a closed-loop biomass facility placed in service after December 31, 1992, and before January 1, 2004, and to a poultry waste facility placed in service after December 31, 1999, and before January 1, 2004. The credit is allowable for production during the 10-year period after a facility is originally placed in service. In order to claim the credit, a taxpayer must own the facility and sell the electricity produced by the facility to an unrelated party. In the case of a poultry waste facility, the taxpayer may claim the credit as a lessee/operator of a facility owned by a governmental unit.

Closed-loop biomass is plant matter, where the plants are grown for the sole purpose of being used to generate electricity. It does not include waste materials (including, but not limited to, scrap wood, manure, and municipal or agricultural waste). The credit also is not available to taxpayers who use standing timber to produce electricity. Poultry waste means poultry manure and litter, including wood shavings, straw, rice hulls, and other bedding material for the disposition of manure.

The credit for electricity produced from wind, closed-loop biomass, or poultry waste is a component of the general business credit (sec. 38(b)(8)). The credit, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of (1) 25 percent of net regular tax liability above $25,000, or (2) the tentative minimum tax. For credits arising in taxable years beginning after December 31, 1997, an unused general business credit generally may be carried back one year and carried forward 20 years (sec. 39). To coordinate the carryback with the period of application for this credit, the credit for electricity produced from closed-loop biomass facilities may not be carried back to a tax year ending before 1993 and the credit for electricity produced from wind energy may not be carried back to a tax year ending before 1994 (sec. 39).

Description of Proposal

The proposal extends the placed in service date for wind facilities, closed-loop biomass facilities, and poultry waste facilities to facilities placed in service after December 31, 1993 (December 31, 1992 in the case of closed-loop biomass facilities and December 31, 1999 in the case of poultry waste facilities) and before January 1, 2007.

The proposal provides that, for facilities placed in service after the date of enactment, the amount of the credit will be 1.5 cents per kilowatt hour with no adjustment for inflation for production in years after 2003.

The proposal also defines six new qualifying energy resources: biomass (including agricultural livestock waste nutrients), geothermal energy, solar energy, small irrigation power, municipal biosolids, and recycled sludge.

Qualifying biomass facilities are facilities using biomass to produce electricity that are placed in service prior to January 1, 2005. Qualifying agricultural livestock waste nutrient facilities are facilities using agricultural livestock waste nutrients to produce electricity that are placed in service after the date of enactment and before January 1, 2007.

For a facility placed in service after the date of enactment, the ten-year credit period commences when the facility is placed in service. In the case of biomass facility originally placed in service before the date of enactment, the ten-year credit period is reduced to a five-year period and commences after December 31, 2003 and the otherwise allowable 1.5 cent-per-kilowatt-hour credit is reduced to a1.0 cent-per-kilowatt-hour credit.

The proposal modifies present law to provide that qualifying closed-loop biomass facilities include any facility originally placed in service before December 31, 1992 and modified to use closed-loop biomass to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, before January 1, 2007. The taxpayer may claim credit for electricity produced at such qualifying facilities with the credit amount equal to the otherwise allowable credit multiplied by the ratio of the thermal content of the closed loop biomass fuel burned in the facility to the thermal content of all fuels burned in the facility.

Qualifying geothermal energy facilities are facilities using geothermal deposits to produce electricity that are placed in service after the date of enactment and before January 1, 2007. Qualifying solar energy facilities are facilities using solar energy to generate electricity that are placed in service after the date of enactment and before January 1, 2007. In the case of qualifying geothermal energy facilities and qualifying solar energy facilities, taxpayers may claim the otherwise allowable credit for the five-year period commencing when the facility is placed service.

A qualified small irrigation power facility is a facility originally placed in service after the date of enactment and before January 1, 2007. A small irrigation power facility is a facility that generates electric power through an irrigation system canal or ditch without any dam or impoundment of water. The installed capacity of a qualified facility is less than five megawatts.

A qualified municipal biosolids facility is a facility originally placed in service after the date of enactment and before January 1, 2007. A qualifying recycled sludge facilities is a facility originally placed in service after the date of enactment and before January 1, 2007.

Biomass is defined as any solid, nonhazardous, cellulosic waste material which is segregated from other waste materials and which is derived from any of forest-related resources, solid wood waste materials, or agricultural sources. Eligible forest-related resources are mill and harvesting residues, precommercial thinnings, slash, and brush. Solid wood waste materials

include waste pallets, crates, dunnage, manufacturing and construction wood wastes (other than pressure-treated, chemically-treated, or painted wood wastes), and landscape or right-of-way tree trimmings. Agricultural sources include orchard tree crops, vineyard, grain, legumes, sugar, and other crop by-products or residues. However, qualifying biomass for purposes of this proposal does not include municipal solid waste (garbage), gas derived from biodegradation of solid waste, or paper that is commonly recycled. Agricultural waste nutrients are defined as livestock manure and litter, including bedding material for the disposition of manure. Agricultural livestock comprise bovine, swine, poultry,[2] and sheep among others.

Geothermal energy is energy derived from a geothermal deposit which is a geothermal reservoir consisting of natural heat which is stored in rocks or in an aqueous liquid or vapor (whether or not under pressure).

Municipal biosolids are the residue or solids removed by a municipal wastewater treatment facility.

Recycled sludge is the recycled residue byproduct created in the treatment of commercial, industrial, municipal, or navigational wastewater, but not including residues from incineration.

The proposal provides that certain persons (public utilities, electric cooperatives, rural electric cooperatives, and Indian tribes) may sell, trade, or assign to any taxpayer any credits that would otherwise be allowable to that person, if that person were a taxpayer, for production of electricity from a qualified facility owned by such person. However, any credit sold, traded, or assigned may only be sold, traded, or assigned once. Subsequent transfers are not permitted. In addition, any credits that would otherwise be allowable to such person, to the extent provided by the Administrator of the Rural Electrification Administration, may be applied as a prepayment to certain loans or obligations undertaken by such person under the Rural Electrification Act of 1936.

In the case of qualifying open-loop biomass facilities and qualifying closed-loop biomass facilities modified to use closed-loop biomass to co-fire with coal, with other biomass, or with coal and other biomass, the provision permits a lessee or operator to claim the credit in lieu of the owner of the facilities.

Lastly, the proposal repeals the present-law reduction in allowable credit for facilities financed with tax-exempt bonds or with certain loans received under the Rural Electrification Act of 1936. In the case of qualifying closed-loop biomass facilities modified to use closed-loop biomass to co-fire with coal, with other biomass, or with coal and other biomass, the proposal repeals the present-law reduction in allowable credit for facilities that receive any subsidy.

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[2] The proposal deletes poultry litter as a separate qualifying facility for facilities placed in service after the effective date.

Effective Date

The proposal generally is effective for electricity sold from qualifying facilities after the date of enactment. For electricity produced from qualifying open-loop biomass facilities originally placed in service prior to the date of enactment, the provision is effective January 1, 2004.

II. ALTERNATIVE VEHICLES AND FUEL INCENTIVES

A. Modifications and Extensions of Provisions Relating to Electric Vehicles, Clean-Fuel Vehicles, and Clean-Fuel Vehicle Refueling Property

Present Law

Electric vehicles

A 10-percent tax credit is provided for the cost of a qualified electric vehicle, up to a maximum credit of $4,000 (sec. 30). A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electrical current, the original use of which commences with the taxpayer, and that is acquired for the use by the taxpayer and not for resale. The full amount of the credit is available for purchases prior to 2002. The credit phases down in the years 2004 through 2006, and is unavailable for purchases after December 31, 2006.

Clean-fuel vehicles

Certain costs of qualified clean-fuel vehicle may be expensed and deducted when such property is placed in service (sec. 179A). Qualified clean-fuel vehicle property includes motor vehicles that use certain clean-burning fuels (natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity and any other fuel at least 85 percent of which is methanol, ethanol, any other alcohol or ether). The maximum amount of the deduction is $50,000 for a truck or van with a gross vehicle weight over 26,000 pounds or a bus with seating capacities of at least 20 adults; $5,000 in the case of a truck or van with a gross vehicle weight between 10,000 and 26,000 pounds; and $2,000 in the case of any other motor vehicle. Qualified electric vehicles do not qualify for the clean-fuel vehicle deduction. The deduction phases down in the years 2004 through 2006, and is unavailable for purchases after December 31, 2006.

Clean-fuel vehicle refueling property

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

Description of Proposal

Alternative motor vehicle credits

The proposal would provide a credit for the purchase of a new qualified fuel cell motor vehicle, a new qualified hybrid motor vehicle, and a new qualified alternative fuel motor vehicle.

In general the proposal provides that the buyer claims the credit, unless the buyer is a tax-exempt entity in which case the seller or lessor of the vehicle may claim the credit. The taxpayer may carry forward unused credits for 20 years or carry unused credits back for three years (but not to any taxable year beginning before the date of enactment). Qualified vehicles are vehicles placed in service before 2007 (2012 in the case of fuel cell vehicles). Any deduction otherwise allowable under sec. 179A is reduced by the amount of credit allowable.

Fuel cell vehicles

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

Table 1.–Base Credit Amount for Fuel Cell Vehicles

Vehicle Gross Weight Rating in Pounds	Credit Amount
vehicle ≤ 8,500	$3,400
8,500 < vehicle ≤ 14,000	$8,500
14,000 < vehicle ≤ 26,000	$17,000
26,000 < vehicle	$34,000

Table 2, below, shows the proposed additional credits for passenger automobiles or light trucks.

Table 2.–Credit for Qualifying Fuel Cell Vehicles

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

Hybrid vehicles

A qualifying hybrid vehicle is a motor vehicle that draws propulsion energy from on-board sources of stored energy which include both an internal combustion engine or heat engine using combustible fuel and a rechargeable energy storage system (e.g., batteries). The amount of credit for the purchase of a hybrid vehicle is the sum of two components. In the case of an automobile or light truck, the amount of credit is the sum of a base credit amount that varies with the amount of power available from the rechargeable storage system and a fuel economy credit amount that varies with the rated fuel economy of the vehicle compared to a 2002 model year standard. In the case of a heavy duty hybrid motor vehicle (a vehicle weighing more than 10,000 pounds), the amount of credit is the sum of a base credit amount that varies, by vehicle weight class, with the amount of power available from the rechargeable storage system and an additional credit for early adoption of the technology that varies with the model year of the vehicle purchased.

For these purposes, a vehicle's power available from its rechargeable energy storage system as a percentage of maximum available power is calculated as the maximum value available from the battery or other energy storage device during a standard power test, divided by the sum of the battery or other energy storage device and the SAE net power of the heat engine.

Table 3, below, shows the proposed base credit amounts for automobiles and light trucks.

Table 3.–Hybrid Vehicle Base Credit Amount for Automobiles and Light Trucks, Dependent Upon the Power Available from the Rechargeable Energy Storage System as a Percentage of the Vehicles Maximum Available Power

Base Credit Amount	If Rechargeable Energy Storage System Provides:	
	at least	but less than
$100	4% of maximum available power	10% of maximum available power
$200	10% of maximum available power	20% of maximum available power
$300	20% of maximum available power	30% of maximum available power
$400	30% of maximum available power	

Table 4, below, shows the proposed additional fuel economy credit available to a hybrid passenger automobile or light truck whose fuel economy (on a gasoline gallon equivalent basis) exceeds that of a base fuel economy. For these purposes the base fuel economy is the 2002 model year city fuel economy rating for vehicles of various weight classes (see below).

Table 4.–Additional Fuel Economy Credit for Hybrid Vehicles

Credit	If Fuel Economy of the Hybrid Vehicle Is:	
	at least	but less than
$500	125% of base fuel economy	150% of base fuel economy
$1,000	150% of base fuel economy	175% of base fuel economy
$1,500	175% of base fuel economy	200% of base fuel economy
$2,000	200% of base fuel economy	225% of base fuel economy
$2,500	225% of base fuel economy	250% of base fuel economy
$3,000	250% of base fuel economy	

Table 5 below, shows the proposed base credit amounts for heavy duty hybrid vehicles weighing 14,000 pounds or less.

Table 5.–Hybrid Vehicle Base Credit Amount for Heavy Duty Vehicles Weighing Not More Than 14,000 pounds

Base Credit Amount	If Rechargeable Energy Storage System Provides:	
	at least	but less than
$400	20% of maximum available power	30% of maximum available power
$700	30% of maximum available power	40% of maximum available power
$800	40% of maximum available power	50% of maximum available power
$900	50% of maximum available power	60% of maximum available power
$1,000	60% of maximum available power	

In the case of heavy duty hybrid vehicles weighing not more than 14,000 pounds, the additional credit amount for early adoption of the technology is $3,000 for model year 2003 vehicles, $2,500 for model year 2004 vehicles, $2,000 for model year 2005 vehicles, and $1,500 for model year 2006 vehicles.

Table 6, below, shows the proposed base credit amounts for heavy duty hybrid vehicles weighing more than 14,000 pounds but not more than 26,000 pounds.

Table 6.–Hybrid Vehicle Base Credit Amount for Heavy Duty Hybrid Vehicles Weighing More Than 14,000 Pounds, But Not More Than 26,000 Pounds

Base Credit Amount	If Rechargeable Energy Storage System Provides:	
	at least	but less than
$1,600	20% of maximum available power	30% of maximum available power
$1,800	30% of maximum available power	40% of maximum available power
$2,000	40% of maximum available power	50% of maximum available power
$2,200	50% of maximum available power	60% of maximum available power
$2,400	60% of maximum available power	

In the case of heavy duty hybrid vehicles weighing more than 14,000 pounds but not more than 26,000 pounds, the additional credit amount for early adoption of the technology is $7,750 for model year 2003 vehicles, $6,500 for model year 2004 vehicles, $5,250 for model year 2005 vehicles, and $4,000 for model year 2006 vehicles.

Table 7, below, shows the proposed base credit amounts for heavy duty hybrid vehicles weighing more than 26,000 pounds.

Table 7.–Hybrid Vehicle Base Credit Amount for Heavy Duty Hybrid Vehicles Weighing More Than 26,000 Pounds

Base Credit Amount	If Rechargeable Energy Storage System Provides:	
	at least	but less than
$2,400	20% of maximum available power	30% of maximum available power
$2,800	30% of maximum available power	40% of maximum available power
$3,200	40% of maximum available power	50% of maximum available power
$3,600	50% of maximum available power	60% of maximum available power
$4,000	60% of maximum available power	

In the case of heavy duty hybrid vehicles weighing more than 26,000 pounds, the additional credit amount for early adoption of the technology is $12,000 for model year 2003 vehicles, $10,000 for model year 2004 vehicles, $8,000 for model year 2005 vehicles, and $6,000 for model year 2006 vehicles.

Alternative fuel vehicle

The credit for the purchase of a new alternative fuel vehicle would be 40 percent of the incremental cost of such vehicle, plus an additional 30 percent if the vehicle meets certain emissions standards, but not more than between $4,000 and $35,000 depending upon the weight of the vehicle. Table 8, below, shows the maximum permitted incremental cost for the purpose of calculating the credit for alternative fuel vehicles by vehicle weight class.

Table 8.–Maximum Allowable Incremental Cost for Calculation of Alternative Fuel Vehicle Credit

Vehicle Gross Weight Rating in Pounds	Maximum Allowable Incremental Cost
vehicle $\leq$ 8,500	$4,000
8,500 < vehicle $\leq$ 14,000	$8,500
14,000 < vehicle $\leq$ 26,000	$20,000
26,000 < vehicle	$35,000

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

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

Base fuel economy

The base fuel economy is the 2002 model year city fuel economy for vehicles by inertia weight class by vehicle type. The "vehicle inertia weight class" is that defined in regulations prescribed by the Environmental Protection Agency for purposes of Title II of the Clean Air Act. Table 9, below, shows the 2002 model year city fuel economy for vehicles by type and by inertia weight class.

Table 9.–2002 Model Year City Fuel Economy

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

Modification of credit for qualified electric vehicles

The proposal repeals the phaseout of the credit under present law. The proposal also modifies present law to provide for a credit equal to the lesser of $1,275 or 10 percent of the manufacturer's suggested retail price of certain vehicles that conform to the Motor Vehicle Safety Standard 500. For all other electric vehicles, Table 10, below describes the credit.

Table 10.–Credit for Qualifying Battery Electric Vehicles

Vehicle Gross Weight Rating in Pounds	Credit Amount
Vehicle ≤ 8,500	$2,975
8,500 < vehicle ≤ 14,000	$8,500
14,000 < vehicle ≤ 26,000	$17,000
26,000 < vehicle	$34,000

If an electric vehicle weighing not more than 8,500 pounds has an estimated driving range of at least 100 miles on a single charge of the vehicle's batteries or if it is capable of a payload capacity of at least 1,000 pounds, then the credit amount in Table 10 is $5,100.

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

Credit for installation of alternative fueling stations

The proposal permits taxpayers to claim a 50-percent credit for the cost of installing clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer. In the case of retail clean-fuel vehicle refueling property the allowable credit may not exceed $24,000. In the case of residential clean-fuel vehicle refueling property the allowable credit may not exceed $800. The taxpayer's basis in the property is reduced by the amount of the credit and the taxpayer may not claim deductions under section 179A with respect to property for which the credit is claimed. In the case of refueling property installed on property owned or used by a tax-exempt person, the taxpayer that installs the property may claim the credit. To be eligible for the credit, the property must be placed in service before January 1, 2008 (January 1, 2012 in the case of hydrogen). The credit allowable in the taxable year cannot exceed the difference between the taxpayer's regular tax (reduced by certain other credits) and the taxpayer's tentative minimum tax. The taxpayer may carry forward unused credits for 20 years.

Credit for retail sale of alternative fuels

The proposal permits taxpayers to claim a credit equal to the gasoline gallon equivalent of 20 cents per gallon of alternative fuel sold in 2003, 30 cents per gallon in 2004, 40 cents per gallon in 2005, and 40 cents per gallon in 2006. Qualifying alternative fuels are compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, and any liquid mixture

consisting of at least 85 percent methanol or ethanol. The gasoline gallon equivalency of any alternative fuel is determined by reference to the British thermal unit content of the alternative fuel compared to a gallon of gasoline. The credit may be claimed for sales prior to January 1, 2007. Under the proposal, the credit is part of the general business credit.

Effective Date

The proposals relating to the credit for new fuel cell motor vehicles, hybrid motor vehicles, and alternative fuel motor vehicles, the credit for battery electric vehicles, the credit for alternative fuel vehicle refueling property, and deductions for clean fuel vehicles and clean fuel refueling property are effective for property placed in service after the date of enactment, in taxable years ending after the date of enactment. The credit for retail sales of alternative fuels is effective for sales of fuels after the date of enactment, in taxable years ending after the date of enactment.

B. Modifications to Small Producer Ethanol Credit

Present Law

Small producer credit

Present law provides several tax benefits for ethanol and methanol produced from renewable sources (e.g., biomass) that are used as a motor fuel or that are blended with other fuels (e.g., gasoline) for such a use. In the case of ethanol, a separate 10-cents-per-gallon credit for small producers, defined generally as persons whose production does not exceed 15 million gallons per year and whose production capacity does not exceed 30 million gallons per year. The alcohol fuels tax credits are includible in income. This credit, like tax credits generally, may not be used to offset alternative minimum tax liability. The credit is a 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 is scheduled to expire after December 31, 2007.

Taxation of cooperatives and their patrons

Under present law, cooperatives in essence are treated as pass-through entities in that the cooperative is not subject to corporate income tax to the extent the cooperative timely pays patronage dividends. Under present law, the only excess credits that may be flowed-through to cooperative patrons are the rehabilitation credit (sec. 47), the energy property credit (sec. 48(a)), and the reforestation credit (sec. 48(b)).

Description of Proposal

The proposal makes several modifications to the rules governing the small producer ethanol credit. First, the proposal liberalizes the definition of an eligible small producer to include persons whose production capacity does not exceed 60 million gallons. Second, the proposal allows cooperatives to elect to pass-through the small ethanol producer credits to its patrons. The credit allowed to a particular patron is that proportion of the credit that the cooperative elects to pass-through for that year as the amount of patronage of that patron for that year bears to total patronage of all patrons for that year.

Third, the proposal repeals the rule that includes the small producer credit in income of taxpayers claiming it and liberalizes the ordering and carryforward/carryback rules for the small producer ethanol credit. Fourth, the proposal allows the small producer credit to be claimed against the alternative minimum tax. Finally, the proposal provides that the small producer ethanol credit is not treated as derived from a passive activity under the Code rules restricting credits and deductions attributable to such activities.

Effective Date

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

C. Tax Credit for Biodiesel Fuel Mixtures

Present Law

No income tax credit or excise tax rate reduction is provided for biodiesel fuels under present law.

However, a 52-cents-per-gallon income tax credit (the "alcohol fuels credit") is allowed for ethanol and methanol (derived from renewable sources) when the alcohol is used as a highway motor fuel. The benefit of this income tax credit may be claimed through reductions in excise taxes paid on alcohol fuels. In the case of alcohol blended with other fuels (e.g., gasoline), the excise tax rate reductions are allowable only for blends of 90 percent gasoline/10 percent alcohol, 92.3 percent gasoline/7.7 percent alcohol, or 94.3 percent gasoline/5.7 percent alcohol. These present law provisions are scheduled to expire in 2007.

Description of Proposal

The proposal provides a new income tax credit for qualified biodiesel fuel mixtures. The structure of the new credit would be similar to structure of the present-law alcohol fuels credit. Agri-biodiesel is derived from virgin vegetable oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, or animal fats, for use in diesel engines. Recycled biodiesel is derived from nonvirgin vegetable oils or animal fats for use in diesel engines. Virgin vegetable oils or animal fats mixed with recycled biodiesel will be treated as recycled biodiesel.

The per gallon biodiesel mixture credit rate for agri-biodiesel equals one cent for each percentage point of biodiesel in the fuels mixture, subject to a maximum credit of 20 cents per blended gallon of fuel. The per gallon biodiesel mixture credit rate for recycled biodiesel equals .5 cent for each percentage point of biodiesel in the fuels mixture, subject to a maximum credit of 10 cents per blended gallon of fuel. The amount of the biodiesel fuel mixture credit is includible in income. The credit may not be carried back to a taxable year beginning before date of enactment.

Agri-biodiesel used in the production of a qualified biodiesel mixture is taken into account only if a certification from the producer of the agri-biodiesel which identifies the product produced is obtained. Both agri-biodiesel and recycled biodiesel are required to meet the requirements of the Environmental Protection Agency under section 211 of the Clean Air Act (42 U.S.C. sec. 7545) and the American Society of Testing and Materials D6751.

Under the proposal, in lieu of an income tax credit for agri-biodiesel blends, a refiner blending agri-biodiesel may elect to accrue an excise tax credit equal to the amount of the biodiesel mixture credit for agri-biodiesel. An excise tax credit is not available for recycled biodiesel.

Effective Date

The biodiesel fuel mixture credit (and excise tax credit) is effective for biodiesel fuel blended after (or fuel sold after) date of enactment, and before January 1, 2006.

III. CONSERVATION AND ENERGY EFFICIENCY PROVISIONS

A. Business Credit for Construction of New Energy-Efficient Homes

Present Law

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

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

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

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

Description of Proposal

The proposal provides a credit to an eligible contractor of an amount equal to the aggregate adjusted bases of all energy-efficient property installed in a qualified new energy-efficient home during construction. The credit cannot exceed $1,000 ($2,000) in the case of a new home that has a projected level of annual heating and cooling costs that is 30 percent (50 percent) less than a comparable dwelling constructed in accordance with Chapter 4 of the 2000 International Energy Conservation Code.

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

To qualify as an energy-efficient new home, the home must be: (1) a dwelling located in the United States; (2) the principal residence of the person who acquires the dwelling from the eligible contractor, and (3) certified to have a projected level of annual heating and cooling

energy consumption that meets the standards for either the 30-percent or 50-percent reduction in energy usage. The home may be certified according to a component-based method or an energy performance based method. Additionally, manufactured homes certified by the Energy Star Labeled New Homes program are eligible for the $1,000 credit provided criteria (1) and (2) are met.

The component-based method of certification shall be based on applicable energy-efficiency specifications or ratings, including current product labeling requirements. The Secretary shall develop component-based packages that are equivalent in energy performance to properties that qualify for the credit. The certification shall be provided by a third party, such as a local building regulatory authority, a utility, a manufactured home production inspection agency, or a home energy rating organization.

The performance-based method of certification shall be based on an evaluation of the home in reference to a home which uses the same energy source and system heating type, and is constructed in accordance with the Chapter 4 of the 2000 International Energy Conservation Code. The certification shall be provided by an individual recognized by the Secretary for such purposes.

The certification process requires that energy savings to the consumer be measured in terms of energy costs. To ensure consistent and reasonable energy cost analyses, the Department of Energy shall include in its rulemaking related to this bill specific reference data to be used for qualification for the credit.

The credit will be part of the general business credit. No credits attributable to energy efficient homes may be carried back to any taxable year ending on or before the effective date of the credit.

Effective Date

The credit applies to homes whose construction is substantially completed after the date of enactment and which are purchased during the period beginning on the date of enactment and ending on December 31, 2007 (December 31, 2005 in the case of the $1,000 credit).

B. Tax Credit for Energy-Efficient Appliances

Present Law

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

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

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

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

Description of Proposal

The proposal provides a credit for the production of certain energy-efficient clothes washers and refrigerators. The credit would equal $50 per appliance for energy-efficient clothes washers produced with a modified energy factor ("MEF") of 1.42 MEF or greater for washers produced before 2007 and for refrigerators produced before 2005 that consume 10 percent less kilowatt-hours per year than the energy conservation standards promulgated by the Department of Energy that took effect on July 1, 2001. The credit equals $100 for energy-efficient clothes washers produced with a MEF of 1.5 or greater and for refrigerators produced that consume at least 15 percent less kilowatt-hours per year (at least 20 percent less for production in 2007) than the energy conservation standards promulgated by the Department of Energy that took effect on July 1, 2001. The credit is $150 in the case of a refrigerator that consumes at least 20 percent less kilowatt-hours per year than such standards and is produced before 2007. A refrigerator must be an automatic defrost refrigerator-freezer with an internal volume of at least 16.5 cubic feet to qualify for the credit. A clothes washer is any residential clothes washer, including a residential style coin operated washer, that satisfies the relevant efficiency standard.

For each category of appliances (e.g., washers that meet the lower MEF standard, washers that meet the higher MEF standard, refrigerators that meet the 10 percent standard, refrigerators that meet the 15 percent standard and refrigerators that meet the 20-percent standard), only production in excess of average production for each such category during

calendar years 2000-2002 would be eligible for the credit. For 2003, only production after the date of enactment is eligible for the credit, and special rules apply to determine if production exceeds the average of the base period. The taxpayer may not claim credits in excess of $60 million for all taxable years, and may not claim credits in excess of $30 million with respect to appliances that only qualify for the $50 credit. Additionally, the credit allowed for all appliances may not exceed two percent of the average annual gross receipts of the taxpayer for the three taxable years preceding the taxable year in which the credit is determined.

The credit will be part of the general business credit. No credits attributable to energy-efficient appliances may be carried back to taxable years ending before January 1, 2003.

Effective Date

The credit applies to appliances produced after the date of enactment and prior to January 1, 2008.

C. Credit for Residential Energy Efficient Property

Present Law

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

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

Description of Proposal

The proposal provides a personal tax credit for the purchase of qualified wind energy property, qualified photovoltaic property, and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs. The credit is equal to 15 percent for solar water heating property and photovoltaic property, and 30 percent for wind energy property. The maximum credit for each of these systems of property is $2,000. The proposal also provides a 30 percent credit for the purchase of qualified fuel cell power plants. The credit for any fuel cell may not exceed $1,000 for each kilowatt of capacity.

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

The proposal also provides a credit for the purchase of other qualified energy efficient property, as described below:

Electric heat pump hot water heaters with an Energy Factor of at least 1.7. The maximum credit is $75 per unit.

Electric heat pumps with a heating efficiency of at least 9 HSPF (Heating Seasonal Performance Factor) and a cooling efficiency of at least 15 SEER (Seasonal Energy Efficiency Rating) and an energy efficiency ratio (EER) of 12.5 or greater. The maximum credit is $250 per unit.

Natural gas furnace which achieves 95 percent annual fuel utilization efficiency. The maximum credit is $250 per unit.

Central air conditioners with an efficiency of at least 15 SEER and an EER of 12.5 or greater. The maximum credit is $250 per unit.

Natural gas water heaters with an Energy Factor of at least 0.8. The maximum credit is $75 per unit.

Geothermal heat pumps which have an EER of at least 21. The maximum credit is $250 per unit.

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

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

Effective Date

The credit applies to purchases after the date of enactment and before January 1, 2008.

D. Business Tax Incentives for Fuel Cells

Present Law

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

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

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

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

Description of Proposal

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

Effective Date

The credit for businesses applies to property placed in service after the date of enactment and before January 1, 2008, under rules similar to rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990).

E. Allowance of Deduction for Energy-Efficient Commercial Building Property

Present Law

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

Description of Proposal

The proposal provides a deduction equal to energy-efficient commercial building property expenditures made by the taxpayer. Energy-efficient commercial building property expenditures are defined as amounts paid or incurred for energy-efficient commercial building property installed in connection with the new construction or reconstruction of property: (1) which is otherwise depreciable property; (2) which is located in the United States, and (3) the construction or erection of which is completed by the taxpayer. The deduction is limited to an amount equal to the product of $2.25 and the square footage of the property for which such expenditures were made. No deduction is permitted unless the entire building satisfies the energy efficiency standard. The deduction is allowed in the year in which the property is placed in service.

Energy-efficient commercial building property generally means any property that reduces total annual energy and power costs with respect to the lighting, heating, cooling, ventilation, and hot water supply systems of the building by 50 percent or more in comparison to a reference building which meets the requirements of a Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers ("ASHRAE") and the Illuminating Engineering Society of North America.

Certain certification requirements must be met in order to qualify for the deduction. The Secretary, in consultation with the Secretary of Energy, will promulgate regulations that describe methods of calculating and verifying energy power consumption and cost, taking into consideration provisions of the 2001 California Nonresidential Alternative Calculation Method Approval Manual or the 2001 California Residential Alternative Calculation Method Approval Manual. Additionally, the calculation methods must take into account appropriate energy savings from design methodologies and technologies not otherwise credited in either such ASHRAE Standard 90.1-2001 or in the 2001 California Nonresidential Alternative Calculation Method Approval Manual, including the following: (1) natural ventilation; (2) evaporative cooling; (3) automatic lighting controls such as occupancy sensors, photocells, and timeclocks; (4) daylighting; (5) designs utilizing semi-conditioned spaces which maintain adequate comfort conditions without air conditioning or without heating; (6) improved fan system efficiency, including reductions in static pressure; and (7) advanced unloading mechanisms for mechanical cooling, such as multiple or variable speed compressors. Additionally, the calculational methods may take into account the extent of commissioning in the building, and allow the taxpayer to take into account measured performance which exceeds typical performance.

The Secretary shall promulgate procedures for the inspection and testing for compliance of buildings that are comparable, given the difference between commercial and residential buildings, to the requirements in the Mortgage Industry National Accreditation Procedures for

Home Energy Rating Systems. Individuals qualified to determine compliance shall only be those recognized by one or more organizations certified by the Secretary for such purposes.

For public property, such as schools, the Secretary will issue regulations to allow the deduction to be allocated to the person primarily responsible for designing the property in lieu of the public entity owner. Other rules apply.

Effective Date

The provision is effective for taxable years beginning after the date of enactment for plans certified prior to December 31, 2007, whose construction is completed on or before December 31, 2009.

F. Three-Year Applicable Recovery Period for Depreciation of Qualified Energy Management Devices

Present Law

No special recovery period is currently provided for depreciation of qualified energy management devices.

Description of Proposal

The proposal provides a three-year recovery period for qualified new energy management devices placed in service by any taxpayer who is a supplier of electric energy or is a provider of electric energy services. A qualified energy management device is any tangible property eligible for accelerated depreciation under code section 168 and which

(1) is acquired and used by the taxpayer to measure and record electricity usage data on a time-differentiated basis in at least four separate time segments per day, and

(2) provides such time-differentiated electricity price and usage data on at least a monthly basis to both consumers and the supplier or provider.

Effective Date

The proposal is effective for any qualified energy management device placed in service after the date of enactment of the Act and before January 1, 2008.

G. Three-Year Applicable Recovery Period for Depreciation of Qualified Water Submetering Devices

Present Law

No special recovery period is currently provided for depreciation of qualified water submetering devices.

Description of Proposal

The proposal provides a three-year recovery period for qualified new water submetering devices placed in service by any taxpayer who is an eligible resupplier. An eligible resupplier is any taxpayer who purchases and installs qualified water submetering devices in every unit in any multi-unit property. A qualified water submetering device is any tangible property eligible for accelerated depreciation under code section 168 and which

(1) is acquired and used by the taxpayer to measure and record water usage data, and

(2) provides such water usage data on at least a monthly basis to both consumers and the supplier or provider.

Effective Date

The proposal is effective for any qualified water submetering device placed in service after the date of enactment of the Act and before January 1, 2008.

H. Energy Credit for Combined Heat and Power System Property

Present Law

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

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

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

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

Description of Proposal

The proposal provides a 10-percent credit for the purchase of combined heat and power property. CHP property is defined as property: (1) which uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) which has an electrical capacity of more than 50 kilowatts or a mechanical energy capacity of more than 67 horsepower or an equivalent combination of electrical and mechanical energy capacities; (3) which produces at least 20 percent of its total useful energy in the form of thermal energy and at least 20 percent in the form of electrical or mechanical power (or a combination thereof); and (4) the energy efficiency percentage of which exceeds 60 percent (70 percent in the case of a system with an electrical capacity in excess of 50 megawatts or a mechanical energy capacity in excess of 67,000 horsepower, or an equivalent combination of electrical and mechanical capacities.) Also, for purposes of determining whether CHP property includes technologies which generate electricity or mechanical power using back-pressure steam turbines in place of existing pressure-reducing valves, or which make use of waste heat from industrial processes such as by using organic rankine, stirling, or kalina heat engine systems, the energy output requirements related to heat versus power described under (3), above, and the energy efficiency requirements of (4), above, may be disregarded.

CHP property does include property used to transport the energy source to the generating facility or to distribute energy produced by the facility.

If a taxpayer is allowed a credit for CHP property, and the property would ordinarily have a depreciation class life of 15 years or less, the depreciation period for the property is treated as having a 22-year class life. The present-law carry back rules of the general business credit generally would apply except that no credits attributable to combined heat and power property may be carried back before the effective date of this provision.

Effective Date

The credit applies to property placed in service after the date of enactment and before January 1, 2007.

I. Credit for Energy Efficiency Improvements to Existing Homes

Present Law

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

There is no present law credit for energy efficiency improvements to existing homes.

Description of Proposal

The proposal would provide a 10-percent nonrefundable credit for the purchase of qualified energy efficiency improvements. The maximum credit for a taxpayer with respect to the same dwelling for all taxable years is $300. A qualified energy efficiency improvement would be any energy efficiency building envelope component that is certified to meet or exceed the prescriptive criteria for such a component established by the 2000 International Energy Conservation Code, or any combination of energy efficiency measures that is certified to achieve at least a 30 percent reduction in heating and cooling energy usage for the dwelling and (1) that is installed in or on a dwelling located in the United States; (2) owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) such component can reasonably be expected to remain in use for at least five years.

Building envelope components would be: (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling, and (2) exterior windows (including skylights) and doors.

Homes shall be certified according to a component-based method or a performance-based method. The component-based method shall be based on applicable energy-efficiency ratings, including current product labeling requirements. Certification by the component method shall be provided by a third party, such as a local building regulatory authority, a utility, a manufactured home production inspection primary inspection agency, or a home energy rating organization. The performance-based method shall be based on a comparison of the projected energy consumption of the dwelling in its original condition and after the completion of energy efficiency measures. The performance-based method of certification shall be conducted by an individual or organization recognized by the Secretary of the Treasury for such purposes.

The certification process requires that energy savings to the consumer be measured in terms of energy costs. To ensure consistent and reasonable energy cost analyses, the Department of Energy shall include in its rulemaking related to this bill specific reference data to be used for qualification for the credit.

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

The credit is allowed against the regular and alternative minimum tax.

Effective Date

The credit is effective for qualified energy efficiency improvements installed on or after the date of enactment and before January 1, 2007.

IV. CLEAN COAL INCENTIVES

A. Investment and Production Credits for Clean Coal Technology

Present Law

Present law does not provide an investment credit for electricity generating units that use coal as a fuel. Nor does present law provide a production credit for electricity generated at units that use coal as a fuel. However, a nonrefundable, 10-percent investment tax credit ("business energy credit") is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) that is used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage (sec. 48). Also, an income tax credit is allowed for the production of electricity from either qualified wind energy, qualified "closed-loop" biomass, or qualified poultry waste units placed in service prior to January 1, 2004 (sec. 45). The credit allowed equals 1.5 cents per kilowatt-hour of electricity sold. The 1.5 cent figure is indexed for inflation and equaled 1.8 cents for 2002. The credit is allowable for production during the 10-year period after a unit is originally placed in service. The business energy tax credits and the production tax credit are components of the general business credit (sec. 38(b)(1)).

Description of Proposal

In general

The proposal creates three new credits: a production credit for electricity produced from qualifying clean coal technology units; a production credit for electricity produced from qualifying advanced clean coal technology units; and a credit for investments in qualifying advanced clean coal technology units. Certain persons (public utilities, electric cooperatives, Indian tribes, and the Tennessee Valley Authority) will be eligible to obtain certifications from the Secretary of the Treasury (as described below) for each of these credits and sell, trade, or assign the credit to any taxpayer. However, any credit sold, traded, or assigned may only be sold, traded, or assigned once. Subsequent transfers are not permitted.

Credit for investments in qualifying advanced clean coal technology units

The proposal provides a 10-percent investment tax credit for qualified investments in advanced clean coal technology units. A qualified investment is that amount that would otherwise be a qualified investment multiplied by a fraction equal to the amount of national megawatt capacity allocated to the taxpayer (as described below) divided by the megawatt capacity of the qualifying unit. Qualifying advanced clean coal technology units must utilize advanced pulverized coal or atmospheric fluidized bed combustion technology, integrated gasification combined cycle technology, or some other technology certified by the Secretary of Energy. Any qualifying advanced clean coal technology unit must meet certain capacity standards, thermal efficiency standards, and emissions standards for SO_2, nitrous oxides, particulate emissions, and source emissions standards as provided in the Clean Air Act. In

addition, a qualifying advanced clean coal technology unit must meet certain carbon emissions requirements.

The proposal defines three types of qualifying advanced clean coal technology units: (1) advanced pulverized coal or atmospheric fluidized bed combustion technology units (2) integrated gasification combined cycle technology units; and (3) other technology units.

(1) A qualifying advanced pulverized coal or atmospheric fluidized bed combustion technology unit is a unit placed in service after the date of enactment and before 2013 and having a design net heat rate of not more than 8,500 Btu (8,900 Btu if the unit is placed in service before 2009).

(2) A qualifying integrated gasification combined cycle technology unit is a unit placed in service after the date of enactment and before 2017 and having a design net heat rate of not more than 7,720 Btu (8,900 Btu if the unit is placed in service before 2009 and 8,350 Btu if the unit is placed in service after 2008 and before 2013).

(3) A qualifying other technology unit use any other technology and is placed in service after the date of enactment and before 2017.

The proposal provides that qualifying advanced clean coal units must satisfy carbon emissions standards. For units using design coal with a heat content of not more than 9,000 Btu per pound, the carbon emission rate must be less than 0.60 pound of carbon per kilowatt hour (0.51 if the unit qualifies as an other technology unit). For units using design coal with a heat content in excess of 9,000 Btu per pound, the carbon emission rate must be less than 0.54 pound of carbon per kilowatt hour (0.459 if the unit qualifies as an other technology unit).

To be a qualified investment in advanced clean coal technology, the taxpayer must receive a certificate from the Secretary of the Treasury. The Secretary may grant certificates to investments only to the point that 3,500 megawatts of electricity production capacity qualifies for the credit. From the potential pool of 3,500 megawatts of capacity, not more than 1,000 megawatts in total and not more than 500 megawatts in years prior to 2009 shall be allocated to units using advanced pulverized coal or atmospheric fluidized bed combustion technology. From the potential pool of 3,500 megawatts of capacity, not more than 2,000 megawatts in total and not more than 750 megawatts in years prior to 2009 shall be allocated to units using integrated gasification combined cycle technology, with or without fuel or chemical co-production. From the potential pool of 3,500 megawatts of capacity, not more than 500 in total and not more than 250 megawatts in years prior to 2009 shall be allocated to any other technology certified by the Secretary of Energy.

Production credit for electricity produced from qualifying clean coal technology units

The proposal provides a production credit for electricity produced from certain units that have been retrofitted, repowered, or replaced with a clean coal technology within ten years of the date of enactment. The value of the credit is 0.34 cents per kilowatt-hour of electricity and the

heat value of other fuels or chemicals produced at the unit[3] multiplied by the fraction equal to the amount of national megawatt capacity limitation (see below) allocated to the qualifying unit divided by the total megawatt capacity of the unit. The value of the credit is indexed for inflation occurring after 2003 with the first potential adjustment in 2005. The taxpayer may claim the credit throughout the ten-year period commencing from the date on which the qualifying unit is placed in service.

A qualifying clean coal technology unit is a clean coal technology unit that meets certain capacity standards, thermal efficiency standards, and emissions standards for SO_2, nitrous oxides, particulate emissions, and source emissions standards as provided in the Clean Air Act. In addition, a qualifying clean coal technology unit cannot be a unit that is receiving or is scheduled to receive funding under the Clean Coal Technology Program, the Power Plant Improvement Initiative, or the Clean Coal Power Initiative administered by the Secretary of the Department of Energy. Lastly, to be a qualified clean coal technology unit, the taxpayer must receive a certificate from the Secretary of the Treasury. The Secretary may grant certificates to units only to the point that 4,000 megawatts of electricity production capacity qualifies for the credit. However, no qualifying unit would be eligible if the unit's capacity exceeded 300 megawatts prior to having been retrofitted, repowered, or replaced. The maximum eligible allocation to any qualifying unit may not exceed 300 megawatts.

Production credit for electricity produced from qualifying advanced clean coal technology

The proposal also provides a production credit for electricity produced from any qualified advanced clean coal technology electricity generation unit that qualifies for the investment credit for qualifying clean coal technology units, as described above.[4] The taxpayer may claim a production credit on the sum of each kilowatt-hour of electricity produced and the heat value of other fuels or chemicals produced by the taxpayer at the unit.[5] The taxpayer may claim the production credit for the 10-year period commencing with the date the qualifying unit is placed in service (or the date on which a conventional unit was retrofitted or repowered). The value of the credit varies depending upon the year the unit is placed in service, whether the unit produces solely electricity or electricity and fuels or chemicals, and the rated thermal efficiency of the unit. In addition, the value of the credit is reduced for the second five years of eligible production. If a unit meets the more stringent qualification standards of post-2008 in years before 2009, the taxpayer may claim the higher post-2008 credit amounts. The value of the

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[3] Each 3,413 Btu of heat content of the fuel or chemical is treated as equivalent to one kilowatt-hour of electricity.

[4] In the case of a taxpayer who received a megawatt allocation for a qualifying advanced clean coal technology unit that is less than the rated capacity of such unit, the taxpayer may claim credit on a percentage of the electricity produced from the unit. The percentage is the percentage that the taxpayer's megawatt allocation represents as a percentage of the rated capacity of the unit.

[5] Each 3,413 Btu of heat content of the fuel or chemical is treated as equivalent to one kilowatt-hour of electricity.

credit is indexed for inflation occurring after 2003 with the first potential adjustment in 2005. The tables below specify the value of the credit (before indexing is applied).

Advanced clean coal technology units producing solely electricity

Table 11.–Units Placed in Service Before 2009

The unit net heat rate, Btu/kWh adjusted for the heat content for the design coal is equal to:	Credit amount per kilowatt-hour	
	For the first five years	For the second five years
Not more than 8,500	$.0060	$.0038
More than 8,500 but not more than 8,750	$.0025	$.0010
More than 8,750 but less than 9,000	$.0010	$.0010

Table 12.–Units Placed in Service After 2008 and Before 2013

The unit net heat rate, Btu/kWh adjusted for the heat content for the design coal is equal to:	Credit amount per kilowatt-hour	
	For the first five years	For the second five years
Not more than 7,770	$.0105	$.0090
More than 7,770 but not more than 8,125	$.0085	$.0068
More than 8,125 but less than 8,350	$.0075	$.0055

Table 13.–Units Placed in Service After 2012 and Before 2017

The unit net heat rate, Btu/kWh adjusted for the heat content for the design coal is equal to:	Credit amount per kilowatt-hour	
	For the first five years	For the second five years
Not more than 7,380	$.0140	$.0115
More than 7,380 but not more than 7,720	$.0120	$.0090

Advanced clean coal technology units producing electricity and a fuel or chemical

Table 14.–Units Placed in Service Before 2009

The unit design net thermal efficiency is equal to:	Credit amount per kilowatt-hour	
	For the first five years	For the second five years
Not less than 40.6%	$.0060	$.0038
Less than 40.6% but not less than 40%	$.0025	$.0010
Less than 40% but not less than 38.4%	$.0010	$.0010

Table 15.–Units Placed in Service After 2008 and Before 2013

The unit design net thermal efficiency is equal to:	Credit amount per kilowatt-hour	
	For the first five years	For the second five years
Not less than 43.6%	$.0105	$.0090
Less than 43.6% but not less than 42%	$.0085	$.0068
Less than 42% but not less than 40.2%	$.0075	$.0055

Table 16.–Units Placed in Service After 2012 and Before 2017

The unit design net thermal efficiency is equal to:	Credit amount per kilowatt-hour	
	For the first five years	For the second five years
Not less than 44.2%	$.0140	$.0115
Less than 44.2% but not less than 43.9%	$.0120	$.0090

The credits are part of the general business credit. No credit may be carried back to taxable years ending on or before the date of enactment.

Effective Date

The proposal relating to investment credits for advanced clean coal technology units is effective after the date of enactment. The proposal relating to production credits are effective after the date of enactment.

V. OIL AND GAS PROVISIONS

A. Tax Credit for Oil and Gas Production from Marginal Wells

Present Law

There is no credit for the production of oil and gas from marginal wells. The costs of such production may be recovered under the Code's depreciation and depletion rules and in other cases as a deduction for ordinary and necessary business expenses.

Description of Proposal

The provision would create a new, $3 per barrel credit for the production of crude oil and a $0.50 credit per 1,000 cubic feet of qualified natural gas production. The maximum amount of production on which credit could be claimed is 1,095 barrels or barrel equivalents. In both cases, the credit is available only for production from a "qualified marginal well." The credit is not available to production occurring if the reference price of oil exceeded $18 ($2.00 for natural gas). The credit is reduced proportionately as for reference prices between $15 and $18 ($1.67 and $2.00 for natural gas). Reference prices are determined on a one-year look-back basis.

A qualified marginal well is defined as (1) a well production from which was marginal production for purposes of the Code percentage depletion rules or (2) a well that during the taxable year had (a) average daily production of not more than 25 barrel equivalents and (b) produced water at a rate of not less than 95 percent of total well effluent.

The credit is treated as part of the general business credit. The credit cannot be carried back to a taxable year ending on or before the date of enactment of the proposal.

Effective Date

The proposal is effective for production in taxable years beginning after the date of enactment.

B. Natural Gas Gathering Lines Treated as Seven-Year Property

Present Law

The applicable recovery period for assets placed in service under the Modified Accelerated Cost Recovery System is based on the "class life of the property." The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[6] Revenue Procedure 87-56 includes two asset classes that could describe natural gas gathering lines owned by nonproducers of natural gas. Asset class 46.0, describing pipeline transportation, provides a class life of 22 years and a recovery period of 15 years. Asset class 13.2, describing assets used in the exploration for and production of petroleum and natural gas deposits, provides a class life of 14 years and a depreciation recovery period of seven years. The uncertainty regarding the appropriate recovery period of natural gas gathering lines has resulted in litigation between taxpayers and the IRS. The 10th Circuit Court of Appeals held that natural gas gathering lines owned by nonproducers falls within the scope of Asset class 13.2 (i.e., seven-year recovery period).[7] More recently, the Tax Court and the U.S. District Court for the Eastern District of Michigan, Southern Division, held that natural gas gathering lines owned by nonproducers falls within the scope of Asset class 46.0 (*i.e.*, 15-year recovery period).[8]

Description of Proposal

The proposal establishes a statutory seven-year recovery period and a class life of 10 years for natural gas gathering lines. A natural gas gathering line is defined to include any pipe, equipment, and appurtenance that is (1) determined to be a gathering line by the Federal Energy Regulatory Commission, or (2) used to deliver natural gas from the wellhead or a common point to the point at which such gas first reaches (a) a gas processing plant, (b) an interconnection with an interstate transmission line, (c) an interconnection with an intrastate transmission line, or (d) a direct interconnection with a local distribution company, a gas storage facility, or an industrial consumer.

Effective Date

The proposal is effective for property placed in service after the date of enactment. No inference is intended as to the proper treatment of natural gas gathering lines placed in service before the date of enactment.

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[6] 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

[7] *Duke Energy v. Commissioner*, 172 F.3d 1255 (10th Cir. 1999), *rev'g* 109 T.C. 416 (1997). See also *True v. United States*, 97-2 U.S. Tax Cas. (CCH) par. 50,946 (D. Wyo. 1997).

[8] *Clajon Gas Co., L.P. v. Commissioner*, 119 T.C. 197 (2002) and *Saginaw Bay Pipeline Co. v. United States*, 124 F. Supp. 2d 465 (E.D. Mich. 2001).

C. Expensing of Capital Costs Incurred and Credit for Production in Complying with Environmental Protection Agency Sulfur Regulations

Present Law

Taxpayers generally may recover the costs of investments in refinery property through annual depreciation deductions. Present law does not provide a credit for the production of low-sulfur diesel fuel.

Description of Proposal

The proposal generally permits small business refiners to claim an immediate deduction (i.e., expensing) for up to 75 percent of the qualified capital costs paid or incurred for the purpose of complying with the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency. Qualified capital costs are those costs paid or incurred and otherwise chargeable to the taxpayer's capital account that are necessary for the refinery to come into compliance with the EPA diesel fuel requirements.

In addition, the proposal provides that a small business refiner may claim a credit equal to five cents per gallon for each gallon of low sulfur diesel fuel produced at a facility of a small business refiner. The total production credit claimed by the taxpayer generally is limited to 25 percent of the qualified capital costs incurred with respect to expenditures at the refinery during the period beginning after the date of enactment and ending with the date that is one year after the date on which the taxpayer must comply with applicable EPA regulations. No deduction is allowed to the taxpayer for expenses otherwise allowable as a deduction in an amount equal to the amount of production credit claimed during the taxable year.

For these purposes a small business refiner is a taxpayer who within the business of refining petroleum products employs not more than 1,500 employees directly in refining on business days during a taxable year in which the deduction or production credit is claimed and had an average daily refinery run (or retained production) not exceeding 205,000 barrels per day for the year prior to enactment.

For taxpayers with an average daily refinery run in the year prior to enactment in excess of 155,000 and not greater than 205,000 barrels per day, the provision limits otherwise qualifying small business refiners to an immediate deduction for a percentage of qualifying capital costs equal to 75 percent less the percentage points determined by the excess of the average daily refinery runs over 155,000 barrels per day divided by 50,000 barrels per day. In addition, for these taxpayers, the limitation on the total production credit that may be claimed also is reduced proportionately.

In the case of a qualifying small business refiner that is owned by a cooperative, the cooperative is allowed to elect to pass any production credits to patrons of the organization.

Effective Date

The proposal is effective for expenses paid or incurred after December 31, 2002.

D. Determination of Small Refiner Exception to Oil Depletion Deduction

Present Law

Present law classifies oil and gas producers as independent producers or integrated companies. The Code provides numerous special tax rules for operations by independent producers. One such rule allows independent producers to claim percentage depletion deductions rather than deducting the costs of their asset, a producing well, based on actual production from the well (i.e., cost depletion).

A producer is an independent producer only if its refining and retail operations are relatively small. For example, an independent producer may not have refining operations the runs from which exceed 50,000 barrels on any day in the taxable year during which independent producer status is claimed.

Description of Proposal

The proposal increases the current 50,000-barrel-per-day limitation to 60,000. In addition, the proposal changes the refinery limitation on claiming independent producer status from a limit based on actual daily production to a limit based on average daily production for the taxable year. Accordingly, the average daily refinery run for the taxable year cannot exceed 60,000 barrels. For this purpose, the taxpayer calculates average daily refinery run by dividing total production for the taxable year by the total number of days in the taxable year.

Effective Date

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

E. Extension of Suspension of Taxable Income Limit With Respect to Marginal Production

Present Law

In general

Depletion, like depreciation, is a form of capital cost recovery. In both cases, the taxpayer is allowed a deduction in recognition of the fact that an asset--in the case of depletion for oil or gas interests, the mineral reserve itself--is being expended in order to produce income. Certain costs incurred prior to drilling an oil or gas property are recovered through the depletion deduction. These include costs of acquiring the lease or other interest in the property and geological and geophysical costs (in advance of actual drilling).

Depletion is available to any person having an economic interest in a producing property. An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in minerals in place, and secures, by any form of legal relationship, income derived from the extraction of the mineral, to which it must look for a return of its capital.[9] Thus, for example, both working interests and royalty interests in an oil- or gas-producing property constitute economic interests, thereby qualifying the interest holders for depletion deductions with respect to the property. A taxpayer who has no capital investment in the mineral deposit does not possess an economic interest merely because it possesses an economic or pecuniary advantage derived from production through a contractual relation.

Cost depletion

Two methods of depletion are currently allowable under the Internal Revenue Code (the "Code"): (1) the cost depletion method, and (2) the percentage depletion method (secs. 611-613). Under the cost depletion method, the taxpayer deducts that portion of the adjusted basis of the depletable property which is equal to the ratio of units sold from that property during the taxable year to the number of units remaining as of the end of taxable year plus the number of units sold during the taxable year. Thus, the amount recovered under cost depletion may never exceed the taxpayer's basis in the property.

Percentage depletion and related income limitations

The Code generally limits the percentage depletion method for oil and gas properties to independent producers and royalty owners.[10] Generally, under the percentage depletion method 15 percent of the taxpayer's gross income from an oil- or gas-producing property is allowed as a deduction in each taxable year (sec. 613A(c)). The amount deducted generally may not exceed 100 percent of the net income from that property in any year (the "net-income limitation") (sec. 613(a)). By contrast, for any other mineral qualifying for the percentage depletion deduction,

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[9] Treas. Reg. sec. 1.611-1(b)(1).

[10] Sec. 613A.

such deduction may not exceed 50 percent of the taxpayer's taxable income from the depletable property. A similar 50-percent net-income limitation applied to oil and gas properties for taxable years beginning before 1991. Section 11522(a) of the Omnibus Budget Reconciliation Act of 1990 prospectively changed the net-income limitation threshold to 100 percent only for oil and gas properties, effective for taxable years beginning after 1990. The 100-percent net-income limitation for marginal wells has been suspended for taxable years beginning after December 31, 1997, and before January 1, 2004.

Additionally, the percentage depletion deduction for all oil and gas properties may not exceed 65 percent of the taxpayer's overall taxable income (determined before such deduction and adjusted for certain loss carrybacks and trust distributions) (sec. 613A(d)(1)).[11] Because percentage depletion, unlike cost depletion, is computed without regard to the taxpayer's basis in the depletable property, cumulative depletion deductions may be greater than the amount expended by the taxpayer to acquire or develop the property.

A taxpayer is required to determine the depletion deduction for each oil or gas property under both the percentage depletion method (if the taxpayer is entitled to use this method) and the cost depletion method. If the cost depletion deduction is larger, the taxpayer must utilize that method for the taxable year in question (sec. 613(a)).

Limitation of oil and gas percentage depletion to independent producers and royalty owners

Generally, only independent producers and royalty owners (as contrasted to integrated oil companies) are allowed to claim percentage depletion. Percentage depletion for eligible taxpayers is allowed only with respect to up to 1,000 barrels of average daily production of domestic crude oil or an equivalent amount of domestic natural gas (sec. 613A(c)). For producers of both oil and natural gas, this limitation applies on a combined basis.

In addition to the independent producer and royalty owner exception, certain sales of natural gas under a fixed contract in effect on February 1, 1975, and certain natural gas from geopressured brine,[12] are eligible for percentage depletion, at rates of 22 percent and 10 percent, respectively. These exceptions apply without regard to the 1,000-barrel-per-day limitation and regardless of whether the producer is an independent producer or an integrated oil company.

Description of Proposal

The suspension of the 100-percent net-income limitation for marginal wells is extended through taxable years beginning before January 1, 2007.

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[11] Amounts disallowed as a result of this rule may be carried forward and deducted in subsequent taxable years, subject to the 65-percent taxable income limitation for those years.

[12] This exception is limited to wells, the drilling of which began between September 30, 1978, and January 1, 1984.

Effective Date

The proposal is effective on date of enactment.

F. Amortization of Geological and Geophysical Expenditures

Present Law

In general

Geological and geophysical expenditures are costs incurred by a taxpayer for the purpose of obtaining and accumulating data that will serve as the basis for the acquisition and retention of mineral properties by taxpayers exploring for minerals. A key issue with respect to the tax treatment of such expenditures is whether or not they are capital in nature. Capital expenditures are not currently deductible as ordinary and necessary business expenses, but are allocated to the cost of the property.[13]

Courts have held that geological and geophysical costs are capital, and therefore are allocable to the cost of the property[14] acquired or retained.[15] The costs attributable to such exploration are allocable to the cost of the property acquired or retained. As described further below, IRS administrative rulings have provided further guidance regarding the definition and proper tax treatment of geological and geophysical costs.

Revenue Ruling 77-188

In Revenue Ruling 77-188[16] (hereinafter referred to as the "1977 ruling"), the IRS provided guidance regarding the proper tax treatment of geological and geophysical costs. The ruling describes a typical geological and geophysical exploration program as containing the following elements:

- It is customary in the search for mineral producing properties for a taxpayer to conduct an exploration program in one or more identifiable project areas. Each

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[13] Under section 263, capital expenditures are defined generally as any amount paid for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. Treasury regulations define capital expenditures to include amounts paid or incurred (1) to add to the value, or substantially prolong the useful life, of property owned by the taxpayer or (2) to adapt property to a new or different use. Treas. Reg. sec. 1.263(a)-1(b).

[14] "Property" means an interest in a property as defined in section 614 of the Code, and includes an economic interest in a tract or parcel of land notwithstanding that a mineral deposit has not been established or proved at the time the costs are incurred.

[15] See, *e.g., Schermerhorn Oil Corporation v. Commissioner,* 46 B.T.A. 151 (1942). By contrast, section 617 of the Code permits a taxpayer to elect to deduct certain expenditures incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (but not oil and gas). These deductions are subject to recapture if the mine with respect to which the expenditures were incurred reaches the producing stage.

[16] 1977-1 C.B. 76.

project area encompasses a territory that the taxpayer determines can be explored advantageously in a single integrated operation. This determination is made after analyzing certain variables such as (1) the size and topography of the project area to be explored, (2) the existing information available with respect to the project area and nearby areas, and (3) the quantity of equipment, the number of personnel, and the amount of money available to conduct a reasonable exploration program over the project area.

- The taxpayer selects a specific project area from which geological and geophysical data are desired and conducts a reconnaissance-type survey utilizing various geological and geophysical exploration techniques. These techniques are designed to yield data that will afford a basis for identifying specific geological features with sufficient mineral potential to merit further exploration.

- Each separable, noncontiguous portion of the original project area in which such a specific geological feature is identified is a separate "area of interest." The original project area is subdivided into as many small projects as there are areas of interest located and identified within the original project area. If the circumstances permit a detailed exploratory survey to be conducted without an initial reconnaissance-type survey, the project area and the area of interest will be coextensive.

- The taxpayer seeks to further define the geological features identified by the prior reconnaissance-type surveys by additional, more detailed, exploratory surveys conducted with respect to each area of interest. For this purpose, the taxpayer engages in more intensive geological and geophysical exploration employing methods that are designed to yield sufficiently accurate sub-surface data to afford a basis for a decision to acquire or retain properties within or adjacent to a particular area of interest or to abandon the entire area of interest as unworthy of development by mine or well.

The 1977 ruling provides that if, on the basis of data obtained from the preliminary geological and geophysical exploration operations, only one area of interest is located and identified within the original project area, then the entire expenditure for those exploratory operations is to be allocated to that one area of interest and thus capitalized into the depletable basis of that area of interest. On the other hand, if two or more areas of interest are located and identified within the original project area, the entire expenditure for the exploratory operations is to be allocated equally among the various areas of interest.

If no areas of interest are located and identified by the taxpayer within the original project area, then the 1977 ruling states that the entire amount of the geological and geophysical costs related to the exploration is deductible as a loss under section 165. The loss is claimed in the taxable year in which that particular project area is abandoned as a potential source of mineral production.

A taxpayer may acquire or retain a property within or adjacent to an area of interest, based on data obtained from a detailed survey that does not relate exclusively to any discrete property within a particular area of interest. Generally, under the 1977 ruling, the taxpayer

allocates the entire amount of geological and geophysical costs to the acquired or retained property as a capital cost under section 263(a). If more than one property is acquired, it is proper to determine the amount of the geological and geophysical costs allocable to each such property by allocating the entire amount of the costs among the properties on the basis of comparative acreage.

If, however, no property is acquired or retained within or adjacent to that area of interest, the entire amount of the geological and geophysical costs allocable to the area of interest is deductible as a loss under section 165 for the taxable year in which such area of interest is abandoned as a potential source of mineral production.

In 1983, the IRS issued Revenue Ruling 83-105,[17] which elaborates on the positions set forth in the 1977 ruling by setting forth seven factual situations and applying the principles of the 1977 ruling to those situations. In addition, Revenue Ruling 83-105 explains what constitutes "abandonment as a potential source of mineral production."

Description of Proposal

The proposal allows geological and geophysical costs incurred in connection with oil and gas exploration in the United States to be amortized over four years. In the case of abandoned property, remaining basis may no longer be recovered in the year of abandonment of a property as all basis is recovered over the four-year amortization period.

Effective Date

The proposal is effective for geological and geophysical costs paid or incurred in taxable years beginning after the date of enactment. No inference is intended from the prospective effective date of this proposal as to the proper treatment of pre-effective date geological and geophysical costs.

[17] 1983-2 C.B. 51.

G. Amortization of Delay Rental Payments

Present Law

Present law generally requires costs associated with inventory and property held for resale to be capitalized rather than currently deducted as they are incurred. (sec. 263). Oil and gas producers typically contract for mineral production in exchange for royalty payments. If mineral production is delayed, these contracts provide for "delay rental payments" as a condition of their extension. In proposed regulations issued in 2000, the Treasury Department took the position that the uniform capitalization rules of section 263A require delay rental payments to be capitalized.[18]

Description of Proposal

The proposal allows delay rental payments incurred in connection with the development of oil or gas within the United States to be amortized over two years. In the case of abandoned property, remaining basis may no longer be recovered in the year of abandonment of a property as all basis is recovered over the two-year amortization period.

Effective Date

The proposal applies to delay rental payments paid or incurred in taxable years beginning after the date of enactment. No inference is intended from the prospective effective date of this proposal as to the proper treatment of pre-effective date delay rental payments.

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[18] 65 Fed. Reg. 6090 (2000).

H. Extension and Modification of Credit for Producing Fuel From a Non-Conventional Source

Present Law

Certain fuels produced from "non-conventional sources" and sold to unrelated parties are eligible for an income tax credit equal to $3 (generally adjusted for inflation)[19] per barrel or Btu oil barrel equivalent (sec. 29). Qualified fuels must be produced within the United States.

Qualified fuels include:

(1) oil produced from shale and tar sands;

(2) gas produced from geopressured brine, Devonian shale, coal seams, tight formations ("tight sands"), or biomass; and

(3) liquid, gaseous, or solid synthetic fuels produced from coal (including lignite).

In general, the credit is available only with respect to fuels produced from wells drilled or facilities placed in service after December 31, 1979, and before January 1, 1993. An exception extends the January 1, 1993 expiration date for facilities producing gas from biomass and synthetic fuel from coal if the facility producing the fuel is placed in service before July 1, 1998, pursuant to a binding contract entered into before January 1, 1997.

The credit may be claimed for qualified fuels produced and sold before January 1, 2003 (in the case of non-conventional sources subject to the January 1, 1993 expiration date) or January 1, 2008 (in the case of biomass gas and synthetic fuel facilities eligible for the extension period).

Description of Proposal

In general

The proposal extends the placed in service date for certain facilities that would otherwise qualify for the section 29 credit under present law and modifies the amount of the credit. The proposal also expands the class of facilities that are eligible for the credit. In addition, under the proposal, the taxpayer would not be able to claim any credit for production in excess of a daily average of 200,000 cubic feet of gas (or barrel of oil equivalent) from a qualifying well or facility.[20]

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[19] The value of the section 29 credit for production in 2001 was $6.28 per barrel of oil equivalent.

[20] The daily average would be computed as total production divided by the total number of days the well or facility was in production during the year.

Extension for certain non-conventional fuels

The proposal permits taxpayers to claim the section 29 credit for production of certain non-conventional fuels produced at wells placed in service after the date of enactment and before January 1, 2007.[21] Under the proposal, qualifying fuels are oil from shale or tar sands, and gas from geopressured brine, Devonian shale, coal seams, a tight formation, or biomass. The value of the credit is re-based to $2.00 and the amount is not indexed for inflation. Taxpayers may claim the credit for production from the well for each of the first three years of production from the qualifying well.

Expansion for fuels from agricultural and animal waste

The proposal adds facilities producing liquid, gaseous, or solid fuels, from agricultural and animal waste placed in service after the date of enactment and before January 1, 2007, to the list of qualified facilities for purposes of the non-conventional fuel credit. The amount of the credit is equal to $3 (unindexed) per barrel or Btu oil barrel equivalent, for three years of production commencing on the date the facility is placed in service. Agricultural and animal waste includes by-products, packaging, and any materials associated with processing, feeding, selling, transporting, or disposal of agricultural or animal products or wastes, including wood shavings, straw, rice hulls, and other bedding for the disposition of manure.

Expansion for "viscous oil"

The proposal expands section 29 to permit taxpayers to claim the section 29 credit for production of certain viscous oil produced at wells placed in service after the date of enactment and before January 1, 2007. The proposal defines "viscous oil" as domestic crude oil produced from any property if the crude oil has a weighted average gravity of 22 degrees API or less (corrected to 60 degrees Fahrenheit). The value of the credit for viscous oil also is $3.00 per barrel. Taxpayers may claim the credit for production from the well for each of the first three years of production from the time the well is placed in service. The proposal provides that qualifying sales to related parties for consumption not in the immediate vicinity of the wellhead qualify for the credit.

Expansion for "refined coal"

The proposal also expands section 29 to include certain "refined coal" as a qualified non-conventional fuel. "Refined coal" is a qualifying liquid, gaseous, or solid synthetic fuel produced from coal (including lignite) from facilities placed in service after date of enactment and before January 1, 2007. Refined coal also would include a qualifying fuel derived from high-carbon fly ash produced from facilities placed in service after the date of enactment and before January 1, 2007. A qualifying fuel is a fuel that when burned emits 20 percent less nitrogen oxide and either sulfur dioxide or mercury than the burning of feedstock coal or comparable coal predominantly available in the marketplace as of January 1, 2003, and if the

[21] The proposal does not apply to liquid, gaseous, or solid synthetic fuels produced from coal as described under present law section 29(c)(1)(C), but does provide credit for a new category, refined coal, described below.

fuel sells at prices at least 50 percent greater than the prices of the feedstock coal or comparable coal. However, no fuel produced at a qualifying advanced clean coal facility (as defined elsewhere in the committee bill) would be a qualifying fuel. The amount of credit for refined coal also is $3.00 per barrel equivalent. Taxpayers may claim the credit for fuel produced during the five-year period beginning on the date the facility is placed in service.

Expansion for coalmine gas

In addition, the proposal permits taxpayers to claim credit for coalmine gas captured by the taxpayer and utilized as a fuel source or sold by or on behalf of the taxpayer to an unrelated person. The term "coalmine gas" means any methane gas which is being liberated during qualified coal mining operations or as a result of past qualified coal mining operations, or which is captured in advance of qualified coal mining operations as part of specific plan to mine a coal deposit. In the case of coalmine gas that is captured in advance of qualified coal mining operations, the credit is allowed only after the date the coal extraction occurs in the immediate area where the coalmine gas was removed. The value of the credit for coalmine methane also is $3.00 per Btu oil barrel equivalent (51.7 cents per million Btu of heat value in the gas) for gas captured and utilized or sold. Taxpayers may claim the credit for gas captured and utilized or sold after the date of enactment and before January 1, 2007.

Extension of credit for certain existing facilities

The proposal extends the present-law credit through December 31, 2005 for production from existing facilities producing coke, coke gas, or natural gas and by-products produced by coal gasification from lignite. The proposal provides that the credit amount will be $3.00 per Btu oil barrel equivalent for production from such facilities after December 31, 2002.

Study of coal bed methane gas

Lastly, the proposal directs the Secretary of the Treasury to undertake a study of effect section 29 has had on the production of coal bed methane. The Secretary's study is to be made in conjunction with the study to be undertaken by the Secretary of the Interior on the effects of coal bed methane production on surface and water resources, as provided in section 608 of the Energy Policy Act of 2002 (should that study be required by law). The study should estimate the total amount of credit claimed annually and in aggregate related to the production of coal bed methane since the enactment of section 29. The study should report the annual value of the credit allowable for coal bed methane compared to the average annual wellhead price of natural gas (per thousand cubic feet of natural gas). The study should estimate the incremental increase in production of coal bed methane that has resulted from the enactment of section 29. The study should estimate the cost to the Federal government, in terms of the net tax benefits claimed, per thousand cubic feet of incremental coal bed methane produced annually and in aggregate since the enactment of section 29.

Effective Date

The proposals apply to fuels sold from qualifying wells and facilities after the date of enactment.

I. Natural Gas Distribution Lines Treated as Fifteen-Year Property

Present Law

The applicable recovery period for assets placed in service under the Modified Accelerated Cost Recovery System is based on the "class life of the property." The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[22] Natural gas distribution pipelines are assigned a 20-year recovery period and a class life of 35 years.

Description of Proposal

The proposal establishes a statutory 15-year recovery period and a class life of 20 years for natural gas distribution lines.

Effective Date

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

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

VI. PROVISIONS RELATING TO ELECTRIC INDUSTRY RESTRUCTURING

A. Modification to Special Rules for Nuclear Decommissioning Costs

Present Law

Overview

Special rules dealing with nuclear decommissioning reserve funds were adopted by Congress in the Deficit Reduction Act of 1984 ("1984 Act"), when tax issues regarding the time value of money were addressed generally. Under general tax accounting rules, a deduction for accrual basis taxpayers is deferred until there is economic performance for the item for which the deduction is claimed. However, the 1984 Act contains an exception under which a taxpayer responsible for nuclear powerplant decommissioning may elect to deduct contributions made to a qualified nuclear decommissioning fund for future decommissioning costs. Taxpayers who do not elect this provision are subject to general tax accounting rules.

Qualified nuclear decommissioning fund

A qualified nuclear decommissioning fund (a "qualified fund") is a segregated fund established by a taxpayer that is used exclusively for the payment of decommissioning costs, taxes on fund income, management costs of the fund, and for making investments. The income of the fund is taxed at a reduced rate of 20 percent for taxable years beginning after December 31, 1995.[23]

Contributions to a qualified fund are deductible in the year made to the extent that these amounts were collected as part of the cost of service to ratepayers (the "cost of service requirement").[24] Funds withdrawn by the taxpayer to pay for decommissioning costs are included in the taxpayer's income, but the taxpayer also is entitled to a deduction for decommissioning costs as economic performance for such costs occurs.

Accumulations in a qualified fund are limited to the amount required to fund decommissioning costs of a nuclear powerplant for the period during which the qualified fund is in existence (generally post-1984 decommissioning costs of a nuclear powerplant). For this purpose, decommissioning costs are considered to accrue ratably over a nuclear powerplant's estimated useful life. In order to prevent accumulations of funds over the remaining life of a nuclear powerplant in excess of those required to pay future decommissioning costs of such

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[23] As originally enacted in 1984, a qualified fund paid tax on its earnings at the top corporate rate and, as a result, there was no present-value tax benefit of making deductible contributions to a qualified fund. Also, as originally enacted, the funds in the trust could be invested only in certain low risk investments. Subsequent amendments to the provision have reduced the rate of tax on a qualified fund to 20 percent and removed the restrictions on the types of permitted investments that a qualified fund can make.

[24] Taxpayers are required to include in gross income customer charges for decommissioning costs (sec. 88).

nuclear powerplant and to ensure that contributions to a qualified fund are not deducted more rapidly than level funding (taking into account an appropriate discount rate), taxpayers must obtain a ruling from the IRS to establish the maximum annual contribution that may be made to a qualified fund (the "ruling amount"). In certain instances (e.g., change in estimates), a taxpayer is required to obtain a new ruling amount to reflect updated information.

A qualified fund may be transferred in connection with the sale, exchange or other transfer of the nuclear powerplant to which it relates. If the transferee is a regulated public utility and meets certain other requirements, the transfer will be treated as a nontaxable transaction. No gain or loss will be recognized on the transfer of the qualified fund and the transferee will take the transferor's basis in the fund.[25] The transferee is required to obtain a new ruling amount from the IRS or accept a discretionary determination by the IRS.[26]

Nonqualified nuclear decommissioning funds

Federal and State regulators may require utilities to set aside funds for nuclear decommissioning costs in excess of the amount allowed as a deductible contribution to a qualified fund. In addition, taxpayers may have set aside funds prior to the effective date of the qualified fund rules.[27] The treatment of amounts set aside for decommissioning costs prior to 1984 varies. Some taxpayers may have received no tax benefit while others may have deducted such amounts or excluded such amounts from income. Since 1984, taxpayers have been required to include in gross income customer charges for decommissioning costs (sec. 88), and a deduction has not been allowed for amounts set aside to pay for decommissioning costs except through the use of a qualified fund. Income earned in a nonqualified fund is taxable to the fund's owner as it is earned.

Description of Proposal

Repeal of cost of service requirement

The proposal repeals the cost of service requirement for deductible contributions to a nuclear decommissioning fund. Thus, all taxpayers, including unregulated taxpayers, would be allowed a deduction for amounts contributed to a qualified fund.

Clarify treatment of transfers of qualified funds

The proposal clarifies the Federal income tax treatment of the transfer of a qualified fund. No gain or loss would be recognized to the transferor or the transferee (or the qualified fund) as a result of the transfer of a qualified fund in connection with the transfer of the power plant with respect to which such fund was established.

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[25] Treas. reg. sec. 1.468A-6.

[26] Treas. reg. sec. 1.468A-6(f).

[27] These funds are generally referred to as "nonqualified funds."

Exception to ruling amount for certain decommissioning costs

The proposal permits a taxpayer to make contributions to a qualified fund in excess of the ruling amount in one circumstance. Specifically, a taxpayer is permitted to contribute up to the present value of the amount required to fund a nuclear powerplant's decommissioning costs which, under present law, is not permitted to be accumulated in a qualified fund (generally pre-1984 decommissioning costs).[28] It is anticipated that an amount that is permitted to be contributed under this special rule shall be determined using the estimate of total decommissioning costs used for purposes of determining the taxpayer's most recent ruling amount. Any amount transferred to the qualified fund under this special rule that has not previously been deducted, or excluded from gross income is allowed as a deduction over the remaining useful life of the nuclear powerplant.[29] If a qualified fund that has received amounts under this rule is transferred to another person, that person will be entitled to the deduction at the same time and in the same manner as the transferor. Thus, if the transferor was not subject to tax at the time and thus would have been unable to use the deduction, the transferee will similarly not be able to utilize the deduction.

Effective Date

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

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[28] The ability to transfer property into a qualified fund under this special rule is available only to the extent the taxpayer has not obtained a new ruling amount incorporating the repeal of the limitation that a qualified fund only accumulate an amount sufficient to pay for decommissioning costs of a nuclear powerplant incurred during the period that the fund is in existence (generally post 1984 decommissioning costs).

[29] A taxpayer recognizes no gain or loss on the contribution of property to a qualified fund under this special rule. The qualified fund will take a transferred (carryover) basis in such property. Correspondingly, a taxpayer's deduction (over the estimated life of the nuclear powerplant) is to be based on the adjusted tax basis of the property contributed rather than the fair market value of such property.

B. Treatment of Certain Income of Cooperatives

Present Law

In general

Under present law, an entity must be operated on a cooperative basis in order to be treated as a cooperative for Federal income tax purposes. Although not defined by statute or regulation, the two principal criteria for determining whether an entity is operating on a cooperative basis are: (1) ownership of the cooperative by persons who patronize the cooperative; and (2) return of earnings to patrons in proportion to their patronage. The IRS requires that cooperatives must operate under the following principles: (1) subordination of capital in control over the cooperative undertaking and in ownership of the financial benefits from the cooperative; (2) democratic control by the members of the cooperative; (3) vesting in and allocation among the members of all excess of operating revenues over the expenses incurred to generate revenues in proportion to their participation in the cooperative (patronage); and (4) operation at cost (not operating for profit or below cost).[30]

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

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

Except for tax-exempt farmers' cooperatives, cooperatives that are subject to the cooperative tax rules of subchapter T of the Code (sec. 1381, *et seq.*) are permitted a deduction for patronage dividends from their taxable income only to the extent of net income that is derived from transactions with patrons who are members of the cooperative (sec. 1382). The availability of such deductions from taxable income has the effect of allowing the cooperative to be treated like a conduit with respect to profits derived from transactions with patrons who are members of the cooperative.

Cooperatives that qualify as tax-exempt farmers' cooperatives are permitted to exclude patronage dividends from their taxable income to the extent of all net income, including net income that is derived from transactions with patrons who are not members of the cooperative, provided the value of transactions with patrons who are not members of the cooperative does not exceed the value of transactions with patrons who are members of the cooperative (sec. 521).

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

Taxation of electric cooperatives exempt from subchapter T

In general, the cooperative tax rules of subchapter T apply to any corporation operating on a cooperative basis (except mutual savings banks, insurance companies, other tax-exempt organizations, and certain utilities), including tax-exempt farmers' cooperatives (described in sec. 521(b)). However, subchapter T does not apply to an organization that is "engaged in furnishing electric energy, or providing telephone service, to persons in rural areas" (sec. 1381(a)(2)(C)). Instead, electric cooperatives are taxed under rules that were generally applicable to cooperatives prior to the enactment of subchapter T in 1962. Under these rules, an electric cooperative can exclude patronage dividends from taxable income to the extent of all net income of the cooperative, including net income derived from transactions with patrons who are not members of the cooperative.[31]

Tax exemption of rural electric cooperatives

Section 501(c)(12) provides an income tax exemption for rural electric cooperatives if at least 85 percent of the cooperative's income consists of amounts collected from members for the sole purpose of meeting losses and expenses of providing service to its members. The IRS takes the position that rural electric cooperatives also must comply with the fundamental cooperative principles described above in order to qualify for tax exemption under section 501(c)(12).[32] The 85-percent test is determined without taking into account any income from qualified pole rentals and cancellation of indebtedness income from the prepayment of a loan under sections 306A, 306B, or 311 of the Rural Electrification Act of 1936 (as in effect on January 1, 1987). The exclusion for cancellation of indebtedness income applies to such income arising in 1987, 1988, or 1989 on debt that either originated with, or is guaranteed by, the Federal Government. Rural electric cooperatives generally are subject to the tax on unrelated trade or business income under section 511.

Description of Proposal

Treatment of income from open access transactions

The proposal provides that income received or accrued by a rural electric cooperative from any "open access transaction" (other than income received or accrued directly or indirectly from a member of the cooperative) is excluded in determining whether a rural electric cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12). The term "open access transaction" is defined as--

(1) the provision or sale of electric energy transmission services or ancillary services on a nondiscriminatory open access basis: (i) pursuant to an open access transmission tariff filed with and approved by the Federal Energy Regulatory Commission ("FERC") (including acceptable reciprocity tariffs), but only if (in the case of a voluntarily filed tariff) the cooperative files a report with FERC

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

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

within 90 days of enactment of this provision relating to whether or not the cooperative will join a regional transmission organization ("RTO"); or (ii) under an RTO agreement approved by FERC (including an agreement providing for the transfer of control--but not ownership--of transmission facilities);[33]

(2) the provision or sale of electric energy distribution services or ancillary services on a nondiscriminatory open access basis to end-users served by distribution facilities owned by the cooperative or its members; or

(3) the delivery or sale of electric energy on a nondiscriminatory open access basis, provided that such electric energy is generated by a generation facility that is directly connected to distribution facilities owned by the cooperative (or its members) which owns the generation facility.

For purposes of the 85-percent test, the proposal also provides that income received or accrued by a rural electric cooperative from any "open access transaction" is treated as an amount collected from members for the sole purpose of meeting losses and expenses if the income is received or accrued indirectly from a member of the cooperative.

Treatment of income from nuclear decommissioning transactions

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

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

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

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

Treatment of income from asset exchange or conversion transactions

The proposal provides that gain realized by a tax-exempt rural electric cooperative from a voluntary exchange or involuntary conversion of certain property is excluded in determining whether a rural electric cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12). This provision only applies to the extent that: (1) the gain would qualify for deferred recognition under section 1031 (relating to exchanges of property held for productive use or investment) or section 1033 (relating to involuntary conversions); and (2) the replacement

[33] Under this provision, references to FERC are treated as including references to the Public Utility Commission of Texas or the Rural Utilities Service.

property that is acquired by the cooperative pursuant to section 1031 or section 1033 (as the case may be) constitutes property that is used, or to be used, for the purpose of generating, transmitting, distributing, or selling electricity or natural gas.

Treatment of cancellation of indebtedness income from prepayment of certain loans

The proposal provides that income from the prepayment of any loan, debt, or obligation of a tax-exempt rural electric cooperative that is originated, insured, or guaranteed by the Federal Government under the Rural Electrification Act of 1936 is excluded in determining whether the cooperative satisfies the 85-percent test for tax exemption under section 501(c)(12).

Treatment of income from load loss transactions

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

The term "load loss transaction" is generally defined as any wholesale or retail sale of electric energy (other than to a member of the cooperative) to the extent that the aggregate amount of such sales during a seven-year period beginning with the "start-up year" does not exceed the reduction in the amount of sales of electric energy during such period by the cooperative to members. The "start-up year" is defined as the calendar year which includes the date of enactment of this provision or, if later, at the election of the cooperative: (1) the first year that the cooperative offers nondiscriminatory open access; or (2) the first year in which at least 10 percent of the cooperative's sales of electric energy are to patrons who are not members of the cooperative.

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

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

Effective Date

This proposal is effective for taxable years beginning after the date of enactment.

C. Sales or Dispositions to Implement Federal Energy Regulatory Commission or State Electric Restructuring Policy

Present Law

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

Description of Proposal

The proposal permits a taxpayer to elect to recognize gain from a qualifying electric transmission transaction ratably over an eight-year period beginning in the year of sale. A qualifying electric transmission transaction is the sale or other disposition of property used by the taxpayer in the trade or business of providing electric transmission services, or an ownership interest in such an entity, to an independent transmission company[34] prior to January 1, 2008.

A taxpayer electing the provisions of the proposal is required to attach a statement to that effect in the tax return for the taxable year in which the transaction takes place in the manner as the Secretary shall prescribe. The election shall be binding for that taxable year and all subsequent taxable years.[35]

Effective Date

The proposal is effective for transactions occurring after the date of enactment.

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[34] In general, an independent transmission company is defined as: (1) a regional transmission organization approved by the FERC; (2) a person (i) who the FERC determines under section 203 of the Federal Power Act is not a "market participant" and (ii) whose transmission facilities are placed under the operational control of a FERC-approved regional transmission organization before the close of the period specified in such authorization, but not later than January 1, 2007; or (3) in the case of facilities subject to the exclusive jurisdiction of the Public Utility Commission of Texas, a person who is approved by that commission as consistent with Texas state law regarding an independent transmission organization.

[35] The proposal also provides that the installment sale rules shall not apply to any qualifying electric transmission transaction that elects the provisions of this proposal.

VII. ADDITIONAL PROVISIONS

A. Extension of Accelerated Depreciation and Wage Credit Benefits on Indian Reservations

Present Law

Present law includes the following tax incentives for businesses located within Indian reservations.

Accelerated depreciation

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

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

"Qualified Indian reservation property" eligible for accelerated depreciation includes property which is (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation, (2) not used or located outside the reservation on a regular basis, (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer (within the meaning of section 465(b)(3)(C)), and (4) described in the recovery-period table above. In addition, property is not "qualified Indian reservation property" if it is placed in service for purposes of conducting gaming activities. Certain "qualified infrastructure property" may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities).

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax. The accelerated depreciation for Indian reservations is available with respect to property placed in service on or after January 1, 1994, and before January 1, 2004.

Indian employment credit

In general, a credit against income tax liability is allowed to employers for the first $20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer with respect to certain employees (sec. 45A). The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs during the current year over the amount of such wages and costs incurred by the employer during 1993. The credit is an

incremental credit, such that an employer's current-year qualified wages and qualified employee health insurance costs (up to $20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993. No deduction is allowed for the portion of the wages equal to the amount of the credit.

Qualified wages means wages paid or incurred by an employer for services performed by a qualified employee. A qualified employee means any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed. An employee will not be treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during the taxable year exceeds an amount determined at an annual rate of $30,000 (adjusted for inflation after 1993).

The wage credit is available for wages paid or incurred on or after January 1, 1994, in taxable years that begin before December 31, 2003.

Explanation of Provision

Accelerated depreciation

The provision extends the accelerated depreciation incentive for one year (to property placed in service before January 1, 2006).

Indian employment credit

The provision extends the Indian employment credit incentive for one year (to taxable years beginning before January 1, 2006).

Effective Date

The provision is effective on the date of enactment.

B. GAO Study

Present Law

Present law does not require study of the present law provisions relating to clean fuel vehicles and electric vehicles.

Description of Proposal

The proposal directs the Comptroller General to undertake an ongoing analysis of the effectiveness of the tax credits allowed to alternative motor vehicles and the tax credits allowed to various alternative fuels under Title II of the bill and the tax credits and enhanced deductions allowed for energy conservation and efficiency under Title III of the bill. The studies should estimate the energy savings and reductions in pollutants achieved from taxpayer utilization of these provisions. The studies should estimate the dollar value of the benefits of reduced energy consumption and reduced air pollution in comparison to estimates of the revenue cost of these provisions to the U.S. Treasury. The studies should include an analysis of the distribution of the taxpayers who utilize these provisions by income and other relevant characteristics.

The proposal directs the Comptroller General to submit annual reports to Congress beginning not later than December 31, 2004.

Effective Date

The proposal is effective on the date of enactment.

JOINT COMMITTEE ON TAXATION
April 1, 2003
JCX-22-03

ESTIMATED REVENUE EFFECTS OF
THE "ENERGY TAX INCENTIVES ACT OF 2003,"
SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON APRIL 2, 2003

Fiscal Years 2003 - 2013

[Millions of Dollars]

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
Extension and Modification of Renewable Electricity Production Tax Credit - Extend (property placed in service before 1/1/07 (1/1/05 in the case of open-loop)) and modify the section 45 credit for producing renewable electricity from certain sources (credit is equal to 1.5 cents per kilowatt hour for production from post-enactment facilities after 12/31/03)	esfqfa DOE	-21	-113	-188	-221	-248	-265	-270	-265	-252	-239	-231	-1,055	-2,312
Alternative Motor Vehicles and Fuel Incentives														
1. Credits for purchase of alternative motor vehicles, modifications to credit for electric vehicles, and extension of deduction for alternative motor vehicles (deduction for property placed in service before 1/1/08 (1/1/12 in the case of hydrogen fuel); credit for alternative and electric vehicles purchased before 1/1/07 (1/1/12 in the case of hydrogen))	ppisa DOE	-24	-137	-305	-468	-452	-187	-28	-32	-43	-35	-25	-1,573	-1,736
2. Credit for installation of alternative fueling stations credit for property placed in service before 1/1/08 (1/1/12 in the case of hydrogen)	ppisa DOE	[1]	-2	-2	-2	-2	-2	-1	[2]	[2]	[2]	[2]	-10	-9
3. Credit for retail sale of alternative fuels (20 cents/gallon in 2003, 30 cents in 2004, 40 cents in 2005 and 2006)	DOE	-3	-70	-121	-153	-64	-1	-1	-1	-1	---	---	-411	-416
4. Modifications to small producer ethanol credit	tyba DOE	[1]	-16	-34	-34	-34	-18	[1]	[1]	[1]	[1]	---	-136	-137
5. Tax incentives for biodiesel (sunset 12/31/05) [3]	DOE	-1	-19	-29	-9	---	---	---	---	---	---	---	-58	-58
Total of Alternative Motor Vehicles and Fuel Incentives		**-28**	**-244**	**-491**	**-666**	**-552**	**-208**	**-30**	**-33**	**-44**	**-35**	**-25**	**-2,188**	**-2,356**
Conservation and Energy Efficiency Provisions														
1. Business credit for construction of new energy efficient homes	ppb DOE & 12/31/07	-18	-78	-112	-101	-108	-68	-21	-4	---	---	---	-485	-510
2. Credit for energy efficient appliances	apb DOE & 12/31/07	-6	-52	-82	-68	-46	-23	-8	-2	[1]	---	---	-277	-288
3. Credit for residential fuel cell, solar, and other energy efficient property	ppb 1/1/04 & 12/31/07	---	-140	-89	-86	-75	-57	---	---	---	---	---	-447	-447
4. Business tax incentives for qualifying fuel cells	ppisb DOE & 12/31/07	[1]	-2	-3	-3	-3	-2	-1	[1]	[2]	[2]	[2]	-10	-9
5. Allowance of deduction for certain energy efficient commercial building property	1/1/04 for pcpt 1/1/08 & ccb 1/1/10	---	-69	-99	-91	-91	-93	-94	-33	---	---	---	-443	-571

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
6. Three-year applicable recovery period for qualified energy management devices (excluding ancillary equipment):														
a. Electric devices (sunset for property placed in service after 12/31/07)	ppisa DOE	-3	-12	-24	-43	-70	-59	-12	17	27	22	14	-212	-144
b. Water submetering devices (sunset for property placed in service after 12/31/07)	ppisa DOE	-1	-5	-13	-22	-31	-23	[2]	12	15	11	5	-95	-52
7. Energy credit for combined heat and power system property	ppisa DOE & ppisb 1/1/07	-23	-80	-56	-22	-5	4	7	10	10	9	9	-181	-134
8. Credit for energy efficiency improvements to existing homes	tyba DOE & tybb 1/1/07	---	-55	-78	-78	-63	---	---	---	---	---	---	-274	-274
Total of Conservation and Energy Efficiency Provisions		**-51**	**-493**	**-556**	**-514**	**-492**	**-321**	**-129**	**0**	**52**	**42**	**28**	**-2,424**	**-2,429**
Clean Coal Incentives - Investment and Production Credits for Clean Coal Technology														
1. Credit for production from qualifying clean coal technology units	pa DOE	-1	-32	-58	-70	-80	-87	-90	-92	-94	-97	-97	-328	-799
2. Credit for investment in qualifying advanced clean coal technology (for property placed in service after the date of enactment and before 1/1/17 (1/1/13 in the case of advanced pulverized coal or atmospheric fluidized bed)	ppisa DOE	---	-17	-40	-42	-35	-23	-98	-84	-35	-24	-16	-158	-416
3. Credit for production of electricity from qualifying advanced clean coal technology units	pa DOE	[1]	-3	-15	-31	-47	-60	-83	-115	-134	-142	-148	-157	-780
Total of Clean Coal Incentives - Investment and Production Credit for Clean Coal Technology		**-1**	**-52**	**-113**	**-143**	**-162**	**-170**	**-271**	**-291**	**-263**	**-263**	**-261**	**-643**	**-1,995**
Oil and Gas Provisions														
1. Credit for marginal domestic oil and natural gas well production	DOE	*No Revenue Effect*												
2. Natural gas gathering pipelines treated as 7-year property	ppisa DOE	-2	-7	-12	-15	-17	-45	-52	-60	-68	-76	-86	-98	-442
3. Expensing of capital costs incurred and credit for production in complying with Environmental Protection Agency sulfur regulations for small refiners	epoia 1/1/03	---	---	-3	-3	-11	-23	-37	-16	[1]	1	2	-39	-89
4. Determination of small refiner exception to oil depletion deduction - modify definition of independent refiner from daily maximum run less than 50,000 barrels to average daily run less than 60,000 barrels	tyea DOE	-2	-7	-7	-8	-8	-8	-8	-8	-9	-9	-9	-39	-83
5. Extension of suspension of 100% of taxable income limit with respect to marginal production (through 12/31/06)	DOE	---	-22	-35	-36	-13	---	---	---	---	---	---	-106	-106
6. Amortize all geological and geophysical ("G&G") expenditures over 4 years	cpoli tyba DOE	50	99	-41	-185	-237	-220	-186	-150	-139	-143	-148	-534	-1,300
7. Amortize all delay rental payments over 2 years	apoli tyba DOE	31	13	-62	-66	-39	-11	-1	-1	-1	-1	-1	-135	-138

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
8. Extension and modification of section 29 credit for facilities placed in service after the date of enactment and before 1/1/07, including viscous oil, coalmine gas, agricultural and animal waste, and refined coal; extension and modification of section 29 credit for certain coal gasification and coke production through 12/31/05; study of coal bed methane; for new facilities described in section 29 (c)(1)(A) & (B), credit rate is equal to $2.00 BOE; and 200,000 cubic feet per day limit [4]	DOE	-37	-138	-276	-406	-464	-360	-172	-38	[1]	---	---	-1,683	-1,898
9. Natural gas distribution lines treated as 15-year property	ppisa DOE	-5	-23	-50	-71	-100	-127	-152	-179	-209	-238	-252	-375	-1,406
Total of Oil and Gas Provisions		**35**	**-85**	**-486**	**-790**	**-889**	**-794**	**-608**	**-452**	**-426**	**-466**	**-494**	**-3,009**	**-5,462**
Electric Utility Restructuring Provisions														
1. Modification to special rules for nuclear decommissioning costs - transfer of non-qualified funds (buyer get deduction over life of plant); eliminate cost of service requirement; and clarify treatment of fund transfers	tyba DOE	-21	-66	-69	-76	-85	-94	-103	-113	-125	-137	-151	-411	-1,040
2. Treatment of certain income of electric cooperatives	tyba DOE	-1	-12	-19	-21	-23	-25	-27	-29	-32	-35	-37	-101	-262
3. Sales or dispositions to implement Federal Energy Regulatory Commission or State electric restructuring policy prior to 1/1/08	ta DOE	-413	-989	-1054	-1271	-816	477	1013	1034	976	798	579	-4,067	334
Total of Electric Utility Restructuring Provisions		**-435**	**-1,067**	**-1,142**	**-1,368**	**-924**	**358**	**883**	**892**	**819**	**626**	**391**	**-4,579**	**-968**
Additional Provisions														
1. Extension of accelerated depreciation and wage credit benefits for businesses on Indian reservations (through 12/31/05)	DOE	---	4	-176	-303	-109	21	75	118	97	52	6	-564	-216
2. Study of effectiveness of certain provisions by GAO	DOE	*No Revenue Effect*												
Total of Additional Provisions		**---**	**4**	**-176**	**-303**	**-109**	**21**	**75**	**118**	**97**	**52**	**6**	**-564**	**-216**
NET TOTAL		**-501**	**-2,050**	**-3,152**	**-4,005**	**-3,376**	**-1,379**	**-350**	**-31**	**-17**	**-283**	**-586**	**-14,462**	**-15,738**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. Date of enactment is assumed to be July 1, 2003.

Legend for "Effective" column:

apoii = amounts paid or incurred in
apb = appliances produced between
ccb = construction completed before
cpoii = costs paid or incurred in
DOE = date of enactment
epoia = expenses paid or incurred after
esfqfa = electricity sold from qualifying facilities after
pa = production after
pcpt = plans certified prior to
ppb = property purchased between
ppisa = property placed in service after
ppisb = property placed in service between
ta = transactions after
tyba = taxable years beginning after
tybb = taxable years beginning before

[1] Loss of less than $500,000.
[2] Gain of less than $500,000.
[3] This provision may also have indirect effects on Federal outlays for certain farm programs. Outlay effects will be estimated by the Congressional Budget Office.
[4] Qualified facilities would be given credit for three years of production (five years in the case of refined coal).

Joint Committee on Taxation
April 2, 2003
JCX-28-03

DESCRIPTION OF CHAIRMAN'S MODIFICATION TO THE "ENERGY TAX INCENTIVES ACT OF 2003"[1]

A. Modifications to the Provisions of the Energy Tax Incentives Act of 2003

1. Section 45 credit at 1.8 cents per kilowatt hour

The chairman's mark is modified to provide a credit rate of 1.8 cents per kilowatt hour, rather than 1.5 cents per kilowatt hour, with no adjustment for inflation for production in years after 2003 from facilities placed in service after the date of enactment.

2. Modifications to alternative fuel vehicle credits, electric vehicle credits, refueling property credits, and credits for the retail sale of alternative fuels

Fuel cell vehicles

The Chairman's modification changes the credit amount for fuel cell vehicles.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Chairman's Modification to the "Energy Tax Incentives Act of 200,"* (JCX-28-03), April 2, 2003.

Table 1, below, is substituted for Table 1 of the Chairman's mark.

Table 1.–Base Credit Amount for Fuel Cell Vehicles

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

Automobiles and light trucks

The Chairman's modification changes the proposed base credit amounts for automobiles and light trucks.

Table 2, below, is substituted for Table 3 of the Chairman's mark.

Table 2.–Hybrid Vehicle Base Credit Amount for Automobiles and Light Trucks, Dependent Upon the Power Available from the Rechargeable Energy Storage System as a Percentage of the Vehicles Maximum Available Power

Base Credit Amount	If Rechargeable Energy Storage System Provides:	
	at least	but less than
$250	4% of maximum available power	10% of maximum available power
$500	10% of maximum available power	20% of maximum available power
$750	20% of maximum available power	30% of maximum available power
$1,000	30% of maximum available power	

Heavy duty hybrid vehicles

The Chairman's modification defines a heavy duty hybrid vehicle as a vehicle weighing more than 8,500 pounds.[2] The Chairman's modification also changes the proposed credit amounts for heavy duty hybrid vehicles weighing 14,000 pounds or less.

Table 3, below, is substituted for Table 5 of the Chairman's mark.

[2] Medium duty passenger vehicles as defined in 40 CFR 86.1830-01 are treated as a passenger automobile or light truck for the purpose of determining the allowable credit.

Table 3.–Hybrid Vehicle Base Credit Amount for Heavy Duty Vehicles Weighing Not More Than 14,000 pounds

Base Credit Amount	If Rechargeable Energy Storage System Provides:	
	at least	but less than
$1,000	20% of maximum available power	30% of maximum available power
$1,750	30% of maximum available power	40% of maximum available power
$2,000	40% of maximum available power	50% of maximum available power
$2,250	50% of maximum available power	60% of maximum available power
$2,500	60% of maximum available power	

The Chairman's modification changes the proposed base credit amounts for heavy duty hybrid vehicles weighing more than 14,000 pounds but not more than 26,000 pounds.

Table 4, below, is substituted for Table 6 of the Chairman's mark.

Table 4.–Hybrid Vehicle Base Credit Amount for Heavy Duty Hybrid Vehicles Weighing More Than 14,000 Pounds, But Not More Than 26,000 Pounds

Base Credit Amount	If Rechargeable Energy Storage System Provides:	
	at least	but less than
$4,000	20% of maximum available power	30% of maximum available power
$4,500	30% of maximum available power	40% of maximum available power
$5,000	40% of maximum available power	50% of maximum available power
$5,500	50% of maximum available power	60% of maximum available power
$6,000	60% of maximum available power	

The Chairman's modification changes the proposed base credit amounts for heavy duty hybrid vehicles weighing more than 26,000 pounds.

Table 5, below, is substituted for Table 7 of the Chairman's mark.

Table 5.–Hybrid Vehicle Base Credit Amount for Heavy Duty Hybrid Vehicles Weighing More Than 26,000 Pounds

Base Credit Amount	If Rechargeable Energy Storage System Provides:	
	at least	but less than
$6,000	20% of maximum available power	30% of maximum available power
$7,000	30% of maximum available power	40% of maximum available power
$8,000	40% of maximum available power	50% of maximum available power
$9,000	50% of maximum available power	60% of maximum available power
$10,000	60% of maximum available power	

Alternative fuel vehicles

The Chairman's modification changes the maximum allowable incremental cost for the purchase of a new alternative fuel vehicle to not more than between $5,000 and $40,000 depending upon the weight of the vehicle weight class.

Table 6, below, is substituted for Table 8 of the Chairman's mark.

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

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

Battery electric vehicles

The Chairman's modification changes present law to provide for a credit equal to the lesser of $1,500 or 10 percent of the manufacturer's suggested retail price of certain vehicles that conform to the Motor Vehicle Safety Standard 500. The Chairman's modification also changes the credit amount for qualifying battery electric vehicles.

Table 7, below, is substituted for Table 10 of the Chairman's mark.

Table 7.–Credit for Qualifying Battery Electric Vehicles

Vehicle Gross Weight Rating in Pounds	Credit Amount
Vehicle ≤ 8,500	$3,500
8,500 < vehicle ≤ 14,000	$10,000
14,000 < vehicle ≤ 26,000	$20,000
26,000 < vehicle	$40,000

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

Extension of present-law section 179A

The Chairman's modification adds an extension for the deduction for costs to qualified clean-fuel vehicle property and clean-fuel vehicle refining property through December 31, 2007 (December 31, 2011 in the case of property relating to hydrogen). The phase-down of present law for clean fuel vehicles is modified such that the taxpayer may claim 75 percent of the otherwise allowable deduction in 2004 and 2005 (2004 through 2009 in the case of property relating to hydrogen), 50 percent of the otherwise allowable deduction in 2006 (2010 in the case of property relating to hydrogen), and 25 percent of the otherwise allowable deduction in 2007 (2011 in the case of property relating to hydrogen).

Credit for installation of alternative fueling stations

The Chairman's modification changes the allowable credit amount of retail clean-fuel vehicle refueling property to not exceed $30,000 and also changes the credit amount of residential clean-fuel vehicle refueling property to not exceed $1,000.

Credit for retail sale of alternative fuels

The Chairman's modification changes the credit equal to the gasoline gallon equivalent to 30 cents per gallon of alternative fuel sold in 2003, 40 cents per gallon in 2004, 50 cents per gallon in 2005, and 50 cents per gallon in 2006.

3. Credit for residential energy efficient property

The Chairman's modification provides that oil and propane furnaces and water heaters that meet the same efficiency standards as their natural gas counterparts are eligible for the same credit.

4. Three-year applicable recovery period for depreciation of qualified energy management devices

The Chairman's modification clarifies that a qualified energy management device is not required to record or communicate price data.

5. Modification to investment and production credits for advanced clean coal technology units

The Chairman's mark is modified to provide that pressurized fluidized bed combustion technology is a qualifying advanced clean coal technology. A qualifying pressurized fluidized bed combustion technology unit is a unit placed in service after the date of enactment and before 2017 and having a design net heat rate of not more than 7,720 Btu (8,900 Btu if the unit is placed in service before 2009 and 8,500 Btu if the unit is placed in service after 2008 and before 2013).

The Chairman's mark is modified to provide that a qualifying integrated gasification combined cycle technology unit must have a design net heat rate of not more than 8,500 Btu if the unit is placed in service after 2008 and before 2013.

The Chairman's mark also is modified so that in the case of units placed in service after 2008 and before 2013 for which the unit net heat rate, Btu/kWh adjusted for the heat content for the design coal, is more than 8,125 Btu but less than 8,500 Btu, the production credit will be $0.0075 for the first five years of production and $0.0055 for the second five years of production. (This modifies the last line of Table 12 of the Chairman's mark.)

Lastly, the Chairman's mark is modified to provide that the Secretary of the Treasury may grant certificates to investments in advanced clean coal technology units to the point the 4,000 megawatts of electricity production capacity qualifies for the investment credit and production credit. From the potential pool of 4,000 megawatts of capacity, not more than 500 megawatts in total and not more than 250 megawatts in years prior to 2009 shall be allocated to units using pressurized fluidized bed combustion technology.

6. Amortization of geological and geophysical expenditures

The Chairman's mark is modified to provide that the amortization of geological and geophysical costs is changed from four years to two years.

7. Extension and modification of credit for producing fuel from a non-conventional source

The Chairman's modification increases the section 29 credit for oil from shale or tar sands, and gas from geopressured brine, Devonian shale, coal seams, a tight formation, or biomass to $3.00.

B. New Energy Provisions

1. Ethanol excise tax credit

Present Law

Alcohol fuels income tax credit

The alcohol fuels credit is the sum of three credits: the alcohol mixture credit, the alcohol credit and the small ethanol producer credit. Generally, the alcohol fuels credit expires after December 31, 2007.[3]

A taxpayer (generally a petroleum refiner, distributor, or marketer) who mixes ethanol with gasoline (or a special fuel[4]) is an "ethanol blender." Ethanol blenders are eligible for an income tax credit of 52 cents per gallon of 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 blender as fuel, or used as fuel by the blender in producing the mixture. Businesses also may reduce their income taxes by 52 cents for each gallon of ethanol (not mixed 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"). The 52-cents-per-gallon income tax credit rate is scheduled to decline to 51 cents per gallon during the period 2005 through 2007.

A separate income tax credit is available for small ethanol producers (the "small ethanol producer credit"). A small ethanol producer is defined as a person whose ethanol production capacity does not exceed 30 million gallons per year. The small ethanol producer credit is 10 cents per gallon of ethanol produced during the taxable year for up to a maximum of 15 million gallons.

The credits that comprise alcohol fuels tax credit are includible in income. The credit may not be used to offset alternative minimum tax liability. The credit is a treated as a general business credit, subject to the ordering rules and carryforward/carryback rules that apply to business credits generally.

Excise tax reduction

Registered ethanol blenders may forgo the full income tax credit and instead pay reduced rates of excise tax on gasoline that they purchase for blending with ethanol. Most of the benefit of the alcohol fuels credit is claimed through the excise tax system.

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[3] The alcohol fuels credit is unavailable when, for any period before January 1, 2008, the tax rates for gasoline and diesel fuels drop to 4.3 cents per gallon.

[4] A special fuel includes any liquid (other than gasoline) that is suitable for use in an internal combustion engine.

The reduced excise tax rates apply when gasoline is being purchased for the production of "gasohol." Gasohol is defined as a gasoline/ethanol blend that contains 5.7 percent ethanol, 7.7 percent ethanol, or 10 percent ethanol. The Federal excise tax on gasoline is 18.4 cents per gallon. For the calendar year 2003, the following reduced rates apply to gasohol:[5]

5.7 percent ethanol	15.436 cents per gallon
7.7 percent ethanol	14.396 cents per gallon
10.0 percent ethanol	13.200 cents per gallon

The person liable for the tax is required to be registered with the IRS and (1) produces gasohol with gasoline within 24 hours of removing or entering the gasoline or (2) at the time the gasoline was sold, has an unexpired certificate from the buyer and has no reason to believe the certificate is false.[6]

If an ethanol blender is not registered with the IRS, the blender must pay the full excise tax of 18.4 cents per gallon on all gasoline that is blended with ethanol. The blender may claim the income tax credit for the ethanol. In addition, in lieu of the credit, the blender may file for a quick excise tax refund. The refund is equal to the difference between the gasoline excise tax that was paid and the tax that would have been paid by a registered blender on the gasoline/ethanol mixture being produced. Generally, the IRS pays these quick refunds within 20 days. Interest accrues if the refund is paid more than 20 days after filing.

The benefits provided by the alcohol fuels income tax credit and the excise tax exemption are integrated such that the alcohol fuels credit is reduced to take into account the benefit of any excise tax reduction.

Highway Trust Fund

In general, 18.3 cents per gallon of the gasoline excise tax is deposited in the Highway Trust Fund and 0.1 cent per gallon is deposited in the Leaking Underground Storage Tank Trust Fund (the "LUST" rate). In the case of gasohol with respect to which a reduced excise tax is paid, 2.5 cents per gallon of the reduced tax is retained in the General Fund.[7] In the case of

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[5] These special rates will terminate on September 30, 2007 (sec. 4081(c)(8)). In addition, the basic fuel tax rate will drop to 4.3 cents per gallon beginning on October 1, 2005.

[6] Treas. Reg. sec. 48.4081-6(c). A certificate from the buyer assures that the gasoline will be used to produce gasohol within 24 hours after purchase. A copy of the registrant's letter of registration cannot be used as a gasohol blender's certificate.

[7] Sec. 9503(b)(4)(E).

gasoline taxed at a reduced rate prior to mixing, 2.8 cents of the reduced rate is retained in the General Fund.[8] The balance of the reduced rate (less the LUST rate) is deposited in the Highway Trust Fund.

Description of Proposal

In lieu of the reduced excise tax rates on gasoline used to produce gasohol, the proposal provides for an excise tax credit equal to the alcohol mixture credit. The alcohol fuel mixture credit is 52 cents and will decline at the same rate as the current alcohol fuels income tax credit to 51 cents in 2005, 2006, and 2007 for each gallon of alcohol used by a person in producing an alcohol fuel mixture. For mixtures not containing ethanol (renewable source methanol), the credit is 60 cents per gallon. This excise tax credit may be taken against excise tax liability. The excise tax credit is to be coordinated with the income tax credit. The proposal extends both the present-law alcohol fuels income tax credit and the new excise tax credit through December 31, 2010.

The proposal eliminates the alcohol blend rate tiers (i.e. 5.7 percent, 7.7 percent and 10 percent) for reduced rates of tax. Under the proposal the full rate of tax for gasoline is imposed on both alcohol fuel mixtures and gasoline used to produce an alcohol fuel mixture. Equivalent amounts of this tax are to be credited to the Highway Trust Fund. Registered ultimate vendors of gasoline used to produce an alcohol fuel mixture could seek a refund equal to the alcohol fuels mixture credit. If such claims are not paid within 45 days, the claim is to be paid with interest. The proposal also provides that in the case of an electronic claim, if such claim is not paid within 20 days, the claim is to be paid with interest.

The proposal eliminates the requirement that 2.5 and 2.8 cents per gallon of excise taxes be retained in the General Fund so that the full amount of tax is credited to the Highway Trust Fund.

Effective Date

The proposal is effective September 30, 2003.

2. Modify income tax and excise tax rules governing treatment of ETBE

Present Law

An 18.4 cents-per-gallon excise tax is imposed on gasoline. The tax is imposed when the fuel is removed from a refinery unless the removal is to a bulk transportation facility (e.g., removal by pipeline or barge to a registered terminal). In the case gasoline removed in bulk by registered parties, tax is imposed when the gasoline is removed from the terminal facility, typically by truck (i.e., "breaks bulk"). If gasoline is sold to an unregistered party before it is removed from a terminal, tax is imposed on that sale. When the gasoline subsequently breaks bulk, a second tax is imposed. The payor of the second tax may file a refund claim if it can

[8] Sec. 9503(b)(4)(F).

prove payment of the first tax. The party liable for payment of the gasoline excise tax is called a "position holder," defined as the owner of record inside the refinery or terminal facility.

A 52-cents-per-gallon income tax credit is allowed for ethanol used as a motor fuel (the "alcohol fuels credit"). The benefit of the alcohol fuels tax credit may be claimed as a reduction in excise tax payments when the ethanol is blended with gasoline ("gasohol"). The reduction is based on the amount of ethanol contained in the gasohol. The excise tax benefits apply to gasohol blends of 90 percent gasoline/10 percent ethanol, 92.3 percent gasoline/7.7 percent ethanol, or 94.3 percent gasoline/5.7 percent ethanol. The income tax credit is based on the amount of alcohol contained in the blended fuel.

ETBE is an ether that is manufactured using ethanol. Unlike ethanol, ETBE can be blended with gasoline before the gasoline enters a pipeline because ETBE does not result in contamination of fuel with water while in transport. Treasury Department regulations provide that gasohol blenders may claim the income tax credit and excise tax rate reductions for ethanol used in the production of ETBE. The regulations also provide a special election allowing refiners to claim the benefit of the excise tax rate reduction even though the fuel being removed from terminals does not contain the requisite percentages of ethanol for claiming the excise tax rate reduction.

Description of Proposal

The proposal replaces the present-law regulatory procedures enabling refiners to claim excise tax benefits on ETBE-blended gasohol with a new excise tax credit alternative to the alcohol fuels income tax credit. Under the provision, in lieu of excise tax rate reductions for specified gasohol blends, a refiner blending ETBE and gasoline accrues an excise tax credit equal to the amount of the alcohol fuels credit or excise tax rate reduction otherwise available for the ETBE blended fuel. The refiner may use this credit to offset its excise tax liability for highway motor fuels under Code section 4081. Alternatively, the credit may be transferred to a registered position holder that is a member of the same controlled group of corporations as the refiner, and the position holder may use the excise tax credit to offset its liability for excise taxes under Code section 4081.

Effective Date

The proposal is effective for fuels blended after date of enactment.

3. Sale of gasoline and diesel fuel at duty-free sales enterprises

Present Law

A duty-free sales enterprise that meets certain conditions may sell and deliver for export from the customs territory of the United States duty-free merchandise. Duty-free merchandise is merchandise sold by a duty-free sales enterprise on which neither federal duty nor federal tax has been assessed pending exportation from the customs territory of the United States. Conditions for qualifying as a duty-free enterprise include (but are limited to) locations within a specified distance from a port of entry, establishment of procedures for ensuring that merchandize is exported from the United States, and prominent posting of rules concerning duty-free treatment

of merchandise. The duty-free statute does not contain any limitation on what goods may qualify for duty-free treatment.

Description of Proposal

The proposal amends Section 555(b) of the Tariff Act of 1930 (19 U.S.C. 1555(b)) to provide that gasoline or diesel fuel sold at duty-free enterprises shall be considered to entered for consumption into the United States and thus ineligible for classification as duty-free merchandise.

Effective Date

The proposal is effective on the date of enactment.

4. Exempt certain prepayments for natural gas from tax-exempt bond arbitrage rules

Present Law

Interest on bonds issued by States or local governments to finance activities carried out or paid for by those entities generally is exempt from income tax.[9] Restrictions are imposed on the ability of States or local governments to invest the proceeds of these bonds for profit (the "arbitrage restrictions"). One such restriction limits the use of bond proceeds to acquire "investment-type property." The term investment-type property includes the acquisition of property in a transaction involving a prepayment. A prepayment can produce prohibited arbitrage profits when the discount received for prepaying the costs exceeds the yield on the tax-exempt bonds. In general, prohibited prepayments include all prepayments that are not customary in an industry by both beneficiaries of tax-exempt bonds and other persons using taxable financing for the same transaction.

On April 17, 2002, the Department of the Treasury issued proposed regulations regarding arbitrage and private activity restrictions applicable to tax-exempt bonds issued by State and local governments. The proposed regulations add an exception to the definition of investment-type property for certain natural gas prepayments that are made by or for one or more utilities that are owned by a governmental person.[10] The exception applies if at least 95 percent of the natural gas purchased with the prepayment is to be (1) consumed by retail customers in the service area of a municipal gas utility, or (2) used to produce electricity that will be furnished to retain customers that a municipal electric utility is obligated to serve under State or Federal law. An obligation that arises solely because of a contract is not an obligation to serve under State or Federal law. For this purpose, the service area of a municipal gas utility is defined as (1) any area throughout which the municipal utility provided (at all times during the five-year period ending on the issue date) gas transmission or distribution service, and any area that is contiguous to such an area, or (2) any area where the municipal utility is obligated under State or Federal

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[9] Sec. 103.

[10] Prop. Treas. Reg. sec. 1.148-1(e)(2)(ii).

law to provide gas distribution services as provided in such law. Issuers may apply principles similar to the rules governing private use to cure a violation of the 95 percent requirement.[11]

A prepayment will not fail to meet the requirements for prepaid gas contracts by reason of any commodity swap contract that may be entered into between the issuer and an unrelated party (other than the gas supplier), or between the gas supplier and an unrelated party (other than the issuer), so long as each swap contract is an independent contract. A swap contract is an independent contract if it is not dependent on performance by any person (other than the party to the swap contract) under another contract (for example, a gas contract or another swap contract). A natural gas commodity swap contract will not fail to be an independent contract solely because the swap contract may terminate in the event of a failure of a gas supplier to deliver gas for which the swap contract is a hedge.[12] The Commissioner may, by published guidance, set forth additional circumstances in which a prepayment does not give rise to investment-type property.

Description of Proposal

In general

The proposal creates a safe harbor exception to the general rule that tax-exempt bond-financed prepayments violate the arbitrage restrictions. The term "investment type property" does not include a prepayment under a qualified natural gas supply contract. The proposal also provides such prepayments are not treated as private loans for purposes of the private business tests.

Under the proposal, a prepayment financed with tax-exempt bond proceeds for the purpose of obtaining a supply of natural gas for service area customers of a governmental utility is not treated as the acquisition of investment-type property. A contract is a qualified natural gas contract if the volume of natural gas secured for any year covered by the prepayment does not exceed the sum of (1) the average annual natural gas purchased (other than for resale) by customers of the utility within the service area of the utility ("retail natural gas consumption") during the testing period, and (2) the amount of natural gas that is needed to fuel transportation of the natural gas to the governmental utility. The testing period is the 5-calendar-year period immediately preceding the calendar year in which the bonds are issued. A retail customer is one who does not purchase natural gas for resale. Natural gas used to generate electricity by a governmental utility is counted as retail natural gas consumption if the electricity was sold to retail customers within the service area of the governmental electric utility.

Adjustments

The volume of gas permitted by the general rule is reduced by natural gas otherwise available on the date of issuance. Specifically, the amount of natural gas permitted to be

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[11] See Treas. Reg. 1.141-12.

[12] Internal Revenue Service, *Clarification of Proposed Regulations Relating to Tax-Exempt Bonds Issued by State or Local Governments*, Notice 2002-52, 2002-30 IRB 1 (July 03, 2002).

acquired under a qualified natural gas contract for any period is to be reduced by natural gas held by the utility on the date of issuance of the bonds and natural gas that the utility has a right to acquire for the prepayment period (determined as of the date of issuance).[13] For purposes of the preceding sentence, applicable share means, with respect to any period, the natural gas allocable to such period if the gas were allocated ratably over the period to which the prepayment relates.

For purposes of the safe harbor, if after the close of the testing period and before the issue date of the bonds (1) the government utility enters into a contract to supply natural gas (other than for resale) for a commercial person for use at a property within the service area of such utility and (2) the gas consumption for such property was not included in the testing period or the ratable amount of natural gas to be supplied under the contract is significantly greater than the ratable amount of gas supplied to such property during the testing period, then the amount of gas permitted to be purchased may be increased to accommodate the contract.

The average annual retail natural gas consumption calculation for purposes of the safe harbor, however, is not to exceed the annual amount of natural gas reasonably expected to be purchased (other than for resale) by persons who are located within the service area of such utility and who, as of the date of issuance of the issue, are customers of such utility.

Intentional acts

The safe harbor does not apply if the utility engages in intentional acts to render (1) the volume of natural gas covered by the prepayment to be in excess of that needed for retail natural gas consumption, and (2) the amount of natural gas that is needed to fuel transportation of the natural gas to the governmental utility.

Definition of service area

Service area is defined as (1) any area throughout which the governmental utility provided (at all times during the testing period) in the case of a natural gas utility, natural gas transmission or distribution service, or in the case of an electric utility, electric distribution service; (2) limited areas contiguous to such areas, and (3) any area recognized as the service area of the governmental utility under State or Federal law. Contiguous areas are limited to any area within a county contiguous to the area described in (1) in which retail customers of the utility are located if such area is not also served by another utility providing the same service.

Ruling request for higher prepayment amounts

Upon written request, the Secretary may allow an issuer to prepay for an amount of gas greater than that allowed by the safe harbor based on objective evidence of growth in gas

[13] For example, natural gas otherwise available on the date the bonds are issued includes supply covered by other prepayment contracts for the period, and supply held in storage or subject to an option to purchase by such utility that is available for retail natural gas consumption during the period covered by the prepayment. It does not include supply that could be purchased on the open market during the prepayment period.

consumption or population that demonstrates that amount permitted by the exception is insufficient.

Effective Date

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

C. Provisions to Discourage Corporate Expatriation

1. Tax treatment of inversion transactions

Present Law

Determination of corporate residence

The U.S. tax treatment of a multinational corporate group depends significantly on whether the top-tier "parent" corporation of the group is domestic or foreign. For purposes of U.S. tax law, a corporation is treated as domestic if it is incorporated under the law of the United States or of any State. All other corporations (i.e., those incorporated under the laws of foreign countries) are treated as foreign. Thus, place of incorporation determines whether a corporation is treated as domestic or foreign for purposes of U.S. tax law, irrespective of other factors that might be thought to bear on a corporation's "nationality," such as the location of the corporation's management activities, employees, business assets, operations, or revenue sources, the exchanges on which the corporation's stock is traded, or the residence of the corporation's managers and shareholders.

U.S. taxation of domestic corporations

The United States employs a "worldwide" tax system, under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. In order to mitigate the double taxation that may arise from taxing the foreign-source income of a domestic corporation, a foreign tax credit for income taxes paid to foreign countries is provided to reduce or eliminate the U.S. tax owed on such income, subject to certain limitations.

Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income is generally deferred. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F[14] and the passive foreign investment company rules.[15] A foreign tax credit is generally available to offset, in whole or in part, the U.S. tax owed on this foreign-source income, whether repatriated as an actual dividend or included under one of the anti-deferral regimes.

U.S. taxation of foreign corporations

The United States taxes foreign corporations only on income that has a sufficient nexus to the United States. Thus, a foreign corporation is generally subject to U.S. tax only on income

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[14] Secs. 951-964.

[15] Secs. 1291-1298.

that is "effectively connected" with the conduct of a trade or business in the United States. Such "effectively connected income" generally is taxed in the same manner and at the same rates as the income of a U.S. corporation. An applicable tax treaty may limit the imposition of U.S. tax on business operations of a foreign corporation to cases in which the business is conducted through a "permanent establishment" in the United States.

In addition, foreign corporations generally are subject to a gross-basis U.S. tax at a flat 30-percent rate on the receipt of interest, dividends, rents, royalties, and certain similar types of income derived from U.S. sources, subject to certain exceptions. The tax generally is collected by means of withholding by the person making the payment. This tax may be reduced or eliminated under an applicable tax treaty.

U.S. tax treatment of inversion transactions

Under present law, U.S. corporations may reincorporate in foreign jurisdictions and thereby replace the U.S. parent corporation of a multinational corporate group with a foreign parent corporation. These transactions are commonly referred to as "inversion" transactions. Inversion transactions may take many different forms, including stock inversions, asset inversions, and various combinations of and variations on the two. Most of the known transactions to date have been stock inversions. In one example of a stock inversion, a U.S. corporation forms a foreign corporation, which in turn forms a domestic merger subsidiary. The domestic merger subsidiary then merges into the U.S. corporation, with the U.S. corporation surviving, now as a subsidiary of the new foreign corporation. The U.S. corporation's shareholders receive shares of the foreign corporation and are treated as having exchanged their U.S. corporation shares for the foreign corporation shares. An asset inversion reaches a similar result, but through a direct merger of the top-tier U.S. corporation into a new foreign corporation, among other possible forms. An inversion transaction may be accompanied or followed by further restructuring of the corporate group. For example, in the case of a stock inversion, in order to remove income from foreign operations from the U.S. taxing jurisdiction, the U.S. corporation may transfer some or all of its foreign subsidiaries directly to the new foreign parent corporation or other related foreign corporations.

In addition to removing foreign operations from the U.S. taxing jurisdiction, the corporate group may derive further advantage from the inverted structure by reducing U.S. tax on U.S.-source income through various "earnings stripping" or other transactions. This may include earnings stripping through payment by a U.S. corporation of deductible amounts such as interest, royalties, rents, or management service fees to the new foreign parent or other foreign affiliates. In this respect, the post-inversion structure enables the group to employ the same tax-reduction strategies that are available to other multinational corporate groups with foreign parents and U.S. subsidiaries, subject to the same limitations. These limitations under present law include section 163(j), which limits the deductibility of certain interest paid to related parties, if the payor's debt-equity ratio exceeds 1.5 to 1 and the payor's net interest expense exceeds 50 percent of its "adjusted taxable income." More generally, section 482 and the regulations thereunder require that all transactions between related parties be conducted on terms consistent with an "arm's length" standard, and permit the Secretary of the Treasury to reallocate income and deductions among such parties if that standard is not met.

Inversion transactions may give rise to immediate U.S. tax consequences at the shareholder and/or the corporate level, depending on the type of inversion. In stock inversions, the U.S. shareholders generally recognize gain (but not loss) under section 367(a), based on the difference between the fair market value of the foreign corporation shares received and the adjusted basis of the domestic corporation stock exchanged. To the extent that a corporation's share value has declined, and/or it has many foreign or tax-exempt shareholders, the impact of this section 367(a) "toll charge" is reduced. The transfer of foreign subsidiaries or other assets to the foreign parent corporation also may give rise to U.S. tax consequences at the corporate level (e.g., gain recognition and earnings and profits inclusions under sections 1001, 311(b), 304, 367, 1248 or other provisions). The tax on any income recognized as a result of these restructurings may be reduced or eliminated through the use of net operating losses, foreign tax credits, and other tax attributes.

In asset inversions, the U.S. corporation generally recognizes gain (but not loss) under section 367(a) as though it had sold all of its assets, but the shareholders generally do not recognize gain or loss, assuming the transaction meets the requirements of a reorganization under section 368.

Description of Proposal

In general

The proposal defines two different types of corporate inversion transactions and establishes a different set of consequences for each type. Certain partnership transactions also are covered.

Transactions involving at least 80 percent identity of stock ownership

The first type of inversion is a transaction in which, pursuant to a plan or a series of related transactions: (1) a U.S. corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity;[16] (2) the former shareholders of the U.S. corporation hold (by reason of holding stock in the U.S. corporation) 80 percent or more (by vote or value) of the stock of the foreign-incorporated entity after the transaction; and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50 percent ownership (i.e., the "expanded affiliated group"), does not have substantial business activities in the entity's country of incorporation, compared to the total worldwide business activities of the expanded affiliated group. The provision denies the intended tax benefits of this type of inversion by deeming the top-tier foreign corporation to be a domestic corporation for all purposes of the Code.[17]

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[16] It is expected that the Treasury Secretary will issue regulations applying the term "substantially all" in this context and will not be bound in this regard by interpretations of the term in other contexts under the Code.

[17] Since the top-tier foreign corporation is treated for all purposes of the Code as domestic, the shareholder-level "toll charge" of sec. 367(a) does not apply to these inversion transactions. However, regulated investment companies and certain similar entities are allowed

Except as otherwise provided in regulations, the provision does not apply to a direct or indirect acquisition of the properties of a U.S. corporation no class of the stock of which was traded on an established securities market at any time within the four-year period preceding the acquisition. In determining whether a transaction would meet the definition of an inversion under the provision, stock held by members of the expanded affiliated group that includes the foreign incorporated entity is disregarded. For example, if the former top-tier U.S. corporation receives stock of the foreign incorporated entity (e.g., so-called "hook" stock), the stock would not be considered in determining whether the transaction meets the definition. Stock sold in a public offering (whether initial or secondary) or private placement related to the transaction also is disregarded for these purposes. Acquisitions with respect to a domestic corporation or partnership are deemed to be "pursuant to a plan" if they occur within the four-year period beginning on the date which is two years before the ownership threshold under the provision is met with respect to such corporation or partnership.

Transfers of properties or liabilities as part of a plan a principal purpose of which is to avoid the purposes of the provision are disregarded. In addition, the Treasury Secretary is granted authority to prevent the avoidance of the purposes of the provision, including avoidance through the use of related persons, pass-through or other noncorporate entities, or other intermediaries, and through transactions designed to qualify or disqualify a person as a related person, a member of an expanded affiliated group, or a publicly traded corporation. Similarly, the Treasury Secretary is granted authority to treat certain non-stock instruments as stock, and certain stock as not stock, where necessary to carry out the purposes of the provision.

Transactions involving greater than 50 percent but less than 80 percent identity of stock ownership

The second type of inversion is a transaction that would meet the definition of an inversion transaction described above, except that the 80-percent ownership threshold is not met. In such a case, if a greater-than-50-percent ownership threshold is met, then a second set of rules applies to the inversion. Under these rules, the inversion transaction is respected (i.e., the foreign corporation is treated as foreign), but: (1) any applicable corporate-level "toll charges" for establishing the inverted structure may not be offset by tax attributes such as net operating losses or foreign tax credits; (2) the IRS is given expanded authority to monitor related-party transactions that may be used to reduce U.S. tax on U.S.-source income going forward; and (3) section 163(j), relating to "earnings stripping" through related-party debt, is strengthened. These measures generally apply for a 10-year period following the inversion transaction. In addition, inverting entities are required to provide information to shareholders or partners and the IRS with respect to the inversion transaction.

With respect to "toll charges," any applicable corporate-level income or gain required to be recognized under sections 304, 311(b), 367, 1001, 1248, or any other provision with respect to the transfer of controlled foreign corporation stock or other assets by a U.S. corporation as part of the inversion transaction or after such transaction to a related foreign person is taxable,

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to elect to recognize gain as if sec. 367(a) did apply. This election is available for the calendar year of enactment and, if enactment occurs after October 31, the succeeding calendar year.

without offset by any tax attributes (e.g., net operating losses or foreign tax credits). To the extent provided in regulations, this rule will not apply to certain transfers of inventory and similar transactions conducted in the ordinary course of the taxpayer's business.

In order to enhance IRS monitoring of related-party transactions, the provision establishes a new pre-filing procedure. Under this procedure, the taxpayer will be required annually to submit an application to the IRS for an agreement that all return positions to be taken by the taxpayer with respect to related-party transactions comply with all relevant provisions of the Code, including sections 163(j), 267(a)(3), 482, and 845. The Treasury Secretary is given the authority to specify the form, content, and supporting information required for this application, as well as the timing for its submission.

The IRS will be required to take one of the following three actions within 90 days of receiving a complete application from a taxpayer: (1) conclude an agreement with the taxpayer that the return positions to be taken with respect to related-party transactions comply with all relevant provisions of the Code; (2) advise the taxpayer that the IRS is satisfied that the application was made in good faith and substantially complies with the requirements set forth by the Treasury Secretary for such an application, but that the IRS reserves substantive judgment as to the tax treatment of the relevant transactions pending the normal audit process; or (3) advise the taxpayer that the IRS has concluded that the application was not made in good faith or does not substantially comply with the requirements set forth by the Treasury Secretary.

In the case of a compliance failure described in (3) above (and in cases in which the taxpayer fails to submit an application), the following sanctions will apply for the taxable year for which the application was required: (1) no deductions or additions to basis or cost of goods sold for payments to foreign related parties will be permitted; (2) any transfers or licenses of intangible property to related foreign parties will be disregarded; and (3) any cost-sharing arrangements will not be respected. In such a case, the taxpayer may seek direct review by the U.S. Tax Court of the IRS's determination of compliance failure.

If the IRS fails to act on the taxpayer's application within 90 days of receipt, then the taxpayer will be treated as having submitted in good faith an application that substantially complies with the above-referenced requirements. Thus, the deduction disallowance and other sanctions described above will not apply, but the IRS will be able to examine the transactions at issue under the normal audit process. The IRS is authorized to request that the taxpayer extend this 90-day deadline in cases in which the IRS believes that such an extension might help the parties to reach an agreement.

The "earnings stripping" rules of section 163(j), which deny or defer deductions for certain interest paid to foreign related parties, are strengthened for inverted corporations. With respect to such corporations, the provision eliminates the debt-equity threshold generally applicable under section 163(j) and reduces the 50-percent thresholds for "excess interest expense" and "excess limitation" to 25 percent.

In cases in which a U.S. corporate group acquires subsidiaries or other assets from an unrelated inverted corporate group, the provisions described above generally do not apply to the acquiring U.S. corporate group or its related parties (including the newly acquired subsidiaries or

assets) by reason of acquiring the subsidiaries or assets that were connected with the inversion transaction. The Treasury Secretary is given authority to issue regulations appropriate to carry out the purposes of this provision and to prevent its abuse.

Partnership transactions

Under the proposal, both types of inversion transactions include certain partnership transactions. Specifically, both parts of the provision apply to transactions in which a foreign-incorporated entity acquires substantially all of the properties constituting a trade or business of a domestic partnership (whether or not publicly traded), if after the acquisition at least 80 percent (or more than 50 percent but less than 80 percent, as the case may be) of the stock of the entity is held by former partners of the partnership (by reason of holding their partnership interests), and the "substantial business activities" test is not met. For purposes of determining whether these tests are met, all partnerships that are under common control within the meaning of section 482 are treated as one partnership, except as provided otherwise in regulations. In addition, the modified "toll charge" provisions apply at the partner level.

Effective Date

The regime applicable to transactions involving at least 80 percent identity of ownership applies to inversion transactions completed after March 20, 2002. The rules for inversion transactions involving greater-than-50-percent identity of ownership apply to inversion transactions completed after 1996 that meet the 50-percent test and to inversion transactions completed after 1996 that would have met the 80-percent test but for the March 20, 2002 date.

2. Excise tax on stock compensation of insiders of inverted corporations

Present Law

The income taxation of a nonstatutory[18] compensatory stock option is determined under the rules that apply to property transferred in connection with the performance of services (sec. 83). If a nonstatutory stock option does not have a readily ascertainable fair market value at the time of grant, which is generally the case unless the option is actively traded on an established market, no amount is included in the gross income of the recipient with respect to the option until the recipient exercises the option.[19] Upon exercise of such an option, the excess of the fair market value of the stock purchased over the option price is included in the recipient's gross income as ordinary income in such taxable year.

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[18] Nonstatutory stock options refer to stock options other than incentive stock options and employee stock purchase plans, the taxation of which is determined under sections 421-424.

[19] If an individual receives a grant of a nonstatutory option that has a readily ascertainable fair market value at the time the option is granted, the excess of the fair market value of the option over the amount paid for the option is included in the recipient's gross income as ordinary income in the first taxable year in which the option is either transferable or not subject to a substantial risk of forfeiture.

The tax treatment of other forms of stock-based compensation (e.g., restricted stock and stock appreciation rights) is also determined under section 83. The excess of the fair market value over the amount paid (if any) for such property is generally includable in gross income in the first taxable year in which the rights to the property are transferable or are not subject to substantial risk of forfeiture.

Shareholders are generally required to recognize gain upon stock inversion transactions. An inversion transaction is generally not a taxable event for holders of stock options and other stock-based compensation.

Description of Proposal

Under the provision, specified holders of stock options and other stock-based compensation are subject to an excise tax upon certain inversion transactions. The provision imposes a 20 percent excise tax on the value of specified stock compensation held (directly or indirectly) by or for the benefit of a disqualified individual, or a member of such individual's family, at any time during the 12-month period beginning six months before the corporation's inversion date. Specified stock compensation is treated as held for the benefit of a disqualified individual if such compensation is held by an entity, e.g., a partnership or trust, in which the individual, or a member of the individual's family, has an ownership interest.

A disqualified individual is any individual who, with respect to a corporation, is, at any time during the 12-month period beginning on the date which is six months before the inversion date, subject to the requirements of section 16(a) of the Securities and Exchange Act of 1934 with respect to the corporation, or any member of the corporation's expanded affiliated group,[20] or would be subject to such requirements if the corporation (or member) were an issuer of equity securities referred to in section 16(a). Disqualified individuals generally include officers (as defined by section 16(a)),[21] directors, and 10-percent owners of private and publicly-held corporations.

The excise tax is imposed on a disqualified individual of an inverted corporation only if gain (if any) is recognized in whole or part by any shareholder by reason of either the 80 percent or 50 percent identity of stock ownership corporate inversion transactions previously described in the provision.

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[20] An expanded affiliated group is an affiliated group (under section 1504) except that such group is determined without regard to the exceptions for certain corporations and is determined applying a greater than 50 percent threshold, in lieu of the 80 percent test.

[21] An officer is defined as the president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions.

Specified stock compensation subject to the excise tax includes any payment[22] (or right to payment) granted by the inverted corporation (or any member of the corporation's expanded affiliated group) to any person in connection with the performance of services by a disqualified individual for such corporation (or member of the corporation's expanded affiliated group) if the value of the payment or right is based on, or determined by reference to, the value or change in value of stock of such corporation (or any member of the corporation's expanded affiliated group). In determining whether such compensation exists and valuing such compensation, all restrictions, other than non-lapse restrictions, are ignored. Thus, the excise tax applies, and the value subject to the tax is determined, without regard to whether such specified stock compensation is subject to a substantial risk of forfeiture or is exercisable at the time of the inversion transaction. Specified stock compensation includes compensatory stock and restricted stock grants, compensatory stock options, and other forms of stock-based compensation, including stock appreciation rights, phantom stock, and phantom stock options. Specified stock compensation also includes nonqualified deferred compensation that is treated as though it were invested in stock or stock options of the inverting corporation (or member). For example, the provision applies to a disqualified individual's deferred compensation if company stock is one of the actual or deemed investment options under the nonqualified deferred compensation plan.

Specified stock compensation includes a compensation arrangement that gives the disqualified individual an economic stake substantially similar to that of a corporate shareholder. Thus, the excise tax does not apply where a payment is simply triggered by a target value of the corporation's stock or where a payment depends on a performance measure other than the value of the corporation's stock. Similarly, the tax does not apply if the amount of the payment is not directly measured by the value of the stock or an increase in the value of the stock. For example, an arrangement under which a disqualified individual is paid a cash bonus of $500,000 if the corporation's stock increased in value by 25 percent over two years or $1,000,000 if the stock increased by 33 percent over two years is not specified stock compensation, even though the amount of the bonus generally is keyed to an increase in the value of the stock. By contrast, an arrangement under which a disqualified individual is paid a cash bonus equal to $10,000 for every $1 increase in the share price of the corporation's stock is subject to the provision because the direct connection between the compensation amount and the value of the corporation's stock gives the disqualified individual an economic stake substantially similar to that of a shareholder.

The excise tax applies to any such specified stock compensation previously granted to a disqualified individual but cancelled or cashed-out within the six-month period ending with the inversion transaction, and to any specified stock compensation awarded in the six-month period beginning with the inversion transaction. As a result, for example, if a corporation were to cancel outstanding options three months before the transaction and then reissue comparable options three months after the transaction, the tax applies both to the cancelled options and the newly granted options. It is intended that the Treasury Secretary issue guidance to avoid double counting with respect to specified stock compensation that is cancelled and then regranted during the applicable twelve-month period.

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[22] Under the provision, any transfer of property is treated as a payment and any right to a transfer of property is treated as a right to a payment.

Specified stock compensation subject to the tax does not include a statutory stock option or any payment or right from a qualified retirement plan or annuity, a tax-sheltered annuity, a simplified employee pension, or a simple retirement account. In addition, under the provision, the excise tax does not apply to any stock option that is exercised during the six-month period before the inversion or to any stock acquired pursuant to such exercise. The excise tax also does not apply to any specified stock compensation which is sold, exchanged, distributed or cashed-out during such period in a transaction in which gain or loss is recognized in full.

For specified stock compensation held on the inversion date, the amount of the tax is determined based on the value of the compensation on such date. The tax imposed on specified stock compensation cancelled during the six-month period before the inversion date is determined based on the value of the compensation on the day before such cancellation, while specified stock compensation granted after the inversion date is valued on the date granted. Under the provision, the cancellation of a non-lapse restriction is treated as a grant.

The value of the specified stock compensation on which the excise tax is imposed is the fair value in the case of stock options (including warrants and other similar rights to acquire stock) and stock appreciation rights and the fair market value for all other forms of compensation. For purposes of the tax, the fair value of an option (or a warrant or other similar right to acquire stock) or a stock appreciation right is determined using an appropriate option-pricing model, as specified or permitted by the Treasury Secretary, that takes into account the stock price at the valuation date; the exercise price under the option; the remaining term of the option; the volatility of the underlying stock and the expected dividends on it; and the risk-free interest rate over the remaining term of the option. Options that have no intrinsic value (or "spread") because the exercise price under the option equals or exceeds the fair market value of the stock at valuation nevertheless have a fair value and are subject to tax under the provision. The value of other forms of compensation, such as phantom stock or restricted stock, are the fair market value of the stock as of the date of the inversion transaction. The value of any deferred compensation that could be valued by reference to stock is the amount that the disqualified individual would receive if the plan were to distribute all such deferred compensation in a single sum on the date of the inversion transaction (or the date of cancellation or grant, if applicable). It is expected that the Treasury Secretary issue guidance on valuation of specified stock compensation, including guidance similar to the revenue procedures issued under section 280G, except that the guidance would not permit the use of a term other than the full remaining term. Pending the issuance of guidance, it is intended that taxpayers could rely on the revenue procedures issued under section 280G (except that the full remaining term must be used).

The excise tax also applies to any payment by the inverted corporation or any member of the expanded affiliated group made to an individual, directly or indirectly, in respect of the tax. Whether a payment is made in respect of the tax is determined under all of the facts and circumstances. Any payment made to keep the individual in the same after-tax position that the individual would have been in had the tax not applied is a payment made in respect of the tax. This includes direct payments of the tax and payments to reimburse the individual for payment of the tax. It is expected that the Treasury Secretary issue guidance on determining when a payment is made in respect of the tax and that such guidance would include certain factors that give rise to a rebuttable presumption that a payment is made in respect of the tax, including a rebuttable presumption that if the payment is contingent on the inversion transaction, it is made

in respect to the tax. Any payment made in respect of the tax is includible in the income of the individual, but is not deductible by the corporation.

To the extent that a disqualified individual is also a covered employee under section 162(m), the $1,000,000 limit on the deduction allowed for employee remuneration for such employee is reduced by the amount of any payment (including reimbursements) made in respect of the tax under the provision. As discussed above, this includes direct payments of the tax and payments to reimburse the individual for payment of the tax.

The payment of the excise tax has no effect on the subsequent tax treatment of any specified stock compensation. Thus, the payment of the tax has no effect on the individual's basis in any specified stock compensation and no effect on the tax treatment for the individual at the time of exercise of an option or payment of any specified stock compensation, or at the time of any lapse or forfeiture of such specified stock compensation. The payment of the tax is not deductible and has no effect on any deduction that might be allowed at the time of any future exercise or payment.

Under the provision, the Treasury Secretary is authorized to issue regulations as may be necessary or appropriate to carry out the purposes of the section.

Effective Date

The provision is effective as of July 11, 2002, except that periods before July 11, 2002, are not taken into account in applying the tax to specified stock compensation held or cancelled during the six-month period before the inversion date.

3. Reinsurance agreements

Present Law

In the case of a reinsurance agreement between two or more related persons, present law provides the Treasury Secretary with authority to allocate among the parties or recharacterize income (whether investment income, premium or otherwise), deductions, assets, reserves, credits and any other items related to the reinsurance agreement, or make any other adjustment, in order to reflect the proper source and character of the items for each party.[23] For this purpose, related persons are defined as in section 482. Thus, persons are related if they are organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) that are owned or controlled directly or indirectly by the same interests. The provision may apply to a contract even if one of the related parties is not a domestic company.[24] In addition, the provision also permits such allocation, recharacterization, or other adjustments in a case in which one of the parties to a reinsurance agreement is, with respect to

[23] Sec. 845(a).

[24] See S. Rep. No. 97-494, "Tax Equity and Fiscal Responsibility Act of 1982," July 12, 1982, 337 (describing provisions relating to the repeal of modified coinsurance provisions).

any contract covered by the agreement, in effect an agent of another party to the agreement, or a conduit between related persons.

Description of Proposal

The proposal clarifies the rules of section 845, relating to authority for the Treasury Secretary to allocate items among the parties to a reinsurance agreement, recharacterize items, or make any other adjustment, in order to reflect the proper source and character of the items for each party. The proposal authorizes such allocation, recharacterization, or other adjustment, in order to reflect the proper source, character or amount of the item. It is intended that this authority[25] be exercised in a manner similar to the authority under section 482 for the Treasury Secretary to make adjustments between related parties. It is intended that this authority be applied in situations in which the related persons (or agents or conduits) are engaged in cross-border transactions that require allocation, recharacterization, or other adjustments in order to reflect the proper source, character or amount of the item or items. No inference is intended that present law does not provide this authority with respect to reinsurance agreements.

No regulations have been issued under section 845(a). It is expected that the Treasury Secretary will issue regulations under section 845(a) to address effectively the allocation of income (whether investment income, premium or otherwise) and other items, the recharacterization of such items, or any other adjustment necessary to reflect the proper amount, source or character of the item.

Effective Date

The provision is effective for any risk reinsured after April 11, 2002.

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[25] The authority to allocate, recharacterize or make other adjustments was granted in connection with the repeal of provisions relating to modified coinsurance transactions.

D. Provisions Relating to Alaska Natural Gas

1. Credit for production of Alaska natural gas

Present Law

Present law does not provide a credit for conventional production of natural gas or delivery of fuels to a pipeline. However, certain fuels produced from "non-conventional sources" and sold to unrelated parties are eligible for an income tax credit equal to $3 (generally adjusted for inflation) per barrel or BTU oil barrel equivalent (sec. 29). Qualified fuels must be produced within the United States.

Qualified fuels include:

(1) gas produced from geopressured brine, Devonian shale, coal seams, tight formations ("tight sands"), or biomass; and

(2) liquid, gaseous, or solid synthetic fuels produced from coal (including lignite).

In general, the credit is available only with respect to fuels produced from wells drilled or facilities placed in service after December 31, 1979, and before January 1, 1993. An exception extends the January 1, 1993 expiration date for facilities producing gas from biomass and synthetic fuel from coal if the facility producing the fuel is placed in service before July 1, 1998, pursuant to a binding contract entered into before January 1, 1997.

The credit may be claimed for qualified fuels produced and sold before January 1, 2003 (in the case of non-conventional sources subject to the January 1, 1993 expiration date) or January 1, 2008 (in the case of biomass gas and synthetic fuel facilities eligible for the extension period).

Description of Proposal

The proposal provides a credit per million British thermal units (Btu) of natural gas for Alaska natural gas entering a pipeline during the 15-year period beginning the later of January 1, 2010 or the initial date for the interstate transportation of Alaska natural gas. Taxpayers may claim the credit against both the regular and minimum tax.

The credit amount for any month is a maximum of 52 cents (indexed for inflation) per million Btu of natural gas. The credit phases out as the price at the wellhead rises above 83 cents per million Btu. The credit is not available if the price at the wellhead rises above $1.35 (indexed for inflation) per million Btu.

Alaska natural gas is any gas derived from an area of the State of Alaska lying north of 64 degrees North latitude generally from the area known as the "North Slope of Alaska," but not including the Alaska National Wildlife Refuge.

Effective date

The proposal is effective on the date of enactment.

2. Treat certain Alaska pipeline property as seven-year property

Present Law

The applicable recovery period for assets placed in service under the Modified Accelerated Cost Recovery System is based on the "class life of the property." The class lives of assets placed in service after 1986 are generally set forth in Revenue Procedure 87-56.[26] Asset class 46.0, describing pipeline transportation, provides a class life of 22 years and a recovery period of 15 years.

Description of Proposal

The proposal establishes a statutory seven-year recovery period and a class life of 10 years for any natural gas pipeline system, located in Alaska, that has a capacity greater than five hundred billion Btu of natural gas per day and is placed in service after 2014. For purposes of the proposal, a natural gas pipeline system is defined as any system used in the carrying of natural gas by means of pipes, including pipe, trunk lines, related equipment, and appurtenances. It does not include any natural gas processing plant related to the pipeline itself.

Effective Date

The proposal is effective on the date of enactment.

[26] 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

E. Extension of IRS User Fees

Present Law

The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. Public Law 104-117[27] extended the statutory authorization for these user fees[28] through September 30, 2003.

Description of Proposal

The proposal extends the statutory authorization for these user fees through September 30, 2013. The proposal also moves the statutory authorization for these fees into the Code.[29]

Effective Date

The proposal, including moving the statutory authorization for these fees into the Code and repealing the off-Code statutory authorization for these fees, is effective through September 30, 2007.

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[27] An Act to provide that members of the Armed Forces performing services for the peacekeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia shall be entitled to tax benefits in the same manner as if such services were performed in a combat zone, and for other purposes (March 20, 1996).

[28] These user fees were originally enacted in section 10511 of the Revenue Act of 1987 (Pub. Law No. 100-203, December 22, 1987).

[29] The provision also moves into the Code the user fee provision relating to pension plans that was enacted in section 620 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. 107-16, June 7, 2001).

JOINT COMMITTEE ON TAXATION
April 2, 2003
JCX-29-03

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MODIFICATION TO THE "ENERGY TAX INCENTIVES ACT OF 2003," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON APRIL 2, 2003

Fiscal Years 2003 - 2013

[Millions of Dollars]

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
Extension and Modification of Renewable Electricity Production Tax Credit - Extend (property placed in service before 1/1/07 (1/1/05 in the case of open-loop)) and modify the section 45 credit for producing renewable electricity from certain sources (credit is equal to 1.8 cents per kilowatt hour for production from post-enactment facilities after 12/31/03)	esfqfa DOE	-21	-117	-202	-249	-289	-315	-323	-317	-301	-287	-277	-1,193	-2,698
Alternative Motor Vehicles and Fuel Incentives														
1. Credits for purchase of alternative motor vehicles, modifications to credit for electric vehicles, and extension of deduction for alternative motor vehicles (deduction for property placed in service before 1/1/08 (1/1/12 in the case of hydrogen fuel); credit for alternative and electric vehicles purchased before 1/1/07 (1/1/12 in the case of hydrogen))	ppisa DOE	-21	-154	-355	-551	-545	-229	-32	-36	-47	-37	-26	-1,859	-2,037
2. Credit for installation of alternative fueling stations credit for property placed in service before 1/1/08 (1/1/12 in the case of hydrogen)	ppisa DOE	-1	-2	-48	-94	-107	-6	60	40	28	15	5	-257	-109
3. Credit for retail sale of alternative fuels (30 cents/gallon in 2003, 40 cents in 2004, 50 cents in 2005 and 2006)	DOE	-4	-103	-169	-215	-90	-1	-1	-1	-1	---	---	-582	-587
4. Modifications to small producer ethanol credit	tyba DOE	[1]	-16	-34	-34	-34	-18	[1]	[1]	[1]	[1]	---	-136	-137
5. Tax incentives for biodiesel (sunset 12/31/05) [2]	DOE	-1	-19	-29	-9	---	---	---	---	---	---	---	-58	-58
Total of Alternative Motor Vehicles and Fuel Incentives		-27	-294	-635	-903	-776	-254	27	3	-20	-22	-21	-2,892	-2,928
Conservation and Energy Efficiency Provisions														
1. Business credit for construction of new energy efficient homes	ppb DOE & 12/31/07	-18	-78	-112	-101	-108	-68	-21	-4	---	---	---	-485	-510
2. Credit for energy efficient appliances	apb DOE & 12/31/07	-6	-52	-82	-68	-46	-23	-8	-2	[1]	---	---	-277	-288
3. Credit for residential fuel cell, solar, and other energy efficient property	ppb 1/1/04 & 12/31/07	---	-140	-89	-86	-75	-57	---	---	---	---	---	-448	-448
4. Business tax incentives for qualifying fuel cells	ppisb DOE & 12/31/07	[1]	-2	-3	-3	-3	-2	-1	[1]	[3]	[3]	[3]	-10	-9
5. Allowance of deduction for certain energy efficient commercial building property	1/1/04 for pcpt 1/1/08 & ccb 1/1/10	---	-69	-99	-91	-91	-93	-94	-33	---	---	---	-443	-571

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
6. Three-year applicable recovery period for qualified energy management devices (excluding ancillary equipment):														
a. Electric devices (sunset for property placed in service after 12/31/07)	ppisa DOE	-3	-12	-24	-43	-70	-59	-12	17	27	22	14	-212	-144
b. Water submetering devices (sunset for property placed in service after 12/31/07)	ppisa DOE	-1	-5	-13	-22	-31	-23	[3]	12	15	11	5	-95	-52
7. Energy credit for combined heat and power system property	ppisa DOE & ppisb 1/1/07	-23	-80	-56	-22	-5	4	7	10	10	9	9	-181	-134
8. Credit for energy efficiency improvements to existing homes	tyba DOE & tybb 1/1/07	---	-55	-78	-78	-63	---	---	---	---	---	---	-274	-274
Total of Conservation and Energy Efficiency Provisions		**-51**	**-493**	**-556**	**-514**	**-492**	**-321**	**-129**	**---**	**52**	**42**	**28**	**-2,425**	**-2,430**
Clean Coal Incentives - Investment and Production Credits for Clean Coal Technology														
1. Credit for production from qualifying clean coal technology units	pa DOE	-1	-32	-58	-70	-80	-87	-90	-92	-94	-97	-97	-328	-799
2. Credit for investment in qualifying advanced clean coal technology (for property placed in service after the date of enactment and before 1/1/17 (1/1/13 in the case of advanced pulverized coal or atmospheric fluidized bed)	ppisa DOE	---	-20	-47	-49	-41	-27	-111	-94	-39	-28	-18	-184	-475
3. Credit for production of electricity from qualifying advanced clean coal technology units	pa DOE	---	-4	-17	-36	-55	-70	-96	-132	-153	-162	-168	-183	-895
Total of Clean Coal Incentives - Investment and Production Credit for Clean Coal Technology		**-1**	**-56**	**-122**	**-155**	**-176**	**-184**	**-297**	**-318**	**-286**	**-287**	**-283**	**-695**	**-2,169**
Oil and Gas Provisions														
1. Credit for marginal domestic oil and natural gas well production	DOE	*No Revenue Effect*												
2. Natural gas gathering pipelines treated as 7-year property	ppisa DOE	-2	-7	-12	-15	-17	-45	-52	-60	-68	-76	-86	-98	-442
3. Expensing of capital costs incurred and credit for production in complying with Environmental Protection Agency sulfur regulations for small refiners	epoia 1/1/03	---	---	-3	-3	-11	-23	-37	-16	[1]	1	2	-39	-89
4. Determination of small refiner exception to oil depletion deduction - modify definition of independent refiner from daily maximum run less than 50,000 barrels to average daily run less than 60,000 barrels	tyea DOE	-2	-7	-7	-8	-8	-8	-8	-8	-9	-9	-9	-39	-83
5. Extension of suspension of 100% of taxable income limit with respect to marginal production (through 12/31/06)	DOE	---	-22	-35	-36	-13	---	---	---	---	---	---	-106	-106
6. Amortize all geological and geophysical ("G&G") expenditures over 2 years	cpoil tyba DOE	20	-174	-429	-434	-325	-262	-227	-192	-182	-188	-194	-1,604	-2,586
7. Amortize all delay rental payments over 2 years	apoil tyba DOE	31	13	-82	-88	-39	-11	-1	-1	-1	-1	-1	-135	-138

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
8. Extension and modification of section 29 credit for facilities placed in service after the date of enactment and before 1/1/07, including viscous oil, coalmine gas, agricultural and animal waste, and refined coal; extension and modification of section 29 credit for certain coal gasification and coke production through 12/31/05; study of coal bed methane; for new facilities described in section 29 (c)(1)(A) & (B), credit rate is equal to $3.00 BOE; and 200,000 cubic feet per day limit [4]	DOE	-43	-176	-357	-535	-607	-469	-230	-50	[1]	---	---	-2,187	-2,469
9. Natural gas distribution lines treated as 15-year property	ppisa DOE	-5	-23	-50	-71	-100	-127	-152	-179	-209	-238	-252	-375	-1,406
Total of Oil and Gas Provisions		-1	-396	-955	-1,168	-1,120	-945	-707	-506	-469	-511	-540	-4,583	-7,319
Electric Utility Restructuring Provisions														
1. Modification to special rules for nuclear decommissioning costs - transfer of non-qualified funds (buyer get deduction over life of plant); eliminate cost of service requirement; and clarify treatment of fund transfers	tyba DOE	-21	-66	-69	-76	-85	-94	-103	-113	-125	-137	-151	-411	-1,040
2. Treatment of certain income of electric cooperatives	tyba DOE	-1	-12	-19	-21	-23	-25	-27	-29	-32	-35	-37	-101	-262
3. Sales or dispositions to implement Federal Energy Regulatory Commission or State electric restructuring policy prior to 1/1/08	ta DOE	-413	-989	-1054	-1271	-816	477	1013	1034	976	798	579	-4,067	334
Total of Electric Utility Restructuring Provisions		-435	-1,067	-1,142	-1,368	-924	358	883	892	819	626	391	-4,579	-968
Additional Provisions														
1. Extension of accelerated depreciation and wage credit benefits for businesses on Indian reservations (through 12/31/05)	DOE	---	4	-176	-303	-109	21	75	118	97	52	6	-564	-216
2. Study of effectiveness of certain provisions by GAO	DOE	*No Revenue Effect*												
Total of Additional Provisions		---	4	-176	-303	-109	21	75	118	97	52	6	-564	-216
Miscellaneous Provisions														
1. Ethanol Excise Tax Credit	9/30/03	---	31	46	49	48	45	43	40	36	33	30	221	402
2. Modify income tax and excise tax rules governing treatment of ETBE	fba DOE	*Negligible Revenue Effect*												
3. Sale of gasoline and diesel fuel at duty-free sales enterprises	DOE	[3]	1	1	1	1	1	1	1	1	1	1	4	9
4. Exempt certain prepayments for natural gas from tax-exempt bond arbitrage rules	oia DOE	[1]	[1]	-1	-1	-2	-3	-3	-4	-5	-5	-6	-7	-31
5. Provisions to Discourage Corporate Expatriation:														
a. Tax treatment of inversion transactions	[5]	34	159	117	140	168	202	242	290	348	418	493	820	2,611
b. Excise tax on stock compensation of insiders in inverted corporations	generally 7/11/02	21	14	10	10	10	10	10	10	10	10	10	75	125
c. Reinsurance agreements	rra 4/11/02	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	2	5

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
6. Provisions Relating to Alaska Natural Gas:														
a. Credit for Production of Alaska Natural Gas	DOE	*No Revenue Effect*												
b. Treat certain Alaska pipeline property as 7-year property	ppisa 2014	*No Revenue Effect*												
7. Extend IRS User Fees (through 9/30/07) [7]	DOE	---	33	34	35	36	---	---	---	---	---	---	138	138
Total of Miscellaneous Provisions		55	238	207	234	261	255	293	337	390	457	528	1,253	3,259
NET TOTAL		-481	-2,181	-3,581	-4,426	-3,625	-1,385	-178	209	282	70	-168	-15,678	-15,469

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. Date of enactment is assumed to be July 1, 2003.

Legend for "Effective" column:

apoii = amounts paid or incurred in
apb = appliances produced between
ccb = construction completed before
cpoii = costs paid or incurred in
DOE = date of enactment
epoia = expenses paid or incurred after
esfqfa = electricity sold from qualifying facilities after
fba = fuels blended after
oia = obligation issued after
pa = production after
pcpt = plans certified prior to
ppb = property purchased between
ppisa = property placed in service after
ppisb = property placed in service between
rra = risk reinsured after
ta = transactions after
tyba = taxable years beginning after
tybb = taxable years beginning before

[1] Loss of less than $500,000.
[2] This provision may also have indirect effects on Federal outlays for certain farm programs. Outlay effects will be estimated by the Congressional Budget Office.
[3] Gain of less than $500,000.
[4] Qualified facilities would be given credit for three years of production (five years in the case of refined coal).
[5] Effective for certain transactions completed after March 20, 2002, and would also affect certain taxpayers who completed transactions before March 21, 2002.
[6] Gain of less than $1 million.
[7] Estimate provided by the Congresisonal Budget Office.

CLEAN DIAMOND TRADE ACT

The Clean Diamond Trade Act implements the United States' obligations as a participant in the Kimberley Process Certification Scheme (KPCS). The KPCS was developed by the United States and other nations to remove conflict diamonds from the legitimate diamond trade. Conflict diamonds are so named because fighting over diamond mines fuels and sometimes funds civil conflicts in some African countries. The KPCS represents the culmination of many years of work by President Bush and prior administrations to end trade in conflict diamonds. This legislation ensures that the United States will assume the specified responsibilities of participation, including that imported and exported rough diamonds be properly certified, and that the United States trade only with participating countries.[1] The next plenary session of the Kimberley Process is scheduled to convene in Johannesburg from April 28th to the 30th, 2003. Implementation of the KPCS by the United States prior to April 28th, 2003 will ensure that the U.S. continues its leadership role in curtailing trade in conflict diamonds.

SUMMARY OF PROVISIONS

Sec. 1. Short Title. This Act may be cited as the "Clean Diamond Trade Act."

Sec. 2. Findings. Enumerates congressional findings regarding the Act.

Sec. 3. Definitions. Defines terms utilized in the Act.

Sec. 4. Measures for the Importation and Exportation of Rough Diamonds. Sec. 4(a) Requires the President to prohibit the importation or exportation of rough diamonds that have not been controlled through the Kimberley Process Certification Scheme. Sec. 4(b) Authorizes the President to waive the prohibition for periods of not more than one year if the President determines and reports to Congress that a country is taking steps to implement the Kimberley Process or the President determines and reports to Congress that the wavier is in the national interest of the United States.

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[1]. Presently, the participating countries include: Algeria, Angola, Armenia, Australia, Belarus, Botswana, Brazil, Burkina Faso, Cameroon, Canada, Central African Republic, China (People's Republic of), Congo (Democratic Republic of) , Congo (Republic of), Cote D'Ivoire, Cyprus, Czech Republic, European Community, Gabon, Ghana, Guinea, Guyana, Hungary, India, Israel, Japan, Korea (Democratic People's Republic of), Korea (Republic of), Laos, Lebanon, Lesotho, Malaysia, Mali, Malta, Mauritius, Mexico, Namibia, Norway, Philippines, Russian Federation, Sierra Leone, South Africa, Sri Lanka, Swaziland, Switzerland, Tanzania, Thailand, Togo, Turkey, Ukraine, United Arab Emirates, United States of America, Venezuela, Vietnam, and Zimbabwe. The trading entities of Taiwan, Penghu, Kinmen and Matsu are also recognized as participants.

Sec. 5. Regulatory and Other Authority. Sec. 5(a) Authorizes the President to issue such proclamations, regulations, licenses, and orders, and conduct such investigations as necessary to carry out the legislation. Sec. 5(b) Requires any U.S. person importing rough diamonds into or exporting rough diamonds from the United States to keep a full record of any transaction covered by the legislation and authorizes the President to require the production of such records under oath. Sec. 5(c) Mandates the President to require the appropriate agency to conduct annual reviews of the procedures of any entity in the United States that issues Kimberley Process Certificates for exportation, to determine whether they are in accordance with the Kimberley Process.

Sec. 6. Importing and Exporting Authorities. Sec. 6(a) Provides that the importing authority shall be the U.S. Bureau of Customs and Border Protection and that the exporting authority shall be the U.S. Census Bureau. Sec. 6(b) Requires the Secretary of State to publish a list of all participants to the Kimberley Process and all exporting and importing authorities of those participants. Sec. 6(b) Also requires the Secretary to update the list of participants as necessary.

Sec. 7. Statement of Policy. Expresses Congressional support for Presidential efforts to facilitate the adoption of the KPCS by other countries.

Sec. 8. Enforcement. Provides for civil and criminal penalties for violations of the Act both under and in addition to existing law.

Sec. 9. Technical Assistance. Permits the President to direct federal agencies to provide technical assistance to countries trying to implement the Kimberley Process.

Sec. 10. Sense of Congress. Expresses the Sense of the Congress that: the Kimberley Process is an ongoing process and that the President should work to strengthen the KPCS through the adoption of measures on the sharing of statistics on rough diamond trade and for monitoring the effectiveness of the process; that the President should keep and publish statistics on the importation and exportation of rough diamonds, make these statistics available for analysis, and take a leadership role in negotiating a standardized methodology for reporting import and export statistics; and that the President should establish a Kimberley Process Implementation Coordinating Committee to coordinate the implementation of the Act.

Sec. 11. Reports. Provides for annual and semiannual reports to be submitted by the President to Congress, including a report on whether there is statistical or other information that would indicate circumvention of the KPCS.

Sec. 12. GAO Report. Requires the Comptroller General to transmit a report to Congress no later than 24 months after the effective date of the Act on the effectiveness of the Act in preventing trade in conflict diamonds.

Sec. 13. Effective Date. Provides an effective date for the Act.

O:\CRA\CRA03.191 S.L.C.

Chuck Grassley

Original cosponsors:
Baucus
DeWine
Durbin
Gregg
Bingaman
Feingold
Snowe
Rockefeller
Santorum
Leahy

108TH CONGRESS
1ST SESSION

S. 760

IN THE SENATE OF THE UNITED STATES

Mr. GRASSLEY introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To implement effective measures to stop trade in conflict diamonds, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Clean Diamond Trade Act".

SEC. 2. FINDINGS.

Congress finds the following:

(1) Funds derived from the sale of rough diamonds are being used by rebels and state actors to finance military activities, overthrow legitimate governments, subvert international efforts to promote

peace and stability, and commit horrifying atrocities against unarmed civilians. During the past decade, more than 6,500,000 people from Sierra Leone, Angola, and the Democratic Republic of the Congo have been driven from their homes by wars waged in large part for control of diamond mining areas. A million of these are refugees eking out a miserable existence in neighboring countries, and tens of thousands have fled to the United States. Approximately 3,700,000 people have died during these wars.

(2) The countries caught in this fighting are home to nearly 70,000,000 people whose societies have been torn apart not only by fighting but also by terrible human rights violations.

(3) Human rights and humanitarian advocates, the diamond trade as represented by the World Diamond Council, and the United States Government have been working to block the trade in conflict diamonds. Their efforts have helped to build a consensus that action is urgently needed to end the trade in conflict diamonds.

(4) The United Nations Security Council has acted at various times under chapter VII of the Charter of the United Nations to address threats to international peace and security posed by conflicts

linked to diamonds. Through these actions, it has prohibited all states from exporting weapons to certain countries affected by such conflicts. It has further required all states to prohibit the direct and indirect import of rough diamonds from Sierra Leone unless the diamonds are controlled under specified certificate of origin regimes and to prohibit absolutely the direct and indirect import of rough diamonds from Liberia.

(5) In response, the United States implemented sanctions restricting the importation of rough diamonds from Sierra Leone to those diamonds accompanied by specified certificates of origin and fully prohibiting the importation of rough diamonds from Liberia. The United States is now taking further action against trade in conflict diamonds.

(6) Without effective action to eliminate trade in conflict diamonds, the trade in legitimate diamonds faces the threat of a consumer backlash that could damage the economies of countries not involved in the trade in conflict diamonds and penalize members of the legitimate trade and the people they employ. To prevent that, South Africa and more than 30 other countries are involved in working, through the "Kimberley Process", toward devising a

solution to this problem. As the consumer of a majority of the world's supply of diamonds, the United States has an obligation to help sever the link between diamonds and conflict and press for implementation of an effective solution.

(7) Failure to curtail the trade in conflict diamonds or to differentiate between the trade in conflict diamonds and the trade in legitimate diamonds could have a severe negative impact on the legitimate diamond trade in countries such as Botswana, Namibia, South Africa, and Tanzania.

(8) Initiatives of the United States seek to resolve the regional conflicts in sub-Saharan Africa which facilitate the trade in conflict diamonds.

(9) The Interlaken Declaration on the Kimberley Process Certification Scheme for Rough Diamonds of November 5, 2002, states that Participants will ensure that measures taken to implement the Kimberley Process Certification Scheme for Rough Diamonds will be consistent with international trade rules.

SEC. 3. DEFINITIONS.

In this Act:

(1) CONTROLLED THROUGH THE KIMBERLEY PROCESS CERTIFICATION SCHEME.—An importation

or exportation of rough diamonds is "controlled through the Kimberley Process Certification Scheme" if it is an importation from the territory of a Participant or exportation to the territory of a Participant of rough diamonds that is—

(A) carried out in accordance with the Kimberley Process Certification Scheme, as set forth in regulations promulgated by the President; or

(B) controlled under a system determined by the President to meet substantially the standards, practices, and procedures of the Kimberley Process Certification Scheme.

(2) EXPORTING AUTHORITY.—The term "exporting authority" means 1 or more entities designated by a Participant from whose territory a shipment of rough diamonds is being exported as having the authority to validate the Kimberley Process Certificate.

(3) IMPORTING AUTHORITY.—The term "importing authority" means 1 or more entities designated by a Participant into whose territory a shipment of rough diamonds is imported as having the authority to enforce the laws and regulations of the Participant regulating imports, including the

verification of the Kimberley Process Certificate accompanying the shipment.

(4) KIMBERLEY PROCESS CERTIFICATE.—The term "Kimberley Process Certificate" means a forgery resistant document of a Participant that demonstrates that an importation or exportation of rough diamonds has been controlled through the Kimberley Process Certification Scheme and contains the minimum elements set forth in Annex I of the Kimberley Process Certification Scheme.

(5) KIMBERLEY PROCESS CERTIFICATION SCHEME.—The term "Kimberley Process Certification Scheme" means those standards, practices, and procedures of the international certification scheme for rough diamonds presented in the document entitled "Kimberley Process Certification Scheme" referred to in the Interlaken Declaration on the Kimberley Process Certification Scheme for Rough Diamonds of November 5, 2002.

(6) PARTICIPANT.—The term "Participant" means a state, customs territory, or regional economic integration organization identified by the Secretary of State.

(7) PERSON.—The term "person" means an individual or entity.

(8) ROUGH DIAMOND.—The term "rough diamond" means any diamond that is unworked or simply sawn, cleaved, or bruted and classifiable under subheading 7102.10, 7102.21, or 7102.31 of the Harmonized Tariff Schedule of the United States.

(9) UNITED STATES.—The term "United States", when used in the geographic sense, means the several States, the District of Columbia, and any commonwealth, territory, or possession of the United States.

(10) UNITED STATES PERSON.—The term "United States person" means—

(A) any United States citizen or any alien admitted for permanent residence into the United States;

(B) any entity organized under the laws of the United States or any jurisdiction within the United States (including its foreign branches); and

(C) any person in the United States.

SEC. 4. MEASURES FOR THE IMPORTATION AND EXPORTATION OF ROUGH DIAMONDS.

(a) PROHIBITION.—The President shall prohibit the importation into, or exportation from, the United States of any rough diamond, from whatever source, that has not

been controlled through the Kimberley Process Certification Scheme.

(b) WAIVER.—The President may waive the requirements set forth in subsection (a) with respect to a particular country for periods of not more than 1 year each, if, with respect to each such waiver—

(1) the President determines and reports to Congress that such country is taking effective steps to implement the Kimberley Process Certification Scheme; or

(2) the President determines that the waiver is in the national interests of the United States, and reports such determination to Congress, together with the reasons therefor.

SEC. 5. REGULATORY AND OTHER AUTHORITY.

(a) IN GENERAL.—The President is authorized to and shall as necessary issue such proclamations, regulations, licenses, and orders, and conduct such investigations, as may be necessary to carry out this Act.

(b) RECORDKEEPING.—Any United States person seeking to export from or import into the United States any rough diamonds shall keep a full record of, in the form of reports or otherwise, complete information relating to any act or transaction to which any prohibition imposed under section 4(a) applies. The President may require

such person to furnish such information under oath, including the production of books of account, records, contracts, letters, memoranda, or other papers, in the custody or control of such person.

(c) OVERSIGHT.—The President shall require the appropriate Government agency to conduct annual reviews of the standards, practices, and procedures of any entity in the United States that issues Kimberley Process Certificates for the exportation from the United States of rough diamonds to determine whether such standards, practices, and procedures are in accordance with the Kimberley Process Certification Scheme. The President shall transmit to Congress a report on each annual review under this subsection.

SEC. 6. IMPORTING AND EXPORTING AUTHORITIES.

(a) IN THE UNITED STATES.—For purposes of this Act—

(1) the importing authority shall be the United States Bureau of Customs and Border Protection or, in the case of a territory or possession of the United States with its own customs administration, analogous officials; and

(2) the exporting authority shall be the Bureau of the Census.

(b) OF OTHER COUNTRIES.—The Secretary of State shall publish in the Federal Register a list of all Participants, and all exporting authorities and importing authorities of Participants. The Secretary shall update the list as necessary.

SEC. 7. STATEMENT OF POLICY.

Congress supports the policy that the President take appropriate steps to promote and facilitate the adoption by the international community of the Kimberley Process Certification Scheme implemented under this Act.

SEC. 8. ENFORCEMENT.

(a) IN GENERAL.—In addition to the enforcement provisions set forth in subsection (b)—

(1) a civil penalty of not to exceed $10,000 may be imposed on any person who violates, or attempts to violate, any license, order, or regulation issued under this Act; and

(2) whoever willfully violates, or willfully attempts to violate, any license, order, or regulation issued under this Act shall, upon conviction, be fined not more than $50,000, or, if a natural person, may be imprisoned for not more than 10 years, or both; and any officer, director, or agent of any corporation who willfully participates in such violation may be punished by a like fine, imprisonment, or both.

(b) IMPORT VIOLATIONS.—The civil and criminal customs laws and penalities of the United States, including seizure and forfeiture, that apply to merchandise imported in violation of such laws shall apply with respect to rough diamonds imported in violation of this Act.

SEC. 9. TECHNICAL ASSISTANCE.

The President may direct the appropriate agencies of the United States Government to make available technical assistance to countries seeking to implement the Kimberley Process Certification Scheme.

SEC. 10. SENSE OF CONGRESS.

(a) ONGOING PROCESS.—It is the sense of Congress that the Kimberley Process Certification Scheme, officially launched on January 1, 2003, is an ongoing process. The President should work with Participants to strengthen the Kimberley Process Certification Scheme through the adoption of measures for the sharing of statistics on the production of and trade in rough diamonds, and for monitoring the effectiveness of the Kimberley Process Certification Scheme in stemming trade in diamonds the importation or exportation of which is not controlled through the Kimberley Process Certification Scheme.

(b) STATISTICS AND REPORTING.—It is the sense of Congress that under Annex III to the Kimberley Process Certification Scheme, Participants recognized that reliable

and comparable data on the international trade in rough diamonds are an essential tool for the effective implementation of the Kimberley Process Certification Scheme. Therefore, the executive branch should continue to—

(1) keep and publish statistics on imports and exports of rough diamonds under subheadings 7102.10.00, 7102.21, and 7102.31.00 of the Harmonized Tariff Schedule of the United States;

(2) make these statistics available for analysis by interested parties and by Participants; and

(3) take a leadership role in negotiating a standardized methodology among Participants for reporting statistics on imports and exports of rough diamonds.

(c) KIMBERLEY PROCESS IMPLEMENTATION COORDINATING COMMITTEE.—It is the sense of Congress that the President should establish a Kimberley Process Implementation Coordinating Committee to coordinate the implementation of this Act. The Committee should be composed of the following individuals or their designee:

(1) The Secretary of the Treasury and the Secretary of State, who shall be co-chairpersons.

(2) The Secretary of Commerce.

(3) The United States Trade Representative.

(4) The Secretary of Homeland Security.

(5) A representative of any other agency the President deems appropriate.

SEC. 11. REPORTS.

(a) ANNUAL REPORTS.—Not later than 1 year after the date of enactment of this Act and every 12 months thereafter for such period as this Act is in effect, the President shall transmit to Congress a report—

(1) describing actions taken by countries that have exported rough diamonds to the United States during the preceding 12-month period to control the exportation of the diamonds through the Kimberley Process Certification Scheme;

(2) describing whether there is statistical information or other evidence that would indicate efforts to circumvent the Kimberley Process Certification Scheme, including cutting rough diamonds for the purpose of circumventing the Kimberley Process Certification Scheme; and

(3) identifying each country that, during the preceding 12-month period, exported rough diamonds to the United States and was exporting rough diamonds not controlled through the Kimberley Process Certification Scheme, if the failure to do so has significantly increased the likelihood that those

diamonds not so controlled are being imported into the United States.

(b) SEMIANNUAL REPORTS.—For each country identified in subsection (a)(2), the President, during such period as this Act is in effect, shall, every 6 months after the initial report in which the country was identified, transmit to Congress a report that explains what actions have been taken by the United States or such country since the previous report to ensure that diamonds the exportation of which was not controlled through the Kimberley Process Certification Scheme are not being imported from that country into the United States. The requirement to issue a semiannual report with respect to a country under this subsection shall remain in effect until such time as the country is controlling the importation and exportation of rough diamonds through the Kimberley Process Certification Scheme.

SEC. 12. GAO REPORT.

Not later than 24 months after the effective date of this Act, the Comptroller General of the United States shall transmit a report to Congress on the effectiveness of the provisions of this Act in preventing the importation or exportation of rough diamonds that is prohibited under section 4. The Comptroller General shall include in the

report any recommendations on any modifications to this Act that may be necessary.

SEC. 13. EFFECTIVE DATE.

This Act shall take effect on the date on which the President certifies to Congress that—

(1) an applicable waiver that has been granted by the World Trade Organization is in effect; or

(2) an applicable decision in a resolution adopted by the United Nations Security Council pursuant to Chapter VII of the Charter of the United Nations is in effect.

This Act shall thereafter remain in effect during those periods in which, as certified by the President to Congress, an applicable waiver or decision referred to in paragraph (1) or (2) is in effect.

DESCRIPTION OF
THE "TAX COURT MODERNIZATION ACT"

Scheduled for Markup
by the
SENATE COMMITTEE ON FINANCE
on April 2, 2003

Prepared by
the Staff of the
JOINT COMMITTEE ON TAXATION

April 1, 2003
JCX-26-03

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup on April 2, 2003, on the "Tax Court Modernization Act." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's mark of the "Tax Court Modernization Act."

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the "Tax Court Modernization Act"* (JCX-26-03), April 1, 2003.

I. TAX COURT PROCEDURE

A. Consolidate Review of Collection Due Process Cases in the United States Tax Court (the "Tax Court")

Present Law

In general, the Internal Revenue Service ("IRS") is required to notify taxpayers that they have a right to a fair and impartial hearing before levy may be made on any property or right to property.[2] Similar rules apply with respect to liens.[3] The hearing is held by an impartial officer from the IRS Office of Appeals, who is required to issue a determination with respect to the issues raised by the taxpayer at the hearing. The taxpayer is entitled to appeal that determination to a court. The appeal must be brought to the Tax Court, unless the Tax Court does not have jurisdiction over the underlying tax liability. If that is the case, then the appeal must be brought in the district court of the United States.[4] If a court determines that an appeal was not made to the correct court, the taxpayer has 30 days after such determination to file with the correct court.

The Tax Court is established under Article I of the United States Constitution[5] and is a court of limited jurisdiction.[6] Thus, the Tax Court may not have jurisdiction over the underlying tax liability with respect to an appeal of a due process hearing relating to a collections matter. As a practical matter, many cases involving such appeals do not involve the underlying tax liability.

Description of Proposal

The proposal modifies the jurisdiction of the Tax Court by providing that all appeals of collection due process determinations are to be made to the United States Tax Court.

Effective Date

The proposal applies to determinations made after the date of enactment.

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[2] Sec. 6330(a).

[3] Sec. 6320.

[4] Sec. 6330(d).

[5] Sec. 7441.

[6] Sec. 7442.

B. Extend Authority for Special Trial Judges to Hear and Decide Certain Employment Status Cases

Present Law

In connection with the audit of any person, if there is an actual controversy involving a determination by the IRS as part of an examination that (1) one or more individuals performing services for that person are employees of that person or (2) that person is not entitled to relief under section 530 of the Revenue Act of 1978, the Tax Court has jurisdiction to determine whether the IRS is correct and the proper amount of employment tax under such determination.[7] Any redetermination by the Tax Court has the force and effect of a decision of the Tax Court and is reviewable.

An election may be made by the taxpayer for small case procedures if the amount of the employment taxes in dispute is $50,000 or less for each calendar quarter involved.[8] The decision entered under the small case procedure is not reviewable in any other court and should not be cited as authority.

The chief judge of the Tax Court may assign proceedings to special trial judges. The Code enumerates certain types of proceedings that may be so assigned and may be decided by a special trial judge. In addition, the chief judge may designate any other proceeding to be heard by a special trial judge.[9]

Description of Proposal

The proposal clarifies that the chief judge of the Tax Court may assign to special trial judges any employment tax cases that are subject to the small case procedure and may authorize special trial judges to decide such small tax cases.

Effective Date

The proposal is effective for any action or proceeding in the Tax Court with respect to which a decision has not become final as of the date of enactment.

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[7] Sec. 7436.

[8] Sec. 7436(c).

[9] Sec. 7443A.

C. Confirmation of Tax Court Authority to Apply Equitable Recoupment

Present Law

Equitable recoupment is a common-law equitable principle that permits the defensive use of an otherwise time-barred claim to reduce or defeat an opponent's claim if both claims arise from the same transaction. U.S. District Courts and the U.S. Court of Federal Claims, the two Federal tax refund forums, may apply equitable recoupment in deciding tax refund cases.[10] In *Estate of Mueller v. Commissioner*,[11] the Court of Appeals for the Sixth Circuit held that the Tax Court may not apply the doctrine of equitable recoupment. More recently, the Court of Appeals for the Ninth Circuit, in *Branson v. Commissioner*,[12] held that the Tax Court may apply the doctrine of equitable recoupment.

Description of Proposal

The proposal confirms that the Tax Court may apply the principle of equitable recoupment to the same extent that it may be applied in Federal civil tax cases by the U.S. District Courts or the U.S. Court of Claims. No implication is intended as to whether the Tax Court has the authority to continue to apply other equitable principles in deciding matters over which it has jurisdiction.

Effective Date

The proposal is effective for any action or proceeding in the Tax Court with respect to which a decision has not become final as of the date of enactment.

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[10] *See Stone v. White*, 301 U.S. 532 (1937); *Bull v. United States*, 295 U.S. 247 (1935).

[11] 153 F.3d 302 (6th Cir.), *cert. den.*, 525 U.S. 1140 (1999).

[12] 264 F.3d 904 (9th Cir.), *cert. den.*, 2002 U.S. LEXIS 1545 (U.S. Mar. 18, 2002).

D. Tax Court Filing Fee

Present Law

The Tax Court is authorized to impose a fee of up to $60 for the filing of any petition for the redetermination of a deficiency or for declaratory judgments relating to the status and classification of 501(c)(3) organizations, the judicial review of final partnership administrative adjustments, and the judicial review if an administrative adjustment request of partnership items is not allowed in full.[13] The statute does not specifically authorize the Tax Court to impose a filing fee for the filing of a petition for review of the IRS's failure to abate interest or for failure to award administrative costs and other areas of jurisdiction for which a petition may be filed. The practice of the Tax Court is to impose a $60 filing fee in all cases commenced by petition.[14]

Description of Proposal

The proposal provides that the Tax Court is authorized to charge a filing fee of up to $60 in all cases commenced by the filing of a petition.

Effective Date

The proposal is effective on the date of enactment.

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[13] Sec. 7451.

[14] *See* Rule 20(a) of the Tax Court Rules of Practice and Procedure.

E. Employees of the Tax Court

Present Law

The Tax Court is a legislative court established by the Congress pursuant to Article I of the U.S. Constitution.[15] The Tax Court is authorized to appoint employees, subject to the rules applicable to employment with the Federal Executive Branch (generally referred to as "competitive service"), as administered by the Office of Personnel Management.[16]

Employment with the Federal Executive Branch is governed by certain general statutory principles, such as recruitment of qualified individuals, fair and equitable treatment of employees and applicants, maintenance of high standards of employee conduct, and protection of employees against arbitrary action. The rules for employment in the Federal Executive Branch address various aspects of such employment, including: (1) procedures for the appointment of employees in the competitive service, including preferences for certain individuals (e.g., veterans); (2) compensation, benefits, and leave programs for employees; (3) appraisals of employee performance; (4) disciplinary actions; and (5) employee rights, including appeal rights. In addition, employees are protected from certain personnel practices (referred to as "prohibited personnel practices"), such as discrimination on the basis of race, color, religion, age, sex, national origin, political affiliation, marital status, or handicapping condition.

Description of Proposal

The proposal extends to the Tax Court authority to establish its own personnel system. Similar authority has previously been provided to Article III courts. Under the proposal, various rules and procedures that apply to employment with the Federal Executive Branch do not apply to employment with the Tax Court, as described below. However, any personnel management system adopted by the Tax Court must: (1) include the general principles that govern employment with the Federal Executive Branch; (2) prohibit personnel practices that are prohibited in the Federal Executive Branch; and (3) in the case of an individual eligible for preference for employment in the Federal Executive Branch, provide preference for that individual in a manner and to an extent consistent with preference in the Federal Executive Branch.

The proposal allows the Tax Court to appoint a clerk without regard to the Federal Executive Branch rules regarding appointments in the competitive service. Under the proposal, the clerk serves at the pleasure of the Tax Court.

The proposal allows the clerk of the Tax Court to appoint deputies and other employees without regard to the Federal Executive Branch rules regarding appointments in the competitive service. Under the proposal, these deputies and employees are subject to removal by the clerk.

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[15] Sec. 7441.

[16] Sec. 7471.

The proposal allows judges and special trial judges of the Tax Court to appoint law clerks and secretaries, in such numbers as the Tax Court may approve, without regard to the Federal Executive Branch rules regarding appointments in the competitive service. Under the proposal, a law clerk or secretary serves at the pleasure of the appointing judge.

The proposal exempts law clerks from the sick leave and annual leave provisions applicable to employees of the Federal Executive Branch. Any unused sick or annual leave to the credit of a law clerk as of the effective date of the proposal remains credited to the individual and is available to the individual upon separation from the Federal Government.

The proposal allows the Tax Court to fix and adjust the compensation of the clerk and other employees without regard to the Federal Executive Branch rules regarding employee classifications and pay rates. To the maximum extent feasible, Tax Court employees are to be compensated at rates consistent with those of employees holding comparable positions in the Federal Judicial Branch. The Tax Court may also establish programs for employee evaluations, premium pay, and resolution of employee grievances.

The proposal requires the Tax Court to prohibit discrimination on the basis of race, color, religion, age, sex, national origin, political affiliation, marital status, or handicapping condition. The Tax Court is also required to promulgate regulations providing procedures for resolving complaints of discrimination by employees and applicants for employment.

In the case of an individual who is an employee of the Tax Court on the day before the effective date of the proposal, the proposal preserves certain rights that the employee is entitled to as of that day. The proposal preserves the right to: (1) appeal a reduction in grade or removal; (2) appeal an adverse action; (3) appeal a prohibited personnel practice; (4) make an allegation of a prohibited personnel practice; or (5) file an employment discrimination appeal. These rights are preserved for as long as the individual remains an employee of the Tax Court.

Under the proposal, a Tax Court employee who completes at least one year of continuous service under a nontemporary appointment with the Tax Court acquires competitive service status for appointment to any position in the Federal Executive Branch competitive service for which the employee possesses the required qualifications.

The proposal also allows the Tax Court to procure the services of experts and consultants in accordance with Federal Executive Branch rules.

Effective Date

The proposal is effective on the date that the Tax Court adopts a personnel management system after date of enactment of the proposal.

F. Use of Practitioner Fee

Present Law

The Tax Court is authorized to impose on practitioners admitted to practice before the Tax Court a fee of up to $30 per year.[17] These fees are to be used to employ independent counsel to pursue disciplinary matters.

Description of Proposal

The proposal provides that Tax Court fees imposed on practitioners also are available to provide services to pro se taxpayers.

Effective Date

The proposal is effective on the date of enactment.

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[17] Sec. 7475.

II. TAX COURT PENSION AND COMPENSATION

A. Judges of the Tax Court

Present Law

The Tax Court is a legislative court established by the Congress pursuant to Article I of the U.S. Constitution.[18] The salary of a Tax Court judge is the same salary as received by a United States District Court judge.[19] Present law also provides Tax Court judges with some benefits that correspond to benefits provided to United States District Court judges, including specific retirement and survivor benefit programs for Tax Court judges.[20]

Under the retirement program, a Tax Court judge may elect to receive retirement pay from the Tax Court in lieu of benefits under another Federal retirement program. A Tax Court judge may also elect to participate in a plan providing annuity benefits for the judge's surviving spouse and dependent children (the "survivors' annuity plan"). Generally, benefits under the survivors' annuity plan are payable only if the judge has performed at least five years of service. Cost-of-living increases in benefits under the survivors' annuity plan are generally based on increases in pay for active judges.

Tax Court judges participate in the Federal Employees Group Life Insurance program (the "FEGLI" program). Retired Tax Court judges are eligible to participate in the FEGLI program as the result of an administrative determination of their eligibility, rather than a specific statutory provision.

Tax Court judges are not covered by the leave system for Federal Executive Branch employees. As a result, an individual who works in the Federal Executive Branch before being appointed to the Tax Court does not continue to accrue annual leave under the same leave program and may not use leave accrued prior to his or her appointment to the Tax Court.

Tax Court judges are not eligible to participate in the Thrift Savings Plan.

Tax Court judges are subject to limitations on outside earned income under the Ethics in Government Act of 1978.

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[18] Sec. 7441.

[19] Sec. 7443(c).

[20] Secs. 7447 and 7448.

Description of Proposal

In general

The proposal makes various changes to the compensation and benefits rules that apply to Tax Court judges to eliminate disparities between the treatment of Tax Court judges and the treatment of other Federal judges.

Survivor annuities for assassinated judges

Under the proposal, benefits under the survivors' annuity plan are payable if a Tax Court judge is assassinated before the judge has performed five years of service.

Cost-of-living adjustments for survivor annuities

The proposal provides that cost-of-living increases in benefits under the survivors' annuity plan are generally based on cost-of-living increases in benefits paid under the Civil Service Retirement System.

FEGLI program

Under the proposal, a judge or retired judge of the Tax Court is deemed to be an employee continuing in active employment for purposes of participation in the FEGLI program. In addition, in the case of a Tax Court judge age 65 or over, the Tax Court is authorized to pay on behalf of the judge any increase in employee premiums under the FEGLI program that occur after April 24, 1999,[21] including expenses generated by such payment, as authorized by the chief judge of the Tax Court in a manner consistent with payments authorized by the Judicial Conference of the United States (i.e., the body with policy-making authority over the administration of the courts of the Federal Judicial Branch).

Accrued annual leave

Under the proposal, in the case of a judge who is employed by the Federal Executive Branch before appointment to the Tax Court, the judge is entitled to receive a lump-sum payment for the balance of his or her accrued annual leave on appointment to the Tax Court.

Thrift Savings Plan participation

Under the proposal, Tax Court judges are permitted to participate in the Thrift Savings Plan. A Tax Court judge is not eligible for agency contributions to the Thrift Savings Plan.

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[21] This date relates to changes in the FEGLI program, including changes to premium rates to reflect employees' ages.

Exemption for teaching compensation from outside earned income limitations

Under the proposal, compensation earned by a retired Tax Court judge for teaching is not treated as outside earned income for purposes of limitations under the Ethics in Government Act of 1978.

Effective Date

The proposals are effective on the date of enactment, except that: (1) the proposal relating to cost-of-living increases in benefits under the survivors' annuity plan applies with respect to increases in Civil Service Retirement benefits taking effect after the date of enactment; (2) the proposal relating to payment of accrued annual leave applies to any Tax Court judge with an outstanding leave balance as of the date of enactment and to any individual appointed to serve as a Tax Court judge after such date; (3) the proposal relating to participation by Tax Court judges in the Thrift Savings Plan applies as of the next open season; and (4) the proposal relating to teaching compensation of a retired Tax Court judge applies to any individual serving as a retired Tax Court judge on or after the date of enactment.

B. Special Trial Judges of the Tax Court

Present Law

The chief judge of the Tax Court may appoint special trial judges to handle certain cases.[22] Special trial judges serve for an indefinite term. Special trial judges receive pay at a rate of 90 percent of the pay of a Tax Court judge and are generally covered by the benefit programs that apply to Federal Executive Branch employees.

Description of Proposal

Magistrate judges of the Tax Court

The proposal is generally designed to eliminate disparities between the treatment of special trial judges of the Tax Court and magistrate judges in the Article III courts.

Under the proposal, the position of special trial judge of the Tax Court is renamed as magistrate judge of the Tax Court. Magistrate judges are appointed (or reappointed) to serve for eight-year terms and are subject to removal in limited circumstances.

Under the proposal, magistrate judges receive pay at a rate of 92 percent of the pay of a Tax Court judge.

The proposal exempts magistrate judges from the leave program that applies to employees of the Federal Executive Branch and provides rules for individuals who are subject to such leave program before becoming exempt.

Survivors' annuity plan

Under the proposal, magistrate judges of the Tax Court are eligible to participate in the survivors' annuity plan for Tax Court judges.

Retirement annuity program for magistrate judges

The proposal establishes a new retirement annuity program for magistrate judges, under which a magistrate judge may elect to receive a retirement annuity from the Tax Court in lieu of benefits under another Federal retirement program. The proposal establishes the "Tax Court Judicial Officers' Retirement Fund" to hold contributions and investments to finance the new retirement annuity program for magistrate judges. The proposal also provides transition rules for sitting special trial judges on the date of enactment of the proposal.

Under the proposal, a magistrate judge who elects to participate in the retirement annuity program is also permitted to participate in the Thrift Savings Plan. Such a magistrate judge is not eligible for agency contributions to the Thrift Savings Plan.

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[22] Sec. 7443A.

Recall of retired magistrate judges

The proposal provides rules under which a retired magistrate judge may be recalled to perform services for a limited period.

Effective Date

The proposals are effective on date of enactment.

JOINT COMMITTEE ON TAXATION
April 1, 2003
JCX-27-03

ESTIMATED BUDGET EFFECTS OF THE "TAX COURT MODERNIZATION ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON APRIL 2, 2003

Fiscal Years 2003 - 2013

[Millions of Dollars]

Provision	Effective	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
Tax Court Procedure	various	*Negligible Revenue Effect*												
Tax Court Pension and Compensation [1] [2]	various	---	-3	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-1	-4	-6
NET TOTAL		[4]	-3	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-1	-4	-6

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

[1] Certain portions of the estimate were provided by the Congressional Budget Office.

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2003-08	2003-13
[2] Includes the following outlay effects	---	-3	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-3	-5

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

[4] Negligible revenue effect.

U.S. Tax Court Modernization

Jurisdiction of Tax Court over collection due process cases. Currently, if a taxpayer's underlying tax liability does not relate to income taxes or a type of tax over which the Tax Court normally has deficiency jurisdiction, there is no opportunity for Tax Court review and the taxpayer must file in a District Court to obtain review. This provision consolidates judicial review of collection due process activity in the Tax Court.

Authority for special trial judges to hear and decide certain employment status cases. This provision clarifies that the Tax Court may authorize its special trial judges to enter decisions in employment status cases that are subject to small case proceedings under section 7436(c).

Confirmation of authority of Tax Court to apply doctrine of equitable recoupment. The common-law principle of equitable recoupment permits a party to assert an otherwise time-barred claim to reduce or defeat an opponent's claim if both claims arise from the same transaction. This provision confirms statutorily that the Tax Court may apply equitable recoupment principles to the same extent as District Courts and the Court of Federal Claims.

Tax Court filing fee in all cases commenced by filing petition. This provision clarifies, in keeping with current Tax Court procedure, that the Tax Court is authorized to impose a $60 filing fee for all cases commenced by petition. The proposal would eliminate the need to amend section 7451 each time the Tax Court is granted new jurisdiction.

Amendments to appoint employees. Currently, the Tax Court has to go to the executive branch, the Office of Personnel Management, to change a position. It is inappropriate to require the Tax Court to seek permission from the executive since that branch is a party (Commissioner of Internal Revenue) before the Tax Court. This change would allow the Tax Court to be independent in fact and perception from the Executive Branch while ensuring that basic employee rights, protections, and remedies are retained or required in an appropriate way (e.g., whistleblower protection, civil rights, merit system principles, etc.).

Expanded use of Tax Court practice fee for pro se taxpayers. The Tax Court is authorized to charge practitioners a fee of up to $30 per year and to use these fees to pursue disciplinary matters. The provision expands use of these fees to provide services to pro se taxpayers. Fees could be used for education programs for pro se taxpayers.

Annuities for survivors of Tax Court judges who are assassinated. The reality is that many people do not like to pay taxes. There is as much risk of a Tax Court judge being assassinated as any other Federal judge. The proposal would conform the treatment of Tax Court judges to District Court judges.

Cost-of-living adjustments for Tax Court judicial survivor annuities. All Federal employees have this provision except the Tax Court. Survivors of Tax Court judges are subject to an obsolete method of indexing.

Life insurance coverage for Tax Court judges. This simply codifies current Office of Personnel Management interpretation, as was previously done for District Court judges.

Cost of life insurance coverage for Tax Court judges age 65 or over. Congress established the Tax Court in 1969 and required that Tax Court judges receive the same compensation as District Court judges. The District Court judges were given this benefit to ensure that there was no diminution of their compensation (as required by the Constitution). This provision is in keeping with the original intent of Congress.

Modification of timing of lump-sum payment of judge's accrued annual leave. District Court judges are allowed to receive a lump-sum payment due to the life-time tenure of Article III judges. Tax Court judges, while they have a 15 year term, effectively have a life-time term because they are always subject to recall.

Participation of Tax Court judges in the Thrift Savings Plan. The proposal would allow Tax Court judges to participate in Thrift Savings Plan. Currently, only 19 federal government employees are left out of the Thrift Savings Plan (i.e., Tax Court judges).

Exemption of teaching compensation of retired judges for limitation on outside earned income. After retirement, Tax Court judges should have the same ability to teach as District Court judges.

General provisions relating to magistrate judges of the Tax Court. "Magistrate" is more recognizable to the American public because it is the term used by Article III courts. The provision changes the term "Special Trial Judge" to " Magistrate Judge of the United States Tax Court " and provides for alignment of term of office and removal applicable to District Court magistrate judges.

Annuities to surviving spouses and dependent children of magistrate judges of the Tax Court. This section gives Magistrates/Special Trial Judges the same advantages as Tax Court judges, thus ensuring a greater pool of participants in the fund.

Retirement and annuity program for magistrate judges. A retirement and annuity program more aligned with District Court Magistrates and the Tax Court judges is key for attracting and retaining qualified judges.

Incumbent magistrate judges of the Tax Court. The provision provides transition rules similar to those given to the District Court magistrate judges.

Provisions for recall. Article III judges are "self-recalling" (i.e., they decide for themselves whether they are recalled or not). In contrast, Tax Court judges are subject to provisions that authorize mandatory recall by the Chief Judge. These provisions authorize the recall of Magistrates/Special Trial judges in a manner similar to those now applicable to the regular judges of the Court.

Bob

108TH CONGRESS
1ST SESSION

S. 753

April 1, 2003

IN THE SENATE OF THE UNITED STATES

Mr. Hatch Mr. Breaux,
~~Mr. BREAUX~~ (for himself, ~~Mr. HATCH~~, Mr. BAUCUS, and Mr. GRASSLEY) introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To amend the Internal Revenue Code of 1986 to provide for the modernization of the United States Tax Court, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Tax Court Modernization Act".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference

shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

Sec. 1. Short title; etc.

TITLE I—TAX COURT PROCEDURE

Sec. 101. Jurisdiction of Tax Court over collection due process cases.
Sec. 102. Authority for special trial judges to hear and decide certain employment status cases.
Sec. 103. Confirmation of authority of Tax Court to apply doctrine of equitable recoupment.
Sec. 104. Tax Court filing fee in all cases commenced by filing petition.
Sec. 105. Amendments to appoint employees.
Sec. 106. Expanded use of Tax Court practice fee for pro se taxpayers.

TITLE II—TAX COURT PENSION AND COMPENSATION

Sec. 201. Annuities for survivors of Tax Court judges who are assassinated.
Sec. 202. Cost-of-living adjustments for Tax Court judicial survivor annuities.
Sec. 203. Life insurance coverage for Tax Court judges.
Sec. 204. Cost of life insurance coverage for Tax Court judges age 65 or over.
Sec. 205. Modification of timing of lump-sum payment of judges' accrued annual leave.
Sec. 206. Participation of Tax Court judges in the Thrift Savings Plan.
Sec. 207. Exemption of teaching compensation of retired judges from limitation on outside earned income.
Sec. 208. General provisions relating to magistrate judges of the Tax Court.
Sec. 209. Annuities to surviving spouses and dependent children of magistrate judges of the Tax Court.
Sec. 210. Retirement and annuity program.
Sec. 211. Incumbent magistrate judges of the Tax Court.
Sec. 212. Provisions for recall.
Sec. 213. Effective date.

TITLE I—TAX COURT PROCEDURE

SEC. 101. JURISDICTION OF TAX COURT OVER COLLECTION DUE PROCESS CASES.

(a) IN GENERAL.—Paragraph (1) of section 6330(d) (relating to proceeding after hearing) is amended to read as follows:

"(1) JUDICIAL REVIEW OF DETERMINATION.—The person may, within 30 days of a determination under this section, appeal such determination to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to determinations made after the date of the enactment of this Act.

SEC. 102. AUTHORITY FOR SPECIAL TRIAL JUDGES TO HEAR AND DECIDE CERTAIN EMPLOYMENT STATUS CASES.

(a) IN GENERAL.—Section 7443A(b) (relating to proceedings which may be assigned to special trial judges) is amended by striking "and" at the end of paragraph (4), by redesignating paragraph (5) as paragraph (6), and by inserting after paragraph (4) the following new paragraph:

"(5) any proceeding under section 7436(c), and".

(b) CONFORMING AMENDMENT.—Section 7443A(c) is amended by striking "or (4)" and inserting "(4), or (5)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to any proceeding under section 7436(c) of the Internal Revenue Code of 1986 with respect to which a decision has not become final (as deter-

mined under section 7481 of such Code) before the date of the enactment of this Act.

SEC. 103. CONFIRMATION OF AUTHORITY OF TAX COURT TO APPLY DOCTRINE OF EQUITABLE RECOUPMENT.

(a) CONFIRMATION OF AUTHORITY OF TAX COURT TO APPLY DOCTRINE OF EQUITABLE RECOUPMENT.—Section 6214(b) (relating to jurisdiction over other years and quarters) is amended by adding at the end the following new sentence: "Notwithstanding the preceding sentence, the Tax Court may apply the doctrine of equitable recoupment to the same extent that it is available in civil tax cases before the district courts of the United States and the United States Court of Federal Claims.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to any action or proceeding in the United States Tax Court with respect to which a decision has not become final (as determined under section 7481 of the Internal Revenue Code of 1986) as of the date of the enactment of this Act.

SEC. 104. TAX COURT FILING FEE IN ALL CASES COMMENCED BY FILING PETITION.

(a) IN GENERAL.—Section 7451 (relating to fee for filing a Tax Court petition) is amended by striking all that follows "petition" and inserting a period.

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

SEC. 105. AMENDMENTS TO APPOINT EMPLOYEES.

(a) IN GENERAL.—Subsection (a) of section 7471 (relating to Tax Court employees) is amended to read as follows:

"(a) APPOINTMENT AND COMPENSATION.—

"(1) CLERK.—The Tax Court may appoint a clerk without regard to the provisions of title 5, United States Code, governing appointments in the competitive service. The clerk shall serve at the pleasure of the Tax Court.

"(2) LAW CLERKS AND SECRETARIES.—

"(A) IN GENERAL.—The judges and special trial judges of the Tax Court may appoint law clerks and secretaries, in such numbers as the Tax Court may approve, without regard to the provisions of title 5, United States Code, governing appointments in the competitive service. Any such law clerk or secretary shall serve at the pleasure of the appointing judge.

"(B) EXEMPTION FROM FEDERAL LEAVE PROVISIONS.—A law clerk appointed under this subsection shall be exempt from the provisions

of subchapter I of chapter 63 of title 5, United States Code. Any unused sick leave or annual leave standing to the employee's credit as of the effective date of this subsection shall remain credited to the employee and shall be available to the employee upon separation from the Federal Government.

"(3) DEPUTIES AND OTHER EMPLOYEES.—The clerk may appoint necessary deputies and employees without regard to the provisions of title 5, United States Code, governing appointments in the competitive service. Such deputies and employees shall be subject to removal by the clerk.

"(4) PAY.—The Tax Court may fix and adjust the compensation for the clerk and other employees of the Tax Court without regard to the provisions of chapter 51, subchapter III of chapter 53, or section 5373 of title 5, United States Code. To the maximum extent feasible, the Tax Court shall compensate employees at rates consistent with those for employees holding comparable positions in the judicial branch.

"(5) PROGRAMS.—The Tax Court may establish programs for employee evaluations, incentive awards,

flexible work schedules, premium pay, and resolution of employee grievances.

"(6) DISCRIMINATION PROHIBITED.—The Tax Court shall—

"(A) prohibit discrimination on the basis of race, color, religion, age, sex, national origin, political affiliation, marital status, or handicapping condition; and

"(B) promulgate regulations providing procedures for resolving complaints of discrimination by employees and applicants for employment.

"(7) EXPERTS AND CONSULTANTS.—The Tax Court may procure the services of experts and consultants under section 3109 of title 5, United States Code.

"(8) RIGHTS TO CERTAIN APPEALS RESERVED.—Notwithstanding any other provision of law, an individual who is an employee of the Tax Court on the day before the effective date of this subsection and who, as of that day, was entitled to—

"(A) appeal a reduction in grade or removal to the Merit Systems Protection Board under chapter 43 of title 5, United States Code,

"(B) appeal an adverse action to the Merit Systems Protection Board under chapter 75 of title 5, United States Code,

"(C) appeal a prohibited personnel practice described under section 2302(b) of title 5, United States Code, to the Merit Systems Protection Board under chapter 77 of that title,

"(D) make an allegation of a prohibited personnel practice described under section 2302(b) of title 5, United States Code, with the Office of Special Counsel under chapter 12 of that title for action in accordance with that chapter, or

"(E) file an appeal with the Equal Employment Opportunity Commission under part 1614 of title 29 of the Code of Federal Regulations,

shall be entitled to file such appeal or make such an allegation so long as the individual remains an employee of the Tax Court.

"(9) COMPETITIVE STATUS.—Notwithstanding any other provision of law, any employee of the Tax Court who has completed at least 1 year of continuous service under a non temporary appointment with the Tax Court acquires a competitive status for

appointment to any position in the competitive service for which the employee possesses the required qualifications.

"(10) MERIT SYSTEM PRINCIPLES; PROHIBITED PERSONNEL PRACTICES; AND PREFERENCE ELIGIBLES.—Any personnel management system of the Tax Court shall—

"(A) include the principles set forth in section 2301(b) of title 5, United States Code;

"(B) prohibit personnel practices prohibited under section 2302(b) of title 5, United States Code; and

"(C) in the case of any individual who would be a preference eligible in the executive branch, the Tax Court will provide preference for that individual in a manner and to an extent consistent with preference accorded to preference eligibles in the executive branch.".

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date the United States Tax Court adopts a personnel management system after the date of the enactment of this Act.

SEC. 106. EXPANDED USE OF TAX COURT PRACTICE FEE FOR PRO SE TAXPAYERS.

(a) IN GENERAL.—Section 7475(b) (relating to use of fees) is amended by inserting before the period at the end "and to provide services to pro se taxpayers".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

TITLE II—TAX COURT PENSION AND COMPENSATION

SEC. 201. ANNUITIES FOR SURVIVORS OF TAX COURT JUDGES WHO ARE ASSASSINATED.

(a) ELIGIBILITY IN CASE OF DEATH BY ASSASSINATION.—Subsection (h) of section 7448 (relating to annuities to surviving spouses and dependent children of judges) is amended to read as follows:

"(h) ENTITLEMENT TO ANNUITY.—

"(1) IN GENERAL.—

"(A) ANNUITY TO SURVIVING SPOUSE.—If a judge described in paragraph (2) is survived by a surviving spouse but not by a dependent child, there shall be paid to such surviving spouse an annuity beginning with the day of the death of the judge or following the surviving spouse's attainment of the age of 50 years,

whichever is the later, in an amount computed as provided in subsection (m).

"(B) ANNUITY TO CHILD.—If such a judge is survived by a surviving spouse and a dependent child or children, there shall be paid to such surviving spouse an immediate annuity in an amount computed as provided in subsection (m), and there shall also be paid to or on behalf of each such child an immediate annuity equal to the lesser of—

"(i) 10 percent of the average annual salary of such judge (determined in accordance with subsection (m)), or

"(ii) 20 percent of such average annual salary, divided by the number of such children.

"(C) ANNUITY TO SURVIVING DEPENDENT CHILDREN.—If such a judge leaves no surviving spouse but leaves a surviving dependent child or children, there shall be paid to or on behalf of each such child an immediate annuity equal to the lesser of—

"(i) 20 percent of the average annual salary of such judge (determined in accordance with subsection (m)), or

"(ii) 40 percent of such average annual salary, divided by the number of such children.

"(2) COVERED JUDGES.—Paragraph (1) applies to any judge electing under subsection (b)—

"(A) who dies while a judge after having rendered at least 5 years of civilian service computed as prescribed in subsection (n), for the last 5 years of which the salary deductions provided for by subsection (c)(1) or the deposits required by subsection (d) have actually been made or the salary deductions required by the civil service retirement laws have actually been made, or

"(B) who dies by assassination after having rendered less than 5 years of civilian service computed as prescribed in subsection (n) if, for the period of such service, the salary deductions provided for by subsection (c)(1) or the deposits required by subsection (d) have actually been made.

"(3) TERMINATION OF ANNUITY.—

"(A) IN THE CASE OF A SURVIVING SPOUSE.—The annuity payable to a surviving spouse under this subsection shall be terminable

upon such surviving spouse's death or such surviving spouse's remarriage before attaining age 55.

"(B) IN THE CASE OF A CHILD.—The annuity payable to a child under this subsection shall be terminable upon (i) the child attaining the age of 18 years, (ii) the child's marriage, or (iii) the child's death, whichever first occurs, except that if such child is incapable of self-support by reason of mental or physical disability the child's annuity shall be terminable only upon death, marriage, or recovery from such disability.

"(C) IN THE CASE OF A DEPENDENT CHILD AFTER DEATH OF SURVIVING SPOUSE.—In case of the death of a surviving spouse of a judge leaving a dependent child or children of the judge surviving such spouse, the annuity of such child or children shall be recomputed and paid as provided in paragraph (1)(C).

"(D) RECOMPUTATION.—In any case in which the annuity of a dependent child is terminated under this subsection, the annuities of any remaining dependent child or children, based upon the service of the same judge, shall

be recomputed and paid as though the child whose annuity was so terminated had not survived such judge.

"(4) SPECIAL RULE FOR ASSASSINATED JUDGES.—In the case of a survivor or survivors of a judge described in paragraph (2)(B), there shall be deducted from the annuities otherwise payable under this section an amount equal to—

"(A) the amount of salary deductions provided for by subsection (c)(1) that would have been made if such deductions had been made for 5 years of civilian service computed as prescribed in subsection (n) before the judge's death, reduced by

"(B) the amount of such salary deductions that were actually made before the date of the judge's death.

(b) DEFINITION OF ASSASSINATION.—Section 7448(a) (relating to definitions) is amended by adding at the end the following new paragraph:

"(8) The terms 'assassinated' and 'assassination' mean the killing of a judge that is motivated by the performance by that judge of his or her official duties.".

(c) DETERMINATION OF ASSASSINATION.—Subsection (i) of section 7448 is amended—

(1) by striking the subsection heading and inserting the following:

"(i) DETERMINATIONS BY CHIEF JUDGE.—

"(1) DEPENDENCY AND DISABILITY.—",

(2) by moving the text 2 ems to the right, and

(3) by adding at the end the following new paragraph:

"(2) ASSASSINATION.—The chief judge shall determine whether the killing of a judge was an assassination, subject to review only by the Tax Court. The head of any Federal agency that investigates the killing of a judge shall provide information to the chief judge that would assist the chief judge in making such a determination.".

(d) COMPUTATION OF ANNUITIES.—Subsection (m) of section 7448 is amended—

(1) by striking the subsection heading and inserting the following:

"(m) COMPUTATION OF ANNUITIES.—

"(1) IN GENERAL.—",

(2) by moving the text 2 ems to the right, and

(3) by adding at the end the following new paragraph:

"(2) ASSASSINATED JUDGES.—In the case of a judge who is assassinated and who has served less than 3 years, the annuity of the surviving spouse of such judge shall be based upon the average annual salary received by such judge for judicial service.".

(e) OTHER BENEFITS.—Section 7448 is amended by adding at the end the following:

"(u) OTHER BENEFITS.—In the case of a judge who is assassinated, an annuity shall be paid under this section notwithstanding a survivor's eligibility for or receipt of benefits under chapter 81 of title 5, United States Code, except that the annuity for which a surviving spouse is eligible under this section shall be reduced to the extent that the total benefits paid under this section and chapter 81 of that title for any year would exceed the current salary for that year of the office of the judge.".

SEC. 202. COST-OF-LIVING ADJUSTMENTS FOR TAX COURT JUDICIAL SURVIVOR ANNUITIES.

(a) IN GENERAL.—Subsection (s) of section 7448 (relating to annuities to surviving spouses and dependent children of judges) is amended to read as follows:

"(s) INCREASES IN SURVIVOR ANNUITIES.—Each time that an increase is made under section 8340(b) of title 5, United States Code, in annuities payable under subchapter III of chapter 83 of that title, each annuity

payable from the survivors annuity fund under this section shall be increased at the same time by the same percentage by which annuities are increased under such section 8340(b).".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to increases made under section 8340(b) of title 5, United States Code, in annuities payable under subchapter III of chapter 83 of that title, taking effect after the date of the enactment of this Act.

SEC. 203. LIFE INSURANCE COVERAGE FOR TAX COURT JUDGES.

(a) IN GENERAL.—Section 7447 (relating to retirement of judges) is amended by adding at the end the following new subsection:

"(j) LIFE INSURANCE COVERAGE.—For purposes of chapter 87 of title 5, United States Code (relating to life insurance), any individual who is serving as a judge of the Tax Court or who is retired under this section is deemed to be an employee who is continuing in active employment.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to any individual serving as a judge of the United States Tax Court or to any retired judge

of the United States Tax Court on the date of the enactment of this Act.

SEC. 204. COST OF LIFE INSURANCE COVERAGE FOR TAX COURT JUDGES AGE 65 OR OVER.

Section 7472 (relating to expenditures) is amended by inserting after the first sentence the following new sentence: "Notwithstanding any other provision of law, the Tax Court is authorized to pay on behalf of its judges, age 65 or over, any increase in the cost of Federal Employees' Group Life Insurance imposed after April 24, 1999, including any expenses generated by such payments, as authorized by the chief judge in a manner consistent with such payments authorized by the Judicial Conference of the United States pursuant to section 604(a)(5) of title 28, United States Code.".

SEC. 205. MODIFICATION OF TIMING OF LUMP-SUM PAYMENT OF JUDGES' ACCRUED ANNUAL LEAVE.

(a) IN GENERAL.—Section 7443 (relating to membership of the Tax Court) is amended by adding at the end the following new subsection:

"(h) LUMP-SUM PAYMENT OF JUDGES' ACCRUED ANNUAL LEAVE.—Notwithstanding the provisions of sections 5551 and 6301 of title 5, United States Code, when an individual subject to the leave system provided in chapter 63 of that title is appointed by the President to be

a judge of the Tax Court, the individual shall be entitled to receive, upon appointment to the Tax Court, a lump-sum payment from the Tax Court of the accumulated and accrued current annual leave standing to the individual's credit as certified by the agency from which the individual resigned.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to any judge of the United States Tax Court who has an outstanding leave balance on the date of the enactment of this Act and to any individual appointed by the President to serve as a judge of the United States Tax Court after such date.

SEC. 206. PARTICIPATION OF TAX COURT JUDGES IN THE THRIFT SAVINGS PLAN.

(a) IN GENERAL.—Section 7447 (relating to retirement of judges), as amended by this Act, is amended by adding at the end the following new subsection:

"(k) THRIFT SAVINGS PLAN.—

"(1) ELECTION TO CONTRIBUTE.—

"(A) IN GENERAL.—A judge of the Tax Court may elect to contribute to the Thrift Savings Fund established by section 8437 of title 5, United States Code.

"(B) PERIOD OF ELECTION.—An election may be made under this paragraph only during

a period provided under section 8432(b) of title 5, United States Code, for individuals subject to chapter 84 of such title.

"(2) APPLICABILITY OF TITLE 5 PROVISIONS.—Except as otherwise provided in this subsection, the provisions of subchapters III and VII of chapter 84 of title 5, United States Code, shall apply with respect to a judge who makes an election under paragraph (1).

"(3) SPECIAL RULES.—

"(A) AMOUNT CONTRIBUTED.—The amount contributed by a judge to the Thrift Savings Fund in any pay period shall not exceed the maximum percentage of such judge's basic pay for such period as allowable under section 8440f of title 5, United States Code. Basic pay does not include any retired pay paid pursuant to this section.

"(B) CONTRIBUTIONS FOR BENEFIT OF JUDGE.—No contributions may be made for the benefit of a judge under section 8432(c) of title 5, United States Code.

"(C) APPLICABILITY OF SECTION 8433(b) OF TITLE 5 WHETHER OR NOT JUDGE RETIRES.—Section 8433(b) of title 5, United

States Code, applies with respect to a judge who makes an election under paragraph (1) and who either—

"(i) retires under subsection (b), or

"(ii) ceases to serve as a judge of the Tax Court but does not retire under subsection (b).

Retirement under subsection (b) is a separation from service for purposes of subchapters III and VII of chapter 84 of that title.

"(D) APPLICABILITY OF SECTION 8351(b)(5) OF TITLE 5.—The provisions of section 8351(b)(5) of title 5, United States Code, shall apply with respect to a judge who makes an election under paragraph (1).

"(E) EXCEPTION.—Notwithstanding subparagraph (C), if any judge retires under this section, or resigns without having met the age and service requirements set forth under subsection (b)(2), and such judge's nonforfeitable account balance is less than an amount that the Executive Director of the Office of Personnel Management prescribes by regulation, the Executive Director shall pay the nonforfeitable ac-

count balance to the participant in a single payment.".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act, except that United States Tax Court judges may only begin to participate in the Thrift Savings Plan at the next open season beginning after such date.

SEC. 207. EXEMPTION OF TEACHING COMPENSATION OF RETIRED JUDGES FROM LIMITATION ON OUTSIDE EARNED INCOME.

(a) IN GENERAL.—Section 7447 (relating to retirement of judges), as amended by this Act, is amended by adding at the end the following new subsection:

"(l) TEACHING COMPENSATION OF RETIRED JUDGES.—For purposes of the limitation under section 501(a) of the Ethics in Government Act of 1978 (5 U.S.C. App.), any compensation for teaching approved under subsection (a)(5) of that section shall not be treated as outside earned income when received by a judge of the Tax Court who has retired under subsection (b) for teaching performed during any calendar year for which such a judge has met the requirements of subsection (c), as certified by the chief judge of the Tax Court.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to any individual serving as a re-

tired judge of the United States Tax Court on or after the date of the enactment of this Act.

SEC. 208. GENERAL PROVISIONS RELATING TO MAGISTRATE JUDGES OF THE TAX COURT.

(a) TITLE OF SPECIAL TRIAL JUDGE CHANGED TO MAGISTRATE JUDGE OF THE TAX COURT.—The heading of section 7443A is amended to read as follows:

"SEC. 7443A. MAGISTRATE JUDGES OF THE TAX COURT.".

(b) APPOINTMENT, TENURE, AND REMOVAL.—Subsection (a) of section 7443A is amended to read as follows:

"(a) APPOINTMENT, TENURE, AND REMOVAL.—

"(1) APPOINTMENT.—The chief judge may, from time to time, appoint and reappoint magistrate judges of the Tax Court for a term of 8 years. The magistrate judges of the Tax Court shall proceed under such rules as may be promulgated by the Tax Court.

"(2) REMOVAL.—Removal of a magistrate judge of the Tax Court during the term for which he or she is appointed shall be only for incompetency, misconduct, neglect of duty, or physical or mental disability, but the office of a magistrate judge of the Tax Court shall be terminated if the judges of the Tax Court determine that the services performed by the magistrate judge of the Tax Court

are no longer needed. Removal shall not occur unless a majority of all the judges of the Tax Court concur in the order of removal. Before any order of removal shall be entered, a full specification of the charges shall be furnished to the magistrate judge of the Tax Court, and he or she shall be accorded by the judges of the Tax Court an opportunity to be heard on the charges.".

(c) SALARY.—Section 7443A(d) (relating to salary) is amended by striking "90" and inserting "92".

(d) EXEMPTION FROM FEDERAL LEAVE PROVISIONS.—Section 7443A is amended by adding at the end the following new subsection:

"(f) EXEMPTION FROM FEDERAL LEAVE PROVISIONS.—

"(1) IN GENERAL.—A magistrate judge of the Tax Court appointed under this section shall be exempt from the provisions of subchapter I of chapter 63 of title 5, United States Code.

"(2) TREATMENT OF UNUSED LEAVE.—

"(A) AFTER SERVICE AS MAGISTRATE JUDGE.—If an individual who is exempted under paragraph (1) from the subchapter referred to in such paragraph was previously subject to such subchapter and, without a break in

service, again becomes subject to such subchapter on completion of the individual's service as a magistrate judge, the unused annual leave and sick leave standing to the individual's credit when such individual was exempted from this subchapter is deemed to have remained to the individual's credit.

"(B) COMPUTATION OF ANNUITY.—In computing an annuity under section 8339 of title 5, United States Code, the total service of an individual specified in subparagraph (A) who retires on an immediate annuity or dies leaving a survivor or survivors entitled to an annuity includes, without regard to the limitations imposed by subsection (f) of such section 8339, the days of unused sick leave standing to the individual's credit when such individual was exempted from subchapter I of chapter 63 of title 5, United States Code, except that these days will not be counted in determining average pay or annuity eligibility.

"(C) LUMP SUM PAYMENT.—Any accumulated and current accrued annual leave or vacation balances credited to a magistrate judge as of the date of the enactment of this subsection

shall be paid in a lump sum at the time of separation from service pursuant to the provisions and restrictions set forth in section 5551 of title 5, United States Code, and related provisions referred to in such section.".

(e) CONFORMING AMENDMENTS.—

(1) The heading of subsection (b) of section 7443A is amended by striking "SPECIAL TRIAL JUDGES" and inserting "MAGISTRATE JUDGES OF THE TAX COURT".

(2) Section 7443A(b) is amended by striking "special trial judges of the court" and inserting "magistrate judges of the Tax Court".

(3) Subsections (c) and (d) of section 7443A are amended by striking "special trial judge" and inserting "magistrate judge of the Tax Court" each place it appears.

(4) Section 7443A(e) is amended by striking "special trial judges" and inserting "magistrate judges of the Tax Court".

(5) Section 7456(a) is amended by striking "special trial judge" each place it appears and inserting "magistrate judge".

(6) Subsection (c) of section 7471 is amended—

(A) by striking the subsection heading and inserting "MAGISTRATE JUDGES OF THE TAX COURT.—", and

(B) by striking "special trial judges" and inserting "magistrate judges".

SEC. 209. ANNUITIES TO SURVIVING SPOUSES AND DEPENDENT CHILDREN OF MAGISTRATE JUDGES OF THE TAX COURT.

(a) DEFINITIONS.—Section 7448(a) (relating to definitions), as amended by this Act, is amended by redesignating paragraphs (5), (6), (7), and (8) as paragraphs (7), (8), (9), and (10), respectively, and by inserting after paragraph (4) the following new paragraphs:

"(5) The term 'magistrate judge' means a judicial officer appointed pursuant to section 7443A, including any individual receiving an annuity under section 7443B, or chapters 83 or 84, as the case may be, of title 5, United States Code, whether or not performing judicial duties under section 7443C.

"(6) The term 'magistrate judge's salary' means the salary of a magistrate judge received under section 7443A(d), any amount received as an annuity under section 7443B, or chapters 83 or 84, as the case may be, of title 5, United States Code, and compensation received under section 7443C.".

(b) ELECTION.—Subsection (b) of section 7448 (relating to annuities to surviving spouses and dependent children of judges) is amended—

(1) by striking the subsection heading and inserting the following:

"(b) ELECTION.—

"(1) JUDGES.—",

(2) by moving the text 2 ems to the right, and

(3) by adding at the end the following new paragraph:

"(2) MAGISTRATE JUDGES.—Any magistrate judge may by written election filed with the chief judge bring himself or herself within the purview of this section. Such election shall be filed not later than the later of 6 months after—

"(A) 6 months after the date of the enactment of this paragraph,

"(B) the date the judge takes office, or

"(C) the date the judge marries.".

(c) CONFORMING AMENDMENTS.—

(1) The heading of section 7448 is amended by inserting "**AND MAGISTRATE JUDGES**" after "**JUDGES**".

(2) The item relating to section 7448 in the table of sections for part I of subchapter C of chap-

ter 76 is amended by inserting "and magistrate judges" after "judges".

(3) Subsections (c)(1), (d), (f), (g), (h), (j), (m), (n), and (u) of section 7448, as amended by this Act, are each amended—

(A) by inserting "or magistrate judge" after "judge" each place it appears other than in the phrase "chief judge", and

(B) by inserting "or magistrate judge's" after "judge's" each place it appears.

(4) Section 7448(c) is amended—

(A) in paragraph (1), by striking "Tax Court judges" and inserting "Tax Court judicial officers",

(B) in paragraph (2)—

(i) in subparagraph (A), by inserting "and section 7443A(d)" after "(a)(4)", and

(ii) in subparagraph (B), by striking "subsection (a)(4)" and inserting "subsections (a)(4) and (a)(6)".

(5) Section 7448(g) is amended by inserting "or section 7443B" after "section 7447" each place it appears, and by inserting "or an annuity" after "retired pay".

(6) Section 7448(j)(1) is amended—

(A) in subparagraph (A), by striking "service or retired" and inserting "service, retired", and by inserting ", or receiving any annuity under section 7443B or chapters 83 or 84 of title 5, United States Code," after "section 7447", and

(B) in the last sentence, by striking "subsections (a)(6) and (7)" and inserting "paragraphs (8) and (9) of subsection (a)".

(7) Section 7448(m)(1), as amended by this Act, is amended—

(A) by inserting "or any annuity under section 7443B or chapters 83 or 84 of title 5, United States Code" after "7447(d)", and

(B) by inserting "or 7443B(m)(1)(B) after "7447(f)(4)".

(8) Section 7448(n) is amended by inserting "his years of service pursuant to any appointment under section 7443A," after "of the Tax Court,".

(9) Section 3121(b)(5)(E) is amended by inserting "or magistrate judge" before "of the United States Tax Court".

(10) Section 210(a)(5)(E) of the Social Security Act is amended by inserting "or magistrate judge" before "of the United States Tax Court".

SEC. 210. RETIREMENT AND ANNUITY PROGRAM.

(a) RETIREMENT AND ANNUITY PROGRAM.—Part I of subchapter C of chapter 76 is amended by inserting after section 7443A the following new section:

"SEC. 7443B. RETIREMENT FOR MAGISTRATE JUDGES OF THE TAX COURT.

"(a) RETIREMENT BASED ON YEARS OF SERVICE.—A magistrate judge of the Tax Court to whom this section applies and who retires from office after attaining the age of 65 years and serving at least 14 years, whether continuously or otherwise, as such magistrate judge shall, subject to subsection (f), be entitled to receive, during the remainder of the magistrate judge's lifetime, an annuity equal to the salary being received at the time the magistrate judge leaves office.

"(b) RETIREMENT UPON FAILURE OF REAPPOINTMENT.—A magistrate judge of the Tax Court to whom this section applies who is not reappointed following the expiration of the term of office of such magistrate judge, and who retires upon the completion of the term shall, subject to subsection (f), be entitled to receive, upon attaining the age of 65 years and during the remainder of

such magistrate judge's lifetime, an annuity equal to that portion of the salary being received at the time the magistrate judge leaves office which the aggregate number of years of service, not to exceed 14, bears to 14, if—

"(1) such magistrate judge has served at least 1 full term as a magistrate judge, and

"(2) not earlier than 9 months before the date on which the term of office of such magistrate judge expires, and not later than 6 months before such date, such magistrate judge notified the chief judge of the Tax Court in writing that such magistrate judge was willing to accept reappointment to the position in which such magistrate judge was serving.

"(c) SERVICE OF AT LEAST 8 YEARS.—A magistrate judge of the Tax Court to whom this section applies and who retires after serving at least 8 years, whether continuously or otherwise, as such a magistrate judge shall, subject to subsection (f), be entitled to receive, upon attaining the age of 65 years and during the remainder of the magistrate judge's lifetime, an annuity equal to that portion of the salary being received at the time the magistrate judge leaves office which the aggregate number of years of service, not to exceed 14, bears to 14. Such annuity shall be reduced by 1/6 of 1 percent for each full month such magistrate judge was under the age of 65 at the time

the magistrate judge left office, except that such reduction shall not exceed 20 percent.

"(d) RETIREMENT FOR DISABILITY.—A magistrate judge of the Tax Court to whom this section applies, who has served at least 5 years, whether continuously or otherwise, as such a magistrate judge, and who retires or is removed from office upon the sole ground of mental or physical disability shall, subject to subsection (f), be entitled to receive, during the remainder of the magistrate judge's lifetime, an annuity equal to 40 percent of the salary being received at the time of retirement or removal or, in the case of a magistrate judge who has served for at least 10 years, an amount equal to that proportion of the salary being received at the time of retirement or removal which the aggregate number of years of service, not to exceed 14, bears to 14.

"(e) COST-OF-LIVING ADJUSTMENTS.—A magistrate judge of the Tax Court who is entitled to an annuity under this section is also entitled to a cost-of-living adjustment in such annuity, calculated and payable in the same manner as adjustments under section 8340(b) of title 5, United States Code, except that any such annuity, as increased under this subsection, may not exceed the salary then payable for the position from which the magistrate judge retired or was removed.

"(f) ELECTION; ANNUITY IN LIEU OF OTHER ANNUITIES.—

"(1) IN GENERAL.—A magistrate judge of the Tax Court shall be entitled to an annuity under this section if the magistrate judge elects an annuity under this section by notifying the chief judge of the Tax Court not later than the later of—

"(A) 5 years after the magistrate judge of the Tax Court begins judicial service, or

"(B) 5 years after the date of the enactment of this subsection.

Such notice shall be given in accordance with procedures prescribed by the Tax Court.

"(2) ANNUITY IN LIEU OF OTHER ANNUITY.—A magistrate judge who elects to receive an annuity under this section shall not be entitled to receive—

"(A) any annuity to which such magistrate judge would otherwise have been entitled under subchapter III of chapter 83, or under chapter 84 (except for subchapters III and VII), of title 5, United States Code, for service performed as a magistrate or otherwise,

"(B) an annuity or salary in senior status or retirement under section 371 or 372 of title 28, United States Code,

"(C) retired pay under section 7447, or

"(D) retired pay under section 7296 of title 38, United States Code.

"(3) COORDINATION WITH TITLE 5.—A magistrate judge of the Tax Court who elects to receive an annuity under this section—

"(A) shall not be subject to deductions and contributions otherwise required by section 8334(a) of title 5, United States Code,

"(B) shall be excluded from the operation of chapter 84 (other than subchapters III and VII) of such title 5, and

"(C) is entitled to a lump-sum credit under section 8342(a) or 8424 of such title 5, as the case may be.

"(g) CALCULATION OF SERVICE.—For purposes of calculating an annuity under this section—

"(1) service as a magistrate judge of the Tax Court to whom this section applies may be credited, and

"(2) each month of service shall be credited as 1/12 of a year, and the fractional part of any month shall not be credited.

"(h) COVERED POSITIONS AND SERVICE.—This section applies to any magistrate judge of the Tax Court or

special trial judge of the Tax Court appointed under this subchapter, but only with respect to service as such a magistrate judge or special trial judge after a date not earlier than 9½ years before the date of the enactment of this subsection.

"(i) PAYMENTS PURSUANT TO COURT ORDER.—

"(1) IN GENERAL.—Payments under this section which would otherwise be made to a magistrate judge of the Tax Court based upon his or her service shall be paid (in whole or in part) by the chief judge of the Tax Court to another person if and to the extent expressly provided for in the terms of any court decree of divorce, annulment, or legal separation, or the terms of any court order or court-approved property settlement agreement incident to any court decree of divorce, annulment, or legal separation. Any payment under this paragraph to a person bars recovery by any other person.

"(2) REQUIREMENTS FOR PAYMENT.—Paragraph (1) shall apply only to payments made by the chief judge of the Tax Court after the date of receipt by the chief judge of written notice of such decree, order, or agreement, and such additional information as the chief judge may prescribe.

"(3) COURT DEFINED.—For purposes of this subsection, the term 'court' means any court of any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Northern Mariana Islands, or the Virgin Islands, and any Indian tribal court or courts of Indian offense.

"(j) DEDUCTIONS, CONTRIBUTIONS, AND DEPOSITS.—

"(1) DEDUCTIONS.—Beginning with the next pay period after the chief judge of the Tax Court receives a notice under subsection (f) that a magistrate judge of the Tax Court has elected an annuity under this section, the chief judge shall deduct and withhold 1 percent of the salary of such magistrate judge. Amounts shall be so deducted and withheld in a manner determined by the chief judge. Amounts deducted and withheld under this subsection shall be deposited in the Treasury of the United States to the credit of the Tax Court Judicial Officers' Retirement Fund. Deductions under this subsection from the salary of a magistrate judge shall terminate upon the retirement of the magistrate judge or upon completion of 14 years of service for which contributions under this section have been made, whether continuously or otherwise, as

calculated under subsection (g), whichever occurs first.

"(2) CONSENT TO DEDUCTIONS; DISCHARGE OF CLAIMS.—Each magistrate judge of the Tax Court who makes an election under subsection (f) shall be deemed to consent and agree to the deductions from salary which are made under paragraph (1). Payment of such salary less such deductions (and any deductions made under section 7448) is a full and complete discharge and acquittance of all claims and demands for all services rendered by such magistrate judge during the period covered by such payment, except the right to those benefits to which the magistrate judge is entitled under this section (and section 7448).

"(k) DEPOSITS FOR PRIOR SERVICE.—Each magistrate judge of the Tax Court who makes an election under subsection (f) may deposit, for service performed before such election for which contributions may be made under this section, an amount equal to 1 percent of the salary received for that service. Credit for any period covered by that service may not be allowed for purposes of an annuity under this section until a deposit under this subsection has been made for that period.

"(l) INDIVIDUAL RETIREMENT RECORDS.—The amounts deducted and withheld under subsection (j), and the amounts deposited under subsection (k), shall be credited to individual accounts in the name of each magistrate judge of the Tax Court from whom such amounts are received, for credit to the Tax Court Judicial Officers' Retirement Fund.

"(m) ANNUITIES AFFECTED IN CERTAIN CASES.—

"(1) 1-YEAR FORFEITURE FOR FAILURE TO PERFORM JUDICIAL DUTIES.—Subject to paragraph (3), any magistrate judge of the Tax Court who retires under this section and who fails to perform judicial duties required of such individual by section 7443C shall forfeit all rights to an annuity under this section for a 1-year period which begins on the 1st day on which such individual fails to perform such duties.

"(2) PERMANENT FORFEITURE OF RETIRED PAY WHERE CERTAIN NON-GOVERNMENT SERVICES PERFORMED.—Subject to paragraph (3), any magistrate judge of the Tax Court who retires under this section and who thereafter performs (or supervises or directs the performance of) legal or accounting services in the field of Federal taxation for the individual's client, the individual's employer, or any of

such employer's clients, shall forfeit all rights to an annuity under this section for all periods beginning on or after the first day on which the individual performs (or supervises or directs the performance of) such services. The preceding sentence shall not apply to any civil office or employment under the Government of the United States.

"(3) FORFEITURES NOT TO APPLY WHERE INDIVIDUAL ELECTS TO FREEZE AMOUNT OF ANNUITY.—

"(A) IN GENERAL.—If a magistrate judge of the Tax Court makes an election under this paragraph—

"(i) paragraphs (1) and (2) (and section 7443C) shall not apply to such magistrate judge beginning on the date such election takes effect, and

"(ii) the annuity payable under this section to such magistrate judge, for periods beginning on or after the date such election takes effect, shall be equal to the annuity to which such magistrate judge is entitled on the day before such effective date.

"(B) ELECTION REQUIREMENTS.—An election under subparagraph (A)—

"(i) may be made by a magistrate judge of the Tax Court eligible for retirement under this section, and

"(ii) shall be filed with the chief judge of the Tax Court.

Such an election, once it takes effect, shall be irrevocable.

"(C) EFFECTIVE DATE OF ELECTION.—Any election under subparagraph (A) shall take effect on the first day of the first month following the month in which the election is made.

"(4) ACCEPTING OTHER EMPLOYMENT.—Any magistrate judge of the Tax Court who retires under this section and thereafter accepts compensation for civil office or employment under the United States Government (other than for the performance of functions as a magistrate judge of the Tax Court under section 7443C) shall forfeit all rights to an annuity under this section for the period for which such compensation is received. For purposes of this paragraph, the term 'compensation' includes retired pay or salary received in retired status.

"(n) LUMP-SUM PAYMENTS.—

"(1) ELIGIBILITY.—

"(A) IN GENERAL.—Subject to paragraph (2), an individual who serves as a magistrate judge of the Tax Court and—

"(i) who leaves office and is not reappointed as a magistrate judge of the Tax Court for at least 31 consecutive days,

"(ii) who files an application with the chief judge of the Tax Court for payment of a lump-sum credit,

"(iii) is not serving as a magistrate judge of the Tax Court at the time of filing of the application, and

"(iv) will not become eligible to receive an annuity under this section within 31 days after filing the application,

is entitled to be paid the lump-sum credit. Payment of the lump-sum credit voids all rights to an annuity under this section based on the service on which the lump-sum credit is based, until that individual resumes office as a magistrate judge of the Tax Court.

"(B) PAYMENT TO SURVIVORS.—Lump-sum benefits authorized by subparagraphs (C), (D), and (E) of this paragraph shall be paid to

the person or persons surviving the magistrate judge of the Tax Court and alive on the date title to the payment arises, in the order of precedence set forth in subsection (o) of section 376 of title 28, United States Code, and in accordance with the last 2 sentences of paragraph (1) of that subsection. For purposes of the preceding sentence, the term 'judicial official' as used in subsection (o) of such section 376 shall be deemed to mean 'magistrate judge of the Tax Court' and the terms 'Administrative Office of the United States Courts' and 'Director of the Administrative Office of the United States Courts' shall be deemed to mean 'chief judge of the Tax Court'.

"(C) PAYMENT UPON DEATH OF JUDGE BEFORE RECEIPT OF ANNUITY.—If a magistrate judge of the Tax Court dies before receiving an annuity under this section, the lump-sum credit shall be paid.

"(D) PAYMENT OF ANNUITY REMAINDER.—If all annuity rights under this section based on the service of a deceased magistrate judge of the Tax Court terminate before the

total annuity paid equals the lump-sum credit, the difference shall be paid.

"(E) PAYMENT UPON DEATH OF JUDGE DURING RECEIPT OF ANNUITY.—If a magistrate judge of the Tax Court who is receiving an annuity under this section dies, any accrued annuity benefits remaining unpaid shall be paid.

"(F) PAYMENT UPON TERMINATION.—Any accrued annuity benefits remaining unpaid on the termination, except by death, of the annuity of a magistrate judge of the Tax Court shall be paid to that individual.

"(G) PAYMENT UPON ACCEPTING OTHER EMPLOYMENT.—Subject to paragraph (2), a magistrate judge of the Tax Court who forfeits rights to an annuity under subsection (m)(4) before the total annuity paid equals the lump-sum credit shall be entitled to be paid the difference if the magistrate judge of the Tax Court files an application with the chief judge of the Tax Court for payment of that difference. A payment under this subparagraph voids all rights to an annuity on which the payment is based.

"(2) SPOUSES AND FORMER SPOUSES.—

"(A) IN GENERAL.—Payment of the lump-sum credit under paragraph (1)(A) or a payment under paragraph (1)(G)—

"(i) may be made only if any current spouse and any former spouse of the magistrate judge of the Tax Court are notified of the magistrate judge's application, and

"(ii) shall be subject to the terms of a court decree of divorce, annulment, or legal separation, or any court or court approved property settlement agreement incident to such decree, if—

"(I) the decree, order, or agreement expressly relates to any portion of the lump-sum credit or other payment involved, and

"(II) payment of the lump-sum credit or other payment would extinguish entitlement of the magistrate judge's spouse or former spouse to any portion of an annuity under subsection (i).

"(B) NOTIFICATION.—Notification of a spouse or former spouse under this paragraph shall be made in accordance with such proce-

dures as the chief judge of the Tax Court shall prescribe. The chief judge may provide under such procedures that subparagraph (A)(i) may be waived with respect to a spouse or former spouse if the magistrate judge establishes to the satisfaction of the chief judge that the whereabouts of such spouse or former spouse cannot be determined.

"(C) RESOLUTION OF 2 OR MORE ORDERS.—The chief judge shall prescribe procedures under which this paragraph shall be applied in any case in which the chief judge receives 2 or more orders or decrees described in subparagraph (A).

"(3) DEFINITION.—For purposes of this subsection, the term 'lump-sum credit' means the unrefunded amount consisting of—

"(A) retirement deductions made under this section from the salary of a magistrate judge of the Tax Court,

"(B) amounts deposited under subsection (k) by a magistrate judge of the Tax Court covering earlier service, and

"(C) interest on the deductions and deposits which, for any calendar year, shall be equal

to the overall average yield to the Tax Court Judicial Officers' Retirement Fund during the preceding fiscal year from all obligations purchased by the Secretary during such fiscal year under subsection (o); but does not include interest—

"(i) if the service covered thereby aggregates 1 year or less, or

"(ii) for the fractional part of a month in the total service.

"(o) TAX COURT JUDICIAL OFFICERS' RETIREMENT FUND.—

"(1) ESTABLISHMENT.—There is established in the Treasury a fund which shall be known as the 'Tax Court Judicial Officers' Retirement Fund'. Amounts in the Fund are authorized to be appropriated for the payment of annuities, refunds, and other payments under this section.

"(2) INVESTMENT OF FUND.—The Secretary shall invest, in interest bearing securities of the United States, such currently available portions of the Tax Court Judicial Officers' Retirement Fund as are not immediately required for payments from the Fund. The income derived from these investments constitutes a part of the Fund.

"(3) UNFUNDED LIABILITY.—

"(A) IN GENERAL.—There are authorized to be appropriated to the Tax Court Judicial Officers' Retirement Fund amounts required to reduce to zero the unfunded liability of the Fund.

"(B) UNFUNDED LIABILITY.—For purposes of subparagraph (A), the term 'unfunded liability' means the estimated excess, determined on an annual basis in accordance with the provisions of section 9503 of title 31, United States Code, of the present value of all benefits payable from the Tax Court Judicial Officers' Retirement Fund over the sum of—

"(i) the present value of deductions to be withheld under this section from the future basic pay of magistrate judges of the Tax Court, plus

"(ii) the balance in the Fund as of the date the unfunded liability is determined.

"(p) PARTICIPATION IN THRIFT SAVINGS PLAN.—

"(1) ELECTION TO CONTRIBUTE.—

"(A) IN GENERAL.—A magistrate judge of the Tax Court who elects to receive an annuity under this section or under section 211 of the

Tax Court Modernization Act may elect to contribute an amount of such individual's basic pay to the Thrift Savings Fund established by section 8437 of title 5, United States Code.

"(B) PERIOD OF ELECTION.—An election may be made under this paragraph only during a period provided under section 8432(b) of title 5, United States Code, for individuals subject to chapter 84 of such title.

"(2) APPLICABILITY OF TITLE 5 PROVISIONS.—Except as otherwise provided in this subsection, the provisions of subchapters III and VII of chapter 84 of title 5, United States Code, shall apply with respect to a magistrate judge who makes an election under paragraph (1).

"(3) SPECIAL RULES.—

"(A) AMOUNT CONTRIBUTED.—The amount contributed by a magistrate judge to the Thrift Savings Fund in any pay period shall not exceed the maximum percentage of such judge's basic pay for such pay period as allowable under section 8440f of title 5, United States Code.

"(B) CONTRIBUTIONS FOR BENEFIT OF JUDGE.—No contributions may be made for the

benefit of a magistrate judge under section 8432(c) of title 5, United States Code.

"(C) APPLICABILITY OF SECTION 8433(b) OF TITLE 5.—Section 8433(b) of title 5, United States Code, applies with respect to a magistrate judge who makes an election under paragraph (1) and—

"(i) who retires entitled to an immediate annuity under this section (including a disability annuity under subsection (d) of this section) or section 211 of the Tax Court Modernization Act,

"(ii) who retires before attaining age 65 but is entitled, upon attaining age 65, to an annuity under this section or section 211 of the Tax Court Modernization Act, or

"(iii) who retires before becoming entitled to an immediate annuity, or an annuity upon attaining age 65, under this section or section 211 of the Tax Court Modernization Act.

"(D) SEPARATION FROM SERVICE.—With respect to a magistrate judge to whom this subsection applies, retirement under this section or

section 211 of the Tax Court Modernization Act is a separation from service for purposes of subchapters III and VII of chapter 84 of title 5, United States Code.

"(4) DEFINITIONS.—For purposes of this subsection, the terms 'retirement' and 'retire' include removal from office under section 7443A(a)(2) on the sole ground of mental or physical disability.

"(5) OFFSET.—In the case of a magistrate judge who receives a distribution from the Thrift Savings Fund and who later receives an annuity under this section, that annuity shall be offset by an amount equal to the amount which represents the Government's contribution to that person's Thrift Savings Account, without regard to earnings attributable to that amount. Where such an offset would exceed 50 percent of the annuity to be received in the first year, the offset may be divided equally over the first 2 years in which that person receives the annuity.

"(6) EXCEPTION.—Notwithstanding clauses (i) and (ii) of paragraph (3)(C), if any magistrate judge retires under circumstances making such magistrate judge eligible to make an election under subsection (b) of section 8433 of title 5, United States Code,

and such magistrate judge's nonforfeitable account balance is less than an amount that the Executive Director of the Office of Personnel Management prescribes by regulation, the Executive Director shall pay the nonforfeitable account balance to the participant in a single payment.".

(b) CONFORMING AMENDMENT.—The table of section for part I of subchapter C of chapter 76 is amended by inserting after the item relating to section 7443A the following new item:

"Sec. 7443B. Retirement for magistrate judges of the Tax Court.".

SEC. 211. INCUMBENT MAGISTRATE JUDGES OF THE TAX COURT.

(a) RETIREMENT ANNUITY UNDER TITLE 5 AND SECTION 7443B OF THE INTERNAL REVENUE CODE OF 1986.—A magistrate judge of the United States Tax Court in active service on the date of the enactment of this Act shall, subject to subsection (b), be entitled, in lieu of the annuity otherwise provided under the amendments made by this title, to—

(1) an annuity under subchapter III of chapter 83, or under chapter 84 (except for subchapters III and VII), of title 5, United States Code, as the case may be, for creditable service before the date on

which service would begin to be credited for purposes of paragraph (2), and

(2) an annuity calculated under subsection (b) or (c) and subsection (g) of section 7443B of the Internal Revenue Code of 1986, as added by this Act, for any service as a magistrate judge of the United States Tax Court or special trial judge of the United States Tax Court but only with respect to service as such a magistrate judge or special trial judge after a date not earlier than 9½ years prior to the date of the enactment of this Act (as specified in the election pursuant to subsection (b)) for which deductions and deposits are made under subsections (j) and (k) of such section 7443B, as applicable, without regard to the minimum number of years of service as such a magistrate judge of the United States Tax Court, except that—

(A) in the case of a magistrate judge who retired with less than 8 years of service, the annuity under subsection (c) of such section 7443B shall be equal to that proportion of the salary being received at the time the magistrate judge leaves office which the years of service bears to 14, subject to a reduction in accordance with subsection (c) of such section 7443B

if the magistrate judge is under age 65 at the time he or she leaves office, and

(B) the aggregate amount of the annuity initially payable on retirement under this subsection may not exceed the rate of pay for the magistrate judge which is in effect on the day before the retirement becomes effective.

(b) FILING OF NOTICE OF ELECTION.—A magistrate judge of the United States Tax Court shall be entitled to an annuity under this section only if the magistrate judge files a notice of that election with the chief judge of the United States Tax Court specifying the date on which service would begin to be credited under section 7443B of the Internal Revenue Code of 1986, as added by this Act, in lieu of chapter 83 or chapter 84 of title 5, United States Code. Such notice shall be filed in accordance with such procedures as the chief judge of the United States Tax Court shall prescribe.

(c) LUMP-SUM CREDIT UNDER TITLE 5.—A magistrate judge of the United States Tax Court who makes an election under subsection (b) shall be entitled to a lump-sum credit under section 8342 or 8424 of title 5, United States Code, as the case may be, for any service which is covered under section 7443B of the Internal Revenue Code of 1986, as added by this Act, pursuant to that

election, and with respect to which any contributions were made by the magistrate judge under the applicable provisions of title 5, United States Code.

(d) RECALL.—With respect to any magistrate judge of the United States Tax Court receiving an annuity under this section who is recalled to serve under section 7443C of the Internal Revenue Code of 1986, as added by this Act—

(1) the amount of compensation which such recalled magistrate judge receives under such section 7443C shall be calculated on the basis of the annuity received under this section, and

(2) such recalled magistrate judge of the United States Tax Court may serve as a reemployed annuitant to the extent otherwise permitted under title 5, United States Code.

Section 7443B(m)(4) of the Internal Revenue Code of 1986, as added by this Act, shall not apply with respect to service as a reemployed annuitant described in paragraph (2).

SEC. 212. PROVISIONS FOR RECALL.

(a) IN GENERAL.—Part I of subchapter C of chapter 76, as amended by this Act, is amended by inserting after section 7443B the following new section:

"SEC. 7443C. RECALL OF MAGISTRATE JUDGES OF THE TAX COURT.

"(a) RECALLING OF RETIRED MAGISTRATE JUDGES.—Any individual who has retired pursuant to section 7443B or the applicable provisions of title 5, United States Code, upon reaching the age and service requirements established therein, may at or after retirement be called upon by the chief judge of the Tax Court to perform such judicial duties with the Tax Court as may be requested of such individual for any period or periods specified by the chief judge; except that in the case of any such individual—

"(1) the aggregate of such periods in any 1 calendar year shall not (without such individual's consent) exceed 90 calendar days, and

"(2) such individual shall be relieved of performing such duties during any period in which illness or disability precludes the performance of such duties.

Any act, or failure to act, by an individual performing judicial duties pursuant to this subsection shall have the same force and effect as if it were the act (or failure to act) of a magistrate judge of the Tax Court.

"(b) COMPENSATION.—For the year in which a period of recall occurs, the magistrate judge shall receive, in addition to the annuity provided under the provisions

of section 7443B or under the applicable provisions of title 5, United States Code, an amount equal to the difference between that annuity and the current salary of the office to which the magistrate judge is recalled. The annuity of the magistrate judge who completes that period of service, who is not recalled in a subsequent year, and who retired under section 7443B, shall be equal to the salary in effect at the end of the year in which the period of recall occurred for the office from which such individual retired.

"(c) RULEMAKING AUTHORITY.—The provisions of this section may be implemented under such rules as may be promulgated by the Tax Court.".

(b) CONFORMING AMENDMENT.—The table of sections for part I of subchapter C of chapter 76, as amended by this Act, is amended by inserting after the item relating to section 7443B the following new item:

"Sec. 7443C. Recall of magistrate judges of the Tax Court.".

SEC. 213. EFFECTIVE DATE.

Except as otherwise provided, the amendments made by this title shall take effect on the date of the enactment of this Act.