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ENERGY TAX INCENTIVES ACT OF 2002

MARCH 1, 2002.—Ordered to be printed

Mr. BAUCUS, from the Committee on Finance, submitted the following

R E P O R T

[To accompany S. 1979]

[Including cost estimate of the Congressional Budget Office]

The Committee on Finance reported an original bill (S. 1979) to provide energy tax incentives, having considered the same, reports favorably thereon and recommends that the bill do pass.

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I. LEGISLATIVE BACKGROUND

The Senate Committee on Finance marked up an original bill, S. 1979 (the "Energy Tax Incentives Act of 2002"), on February 13, 2002, and, with a quorum present, ordered the bill favorably reported by a unanimous voice vote on that date.

The Committee held a series of hearings in 2001 to consider the role of tax incentives in energy policy. The first hearing, on July 10, 2001, addressed alternative vehicles and fuels and tax incentives to encourage their development. The second hearing, on July 11, 2001, considered incentives for domestic production of conventional fuels and development of alternative and renewable energy sources. The third hearing, in Billings, Montana, on August 24, 2001, addressed rural energy needs and how energy tax incentives might address those needs.[1] A fourth hearing on electric utility restructuring was scheduled for September 12, 2001, but was cancelled after the September 11, 2001 terrorist attacks.

II. EXPLANATION OF THE BILL

TITLE I. RENEWABLE ENERGY

A. EXTENSION AND MODIFICATION OF THE SECTION 45 ELECTRICITY PRODUCTION CREDIT

(Secs. 101–104 of the bill and sec. 45 of the Code)

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 1.7 cents per kilowatt hour for 2001. 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, 2002, to electricity produced by a closed-loop biomass facility placed in service after December 31, 1992, and before January 1, 2002, and to a poultry waste facility placed in service after December 31, 1999, and before January 1, 2002. 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

[1] See S. Hrg. 107–267 and S. Hrg. 107–192.

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).

REASONS FOR CHANGE

The Committee recognizes that the section 45 production credit has fostered additional electricity generation capacity in the form of non-polluting wind power. The Committee believes it is important to continue this tax credit by extending the placed in service date for such facilities to bring more wind energy to the United States electric grid. The Committee also believes it is important to extend the placed in service date for closed-loop biomass facilities and poultry waste facilities to give those potential fuel sources an opportunity in the market place. The Committee also believes it is appropriate to include in qualifying facilities those facilities that co-fire closed-loop biomass fuels with coal.

Based on the success of the section 45 credit in the development of wind power as an alternative source of electricity generation, the committee further believes the country will benefit from the expansion of the production credit to certain other "environmentally friendly" sources of electricity generation such as swine and bovine waste nutrients, geothermal power, solar power, and open-loop biomass. While open-loop biomass facilities are not pollution free, they do address environmental concerns related to waste disposal. In addition, these potential power sources further diversify the nation's energy supply.

Because tax-exempt persons such as public power systems and cooperatives provide a significant percentage of electricity in the United States, the Committee believes it is important to provide the incentive for production from renewable resources to these persons in addition to taxable persons.

Lastly, the Committee believes that certain pre-existing facilities should qualify for the section 45 production credit, albeit at a reduced rate. These facilities previously received explicit subsidies, or implicit subsidies provided through rate regulation. In a deregulated electricity market, these facilities, and the environmental benefits they yield, may be uneconomic without additional economic incentive. The Committee believes the benefits provided by

such existing facilities warrant their inclusion in the section 45 production credit.

EXPLANATION OF PROVISION

The provision 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 provision also defines four new qualifying energy resources: open-loop biomass, swine and bovine waste nutrients, geothermal energy, and solar energy. Open-loop 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 residues, precommercial thinnings, slash, and brush, but not including old-growth timber (other than old growth timber that has been permitted or contracted for removal by appropriate Federal authority under the National Environmental Policy Act or appropriate State law authority). 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 open-loop biomass does not include municipal solid waste (garbage), gas derived from biodegradation of solid waste, or paper that is commonly recycled. Swine and bovine waste nutrients are defined as swine and bovine manure and litter, including bedding material for the disposition of manure. 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).

Qualifying open-loop biomass facilities are facilities using open-loop biomass to produce electricity that are placed in service prior to January 1, 2005. Qualifying swine and bovine waste nutrient facilities are facilities using swine and bovine waste nutrients to produce electricity that are placed in service after the date of enactment and before January 1, 2007. 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 open-loop biomass facilities, taxpayers may claim the otherwise allowable credit for a three-year period. For a facility placed in service after the date of enactment, the three-year period commences when the facility is placed in service. In the case of open-loop biomass facility originally placed in service before the date of enactment, the three-year period commences after December 31, 2002 and the otherwise allowable 1.5 cent-per-kilowatt-hour credit (adjusted for inflation) is reduced to 1.0 cent-per-kilowatt-hour credit (adjusted for inflation). In the case of

qualifying geothermal energy and solar energy facilities, taxpayers may claim the otherwise allowable credit for the five-year period commencing when the facility is placed in service.

The provision 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 before January 1, 2007. The taxpayer may claim credit for all electricity produced at such qualifying facilities with no reduction for the thermal value of the coal.

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, the provision permits a lessee operator to claim the credit in lieu of the owner of the facilities.

The provision 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 trades 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.

Lastly, the provision 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.

EFFECTIVE DATE

The provision 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, 2003.

TITLE 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

(Secs. 201–205 of the bill and sec. 30 and 179A of the Code and new Code secs. 30B, 30C, and 40A)

PRESENT LAW

A 10-percent tax credit is provided for the cost of a qualified electric vehicle, up to a maximum credit of $4,000 (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 2002 through 2004, and is unavailable for purchases

after December 31, 2004. There is no carry forward or carryback of the credit for electric vehicles.

Certain costs of qualified clean-fuel vehicle property and clean-fuel vehicle refueling property 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, or 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.

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 phases down in the years 2002 through 2004, and is unavailable for purchases after December 31, 2004.

REASONS FOR CHANGE

The Committee believes that further investments in alternative fuel and advanced technology vehicles are necessary to transform automotive transportation in the United States to be cleaner, more fuel efficient, and less reliant on petroleum fuels.

Tax benefits provided directly to the consumer to lower the cost of new technology and alternative-fueled vehicles can help lower consumer resistance to these technologies by making the vehicles more price competitive with purely petroleum-based fuel vehicles and creating increased demand for manufacturers to produce the technologies. The eventual goal is mass production and mass market acceptance of new technology vehicles. No one technology has established that it alone provides the solution. Therefore, it is appropriate to provide tax benefits tailored to specific vehicle technologies, as long as the vehicle's engine technology directly replaces gasoline and diesel fuel with an alternative energy source.

The Committee expects that hybrid motor vehicles and dedicated alternative fuel vehicles are the near-term technological advancement that will replace gasoline- and diesel-burning engines with alternative-powered engines, and electrical and fuel cell vehicles will be the long-term technological advancement.

Applying these technologies to medium and heavy-duty trucks and buses is also important for transforming the transportation sector to a cleaner, more fuel efficient sector less reliant on petroleum-based fuels. Therefore, it is appropriate to use tax incentives to encourage the introduction of advanced vehicle technologies in large trucks and buses.

In addition, because new vehicle technologies require new fuels and infrastructure to deliver those fuels, investments in new technology automobiles alone are not sufficient to transform the market to accept these vehicles. Therefore, substantial investments in new refueling stations and new fuels are also necessary to make alternative vehicle technologies feasible.

EXPLANATION OF PROVISION

Alternative motor vehicle credits

The provision provides a credit to the taxpayer for the purchase of a new qualified fuel cell motor vehicle, a new qualified alternative fuel motor vehicle, and a new qualified hybrid motor vehicle. In general, the credit amount is determined by calculation of a base credit for attainment of a particular technology and an additional credit if the vehicle attains certain improvements in fuel economy or complies with an emissions standard in advance of the date the standard goes into effect. 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 or carry unused credits back for three years (but not carried back to taxable years beginning before October 1, 2002). In the case of property purchased by tax-exempt persons, the seller may claim the credit. In addition to the specifications described below, a qualifying vehicle must meet certain emissions standards.

Fuel cell motor vehicles

The base credit for the purchase of new qualified fuel cell motor vehicles ranges between $4,000 and $40,000 depending upon the weight class of the vehicle. For automobiles and light trucks, the otherwise allowable credit amount ($4,000) is increased by an amount from $1,000 to $4,000 if the vehicle meets certain fuel economy increases compared to a stated standard.[2] Credit may not be claimed for qualified fuel cell motor vehicles purchased after December 31, 2011. The taxpayer's basis in the property is reduced by the amount of credit claimed.

Hybrid motor vehicles

The base credit for the purchase of a new qualified hybrid motor vehicle ranges from $250 to $10,000 depending upon the weight of the vehicle and the maximum power available from the vehicle's rechargeable energy storage system.[3] For automobiles and light trucks, the otherwise allowable credit amount ($250 to $1,000) is increased by an amount from $500 to $3,000 if the vehicle meets certain fuel economy increases. For heavy duty hybrid motor vehicles, the otherwise allowable credit ($1,000 to $10,000) is increased

[2] The fuel efficiency comparison of fuel cell vehicles is to be made on the basis of Btu equivalent measures of the fuel utilized in the fuel cell to one gallon of gasoline.

[3] In the case of an electric rechargeable energy storage system consisting of a battery pack, the percentage of maximum available power is the electrical power verified by the 10 second discharge test divided by the sum of the electric power plus the SAE net engine power for the conventional engine. In order to determine this percentage for any vehicle, the manufacturer shall need to document both SAE net engine power and verification of the net electric power of the battery pack over a 10–second discharge. The constant power discharge applied for this verification is the same experienced by the battery during nominal operating conditions in the vehicle as specified by the manufacturer (i.e., the battery capability as limited by the electric motor, power electronics and/or control logic on the vehicle as applicable).

depending upon the vehicle's weight and provided the vehicle meets certain 2007 (and beyond) emissions standards. The amount of credit is increased by between $3,500 and $14,000 for vehicles placed in service in 2002; is increased by between $3,000 and $12,000 for vehicles placed in service in 2003, is increased by between $2,500 and $10,000 for vehicles placed in service in 2004, is increased by between $2,000 and $8,000 for vehicles placed in service in 2005, and is increased by between $1,500 and $6,000 for vehicles placed in service in 2006. Credit may not be claimed for qualified hybrid motor vehicles purchased after December 31, 2006. The taxpayer's basis in the property is reduced by the amount of credit claimed.

Alternative fuel motor vehicles

The base credit for the purchase of a new alternative fuel motor vehicle equals 40 percent of the incremental cost of such vehicle. The otherwise allowable credit for 40 percent of the incremental cost is increased by an additional 30 percent of the incremental cost of the vehicle if the vehicle meets certain emissions standards. For computation of the credit, the incremental cost of the vehicle may not exceed between $5,000 and $40,000 (resulting in a maximum total credit of between $3,500 and $28,000) depending upon the weight of the vehicle. For this purpose, incremental cost generally is defined as the amount of the increase of the manufacturer's suggested retail price of such a vehicle compared to the manufacturer's suggested retail price of a comparable gasoline or diesel model. 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). 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.

Taxpayers purchasing certain mixed-fuel vehicles also may claim the alternative fuel motor vehicle credit, at a reduced rate. A mixed-fuel vehicle is a vehicle with gross weight of seven tons or more and is certified by the manufacturer as being able to operate on a combination of alternative fuel and a petroleum-based fuel. A qualifying mixed-fuel vehicle must use at least 75 percent alternative fuel (a "75/25 mixed-fuel vehicle") or 90 percent alternative fuel (a "90/10 mixed-fuel vehicle") and be incapable of operating on a mixture containing less than 75 percent alternative fuel in the case of a 75/25 vehicle (less than 90 percent alternative fuel in the case of a 90/10 vehicle). A taxpayer purchasing a 75/25 mixed-fuel vehicle may claim 70 percent of the otherwise allowable credit. A taxpayer purchasing a 90/10 mixed-fuel vehicle may claim 90 percent of the otherwise allowable credit.

Credit may not be claimed for qualified alternative fuel motor vehicles purchased after December 31, 2006. The taxpayer's basis in the property is reduced by the amount of credit claimed.

Modification of credit for qualified electric vehicles

The provision modifies the present-law credit for electric vehicles to provide that the credit for qualifying vehicles generally ranges between $3,500 and $40,000 depending upon the weight of the ve-

hicle and, for certain vehicles, the driving range of the vehicle. In the case of property purchased by tax-exempt persons, the seller may claim the credit. The taxpayer would be ineligible for the deduction allowable under present-law section 179A for a qualified battery electric vehicle on which a credit is allowable. The provision also extends the expiration date of the credit from December 31, 2004 to December 31, 2006 and would repeal the phaseout schedule of present law. The taxpayer would be able to carry forward unused credits for 20 years or carry unused credits back for three years (but not carried back to taxable years beginning before October 1, 2002).

Extension of present-law section 179A

The provision extends the deduction for costs of qualified clean-fuel vehicle property and clean-fuel vehicle refueling property through December 31, 2006. The phase-down of present law for clean fuel vehicles would be modified such that the taxpayer may claim 75 percent of the otherwise allowable deduction in 2003 and 2004, 50 percent of the otherwise allowable deduction in 2005, and 25 percent of the otherwise allowable deduction in 2006.

Credit for installation of alternative fueling stations

The provision permits taxpayers to claim a 50–percent credit for the cost of installing clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer. In the case of retail clean-fuel vehicle refueling property the allowable credit may not exceed $30,000. In the case of residential clean-fuel vehicle refueling property the allowable credit may not exceed $1,000. 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, 2007. 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 provision permits taxpayers to claim a credit equal to the gasoline gallon equivalent of 30 cents per gallon of alternative fuel sold in 2002 and 2003, 40 cents per gallon in 2004, and 50 cents per gallon thereafter. Qualifying alternative fuels are compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, any liquid mixture consisting of at least 85 percent methanol, and any liquid mixture consisting of at least 85 percent 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 provision, the credit is part of the general business credit.

EFFECTIVE DATE

The provisions 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 September 30, 2002, in taxable years ending after September 30, 2002. The credit for retail sales of alternative fuels is effective for sales of fuels after September 30, 2002, in taxable years ending after September 30, 2002.

B. Modifications to Small Producer Ethanol Credit

(Sec. 206 of the bill and secs. 38, 40, 87 and 469 of the Code)

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 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)).

REASONS FOR CHANGE

The Committee believes provisions allowing greater flexibility in utilizing the benefits of the small ethanol producer credit are consistent with the objective of the bill to increase availability of alternative fuels.

EXPLANATION OF PROVISION

The provision makes several modifications to the rules governing the small producer ethanol credit. First, the provision liberalizes the definition of an eligible small producer to include persons whose production capacity does not exceed 60 million gallons. Second, the provision 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 coopera-

tive 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 provision 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 provision allows the small producer credit to be claimed against the alternative minimum tax. Finally, the provision 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 provision is effective for taxable years beginning after date of enactment.

C. TRANSFER FULL AMOUNT OF EXCISE TAX IMPOSED ON GASOHOL TO THE HIGHWAY TRUST FUND

(Sec. 207 of the bill and sec. 9503 of the Code)

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 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 53-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.

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. The balance of the reduced rate (less the LUST rate) is deposited in the Highway Trust Fund.

REASONS FOR CHANGE

The Committee believes that it is appropriate that the entire amount of alcohol fuel taxes be devoted to the Highway Trust Fund.

EXPLANATION OF PROVISION

The provision transfers the 2.5 cents per gallon of excise tax on gasohol that currently is retained in the General Fund to the Highway Trust Fund.

EFFECTIVE DATE

The proposal would be effective on taxes imposed after September 31, 2003.

D. Modify Income Tax and Excise Tax Rules Governing Treatment of ETBE

(Sec. 208 of the bill and secs. 40 and 4081 of the Code)

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 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 53-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.

REASONS FOR CHANGE

The Committee believes the tax benefits currently available to ethanol used in the production of ETBE should be clarified. The provision will simplify significantly the current regulatory rules under which the alcohol fuels credit may be claimed for alcohol used in the production of ETBE.

EXPLANATION OF PROVISION

The provision 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 will accrue 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 provision is effective for fuels blended after date of enactment.

E. INCOME TAX CREDIT AND EXCISE TAX RATE REDUCTION FOR BIODIESEL FUEL MIXTURES

(Sec. 209 of the bill and new sec. 40B of the Code)

PRESENT LAW

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

However, a 53-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 53-cents-per-gallon rate is scheduled to decline to 51 cents per gallon in two steps, beginning in calendar years 2003 and 2005. 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.

REASONS FOR CHANGE

The Committee believes that providing a new income tax credit for biodiesel fuel will promote energy self-sufficiency and also is consistent with the environmental objectives of the bill.

EXPLANATION OF PROVISION

A new income tax credit is provided for biodiesel fuel mixtures. The structure of the new credit is similar to structure of the present-law alcohol fuels credit. Biodiesel is defined as virgin vegetable oils derived from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, or mustard seeds and meeting the requirements of the Environmental Protection Agency under section 211 of the Clean Air Act (42 U.S.C. 7545) and the American Society of Testing and Materials D6751. The per gallon biodiesel credit rate 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.

As with the present-law alcohol fuels credit, the biodiesel fuel mixture credit can be claimed as a reduction in excise tax paid on these mixtures. Also, like the present-law alcohol fuels credit, the amount of the biodiesel fuel mixture credit is includible in income.

The provision further provides for transfers to the Highway Trust Fund from the funds of the Commodity Credit Corporation of amounts equivalent to the reduction in receipts to the Trust Fund resulting from the excise tax rate reduction allowed under the provision.

EFFECTIVE DATE

The biodiesel fuel mixture credit (and excise tax rate reductions) is effective for biodiesel fuel blended after December 31, 2002, and before January 1, 2006.

TITLE III. CONSERVATION AND ENERGY EFFICIENCY PROVISIONS

A. BUSINESS CREDIT FOR CONSTRUCTION OF NEW ENERGY-EFFICIENT HOMES

(Sec. 301 of the bill and new sec. 45G of the Code)

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.

REASONS FOR CHANGE

The Committee recognizes that residential energy use for heating and cooling represents a large share of national energy consumption, and accordingly believes that measures to reduce heating and cooling energy requirements have the potential to substantially reduce national energy consumption. The Committee further recognizes that the most cost-effective time to properly insulate a home is when it is under construction and that the most effective mechanism to encourage the utilization of energy-efficient components in the construction of new homes is through an incentive to the builder. Accordingly, the Committee believes that a tax credit for the use of energy-efficiency components in a home's envelope (exterior windows (including skylights) and doors and insulation) or heating and cooling appliances will encourage contractors to produce highly energy-efficient homes, which in turn will reduce national energy consumption. Reduced energy consumption will in turn reduce reliance on foreign suppliers of oil and will reduce pollution in general.

EXPLANATION OF PROVISION

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 $1,250 ($2,000) in the case of a new home which 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 credit. The home may be certified according to a component-based method or an energy performance based method.

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 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.

B. TAX CREDIT FOR ENERGY-EFFICIENT APPLIANCES

(Sec. 302 of the bill and new sec. 45H of the Code)

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.

REASONS FOR CHANGE

The Committee believes that providing a tax credit for the production of energy-efficient clothes washers and refrigerators will

encourage manufacturers to produce such products currently and to invest in technologies to achieve higher energy-efficiency standards for the future. In addition, the Committee intends to encourage those manufacturers already producing energy-efficient clothes washers and refrigerators to accelerate production.

EXPLANATION OF PROVISION

The bill 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 1.26 or greater and for refrigerators produced 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 1.42 or greater (1.5 or greater for washers produced after 2004) and for refrigerators produced that consume 15 percent less kilowatt-hours per year than the energy conservation standards promulgated by the Department of Energy that took effect on July 1, 2001. 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 (i.e., 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), only production in excess of average production for each such category during calendar years 1999–2001 would be eligible for the credit. The taxpayer may not claim credits in excess of $30 million for all taxable years for appliances that qualify for the $50 credit, and may not claim credits in excess of $30 million for all taxable years for appliances that qualify for the $100 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 December 31, 2002 and prior to (1) January 1, 2005 in the case of refrigerators that only meet the 10 percent credit standard, or (2) January 1, 2007 in the case of all other qualified energy-efficient appliances.

C. Credit for Residential Energy Efficient Property

(Sec. 303 of the bill and new sec. 25C of the Code)

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.

REASONS FOR CHANGE

The Committee believes that allowing a credit for the purchase of certain energy efficient appliances and systems that generate electricity through renewable and pollution-free alternative energy sources will encourage the purchase of these products. The Committee believes that the use of these products will help reduce reliance on conventional energy sources and reduce atmospheric pollutants. The Committee believes that the on-site generation of electricity and solar hot water will reduce reliance on the United States' electricity grid and on natural gas pipelines. Furthermore, the Committee believes that the use of highly efficient residential equipment will lead to decreased energy consumption in households, resulting in significant energy savings.

EXPLANATION OF PROVISION

The bill 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 1 kilowatt 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 heat pumps with a coefficient of performance for heating of at least 1.25 and for cooling of at least 0.70. The maximum credit is $500 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.

EFFECTIVE DATE

The credit applies to purchases after December 31, 2002 and before January 1, 2008.

D. Business Tax Incentives for Fuel Cells

(Sec. 304 of the bill and sec. 48 of the Code)

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.

REASONS FOR CHANGE

The Committee believes that investments in qualified fuel cell power plants represent a promising means to produce electricity through non-polluting means and from nonconventional energy sources. Furthermore, the on-site generation of electricity provided by fuel cell power plants will reduce reliance on the United States' electricity grid. The Committee believes that providing a tax credit for investment in qualified fuel cell power plants will encourage investments in such systems.

EXPLANATION OF PROVISION

The bill provides a 30 percent business energy credit for the purchase of qualified stationary or portable fuel cell power plants for businesses. A qualified stationary 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. A qualified portable fuel cell is a portable fuel cell that generates at least 1 kilowatt of electricity using an electrochemical process. The credit for any fuel cell may not exceed $1,000 for each kilowatt of capacity. The credit is nonrefundable. The taxpayer's basis in the property is reduced by the amount of the credit claimed.

EFFECTIVE DATE

The credit for businesses applies to property placed in service after December 31, 2002 and before January 1, 2007, 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

(Sec. 305 of the bill and new sec. 179B of the Code)

PRESENT LAW

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

REASONS FOR CHANGE

The Committee recognizes that commercial buildings consume a significant amount of energy resources and that reductions in commercial energy use have the potential to significantly reduce national energy consumption. Accordingly, the Committee believes that a special deduction for commercial building property (lighting, heating, cooling, ventilation, and hot water supply systems) that meets a high energy-efficiency standard will encourage construction of buildings that are significantly more energy efficient than the norm. The Committee further believes that the special deduction will encourage innovation to reduce the costs of meeting the energy-efficiency standard.

EXPLANATION OF PROVISION

The bill 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 are otherwise be 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. The deduction is allowed in the year in which the property is placed in service.

Energy-efficient commercial building property mean 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 90.1–1999 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America. Certain certification requirements must be met in order to qualify for the deduction. The Secretary shall promulgate procedures for the inspection and testing of compliance for buildings. 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 will apply.

EFFECTIVE DATE

The provision is effective for taxable years beginning after October 1, 2002 for plans certified prior to December 31, 2007, whose construction is completed on or before December 31, 2009.

F. Allowance of Deduction for Qualified Energy Management Devices and Retrofitted Qualified Meters

(Sec. 306 of the bill and new sec. 179C of the Code)

PRESENT LAW

No special deduction is currently provided for expenses incurred for qualified energy management devices.

REASONS FOR CHANGE

The Committee believes that consumers could better manage their electricity and natural gas use if they had better information concerning its price. In the case of electricity, if time-of-day pricing is used, energy management devices that provide information to consumers regarding their peak electrical use and the time-of-day price variation could encourage consumers to defer certain electrical use, such as use of a clothes washer and dryer, to periods of the day when electricity prices are lower. In addition to reducing

consumers' electricity bill, spreading the demand for electricity throughout the day will reduce the need for utility investments in generation capacity to satisfy peak demand periods.

The Committee believes that a deduction for qualified energy management devices, in conjunction with a 3-year recovery period for qualified energy management devices provided in the bill, will provide sufficient incentive to encourage their adoption as a means for consumers to control electricity and natural gas usage.

EXPLANATION OF PROVISION

The bill provides a $30 deduction for each qualified new or retrofitted energy management device placed in service by any taxpayer who is a supplier of electric energy or natural gas or is a provider of electric energy or natural gas services. A qualified energy management device is any tangible property eligible for accelerated depreciation under section 168 and which is acquired and used by the taxpayer to enable consumers or others to manage their purchase, sale, or use of electricity in response to energy price and usage signals and which permits reading of energy price and usage signals on at least a daily basis.

The deduction is not allowed to property used outside of the United States. The taxpayer would have basis reduction for such property equal to the deduction. Other rules apply.

EFFECTIVE DATE

The proposal is effective for any qualified energy management device placed in service after the date of enactment of the Act.

G. Three-Year Applicable Recovery Period for Depreciation of Qualified Energy Management Devices

(Sec. 307 of the bill and sec. 168 of the Code)

PRESENT LAW

No special recovery period is currently provided for depreciation of qualified energy management devices.

REASONS FOR CHANGE

The Committee believes that consumers could better manage their electricity and natural gas costs if they had better information concerning the price of electricity and natural gas use. In the case of electricity, if time-of-day pricing is used, energy management devices that provide information to consumers regarding their peak electrical use and the time-of-day price variation could encourage consumers to defer certain electrical use, such as use of a clothes washer and dryer, to periods of the day when electricity prices are lower. In addition to reducing consumers' electricity bill, spreading the demand for electricity throughout the day will reduce the need for utility investments in generation capacity to satisfy peak demand periods.

The Committee believes that a 3-year recovery period for qualified energy management devices, in conjunction with the special deduction for qualified energy management devices provided in the bill, will provide sufficient incentive to encourage their adoption as a means for consumers to control electricity and natural gas usage.

EXPLANATION OF PROVISION

The bill provides a three-year recovery period for qualified new or retrofitted energy management devices placed in service by any taxpayer who is a supplier of electric energy or natural gas or is a provider of electric energy or natural gas services. A qualified energy management device is any tangible property eligible for accelerated depreciation under code section 168 and which is acquired and used by the taxpayer to enable consumers or others to manage their purchase, sale, or use of electricity in response to energy price and usage signals and which permits reading of energy price and usage signals on at least a daily basis.

EFFECTIVE DATE

The provision is effective for any qualified energy management device placed in service after the date of enactment of the Act.

H. Energy Credit for Combined Heat and Power System Property

(Sec. 308 of the bill and sec. 48 of the Code)

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.

REASONS FOR CHANGE

The Committee believes that investments in combined heat and power systems represent a promising means to achieve greater national energy efficiency by encouraging the dual use of the energy from the burning of fossil fuels. Furthermore, the on-site generation of electricity provided by CHP systems will reduce reliance on

the United States' electricity grid. The Committee believes that providing a tax credit for investment in combined heat and power property will encourage investments in such systems.

EXPLANATION OF PROVISION

The bill provides a 10 percent credit for the purchase of combined heat and power property. ("CHP 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.)

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 December 31, 2002 and before January 1, 2007.

I. CREDIT FOR ENERGY EFFICIENCY IMPROVEMENTS TO EXISTING HOMES

(Sec. 309 of the bill and new sec. 25D of the Code)

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.

REASONS FOR CHANGE

Since residential energy consumption represents a large fraction of national energy use, the Committee believes that energy savings in this sector of the economy have the potential to significantly impact national energy consumption, which will reduce reliance on foreign suppliers of oil and reduce pollution in general. The Committee further recognizes that many existing homes are inadequately insulated. Accordingly, the Committee believes that a tax credit for certain energy-efficiency improvements related to a home's envelope (exterior windows (including skylights) and doors, insulation, and certain roofing systems) will encourage homeowners to improve the insulation of their homes, which in turn will reduce national energy consumption.

EXPLANATION OF PROVISION

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. 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 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, 2006.

TITLE IV. CLEAN COAL INCENTIVES

A. INVESTMENT AND PRODUCTION CREDITS FOR CLEAN COAL TECHNOLOGY

(Secs. 401, 411–412, and 421 of the bill and new Code secs. 45I, 45J, and 48A)

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, 2002 (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 equals 1.7 cents for 2001. 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)).

REASONS FOR CHANGE

The Committee recognizes that coal is the nation's most abundant fuel source. The Committee is also sensitive to the environmental impact of burning coal for the production of electricity. For coal to continue to be a viable fuel source, the Committee seeks to encourage ways to burn coal in a more efficient and environmentally friendly manner. Therefore, the Committee supports the development and deployment of the most advanced technologies for generating electricity from coal by providing investment and production credits to a limited number of experimental production-scale electricity generating units to reduce the cost of building and operating units that represent the frontier of thermal efficiency and pollution control.

Tax-exempt organizations make up a significant percentage of the electricity industry in the United States. The Committee believes it is important to provide the incentives for investment in, and production from, clean coal technologies to all producers.

DESCRIPTION OF PROVISION

In general

The provision 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 trades are not permitted.

Credit for investments in qualifying advanced clean coal technology units

The provision provides a 10-percent investment tax credit for qualified investments in advanced clean coal technology units.[4] Qualifying advanced clean coal technology units must utilize advanced pulverized coal or atmospheric fluidized bed combustion technology, pressurized 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.

If the advanced clean coal technology unit is an advanced pulverized coal or atmospheric fluidized bed combustion technology unit, a pressurized fluidized bed combustion technology unit, or an integrated gasification combined cycle technology unit and if the unit uses a design coal with a heat content of not more than 9,000 Btu per pound, the unit must have a carbon emission rate less than 0.60 pound of carbon per kilowatt hour of electricity produced. If the advanced clean coal technology unit is an advanced pulverized coal or atmospheric fluidized bed combustion technology unit, a pressurized fluidized bed combustion technology unit, or an integrated gasification combined cycle technology unit and if the unit uses a design coal with a heat content greater than 9,000 Btu per pound, the unit must have a carbon emission rate less than 0.54 pound of carbon per kilowatt hour of electricity produced. In the case of an advanced clean coal technology unit that uses another eligible technology and if the unit uses a design coal with a heat content of not more than 9,000 Btu per pound, the unit must have a carbon emission rate less than 0.51 pound of carbon per kilowatt hour of electricity produced. In the case of an advanced clean coal technology unit that uses another eligible technology and if the unit uses a design coal with a heat content greater than 9,000 Btu

[4] A qualifying advanced clean coal unit does not include any unit that uses "refined coal" (as defined elsewhere in the bill). Nor, can the unit be a qualified clean coal technology unit as defined below.

per pound, the unit must have a carbon emission rate less than 0.459 pound of carbon per kilowatt hour of electricity produced.

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 4,000 megawatts of electricity production capacity qualifies for the credit.[5] From the potential pool of 4,000 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 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. From the potential pool of 4,000 megawatts of capacity, not more than 2,000 megawatts in total and not more than 1,000 megawatts in years prior to 2009 and not more than 1,500 megawatts in year prior to 2013 shall be allocated to units using integrated gasification combined cycle technology, with or without fuel or chemical co-production. From the potential pool of 4,000 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 provision 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 produced and is indexed for inflation occurring after 2002 with the first potential adjustment in 2004. 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.

[5] If the Secretary grants a certificate for a megawattage allocation that is less than the rated megawatt capacity of the unit, the taxpayer may claim credit for expenses related to the percentage of the unit equal to the percentage of the Secretary's allocation compared to the unit's capacity.

Production credit for electricity produced from qualifying advanced clean coal technology

The provision 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.[6] 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.[7] 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. The value of the credit is indexed for inflation occurring after 2002 with the first potential adjustment in 2004. The tables below specify the value of the credit (before indexing is applied).

Advanced clean coal technology units producing solely electricity

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 8,400	$.0060	$.0038
More than 8,400 but not more than 8,550	.0025	.0010
More than 8,550 but less than 8,750	.0010	.0010

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

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

[6] 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.

[7] Each 3,413 Btu of heat content of the fuel or chemical is treated as equivalent to one kilowatt-hour of electricity.

Advanced clean coal technology units producing electricity and a fuel or chemical

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 39%	.0010	.0010

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 40.9%	.0075	.0055

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 provision relating to investment credits for advanced clean coal technology units is effective after the date of enactment. The provisions relating to production credits are effective after the date of enactment.

TITLE V. OIL AND GAS PROVISIONS

A. TAX CREDIT FOR OIL AND GAS PRODUCTION FROM MARGINAL WELLS

(Sec. 501 of the bill and new sec. 45K of the Code)

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.

REASONS FOR CHANGE

The highly volatile price of oil and gas can result in lost production during periods when prices are low. The Committee determined that a price support program administered through a tax

credit will help ensure that supply is not lost as a result of low market prices.

EXPLANATION OF PROVISION

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.

EFFECTIVE DATE

The provision is effective for production in taxable years beginning after the date of enactment.

B. Natural Gas Gathering Lines Treated as Seven-Year Property

(Sec. 502 of the bill and sec. 168 of the Code)

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.[8] 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., 7-year recovery period).[9] More recently, the U.S. District Court for the Eastern District of Michigan, Southern Division, held that natural gas gathering lines owned by

[8] 1987–2 C.B. 674 (as clarified and modified by Rev. Proc. 88–22, 1988–1 C.B. 785).
[9] *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).

nonproducers falls within the scope of Asset class 46.0 (i.e., 15-year recovery period).[10]

REASONS FOR CHANGE

The Committee believes the appropriate recovery period for natural gas gathering lines is seven years.

EXPLANATION OF PROVISION

The provision establishes a statutory 7-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 provision 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.

C. Repeal of Requirement of Certain Approved Terminals To Offer Dyed Diesel or Kerosene for Nontaxable Purposes

(Sec. 503 of the bill and sec. 4101 of the Code)

PRESENT AND PRIOR LAW

Excise taxes are imposed on highway motor fuels, including gasoline, diesel fuel, and kerosene, to finance the Highway Trust Fund programs. Subject to limited exceptions, these taxes are imposed on all such fuels when they are removed from registered pipeline or barge terminal facilities, with any tax-exemptions being accomplished by means of refunds to consumers of the fuel. One such exception allows removal of diesel fuel and kerosene without payment of tax if the fuel is destined for a nontaxable use (e.g., use as heating oil) and is indelibly dyed.

Terminal facilities are not permitted to receive and store non-tax-paid motor fuels unless they are registered with the Internal Revenue Service. Under present law, a prerequisite to registration is that if the terminal offers for sale diesel fuel, it must offer both dyed and undyed diesel fuel. Similarly, if the terminal offers for sale kerosene, it must offer both dyed and undyed kerosene. This "dyed-fuel mandate" was enacted in 1997, to be effective on July 1, 1998. Subsequently, the effective date was delayed until July 1, 2000 and delayed again through December 31, 2001.

[10] *Saginaw Bay Pipeline Co.* v. *United States,* 124 F. Supp. 2d 465 (E.D. Mich. 2001).

REASONS FOR CHANGE

When the rules governing taxation of kerosene used as a highway motor fuel were enacted in 1997, there was a concern that dyed kerosene (destined for nontaxable use) might not be available in markets where that fuel was commonly used (e.g., as heating oil). To ensure availability of untaxed kerosene for these uses, a requirement that terminals offer both dyed and undyed kerosene and diesel fuel (if they offered the fuels for sale at all) as a condition of receiving untaxed fuels was included. Since that time, markets have provided dyed kerosene and diesel fuel for nontaxable uses in markets where there is a demand for such fuel even in the absence of a statutory mandate for such fuels. The Committee believes that a statutory mandate is not necessary and should be repealed.

EXPLANATION OF PROVISION

The provision repeals the diesel fuel and kerosene-dyeing mandate.

EFFECTIVE DATE

The provision is effective on January 1, 2002.

D. Expensing of Capital Costs Incurred and Credit for Production in Complying With Environmental Protection Agency Sulfur Regulations

(Secs. 504 and 505 of the bill and new secs. 45L and 179D of the Code)

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.

REASONS FOR CHANGE

The Committee believes it is important for all refiners to meet applicable pollution control standards. However, the Committee is concerned that the cost of complying with the Highway Diesel Fuel Sulfur Control Requirement of the Environmental Protection Agency may force some small refiners out of business. To maintain this refining capacity and to foster compliance with pollution control standards the committee believes it is appropriate to modify cost recovery provisions for small refiners to reduce their capital costs of complying with the Highway Diesel Fuel Sulfur Control Requirement of the Environmental Protection Agency.

DESCRIPTION OF PROVISION

The bill 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 bill 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 one year 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 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 provision is effective for expenses paid or incurred after the date of enactment.

E. DETERMINATION OF SMALL REFINER EXCEPTION TO OIL DEPLETION DEDUCTION

(Sec. 506 of the bill and sec. 613A of the Code)

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.

REASONS FOR CHANGE

The Committee believes that the goal of present law, to identify producers without significant refining capacity, can be achieved while permitting more flexibility to refinery operations.

EXPLANATION OF PROVISION

The provision increases the current 50,000-barrel-per-day limitation to 60,000. In addition, the provision 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 would calculate 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 provision is effective for taxable years beginning after December 31, 2002.

F. EXTENSION OF SUSPENSION OF TAXABLE INCOME LIMIT WITH RESPECT TO MARGINAL PRODUCTION

(Sec. 507 of the bill and sec. 613A of the Code)

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.[11] 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,

[11] Treas. Reg. sec. 1.611–1(b)(1).

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.[12] 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") 613(a)). By contrast, for any other mineral qualifying for the percentage depletion deduction, 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, 2002.

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)).[13] 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.

[12] Sec. 613A.

[13] 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.

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,[14] 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.

REASONS FOR CHANGE

The Committee is concerned that, while current oil and gas operations may be profitable, the highly volatile nature of oil and gas prices could quickly create economic hardships in the industry. Thus, to help minimize the adverse effects of future price fluctuations, the Committee believes it is appropriate to extend the suspension of the 100-percent net-income limitation for marginal wells.

EXPLANATION OF PROVISION

The suspension of the 100-percent net-income limitation for marginal wells is extended an additional five years, through taxable years beginning before January 1, 2007.

EFFECTIVE DATE

The provision is effective on date of enactment for taxable years after December 31, 2001.

G. Amortization of Geological and Geophysical Expenditures

(Sec. 508 of the bill and new sec. 199 of the Code)

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.[15]

Courts have held that geological and geophysical costs are capital, and therefore are allocable to the cost of the property[16] acquired or retained.[17] The costs attributable to such exploration are

[14] This exception is limited to wells, the drilling of which began between September 30, 1978, and January 1, 1984.

[15] 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).

[16] "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.

[17] 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

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 [18] (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 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

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.

[18] 1977–1 C.B. 76.

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,[19] 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."

REASONS FOR CHANGE

The Committee believes that substantial simplification for taxpayers and significant gains in taxpayer compliance and reductions in administrative cost can be obtained by establishing that geological and geophysical costs can be amortized over two years, regardless of the taxpayer's determination of the suitability of the site or sites examined for future production.

EXPLANATION OF PROVISION

The provision allows geological and geophysical costs incurred in connection with oil and gas exploration in the United States to be amortized over two years.

EFFECTIVE DATE

The provision is effective for geological and geophysical costs paid or incurred in taxable years beginning after December 31, 2002. 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.

[19] 1983–2 C.B. 51.

H. Amortization of Delay Rental Payments

(Sec. 509 of the bill and new sec. 199A of the Code)

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.[20]

REASONS FOR CHANGE

The Committee believes that, in essence, a delay rental payment is a substitute, both in the eyes of the payor and the payee, for a royalty payment that would have been made had the property been brought into production. The Committee believes it appropriate to allow delay rental payments to be amortized over a two year period.

EXPLANATION OF PROVISION

The provision allows delay rental payments incurred in connection with the development of oil or gas within the United States to be amortized over two years.

EFFECTIVE DATE

The provision applies to delay rental payments paid or incurred in taxable years beginning after December 31, 2002. No inference is intended from the prospective effective date of this proposal as to the proper treatment of pre-effective date delay rental payments.

I. Extension and Modification of Credit for Producing Fuel From a Non-Conventional Source

(Secs. 510 and 511 of the bill and sec. 29 of the Code)

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) 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 Decem-

[20] 65 Fed. Reg. 6090 (2000).

ber 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).[21]

REASONS FOR CHANGE

The Committee concludes that the section 29 credit on the margins has increased production of oil and natural gas from domestic sources and that in the absence of these non-conventional sources the demand for imported fuels may have increased. To increase domestic sources of supply, the Committee believes it is appropriate to extend the section 29 credit to help foster new domestic fuel sources. The Committee is also concerned that, because of the higher extraction costs of certain "viscous oil," without the implicit subsidy of the production credit, entrepreneurs will not exploit this domestic energy source. Therefore, the Committee believes it is appropriate to extend the credit for certain fuels produced from new wells or facilities.

The Committee also recognizes that the credit for production of synthetic fuels from coal has been interpreted to include fuels that are merely chemical changes to coal that do not necessarily enhance the value or environmental performance of the feedstock coal. Therefore, the Committee believes it is appropriate to extend the section 29 credit only to fuels produced from coal that achieve significant environmental and value-added improvements.

Methane in coal mines is a serious safety hazard. In many coal mining operations, the cost of collection exceeds the value of the recovered methane so the methane is vented directly into the atmosphere. Methane is an extremely potent and long-lived greenhouse gas. Therefore, the Committee seeks to encourage capture of methane from coal mines in particular.

The Committee recognizes that the world price of oil as the nation enters the 21st century has not risen to levels forecast in 1978. Therefore, the Committee believes it is appropriate to restart the section 29 credit at a level lower than that currently available to existing production.

Lastly, the Committee believes it is important to study the efficacy of the section 29 credit in the case of methane recovered from coal seams or so-called "coal beds."

EXPLANATION OF PROVISION

Extension for certain non-conventional fuels

The provision 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

[21] The provision 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.

1, 2005. Under the provision, 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 rebased to $3.00 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 "viscous oil"

The provision 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, 2005. The provision 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 provision provides that qualifying sales to related parties for consumption not in the immediate vicinity of the wellhead qualify for the credit.

Extension and modification for "refined coal"

The provision 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 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 SO_2 and nitrogen oxides than the burning of feedstock coal or comparable coal predominantly available in the marketplace as of January 1, 2002, and if the 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.

Credit for coalmine methane gas

In addition, the provision permits taxpayers to claim credit for coalmine methane 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 methane 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 methane 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 methane 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, 2005.

Study of coal bed methane gas

Lastly, the committee bill 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 provisions apply to fuels sold from qualifying wells and facilities after the date of enactment.

J. NATURAL GAS DISTRIBUTION LINES TREATED AS FIFTEEN-YEAR PROPERTY

(Sec. 512 of the bill and sec. 168 of the Code)

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.

REASONS FOR CHANGE

The Committee recognizes the importance of modernizing our aging energy infrastructure to meet the demands of the twenty-first century, and the Committee also recognizes that both short-term and long-term solutions are required to meet this challenge. The Committee understands that investment in our energy infrastructure has not kept pace with the nation's needs. In light of this, the Committee believes it is appropriate to reduce the recovery period for investment in certain energy infrastructure property to encourage investment in such property. In particular, more rapid depreciation of natural gas distribution lines will help rural utilities

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

overcome the higher cost of service in rural areas, where there are fewer customers per mile of pipeline.

EXPLANATION OF PROVISION

The provision establishes a statutory 15–year recovery period and a class life of 20 years for natural gas distribution lines.

EFFECTIVE DATE

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

TITLE VI. PROVISIONS RELATING TO ELECTRIC INDUSTRY RESTRUCTURING

The electric service industry has undergone great change in the past decade. The Federal Energy Regulatory Commission ("FERC") has undertaken significant initiatives, such as Order No. 2000 and more recent guidance, to encourage organization of the electric transmission system into a national grid. At the present time, however, the ultimate structure of the industry when the currently anticipated industry restructuring is completed remains highly uncertain.[23] For example, representatives of the Federal Energy Regulatory Commission ("FERC") have stated there is a policy goal to form separate regional transmission organizations ("RTOs"), but the ultimate structure and ownership of such organizations is not fully resolved. Further, the role of public power entities, including the extent to which and the circumstances under which these entities legally or economically may be required to participate in open access arrangements, is unresolved.

The Committee believes that the tax code should not be an obstacle to this changing electric industry marketplace. However, the Committee concluded that it is not possible at the present time to design tax provisions that will address as yet undefined legal and economic industry structures. The bill puts in place a mechanism to ensure that up-to-date information on tax issues that arise from future developments is available to the Congress so that appropriate changes to the tax law can be considered on a timely basis.

With respect to changes that already have occurred in the electric service industry, the Committee believes it is appropriate to provide certainty to industry participants. On January 18, 2001, the Department of the Treasury ("Treasury") published temporary and proposed regulations to provide guidance to issuers of governmental bonds for electric output facilities. Those regulations provide interim relief for outstanding electric output facility bonds. Because of this interim relief and the aforementioned uncertainty regarding future industry structure, the bill does not address issues related to issuance of tax-exempt bonds. The bill does, however, ad-

[23] The Committee held a field hearing that addressed these issues in Billings, Montana, on August 24, 2001. In addition, the Committee scheduled a hearing for September 12, 2001, on electricity restructuring and associated tax issues. This hearing was cancelled due to the September 11, 2001, terrorist attacks, but the Committee has reviewed the written testimony of the witnesses who were scheduled to appear. The scheduled witnesses were John Tiencken, Jr., on behalf of the American Public Power Association and the Large Public Power Council; Theodore Vogel on behalf of the Edison Electric Institute; Robert Bauman with the Butler County Rural Electric Cooperative, Allison, Iowa; Brett Harvey with CONSOL Energy, Inc., Pittsburgh, Pennsylvania (testimony relating to clean coal incentives); and Howard Gruenspecht, Ph.D., with Resources for the Future, Washington, D.C.

dress certain aspects of electric industry restructuring that are known at the present time and for which comparable interim regulatory relief has not been provided—issues relating to certain transfers of nuclear decommissioning plants by investor-owned utilities ("IOUs") and certain transactions engaged in by rural electric cooperatives.

A. Ongoing Study and Reports With Regard to Tax Issues Resulting From Future Restructuring Decisions

(Sec. 601 of the bill)

The bill directs Treasury to conduct an ongoing study of tax issues resulting from restructuring of the electric service industry. Treasury (after consultation with FERC) is required to report to the Senate Committee on Finance and the House Committee on Ways and Means at least annually, no later than December 31, on tax issues identified since its last report. The first report is due no later than December 31, 2002. These annual reports are to continue until such time as the electric industry restructuring activities contemplated under the legislation in conjunction with which the provision is to be considered have been completed.

Among other issues, this ongoing study is expected to focus on the tax consequences of restructuring for IOUs and cooperatives (e.g., asset divestitures). In addition, the Committee anticipates that Treasury as part of the analysis underlying its ongoing study will review the interim relief provided to certain tax-exempt bonds in the regulations described above. The Committee hopes that Treasury will finalize as quickly as possible regulations relating to the definition of private activity bond for public power entities. In adopting its regulations, the Committee hopes that Treasury will use its regulatory authority, as appropriate, to provide flexibility to foster the participation of public power in a restructured electric industry (e.g., relating to participation in RTOs and treatment of distribution facilities). Where Treasury determines that changes in the Code's private business use rules to accommodate restructuring exceed its regulatory authority or otherwise are more appropriately accomplished through legislation, the Committee anticipates that Treasury will include recommendations on such changes in its annual reports to Congress.

Further, in connection with its study, the Committee believes that Treasury should exercise its authority, as appropriate, to modify or suspend regulations that may impede an IOU's ability to reorganize its capital stock structure to respond to a competitive marketplace.

B. Modification to Special Rules for Nuclear Decommissioning Costs

(Sec. 602 of the bill and sec. 468A of the Code)

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.[24]

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").[25] 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 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.[26] The transferee is required to obtain a

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[24] 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.

[25] Taxpayers are required to include in gross income customer charges for decommissioning costs (sec. 88).

[26] Treas. reg. sec. 1.468A–6.

new ruling amount from the IRS or accept a discretionary determination by the IRS.[27]

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.[28] 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.

REASONS FOR CHANGE

The Committee does not believe a utility should be denied the opportunity to contribute to a qualified fund simply because it operates in a deregulated environment. In addition, the Committee recognizes the importance of providing clear and concise rules to minimize disputes between taxpayers and the IRS.

EXPLANATION OF PROVISION

Repeal of cost of service requirement

The provision 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 and deductibility of decommissioning costs

The provision 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. In addition, the provision provides that all nuclear decommissioning costs are deductible when paid or incurred.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2002.

[27] Treas. reg. sec. 1.468A–6(f).
[28] These funds are generally referred to as "nonqualified funds."

C. Treatment of Certain Income of Electric Cooperatives

(Sec. 603 of the bill and sec. 501 of the Code)

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 Internal Revenue Service requires that cooperatives must operate under the following principles: (1) subordination of capital in control over the cooperative undertaking and in ownership of the financial benefits from ownership; (2) democratic control by the members of the cooperative; (3) vesting in and allocation among the members of all excess of operating revenues over the expenses incurred to generate revenues in proportion to their participation in the cooperative (patronage); and (4) operation at cost (not operating for profit or below cost).[29]

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).

[29] 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.[30]

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 Internal Revenue Service 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).[31] 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.

REASONS FOR CHANGE

The purpose of the 85-percent test under section 501(c)(12) is to ensure that the primary activities of a tax-exempt electric cooperative fulfill the statutory purpose of providing electricity services to the members of the cooperative. Similarly, the fundamental cooperative principles described above are the defining characteristics of a cooperative upon which the Federal tax rules condition conduit treatment.

The Committee believes that the nature of an electric cooperative's activities does not change because it has income from open access transactions with non-members or from nuclear decommissioning transactions (as these terms are defined in the bill). Accordingly, the Committee believes that the 85-percent test for tax exemption under present law should be applied without regard to such income. The Committee intends that the term "open access transaction" shall be applied in a manner that allows an electric cooperative to carry out its statutory purpose in a restructured

[30] See Rev. Rul. 83–135, 1983–2 C.B. 149.
[31] Rev. Rul. 72–36, 1972–1 C.B. 151.

electric energy market environment without adversely impacting its tax-exempt status.

For similar reasons, the Committee believes that the 85-percent test for tax exemption under present law should be applied without regard to cancellation of indebtedness income from the prepayment of certain loans that are provided, insured, or guaranteed by the Federal government, as well as income from certain transactions that would otherwise qualify for deferred gain recognition under section 1031 or 1033.

The Committee further believes that electric energy sales to non-members should not result in a loss of tax-exempt status or cooperative status to the extent that such sales are necessary to replace lost sales of electric energy to members as a result of restructuring of the electric energy industry. Accordingly, the Committee believes that replacement electric energy sales to non-members (defined as "load loss transactions" in the bill) should be treated, for a limited period of time, as member income in applying the 85-percent test for tax exemption of rural electric cooperatives. The Committee believes that such treatment also should apply for purposes of determining whether tax-exempt and taxable electric cooperatives comply with the fundamental cooperative principles. Finally, the Committee believes that income from replacement electric energy sales should not be subject to the tax on unrelated trade or business income under Code section 511.

EXPLANATION OF PROVISION

Treatment of income from open access transactions

The bill 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 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);[32]

(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

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[32] Under this provision, references to FERC are treated as including references to the Public Utility Commission of Texas or the Rural Utilities Service.

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 bill 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 bill 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 bill 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 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 bill 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 bill 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 bill 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 bill 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 bill 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 bill 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 provision is effective for taxable years beginning after the date of enactment.

TITLE VII. ADDITIONAL PROVISIONS

A. EXTENSION OF ACCELERATED DEPRECIATION AND WAGE CREDIT BENEFITS ON INDIAN RESERVATIONS

(Sec. 701 of the bill and secs. 45A and 168(j) of the Code)

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:

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

"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.

REASONS FOR CHANGE

The Committee recognizes the significant potential on Indian lands for development of energy resources and other projects. The special nature of Native American tribes and high poverty rates in certain areas in some circumstances create unique barriers to development that these incentives help overcome. The Committee understands that a significant portion of these incentives are used in development of energy projects.

The Committee concluded that extending the accelerated depreciation and wage credit tax incentives within Indian reservations will both increase the supply of energy and expand business and employment opportunities in these areas.

EXPLANATION OF PROVISION

Accelerated depreciation

The provision extends the accelerated depreciation incentive for two years (to property placed in service before January 1, 2006).

Indian employment credit

The provision extends the Indian employment credit incentive for two years (to taxable years beginning before January 1, 2006).

EFFECTIVE DATE

The provision is effective on the date of enactment.

B. GAO STUDY

(Sec. 702 of the bill)

PRESENT LAW

Present law does not require study of the present law provisions relating to clean fuel vehicles and electric vehicles.

REASONS FOR CHANGE

The Committee believes it is important to gain information on the value of benefits compared to costs in order to make informed decisions regarding the propriety of special tax treatment of various products or technologies designed to reduce dependence on petroleum, reduce emissions of pollutants, or to promote energy conservation. The Committee believes it is important to have measures of the amount of conservation or reduction in pollution that results from provisions designed to achieve such results.

EXPLANATION OF PROVISION

The bill 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 bill directs the Comptroller General to submit annual reports to Congress beginning not later than December 31, 2002.

EFFECTIVE DATE

The provision is effective on the date of enactment.

III. BUDGET EFFECTS OF THE BILL

A. COMMITTEE ESTIMATES

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the revenue provisions of the "Energy Tax Incentives Act of 2002" as reported.

ESTIMATED REVENUE EFFECTS OF THE "ENERGY TAX INCENTIVES ACT OF 2002," AS REPORTED BY THE COMMITTEE ON FINANCE

[Fiscal years 2002–2012, in millions of dollars]

Provision	Effective	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002–07	2002–12
Renewable Energy—Extend and Modify the Section 45 Credit for Producing electricity From Certain Sources.	esfqfa DOE	−30	−133	−243	−336	−364	−375	−379	−372	−370	−364	−306	−1,481	−3,272
Alternative Vehicles and Fuel Incentives														
1. GAO study	DOE						No Revenue Effect							
2. Modified CLEAR Act:														
a. Credits for purchase of alternative motor vehicles and modifications to credit for electric vehicles.	10/1/02	....	−61	−205	−319	−350	−219	22	15	10	4	1	−1,156	−1,104
b. Credit for retail sale of alternative fuels (30 cents/gallon in 2002 and 2003, 40 cents in 2004, and 50 cents in 2005 through 2006).	10/1/02	....	−52	−100	−169	−215	−90	−1	−1	−1	−1	(1)	−627	−632
c. Extension of deduction for certain vehicles and refueling property	10/1/02	....	−50	−122	−133	−62	50	73	48	29	12	3	−316	−150
d. Credit for installation of alternative fueling stations	10/1/02	....	−2	−2	−2	−2	(1)	(2)	(2)	(2)	(2)	....	−9	−8
3. Modifications to small producer ethanol credit	tyba DOE	....	−16	−34	−34	−34	−34	−18	(1)	(1)	(1)	....	−152	−171
4. Transfer full amount of excise tax imposed on gasohol to the Highway Trust Fund.	10/1/03						No Revenue Effect							
5. Modify income tax and fuels excise tax treatment of ETBE	DOE						Negligible Revenue Effect							
6. Biodiesel income tax credit and excise tax rate reduction (sunset 12/31/05) [3].	1/1/03	....	−12	−22	−30	−10	....	....	....	....	....	....	−74	−74
Total of Alternative Vehicles and Fuel Incentives	....	....	−193	−485	−687	−673	−293	76	62	38	15	4	−2,334	−2,139
Conservation and Energy Efficiency Provisions														
1. Business credit for construction of new energy efficient homes	DOE & ppisb 1/1/08	−8	−16	−16	−11	−8	−7	−4	−1	(1)	....	....	−66	−72
2. Credit for energy efficiency improvements to existing homes	tyeo/a DOE	....	−89	−117	−128	−111	−38	−10	....	....	....	....	−483	−494
3. Tax credit for energy efficient appliances	ppb 1/1/07	....	−19	−31	−33	−65	−50	−28	−13	−2	....	....	−198	−241
4. Tax credit for residential fuel cell, solar, and wind energy property	tyea 12/31/02 & ppb 1/1/08	....	−4	−18	−22	−29	−32	−30	....	....	....	....	−105	−135
5. Credit for energy efficient air conditioners, water heaters, heat pumps, and geothermal heat pumps.	tyea 12/31/02	....	−21	−97	−55	−47	−38	−33	−34	−35	−36	−36	−259	−433
6. Business tax incentives for qualifying fuel cells (through 12/31/06):														
a. Stationary	ppisa 12/31/02	....	−3	−8	−14	−16	−10	−6	−3	−2	(1)	....	−51	−62
b. Portable	ppisa 12/31/02						Negligible Revenue Effect							
7. Allowance of deduction for certain energy efficient commercial building property.	pcpt 1/1/08 & 10/1/02 & ccb 1/1/10	....	−60	−61	−63	−64	−65	−65	−23	....	....	....	−313	−401
8. Allowance of deduction for new and retrofitted energy management devices; three-year applicable recovery period for depreciation of qualified new energy management devices.	ppisa DOE	−11	−17	−20	−23	−24	−22	−20	−18	−17	−16	−16	−117	−205
9. Energy credit for combined heat and power system property	episa 12/31/02 & episb 1/1/07	....	−34	−65	−72	−76	−51	−26	−15	−7	−1	....	−298	−347
Total of Conservation and Energy Efficiency Provisions	....	−19	−263	−433	−421	−440	−313	−222	−107	−63	−53	−52	−1,890	−2,390
Clean Coal Incentives—Investment and Production Credits for Clean Coal Technology														
1. Credit for production from a qualifying clean coal technology unit	pa DOE	....	−2	−33	−61	−73	−84	−91	−94	−97	−99	−101	−253	−733
2. Credit for investment in qualifying advanced clean coal technology	ppisa DOE	....	−1	−22	−54	−56	−47	−31	−77	−62	−26	−17	−180	−394

ESTIMATED REVENUE EFFECTS OF THE "ENERGY TAX INCENTIVES ACT OF 2002," AS REPORTED BY THE COMMITTEE ON FINANCE—Continued

[Fiscal years 2002–2012, in millions of dollars]

Provision	Effective	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002–07	2002–12
3. Credit for production of electricity from qualifying advanced clean coal technology units.	pa DOE	....	[1]	−5	−19	−42	−63	−80	−104	−136	−158	−171	−129	−780
Total of Clean Coal Incentives—Investment and Production Credit for Clean Coal Technology.	....	....	−3	−60	−134	−171	−194	−202	−275	−295	−283	−289	−562	−1,907
Oil and Gas Provisions														
1. Tax 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	−1	−4	−5	−6	−7	−8	−9	−11	−11	−12	−13	−31	−87
3. Repeal of requirement that certain terminals offer both dyed and undyed diesel fuel and kerosene as a condition of registration.	1/1/02							Negligible Revenue Effect						
4. Expensing of capital costs incurred and credit for Production in complying with Environmental Protection Agency sulfur regulations for small refiners.	epoia DOE	....	....	....	....	−5	−10	−17	−27	−7	5	4	−14	−57
5. 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.	tyba 12/31/02	....	−4	−7	−7	−7	−7	−7	−8	−8	−8	−8	−32	−71
6. Extension of suspension of 100% of taxable income limit with respect to marginal production (through 12/31/06).	tyba 12/31/01	−21	−35	−38	−40	−42	−15	....	....	....	....	....	−191	−191
7. Election to amortize geological and geophysical expenditures over 2 years (no transition rule).	cpoii tyba 12/31/02	....	291	205	−73	−154	−146	−146	−155	−161	−165	−170	−122	−675
8. Election to amortize delay rental payments over 2 years (no transition rule).	apoii tyba 12/31/02	....	107	44	−82	−116	−116	−55	−86	−121	−123	−124	−162	−672
9. Study of coal bed methane	DOE							No Revenue Effect						
10. $3 credit for refined coal	fsa DOE	....	[1]	−1	−4	−8	−9	−8	−8	−5	−1	....	−22	−44
11. Natural gas distribution lines treated as 15-year property	ppisa DOE	−8	−30	−59	−87	−111	−133	−152	−173	−199	−226	−254	−427	−1,431
12. Extend section 29 credit for facilities placed in service after the date of enactment including viscous oil and coal mine methane ($3 credit)[4].	DOE	−32	−177	−380	−445	−297	−77	....	....	....	....	....	−1,409	−1,409
Total of Oil and Gas Provisions	....	−62	148	−241	−744	−747	−521	−394	−468	−512	−530	−565	−2,166	−4,637
Provisions Relating to Electric Industry Restructuring														
1. Ongoing study and reports with regard to tax issues resulting from future restructuring decisions.	DOE							No Revenue Effect						
2. Modification to Special Rules for Nuclear Decommissioning Costs—eliminate cost of service requirement and clarify treatment of fund transfers.	tyba 2002	....	−18	−46	−56	−75	−99	−131	−143	−152	−161	−171	−294	−1,052
3. Treatment of certain income of electric cooperatives	tyba DOE	−6	−13	−16	−19	−21	−23	−25	−27	−29	−32	−35	−97	−245
Total of Provisions Relating to Electric Industry Restructuring	....	−6	−31	−62	−75	−96	−122	−156	−170	−181	−193	−206	−391	−1,297
Extension of Tax incentives for Indian Reservations—Extension of Accelerated Depreciation and Wage Credit Benefits for Businesses on Indian Reservation (through 12/31/05).	DOE	....	8	−153	−468	−427	−100	97	200	225	157	62	−1,140	−399

Net Total		−117	−468	−1,677	−2,865	−2,918	−1,918	−1,180	−1,130	−1,158	−1,251	−1,352	−9,964	−16,041

[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] Effective for facilities placed in service from the date of enactment through December 31, 2004. Qualified facilities would be given 3 years of credit.

Legend for ''Effective'' column: apoii=amounts paid or incurred in; ccb=construction completed before; cpoii=costs paid or incurred in; DOE=date of enactment; epoia=expenses paid or incurred after; episa=equipments placed in service after; episb=equipment placed in service before; esfqfa=electricity sold from qualifying facilities after; fsa=fuels sold after; pa=production after; pccpt=plans certified prior to; ppb=property purchased before; ppisa=property placed in service after; ppisb=property placed in service before; tyba=taxable years beginning after; tyea=taxable years ending after; and tyeo/a=taxable years ending on or after.

Note.—Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

B. BUDGET AUTHORITY AND TAX EXPENDITURES

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the revenue provisions of the bill as reported involve no new or increased budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the revenue-reducing provisions of the bill involve increased tax expenditures (see revenue table in Part III. A., above).

C. CONSULTATION WITH CONGRESSIONAL BUDGET OFFICE

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office submitted the following statement on this bill:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, February 27, 2002.

Hon. MAX BAUCUS,
Chairman, Committee on Finance,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for the Energy Tax Incentives Act of 2002.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Erin Whitaker.

Sincerely,

DAN L. CRIPPEN,
Director.

Enclosure.

Energy Tax Incentives Act of 2002

Summary: The Energy Tax Incentives Act (ETIA) would amend numerous provisions of tax law relating to energy. The bill would enhance and create credits for the use and development of energy-efficient technologies, amend tax rules to provide deductions for certain devices and credits for businesses that provide energy, and enhance and create credits and deductions for the production of oil, gas, and other types of fuel. Provisions of the bill would generally take affect in 2003, but some provisions would take effect in 2002, and some provisions would expire during the 2006–2012 period.

The Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) estimate that enacting the bill would decrease governmental receipts by $117 million in 2002, by about $10 billion over the 2002–2007 period, and by about $16 billion over the 2002–2012 period. CBO estimates that certain provisions requiring studies and reports would have an insignificant impact on spending subject to appropriation. Since ETIA would affect receipts, pay-as-you-go procedures would apply.

JCT and CBO have determined that the bill contains no intergovernmental or private-sector mandates as defined in the Un-

funded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

Estimated Cost to the Federal Government: The estimated budgetary impact on the bill is shown in the following table. All revenue estimates were provided by JCT.

	By fiscal year, in millions of dollars—					
	2002	2003	2004	2005	2006	2007
	CHANGES IN REVENUES					
Estimated Revenues	−117	−467	−1,677	−2,865	−2,918	−1,918

Basis of estimate

Revenues

All estimates of the revenue provisions were provided by JCT. Four provisions would compose a significant portion of the effect on revenues if enacted. Those provisions would extend the credit for producing energy from certain sources, extend the credit for purchase of alternative motor vehicles, and modify the credit for purchase of electric vehicles. They also would establish a statutory 15-year recovery period for natural gas distribution lines, expand the credit for certain qualifying fuels produced from coal to fuels produced in facilities placed in service after the date of enactment, and modify the rules governing certain requirements for contributions to, and transfers of, qualified nuclear decommissioning funds. These provisions would, if enacted, reduce revenues by $40 million in 2002, $3.2 billion over the 2002–2007 period, and $4.9 billion over the 2002–2012 period.

Spending subject to appropriation

The bill would require the General Accounting Office and the Department of the Treasury to provide annual reports on energy tax incentives. Based on information from these agencies, CBO expects that preparing the reports would cost less than $500,000 per year, assuming appropriation of the necessary amounts.

Pay-as-you-go considerations: The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The net changes in governmental receipts that are subject to pay-as-you-go procedures are shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the effects through 2006 are counted.

	By fiscal year, in millions of dollars—										
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Changes in outlays	Not applicable										
Changes in receipts	−117	−467	−1,677	−2,865	−2,918	−1,918	−1,180	−1,130	−1,158	−1,251	−1,352

Intergovernmental and private-sector impact: The bill contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

Estimate prepared by: Revenues: Erin Whitaker; Federal Costs: Matthew Pickford; Impact on State, Local, and Tribal Governments: Susan Sieg Tompkins; and Impact on the Private Sector: Paige Piper/Bach.

Estimate approved by: G. Thomas Woodward, Assistant Director for Tax Analysis and Robert A. Sunshine, Assistant Director for Budget Analysis.

IV. VOTES OF THE COMMITTEE

In compliance with paragraph 7(b) of rule XXVI of the Standing Rules of the Senate, the following statements are made concerning the roll call votes in the Committee's consideration of the "Energy Tax Incentives Act of 2002."

Motion to report the bill

The bill (S.______, the "Energy Tax Incentives Act of 2002") was ordered favorably reported, by a unanimous voice vote on February 13, 2002.

Votes on other amendments

An amendment by Senator Thomas to provide a tax credit for producing fuel from a nonconventional source was agreed to by voice vote.

An amendment by Senator Lincoln to provide tax benefits for biodiesel fuel mixtures was agreed to by a record vote of 16 ayes and 5 nays. The ayes and nays were:

Ayes.—Senators Baucus, Rockefeller, Daschle (proxy), Breaux, Conrad (proxy), Graham, Jeffords, Bingaman, Kerry, Torricelli (proxy), Lincoln, Grassley, Hatch, Murkowski, Thompson, and Snowe.

Nays.—Senators Nickles, Gramm, Lott, Kyl (proxy), and Thomas.

An amendment by Senator Baucus (for Senator Kyl), and modified by Senators Hatch and Nickles to study the efficacy of the new credits for vehicles and fuels and the new tax credits and enhanced deductions for energy conservation, was agreed to by voice vote.

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

Pursuant to paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of the bill as amended.

Impact on individuals and businesses

With respect to individuals and businesses, the bill modifies the rules relating to (1) tax benefits for alternative fuels; (2) coal production; (3) oil and gas production; (4) energy conservation; and (5) electric industry participants involved in industry restructuring activities. Taxpayers may elect whether to avail themselves of the

provisions of the bill. Thus, the provisions do not impose increased regulatory burdens on individuals or businesses. Certain provisions of the bill, such as the provision relating to transfers of decommissioning funds associated with nuclear generating facilities, simplify the present-law rules and, therefore, reduce burdens on taxpayers electing to utilize the provision. Thus, the bill does not impose increased regulatory burdens on individuals and businesses.

Impact on personal privacy and paperwork

The provisions of the bill do not impact personal privacy. Individuals may elect whether to avail themselves of the provisions of the bill. Thus, the bill does not impose increased paperwork burdens on individuals. Individuals who elect to take advantage of the bill may in some cases need to keep records in order to demonstrate that they qualify for the tax treatment provided by the bill. In some cases the bill simplifies present law, thus reducing recordkeeping requirements.

B. Unfunded Mandates Statement

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (P.L. 104–4).

The Committee has determined that the revenue provisions of the bill do not contain Federal mandates on the private sector. The Committee has determined that the revenue provisions of the bill do not impose a Federal intergovernmental mandate on State, local, or tribal governments.

C. Tax Complexity Analysis

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

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

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the Committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill as reported by the Committee).

○