JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 6), to provide for security and diversity in the energy supply for the American people, and for other purposes, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment struck all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment that is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clarifying changes.

TITLE I – ENERGY EFFICIENCY

Title I of the conference report sets new performance requirements for the operations of Federal agencies and buildings, requires Federal agencies to procure energy efficient products, and mandates metering of energy use in Federal buildings. The title has a permanent authorization for the Energy Savings Performance Contracts (ESPC) program, and establishes a pilot program for ESPC non-building applications. The conference report authorizes funding for new programs to expand state and local energy efficiency programs in low-income communities and in public buildings such as schools, hospitals and government facilities. It provides funding to States and local governments to encourage consumers to replace existing appliances with more energy efficient units. The conference report sets energy efficiency standards for a number of new consumer products, and directs the Department of Energy to initiate rulemakings to set standards for others. It requires the Federal Trade Commission to review and improve energy efficiency labeling programs. The conference report also authorizes funding for the Energy Star program and a consumer education program on HVAC maintenance. Authorization for the Low-Income Home Energy Assistance Program is extended and expanded, and additional funds are provided for state energy and weatherization programs. The report includes a number of changes to public housing law that encourage improved energy efficiency in the construction and maintenance of public housing, improve Federal efficiency standards for public housing facilities, and require public housing agencies to purchase energy efficient products.

TITLE II – RENEWABLE ENERGY

Title II of the conference report provides for an ongoing assessment of renewable energy resources, extends existing authority for incentive programs for production of renewable electricity, requires an update of energy plans for insular areas, and requires the Federal government to purchase a set amount of electric energy from renewable resources. The report authorizes $300 million for solar programs, and sets a goal of installing 20,000 solar roof-top systems in Federal buildings by 2010. The use of biomass from Federal or Indian lands is encouraged by the creation of a grant program to produce electric energy, transportation fuels, or substitutes for petroleum products from biomass. The program encourages removal of hazardous fuels from the highest risk areas on Federal and Indian lands and development of new technologies to use biomass.

Subtitle B updates the Geothermal Steam Act by amending the leasing provisions to provide for a competitive leasing system. The subtitle also directs other actions that will facilitate new development of geothermal resources. Subtitle C amends the Federal Power Act to streamline the process for issuance of hydroelectric licenses. It also provides production incentives and promotes efficiency improvements at hydroelectric facilities.

TITLE III – OIL AND GAS

Title III of the conference report includes a variety of oil and gas production provisions. It improves the Federal permitting process and expedites the construction of the Alaska Natural Gas Pipeline.

Subtitle A permanently authorizes the Strategic Petroleum Reserve and extends authorization for the National Oilheat Research Alliance. Subtitle B provides financial incentives to encourage production in deep water and production from deep natural gas wells in the Gulf of Mexico. The subtitle also provides royalty relief to marginal wells located on Federal lands and the Outer Continental Shelf. The Secretary of the Interior is authorized to provide royalty relief to existing, non-producing offshore leases in Alaska. The report addresses natural gas market transparency, and provides additional market reforms.

Subtitle C includes several provisions that will improve access to Federal lands and expedite the approval of permits on multiple-use lands. There are also provisions to improve inspection and enforcement of existing permits. The Secretaries of the Interior and Agriculture are instructed to designate energy corridors on western lands that can be used for the deployment of energy transportation and transmission rights-of-way. A regional pilot program is established to develop procedures for the timely processing of applications and permits for Federal lands.

Subtitle D authorizes expedited certification and permitting of a pipeline to transport natural gas from Alaska to markets in the continental United States to meet the rapidly growing demand for natural gas. The conference report includes loan guarantee authority to support the construction of the pipeline, and establishes an executive-level office to coordinate agency actions related to the pipeline.

TITLE IV – COAL

Title IV of the conference report contains provisions that provide critical research related to the country's most abundant fossil resource: coal. Subtitle A authorizes a Clean Coal Power Initiative, providing $200 million annually for clean coal research in coal-based gasification technologies. The Secretary of Energy is directed to set increasingly restrictive emission targets over the life of the program to develop state-of-the-art technology. Subtitle B provides financial assistance to a variety of clean coal projects around the nation. Subtitle C amends several provisions of the Mineral Leasing Act governing the Federal Coal Leasing Program, including those pertaining to: lease modifications to avoid the bypass of coal; mining requirements for logical mining units; payment of advance royalties; and the deadline for submission of a coal lease operation and reclamation plan.

TITLE V – INDIAN ENERGY

Title V of the conference report, referred to as the Indian Tribal Energy Development and Self-Determination Act of 2003, assists Indian Tribes in the development of Indian energy resources by increasing Tribes' internal capacity to develop their own resources. The title provides grants and technical assistance, and streamlines the approval process for Tribal leases, agreements, and rights-of-way so that outside parties have more incentive to partner with Tribes in developing energy resources. Included in this title are provisions creating an Office of Indian Energy Policy and Programs within the Department of Energy to support the development of tribal energy resources. Section 505 makes Dine Power Authority, a Navajo Nation enterprise, eligible for funding under this title. Section 506 directs the Secretary of Housing and Urban Development to promote energy efficiency for Indian housing.

The title also provides a complete substitute for title 26 of the Energy Policy Act of 1992. Sections 2602 and 2603 authorize the Secretary of the Interior to provide grants to tribes to develop and utilize their energy resources and to enhance the legal and administrative ability of tribes to manage their resources. Section 2604 establishes a process by which an Indian tribe, upon demonstrating its technical and financial capacity, could negotiate and execute energy resource development leases, agreements and rights-of-way with third parties without first obtaining the approval of the Secretary of the Interior. Section 2605 authorizes the Secretary of the Interior to review activities authorized under the Indian Mineral Development Act. Section 2606 authorizes WAPA to make power allocations to meet the firming and reserve needs of Indian-owned energy projects and acquire power generated by Indian tribes for firming and reserve needs, so long as the rates and terms are competitive. Section 2607 authorizes a study of wind and hydropower potential along the Missouri River.

TITLE VI – NUCLEAR MATTERS

Title VI of the conference report provides for programs to ensure that nuclear energy remains a major component of the Nation's energy supply. Price Anderson liability protection is extended for both NRC licensees and DOE contractors. Coverage is increased and indexed for inflation, and non-profit contractors of the Department are made subject to payment of penalties assessed for nuclear safety violations. A research, development, and construction project is authorized for a new test reactor to be constructed at the Idaho National Engineering and Environmental Laboratory. The reactor will serve as a national testbed for advanced reactor technologies that provide improved attributes over existing plants, and for co-generation of hydrogen by nuclear energy. Limits, with several listed exemptions, are imposed on future sales or transfers of government stockpiles of uranium, subject to tests that fair market value is received for sales and that national security is not adversely impacted. Important nuclear security programs are established, along with industry reforms, including whistleblower protection, antitrust review, and legal fee reimbursement.

TITLE VII – FUELS AND VEHICLES

Title VII of the conference report makes a number of changes to the alternative fuel vehicle mandate program applicable to Federal, State, local and fuel provider vehicle fleets pursuant to the Energy Policy Act of 1992. In particular, credits towards compliance with fleet mandates can be accrued for the actual use of alternative fuels, the purchase of neighborhood electric vehicles, investment in alternative fuel infrastructures, or equivalent contributions toward compliance by other fleets with their mandates through the purchase of vehicles or fueling infrastructure. The bill requires a complete review of alternative fuel mandates, and enables States to enact regulations to allow alternative fuel vehicles to use High Occupancy Vehicle lanes regardless of the number of passengers carried. The conference report requires the National Highway Transportation Safety Administration (NHTSA) to additionally consider the effects on passenger safety and employment levels in the U.S. auto industry when setting fuel economy standards, requires an analysis of the fuel economy program, and extends incentives for "dual-fuel" vehicles for another four years.

TITLE VIII – HYDROGEN

Title VIII of the conference report provides for basic hydrogen energy research and development programs. The title authorizes new research and development programs for hydrogen vehicle technologies and hydrogen fuel. The title provides authorization for a variety of programs to demonstrate hydrogen and fuel cells for use in light- and heavy-duty vehicle fleets, stationary power applications, and international projects. The title requires Federal agencies to consider methods of incorporating hydrogen and fuel cell technologies into their missions, and establishes an interagency task force to oversee hydrogen initiatives.

TITLE IX – RESEARCH AND DEVELOPMENT

Title IX of the conference report provides the research and development base for the full range of energy-related technologies. Subtitles include those devoted to Energy Efficiency, Distributed Energy and Electric Energy Systems, Renewable Energy, Nuclear Energy, Fossil Energy, Science, Energy and Environment, and Management. Broad goals are established to guide the research and development activities of diversifying energy supplies, increasing energy efficiency, decreasing dependence on foreign energy supplies, improving energy security, and decreasing environmental impact. The Secretary is annually directed to publish specific goals in major program areas consistent with these broad goals.

TITLE X – DEPARTMENT OF ENERGY MANAGEMENT

Title X of the conference report creates a new Assistant Secretary position and expresses the sense of the Congress that the position should be used to improve management of Nuclear Energy at the Department of Energy, and grants the Secretary of Energy authority to enter into other transactions as appropriate to further research, development, or demonstration goals of the Department.

TITLE XI – PERSONNEL AND TRAINING

Title XI of the conference report requires establishment of training guidelines for electric energy industry personnel and centers for building technologies and power plant operations training. It also directs increased activity by the Department of Energy to improve recruitment of under-represented groups into energy professions. The title directs the Secretary of Energy to support establishment of a National Power Plant Operations Center, and encourages agency coordination for training and outreach efforts for international commercial energy markets in countries with developing and restructuring economies.

TITLE XII – ELECTRICITY

Title XII of the conference report reduces regulatory uncertainty, promotes transmission infrastructure development and security, and increases consumer protections associated with the production and delivery of electricity. Subtitle A requires development of mandatory rules to ensure transmission grid reliability. Subtitle B addresses transmission siting, third-party financing of transmission, and research programs related to transmission upgrades and improvements. Subtitle C protects transmission access for native load customers and authorizes the Federal Energy Regulatory Commission [FERC] to exercise limited jurisdiction over currently unregulated transmitting utilities to ensure open access to the transmission grid. It also remands the proposed rulemaking on Standard Market Design to FERC and prohibits a final rule before December 31, 2006. Subtitle D directs FERC to issue rules on transmission pricing policies and cost allocation for transmission expansion. Subtitle E amends the Public Utility Regulatory Policies Act of 1978 (PURPA). It prospectively repeals the requirement for mandatory purchase from qualifying facilities by electric utilities if a competitive market exists and establishes new criteria for qualifying cogeneration facilities. Subtitle F repeals the Public Utility Holding Company Act of 1935 (PUHCA). Subtitle G addresses market transparency and manipulation, contract sanctity, and unfair trade practices. It also increases penalties for violations of the Federal Power Act. Subtitle H provides for merger review reform and accountability. Subtitle I defines new terms in the Federal Power Act, and Subtitle J makes technical and conforming amendments..

TITLE XIII – ENERGY TAXES

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I. CONSERVATION

A. Residential and Business Property

1. Residential solar hot water, photovoltaics and other energy efficient property (sec. 41001 of the House bill, sec. 2103 of the Senate amendment, and new sec. 25C 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 personal tax credit for energy efficient residential property.

House Bill

The provision provides a personal tax credit for the purchase of qualified photovoltaic property and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs. The credit is equal to 15 percent of qualified investment up to a maximum credit of $2,000 for solar water heating property and $2,000 for rooftop photovoltaic property. This credit is nonrefundable, and the depreciable basis of the property is reduced by the amount of the credit.

Qualifying solar water heating property is property that heats 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. Expenditures for labor costs allocable to onsite preparation, assembly, or original installation of property eligible for the credit are eligible expenditures.

Certain equipment safety requirements need to be met to qualify for the credit. Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations.

Effective date.–The credit applies to purchases in taxable years ending after December 31, 2003 and before January 1, 2007 (January 1, 2009 in the case of qualified photovoltaic property).

Senate Amendment

The Senate amendment includes the provisions of the House bill. Additionally, the Senate amendment adds a 30-percent credit for qualified wind energy property, up to a maximum credit of $2,000. Qualified wind energy property is property that uses wind energy to generate electricity for use in a dwelling unit.

The Senate amendment also provides a 100 percent credit, with caps, 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.

Advanced natural gas furnaces that achieve a 95 percent annual fuel utilization efficiency. The maximum credit is $250 per unit.

Central air conditioners with an efficiency of at least 15 SEER and an EER of 12.5 or greater. The maximum credit is $250 per unit.

Natural gas water heaters with an Energy Factor of at least 0.8. The maximum credit is $75 per unit.

Geothermal heat pumps that have an EER of at least 21. The maximum credit is $250 per unit.

With the exception of wind energy property, if less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

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

Conference Agreement

The conference agreement generally follows the House bill with respect to residential solar and photovoltaic property. With respect to wind energy property, the conference agreement follows the Senate amendment with two modifications. First, the credit rate is reduced to 15 percent. Second, with respect to property a portion of which is used in business, the taxpayer may choose either to claim the personal credit, or to claim depreciation for the business use portion of the property, but not both. The conference agreement clarifies that the $2,000 credit cap that applies to solar, photovoltaic, and wind energy property applies across all taxable years. Thus, with respect to a given dwelling, a taxpayer can claim at most $2,000 in credits for solar water heating property, $2,000 for photovoltaic property, and $2,000 for wind energy property. The conference agreement also clarifies that no section 45 credit may be claimed with respect to any electricity produced from property for which a residential energy efficient property credit has been claimed.

The conference agreement does not follow the Senate amendment with respect to all other energy efficient property.

It is intended under the conference agreement that availability of the credit for photovoltaic and wind energy property would not be impacted by any net-metering or net-billing arrangements under which the taxpayer sells excess electricity back to a utility. It is also intended that expenditures for labor costs properly allocable to the onsite preparation, assembly, or original installation of qualifying property and for piping or wiring to interconnect such property to the dwelling unit can be taken into account for determining the amount of the credit.

Effective date.–The credit applies to purchases in taxable years ending after December 31, 2003, and before January 1, 2007 (January 1, 2009, in the case of qualified photovoltaic property).

2. Credit for electricity produced from certain sources (sec. 41002 of the House bill, secs. 1901, 1902, 1903, 1904, 1905, and 1906 of Senate amendment, 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 is 1.8 cents per kilowatt-hour for 2003. The credit is reduced for grants, tax-exempt bonds, subsidized energy financing, and other credits.

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

House Bill

Extension of placed in service date for existing facilities

The House bill extends the placed in service date for wind facilities and closed-loop biomass facilities to facilities placed in service after December 31, 1993 (December 31, 1992, in the case of closed-loop biomass facilities) and before January 1, 2007. The House bill does not extend the placed in service date for poultry waste facilities.

Additional qualifying facilities

The House bill also defines three new qualifying facilities: open-loop biomass facilities, landfill gas facilities, and trash combustion facilities. 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. Landfill gas is defined as methane gas derived from the biodegradation of municipal solid waste. Trash combustion facilities are facilities that burn municipal solid waste (garbage) to produce steam to drive a turbine for the production of electricity. Qualifying open-loop biomass facilities and qualifying landfill gas facilities include facilities used to produce electricity placed in service before January 1, 2007. Qualifying trash combustion facilities include facilities placed in service after the date of enactment and before January 1, 2007.

In the case of qualifying open-loop biomass facilities and qualifying landfill gas facilities placed in service on or before the date of enactment, the taxpayer may claim the section 45 production credit for only five years, commencing on the date of enactment. In the case of qualifying open-loop biomass facilities and qualifying landfill gas facilities placed in service on or before the date of enactment, the taxpayer may claim two-thirds of the otherwise allowable credit for electricity produced at the facility.

Credit claimants and treatment of other subsidies

In the case of qualifying open-loop biomass facilities originally placed in service on or before the date of enactment, a lessee or operator may claim the credit in lieu of the owner of the qualifying facility. In addition, for such facilities, any reduction in credit by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits cannot exceed 50 percent.

Alternative minimum tax

In the case of wind facilities placed in service after the date of enactment, the taxpayer may claim credit for electricity production against both the taxpayer's regular tax and the taxpayer's alternative minimum tax, if any, for electricity produced during the first four years of production measured from the date on which the facility is placed in service.

No facility that previously claimed or currently claims credit under section 29 of the Code is a qualifying facility for purposes of section 45.

Effective date.–The provision is effective for electricity sold from qualifying facilities after the date of enactment.

Senate Amendment

Extension of placed in service date for existing facilities

The Senate amendment 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.

Additional qualifying facilities

The Senate amendment also defines seven new qualifying energy resources: open-loop biomass, swine and bovine waste nutrients, geothermal energy, solar energy, municipal biosolids, recycled sludge, and small irrigation.

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).

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

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

A small irrigation power facility is a facility that generates electric power through an irrigation system canal or ditch without any dam or impoundment of water. The installed capacity of a qualified facility is less than five megawatts.

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. Qualifying municipal biosolids facilities are facilities using municipal biosolids to generate electricity that are originally placed in service after December 31, 2001, and before January 1, 2007. Qualifying recycled sludge facilities are facilities using recycled sludge to generate electricity that are originally placed in service before January 1, 2007. Qualifying small irrigation power facilities are facilities using small irrigation power systems to generate electricity that are originally 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 service. In the case of electricity generated from a recycled sludge facility the 10-year credit period shall begin no earlier than the date of enactment.

In addition, the Senate amendment 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.

__Credit claimants and treatment of other subsidies__

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 Senate amendment permits a lessee operator to claim the credit in lieu of the owner of the facilities.

The Senate amendment 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.

The Senate amendment 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 Senate amendment is 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.

Conference Agreement

Extension of placed in service date for existing facilities

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

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

Additional qualifying resource and facilities

The conference agreement also defines five new qualifying resources: open-loop biomass (including agricultural livestock waste nutrients), geothermal energy, solar energy, small irrigation power, and municipal solid waste. Two different qualifying facilities use municipal solid waste as a qualifying resource: landfill gas facilities and trash combustion facilities.

Qualifying open-loop biomass facilities are facilities using biomass to produce electricity that are placed in service prior to January 1, 2007. Qualifying agricultural livestock waste nutrient facilities are facilities using agricultural livestock waste nutrients to produce electricity that are placed in service after the date of enactment and before January 1, 2007.[1] The installed capacity of a qualified agricultural livestock waste nutrient facility is not less than 150 kilowatts.

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[1] The provision deletes poultry litter as a separate qualifying facility for facilities placed in service after the effective date. Poultry litter facilities remain qualifying facilities as agricultural waste nutrient facilities. Any poultry litter facility placed in service on or prior to December 31, 2003, is unaffected by the modifications made by this provision. For example, the value of the credit that may be claimed for production from such a facility would not be reduced by one-third as would be the case for other animal waste nutrient facilities.

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. A qualifying geothermal energy facility or solar energy facility may not have claimed any credit under sec. 48 of the Code.[2]

A qualified small irrigation power facility is a facility originally placed in service after the date of enactment and before January 1, 2007. A small irrigation power facility is a facility that generates electric power through an irrigation system canal or ditch without any dam or impoundment of water. The installed capacity of a qualified facility is not less than 150 kilowatts and less than five megawatts.

Landfill gas is defined as methane gas derived from the biodegradation of municipal solid waste. Trash combustion facilities are facilities that burn municipal solid waste (garbage) to produce steam to drive a turbine for the production of electricity. Qualifying landfill gas facilities and qualifying trash combustion facilities include facilities used to produce electricity placed in service after the date of enactment and before January 1, 2007.

Credit period and credit rates

In general, as under present law, taxpayers may claim the credit at a rate of 1.5 cents per kilowatt-hour (indexed for inflation and currently 1.8 cents per kilowatt-hour) for 10 years of production commencing on the date the facility is placed in service. In the case of open-loop biomass facilities, (including agricultural livestock waste nutrients), geothermal energy, solar energy, small irrigation power, landfill gas facilities, and trash combustion facilities the 10-year credit period is reduced to five years commencing on the date the facility is placed in service. In general, for facilities placed in service prior to January 1, 2004, the credit period commences on January 1, 2004. In the case of a closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, the credit period shall begin no earlier than the date of enactment.

In the case of open-loop biomass facilities (including agricultural livestock waste nutrients), small irrigation power, landfill gas facilities, and trash combustion facilities, the otherwise allowable credit amount is reduced by one third.

Credit claimants and treatment of other subsidies

A lessee or operation may claim the credit in lieu of the owner of the qualifying facility in the case of qualifying open-loop biomass facilities originally placed in service on or before the date of enactment and in the case of a closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass.

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[2] If a geothermal facility or solar facility claims credit for any year under section 45 of the Code, the facility is precluded from claiming any investment credit under section 48 of the Code in the future.

In addition, for all qualifying facilities, other than closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, any reduction in credit by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits cannot exceed 50 percent. In the case of closed-loop biomass facilities modified to co-fire with coal, to co-fire with other biomass, or to co-fire with coal and other biomass, there is no reduction in credit by reason of grants, tax-exempt bonds, subsidized energy financing, and other credits.

No facility that previously claimed or currently claims credit under section 45K of the Code (as amended by the conference agreement)[3] is a qualifying facility for purposes of section 45.

Alternative minimum tax

In the case of qualifying facilities placed in service after the date of enactment, the taxpayer may claim credit for electricity production against both the taxpayer's regular tax and the taxpayer's alternative minimum tax, if any, for electricity produced during the first four years of production measured from the date on which the facility is placed in service.

GAO study

The conference agreement directs the Comptroller General of the United States to conduct a study of the market viability of producing electricity from resources qualifying for the section 45 production credit (as amended by the conference agreement). The conferees seek a comparison of the cost of producing electricity from the various qualifying resources compared to the cost of producing electricity from fossil fuels (*i.e.*, coal, oil, and natural gas) using the latest generation of production technology currently in service in the United States. The cost of producing electricity should be reported, on a per kilowatt-hour basis, both as the incremental cost of production from a facility and on a fully-amortized cost basis assuming capital costs are amortized over the useful life of the property. In the case of facilities using open-loop biomass and municipal solid waste resources, the measurement of costs should take into account the avoided costs of waste disposal for which taxpayers otherwise would be responsible. The study is to estimate the dollar value of the environmental impact of producing electricity from qualifying resources compared to fossil fuels. The Comptroller General is to report his findings to the Committee on Ways and Means and Committee on Finance not later than June 30, 2006.

Effective date.–The provision is effective for electricity produced and sold from qualifying facilities after the date of enactment.

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[3] The conference agreement modifies present-law section 29 as described below and moves present-law section 29 to new Code section 45K.

3. Tax incentives for fuel cells (sec. 41003 of the House bill, secs. 2103 and 2104 of the Senate amendment, and sec. 48 and new sec. 25C 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 stationary fuel cell power plant property.

House Bill

The provision provides a 10-percent credit for the purchase of qualified fuel cell power plants for businesses and individuals. 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. The credit may not exceed $500 for each 0.5 kilowatt of capacity. For individuals, 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 residence. 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, 2003, 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). The credit for individuals applies to expenditures made after December 31, 2003, and before January 1, 2007.

Senate Amendment

The Senate amendment provides a 30-percent business energy credit for the purchase of qualified fuel cell power plants for businesses. A qualified fuel cell power plant is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that converts a fuel into electricity using electrochemical means, and which has an electricity-only generation efficiency of greater than 30 percent and generates at least 500 watts of electricity. The credit for any fuel cell may not exceed $500 for each kilowatt of capacity. The taxpayer's basis in the property is reduced by the amount of the credit claimed.

The proposal also provides a 30-percent credit for individuals 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. 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.

Additionally, the Senate amendment provides a 10-percent credit for the purchase of qualifying stationary microturbine power plants. A qualified stationary microturbine power plant is a system comprising a rotary engine that is actuated by the aerodynamic reaction or impulse or both on radial or axial curved full-circumferential-admission airfoils on a central axial rotating spindle. Such system must have an electricity-only generation efficiency of not less that 26 percent at International Standard Organization conditions. The credit is limited to the lesser of 10 percent of the basis of the property or $200 for each kilowatt of capacity.

Effective date.–The credit for businesses applies to property placed in service after December 31, 2002, and before January 1, 2008 (January 1, 2007, in the case of microturbines), under rules similar to rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990). The credit for individuals applies to expenditures made after December 31, 2002, and before January 1, 2008

Conference Agreement

The conference agreement follows the House bill with the modification that the credit rate is increased to 20 percent.

Effective date.–The provision applies to periods after December 31, 2003, 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), for property placed in service before January 1, 2007. The credit for individuals applies to expenditures made after December 31, 2003, and before January 1, 2007.

4. Energy efficient improvements to existing homes (secs. 41004 of the House bill, sec. 2109 of the Senate amendment, and new sec. 25D of the Code)

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

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.

<u>**House Bill**</u>

The provision provides a 20-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 $2,000. A qualified energy efficiency improvement is any energy efficiency building envelope component that is certified (in the case of expenditures that exceed $1,000) to meet or exceed the prescriptive criteria for such a component established by the 2000 International Energy Conservation Code (or, in the case of metal roofs with appropriate pigmented coatings, meets the Energy Star program requirements), 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 reasonably can be expected to remain in use for at least five years.

Building envelope components are: (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling; (2) exterior windows (including skylights) and doors; and (3) metal roofs with appropriate pigmented coatings which are specifically and primarily designed to reduce the heat loss or gain for a dwelling.

The taxpayer's basis in the property is reduced by the amount of the credit. Special rules apply in the case of condominiums and tenant-stockholders in cooperative housing corporations.

Any unused credit may be carried forward to future years.

<u>Effective date</u>.–The credit is effective for qualified energy efficiency improvements installed after December 31, 2003 and before January 1, 2007.

<u>**Senate Amendment**</u>

The provision provides 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 is 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) that is 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 are: (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 must be certified according to a component-based method or a performance-based method. The component-based method is based on applicable energy-efficiency ratings, including current product labeling requirements. The performance-based method is 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 must 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 is reduced by the amount of the credit. Special rules 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.

Conference Agreement

The conference agreement generally follows the House bill with the modification that the credit may not be carried forward. Additionally, the efficiency is to be measured relative to the 2000 IECC standards as supplemented and as in effect on the date of enactment.

Effective date.–The credit is effective for qualified energy efficiency improvements installed after December 31, 2003, and before January 1, 2007.

5. Energy efficient new homes (sec. 41005 of the House bill, sec. 2101 of the Senate amendment, 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.

House Bill

The provision provides a credit to an eligible contractor (up to $2,000 per dwelling) 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 eligible contractor is the person who constructs 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, exterior windows and doors, metal roofs with appropriate pigmented coatings) and any energy-efficient heating or cooling appliance.

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; (3) certified to have a level of annual heating and cooling energy consumption that is at least 30 percent below the annual level of heating and cooling energy consumption of a comparable dwelling constructed in accordance with the standards of the 2000 International Energy Conservation Code; and (4) with respect to the building envelope alone, certified to have a level of annual heating and cooling energy consumption that is 10 percent below the annual level of heating and cooling energy consumption of a comparable dwelling constructed in accordance with the standards of the 2000 International Energy Conservation Code.

Effective date.–The credit applies to homes whose construction is substantially completed after December 31, 2003, and which are purchased during the period beginning on January 1, 2003, and ending on December 31, 2006.

Senate Amendment

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 is either 30-percent or 50-percent less than a comparable dwelling constructed in accordance with Chapter 4 of the 2000 International Energy Conservation Code. The home may be certified according to a component-based method or an energy performance based method. Manufactured homes that meet the standards of the Department of Energy's Energy Star program are deemed to satisfy the 30-percent energy efficiency standard.

The component-based method of certification will be based on applicable energy-efficiency specifications or ratings, including current product labeling requirements. The Secretary will develop component-based packages that are equivalent in energy performance to properties that qualify for the credit.

The performance-based method of certification will 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 will 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 will 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.

Conference Agreement

The conference agreement generally follows the House bill with modifications. The requirement that the qualified new energy efficient home be used as the principal residence of the person acquiring the home is modified to provide that the contractor reasonably expect such home to be used as a residence of the person who acquires the home from the contractor. The credit amount is limited to $1,000 for new homes that are 30 percent more efficient than the 2000 IECC standards, as supplemented and as in effect on the date of enactment. The credit amount is limited to $2,000 for new homes that are 50 percent more efficient than the 2000 IECC standards, as supplemented and as in effect on the date of enactment. With respect to the building envelope alone, all qualifying new homes must be at least 10 percent more efficient than the 2000 IECC standard as supplemented and as in effect on the date of enactment. Additionally, the conference agreement includes the Senate amendment provision with respect to Energy Star manufactured homes, though the credit is limited to $1,000.

Certification requirements are to be met in accordance with guidance prescribed by the Secretary of the Treasury. Such guidance shall specify procedures and methods for calculating energy and cost savings. It is expected that such guidance will allow for third-party certification, but will also allow the eligible contractor to meet the certification requirements without necessarily involving a third-party certifier. It is also expected that such guidance will provide sufficient safeguards to ensure that only homes meeting the required standards will obtain certification.

The certification shall be made in writing in a manner which specifies the energy efficient building envelope components and energy efficient heating or cooling equipment installed and their respective energy efficiency performance. In the case of homes qualifying under the Energy Star program, the certification shall be accompanied by documentation as required by the Administrator of the Environmental Protection Agency under the Energy Star Labeled Homes program.

The credit is treated as part of the general business credit and, under a special transition rule, may not be carried back to a taxable year ending before or on the effective date of the provision.

Effective date.–The credit applies to homes whose construction is substantially completed after December 31, 2003, and which are purchased during the period beginning on January 1, 2004, and ending on December 31, 2006.

6. Energy credit for combined heat and power system property (sec. 41006 of the House bill, sec. 2108 of the Senate amendment, 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.

House Bill

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

CHP property is property: (1) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) that has an electrical capacity of 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) that 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 not 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 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, 2003 and before January 1, 2007.

Senate Amendment

The Senate amendment is similar to the House bill. However, for purposes of determining whether CHP property includes technologies which generate electricity or mechanical power using back-pressure steam turbines in place of existing pressure-reducing valves, or which make use of waste heat from industrial processes such as by using organic rankine, stirling, or kalina heat engine systems, the energy output requirements related to heat versus power described under (3), above, and the energy efficiency requirements of (4), above, may be disregarded.

Effective date.–The credit applies to property placed in service after December 31, 2002 and before January 1, 2007.

Conference Agreement

The conference agreement follows the House bill with modifications. The first modification removes the minimum system size requirement and limits the availability of the credit to systems with capacity less than 15 megawatts or 2,000 horsepower. The second modification eliminates the extension of the depreciation period from 15 to 22 years. The third modification is that systems whose fuel source is at least 90 percent bagasse and that would qualify for the credit, but for the failure to meet the efficiency standard, are eligible for a credit that is reduced in proportion to the degree to which the system fails to meet the efficiency standard. For example, a system that would otherwise be required to meet the 60-percent efficiency standard, but which only achieves 30-percent efficiency, would be permitted a credit equal to one-half of the otherwise allowable credit (i.e., a 5-percent credit).

The credit may not be carried back to a taxable year ending before January 1, 2004.

Effective date.–The provision applies to periods after December 31, 2003, in taxable years ending after such date, 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), for property placed in service before January 1, 2007.

7. Energy efficient appliances (sec. 2102 of the Senate amendment 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 energ 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.

House Bill

No provision.

Senate Amendment

The Senate amendment 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 clothes 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., clothes 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.

Conference Agreement

The conference agreement generally follows the Senate amendment with modifications. The $50 credit is eliminated for clothes washers and refrigerators. A credit of $100 is allowed for refrigerators that consume 15 percent (20 percent for refrigerators produced after 2006) less kilowatt-hours per year than the energy conservation standards promulgated by the Department of Energy that took effect on July 1, 2001. A credit of $100 is allowed for clothes washers with a MEF of 1.5 or greater. A credit of $150 is allowed for refrigerators produced prior to 2007 that consume 20 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 $30 million overall credit limitation for each of two separate categories of appliances is replaced with a cap of $60 million across all appliances combined.

The three prior years are the base period years for calculation of the credit for any specific year. To qualify for any credit, production must exceed 110 percent of the average annual production in the base period years. Additionally, in order to determine if production has exceeded the baseline, all clothes washers and refrigerators are treated as a single group, rather than separately by their credit-specific efficiency standard. For example, if in the base period a producer produced an average of 1000 refrigerators and clothes washers combined that would have met the $100 credit standard, and no refrigerators that would have met the $150 credit standard, such producer would need to produce a combination of at least 1100 (110 percent of base period average) refrigerators or clothes washers that met the efficiency standards in order to receive any tax credit. Thus, even thought the base period production of refrigerators meeting the $150 credit standard is zero, a producer would not be eligible to receive a credit for production of such refrigerators unless a combination of at least 1100 refrigerators or clothes washers meeting any of the efficiency standards were produced. The aggregate amount of production eligible for a credit is allocated between the $100 and $150 credit categories in proportion to the total production in each credit category. Only production in the United States is eligible for credit and only U.S. production is considered for the base-period production levels.

The credit is treated as part of the general business credit and, under a special transition rule, may not be carried back to a taxable year ending before or on the effective date of the provision.

Effective date.–The credit applies to appliances produced after December 31, 2003, and before January 1, 2008.

8. Energy efficient commercial building deduction (sec. 2105 of Senate amendment, and new sec. 179B of the Code)

Present Law

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

House Bill

No provision.

Senate Amendment

The Senate amendment provides a deduction equal to energy-efficient commercial building property expenditures made by the taxpayer. Energy-efficient commercial building property expenditures are defined as amounts paid or incurred for energy-efficient commercial building property installed in connection with the new construction or reconstruction of property: (1) which is 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 taxable year in which the construction of the building is completed.

Energy-efficient commercial building property means any property that reduces total annual energy and power costs with respect to the lighting, heating, cooling, ventilation, and hot water supply systems of the building by 50 percent or more in comparison to a reference building which meets the requirements of a Standard 90.1-1999 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America ("ASHRAE/IESNA").

Certain certification requirements must be met in order to qualify for the deduction. The Secretary, in consultation with the Secretary of Energy, is directed to promulgate regulations that describe methods of calculating and verifying energy and power costs, taking into consideration the provisions of the 2001 California Nonresidential Alternative Calculation Method Approval Manual. To allow proper calculations of cost, the Secretary shall prescribe the costs per unit of energy and power, such as kilowatt hour, kilowatt, gallon of fuel oil, and cubic foot or Btu of natural gas, which may be dependent on time of usage.

The Secretary shall promulgate procedures for the inspection and testing for compliance of buildings that are comparable, given the difference between commercial and residential buildings, to the requirements in the Mortgage Industry National Home Energy Rating Standards. Such procedures are to be fuel neutral, such that the same energy efficiency features shall qualify a building for the deduction under this subsection regardless of whether the heating source is a gas or oil furnace or an electric heat pump. Individuals qualified to determine compliance shall only be those recognized by one or more organizations certified by the Secretary for such purposes.

When final regulations are adopted, such regulations shall, with respect to methods of calculating and verifying energy and power costs, take into consideration appropriate energy savings from design methodologies and technologies not otherwise credited in ASHRAE/IESNA Standard 90.1-1999 or in the 2001 California Nonresidential Alternative Calculation Method Approval Manual.

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.

The basis of the property is reduced by the amount of the deduction allowed.

Effective date.–The Senate amendment is effective for taxable years beginning after September 1, 2002, for plans certified prior to December 31, 2007, whose construction is completed on or before December 31, 2009.

Conference Agreement

The conference agreement follows the Senate amendment with modifications. The maximum deduction is limited to $1.50 per square foot, and energy efficiency is to be measured relative to the Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America, as in effect on April 2, 2003. Additionally, with respect to public property, no transfer of the deduction to the person primarily responsible for designing the property is allowed.

In the case of a retrofitted or reconstructed building, but not a new building placed in service after the date of enactment, that does not meet the overall building requirement of a 50-percent energy savings, a partial deduction is allowed with respect to each separate building system that comprises energy efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system-specific savings targets established by the Secretary of the Treasury. The applicable system-specific savings targets to be established by the Secretary are those that would result in a total annual energy savings with respect to the whole building of 50 percent, if each of the separate systems met the system specific target. The separate building systems are (1) the lighting system, (2) the heating cooling and ventilation and hot water systems, and (3) the building envelope. The maximum allowable deduction is $0.50 per square foot for each separate system.

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

The conference agreement provides that the Secretary shall establish procedures for certifying eligibility to claim the deduction. The Secretary shall include as part of the certification process procedures for inspection and testing by qualified individuals to ensure compliance of buildings with energy savings plans and targets. Individuals qualifed to determine compliance shall only be those individuals who are recognized by an organization certified by the Secretary for such purposes.

The Secretary, in consultation with the Secretary of Energy, is directed to promulgate regulations that describe methods of calculating and verifying energy and power costs. Additionally, the Secretary is directed to promulgate regulations as necessary to take into account new technologies regarding energy efficiency and renewable energy for purposes of determining energy efficiency and savings. Additionally, the Secretary shall promulgate regulations for recapture of the deduction if the deduction is taken pursuant to a plan to achieve the requisite energy efficiency standard that is subsequently not fully implemented as necessary to achieve such standard.

Effective date.–The provision is effective for property placed in service after the date of enactment and on or before December 31, 2007.

9. Three-year applicable recovery period for depreciation of qualified energy management devices and qualified water submetering devices (secs. 2107 and 2111 of the Senate amendment and sec. 168 of the Code)

Present Law

No special recovery period is currently provided for depreciation of energy management devices or water submetering devices.

House Bill

No provision.

Senate Amendment

The Senate amendment 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 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.

Additionally, the provision provides a three-year recovery period for qualified new water submetering devices placed in service by any taxpayer who is an eligible resupplier. An eligible resupplier is any taxpayer who purchases and installs qualified water submetering devices in every unit in any multi-unit property. A qualified water submetering device is any tangible property eligible for accelerated depreciation under section 168 that enables consumers to manage their purchase or use of water in response to water price and usage signals and that permits reading of water 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, and for any water submetering device placed in service after the date of enactment of the Act and prior to January 1, 2008.

Conference Agreement

The conference agreement generally follows the Senate amendment with respect to energy management devices, but with modifications. The conference agreement provides a three-year recovery period for qualified new energy management devices placed in service by any taxpayer who is a supplier of electric energy or is a provider of electric energy services. A qualified energy management device is any meter or metering device eligible for accelerated depreciation under section 168 and which is used by the taxpayer (1) to measure and record electricity usage data on a time-differentiated basis in at least 4 separate time segments per day, and (2) to provide such data on at least a monthly basis to both consumers and the taxpayer.

The conference agreement does not include the Senate amendment provision related to water submetering devices.

Effective date.–The provision is effective for any qualified energy management device placed in service after the date of enactment and prior to January 1, 2008.

10. Allowance of deduction for qualified energy management devices and qualified water submetering devices (secs. 2106 and 2110 of the Senate amendment)

Present Law

No special deduction is currently provided for expenses incurred for energy management devices or water submetering devices.

House Bill

No provision.

Senate Amendment

The Senate amendment 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.

In addition, the Senate amendment provides a $30 deduction for qualified water submetering devices. A qualified water submetering device is any tangible property eligible for accelerated depreciation under section 168 that enables consumers to manage their purchase or use of water in response to water price and usage signals and that permits reading of water 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, and for any water submetering device placed in service after the date of enactment of the Act and prior to January 1, 2008.

Conference Agreement

The conference agreement does not include the Senate amendment.

11. Credit for electricity produced from advanced nuclear power facilities (new sec. 45L 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 is 1.8 cents per kilowatt-hour for 2003. The credit is reduced for grants, tax-exempt bonds, subsidized energy financing, and other credits.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement that a taxpayer producing electricity at a qualifying advanced nuclear power facility may claim a credit equal to 1.8 cents per kilowatt-hour of electricity produced for the eight year period starting when the facility is placed in service.[4] The aggregate amount of credit that a taxpayer may claim in any year during the eight-year period is subject to limitation based on allocated capacity and an annual limitation as described below.

A qualifying advanced nuclear facility is an advanced nuclear facility for which the taxpayer has received an allocation of megawatt capacity from the Secretary and is placed in service before January 1, 2021. The taxpayer may only claim credit for production of electricity equal to the ratio of the allocated capacity that the taxpayer receives from the Secretary to the rated nameplate capacity of the taxpayer's facility. For example, if the taxpayer receives an allocation of 750 megawatts of capacity from the Secretary and the taxpayer's facility has a rated nameplate capacity of 1,000 megawatts, then the taxpayer may claim three-quarters of the

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

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

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

An advanced nuclear facility is any nuclear facility for the production of electricity, the reactor design for which is approved after the date of enactment. For this purpose, a qualifying advanced nuclear facility is not any facility for which a substantial similar design for a facility of comparable capacity was approved on or before the date of enactment.

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

Effective date.–The provision is effective for production in taxable years beginning after December 31, 2003.

B. Fuels and Alternative Motor Vehicles

1. Repeal certain excise taxes on rail diesel fuel and inland waterway barge fuels (sec. 41008 of the House bill and secs. 4041, 4042, 6421, and 6427 of the Code)

Present Law

Under present law, diesel fuel used in trains is subject to a 4.4-cents-per gallon excise tax. Revenues from 4.3 cents per gallon of this excise tax are retained in the General Fund of the Treasury. The remaining 0.1 cent per gallon is deposited in the Leaking Underground Storage Tank ("LUST") Trust Fund.

Similarly, fuels used in barges operating on the designated inland waterways system are subject to a 4.3-cents-per-gallon General Fund excise tax. This tax is in addition to the 20.1-cents-per-gallon tax rates that are imposed on fuels used in these barges to fund the Inland Waterways Trust Fund and the Leaking Underground Storage Tank Trust Fund.

In both cases, the 4.3-cents-per-gallon excise tax rates are permanent. The LUST tax is scheduled to expire after March 31, 2005.

House Bill

The 4.3-cents-per-gallon General Fund excise tax rate on diesel fuel used in trains and fuels used in barges operating on the designated inland waterways system is repealed. The 0.1 cent per gallon for the Leaking Underground Storage Tank ("LUST") Trust Fund is unchanged by the provision.

Effective date.–The provision is effective on January 1, 2004.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

2. Btu-based rate for diesel/water emulsion fuel (sec. 41009 of the House bill and secs. 4081 and 6427 of the Code)

Present Law

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

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

No special tax rate is provided for diesel fuel blended in a water emulsion fuel.

House Bill

A special tax rate of 19.7 cents per gallon is provided for diesel fuel blended with water into a diesel/water emulsion fuel to reflect the reduced Btu content per gallon resulting from the water. Emulsion fuels eligible for the special rate must consist of not more than 86 percent diesel fuel (and other minor chemical additives to enhance combustion) and at least 14 percent water. Anyone who separates the diesel fuel from the diesel-water fuel emulsion on which a reduced rate of tax was imposed is treated as a refiner of the fuel and is liable for the difference between the amount of tax on the latest removal of the separated fuel and the amount of tax that was imposed on any prior removal or entry of such fuel.

Effective date.–The provision applies to fuels removed after September 30, 2003.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill except as to the effective date.

Effective date.–The provision is effective January 1, 2004.

3. Modifications to small producer ethanol credit (sec. 2005 of the Senate amendment and sec. 40 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 is provided 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 small producer credit is part of the alcohol fuels tax credit under section 40 of the Code. 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 (sec. 38(d)(4)), the only excess credits that may be passed through to cooperative patrons are the rehabilitation credit (sec. 47), the energy property credit (sec. 48(a)), and the reforestation credit (sec. 48(b)).

House Bill

No provision.

Senate Amendment

The Senate amendment 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 is apportioned pro rata among patrons of the cooperative on the basis of the quantity or value of the business done with or for such patrons for the taxable year. An election to pass through the credit is made on a timely filed return for the taxable year and is irrevocable for such taxable year.

Third, the provision repeals the rule that includes the small producer credit in income of taxpayers claiming it. 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.

Conference Agreement

The conference agreement generally follows the Senate amendment except the small producer credit will continue to be included in the income of taxpayers claiming it and no exemption from the passive activity rules under the Code is provided. With respect to the alternative minimum tax, the conference agreement provides the same treatment given other business related energy credits that are the subject of the agreement as described below (see sec. 1347 of the Act).

Effective date.–The provision is effective for taxable years beginning after December 31, 2003.

4. Transfer full amount of excise tax imposed on gasohol to the highway trust fund (sec. 2006 of the Senate amendment)

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 of 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 52-cents-per-gallon income tax credit is allowed for ethanol used as a motor fuel (the "alcohol fuels credit"). The benefit of the alcohol fuels tax credit may be claimed as a reduction in excise tax payments when the ethanol is blended with gasoline ("gasohol"). The reduction is based on the amount of ethanol contained in the gasohol. The excise tax benefits apply to gasohol blends of 90 percent gasoline/10 percent ethanol, 92.3 percent gasoline/7.7 percent ethanol, or 94.3 percent gasoline/5.7 percent ethanol. The income tax credit is based on the amount of alcohol contained in the blended fuel.

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.

House Bill

No provision.

Senate Amendment

The Senate amendment 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 Senate amendment would be effective for taxes imposed after September 30, 2003.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

5. Incentives for biodiesel (sec. 2008 of the Senate amendment and new sec. 40A of the Code)

Present Law

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

However, a 52-cents-per-gallon income tax credit (the "alcohol fuels credit") is allowed for ethanol and methanol (derived from renewable sources) when the alcohol is used as a highway motor fuel. The 52-cents-per-gallon rate is scheduled to decline to 51 cents per gallon beginning in calendar year 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 after 2007.

House Bill

No provision.

Senate Amendment

A new income tax credit is provided for biodiesel fuel mixtures ("biodiesel V" and "biodiesel NV"). The structure of the new credit is similar to structure of the present-law alcohol fuels credit. Biodiesel V is derived from virgin vegetable oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, or mustard seeds, for use in diesel engines. Biodiesel NV is derived from nonvirgin vegetable oils or animal fats for use in diesel engines. Both biodiesel V and biodiesel NV must meet the requirements of the Environmental Protection Agency under section 211 of the Clean Air Act (42 USC 7545) and the American Society of Testing and Materials D6751.

The per gallon biodiesel mixture credit rate for biodiesel V equals one cent for each percentage point of biodiesel in the fuels mixture, subject to a maximum credit of 20 cents per blended gallon of fuel. The per gallon biodiesel mixture credit rate for biodiesel NV equals .5 cent for each percentage point of biodiesel in the fuels mixture, subject to a maximum credit of 20 cents per blended gallon of fuel. The amount of the biodiesel fuel mixture credit is includible in income. The credit cannot be carried back to a taxable year beginning before January 1, 2003.

Mixtures of biodiesel V are subject to a reduced rate of excise tax, which is coordinated with the income tax credit. An excise tax reduction is not available for biodiesel NV.

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 income tax provision is effective for taxable years beginning after December 31, 2002, for fuel sold before January 1, 2006. The excise tax provision is effective for fuel sold after December 31, 2002, and before January 1, 2006.

Conference Agreement

The conference agreement generally follows S. 1548 as ordered reported by the Committee on Finance on September 17, 2003, with respect to the income tax credit for biodiesel and biodiesel mixtures. The conference agreement does not provide for any reduced excise tax rate for mixtures of biodiesel, including virgin biodiesel.

The provision provides a new income tax credit for biodiesel and qualified biodiesel mixtures, the biodiesel fuels credit. The biodiesel fuels credit is the sum of the biodiesel mixture credit plus the biodiesel credit and is treated as a general business credit. The amount of the biodiesel fuels credit is includable in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the excise tax credit for qualified biodiesel mixtures. The credit is treated as part of the general business credit and, under a special transition rule, may not be carried back to a taxable year ending before or on the effective date of the provision. The provision does not apply to fuel used or sold after December 31, 2005.

Biodiesel may be taken into account for purposes of the credit only if the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product. Biodiesel is monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet (1) the registration requirements established by the Environmental Protection Agency under section 211 of the Clean Air Act, and (2) the requirements of the American Society of Testing and Materials D6751. Agri-biodiesel is biodiesel derived from virgin oils including esters derived from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, or animal fats.

Biodiesel mixture credit

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

Biodiesel credit

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

Later separation or failure to use as fuel

In a manner similar to the treatment of alcohol fuels, a tax is imposed if a biodiesel fuels credit is claimed with respect to biodiesel that is subsequently used for a purpose for which the credit is not allowed or that is changed into a substance that does not qualify for the credit. The first tax applies if two conditions are satisfied. First, a biodiesel mixture credit must have been allowed with respect to biodiesel used in the production of a qualified mixture. Second, any person either separates the biodiesel from the mixture or, without separation, uses the mixture other than as a fuel. The tax equals the applicable amount ($1.00 in the case of agri-biodiesel or 50 cents in the case of other biodiesel) multiplied by the number of gallons of biodiesel in such mixture. The second tax applies if two conditions are satisfied. First, a biodiesel credit must have been allowed with respect to the retail sale of any biodiesel. Second, any person mixes that biodiesel or uses it other than as a fuel. The tax equals the applicable amount multiplied by the number of gallons of biodiesel.

Effective date.–The biodiesel fuel income tax credit provision is effective for fuel produced, and sold or used, after December 31, 2003, in taxable years ending after such date.

6. Alcohol and biodiesel excise tax credit and extension of alcohol fuels income tax credit (secs. 40, 4101, 6427, 9503 and new secs. 4104, and 6426 of the Code)

Present Law

Alcohol fuels income tax credit

The alcohol fuels credit is the sum of three credits: the alcohol mixture credit, the alcohol credit, and the small ethanol producer credit. Generally, the alcohol fuels credit expires after December 31, 2007.[5]

A taxpayer (generally a petroleum refiner, distributor, or marketer) who mixes ethanol with gasoline (or a special fuel[6]) is an "ethanol blender." Ethanol blenders are eligible for an income tax credit of 52 cents per gallon of ethanol used in the production of a qualified mixture (the "alcohol mixture credit"). A qualified mixture means a mixture of alcohol and gasoline, (or of alcohol and a special fuel) sold by the blender as fuel, or used as fuel by the blender in producing the mixture. The term alcohol includes methanol and ethanol but does not include (1) alcohol produced from petroleum, natural gas, or coal (including peat), or (2) alcohol with a proof of less than 150. Businesses also may reduce their income taxes by 52 cents for each gallon of ethanol (not mixed with gasoline or other special fuel) that they sell at the retail level as

[5] The alcohol fuels credit is unavailable when, for any period before January 1, 2008, the tax rates for gasoline and diesel fuels drop to 4.3 cents per gallon.

[6] A special fuel includes any liquid (other than gasoline) that is suitable for use in an internal combustion engine.

vehicle fuel or use themselves as a fuel in their trade or business ("the alcohol credit"). The 52-cents-per-gallon income tax credit rate is scheduled to decline to 51 cents per gallon during the period 2005 through 2007. For blenders using an alcohol other than ethanol, the rate is 60 cents per gallon.[7]

A separate income tax credit is available for small ethanol producers (the "small ethanol producer credit"). A small ethanol producer is defined as a person whose ethanol production capacity does not exceed 30 million gallons per year. The small ethanol producer credit is 10 cents per gallon of ethanol produced during the taxable year for up to a maximum of 15 million gallons.

The credits that comprise the alcohol fuels tax credit are includible in income. The credit may not be used to offset alternative minimum tax liability. The credit is a treated as a general business credit, subject to the ordering rules and carryforward/carryback rules that apply to business credits generally.

Excise tax reductions for alcohol mixture fuels

Generally, motor fuels tax rates are as follows[8]:

Gasoline	18.4 cents per gallon
Diesel fuel and kerosene	24.4 cents per gallon
Special motor fuels	18.4 cents per gallon generally

Alcohol-blended fuels are subject to a reduced rate of tax. The benefits provided by the alcohol fuels income tax credit and the excise tax reduction are integrated such that the alcohol fuels credit is reduced to take into account the benefit of any excise tax reduction.

Gasohol

Registered ethanol blenders may forgo the full income tax credit and instead pay reduced rates of excise tax on gasoline that they purchase for blending with ethanol. Most of the benefit of the alcohol fuels credit is claimed through the excise tax system.

[7] In the case of any alcohol (other than ethanol) with a proof that is at least 150 but less than 190, the credit is 45 cents per gallon (the "low-proof blender amount"). For ethanol with a proof that is at least 150 but less than 190, the low-proof blender amount is 38.52 cents for sales or uses during calendar year 2003 and 2004, and 37.78 cents for calendar years 2005, 2006, and 2007.

[8] These rates include an additional 0.1 cent-per-gallon excise tax to fund the Leaking Underground Storage Tank Trust Fund. *See* secs. 4041(d) and 4081(a)(2)(B). In addition, the basic fuel tax rate will drop to 4.3 cents per gallon beginning on October 1, 2005.

The reduced excise tax rates apply to gasohol upon its removal or entry. Gasohol is defined as a gasoline/ethanol blend that contains 5.7 percent ethanol, 7.7 percent ethanol, or 10 percent ethanol. For the calendar year 2003, the following reduced rates apply to gasohol:[9]

5.7 percent ethanol	15.436 cents per gallon
7.7 percent ethanol	14.396 cents per gallon
10.0 percent ethanol	13.200 cents per gallon

Reduced excise tax rates also apply when gasoline is being purchased for the production of "gasohol." When gasoline is purchased for blending into gasohol, the rates above are multiplied by a fraction (e.g., 10/9 for 10-percent gasohol) so that the increased volume of motor fuel will be subject to tax. The reduced tax rates apply if the person liable for the tax is registered with the IRS and (1) produces gasohol with gasoline within 24 hours of removing or entering the gasoline or (2) gasoline is sold upon its removal or entry and such person has an unexpired certificate from the buyer and has no reason to believe the certificate is false.[10]

Qualified methanol and ethanol fuels

Qualified methanol or ethanol fuel is any liquid that contains at least 85 percent methanol or ethanol or other alcohol produced from a substance other than petroleum or natural gas. These fuels are taxed at reduced rates.[11] The rate of tax on qualified methanol is 12.35 cents per gallon. The rate on qualified ethanol in 2003 and 2004 is 13.15 cents. From January 1, 2005, through September 30, 2007, the rate of tax on qualified ethanol is 13.25 cents.[12]

Alcohol produced from natural gas

A mixture of methanol, ethanol, or other alcohol produced from natural gas that consists of at least 85 percent alcohol is also taxed at reduced rates.[13] For mixtures not containing ethanol, the applicable rate of tax is 9.25 cents per gallon before October 1, 2005. In all other

[9] These rates include the additional 0.1 cent-per-gallon excise tax to fund the Leaking Underground Storage Tank Trust Fund. These special rates will terminate after September 30, 2007 (sec. 4081(c)(8)).

[10] Treas. Reg. sec. 48.4081-6(c). A certificate from the buyer assures that the gasoline will be used to produce gasohol within 24 hours after purchase. A copy of the registrant's letter of registration cannot be used as a gasohol blender's certificate.

[11] A 0.05-cent-per-gallon Leaking Underground Storage Tank Trust Fund tax is imposed on such fuel. This provision expires on October 1, 2007 (sec. 4041(b)(2)).

[12] These reduced rates terminate after September 30, 2007.

[13] These rates include the additional 0.1 cent-per-gallon excise tax to fund the Leaking Underground Storage Tank Trust Fund (sec. 4041(d)(1)).

cases, the rate is 11.4 cents per gallon. After September 31, 2005, the rate is reduced to 2.15 cents per gallon when the mixture does not contain ethanol and 4.3 cents per gallon in all other cases.

Blends of alcohol and diesel fuel or special motor fuels

A reduced rate of tax applies to diesel fuel or kerosene that is combined with alcohol as long as at least 10 percent of the finished mixture is alcohol. If none of the alcohol in the mixture is ethanol, the rate of tax is 18.4 cents per gallon. For alcohol mixtures containing ethanol, the rate of tax in 2003 and 2004 is 19.2 cents per gallon and for 2005 through September 30, 2007, the rate for ethanol mixtures is 19.3 cents per gallon. Fuel removed or entered for use in producing a 10 percent diesel-alcohol fuel mixture (without ethanol), is subject to a tax of 20.44 cents. The rate of tax for fuel removed or entered to produce a 10 percent diesel-ethanol fuel mixture is 21.333 cents per gallon for 2003 and 2004 and 21.444 cents per gallon for the period January 1, 2005, through September 30, 2007.

Special motor fuel (nongasoline) mixtures with alcohol also are taxed at reduced rates.

Aviation fuel

Noncommercial aviation fuel is subject to a tax of 21.9 cents per gallon.[14] Fuel mixtures containing at least 10 percent alcohol are taxed at lower rates.[15] In the case of 10 percent ethanol mixtures, any sale or use during 2003 and 2004, the 21.9 cents is reduced by 13.2 cents (for a tax of 8.7 cents per gallon), for 2005, 2006, and 2007 the reduction is 13.1 cents (for a tax of 8.8 cents per gallon) and is reduced by 13.4 cents in the case of any sale during 2008 or thereafter. For mixtures not containing ethanol, the 21.9 cents is reduced by 14 cents for a tax of 7.9 cents. These reduced rates expire after September 30, 2007. [16]

When aviation fuel is purchased for blending with alcohol, the rates above are multiplied by a fraction (10/9) so that the increased volume of aviation fuel will be subject to tax.

Refunds and payments

If fully taxed gasoline (or other taxable fuel) is used to produce a qualified alcohol mixture, the Code permits the blender to file a claim for a quick excise tax refund. The refund is equal to the difference between the gasoline (or other taxable fuel) excise tax that was paid and the tax that would have been paid by a registered blender on the alcohol fuel mixture being produced. Generally, the IRS pays these quick refunds within 20 days. Interest accrues if the refund is paid more than 20 days after filing. A claim may be filed by any person with respect to

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[14] This rate includes the additional 0.1 cent-per-gallon tax for the Leaking Underground Storage Tank Trust fund.

[15] Sec. 4041(k)(1) and 4091(c).

[16] Sec. 4091(c)(1).

gasoline, diesel fuel, or kerosene used to produce a qualified alcohol fuel mixture for any period for which $200 or more is payable and which is not less than one week.

Ethyl tertiary butyl ether (ETBE)

Ethyl tertiary butyl ether ("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 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.

Highway Trust Fund

With certain exceptions, the taxes imposed by section 4041 (relating to retail taxes on diesel fuels and special motor fuels) and section 4081 (relating to tax on gasoline, diesel fuel and kerosene) are credited to the Highway Trust Fund. In the case of alcohol fuels, 2.5 cents per gallon of the tax imposed is retained in the General Fund.[17] In the case of a taxable fuel taxed at a reduced rate upon removal or entry prior to mixing with alcohol, 2.8 cents of the reduced rate is retained in the General Fund.[18]

Biodiesel

If biodiesel is used in the production of blended taxable fuel, the Code imposes tax on the removal or sale of the blended taxable fuel.[19] In addition, the Code imposes tax on any liquid other than gasoline sold for use or used as a fuel in a diesel-powered highway vehicle or diesel-powered train unless tax was previously imposed and not refunded or credited.[20] If biodiesel that was not previously taxed or exempt is sold for use or used as a fuel in a diesel-powered highway

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[17] Sec. 9503(b)(4)(E).

[18] Sec. 9503(b)(4)(F).

[19] Sec. 4081(b); Rev. Rul. 2002-76, 2002-46 I.R.B. 841 (2002). "Taxable fuels" are gasoline, diesel and kerosene (sec. 4083). Biodiesel, although suitable for use as a fuel in a diesel-powered highway vehicle or diesel-powered train, contains less than four percent normal paraffins and, therefore, is not treated as diesel fuel under the applicable Treasury regulations. Treas. Reg. secs. 48.4081-1(c)(2)(i) and (ii), and 48.4081-1(b); Rev. Rul. 2002-76, 2002-46 I.R.B. 841 (2002). As a result, biodiesel alone is not a taxable fuel for purposes of section 4081. As noted above, however, tax is imposed upon the removal or entry of blended taxable fuel made with biodiesel.

[20] Sec. 4041. The tax imposed under section 4041 also will not apply if an exemption from tax applies.

vehicle or a diesel-powered train, tax is imposed.[21] There are no reduced excise tax rates for biodiesel.

House bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement creates two new excise tax credits, the alcohol fuel mixture excise tax credit and the biodiesel fuel mixture excise tax credit. The sum of these credits may be taken against the tax imposed on taxable fuels (by section 4081). The amount of fuel taxes transferred to the Highway Trust Fund is not reduced by any excise tax credits claimed. The conference agreement also extends the alcohol fuels income tax credit (sec. 40) through December 31, 2010.[22]

Alcohol fuel mixture excise tax credit

The conference agreement provides for an excise tax credit, the alcohol fuel mixture credit. The alcohol fuel mixture credit is 52 cents for each gallon of alcohol used by a person in producing an alcohol fuel mixture for sale or use in a trade or business of the taxpayer. The credit declines to 51 cents per gallon after calendar year 2004. For mixtures not containing ethanol (renewable source methanol), the credit is 60 cents per gallon.

For purposes of the alcohol fuel mixture credit, an "alcohol fuel mixture" is a mixture of alcohol and a taxable fuel that is (1) sold for use or used as a fuel by the taxpayer producing the mixture or (2) removed from the refinery by a person producing the mixture. Alcohol for this purpose includes methanol, ethanol, and alcohol gallon equivalents of ETBE or other ethers produced from such alcohol. It does not include alcohol produced from petroleum, natural gas,

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[21] Rev. Rul. 2002-76, 2002-46 I.R.B. 841 (2002).

[22] The conference agreement contains several provisions found in S. 1548 as ordered reported by the Committee on Finance on September 17, 2003. While similar to S. 1548, the conference agreement differs from S. 1548 in several respects. Unlike S. 1548, the conference agreement leaves in place the present-law reduced rate excise tax structure. Also, the conference agreement does not eliminate the requirement that 2.5 and 2.8 cents per gallon of the reduced rate of excise tax be retained in the General Fund. In addition, the conference agreement does not contain any provisions regarding payments with respect to qualified alcohol and biodiesel fuel mixtures nor with respect to alcohol and biodiesel used as a fuel.

or coal (including peat), or alcohol with a proof of less than 190 (determined without regard to any added denaturants). Taxable fuel is gasoline, diesel, and kerosene.[23]

The excise tax credit is coordinated with the alcohol fuels income tax credit and is available through December 31, 2010. In addition, any excise tax exemption for alcohol fuels reduces the amount of the alcohol fuel excise tax credit.[24]

<u>Biodiesel mixture excise tax credit</u>

The provision provides an excise tax credit for biodiesel mixtures.[25] The credit is 50 cents for each gallon of biodiesel used by the taxpayer in producing a qualified biodiesel mixture for sale or use in a trade or business of the taxpayer. A qualified biodiesel mixture is a mixture of biodiesel and taxable fuel that is (1) sold for use or used by the taxpayer producing such mixture as a fuel, or (2) removed from the refinery by a person producing the mixture. In the case of agri-biodiesel, the amount of the credit is $1.00 per gallon. The credit applies only if the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary) from the producer of the biodiesel which identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.

The credit is not available for any sale, use or removal for any period after December 31, 2005. This excise tax credit is coordinated with the income tax credit for biodiesel such that the credit for the same biodiesel cannot be claimed for both income and excise tax purposes.

<u>Later separation or mixture not used as fuel</u>

Under certain circumstances, a tax is imposed if an alcohol fuel mixture credit or biodiesel fuel mixture credit is claimed with respect to alcohol or biodiesel used in the production of any alcohol or biodiesel mixture, that is subsequently used for a purpose for which the credit is not allowed or changed into a substance that does not qualify for the credit. The tax applies if two conditions are satisfied. First, a credit must have been allowed with respect to alcohol or biodiesel used in the production of a qualified mixture. Second, any person either separates the alcohol or biodiesel from the mixture or, without separation, uses the mixture other than as a fuel. The tax equals the applicable amount multiplied by the number of gallons of such alcohol or biodiesel.

<u>Registration requirements</u>

Under the provision, the Secretary shall require registration of every person that produces biodiesel or alcohol.

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

[24] Rules similar to those found in section 40(c) regarding the income tax credit for alcohol fuels apply.

[25] The excise tax credit uses the same definitions as the biodiesel fuels income tax credit.

Information reporting for persons claiming certain tax benefits

The Secretary shall require any person claiming tax benefits under certain sections relating to alcohol and biodiesel fuels[26] to file a quarterly return (in such manner as the Secretary may prescribe) providing such information relating to such benefits and the coordination of such benefits as the Secretary may require to ensure the proper administration and use of such benefits. With respect to persons required to register with the Secretary, failure to comply with these information-reporting requirements could subject such a person to the denial, revocation or suspension of registration.

Refund claims

If fully taxed gasoline (or other taxable fuel) is used to produce a qualified alcohol mixture, the Code permits the blender to file a claim for a quick excise tax refund. For claims filed after December 31, 2004, if such claims are not paid within 45 days, the claim is to be paid with interest. In the case of an electronic claim, if such claim is not paid within 20 days, the claim is to be paid with interest. If claims are filed electronically, the claimant may make a claim for less than $200. The Secretary is to prescribe the electronic format for filing claims not later than December 31, 2004.

Highway Trust Fund

The provision provides that the amount of fuel taxes to be appropriated to the Highway Trust Fund shall be determined without reduction for amounts equivalent to the excise tax credits allowed for alcohol fuel mixtures and biodiesel mixtures.

Effective date.–In general, the provisions are effective for fuel sold, used, or removed after December 31, 2003. The provisions relating to refund claims are effective for claims filed after December 31, 2004.

7. Nonapplication of export exemption to delivery of fuel to motor vehicles removed from United States (sec. 2504 of the Senate amendment and secs. 4221, 4041, and 4081 of the Code)

Present Law

A manufacturer's excise tax is imposed upon

(1) The removal of any taxable fuel from a refinery or terminal;

(2) The entry of any taxable fuel into the United States for consumption, use or warehousing; or

[26] These sections are sections 34, 40, 40A, 4041(b)(2), 4041(k), 4081(c), 6426, and 6427(f).

(3) The sale of any taxable fuel to any person who is not registered, unless there was a prior taxable removal or entry.[27]

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

Special provisions under the Code provide for a refund of tax to any person who sells gasoline to another for exportation.[28] Section 6421(c) provides "If gasoline is sold to any person for any purpose described in paragraph (2), (3), (4), or (5) of section 4221(a), the Secretary shall pay (without interest) to such person an amount equal to the product of the number of gallons so sold multiplied by the rate at which tax was imposed on such gasoline by section 4081." Section 4221 provides, in pertinent part, "Under regulations prescribed by the Secretary, no tax shall be imposed under this chapter. . . on the sale by the manufacturer .. of an article--. . . for export, or for resale by the purchaser to a second purchaser for export . . . but only if such exportation or use is to occur before any other use . . ."

It is the IRS administrative position that the exemption from manufacturers excise tax by reason of exportation does not apply to the sale of motor fuel pumped into a fuel tank of a vehicle that is to be driven, or shipped, directly out of the United States.[29]

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

The United States Court of Federal Claims ("Claims Court") and a District Court in Michigan have taken different positions on whether fuel sold from a duty-free facility and placed into the tank of an automobile that is then driven out of the country is exported fuel.[30] Both cases involved the same duty-free facility, which is near the Canadian border and is configured

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

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

[29] Rev. Rul. 69-150.

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

in such a way that anyone leaving the facility must depart the United States and enter into Canada. The District Court agreed with the IRS position that such fuel is not exported, while the Claims Court reached the opposite conclusion. The Claims Court concluded that the act of exportation began with the consumer's purchase and that the fuel necessarily enters into the stream of exportation at the moment it is placed into the fuel supply tank and the customer drives into Canada.

House Bill

No provision.

Senate Amendment

The Senate amendment amends section 555(b) of the Tariff Act of 1930 (19 U.S.C. 1555(b)) to provide that gasoline or diesel fuel sold at duty-free facilities are considered to be entered for consumption into the United States and thus ineligible for classification as duty-free merchandise.

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

Conference Agreement

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

Effective date.–The provision applies to sales or deliveries made after the date of enactment.

8. Modification of credit for electric vehicles (sec. 41010 of the House bill, sec. 2002 of Senate amendment, and sec. 30 of the Code)

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 2004 through 2006, and is unavailable for purchases after December 31, 2006. There is no carry forward or carryback of the credit for electric vehicles.

House Bill

The House bill repeals the phased-down reduction in the credit for years 2004, 2005, and 2006. Thus, the House bill provides that a taxpayer may claim the full 10-percent credit (up to a $4,000) maximum for the purchase of qualified electric vehicles before January 1, 2007.

Effective date.–The House bill provision is effective for property placed in service after the date of enactment.

Senate Amendment

The Senate amendment 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 vehicle 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 phase-out 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 the October 1, 2002).

Effective date.–The Senate amendment is effective for property placed in service after September 30, 2002.

Conference Agreement

The conference agreement follows the House bill.

9. Alternative motor vehicle credit (sec. 41011 of the House bill, secs. 2001 and 2010 of Senate amendment, and new sec. 30B of the Code)

Present Law

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

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

House Bill

Clean-fuel vehicles

The House bill repeals the phased-down reduction in the allowable deduction for years 2004, 2005, and 2006. Thus, the provision provides that a taxpayer could claim a full deduction for allowable costs of clean-fuel vehicles purchased before January 1, 2007.

Fuel cell vehicles

The House bill provides a credit for the purchase of a new qualified fuel cell motor vehicle. A qualifying fuel cell vehicle is a motor vehicle that is propelled by power derived from one or more cells which convert chemical energy directly into electricity by combining oxygen with hydrogen fuel which is stored on board the vehicle and may or may not require reformation prior to use. In general the House bill provides that the buyer claims the credit, unless the buyer is a tax-exempt entity in which case the seller or lessor of the vehicle may claim the credit. The provision permits unused credits to be carried forward for up to 20 years. Qualified fuel cell motor vehicles are vehicles placed in service before 2013.

The amount of credit for the purchase of a fuel cell vehicle is determined by a base credit amount that depends upon the weight class of the vehicle and, in the case of automobiles or light trucks, an additional credit amount that depends upon the rated fuel economy of the vehicle compared to a base fuel economy. For these purposes the base fuel economy is the 2000 model year city fuel economy rating for vehicles of various weight classes (see below). Table 1, below, shows the base credit amounts.

Table 1.–Base Credit Amount for Fuel Cell Vehicles

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

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

Table 2.–Credit for Qualifying Fuel Cell Vehicles

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

Advanced lean-burn technology motor vehicle

The House bill provides a credit for the purchase of a new advanced lean burn technology motor vehicle. A qualifying advanced lean burn technology motor vehicle must meet the Environmental Protection Agency's Tier II bin 8 emissions standards. In general the provision provides that the buyer claims the credit, unless the buyer is a tax-exempt entity in which case the seller or lessor of the vehicle may claim the credit. The House bill permits unused credits to be carried forward for up to 20 years. Qualified advanced lean burn technology motor vehicles are vehicles placed in service before 2007. Table 3, below, shows the credits for the purchase of an advanced lean burn technology motor vehicle.

Table 3.–Credit for Qualifying Advanced Lean Burn Technology Motor Vehicles

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

In addition to the credit amount shown in Table 3, an advanced lean burn technology automobile or light truck may be eligible for an additional credit of $250 if the vehicle achieves an estimated lifetime fuel savings of at least 1,500 gallons of fuel and a further additional credit of $500 if the vehicle achieves an estimated lifetime fuel savings of at least 2,500 gallons compared to a like conventional vehicle (using the 2000 model year city fuel economy rating for the like vehicle and assuming 120,000 miles driven).

Base fuel economy

The base fuel economy is the 2000 model year city fuel economy for vehicles by inertia weight class by vehicle type. The "vehicle inertia weight class" is that defined in regulations prescribed by the Environmental Protection Agency for purposes of Title II of the Clean Air Act.

Effective date.–The House bill provision is effective for property placed in service after the date of enactment.

Senate Amendment

Section 179A

The Senate amendment extends the present-law deduction through December 31, 2011, for hydrogen-related property and through December 31, 2007, for all other vehicles. The Senate amendment provides that the otherwise allowable deduction is reduced by 25 percent in 2004 through 2009 for hydrogen-related property and in 2004 and 2005 for all other vehicles. The Senate amendment reduces the otherwise allowable deduction by 50 percent and 75 percent in 2010 and 2011 respectively in the case of hydrogen-related property and in 2006 and 2007 for all other vehicles.

Fuel cell motor vehicles

The Senate amendment provides a credit for the purchase of qualified 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. Credit may not be claimed for qualified fuel cell motor vehicles purchased after December 31, 2011.

Hybrid motor vehicles

The Senate amendment provides a credit for the purchase of qualified 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. 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 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.

Alternative fuel motor vehicles

The Senate amendment provides a credit for the purchase of qualified 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.

Provisions of general application

The Senate amendment provides that unused credits may be carried forward for 20 years and three years (but not into taxable years beginning before October 1, 2002).

If a tax-exempt person purchases or leases a qualifying vehicle, the seller or lessor may claim the credit.

Effective date

The Senate amendment is effective for property placed in service after September 30, 2002.

Conference Agreement

Clean-fuel vehicles (Section 179A)

The conference agreement follows the House bill with respect to modifications to present-law section 179A.

Fuel cell vehicles

The conference agreement follows the House bill with respect to providing a credit for the purchase of a new qualified fuel cell motor vehicle, except the base-year for fuel economy comparisons is modified as described below.

Hybrid motor vehicles

A qualifying hybrid vehicle is a motor vehicle that draws propulsion energy from on-board sources of stored energy which include both an internal combustion engine or heat engine using combustible fuel and a rechargeable energy storage system (e.g., batteries). A qualifying hybrid motor vehicle must be placed in service before January 1, 2009.

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

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

Table 4.–Fuel Economy Credit

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

Credit	If Fuel Economy of the Hybrid Vehicle Is:	
	at least	**but less than**
$2,000	225% of base fuel economy	250% of base fuel economy
$2,400	250% of base fuel economy	

Table 5, below, shows the conservation credit.

Table 5.–Conservation Credit

Estimated Lifetime Fuel Savings	Conservation Amount
At least 1,200 but less than 1,800	$250
At least 1,800 but less than 2,400	$500
At least 2,400 but less than 3,000	$750
At least 3,000	$1,000

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

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

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

The conferees recognize that these heavier hybrid vehicles generally are trucks and vans. The fuel economy performance of trucks and vans varies by the use of such equipment. For example, used by a plumbing company generally carry more weight than an otherwise identical van used by a florist. Hence, the fuel economy performance of the plumbing vans should be worse than that of the floral vans. In basing the credit for these heavier hybrid vehicles on fuel economy, the conferees do not intend that any fuel economy standards for such heavier vehicles be promogulated. Rather, the conferees intend that the Secretary provide guidance so that fuel economy increases may be assessed on a case-by-case basis accounting for the intended use of the vehicles.

Advanced lean-burn technology motor vehicles

The conference agreement a credit for the purchase of a new advanced lean burn technology motor vehicle. The amount of credit for the purchase of an advanced lean burn technology motor vehicle is the sum of two components: a fuel economy credit amount that varies with the rated fuel economy of the vehicle compared to a 2002 model year standard as described in Table 4, above and a conservation credit based on the estimated lifetime fuel savings of a qualifying vehicle compared to a comparable 2002 model year vehicle as described in Table 5 above.

A qualifying advanced lean burn technology motor vehicle that incorporates direct injection, achieves at least 125 percent of the 2002 model year city fuel economy, and 2004 and later model vehicles meets or exceeds certain Environmental Protection Agency emissions standards. For a vehicle with a gross vehicle weight rating of 6,000 pounds or less the applicable emissions standards are the Bin 5 Tier II emissions standards. For a vehicle with a gross vehicle weight rating greater than 6,000 pounds and less than or equal to 8,500 pounds, the applicable emissions standards are the Bin 8 Tier II emissions standards. A qualifying advanced lean burn technology motor vehicle must be placed in service before January 1, 2009.

Limitation on number of qualified hybrid and advanced lean-burn technology motor vehicles eligible for the credit

The conference agreement imposes a limitation on the number of qualified hybrid motor vehicles and advanced lean-burn technology motor vehicles sold by each manufacturer of such vehicles that are eligible for the credit. Taxpayers may claim the full amount of the allowable credit up to the end of the first calendar quarter in which the manufacturer records its sale of the 80,000th hybrid and advanced lean-burn technology motor vehicle. Taxpayers may claim one half of the otherwise allowable credit during the two calendar quarters subsequent to the quarter after the manufacturer has recorded its 80,000th such sale. In the third and fourth calendar quarters subsequent to the quarter after the manufacturer has recorded its 80,000th such sale, the taxpayer may claim one quarter of the otherwise allowable credit.

Thus, summing the sales of qualifying hybrid motor vehicles of all weight classes and all sales of qualifying advanced lean-burn technology motor vehicles, if a manufacturer records the sale of its 80,000th in February of 2006, taxpayers purchasing such vehicles from the manufacturer may claim the full amount of the credit on their purchases of qualifying vehicles through June 20, 2006. For the period July 1, 2006, through December 31, 2006, taxpayers may claim one half of the otherwise allowable credit on purchases of qualifying vehicles of the manufacturer. For the period January 1, 2007, through June 30, 2007, taxpayers may claim one quarter of the otherwise allowable credit on the purchases of qualifying vehicles of the manufacturer. After June 30, 2007, no credit may be claimed for purchases of hybrid motor vehicles or advanced lean-burn technology motor vehicles sold by the manufacturer.

Alternative fuel motor vehicles

The credit for the purchase of a new alternative fuel vehicle is 40 percent of the incremental cost of such vehicle, plus an additional 30 percent if the vehicle meets certain emissions standards, but not more than between $5,000 and $40,000 depending upon the weight of the vehicle. Table 6, below, shows the maximum permitted incremental cost for the purpose of calculating the credit for alternative fuel vehicles by vehicle weight class.

Table 6.–Maximum Allowable Incremental Cost for Calculation of Alternative Fuel Vehicle Credit

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

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

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

A qualifying alternative fuel vehicle (or mixed fuel vehicle) must be placed in service before January 1, 2007.

Base fuel economy

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

Alternative minimum tax and credit carry forward or carry back

Taxpayers may claim credits with respect to purchases of qualified vehicles against both their regular and alternative minimum tax liabilities.

The conference agreement provides that credits allowable, but unused in the current year, from the purchase of a qualifying vehicle for business use may be carried back one year and forward 20 years.[32] Credit allowable with respect to a vehicle purchased for personal use may only be claimed in the year of purchase. The Secretary shall issue regulations under which qualified vehicle sold at retail is display a notice stating that the vehicle is a qualified vehicle and that the buyer may not benefit from the credit allowed if the buyer has insufficient tax liability to be offset by the allowable credit.

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

10. Modifications of deduction for refueling property (secs. 2003 and 2010 of Senate amendment and sec. 179A of the Code)

Present Law

Certain costs of qualified clean-fuel vehicle refueling property may be expensed and deducted when such property is placed in service (sec. 179A). Up to $100,000 of such property at each location owned by the taxpayer may be expensed with respect to that location. 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 comprise clean-burning fuels.

The deduction is unavailable for property placed in service after December 31, 2006.

House Bill

No provision.

Senate Amendment

The Senate amendment extends the present-law deduction to property placed in service before January 1, 2008, and to property placed in service before January 1, 2012, in the case of hydrogen refueling property.

In addition, the Senate amendment 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

[32] The credit, however, is not made part of the general business credit.

$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 (before January 1, 2012 in the hydrogen refueling property). 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.

Effective date.–The Senate amendment is effective for property placed in service after September 30, 2002.

Conference Agreement

The conference agreement extends and modifies present-law section 179A with respect to refueling property. The conference agreement increases the present-law limitation of $100,000 of qualifying expenses per refueling location of the taxpayer to $150,000 per location. In addition, the conference agreement modifies the definition of refueling property with respect to hydrogen produced from another clean-burning fuel (*i.e.*, natural gas, liquefied natural gas, liquefied petroleum gas, any fuel at least 85 percent of which is one or more of methanol, ethanol, or other alcohol or ether) such that qualified refueling property included property for the production of hydrogen fuel, in addition to property for the storage and dispensing of hydrogen fuel, if such property is located at the point where hydrogen fuel is delivered into the fuel tank of a motor vehicle.

The conference agreement extends the placed in service date for qualifying refueling property to property placed in service prior to January 1, 2009 (January 1, 2012, in the case of property related to hydrogen fuel).

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

11. Credit for retail sale of alternative motor vehicle fuels (secs. 2004 and 2010 of Senate amendment)

Present Law

There is no retail credit for the sale of alternative motor vehicle fuels. However, a 52-cents-per-gallon income tax credit is allowed for alcohol fuels for 2003 and 2004 (51 cents for 2005-2007). The alcohol fuels credit may be claimed as a reduction in excise tax payments. Such tax payments generally are made before the retail level. In the case of ethanol, the Code provides a separate 10-cents-per-gallon credit for small producers.

House Bill

No provision.

Senate Amendment

The Senate amendment permits taxpayers to claim a credit equal to the gasoline gallon equivalent of 30 cents per gallon of alternative fuel sold 2002 and in 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 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 Senate amendment is effective for fuel sold at retail after September 30, 2002.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

II. RELIABILITY

A. Natural Gas Gathering Lines Treated as Seven-Year Property (sec. 42001 of the House bill, sec. 2302 of the Senate amendment, 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.[33] 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 and the 6th Circuit Court of Appeals have held that natural gas gathering lines owned by nonproducers falls within the scope of Asset class 13.2 (i.e., seven-year recovery period).[34] The Tax Court has held that natural gas gathering lines owned by nonproducers falls within the scope of Asset class 46.0 (*i.e.*, 15-year recovery period).[35]

House Bill

The House bill establishes a statutory 7-year recovery period and a class life of 10 years for natural gas gathering lines. In addition, the House bill provides that there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to such property. 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.

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33 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

34 *Duke Energy v. Commissioner*, 172 F.3d 1255 (10th Cir. 1999), *rev'g* 109 T.C. 416 (1997). *Saginaw Bay Pipeline Co. v. United States*, 2003 FED App. 0259P (6th Cir.) *rev'g* 124 F. Supp. 2d 465 (E.D. Mich. 2001). See also *True v. United States*, 97-2 U.S. Tax Cas. (CCH) par. 50,946 (D. Wyo. 1997).

35 *Clajon Gas Co., L.P. v. Commissioner*, 119 T.C. 197 (2002).

Senate Amendment

The Senate amendment is the same as the House bill, except that it does not include the provision providing that there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to natural gas gathering lines.

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.

Conference Agreement

The conference agreement follows the House bill with the following modification. The conference agreement provides a class life of 14 years for natural gas gathering lines (instead of 10 years).

B. Natural Gas Distribution Lines Treated as Fifteen-Year Property (sec. 42002 of the House bill, sec. 2311 of the Senate amendment, 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.[36] Natural gas distribution pipelines are assigned a 20-year recovery period and a class life of 35 years.

House Bill

The House bill establishes a statutory 15-year recovery period and a class life of 20 years for natural gas distribution lines. In addition, the House bill provides that there would be no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to such property.

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

Senate Amendment

The Senate amendment 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.

Conference Agreement

The conference agreement follows the House bill with the following modification. The conference agreement provides a class life of 35 years for natural gas distribution lines (instead of 20 years).

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36 1987-2 C.B. 674 (as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785).

C. Transmission Property Treated as Fifteen-Year Property (sec. 42003 of the House 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. Assets used in the transmission and distribution of electricity for sale and related land improvements are assigned a 20-year recovery period and a class life of 30 years.

House Bill

The House bill establishes a statutory 15-year recovery period and a class life of 20 years for certain assets used in the transmission of electricity for sale and related land improvements. For purposes of the provision, section 1245 property used in the transmission of electricity for sale at 69 kilovolts and above will qualify for the new recovery period. In addition, the House bill provides that there would be no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to such property.

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

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill with the following modifications. The conference agreement limits the provision to property the original use[37] of which commences

[37] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. It is intended that, when evaluating whether property qualifies as "original use," the factors used to determine whether property qualified as "new section 38 property" for purposes of the investment tax credit would apply. See Treasury Regulation 1.48-2. Thus, it is intended that additional capital expenditures incurred to recondition or rebuild acquired property (or owned property) would satisfy the "original use" requirement. However, the cost of reconditioned or rebuilt property acquired by the taxpayer would not satisfy the "original use" requirement. For example, if on August 11, 2004, a taxpayer buys from RCM for $200,000 transmission lines that have been previously used by RCM. Subsequent to the purchase, the taxpayer makes an expenditure on the property of $50,000 of the type that must be capitalized. Regardless of whether the $50,000 is added to the basis of such property or is capitalized as a separate asset, such amount would be treated as satisfying the "original use" requirement and would be eligible for the reduced recovery period. No part of the $200,000 purchase price qualifies for the reduced recovery period.

after the date of enactment and alters the class life of such property to 30 years (instead of 20 years).

D. Expensing of Capital Costs Incurred for Production in Complying with Environmental Protection Agency Sulfur Regulations for Small Refiners (sec. 42004 of the House bill, sec. 2303 of the Senate amendment, and new sec. 179C of the Code)

Present Law

Taxpayers generally may recover the costs of investments in refinery property through annual depreciation deductions.

House Bill

The bill permits small business refiners to claim an immediate deduction (i.e., expensing) for up to 75 percent of the costs paid or incurred for the purpose of complying with the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency ("EPA").

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

Effective date.–The provision is effective for expenses paid or incurred after March 31, 2003.

Senate Amendment

The Senate amendment generally is the same as the House bill.

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

Conference Agreement

The conference agreement generally follows the House bill and the Senate amendment except with respect to the effective date. The conference agreement also clarifies that qualifying expenditures are those expenditures paid or incurred with respect to a facility beginning January 1, 2003, and ending the earlier of the date that is one year after the date on which the taxpayer must comply with applicable EPA regulation or December 31, 2009. In addition, with respect to the definition of a small business refiner, the conferees intend that, in any case in which refinery through-put or retained production of the refinery differs substantially from its average daily output of refined product, capacity be measured by reference to the average daily output of refined product.

Effective date.–The provision is effective for expenses paid or incurred after December 31, 2002.