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AMERICAN INFRASTRUCTURE INVESTMENT AND IMPROVEMENT ACT OF 2007

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

R E P O R T

together with

ADDITIONAL VIEWS

[To accompany S. 2345]

The Committee on Finance, having considered an original bill, S. 2345, to amend the Internal Revenue Code of 1986 and to extend the financing for the Airport and Airway Trust Fund, and for other purposes, having considered the same, reports favorably thereon and recommends that the bill do pass.

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I. LEGISLATIVE BACKGROUND

The taxes dedicated to the Airport and Airway Trust Fund generally do not apply after September 30, 2007. The Airport and Airway Trust Fund expenditure authority also terminates on October

1, 2007.[1] On July 12, 2007, and July 19, 2007, the Committee on Finance held hearings on aviation taxes. The Committee heard from a variety of witnesses regarding the financing for the Airport and Airway Trust Fund, including representatives from industry and government. With respect to the Highway Trust Fund, the Committee has been advised that a shortfall of $4.3 billion is forecast for fiscal year 2009.

The Senate Committee on Finance marked up an original bill, S. 2345 (the "American Infrastructure Investment and Improvement Act of 2007") on September 21, 2007, and, with a majority and quorum present, ordered the bill favorably reported, with an amendment on that date. This report describes the provisions of the bill.

II. EXPLANATION OF THE BILL

TITLE I—AIRPORT AND AIRWAY TRUST FUND EXTENSION

A. Extension of Airport and Airway Trust Fund Tax and Expenditure Provisions

(Secs. 101 and 102 of the bill and secs. 4081, 4261, 4271, and 9502 of the Code)

PRESENT LAW

Taxes on transportation of persons by air

The Code imposes an excise tax on both domestic and certain international transportation of passengers by air. The AATF is credited with amounts equivalent to these taxes. The taxes do not apply after September 30, 2007.[2]

Domestic air passenger excise tax

Domestic air passenger transportation generally is subject to a two-part excise tax. The first component is an ad valorem tax imposed at the rate of 7.5 percent of the amount paid for the taxable transportation. The second component is a domestic segment tax. For 2007, the domestic segment tax rate is $3.40.[3] A domestic segment is defined as taxable transportation involving a single takeoff and a single landing. For example, travel from New York to San Francisco, with an intermediate stop in Chicago, consists of two segments (without regard to whether the passenger changes aircraft in Chicago).

The domestic segment component of the tax does not apply to segments to or from qualified "rural airports." For any calendar year, a rural airport is defined as an airport that in the second preceding calendar year had fewer than 100,000 commercial passenger departures and meets one of the following three additional requirements: (1) the airport is not located within 75 miles of another airport that had more than 100,000 such departures in that year, (2)

[1] This report does not reflect the subsequent extension of the taxes and expenditure authority through November 16, 2007, as provided by sec. 149 of Pub. L. No. 110–92.

[2] Sec. 4261(j)(1)(A)(ii). The person making the payment (generally the passenger) is liable for the tax; airlines and others receiving payments are liable for remitting tax and are primarily liable if they fail to collect the tax. Secs. 4261(d) and 4263(c).

[3] Sec. 4261(b)(1) and 4261(d)(4). The Code provides for a $3 tax indexed annually for inflation, effective each January 1, resulting in the current rate of $3.40.

the airport is receiving payments under the Federal "essential air service" program, or (3) the airport is not connected by paved roads to another airport.[4]

The domestic air passenger excise tax applies to "taxable transportation." Taxable transportation means transportation by air that begins in the United States or in the portion of Canada or Mexico that is not more than 225 miles from the nearest point in the continental United States and ends in the United States or in such 225-mile zone. If the domestic transportation is paid for outside of the United States, it is taxable only if it begins and ends in the United States.

For purposes of the domestic air passenger excise tax, taxable transportation does not include "uninterrupted international air transportation." Uninterrupted international air transportation is any transportation that does not both begin and end in the United States or in the 225-mile zone and does not have a layover time of more than 12 hours. The tax on international air passenger transportation is discussed below.

Use of international travel facilities

For 2007, international air passenger transportation is subject to a tax of $15.10 per arrival or departure in lieu of the taxes imposed on domestic air passenger transportation if the transportation begins or ends in the United States.[5] The definition of international transportation includes certain purely domestic transportation that is associated with an international journey. Under these rules, a passenger traveling on separate domestic segments integral to international travel is exempt from the domestic passenger taxes on those segments if the stopover time at any point within the United States does not exceed 12 hours.

In the case of a domestic segment beginning or ending in Alaska or Hawaii, the tax applies to departures only and is $7.50 for calendar year 2007.

"Free" travel

Both the domestic air passenger tax and the use of international travel facilities tax apply only to transportation for which an amount is paid. Thus, free travel, such as that awarded in "frequent flyer" programs and nonrevenue travel by airline industry employees, is not subject to tax. However, amounts paid to air carriers (in cash or in kind) for the right to award free or reduced-fare transportation are treated as amounts paid for taxable air transportation and are subject to the 7.5 percent ad valorem tax (but not the flight segment tax or the use of international travel facilities tax). Examples of such payments are purchases of miles by credit card companies and affiliates (including airline affiliates) for use as "rewards" to cardholders.

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[4] In the case of an airport qualifying as "rural" because it is not connected by paved roads to another airport, only departures for flight segments of 100 miles or more are considered in calculating whether the airport has fewer than 100,000 commercial passenger departures. The Department of Transportation has published a list of airports that meet the definition of rural airports. See Rev. Proc. 2005–45.

[5] Secs. 4261(c) and 4261(d)(4). The international travel facilities tax rate of $12 is indexed annually for inflation, effective each January 1, resulting in the current rate of $15.10.

Disclosure of air passenger transportation taxes on tickets and in advertising

Transportation providers are subject to special penalties if they do not separately disclose the amount of the passenger taxes on tickets and in advertising. Failure to satisfy these disclosure requirements is a misdemeanor, upon conviction of which the guilty party is fined not more than $100 per violation.[6]

Tax on transportation of property (cargo) by air

The AATF is credited with amounts equivalent to the taxes received from the transportation of property by air. Domestic air cargo transportation is subject to a 6.25 percent ad valorem excise tax on the amount paid for the transportation.[7] The tax applies only to transportation that both begins and ends in the United States. Unlike the air passenger taxes, only shippers (the persons paying for the transportation) are liable for payment of the air cargo tax. There is no disclosure requirement for the air cargo tax. This tax does not apply after September 30, 2007.[8]

Aviation fuel taxes

The Code imposes excise taxes on gasoline used in commercial aviation and noncommercial aviation, and on jet fuel (kerosene) and other aviation fuels used in commercial aviation and noncommercial aviation. Amounts equivalent to these taxes are credited to the AATF. With the exception of 4.4 cents per gallon, the fuel taxes will not apply after September 30, 2007. Table 1 below summarizes the taxes on fuel used in aviation:

TABLE 1.—TAXES ON FUEL USED IN AVIATION

Fuel type	Tax rate (including 0.1 cent for Leaking Underground Storage Tank Trust Fund Tax) (cents per gallon)
Jet fuel and liquids other than aviation gasoline	
Commercial aviation	4.4
Noncommercial aviation	21.9
Exempt use	0.1
Aviation gasoline	
Commercial	4.4
Noncommercial	19.4
Exempt use	0.1

Trust Fund expenditure provisions

In general

The AATF was created in 1970 to finance a major portion of the Federal expenditures on national aviation programs. Prior to that time, these expenditures had been financed with General Fund monies. The statutory provisions relating to the AATF were placed in the Code in 1982.[9]

Expenditures from the fund support the Federal Aviation Administration ("FAA") and the majority of the FAA's programs and ac-

[6] Sec. 7275.
[7] Sec. 4271.
[8] Sec. 4271(d).
[9] Sec. 9502.

tivities. The FAA budget has four major components: (1) operations and maintenance; (2) facilities and equipment; (3) research, engineering, and development; and (4) the airport improvement program.[10] Operations and maintenance are the only segments of the FAA budget that are funded by both a trust fund contribution and a General Fund contribution.[11] The remaining three items receive all their funding from the AATF.

The current expenditure purposes for the AATF are:

1. obligations incurred under provisions of previous aviation authorizing legislation enacted since 1970, as those provisions were in effect on the date of enactment of the Vision 100-Century of Aviation Reauthorization Act (December 12, 2003);[12]

2. obligations incurred under part A of subtitle VII of Title 49, United States Code (generally, FAA programmatic provisions), which are attributable to planning, research and development, construction, or operation and maintenance of—

a. air traffic control,

b. air navigation,

c. communications, or

d. supporting services for the airway system; and

3. obligations incurred for administrative expenses of the Department of Transportation that are attributable to activities described in items (1) and (2).

No expenditures are permitted to be made from the AATF after September 30, 2007. Because the purposes for which AATF funds are permitted to be expended are fixed as of the date of enactment of the Vision 100—Century of Aviation Reauthorization Act (December 12, 2003), the Code must be amended in order to accommodate new purposes. In addition, the Code contains a special enforcement provision to prevent expenditure of AATF monies for purposes not authorized in section 9502.[13] This provision provides that, should such unapproved expenditures occur, no further excise tax receipts will be transferred to the AATF. Rather, the taxes will continue to be imposed but the receipts will be retained in the General Fund. This enforcement provision provides specifically that it applies not only to unauthorized expenditures under the current Code provisions, but also to expenditures pursuant to future legislation that may provide for them unless the legislation providing for the expenditure either amends section 9502's expenditure au-

[10] Congressional Research Service, Aviation Taxes and the Airport and Airway Trust Fund, CRS Report 97–657E at CRS–2 (1997). The airport improvement program is only for airports in the National Plan of Integrated Airport Systems.

[11] Id.

[12] The Acts (or provisions of Acts) pursuant to which aviation trust fund expenditures are allowed are Title I of the Airport and Airway Development Act of 1970; the Airport and Airway Development Act Amendments of 1976; the Aviation Safety and Noise Abatement Act of 1979; the Fiscal Year 1981 Airport Development Authorization Act; the provisions of the Airport and Airway Improvement Act of 1982; the Airport and Airway Safety and Capacity Expansion Act of 1987; the Federal Aviation Administration Research, Engineering, and Development Authorization Act of 1990; the Aviation Safety and Capacity Expansion Act of 1990; the Airport and Airway Safety, Capacity, Noise Improvement, and Intermodal Transportation Act of 1992; the Airport Improvement Program Temporary Extension Act of 1994; Federal Aviation Administration Authorization Act of 1994; Federal Aviation Reauthorization Act of 1996; the provisions of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 providing for payments from the Airport and Airway Trust Fund; the Interim Federal Aviation Administration Authorization Act; section 6002 of the 1999 Emergency Supplemental Appropriations Act; Public Law 106–59; the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century; the Aviation and Transportation Security Act; and the Vision 100—Century of Aviation Reauthorization Act.

[13] Sec. 9502(f)(1).

thorization provisions or otherwise authorizes the expenditure as part of a revenue Act.

Specific AATF expenditure programs

Authorized expenditures for the following airport and airway programs are included under the general purposes described above.

1. Airport Improvement Program (AIP).—

a. *Airport planning*.—Planning for airport systems for airport master plans; also, airport noise compatibility planning for air carrier airports eligible for terminal development costs.

b. *Airport construction*.—Construction, improvement, or repair of a public airport (includes removal of airport hazards and construction of physical barriers and landscaping to diminish noise).[14]

c. *Airport terminal facilities*.—Non-revenue-producing public-use areas that are directly related to movement of passengers and baggage at certified air carrier airports; also, development of revenue-producing areas and construction of non- revenue-producing parking lots for nonhub airports (subject to certification that the grant will not defer needed development with respect to safety, security, or capacity).

d. *Land acquisition*.—Includes land or property interests for airport noise control purposes; also includes acquisition of land for, or work necessary to construct, pads suitable for aircraft deicing (subject to certain limitations).

e. *Airport-related equipment*.—Airport security equipment required by Department of Transportation regulations, snow removal equipment, noise suppressing equipment, firefighting equipment, navigation aids, and safety equipment required for airport certification; also includes construction or purchase of capital equipment necessary for compliance by an airport with the Americans with Disabilities Act, the Clean Air Act, or the Federal Water Pollution Control Act, other than capital equipment that would primarily benefit a revenue-producing area of the airport used by a nonaeronautical business.

f. *Airport noise compatibility programs*.—Includes sound-proofing of public buildings; local governmental units are eligible for project grants as well as airports.

2. *Facilities and Equipment Program (F&E)*.—Costs of acquiring, establishing, and improving air navigation facilities.

3. *Research, Engineering, Development, and Demonstration Program (R&D)*.—Projects in connection with FAA research and development activities.

4. *Operations and Maintenance Programs (O&M)*.—Operations and maintenance of air navigation facilities, including air traffic control and flight checks; services provided under international agreements relating to the U.S. share of joint provision of air navigation services; weather reporting services provided to the FAA by the National Oceanic and Atmospheric Administration.

5. *Small Community Air Service Development Pilot Program*.—Payments to ensure that eligible localities receiving airline service at the time of deregulation continue to have airline service.

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[14] Airport construction is usually limited to construction or improvements related to aircraft operations, such as runways, taxiways, etc.

6. *Vocational Technical Institutions*.—Grants to up to four vocational technical institutions for the acquisition of facilities for the advanced training of maintenance technicians for air carrier aircraft.

7. *Airway Science Curriculum Grants*.—Grants for higher education airway science study programs, including equipment, buildings, and associated facilities.

8. *Civil Aircraft Security Research and Development*.—Grants relating to technologies and procedures to counteract terrorist activities against civil aviation.

REASONS FOR CHANGE

To ensure a stable and uninterrupted funding source, the Committee believes it is appropriate to further extend the taxes that finance the AATF.

EXPLANATION OF PROVISION

The provision extends the taxes imposed on the transportation of persons by air and on the transportation of property by air through September 30, 2011. The provision extends the taxes imposed on aviation fuels through September 30, 2011. The provision extends the expenditure authority for the AATF through September 30, 2011, and conforms the purposes for which AATF funds are permitted to be expended to include those obligations authorized by the reauthorization bill.

EFFECTIVE DATE

The provision is effective on the date of enactment.

B. Modification of Excise Tax on Kerosene for Use in Aviation

(Sec. 103 of the bill and secs. 4081, 4082, 6427, 9502, and 9503 of the Code)

PRESENT LAW

In general

Under section 4081, an excise tax is imposed upon (1) the removal of any taxable fuel from a refinery or terminal,[15] (2) the entry of any taxable fuel into the United States, or (3) the sale of any taxable fuel to any person who is not registered with the IRS to receive untaxed fuel, unless there was a prior taxable removal or entry.[16] The tax does not apply to any removal or entry of taxable fuel transferred in bulk by pipeline or vessel to a terminal or refinery if the person removing or entering the taxable fuel, the operator of such pipeline or vessel (excluding deep draft vessels), and the operator of such terminal or refinery are registered with the Secretary.[17] If the bulk transfer exception applies, tax is not im-

[15] A "terminal" is a taxable fuel storage and distribution facility that is supplied by pipeline or vessel and from which taxable fuel may be removed at a rack. A "rack" is a mechanism capable of delivering taxable fuel into a means of transport other than a pipeline or vessel. A terminal can be located at an airport, or fuel may be delivered to the airport from a terminal located off the airport grounds.

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

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

posed until the fuel "breaks bulk," i.e., when it is removed from the terminal, typically by rail car or truck, for delivery to a smaller wholesale facility or retail outlet, or removed directly from the terminal into the fuel tank of an aircraft.[18]

The term "taxable fuel" means gasoline, diesel fuel (including any liquid, other than gasoline, that is suitable for use as a fuel in a diesel-powered highway vehicle or train), and kerosene.[19] The term includes kerosene used in aviation (jet fuel) as well as aviation gasoline.

Section 4041(c) provides a back-up tax for liquids (other than aviation gasoline) that are sold for use as a fuel in aircraft and that have not been previously taxed under section 4081.[20]

Kerosene for use in aviation

In general

Present law generally imposes a tax of 24.4 cents per gallon on kerosene. However, reduced rates apply for kerosene removed directly from a terminal into the fuel tank of an aircraft.[21] For kerosene removed directly from a terminal into the fuel tank of an aircraft for use in commercial aviation, the tax rate is 4.4 cents per gallon.[22] For kerosene removed directly from a terminal into the fuel tank of an aircraft for use in noncommercial aviation, the tax rate is 21.9 cents per gallon. All of these tax rates include a 0.1 cent per gallon component for the Leaking Underground Storage Tank Trust Fund. For kerosene removed directly from a terminal into the fuel tank of an aircraft for an exempt use (such as foreign trade or for the exclusive use of a State or local government), only the Leaking Underground Storage Tank Trust Fund tax of 0.1 cent per gallon applies.

"Commercial aviation" generally means any use of an aircraft in the business of transporting by air persons or property for com-

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[18] In general, the party liable for payment of the taxes when the fuel breaks bulk at the terminal is the "position holder," the person shown on the records of the terminal facility as holding the inventory position in the fuel. However, when fuel is removed directly into the fuel tank of an aircraft for use in commercial aviation, the person who uses the fuel is liable for the tax. The fuel is treated as used when such fuel is removed into the fuel tank. Sec. 4081(a)(4).

[19] Sec. 4083(a).

[20] Sec. 4041(c).

[21] If certain conditions are met, present law permits the removal of kerosene from a refueler truck, tanker, or tank wagon to be treated as a removal from a terminal for purposes of determining whether kerosene is removed directly into the fuel tank of an aircraft. A refueler truck, tanker, or tank wagon is treated as part of a terminal if: (1) the terminal is located within an airport, (2) any kerosene that is loaded in such truck, tanker, or wagon at such terminal is for delivery only into aircraft at the airport in which such terminal is located, and (3) no vehicle licensed for highway use is loaded with kerosene at such terminal, except in exigent circumstances identified by the Secretary in regulations. In order to qualify for the special rule, a refueler truck, tanker, or tank wagon must: (1) have storage tanks, hose, and coupling equipment designed and used for the purposes of fueling aircraft; (2) not be registered for highway use; and (3) be operated by the terminal operator (who operates the terminal rack from which the fuel is unloaded) or by a person that makes a daily accounting to such terminal operator of each delivery of fuel from such truck, tanker, or tank wagon. Sec. 4081(a)(3).

[22] Tax is imposed at this rate if the commercial aircraft operator is registered with the IRS. Tax is imposed on fuel removed directly into the fuel tank of an aircraft by a qualified refueler truck at this rate if the fuel terminal is located within a secured area of an airport. The IRS has published a list of airports with secured areas in which a terminal is located. See Notice 2005–4, 2005–1 C.B. 289, at sec. 4(d)(2)(ii) (2005) (adopting the list from H.R. Conf. Rep. No. 755, 108th Cong., 2d Sess. 692 n.718 (2004) with modifications) and Notice 2005–80, 2005–2 C.B. 953, at sec. 3(c)(2) (2005). If the fuel terminal is located at an airport that is not on the list of secured airports, the fuel is taxed at 21.9 cents per gallon if the fuel is removed directly from the terminal into the fuel tank of an aircraft by a qualified refueler truck.

pensation or hire.[23] Commercial aviation does not include transportation exempt from the ticket taxes and air cargo taxes by reason of sections 4281 or 4282 or by reason of section 4261(h) or 4261(i). Thus, small aircraft operating on nonestablished lines (sec. 4281), air transportation for affiliated group members (sec. 4282), air transportation for skydiving (sec. 4261(h)), and certain air transportation by seaplane (sec. 4261(i)) are excluded from the definition of commercial aviation, and accordingly are subject to the tax regime applicable to noncommercial aviation.

Refunds and credits to obtain the appropriate aviation tax rate

If the kerosene is not removed directly into the fuel tank of an aircraft, the fuel is taxed at the rate of 24.4 cents per gallon. (This is generally the rate applied to diesel fuel and kerosene used in highway vehicles). A claim for credit or payment may be made for the difference between the tax paid and the appropriate aviation rate (21.9 cents per gallon for noncommercial aviation, 4.4 cents per gallon for commercial aviation, and 0.1 cent per gallon for an exempt use).[24]

For noncommercial aviation, other than for an exempt use, only the registered ultimate vendor may make the claim for the 2.5-cents-per-gallon difference between the 24.4 cents per gallon rate and the noncommercial aviation rate of 21.9 cents per gallon.[25] For commercial aviation and exempt use (other than State and local government use), the ultimate purchaser may make a claim for the difference in tax rates, or the ultimate purchaser may waive the right to make the claim for payment to the ultimate vendor.[26] For State and local government use, the registered ultimate vendor is the proper claimant.[27]

Commercial aviation claimants are permitted to credit their fuel tax claims against their other excise tax liabilities, thereby reducing the amount of excise tax to be paid with the excise tax return.

Transfers between the Highway Trust Fund and the AATF to account for aviation use

Kerosene that is not removed directly from the terminal into an airplane (e.g., the jet fuel is transferred from the terminal by highway vehicle to the airport) is taxed at the highway fuel rate of 24.4 cents per gallon. The Highway Trust Fund is credited with 24.3 cents per gallon of the 24.4 cents per gallon imposed. The remaining 0.1 cent is credited to the Leaking Underground Storage Tank Trust Fund. If a claim for payment is later made indicating that the fuel was used in aviation, the Secretary then transfers to the AATF 4.3 cents per gallon for commercial aviation use and 21.8 cents per gallon for noncommercial aviation use. These transfers initially are based on estimates, and proper adjustments are made in amounts subsequently transferred, to the extent that prior estimates were in excess of or less than the amounts required to be transferred. Thus, to the extent that claims for credit or payment

[23] Sec. 4083(b).
[24] Sec. 6427(l)(4).
[25] Sec. 6427(l)(4)(C)(ii).
[26] Sec. 6427(l)(4)(C)(i).
[27] See sec. 6427(l)(5). Special rules apply if the kerosene is purchased with a credit card issued to a State or local government.

are not made for the difference between the highway rate and the aviation rate, the AATF will not be credited for fuel used in aviation that was taxed at the 24.4 cents per gallon rate.

Aviation gasoline

The tax on aviation gasoline is 19.4 cents per gallon (including a 0.1 cent per gallon Leaking Underground Storage Tank Trust Fund component). If aviation gasoline is used in commercial aviation, the ultimate purchaser may obtain a credit or payment in the amount of 15 cents per gallon, such that the tax rate on such gasoline is 4.4 cents per gallon.[28] If aviation gasoline is sold for an exempt use, a credit or refund is allowable for all but the Leaking Underground Storage Tank Trust Fund tax (0.1 cent per gallon).[29]

REASONS FOR CHANGE

The Committee is concerned with the congestion at our airports and in our airways. The Committee believes that action must be taken to address increasing air travel delays, passenger frustrations, and safety concerns. The Committee believes that modernization of the air traffic control system must be adequately funded. The Committee has provided for an increase in the taxes imposed on aviation-grade kerosene used in noncommercial aviation to ensure that funding is available to alleviate congestion through modernization of the air traffic control system. The Committee will continue to look at ways to make the taxes that fund the AATF more equitable.

EXPLANATION OF PROVISION

The provision creates a separate category of kerosene for tax purposes: aviation-grade kerosene.[30] Aviation-grade kerosene is taxed at 35.9 cents per gallon plus 0.1 cent per gallon for the Leaking Underground Storage Tank Trust Fund. Under the provision, aviation-grade kerosene used in noncommercial aviation will bear the full rate of tax. The rate of tax for aviation-grade kerosene used in commercial aviation and for exempt use remains unchanged.[31]

Because the tax on aviation-grade kerosene used in noncommercial aviation is equal to the applicable rate of tax collected, the provision repeals the ultimate vendor refund provisions for noncommercial aviation. In addition, the provision eliminates the inter-fund transfers from the Highway Trust Fund to the AATF for kerosene used in aviation. Instead, the taxes imposed on aviation-grade kerosene will be credited to the AATF only. As a result, the AATF, rather than the Highway Trust Fund, will reimburse the General Fund for any amounts paid with respect to the use of aviation-grade kerosene for a nontaxable use. The provision also provides a refund mechanism for aviation-grade kerosene used for a taxable purpose other than in an aircraft and the related-trust fund accounting.

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[28] Sec. 6421(f)(2).

[29] Sec. 6416(a); sec. 6420 (farming purposes); sec. 6421(c); and sec. 6430.

[30] Aviation-grade kerosene means, as defined by the Internal Revenue Service, kerosene-type jet fuel covered by ASTM specification D1655, or military specification MIL–DTL–5624 (Grade JP–5) or MIL–DTL–83133E (Grade JP–8). See section 4(b) of Notice 2005–4.

[31] Accordingly, commercial aviation use will continue to be subject to a tax of 4.4 cents per gallon and exempt use will be subject to 0.1 cent per gallon.

In the case of aviation-grade kerosene held by any person on January 1, 2008, a floor stocks tax is imposed equal to the tax that would have been imposed if the increased rates had been in effect before such date, less (1) the tax actually imposed on such fuel and (2) for fuel held by a person for his own use, the amount that such person would reasonably expect to be paid as a refund. The tax is to be paid at such time and in such manner as the Secretary shall prescribe.

The floor stocks tax does not apply to fuel held in the fuel tank of an aircraft on January 1, 2008. Nor does it apply to fuel held exclusively for any use to the extent a refund or credit of tax is allowable under the Code. The floor stocks tax does not apply if the amount of fuel held by a person does not exceed 2,000 gallons.

For purposes of the floor stocks tax, a controlled group is treated as one person. "Controlled group" for these purposes means a parent-subsidiary, brother-sister, or combined corporate group with more than 50-percent ownership with respect to either combined voting power or total value. Under regulations, similar principles may apply to a group of persons under common control where one or more persons are not a corporation.

All provisions of law, including penalties, applicable with respect to the taxes imposed by section 4081, also apply to the floor stocks taxes to the extent not inconsistent with the provisions of the proposal. For purposes of determining receipts to the AATF, the floor stocks tax is treated as if it were imposed by section 4081(a)(2)(A)(iv).

EFFECTIVE DATE

The provision generally is effective for fuel removed, entered, or sold after December 31, 2007. The floor stocks tax is effective January 1, 2008.

C. Use of International Travel Facilities Tax

(Sec. 104 of the bill and sec. 4261 of the Code)

PRESENT LAW

For 2007, international air passenger transportation is subject to a tax of $15.10 per arrival or departure in lieu of the taxes imposed on domestic air passenger transportation if the transportation begins or ends in the United States.[32] The definition of international transportation includes certain purely domestic transportation that is associated with an international journey. Under these rules, a passenger traveling on separate domestic segments integral to international travel is exempt from the domestic passenger taxes on those segments if the stopover time at any point within the United States does not exceed 12 hours.

In the case of a domestic segment beginning or ending in Alaska or Hawaii, the tax applies to departures only and is $7.50 for calendar year 2007.

[32] Secs. 4261(c) and 4261(d)(4). The international travel facilities tax rate of $12 is indexed annually for inflation, effective each January 1, resulting in the current rate of $15.10.

REASONS FOR CHANGE

The Committee notes that additional funding is needed for the modernization of the air traffic control system. As all air travelers will use the modernized system, the Committee believes that the burden for funding a modernized system should be broadly shared. Therefore, the Committee believes it is appropriate to increase the tax on the use of international travel facilities from $15.10 to $16.65.

EXPLANATION OF PROVISION

Beginning January 1, 2008, the provision increases the tax on the use of international travel facilities to $16.65. This amount is indexed as under present law. The special rule for Alaska and Hawaii is unchanged by the provision.

EFFECTIVE DATE

The provision is effective on January 1, 2008.

D. Air Traffic Control System Modernization Sub-Account

(Sec. 105 of the bill and sec. 9502 of the Code)

PRESENT LAW

Under present law, there is no special sub-account of the AATF to which funds are dedicated for air traffic control systems modernization.

REASONS FOR CHANGE

The Committee has provided for an increase in the taxes supporting the AATF to ensure that sufficient funding is available to modernize the air traffic control system. To ensure that the funds are not diverted to other purposes, the Committee has created a separate account within the AATF specifically for air traffic control modernization.

EXPLANATION OF PROVISION

The provision creates an Air Traffic Modernization Sub-Account within the AATF. The Modernization Sub-Account is supported through annual transfers of approximately $400 million from the parent AATF. The funds are made available to the FAA through mandatory spending specifically dedicated to modernization costs approved by the Air Traffic Control Modernization Oversight Board. The funds also may be used for the FAA's Facility and Equipment account expenditures.

EFFECTIVE DATE

The provision is effective on the date of enactment.

E. Treatment of Fractional Aircraft Ownership Programs

(Sec. 106 of the bill and sec. 4083 and new sec. 4266 of the Code)

PRESENT LAW

For excise tax purposes, fractional ownership flights are treated as commercial aviation. As commercial aviation, such flights are subject to the ad valorem tax of 7.5 percent of the amount paid for the transportation, a $3.40 segment tax, and tax of 4.4 cents per gallon on fuel. For international flights, fractional ownership flights are subject to the $15.10 international travel facilities use tax and a fuel tax of a 0.1 cent per gallon.

For purposes of the FAA safety regulations, fractional aircraft ownership programs are treated as a special category of general aviation.[33]

REASONS FOR CHANGE

The Committee notes that the IRS and FAA classify flights on aircraft that are part of a fractional ownership program differently. Under the FAA safety regulations, such flights are considered general aviation, while the IRS classifies such flights as commercial aviation for tax purposes. The Committee wishes to make clear that fractional flights should be considered as noncommercial aviation for tax purposes. In keeping with the Committee's view that the burden of funding a modernized system should be broadly shared, the Committee believes it is appropriate to subject such flights to the fuel taxes applicable to noncommercial aviation, as well as a departure tax of $58.

EXPLANATION OF PROVISION

Under the provision, special rules apply to flights on aircraft that are part of a "fractional ownership aircraft program." For this purpose, "fractional ownership aircraft program" is defined as a program in which:

- A single fractional ownership program manager provides fractional ownership program management services on behalf of the fractional owners;
- Two or more airworthy aircraft are part of the program;
- There are one or more fractional owners per program aircraft, with at least one program aircraft having more than one owner;
- Each fractional owner possesses at least a minimum fractional ownership interest in one or more program aircraft;[34]
- There exists a dry-lease exchange arrangement among all of the fractional owners;[35]
- There are multi-year program agreements covering the fractional ownership, fractional ownership program manage-

[33] 14 C.F.R. Part 91, subpart k.

[34] A minimum fractional ownership interest means: (1) A fractional ownership interest equal to or greater than one-sixteenth of at least one subsonic, fixed wing or powered lift program aircraft; or (2) a fractional ownership interest equal to or greater than one-thirty-second of a least one rotorcraft program aircraft.

[35] A "dry-lease aircraft exchange" means an agreement, documented by the written program agreements, under which the program aircraft are available, on an as-needed basis without crew, to each fractional owner.

ment services, and dry-lease aircraft exchange aspects of the program.

Under the provision, in lieu of the present-law taxes on domestic commercial aviation and international flights, every flight on an aircraft that is part of a fractional ownership aircraft program is subject to a $58 departure tax and a 36-cents-per-gallon fuel tax. The presence or absence of the fractional owner during the flight has no bearing on the amount of tax imposed on the flight. Thus, positioning the aircraft for the owner, as well as charter flights for non-owners are subject to the new tax regime.

EFFECTIVE DATE

The provision is effective for transportation beginning after, and fuel sold or used after, December 31, 2007.

F. Repeal Exemption for Small Aircraft Operating on Nonestablished Lines

(Sec. 107 of the bill and sec. 4281 of the Code)

PRESENT LAW

Under present law, transportation by aircraft with a certificated maximum takeoff weight of 6,000 pounds or less is exempt from the excise taxes imposed on the transportation of persons by air and the transportation of cargo by air when operating on a nonestablished line. Similarly, when such an aircraft is operating on a flight for the sole purpose of sightseeing, the taxes imposed on the transportation of persons or cargo by air do not apply.

REASONS FOR CHANGE

The Committee is concerned with the increasing congestion of the nation's airspace. It is the understanding of the Committee that a significant portion of the congestion is, and will continue to be, attributable to the increasing number of small aircraft utilizing FAA resources. As technology advances and permits aircraft to weigh significantly less while carrying a similar load, it is believed that more aircraft will take advantage of the exemption, thus reducing the resources available for the AATF. The Committee believes that small aircraft utilizing FAA resources should contribute to the modernization of the nation's air traffic control system. Therefore, the Committee believes it is appropriate to repeal the exemption from tax for small aircraft operating on nonestablished lines for all flights, except those flights for which the sole purpose is sightseeing.

EXPLANATION OF PROVISION

The provision repeals the exemption for transportation by small aircraft operating on nonestablished lines. The present-law exemption for flights operated for the sole purpose of sightseeing is unchanged by the proposal.

EFFECTIVE DATE

The provision is effective for transportation beginning after December 31, 2007.

G. Transparency in Passenger Tax Disclosures

(Sec. 108 of the bill and sec. 7275 of the Code)

PRESENT LAW

Transportation providers are subject to special penalties if they do not separately disclose the amount of the passenger taxes on tickets and in advertising. Failure to satisfy these disclosure requirements is a misdemeanor, upon conviction of which the guilty party is fined not more than $100 per violation.[36]

There is no prohibition against airlines including other charges in the required passenger taxes disclosure (e.g., fuel surcharges retained by the commercial airline). In practice, some but not all airlines include such other charges in the required passenger taxes disclosure.

REASONS FOR CHANGE

The Committee believes that separating charges payable to a government entity from those paid to a transportation provider will reduce confusion on the part of consumers.

EXPLANATION OF PROVISION

The bill prohibits all transportation providers from including amounts other than charges payable to a government entity in the required disclosure of passenger taxes on tickets and in advertising. Disclosure elsewhere on tickets and in advertising (e.g., as an amount paid for transportation) of charges not payable to a government entity is allowed.

EFFECTIVE DATE

The provision is effective for tickets sold after December 31, 2007.

H. Modification of Pension Funding Rules of Certain Eligible Plans

(Sec. 109 of the bill and sec. 402 of the Pension Protection Act of 2006)

PRESENT LAW

Single-employer defined benefit pension plans are subject to minimum funding requirements under the Code.[37] The Pension Protection Act of 2006 provides for new minimum funding rules, which are generally effective for plan years beginning after December 31, 2007.

Under the new minimum funding rules, the minimum required contribution to a single- employer defined benefit pension plan for a plan year generally depends on a comparison of the value of the plan's assets with the plan's funding target and target normal cost. The plan's funding target is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan's tar-

[36] Sec. 7275.
[37] Sec. 412. Similar rules apply to single-employer defined benefit pension plans under ERISA.

get normal cost for a plan year is the present value of benefits expected to accrue or be earned during the plan year.

In general, a plan has a funding shortfall if the plan's funding target for the year exceeds the value of the plan's assets (reduced, if applicable, by any prefunding balance and funding standard carryover balance). If the value of a plan's assets (reduced by any funding standard carryover balance and prefunding balance) is less than the plan's funding target for a plan year, so that the plan has a funding shortfall, the minimum required contribution is generally equal to the plan's target normal cost, increased by a shortfall amortization charge. Alternatively, if the value of a plan's assets (reduced by any funding standard carryover balance and prefunding balance) is equal to or exceeds the plan's funding target for a plan year, the minimum required contribution is equal to the plan's target normal cost, reduced by the amount by which the plan's assets exceed the funding target.

The shortfall amortization charge for a plan year is the aggregate total of the shortfall amortization installments for the plan year with respect to any shortfall amortization bases for that plan year and the six preceding plan years. A shortfall amortization base is generally required to be established for a plan year if the plan has a funding shortfall for a plan year. The shortfall amortization base for a plan year is (1) the plan's funding shortfall, minus (2) the present value, determined using the segment interest rates (discussed below), of the aggregate total of the shortfall amortization installments (and, if applicable, waiver amortization installments) that have been determined for the plan year and any succeeding plan year with respect to any shortfall amortization bases (and waiver amortization bases) for preceding plan years. The shortfall amortization installments with respect to a shortfall amortization base for a plan year are the amounts necessary to amortize the shortfall amortization base in level annual installments over the seven-plan-year period beginning with the plan year. The shortfall amortization installment with respect to a shortfall amortization base for any plan year in the seven-year period is the annual installment determined for that year for that shortfall amortization base. Shortfall amortization installments are determined using the appropriate segment interest rates.

The new minimum funding rules specify the interest rates and other actuarial assumptions that must be used in determining a plan's target normal cost and funding target. Under the rules, present value is determined using three interest rates ("segment" rates), each of which applies to benefit payments expected to be made from the plan during a certain period. The first segment rate applies to benefits reasonably determined to be payable during the five-year period beginning on the first day of the plan year; the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable at the end of the 15-year period. Each segment rate is a single interest rate determined monthly by the Secretary of the Treasury on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period. In general, the corporate bond yield curve used for this purpose is

to be prescribed on a monthly basis by the Secretary of the Treasury and reflects the average, for the 24–month period ending with the preceding month, of yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. A special transition rule applies for plan years beginning in 2008 and 2009 (other than for plans first effective after December 31, 2007).

In addition to the new minimum funding rules described above, the Pension Protection Act of 2006 also provided for special funding rules to apply for certain eligible plans. An eligible plan is a single-employer defined benefit pension plan sponsored by an employer that is a commercial passenger airline or the principal business of which is providing catering services to a commercial passenger airline.

The plan sponsor of an eligible plan may make one of two alternative elections. In the case of a plan that meets certain benefit accrual and benefit increase restrictions, an election allowing a 17–year amortization of the plan's unfunded liability is available. In lieu of this election, a plan sponsor may alternatively elect, for the first taxable year beginning in 2008, to amortize the shortfall amortization base for such taxable year over a period of 10 plan years (rather than 7 plan years) beginning with such plan year. Under this alternative election, the benefit accrual and benefit increase restrictions do not apply. This 10–year amortization election must be made by December 31, 2007. Public Law No. 110–28 modified the 10–year amortization election. As modified, if a plan sponsor elects to amortize the shortfall amortization base over a period of 10 plan years, the plan is to use an interest rate of 8.25 percent for purposes of determining the funding target for each of the 10 plan years during such period (instead of the segment rates calculated on the basis of the corporate bond yield curve).

REASONS FOR CHANGE

The Committee is concerned about the underfunding of many defined benefit pension plans. The Committee believes that it is appropriate to require defined benefit pension plans to fund for annual accruals so as not to create larger deficiencies in plan funding. As a result of the favorable interest rate, the sponsor of an eligible plan may have a minimum required contribution that is less than the plan's target normal cost for the plan year (or may even have no minimum required contribution). The Committee believes that it is appropriate that an employer that uses the favorable interest rate be required to contribute no less than the plan's target normal cost for the year so that current accruals do not increase the plan's funding shortage.

EXPLANATION OF PROVISION

The provision provides that, in the case of a plan sponsor that elects to amortize the shortfall amortization base over a period of 10 plan years, an election must be made for the plan to use the 8.25 percent interest rate instead of the segment rate for purposes of determining the plan's funding target. The election can be made no more than once and is revocable. If the election is in effect, the minimum required contribution is not less than the target normal cost (which is calculated using the segment rates). Such minimum

contribution is required even if the plan's assets exceed the plan's funding target (determined using 8.25%) plus normal cost. The provision also clarifies that the election to amortize the shortfall amortization base over 10 plan years applies to the first plan year beginning in 2008.

EFFECTIVE DATE

The provision is effective as if included in section 402 of the Pension Protection Act of 2006.

TITLE II—INCREASED FUNDING FOR THE HIGHWAY TRUST FUND

A. REPLENISH EMERGENCY SPENDING FROM THE HIGHWAY TRUST FUND

(Sec. 201 of the bill and sec. 9503 of the Code)

PRESENT LAW

Certain trust funds defined under the Code receive amounts equivalent to the receipts from taxes dedicated to such trust funds, e.g., the Airports and Airways Trust Fund and the Highway Trust Fund. Receipts from undedicated taxes are deposited in the General Fund of the Treasury.

The Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users ("SAFETEA") and previous legislation specifically allowed emergency relief to be paid out of the Highway Trust Fund. Since 1998, there have been six emergency appropriations (excluding regular annual appropriations of $100 million for emergencies) from the Highway Trust Fund, including responses to disaster relief from terrorism and from natural disasters.[38] Infrastructure otherwise benefited by trust funds has previously received its disaster relief from the General Fund.

REASONS FOR CHANGE

The Congressional Budget Office has projected that the Highway Trust Fund will face a shortfall of $4.3 billion in 2009. Since 1998, more than $3.3 billion has been spent from the Highway Trust Fund to respond to emergencies. The Committee believes that unforeseen expenses that result from terrorism or natural disasters should be met by the General Fund. To ensure solvency of the Highway Trust Fund through 2009, the provision replenishes the Highway Trust Fund with a total of $3.4 billion.

EXPLANATION OF PROVISION

The provision replenishes the Highway Trust Fund for emergency appropriations by transferring $3.4 billion from the General Fund of the Treasury to the Highway Trust Fund.

EFFECTIVE DATE

The provision is effective on the date of enactment.

[38] See Pub. L. No. 105–174 ($259 million), Pub. L. No. 106–346 ($720 million), Pub. L. No. 107–117 ($175 million), Pub. L. No. 107–206 ($265 million), Pub. L. No. 324 ($1.2 billion), and Pub. L. No. 108–447 ($741 million).

B. Suspension of Transfers From Highway Trust Fund for Certain Repayments and Credit

(Sec. 202 of the bill and sec. 9503(c)(2) of the Code)

PRESENT LAW

Under sec. 9503(c)(2), certain transfers are made from the Highway Trust Fund to reimburse the General Fund for amounts paid in respect of gasoline used on farms,[39] amounts paid in respect of gasoline used for certain nonhighway purposes or by local transit systems,[40] amounts relating to fuels not used for taxable purposes,[41] and income tax credits allowed with respect to the nontaxable uses of fuels.[42]

REASONS FOR CHANGE

The Committee notes that some nontaxable uses of fuel involve the use of public highways (e.g., use in school buses and in the vehicles of State and local governments) but because of the exemption do not contribute to the maintenance of the highway system. The Committee believes it is appropriate to temporarily suspend the transfers from the Highway Trust Fund to the General Fund that are attributable to the nontaxable uses.

EXPLANATION OF PROVISION

Section 9503(c)(2), relating to certain transfers from the Highway Trust Fund to the General Fund, is suspended on the date of enactment and for six months thereafter.

EFFECTIVE DATE

The provision applies to amounts paid for which no transfer has been made before the date of enactment.

C. Impose Excise Tax on Certain Removals of Taxable Fuel From Foreign Trade Zones

(Sec. 203 of the bill and secs. 4081 and 4083 of the Code)

PRESENT LAW

In general

Generally, excise taxes are imposed on gasoline, diesel fuel and kerosene (collectively referred to as "taxable fuel") when taxable fuel is removed from a refinery or terminal or upon its entry into the United States.[43] The tax does not apply to any removal or entry of taxable fuel transferred in bulk by pipeline or vessel to a terminal or refinery, if the person removing or entering the fuel, the pipeline or vessel operator, and the terminal or refinery operator are all registered with the IRS.[44]

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[39] Sec. 6420.
[40] Sec. 6421.
[41] Sec. 6427.
[42] Sec. 34.
[43] Sec. 4081(a)(1)(A).
[44] Sec. 4081(a)(1)(B)(i). A vessel operator is not required to be registered with respect to certain deep draft ocean-going vessels. Sec. 4081(a)(1)(B)(ii).

The Code generally permits the Secretary of the Treasury to require persons to register with respect to taxable fuel.[45] The American Jobs Creation Act of 2004 requires persons that operate a terminal or refinery within a foreign trade zone or within a customs bonded storage facility, or that hold an inventory position with respect to taxable fuel in such a terminal, to register with the Secretary of the Treasury.[46] Treasury Regulations require blenders, enterers, pipeline operators, position holders, refiners, terminal operators, and vessel operators, among others, to register.[47]

The Code also provides that the Secretary may require information reporting from any registered person.[48] A Department of Treasury fuel information reporting program, the Excise Summary Terminal Activity Reporting System ("ExSTARS"), requires terminal operators and bulk transport carriers to report monthly on the movement of any liquid product into or out of an approved terminal. Terminal operators file Form 720–TO—Terminal Operator Report, which shows the monthly receipts and disbursements of all liquid products to and from an approved terminal.[49] Bulk transport carriers (vessels and pipelines) that receive liquid product from an approved terminal or deliver liquid product to an approved terminal file Form 720–CS—Carrier Summary Report, which details such receipts and disbursements.

Foreign trade zones

Foreign trade zones are established under chapter 1A of title 19 of the United States Code. Customs regulations issued pursuant to title 19 provide that merchandise taken into a foreign trade zone for the sole purpose of exportation or storage will be given "zone restricted" status on proper application and be considered exported for purposes of customs law. If merchandise is to be considered exported for the purpose of any Federal law other than customs laws, the port director shall be satisfied that all pertinent laws, regulations, and rules administered by the Federal agency concerned have been complied with before the application is approved. In general, zone restricted merchandise may not be returned to the customs territory of the United States for domestic consumption.[50]

Rev. Rul. 59–318 holds that an article subject to a manufacturers excise tax is "exported" when it is shipped to a foreign trade zone for the sole purpose of exportation.[51] Consequently, any later removal from such a refinery or terminal in a foreign trade zone for "actual" export is not considered a taxable event.[52] In contrast, if the terminal is located outside of a foreign trade zone, the removal for export is a taxable event unless certain conditions are met.[53]

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[45] Sec. 4101(a).

[46] See Sec. 4101(a)(2), added by the American Jobs Creation Act of 2004, Pub. L. 108–357, sec. 861(a)(2).

[47] Treas. Reg. sec. 48.4101–1(c)(1).

[48] Sec. 4101(d)(1). See also Treas. Reg. sec. 48.4101–2. The reports are required to be filed by the end of the month following the month to which the report relates.

[49] See Announcement 2001–48, 2001–1 C.B. 1168. An approved terminal is a terminal that is operated by a taxable fuel registrant that is a terminal operator. Treas. Reg. sec. 48.4081–1(b).

[50] 19 C.F.R. sec. 146.44.

[51] 1959–2 C.B. 310. Under Rev. Rul. 59–318, a bill of lading containing the statement "Shipped into Foreign-Trade Zone for Export" is acceptable as proof of exportation.

[52] See, e.g., Priv. Ltr. Rul. 9351006 (Sept. 17, 1993), Transaction 4.

[53] For example, regulations provide that the tax does not apply if the buyer is outside the United States, the sale occurs as the fuel is delivered into a vessel with a capacity of at least

Continued

Many petroleum refineries and terminals are located within foreign trade zones or subzones[54] or bonded warehouses. When taxable fuel is removed by truck or rail from such refinery or terminal, excise taxes may or may not be due at the rack, depending on the mode of removal, as follows. If the taxable fuel is entered into the United States upon such removal, excise taxes and duties are generally due at that point. However, the fuel may be removed under bonded transport without immediate tax or duties. Such transported fuel can be destined for export, for entry into another foreign trade zone (or subzone) or bonded warehouse, or may be entered into the United States at its destination. Excise tax only applies if and when the fuel is entered into the United States. No tax is due if the fuel is exported or re-entered into a foreign trade zone or subzone or bonded warehouse.

U.S. Customs enforcement procedures, which may include forfeiture of the full value of the goods, are triggered if fuel removed under bonded transport is not reported within 30 days as exported, entered into another foreign trade zone or subzone or bonded warehouse, or entered into the United States.[55] Customs also tracks all entries and removals from foreign trade zones and subzones.

Refineries in general, and terminals within foreign trade zones or subzones or bonded warehouses, are not currently required to report under Ex-STARS.

REASONS FOR CHANGE

The Committee is concerned about the potential for diversion of certain taxable fuel without the payment of Federal excise tax. The Committee's concern is that taxable fuel removed under bonded, non-bulk transport from a refinery or terminal located in a foreign trade zone, subzone, or bonded warehouse could be diverted from the stream of export or from its designated destination of a second foreign trade zone, subzone or bonded warehouse, without the payment of tax. The Committee believes that imposing tax upon the non-bulk removal of taxable fuel from such refineries and terminals will eliminate the potential for such diversion.

EXPLANATION OF PROVISION

Under the provision, excise tax is generally imposed on the non-bulk removal (i.e., removal by truck or train) of taxable fuel from terminals or refineries within a foreign trade zone or subzone or bonded warehouse at the same time and in the same manner as if such terminal or refinery were not located in such foreign trade zone or subzone or bonded warehouse, notwithstanding any Customs statute, rule, or regulation. Tax is imposed upon such removal even if the fuel is entered into another foreign trade zone or subzone or bonded warehouse or is eventually exported. If such taxable fuel is later exported, a credit or refund may be claimed. No interest shall be due on such credits or refunds.

20,000 barrels, the seller is registered and is the exporter of record, and the fuel is exported in due course. Treas. Reg. sec. 48.4081–3(f)(2).

[54] A subzone is a special-purpose zone established as an adjunct to a zone project for a limited purpose. The rules and regulations applicable to foreign trade zones apply equally to subzones. 15 C.F.R. sec. 400.2(n)–(o).

[55] See, e.g., 19 C.F.R. secs. 18.25 and 18.26.

Under the provision, a removal from a refinery or terminal in a foreign trade zone or subzone or bonded warehouse is not treated any worse than would be the case if the refinery or terminal were not in such a foreign trade zone or subzone or bonded warehouse. Consequently, any removal that would be exempt if the refinery or terminal were not in a foreign trade zone or subzone or bonded warehouse will be exempt where the refinery or terminal is in a foreign trade zone or subzone or bonded warehouse.

The present-law rules continue to apply to any removal by pipeline or vessel of taxable fuel from a terminal or refinery located in a foreign trade zone or subzone or bonded warehouse.

It is intended that the Secretary of the Treasury will require owners and operators of terminals within a foreign trade zone or subzone or bonded warehouse to electronically report monthly all removals of taxable fuel, to the same extent as if such terminal were not located in a foreign trade zone or subzone or bonded warehouse, and it is anticipated that such reporting will be required to be done through Ex-STARS or in some other reasonable form.

EFFECTIVE DATE

The provision is effective for removals and entries after December 31, 2007.

D. Clarification of Penalty for Sale of Fuel Failing To Meet EPA Regulations

(Sec. 204 of the bill and sec. 6720A of the Code)

PRESENT LAW

Under present law, any person other than a retailer who knowingly transfers for resale, sells for resale, or holds out for resale for use in a diesel-powered highway vehicle (or train) any liquid that does not meet applicable Environmental Protection Agency ("EPA") regulations (as defined in section 45H(c)(3)) is subject to a penalty of $10,000 for each such transfer, sale, or holding out for resale, in addition to the tax on such liquid, if any.[56] Any retailer who knowingly holds out for sale (other than for resale) any such liquid is subject to a $10,000 penalty for each such holding out for sale, in addition to the tax on such liquid, if any.

REASONS FOR CHANGE

The Committee believes the current penalty should be expanded beyond failure to meet the EPA sulfur standards to encompass any fuel held out for sale that does not meet the standards for distribution to the public. The Committee believes that expansion of the penalty will discourage the sale of fuel adulterated with hazardous materials, used lube oil, and other contaminants that are used to increase and extend the volume of the fuel being sold.

EXPLANATION OF PROVISION

The provision expands the penalty to include any fuel that does not meet EPA standards for distribution to the public. The provision reaffirms that the Secretary is authorized to make the deter-

[56] Sec. 6720A.

mination that the fuel does not comply with the applicable EPA regulations and standards for purposes of asserting the penalty.

EFFECTIVE DATE

The provision is effective on the date of enactment.

E. Treatment of Qualified Alcohol Fuel Mixtures and Qualified Biodiesel Fuel Mixtures as Taxable Fuel

(Sec. 205 of the bill and sec. 4083 of the Code)

PRESENT LAW

An excise tax is imposed upon (1) the removal of any taxable fuel from a refinery or terminal, (2) the entry of any taxable fuel into the United States, or (3) the sale of any taxable fuel to any person who is not registered with the IRS to receive untaxed fuel, unless there was a prior taxable removal or entry.[57] The tax does not apply to any removal or entry of taxable fuel transferred in bulk by pipeline or vessel to a terminal or refinery if the person removing or entering the taxable fuel, the operator of such pipeline or vessel (excluding deep draft vessels), and the operator of such terminal or refinery are registered with the Secretary.[58] The term "taxable fuel" means gasoline, diesel fuel, and kerosene.[59]

Diesel fuel is (1) any liquid suitable for use in a diesel powered highway vehicle or diesel powered train, (2) transmix, and (3) diesel fuel blendstocks identified by the Secretary.[60] By regulation, diesel fuel does not include kerosene, gasoline, No. 5 and No. 6 fuel oils (as described in ASTM Specification D 396), or F–76 (Fuel Naval Distillates MIL–F–16884), any liquid that contains less than four percent normal paraffins, or any liquid that has a distillation range of 125 degrees Fahrenheit or less, sulfur content of 10 ppm or less, and minimum color of +27 Saybolt.[61]

Biodiesel is not a taxable fuel because it has less than four percent paraffin content. Ethanol and other fuel alcohols also are not treated as taxable fuel. However, such fuels are subject to the backup tax under section 4041 if sold for use or used as a fuel in a diesel-powered highway vehicle or diesel-powered train and not for a nontaxable use.

In addition, such fuels are taxable if used in the production of a blended taxable fuel.[62]

The Code provides per-gallon tax incentives relating to biodiesel fuel used in a qualified mixture. The taxpayer may take the credit amount as an income tax credit, as an excise tax credit against the tax imposed on taxable fuels ("section 4081 liability"), or as a payment from the Secretary in the amount of the credit. The credit is 50 cents for each gallon of biodiesel used by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of

[57] Sec. 4081(a)(1).
[58] Sec. 4081(a)(1)(B).
[59] Sec. 4083(a).
[60] Sec. 4083(a)(3).
[61] Treas. Reg. sec. 48.4081–1(c)(2)(ii).
[62] Under Treas. Reg. sec. 48.4081–1(c), blended taxable fuel generally means any taxable fuel that is produced (1) outside the bulk transfer/terminal system (2) by mixing taxable fuel with respect to which tax has been imposed under sec. 4081(a) (gasoline, diesel fuel, or kerosene) with any other liquid on which tax has not been imposed under sec. 4081.

the taxpayer. In the case of agri-biodiesel, the credit is $1 per gallon.

A qualified biodiesel mixture is a mixture of biodiesel and diesel fuel that is (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) used as a fuel by the taxpayer producing such mixture. Pursuant to Treasury Notice, a mixture of 99.9 percent biodiesel and diesel fuel is considered a mixture, but such mixture is not a blended taxable fuel because it contains less than four percent paraffin content. Thus, while eligible for the biodiesel fuel mixture tax credit and payment provisions, such fuel generally would not be subject to tax until put in a motor vehicle for a taxable use.

The Code also provides per-gallon tax incentives relating to alcohol used in a qualified mixture. A qualified mixture means a mixture of alcohol and gasoline (or of alcohol and a special fuel) sold by the taxpayer as fuel, or used as fuel by the taxpayer producing such mixture. The credit is 51 cents if the alcohol is ethanol (60 cents in the case of other alcohols).

REASONS FOR CHANGE

The Committee notes that when it provided the credit for qualified biodiesel fuel mixtures, it intended that the resulting mixture of biodiesel and diesel fuel would be a taxable fuel and that the credit would be taken against the tax imposed on that fuel if not used for a nontaxable purpose. For biodiesel not in a mixture, it was intended that tax be imposed on the fuel, and the credit be available when the biodiesel was sold at retail into the fuel tank of a motor vehicle. It has come to the Committee's attention that persons are exploiting the Treasury Notice by adding minute amounts of diesel fuel to biodiesel in order to claim the full amount of credit for biodiesel fuel mixtures, while not paying any tax on the fuel because the "mixture" does not meet the regulatory definition of diesel fuel. The Committee believes that such exploitation occurs to avoid both the imposition of tax and the more restrictive rules governing biodiesel that is not in a mixture, which require that the fuel be sold as motor fuel at retail. The Committee believes it is consistent with Committee intent and appropriate to subject all fuel mixtures eligible for the fuel mixture credits to the taxes applicable to diesel fuel.

EXPLANATION OF PROVISION

The provision adds qualified alcohol fuel mixtures and qualified biodiesel fuel mixtures to the definition of taxable fuel.

EFFECTIVE DATE

The provision is effective for fuels removed, entered, or sold after December 31, 2007.

F. Excluding Volume of Denaturants From the Alcohol Fuels Credit

(Sec. 206 of the bill and sec. 40 of the Code)

PRESENT LAW

The Code provides a per-gallon credit for the volume of alcohol used as a fuel or in a qualified mixture. For purposes of determining the number of gallons of alcohol with respect to which the credit is allowable, the volume of alcohol includes any denaturant, including gasoline.[63] The denaturant must be added under a formula approved by the Secretary, and the denaturant cannot exceed five percent of the volume of such alcohol (including denaturants).

REASONS FOR CHANGE

Gasoline can be used as a denaturant of alcohol. The Committee believes it is inappropriate to allow a credit that is intended to be for alcohol to be claimed on liquids that do not constitute alcohol.

EXPLANATION OF PROVISION

The provision provides that the volume of alcohol eligible for the credit does not include the volume of any denaturant.

EFFECTIVE DATE

The provision is effective January 1, 2008.

G. Bulk Transfer Exception Not To Apply to Finished Gasoline

(Sec. 207 of the bill and sec. 4081 of the Code)

PRESENT LAW

An excise tax is imposed upon (1) the removal of any taxable fuel from a refinery or terminal, (2) the entry of any taxable fuel into the United States, or (3) the sale of any taxable fuel to any person who is not registered with the IRS to receive untaxed fuel, unless there was a prior taxable removal or entry.[64] The tax does not apply to any removal or entry of taxable fuel transferred in bulk by pipeline or vessel to a terminal or refinery if the person removing or entering the taxable fuel, the operator of such pipeline or vessel (excluding deep draft vessels), and the operator of such terminal or refinery are registered with the Secretary (the "bulk transfer exception").[65] The term "taxable fuel" means gasoline, diesel fuel (including any liquid, other than gasoline, which is suitable for use as a fuel in a diesel-powered highway vehicle or train), and kerosene.[66]

REASONS FOR CHANGE

The Committee believes that there is potential for fuel to be diverted from pipelines and barges and escape taxation, notwithstanding that the operators of such pipelines and barges must be

[63] Sec. 40(d)(4).
[64] Sec. 4081(a)(1).
[65] Sec. 4081(a)(1)(B).
[66] Sec. 4083(a).

registered with the IRS. As the base components of gasoline (other than oxygenates and detergents that are added at the fuel terminal) are blended at the refinery, the Committee believes it is appropriate to move the point of taxation for gasoline generally from the point of removal from a terminal to removal from the refinery or upon entry into the United States.

EXPLANATION OF PROVISION

The provision asserts the point of taxation for finished gasoline upon removal from the refinery or entry into the United States.[67] The bulk transfer exception does not apply to such removals or entries. Only the increased volume resulting from the addition of oxygenates, detergents and other untaxed liquids after the gasoline leaves the refinery would be subject to a subsequent tax.

EFFECTIVE DATE

The provision is effective for fuel removed, entered, or sold after December 31, 2007.

H. Oil Spill Liability Trust Fund Tax

(Sec. 208 of the bill and sec. 4611 of the Code)

PRESENT LAW

The Oil Spill Liability Trust Fund financing rate ("oil spill tax") was reinstated effective April 1, 2006.[68] The oil spill tax rate is five cents per barrel and generally applies to crude oil received at a U.S. refinery and to petroleum products entered into the United States for consumption, use, or warehousing.[69]

The oil spill tax also applies to certain uses and the exportation of domestic crude oil.[70] If any domestic crude oil is used in or exported from the United States, and before such use or exportation no oil spill tax was imposed on such crude oil, then the oil spill tax is imposed on such crude oil. The tax does not apply to any use of crude oil for extracting oil or natural gas on the premises where such crude oil was produced.

For crude oil received at a refinery, the operator of the U.S. refinery is liable for the tax. For imported petroleum products, the person entering the product for consumption, use, or warehousing is liable for the tax. For certain uses and exports, the person using or exporting the crude oil is liable for the tax. No tax is imposed with respect to any petroleum product if the person who would be liable for such tax establishes that a prior oil spill tax has been imposed with respect to such product.

The imposition of the tax is dependent in part on the balance of the Oil Spill Liability Trust Fund. The oil spill tax does not apply during a calendar quarter if the Secretary estimates that, as of the close of the preceding calendar quarter, the unobligated balance of the Oil Spill Liability Trust Fund exceeds $2.7 billion. If the Sec-

[67] It is intended that finished gasoline include all products that are commonly or commercially known as gasoline capable of being used in gasoline-powered motor vehicles.

[68] Sec. 4611(f).

[69] The term "crude oil" includes crude oil condensates and natural gasoline. The term "petroleum product" includes crude oil.

[70] The term "domestic crude oil" means any crude oil produced from a well located in the United States.

retary estimates that the unobligated balance in the Oil Spill Liability Trust Fund is less than $2 billion at close of any calendar quarter, the oil spill tax will apply on the date that is 30 days from the last day of that quarter. The tax does not apply to any periods after December 31, 2014.

REASONS FOR CHANGE

The Committee believes it is appropriate to increase the rate of taxation for the oil spill tax from five cents to ten cents per barrel and to extend the tax through December 31, 2017. The Committee believes that recent legislation, to include the Gulf of Mexico Energy Security Act of 2006 passed last Congress, opens thousands of new wells and millions of new acres of offshore drilling. The current tax rate does not reflect the new potential for oil spills that may result from the recent opening of an estimated 8.3 million acres of the Outer Continental Shelf. This increase and extension will ensure adequate funding for the Oil Spill Liability Trust Fund. The Committee also believes that the administration of the tax will be simplified by repealing the requirement that the tax be suspended when the unobligated balance exceeds $2.7 billion and then reinstated when the unobligated balance falls below $2 billion.

EXPLANATION OF PROVISION

The provision extends the oil spill tax through December 31, 2017. The provision increases the tax rate from five cents to ten cents per barrel. The provision also repeals the requirement that the tax be suspended when the unobligated balance exceeds $2.7 billion.

EFFECTIVE DATE

The provision increasing the tax rate is effective beginning the first quarter that is more than 60 days after the date of enactment. The remaining provisions are effective on the date of enactment.

I. Tax Treatment of Certain Inverted Corporate Entities

(Sec. 209 of the bill and sec. 7874 of the Code)

PRESENT LAW

Determination of corporate residence

The U.S. tax treatment of a multinational corporate group depends significantly on whether the parent corporation of the group is domestic or foreign. For purposes of U.S. tax law, a corporation is treated as domestic if it is incorporated under the law of the United States or of any State. Other corporations (i.e., those incorporated under the laws of foreign countries or U.S. possessions) generally are treated as foreign.

U.S. taxation of domestic corporations

The United States employs a "worldwide" tax system, under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. In order to mitigate the double taxation that may arise from taxing the foreign-source income of a domestic corporation, a foreign tax credit for in-

come taxes paid to foreign countries is provided to reduce or eliminate the U.S. tax owed on such income, subject to certain limitations.

Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income generally is deferred, and U.S. tax is imposed on such income when repatriated. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F (secs. 951–964) and the passive foreign investment company rules (secs. 1291–1298). A foreign tax credit is generally available to offset, in whole or in part, the U.S. tax owed on this foreign-source income, whether such income is repatriated as an actual dividend or included under one of the anti-deferral regimes.

U.S. taxation of foreign corporations

The United States taxes foreign corporations only on income that has a sufficient nexus to the United States. Thus, a foreign corporation is generally subject to U.S. tax only on income that is "effectively connected" with the conduct of a trade or business in the United States. Such "effectively connected income" generally is taxed in the same manner and at the same rates as the income of a U.S. corporation. An applicable tax treaty may limit the imposition of U.S. tax on business operations of a foreign corporation to cases in which the business is conducted through a "permanent establishment" in the United States.

In addition, foreign corporations generally are subject to a gross-basis U.S. tax at a flat 30-percent rate on the receipt of interest, dividends, rents, royalties, and certain similar types of income derived from U.S. sources, subject to certain exceptions. The tax generally is collected by means of withholding by the person making the payment. This tax may be reduced or eliminated under an applicable tax treaty.

U.S. tax treatment of inversion transactions prior to the American Jobs Creation Act of 2004

Prior to the American Jobs Creation Act of 2004 ("AJCA"), a U.S. corporation could reincorporate in a foreign jurisdiction and thereby replace the U.S. parent corporation of a multinational corporate group with a foreign parent corporation. These transactions were commonly referred to as inversion transactions. Inversion transactions could take many different forms, including stock inversions, asset inversions, and various combinations of and variations on the two. Most of the known transactions were stock inversions. In one example of a stock inversion, a U.S. corporation forms a foreign corporation, which in turn forms a domestic merger subsidiary. The domestic merger subsidiary then merges into the U.S. corporation, with the U.S. corporation surviving, now as a subsidiary of the new

foreign corporation. The U.S. corporation's shareholders receive shares of the foreign corporation and are treated as having exchanged their U.S. corporation shares for the foreign corporation shares. An asset inversion could be used to reach a similar result, but through a direct merger of the top-tier U.S. corporation into a new foreign corporation, among other possible forms. An inversion transaction could be accompanied or followed by further restructuring of the corporate group. For example, in the case of a stock inversion, in order to remove income from foreign operations from the U.S. taxing jurisdiction, the U.S. corporation could transfer some or all of its foreign subsidiaries directly to the new foreign parent corporation or other related foreign corporations.

In addition to removing foreign operations from U.S. taxing jurisdiction, the corporate group could seek to derive further advantage from the inverted structure by reducing U.S. tax on U.S.-source income through various earnings stripping or other transactions. This could include earnings stripping through payment by a U.S. corporation of deductible amounts such as interest, royalties, rents, or management service fees to the new foreign parent or other foreign affiliates. In this respect, the post-inversion structure could enable the group to employ the same tax-reduction strategies that are available to other multinational corporate groups with foreign parents and U.S. subsidiaries, subject to the same limitations (e.g., secs. 163(j) and 482).

Inversion transactions could give rise to immediate U.S. tax consequences at the shareholder and/or the corporate level, depending on the type of inversion. In stock inversions, the U.S. shareholders generally recognized gain (but not loss) under section 367(a), based on the difference between the fair market value of the foreign corporation shares received and the adjusted basis of the domestic corporation stock exchanged. To the extent that a corporation's share value had declined, and/or it had many foreign or tax-exempt shareholders, the impact of this section 367(a) "toll charge" was reduced. The transfer of foreign subsidiaries or other assets to the foreign parent corporation also could give rise to U.S. tax consequences at the corporate level (e.g., gain recognition and earnings and profits inclusions under secs. 1001, 311(b), 304, 367, 1248 or other provisions). The tax on any income recognized as a result of these restructurings could be reduced or eliminated through the use of net operating losses, foreign tax credits, and other tax attributes.

In asset inversions, the U.S. corporation generally recognized gain (but not loss) under section 367(a) as though it had sold all of its assets, but the shareholders generally did not recognize gain or loss, assuming the transaction met the requirements of a reorganization under section 368.

U.S. tax treatment of inversion transactions under AJCA

In general

AJCA added new section 7874 to the Code, which defines two different types of corporate inversion transactions and establishes a different set of consequences for each type. Certain partnership transactions also are covered.

Transactions involving at least 80 percent identity of stock ownership

The first type of inversion is a transaction in which, pursuant to a plan[71] or a series of related transactions: (1) a U.S. corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity in a transaction completed after March 4, 2003; (2) the former shareholders of the U.S. corporation hold (by reason of holding stock in the U.S. corporation) 80 percent or more (by vote or value) of the stock of the foreign-incorporated entity after the transaction; and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50 percent ownership (i.e., the "expanded affiliated group"), does not have substantial business activities in the entity's country of incorporation, compared to the total worldwide business activities of the expanded affiliated group. The provision denies the intended tax benefits of this type of inversion ("80-percent inversion") by deeming the top-tier foreign corporation to be a domestic corporation for all purposes of the Code.[72]

In determining whether a transaction meets the definition of an inversion under the provision, stock held by members of the expanded affiliated group that includes the foreign incorporated entity is disregarded. For example, if the former top-tier U.S. corporation receives stock of the foreign incorporated entity (e.g., so-called "hook" stock), the stock would not be considered in determining whether the transaction meets the definition. Similarly, if a U.S. parent corporation converts an existing wholly owned U.S. subsidiary into a new wholly owned controlled foreign corporation, the stock of the new foreign corporation would be disregarded, with the result that the transaction would not meet the definition of an inversion under the provision. Stock sold in a public offering related to the transaction also is disregarded for these purposes.

Transfers of properties or liabilities as part of a plan a principal purpose of which is to avoid the purposes of the provision are disregarded. In addition, the Treasury Secretary is to provide regulations to carry out the provision, including regulations to prevent the avoidance of the purposes of the provision, including avoidance through the use of related persons, pass-through or other noncorporate entities, or other intermediaries, and through transactions designed to qualify or disqualify a person as a related person or a member of an expanded affiliated group. Similarly, the Treasury Secretary has the authority to treat certain non-stock instruments as stock, and certain stock as not stock, where necessary to carry out the purposes of the provision.

Transactions involving at least 60 percent but less than 80 percent identity of stock ownership

The second type of inversion is a transaction that would meet the definition of an inversion transaction described above, except that

[71] Acquisitions with respect to a domestic corporation or partnership are deemed to be "pursuant to a plan" if they occur within the four-year period beginning on the date which is two years before the ownership threshold under the provision is met with respect to such corporation or partnership.

[72] Since the top-tier foreign corporation is treated for all purposes of the Code as domestic, the shareholder-level "toll charge" of sec. 367(a) does not apply to these inversion transactions.

the 80-percent ownership threshold is not met. In such a case, if at least a 60-percent ownership threshold is met, then a second set of rules applies to the inversion. Under these rules, the inversion transaction is respected (i.e., the foreign corporation is treated as foreign), but any applicable corporate-level "toll charges" for establishing the inverted structure are not offset by tax attributes such as net operating losses or foreign tax credits. Specifically, any applicable corporate-level income or gain required to be recognized under sections 304, 311(b), 367, 1001, 1248, or any other provision with respect to the transfer of controlled foreign corporation stock or the transfer or license of other assets by a U.S. corporation as part of the inversion transaction or after such transaction to a related foreign person is taxable, without offset by any tax attributes (e.g., net operating losses or foreign tax credits). This rule does not apply to certain transfers of inventory and similar property. These measures generally apply for a 10-year period following the inversion transaction.

Other rules

Under section 7874, inversion transactions include certain partnership transactions. Specifically, the provision applies to transactions in which a foreign-incorporated entity acquires substantially all of the properties constituting a trade or business of a domestic partnership, if after the acquisition at least 60 percent (or 80 percent, as the case may be) of the stock of the entity is held by former partners of the partnership (by reason of holding their partnership interests), provided that the other terms of the basic definition are met. For purposes of applying this test, all partnerships that are under common control within the meaning of section 482 are treated as one partnership, except as provided otherwise in regulations. In addition, the modified "toll charge" rules apply at the partner level.

A transaction otherwise meeting the definition of an inversion transaction is not treated as an inversion transaction if, on or before March 4, 2003, the foreign-incorporated entity had acquired directly or indirectly more than half of the properties held directly or indirectly by the domestic corporation, or more than half of the properties constituting the partnership trade or business, as the case may be.

REASONS FOR CHANGE

The Committee believes that the inversions regime should generally apply to companies that completed 80-percent inversion transactions after public notice was given that eventual legislation on this issue could be effective after March 20, 2002.

EXPLANATION OF PROVISION

The provision generally extends the 80-percent inversion regime of section 7874 to 80-percent inversions completed after March 20, 2002 but on or before March 4, 2003, with certain modifications as described below. A transaction otherwise meeting the definition of an 80-percent inversion under the provision (i.e., one completed after March 20, 2002 but on or before March 4, 2003) is not treated as an 80-percent inversion if, on or before March 20, 2002, the foreign-incorporated entity had acquired directly or indirectly more

than half the properties held directly or indirectly by the domestic corporation, or more than half the properties constituting the partnership trade or business, as the case may be.

Under the provision, an 80-percent inversion that is completed after March 20, 2002 but on or before March 4, 2003 is respected until the end of the last day of the foreign-incorporated entity's first taxable year ending after the date of enactment. At the end of that day, the inverted foreign-incorporated entity that completed the 80-percent inversion (or if relevant, any successor entity) is deemed to have transferred all of its assets and liabilities to a domestic corporation in a transaction that is generally treated as a nontaxable inbound reorganization ("repatriation"). The basis of the assets of the foreign-incorporated entity generally remains the same in the hands of the domestic corporation, subject to any special adjustments for importing built-in losses (e.g., sec. 362(e)). Shareholders of the domestic corporation inherit the respective bases of their shares of the foreign-incorporated entity.

On the day of the repatriation, the earnings and profits of the inverted foreign-incorporated entity transfer over to the domestic corporation. The transfer of such earnings and profits is not a deemed dividend and does not result in a tax upon the domestic corporation or its shareholders. In addition, any foreign taxes attributable to such earnings and profits are not creditable. However, shareholders may be subject to tax on distributions of such earnings and profits.

Beginning on the day after the repatriation, the inverted foreign-incorporated entity is treated for all tax purposes as a domestic corporation. Thus, any income earned by the inverted foreign-incorporated entity after the date of repatriation is deemed to be earned by a domestic corporation, and therefore, is fully taxable at U.S. corporate income tax rates. As a further consequence of the repatriation of the inverted foreign-incorporated entity, foreign subsidiaries become controlled foreign corporations, subject to the rules of subpart F.

It is intended that the Secretary will prescribe regulations that are necessary or appropriate to carry out the provision, including, but not limited to, regulations to prevent the avoidance of the purposes of the provision.

EFFECTIVE DATE

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

J. Denial of Deduction for Punitive Damages

(Sec. 210 of the bill and sec. 162(g) of the Code)

PRESENT LAW

In general, a deduction is allowed for all ordinary and necessary expenses that are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business.[73] However, no deduction is allowed for any payment that is made to an official of any governmental agency if the payment constitutes an illegal

[73] Sec. 162(a).

bribe or kickback or if the payment is to an official or employee of a foreign government and is illegal under Federal law.[74] In addition, no deduction is allowed under present law for any fine or similar payment made to a government for violation of any law.[75] Furthermore, no deduction is permitted for two-thirds of any damage payments made by a taxpayer who is convicted of a violation of the Clayton antitrust law or any related antitrust law.[76]

In general, gross income does not include amounts received on account of personal physical injuries and physical sickness.[77] However, this exclusion does not apply to punitive damages.[78]

REASONS FOR CHANGE

The Committee believes that allowing a tax deduction for punitive damages undermines the societal role of punitive damages in discouraging and penalizing the activities or actions for which punitive damages are imposed. Furthermore, the Committee believes that determining the amount of punitive damages to be disallowed as a tax deduction is not administratively burdensome because taxpayers generally can make such a determination readily by reference to pleadings filed with a court, and plaintiffs already make such a determination in determining the taxable portion of any payment.

EXPLANATION OF PROVISION

The provision denies any deduction for punitive damages that are paid or incurred by the taxpayer as a result of a judgment or in settlement of a claim. If the liability for punitive damages is covered by insurance, any such punitive damages paid by the insurer are included in gross income of the insured person and the insurer is required to report such amounts to both the insured person and the IRS.

EFFECTIVE DATE

The provision is effective for punitive damages that are paid or incurred on or after the date of enactment.

K. Fuel Technical Corrections

(Sec. 211 of the bill)

Energy-related technical corrections

Except as otherwise provided, the amendments made by the technical corrections contained in the bill take effect as if included in the original legislation to which each amendment relates.

[74] Sec. 162(c).
[75] Sec. 162(f).
[76] Sec. 162(g).
[77] Sec. 104(a).
[78] Sec. 104(a)(2).

Amendments to the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users

Timing of claims for excess alternative fuel (not in a mixture) credit and liquid hydrocarbons from biomass (Act sec. 11113)

The Code makes the alternative fuel (not in a mixture) credit refundable. Section 6427(i)(3) permits claims to be filed on a weekly basis with respect to alcohol, biodiesel, and alternative fuel mixtures if certain requirements are met. This rule, however, does not reference the alternative fuel credit (for alternative fuel not in a mixture). The amendment clarifies that the same rules for filing claims with respect to fuel mixtures apply to the alternative fuel credit.

The Code provides that alternative fuel includes "liquid hydrocarbons derived from biomass." It was intended that liquid hydrocarbons from biomass include fuels made from biomass such as fish oil, which contains some oxygen in addition to hydrogen and carbon. The amendment provides that alternative fuel includes "liquid fuel from biomass" and clarifies that fuels described in section 6426(b) or (c), or sections 40 or 40A (alcohol, biodiesel, and renewable diesel), do not qualify for the alternative fuel credit or alternative fuel mixture credit.

Amendments to the Energy Policy Act of 2005

Clarify limitation on the credit of installing alternative fuel refueling property (Act sec. 1342)

The present-law credit for qualified alternative fuel vehicle refueling property for a taxable year is limited to $30,000 per property subject to depreciation, and $1,000 for other property (sec. 30C(b)). The provision clarifies that the $30,000 and $1,000 limitations apply to all alternative fuel vehicle refueling property placed in service by the taxpayer at a location. The provision is consistent with similar deduction limitations imposed under section 179A(b)(2)(A) (relating to the deduction for clean-fuel vehicles and certain refueling property).

In addition, section 30C(c)(1) provides that qualified alternative fuel vehicle refueling property has the meaning given to the term by section 179A(d). However, section 179A(d) defines a different term, qualified clean-fuel vehicle refueling property. The provision coordinates the reference to this definition.

Double taxation of rail and inland waterway fuel resulting from the use of dyed fuel on which the Leaking Underground Storage Tank Trust Fund tax has already been imposed; off-highway business use (Act sec. 1362)

Section 4081(a)(2)(B) imposes tax at the Leaking Underground Storage Tank Trust Fund financing tax rate of 0.1 cent per gallon on diesel fuel at the time it is removed from a terminal. Section 4082(a) provides that none of the generally applicable exemptions other than the exemption for export apply to this removal even if the fuel is dyed. When dyed fuel is used or sold for use in a diesel-powered highway vehicle or train (sec. 4041), or such fuel is subject to the inland waterway tax (sec. 4042), the Code inadvertently im-

poses the Leaking Underground Storage Tank Trust Fund tax a second time. Section 6430 prohibits the refund of taxes imposed at the Leaking Underground Storage Tank Trust Fund financing rate, except in the case of fuel destined for export. The amendment eliminates the imposition of the 0.1 cent tax a second time if the Leaking Underground Storage Tank Trust Fund tax was imposed previously under section 4081. The amendment permits a refund in the amount of the Leaking Underground Storage Tank Trust Fund financing rate if such tax was imposed a second time under 4041 or 4042. The amendment also clarifies that off-highway business use is not exempt from the Leaking Underground Storage Tank Trust Fund tax, effective for fuel sold for use or used after the date of enactment.

Exemption from the Leaking Underground Storage Tank Trust Fund financing rate for aircraft and vessels engaged in foreign trade (Act sec. 1362)

Fuel supplied in the United States for use in aircraft engaged in foreign trade is exempt from U.S. customs duties and internal revenue taxes so long as, where the aircraft is registered in a foreign State, the State of registry provides substantially reciprocal privileges for U.S.-registered aircraft. However, the Energy Policy Act of 2005 imposed, without exemption, the Leaking Underground Storage Tank Trust Fund financing rate on all taxable fuels, except in the case of export. As a result, aviation fuel is no longer exempt from the Leaking Underground Storage Tank Trust Fund financing rate. According to the State Department, almost all of the United States' bilateral air services agreements contain provisions exempting from taxation all fuel supplied in the territory of one party for use in the aircraft of the other party. The United States has interpreted these provisions to prohibit the taxation, in any form, of aviation fuel supplied in the United States to the aircraft of airlines of the foreign countries that are parties to these air services agreements. The amendment provides that fuel for use in vessels (including civil aircraft) employed in foreign trade or trade between the United States and any of its possessions is exempt from the Leaking Underground Storage Tank Trust Fund financing rate.

Amendment to the American Jobs Creation Act of 2004

Interaction of rules relating to credit for low sulfur diesel fuel (Act sec. 339)

Section 45H of the Code allows a credit at the rate of five cents per gallon for low sulfur diesel fuel produced at certain small business refineries. The aggregate credit with respect to any refinery is limited to 25 percent of the costs of the type deductible under section 179B of the Code. Section 179B allows a deduction for 75 percent of certain costs paid or incurred with respect to these refineries. The basis of the property is reduced by the amount of any credit determined with respect to any expenditure (sec. 45H(d)). Further, no deduction is allowed for the expenses otherwise allowable as a deduction in an amount equal to the amount of the credit under section 45H (sec. 280C(d)). The interaction of these provisions is unclear, and the basis reduction and deduction denial rules may have an unintentionally duplicative effect. Under the provi-

sion, deductions are denied in an amount equal to the amount of the credit under section 45H, and the provisions of present law reducing basis and denying a deduction are repealed.

L. MOTOR FUEL TAX ENFORCEMENT ADVISORY COMMISSION

(Sec. 212 of the bill)

PRESENT LAW

The Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users established a Motor Fuel Tax Enforcement Advisory Commission ("Commission"). The purpose of the Commission is to: (1) review historical and current motor fuel revenue collections; (2) review the progress of investigations; (3) develop and review legislative proposals with respect to motor fuel taxes; (4) monitor the progress of administrative regulation projects relating to fuel taxes; (5) review the results of Federal and State agency cooperative efforts regarding motor fuel taxes; and (6) review the results of Federal interagency cooperative efforts regarding motor fuel taxes. The Commission also is to evaluate and make recommendations regarding: (1) the effectiveness of existing Federal enforcement programs regarding motor fuel taxes; (2) enforcement personnel allocation; and (3) proposals for regulatory projects, legislation, and funding.

The Commission is to be composed of the following:

- At least one representative from each of the following Federal entities: the Department of Homeland Security, the Department of Transportation-Office of Inspector General, the Federal Highway Administration, the Department of Defense, and the Department of Justice;
- At least one representative from the Federation of State Tax Administrators;
- At least one representative from any State department of transportation;
- Two representatives from the highway construction industry;
- Six representatives from industries relating to fuel distribution: refiners (two representatives), distributors (one representative), pipelines (one representative), terminal operators (two representatives);
- One representative from the retail fuel industry; and
- Two representatives each from the staffs of the Senate Committee on Finance and the House Committee on Ways and Means.

Members of the Commission are to be appointed by the Chairmen and Ranking Members of the Senate Committee on Finance and the House Committee on Ways and Means. Representatives from the Department of Treasury and the IRS shall be available to consult with the Commission upon request. The Commission is to terminate after October 1, 2009.

REASONS FOR CHANGE

The Government Accountability Office has recommended certain changes regarding the operation of the Motor Fuel Tax Advisory Commission. The Committee believes it is appropriate to make lim-

ited changes regarding the composition and operation of the Motor Fuel Tax Advisory Commission.

EXPLANATION OF PROVISION

The provision limits the Commission to 14 members. Under the proposal, the Commission is composed of:

- One member from the Department of Transportation;
- One member from the Department of Transportation—Federal Highway Administration;
- One member from the Department of Transportation—Inspector General;
- One member from the Department of Homeland Security;
- One member from the Department of Defense;
- One member from the Department of Justice;
- Two members shall be appointed by the Chairman of the Senate Committee on Finance;
- Two members shall be appointed by the Ranking Member of the Senate Committee of Finance;
- Two members shall be appointed by the Chairman of the House Committee on Ways and Means;
- Two members shall be appointed by the Ranking Member of the House Committee on Ways and Means.

The appointed members are to include at least one representative from the Federation of State Tax Administrators, at least one representative from a State department of transportation, at least one representative from industries relating to fuel distribution (refiners, distributors, pipelines, and terminal operators), and at least one representative from the retail fuel industry. Not later than September 30, 2009, the Commission is to submit to Congress a final report that contains a detailed statement of the findings and conclusions of the Commission; and the recommendations of the Commission for such legislation and administrative action as the Commission considers appropriate and necessary. The provision also makes other administrative changes.

EFFECTIVE DATE

The provision is effective on the date of enactment.

M. Conform Highway Trust Fund Provisions in the Code To Include Public Law No. 110–56

(Sec. 213 of the bill and sec. 9503 of the Code)

PRESENT LAW

Public Law No. 110–56 authorized additional funds for emergency repairs and reconstruction of the Interstate I–35 bridge, located in Minneapolis, Minnesota, that collapsed on August 1, 2007. That Act also amended section 1112 of the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users ("SAFETEA") to authorize the use of not more than $5 million of funds to reimburse the Minnesota State Department of Transportation for actual and necessary costs of maintenance and operation for providing temporary substitute highway traffic service following the collapse. While the Act amended SAFETEA, it did not make conforming amendments to the Code.

The purposes for which Highway Trust Fund funds are permitted to be expended are fixed as of the date of enactment of SAFETEA (August 10, 2005), and the Code must be amended in order to accommodate new purposes. In addition, the Code contains a special enforcement provision to prevent expenditure of Highway Trust Fund monies for purposes not authorized in section 9503.[79] This provision provides that, should such unapproved expenditures occur, no further excise tax receipts will be transferred to the Highway Trust Fund. Rather, the taxes will continue to be imposed but the receipts will be retained in the General Fund. This enforcement provision specifically provides that it applies not only to unauthorized expenditures under the current Code provisions, but also to expenditures pursuant to future legislation unless either the legislation providing for the expenditure either amends the expenditure authorization provisions of section 9503 or otherwise authorizes the expenditure as part of a revenue Act.

REASONS FOR CHANGE

The Committee believes it is appropriate to make this technical change to the Code to ensure payment of funds as intended by Public Law No. 110–56.

EXPLANATION OF PROVISION

The provision adds section 1112 of SAFETEA as amended by Public Law No. 110–56 to the list of legislation authorizing the expenditure of funds from the Highway Trust Fund.

EFFECTIVE DATE

The provision is effective on the date of enactment.

TITLE III—ADDITIONAL INFRASTRUCTURE MODIFICATIONS AND REVENUE PROVISIONS

A. RESTRUCTURE NEW YORK LIBERTY ZONE TAX INCENTIVES

(Sec. 301 of the bill and secs. 1400K and 1400L of the Code)

PRESENT LAW

In general

Present law includes a number of incentives to invest in property located in the New York Liberty Zone ("NYLZ"), which is the area located on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan in the City of New York, New York. These incentives were enacted following the terrorist attack in New York City on September 11, 2001.[80]

[79] Sec. 9503(b)(6).

[80] In addition to the NYLZ provisions described above, other NYLZ incentives are provided: (1) $8 billion of tax-exempt private activity bond financing for certain nonresidential real property, residential rental property and public utility property is authorized to be issued after March 9, 2002, and before January 1, 2010; and (2) $9 billion of additional tax-exempt advance refunding bonds is available after March 9, 2002, and before January 1, 2006, with respect to certain State or local bonds outstanding on September 11, 2001.

Special depreciation allowance for qualified New York Liberty Zone property

Section 1400L(b) allows an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of qualified NYLZ property.[81] In order to qualify, property generally must be placed in service on or before December 31, 2006 (December 31, 2009 in the case of nonresidential real property and residential rental property).

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.

A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

In order for property to qualify for the additional first-year depreciation deduction, it must meet all of the following requirements. First, the property must be property to which the general rules of the Modified Accelerated Cost Recovery System ("MACRS")[82] apply with (1) an applicable recovery period of 20 years or less, (2) water utility property (as defined in section 168(e)(5)), (3) certain nonresidential real property and residential rental property, or (4) computer software other than computer software covered by section 197. A special rule precludes the additional first-year depreciation under this provision for (1) qualified NYLZ leasehold improvement property[83] and (2) property eligible for the additional first-year depreciation deduction under section 168(k) (i.e., property is eligible for only one 30 percent additional first-year depreciation). Second, substantially all of the use of such property must be in the NYLZ. Third, the original use of the property in the NYLZ must commence with the taxpayer on or after September 11, 2001. Finally, the property must be acquired by purchase[84] by the taxpayer after September 10, 2001 and placed in service on or before December 31, 2006.[85]

Nonresidential real property and residential rental property are eligible for the additional first-year depreciation only to the extent such property rehabilitates real property damaged, or replaces real property destroyed or condemned as a result of the terrorist attacks of September 11, 2001.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies for the additional first-year depreciation deduction if the taxpayer begins the manufacture, construction, or production of the property after September 10, 2001, and the property is placed in service on or before Decem-

[81] The amount of the additional first-year depreciation deduction is not affected by a short taxable year.

[82] A special rule precludes the additional first-year depreciation deduction for property that is required to be depreciated under the alternative depreciation system of MACRS. For qualifying nonresidential real property and residential rental property the property must be placed in service on or before December 31, 2009 in lieu of December 31, 2006. Property will not qualify if a binding written contract for the acquisition of such property was in effect before September 11, 2001.

[83] Qualified NYLZ leasehold improvement property is defined in another provision. Leasehold improvements that do not satisfy the requirements to be treated as "qualified NYLZ leasehold improvement property" may be eligible for the 30 percent additional first-year depreciation deduction

[84] For purposes of this provision, purchase is defined as under section 179(d).

[85] Property is not precluded from qualifying for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to September 11, 2001.

ber 31, 2006[86] (and all other requirements are met). Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

Depreciation of New York Liberty Zone leasehold improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease.[87] This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service.[88] If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement is placed in service.[89]

A special rule exists for qualified NYLZ leasehold improvement property, which is recovered over five years using the straight-line method. The term qualified NYLZ leasehold improvement property means property defined in section 168(e)(6) that is acquired and placed in service after September 10, 2001, and before January 1, 2007 (and not subject to a binding contract on September 10, 2001), in the NYLZ. For purposes of the alternative depreciation system, the property is assigned a nine-year recovery period. A taxpayer may elect out of the 5-year (and 9-year) recovery period for qualified NYLZ leasehold improvement property.

Increased section 179 expensing for qualified New York Liberty Zone property

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under section 179. The Small Business and Work Opportunity Tax Act of 2007[90] increased the amount a taxpayer may deduct, for taxable years beginning in 2007 through 2010, to $125,000 of the cost of qualifying property placed in service for the taxable

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[86] December 31, 2009 with respect to qualified nonresidential real property and residential rental property.

[87] Sec. 168(i)(8). The Tax Reform Act of 1986 modified the Accelerated Cost Recovery System ("ACRS") to institute MACRS. Prior to the adoption of ACRS by the Economic Recovery Tax Act of 1981, taxpayers were allowed to depreciate the various components of a building as separate assets with separate useful lives. The use of component depreciation was repealed upon the adoption of ACRS. The Tax Reform Act of 1986 also denied the use of component depreciation under MACRS.

[88] Former sections 168(f)(6) and 178 provided that, in certain circumstances, a lessee could recover the cost of leasehold improvements made over the remaining term of the lease. The Tax Reform Act of 1986 repealed these provisions.

[89] Secs. 168(b)(3), (c), (d)(2), and (i)(6). If the improvement is characterized as tangible personal property, ACRS or MACRS depreciation is calculated using the shorter recovery periods, accelerated methods, and conventions applicable to such property. The determination of whether improvements are characterized as tangible personal property or as nonresidential real property often depends on whether or not the improvements constitute a "structural component" of a building (as defined by Treas. Reg. sec. 1.48–1(e)(1)). See, e.g., *Metro National Corp* v. *Commissioner,* 52 TCM (CCH) 1440 (1987); *King Radio Corp. Inc.* v. *U.S.,* 486 F.2d 1091 (10th Cir. 1973); *Mallinckrodt, Inc.* v. *Commissioner,* 778 F.2d 402 (8th Cir. 1985) (with respect to various leasehold improvements).

[90] Pub. L. No. 110–28, sec. 8212 (2007).

year.[91] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2010 is treated as qualifying property. The $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000. The $125,000 and $500,000 amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.[92] In general, qualifying property for this purpose is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business.

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

The amount a taxpayer can deduct under section 179 is increased for qualifying property used in the NYLZ. Specifically, the maximum dollar amount that may be deducted under section 179 is increased by the lesser of (1) $35,000 or (2) the cost of qualifying property placed in service during the taxable year. This amount is in addition to the amount otherwise deductible under section 179.

Qualifying property for purposes of the NYLZ provision means section 179 property[93] purchased and placed in service by the taxpayer after September 10, 2001 and before January 1, 2007, where (1) substantially all of the use of such property is in the NYLZ in the active conduct of a trade or business by the taxpayer in the NYLZ, and (2) the original use of which in the NYLZ commences with the taxpayer after September 10, 2001.[94]

The phase-out range for the section 179 deduction attributable to NYLZ property is applied by taking into account only 50 percent of the cost of NYLZ property that is section 179 property. Also, no general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.

The provision is effective for property placed in service after September 10, 2001 and before January 1, 2007.

Extended replacement period for New York Liberty Zone involuntary conversions

A taxpayer may elect not to recognize gain with respect to property that is involuntarily converted if the taxpayer acquires within

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

[92] For taxable years beginning in 2011 and thereafter (or before 2003), the following rules apply. A taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed for inflation.

[93] As defined in sec. 179(d)(1).

[94] See Rev. Proc. 2002–33, 2002–1 C.B. 963 (May 20, 2002), for procedures on claiming the increased section 179 expensing deduction by taxpayers who filed their tax returns before June 1, 2002.

an applicable period (the "replacement period") property similar or related in service or use.[95] If the taxpayer does not replace the converted property with property similar or related in service or use, then gain generally is recognized. If the taxpayer elects to apply the rules of section 1033, gain on the converted property is recognized only to the extent that the amount realized on the conversion exceeds the cost of the replacement property. In general, the replacement period begins with the date of the disposition of the converted property and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized.[96] The replacement period is extended to three years if the converted property is real property held for the productive use in a trade or business or for investment.[97]

The replacement period is extended to five years with respect to property that was involuntarily converted within the NYLZ as a result of the terrorist attacks that occurred on September 11, 2001. However, the five-year period is available only if substantially all of the use of the replacement property is in New York City. In all other cases, the present-law replacement period rules continue to apply.

REASONS FOR CHANGE

The Committee believes it is appropriate to restructure certain of the tax benefits that were provided to stimulate the redevelopment of the portions of the City of New York that were directly affected by the terrorist attacks of September 11, 2001. The restructuring will assist in the development of transit connections necessary for the ongoing redevelopment of the New York Liberty Zone area.

EXPLANATION OF PROVISION

Repeal of certain NYLZ incentives

The provision repeals the first-year depreciation allowance of 30 percent and the additional section 179 expensing in the case of nonresidential real property and residential rental property as of the date of enactment of this provision.[98]

Creation of New York Liberty Zone Tax Credits

The provision provides a credit against tax imposed for any payroll period by section 3402 (related to withholding for wages paid) for which a New York Liberty Zone governmental unit is liable under section 3403. The credit is equal to such portion of the qualifying project expenditure amounts allocated to the governmental unit for the calendar year that such governmental unit allocates to such period. The amount of the credit allowed for any payroll period shall be treated as a payment to the Secretary on the day on which the wages were paid to the employee, but only to the extent the governmental unit actually deducted and withheld such wages

[95] Sec. 1033(a).
[96] Sec. 1033(a)(2)(B).
[97] Sec. 1033(g)(4).
[98] In the case of nonresidential real property and residential rental property acquired pursuant to a binding contract in effect on such enactment date, the first-year depreciation allowance of 30 percent and the additional section 179 expensing provisions terminate on December 31, 2009.

for the applicable period. A New York Liberty Zone governmental unit is the State of New York, the City of New York, or any agency or instrumentality of such State or city.

Qualifying project expenditure amount means, with respect to any calendar year, the sum of (1) the total expenditures paid or incurred during such calendar year by all New York Liberty Zone governmental units and the Port Authority of New York and New Jersey for any portion of qualifying projects located wholly within the City of New York, and (2) any such expenditures paid or incurred in any preceding calendar year beginning after the date of enactment of this provision and not previously allocated.

A qualifying project is any transportation infrastructure project, including highways, mass transit systems, railroads, airports, ports, and waterways, in or connecting with the New York Liberty Zone, which is designated as a qualifying project by the Governor of the State of New York and the Mayor of the City of New York.

The Governor of the State of New York and the Mayor of the City of New York are to jointly allocate to each New York Liberty Zone governmental unit the portion of the qualifying expenditure amount that may be taken into account by such governmental unit to determine the credit for any calendar year in the credit period. The credit period is the 12-year period beginning on January 1, 2008. Aggregate amounts allocated may not exceed $2 billion during the credit period. There is also an annual limit on allocations equal to (1) $169 million for each year of the credit period, plus (2) any amounts in (1) that were authorized to be allocated for prior calendar years in the credit period but not so allocated.

If amounts allocated to a New York Liberty Zone governmental unit exceed the aggregate taxes for which such unit is liable under section 3403, the excess may be carried to the succeeding calendar year and added to the allocation for that calendar year. If a New York Liberty Zone governmental unit does not use an amount allocated to it within the time prescribed by the Governor of the State of New York and the Mayor of the City of New York, such amounts will be treated as if never allocated, and thus they may be reallocated by the Governor and Mayor.

Under the provision, any expenditure for a qualifying project taken into account for purposes of the credit shall be considered State and local funds for the purpose of any Federal program.

The Governor of the State of New York and the Mayor of the City of New York must jointly submit to the Secretary an annual report that certifies the qualifying project expenditure amounts for the calendar year, the amount allocated to each New York Liberty Zone governmental unit, and any other such information as the Secretary may require.

EFFECTIVE DATE

The provision is effective on the date of enactment.

B. Option To Treat Elective Deferrals as After-Tax Contributions

(Sec. 302 of the bill)

PRESENT LAW

Among the various types of tax-favored retirement plans under present law are eligible deferred compensation plans under section 457(b). A section 457(b) plan is a plan maintained by a State or local government or a tax-exempt organization and that meets certain requirements. Generally, the maximum amount that can be deferred under a section 457(b) plan by an individual during any taxable year is limited to the lesser of 100 percent of the participant's includible compensation or the applicable dollar amount for the taxable year. The applicable dollar amount for 2007 is $15,500, and is indexed for future taxable years. A participant's includible compensation means the compensation of the participant from the eligible employer for the taxable year.

Over time, the rules relating to section 457(b) plans of State and local governments ("governmental section 457(b) plans") and those of tax-exempt entities have diverged. Some of the rules relating to governmental section 457(b) plans are similar to those relating to qualified retirement plans. For example, assets under a governmental section 457(b) plan are required to be held in trust for the exclusive benefit of plan participants. Compensation deferred under a governmental section 457(b) plan (and income attributable to the deferral) is generally includible in gross income only for the taxable year in which such compensation (and income) is paid. Rollovers between governmental section 457(b) plans and other tax-favored arrangements (subject to separate accounting requirements) are permitted.

Under present law, section 402A provides that an applicable retirement plan may include a qualified Roth contribution program. A qualified Roth contribution program means a program under which an employee may elect to make designated Roth contributions in lieu of all or a portion of the elective deferrals the employee is otherwise eligible to make under the applicable retirement plan. Designated Roth contributions are treated as elective deferrals (and thus, for example, subject to applicable nondiscrimination rules), except that designated Roth contributions are includible in an employee's gross income. Qualified distributions from a designated Roth account are excludable from gross income.

Applicable retirement plans permitted to include a Roth contribution program are plans qualified under Code section 401(a) and tax-sheltered annuities described in section 403(b). Elective deferral for purposes of a qualified Roth contribution program means an employer contribution under a qualified cash or deferred arrangement (within the meaning of section 401(k)) or an employer contribution to purchase an annuity contract under section 403(b) under a salary reduction agreement.

As part of establishing a qualified Roth contribution program, an applicable retirement plan must establish a separate account, referred to as a designated Roth account, for the designated Roth contributions of each employee and any earnings on such contribu-

tions. In addition, the plan must maintain separate recordkeeping with respect to each account.

The maximum amount that can be designated as a Roth contribution by an employee for a taxable year is the maximum amount of elective deferrals that the employee could have excluded from gross income for the taxable year, less the aggregate elective deferrals that the employee does not designate as Roth contributions.

A qualified distribution from a designated Roth account generally means a distribution that is made after the end of a specified nonexclusion period and that is (1) made on or after the date on which the participant attains age 59½, (2) made to a beneficiary (or to the estate of the participant) on or after the death of the participant, or (3) attributable to the participant's being disabled. The nonexclusion period is the five-taxable-year period beginning with the earlier of (1) the first taxable year for which the participant made a designated Roth contribution to any designated Roth account established for the participant under the plan, or (2) if the participant has made a rollover contribution to the designated Roth account that is the source of the distribution from a designated Roth account established for the participant under another plan, the first taxable year for which the participant made a designated Roth contribution to the previously established account.

REASONS FOR CHANGE

The Roth designated account provisions enacted in 2001 provided participants in section 401(k) plans and tax-sheltered annuities with another form of tax-favored retirement savings. For a variety of reasons, some individuals may prefer to save through a Roth designated account rather than a traditional pre-tax elective deferral or salary reduction contribution to a section 401(k) plan or tax-sheltered annuity. The Committee believes that similar savings choices should be extended to participants in governmental section 457(b) plans.

EXPLANATION OF PROVISION

Under the provision, governmental section 457(b) plans may include a qualified Roth contribution program under which plan participants are permitted to designate elective deferrals that could be otherwise deferred under the plan as Roth contributions subject to the present-law rules. Thus, as under present law, such a designated Roth contribution is includible in gross income in the year of deferral and a subsequent distribution of such a contribution (and the income on such contribution) is excluded from gross income if the distribution is a qualified distribution. Similarly, the present-law separate accounting requirements apply to qualified Roth contribution programs permitted under the provision.

EFFECTIVE DATE

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

C. Increase in Information Return Penalties

(Sec. 303 of the bill and secs. 6721, 6722, and 6723 of the Code)

PRESENT LAW

Present law imposes information reporting requirements on participants in certain transactions. Under section 6721 of the Code, any person required to file a correct information return who fails to do so on or before the prescribed filing date is subject to a penalty that varies based on when, if at all, the correct information return is filed. If a person files a correct information return after the prescribed filing date, but on or before the date that is 30 days after the prescribed filing date, the amount of the penalty is $15 per return (the "first-tier penalty"), with a maximum penalty of $75,000 per calendar year. If a person files a correct information return more than 30 days after the prescribed filing date, but on or before August 1, the amount of the penalty is $30 per return (the "second-tier penalty"), with a maximum penalty of $150,000 per calendar year. If a correct information return is not filed on or before August 1, the amount of the penalty is $50 per return (the "third-tier penalty"), with a maximum penalty of $250,000 per calendar year.

Special lower maximum levels for this penalty apply to small businesses. Small businesses are defined as firms having average annual gross receipts for the most recent three taxable years that do not exceed $5 million. The maximum penalties for small businesses are: $25,000 (instead of $75,000) if the failures are corrected on or before 30 days after the prescribed filing date; $50,000 (instead of $150,000) if the failures are corrected on or before August 1; and $100,000 (instead of $250,000) if the failures are not corrected on or before August 1.

Section 6722 of the Code also imposes penalties for failing to furnish correct payee statements to taxpayers. In addition, section 6723 imposes a penalty for failing to comply with other information reporting requirements. Under both section 6722 and section 6723, the penalty amount is $50 for each failure, up to a maximum of $100,000.

REASONS FOR CHANGE

The Committee believes the present law penalties for failing to file accurate information returns are too low to discourage noncompliance. The Committee believes that increasing the information return penalties will encourage the filing of timely and accurate information returns and generally will improve tax administration and tax compliance.

EXPLANATION OF PROVISION

The provision increases the penalties for failing to file correct information returns, failing to furnish correct payee statements, and failing to comply with other information reporting requirements. Specifically, the provision increases the failure to file correct information returns as follows: the first-tier penalty would be increased from $15 to $50, with a maximum penalty of $500,000 per calendar year; the second-tier penalty would be increased from $30 to $100, with a maximum penalty of $1,500,000 per calendar year; and the

third-tier penalty would be increased from $50 to $250, with a maximum penalty of $3,000,000 per calendar year. The maximum penalties for small businesses would be: $175,000 if the failures are corrected on or before 30 days after the prescribed filing date; $500,000 if the failures are corrected on or before August 1; and $1,000,000 if the failures are not corrected on or before August 1.

The provision increases both the penalty for failing to furnish correct payee statements to taxpayers and the penalty for failing to comply with other information reporting requirements penalties to $250 for each such failure, up to a maximum of $1,000,000 in a calendar year.

EFFECTIVE DATE

The provision is effective with respect to information returns required to be filed on or after January 1, 2008.

D. Exemption of Certain Commercial Cargo From Harbor Maintenance Tax

(Sec. 304 of the bill and sec. 4462 of the Code)

PRESENT LAW

The Code contains provisions imposing a 0.125-percent excise tax on the value of most commercial cargo loaded or unloaded at U.S. ports (other than ports included in the Inland Waterway Trust Fund system). The tax also applies to amounts paid for passenger transportation using these U.S. ports. Exemptions are provided for (1) exported commercial cargo, (2) cargo shipped between the U.S. mainland and Alaska (except for crude oil), Hawaii, and/or U.S. possessions, and (3) cargo shipped between Alaska, Hawaii, and/or U.S. possessions. Receipts from this tax are deposited in the Harbor Maintenance Trust Fund.

REASONS FOR CHANGE

The Committee believes that exempting from the Harbor Maintenance tax non-bulk commercial cargo shipped to U.S. ports located in the Great Lakes Saint Lawrence Seaway System has the potential to enhance the economies of the areas in which such ports are located, while reducing on-road congestion caused by heavy trucks.

EXPLANATION OF PROVISION

The provision exempts from the Harbor Maintenance tax commercial cargo, other than bulk cargo, loaded at a U.S. or Canadian port located in the Great Lakes Saint Lawrence Seaway System and unloaded at another U.S. port located in such system.

For purposes of the provision, the term "bulk cargo" has the meaning given such term by 46 U.S.C. sec. 53101(1), as in effect on the date of the enactment.[99]

For purposes of the provision, the term "Great Lakes Saint Lawrence Seaway System" means the waterway between Duluth, Minnesota and Sept. Iles, Quebec, encompassing the five Great Lakes, their connecting channels, and the Saint Lawrence River.

[99] Under 46 U.S.C. sec. 53101(1), the term "bulk cargo" means cargo that is loaded and carried in bulk without mark or count.

EFFECTIVE DATE

The provision is effective on the date of enactment.

E. TAX EXEMPT AND TAX CREDIT BONDS FOR RAIL INFRASTRUCTURE

(Sec. 305 of the bill and new sec. 54A of the Code)

PRESENT LAW

Tax-exempt bonds

In general

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

Private activity bond tests

Present law provides two tests for determining whether a State or local bond is in substance a private activity bond, the private business test and the private loan test.[100]

Private business tests

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

1. More than 10 percent of the bond proceeds is to be used (directly or indirectly) by a private business (the "private business use test"); and
2. More than 10 percent of the debt service on the bonds is secured by an interest in property to be used in a private business use or to be derived from payments in respect of such property (the "private payment test").[101]

Private business use generally includes any use by a business entity (including the Federal government), which occurs pursuant to terms not generally available to the general public. For example, if bond-financed property is leased to a private business (other than pursuant to certain short-term leases for which safe harbors are

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

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

provided under Treasury regulations), bond proceeds used to finance the property are treated as used in a private business use, and rental payments are treated as securing the payment of the bonds. Private business use also can arise when a governmental entity contracts for the operation of a governmental facility by a private business under a management contract that does not satisfy Treasury regulatory safe harbors regarding the types of payments made to the private operator and the length of the contract.[102]

Private loan test

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

Qualified private activity bonds

As stated, interest on private activity bonds is taxable unless the bonds meet the requirements for qualified private activity bonds. Qualified private activity bonds permit States or local governments to act as conduits providing tax-exempt financing for certain private activities. The definition of qualified private activity bonds includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond (sec. 141(e)). The definition of exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities (sec. 142(a)).

In most cases, the aggregate volume of these tax-exempt private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For calendar year 2007, the State volume cap, which is indexed for inflation, equals $85 per resident of the State, or $256.24 million, if greater.

Exempt facility bonds for high-speed intercity rail facilities

The definition of an exempt facility bond includes bonds issued to finance high-speed intercity rail facilities.[103] A facility qualifies as a high-speed intercity rail facility if it is a facility (other than

[102] See Treas. Reg. sec. 1.141–3(b)(4) and Rev. Proc. 97–13, 1997–1 C.B. 632.
[103] Sec. 142(a)(11) and sec. 142(i).

rolling stock) for fixed guideway rail transportation of passengers and their baggage between metropolitan statistical areas.[104] The facilities must use vehicles that are reasonably expected to operate at speeds in excess of 150 miles per hour between scheduled stops. In addition, the facilities must be made available to members of the general public as passengers. If the bonds are to be issued for a nongovernmental owner of the facility, such owner must irrevocably elect not to claim depreciation or credits with respect to the property financed by the net proceeds of the issue.[105]

The Code imposes a special redemption requirement for these types of bonds. Any proceeds not used within three years of the date of issuance of the bonds must be used within the following six months to redeem such bonds.[106]

Seventy-five percent of the principal amount of the bonds issued for high-speed rail facilities is exempt from the volume limit.[107] If all the property to be financed by the net proceeds of the issue is to be owned by a governmental unit, then such bonds are completely exempt from the volume limit.

Arbitrage restrictions

The tax exemption for State and local bonds also does not apply to any arbitrage bond.[108] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.[109] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal government.

Tax credit bonds

In general

As an alternative to traditional tax-exempt bonds, the Code permits three types of tax-credit bonds. States and local governments have the authority to issue qualified zone academy bonds ("QZABS"), clean renewable energy bonds ("CREBS"), and "Gulf tax credit bonds."[110]

A common feature of the present-law tax-credit bonds is that the taxpayer holding such a bond receives a tax credit, rather than an interest payment. The amount of the credit is determined by multiplying the bond's credit rate by the face amount on the taxpayer's bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits issuance of such bonds without discount and interest cost to the qualified issuer. The credit is includ-

[104] A metropolitan statistical area for this purpose is defined by reference to section 143(k)(2)(B). Under that provision, the term metropolitan statistical area includes the area defined as such by the Secretary of Commerce.
[105] Sec. 142(i)(2).
[106] Sec. 142(i)(3).
[107] Sec. 146(g)(4).
[108] Sec. 103(a) and (b)(2).
[109] Sec. 148.
[110] Secs. 1397E, 54, and 1400N(l), respectively.

ible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability.

Clean renewable energy bonds

CREBs are defined as bonds issued by a qualified issuer if, in addition to the requirements discussed below, 95 percent or more of the proceeds of such bonds are used to finance capital expenditures incurred by qualified borrowers for qualified projects. "Qualified projects" are facilities that qualify for the tax credit under section 45 (other than Indian coal production facilities), without regard to the placed-in-service date requirements of that section.[111] The term "qualified issuers" includes (1) governmental bodies (including Indian tribal governments); (2) mutual or cooperative electric companies (described in section 501(c)(12) or section 1381(a)(2)(C), or a not-for-profit electric utility which has received a loan or guarantee under the Rural Electrification Act); and (3) clean renewable energy bond lenders. The term "qualified borrower" includes a governmental body (including an Indian tribal government) and a mutual or cooperative electric company. A clean renewable energy bond lender means a cooperative which is owned by, or has outstanding loans to, 100 or more cooperative electric companies and is in existence on February 1, 2002.

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

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

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

Qualified zone academy bonds

"QZABs" are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy," and (2) private en-

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

tities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds. Eligible holders of QZABs are limited to financial institutions.

An issuer of QZABs must reasonably expect to and actually spend 95 percent or more of the proceeds of such bonds on qualified zone academy property within the five-year period that begins on the date of issuance. To the extent less than 95 percent of the proceeds are used to finance qualified zone academy property during the five-year spending period, bonds will continue to qualify as QZABs if unspent proceeds are used within 90 days from the end of such five-year period to redeem any nonqualified bonds. For these purposes, the amount of nonqualified bonds is to be determined in the same manner as Treasury regulations under section 142. The provision provides that the five-year spending period may be extended by the Secretary if the issuer establishes that the failure to meet the spending requirement is due to reasonable cause and the related purposes for issuing the bonds will continue to proceed with due diligence.

A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2007. The $400 million aggregate bond cap is allocated to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit authority to qualified zone academies within such State.

Issuers of QZABs are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds. In addition, QZABs are subject to the arbitrage requirements of section 148 that apply to tax-exempt bonds. Principles under section 148 and the regulations thereunder apply for purposes of determining the yield restriction and arbitrage rebate requirements applicable to QZABs.

Gulf tax credit bonds

Gulf tax credit bonds may be issued by the States of Louisiana, Mississippi, and Alabama. To qualify as Gulf tax credit bonds, 95 percent or more of the proceeds of such bonds must be used to (i) pay principal, interest, or premium on a bond (other than a private activity bond) that was outstanding on August 28, 2005, and was issued by the State issuing the Gulf tax credit bonds, or any political subdivision thereof, or (ii) make a loan to any political subdivision of such State to pay principal, interest, or premium on a bond issued by such political subdivision. In addition, the issuer of Gulf tax credit bonds must provide additional funds to pay principal, interest, or premium on outstanding bonds equal to the amount of Gulf tax credit bonds issued to repay such outstanding bonds. Gulf tax credit bonds must be a general obligation of the issuing State and must be designated by the Governor of such State. The maximum maturity on Gulf tax credit bonds is two years. In addition, present-law arbitrage rules that restrict the ability of State and local governments to invest bond proceeds apply to Gulf tax credit bonds.

Gulf tax credit bonds must have been issued in calendar year 2006. The maximum amount of Gulf tax credit bonds authorized to

be issued was $200 million in the case of Louisiana, $100 million in the case of Mississippi, and $50 million in the case of Alabama. Gulf tax credit bonds may not be used to pay principal, interest, or premium on any bond with respect to which there is any outstanding refunded or refunding bond. Moreover, Gulf tax credit bonds may not be used to pay principal, interest, or premium on any prior bond if the proceeds of such prior bond were used to provide any property described in section 144(c)(6)(B) (i.e., any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal purpose of which is the sale of alcoholic beverages for consumption off premises).

As with CREBs and QZABs, issuers of Gulf tax credit bonds are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds.

REASONS FOR CHANGE

The Committee believes the establishment, maintenance, and improvement of the nation's rail infrastructure are a national priority. Investing in rail transportation infrastructure creates long-term capital assets for the nation that will help address infrastructure needs and improve the nation's economic productivity. The Committee believes that existing programs are not meeting the financing needs of long-term rail infrastructure projects. Thus, the Committee believes it is important to explore financing alternatives to assist the economic viability of rail transportation and infrastructure projects.

EXPLANATION OF PROVISION

The provision creates a new category of tax-credit bonds, Qualified Rail Infrastructure Bonds. A Qualified Rail Infrastructure Bond means any bond if: (1) the Secretary has designated the bond as such; (2) 95 percent or more of the proceeds of the bond are to be used for capital expenditures incurred after the date of enactment for a qualified project; (3) the term of each bond satisfies the maximum maturity limitations; and (4) the issue meets certain spending and arbitrage requirements (described below).

The Secretary may designate Qualified Rail Infrastructure Bonds if the following requirements are met.

- First, a State or a group or compact of States must be the proposed issuer of the bonds.
- Second, the bonds must finance qualified projects. A qualified project is defined as a project eligible under section 26101(b) of title 49, United States Code, which the Secretary of Treasury determines was selected using the criteria of section 26101(c) of title 49, United States Code, by the Secretary of Transportation, that makes a substantial contribution to improving a rail transportation corridor for intercity passenger rail use.
- Third, if the rail corridor includes the use of rights-of-way owned by a freight railroad, the applicant must demonstrate that it has entered into a written agreement with such freight railroad regarding the use of the rights-of-way, and that collective bargaining agreements with freight railroad employees (including terms regarding the contracting of work performed on such corridor) shall remain in full force and effect.

• Any person or entity that provides railroad transportation over infrastructure improved or acquired pursuant to this section, is a rail carrier as defined by section 10102 of title 49, United States Code.

• Finally, with respect to qualified projects, the applicant shall comply with the standards applicable to construction work in title 49 in the same manner in which the National Railroad Passenger Corporation is required to comply with such standards.

As with present-law tax credit bonds, the taxpayer holding Qualified Rail Infrastructure Bonds on a credit allowance date is entitled to a tax credit. The amount of the credit is determined by multiplying the bond's credit rate by the face amount on the taxpayer's bond. The credit rate on the bonds is determined by the Secretary and is to be a rate that permits issuance of such bonds without discount and interest cost to the qualified issuer. The credit is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability.

Under the provision, at least 95 percent or more of the proceeds of Qualified Rail Infrastructure Bonds must be spent on qualified projects within the five-year period that begins on the date of issuance of such bonds. To the extent less than 95 percent of the proceeds are spent as required during the five-year spending period, bonds will continue to qualify as Qualified Rail Infrastructure Bonds only if unspent proceeds are used within 90 days from the end of such five-year period to redeem outstanding bonds. The five-year spending period may be extended by the Secretary upon the qualified issuer's request demonstrating that the failure to satisfy the five-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence. The provision also requires level amortization of Qualified Rail Infrastructure Bonds during the period such bonds are outstanding.

Qualified Rail Infrastructure Bonds are subject to a maximum maturity limitation. The maximum maturity is the term which the Secretary estimates will result in the present value of the obligation to repay the principal on Qualified Rail Infrastructure Bonds being equal to 50 percent of the face amount of such bonds. The discount rate used to determine the present value amount is the average annual interest rate of tax-exempt obligations having a term of 10 years or more which are issued during the month the bonds are issued.

Issuers of Qualified Rail Infrastructure Bonds are required to report issuance to the IRS in a manner similar to the information returns required for tax-exempt bonds. In addition, Qualified Rail Infrastructure Bonds are subject to the arbitrage requirements of section 148 that apply to tax-exempt bonds. Principles under section 148 and the regulations thereunder apply for purposes of determining the yield restriction and arbitrage rebate requirements applicable to Qualified Rail Infrastructure Bonds.

The provision establishes a $900 million annual limitation for 2008, 2009, and 2010 on the amount of bonds that may be designated by the Secretary as Qualified Rail Infrastructure Bonds. The provision allows carryover of unused annual limitation to the two following calendar years.

EFFECTIVE DATE

The provision applies to bonds issued after the date of enactment.

F. Repeal of Suspension of Interest and Penalties Where Internal Revenue Service Fails To Contact Taxpayer

(Sec. 306 of the bill and sec. 6404(g) of the Code)

PRESENT LAW

In general, interest and penalties accrue during periods for which taxes were unpaid without regard to whether the taxpayer was aware that there was tax due. Prior to amendment by the Small Business and Work Opportunity Tax Act of 2007, the accrual of certain penalties and interest is suspended starting 18 months after the filing of the tax return if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability within the 18-month period. If a tax return is filed before the due date, for purposes of interest suspension it is considered to have been filed on the due date. Interest and penalties resume 21 days after the IRS sends the required notice to the taxpayer. The provision is applied separately with respect to each item or adjustment. The provision does not apply where a taxpayer has self-assessed the tax. The suspension only applies to taxpayers who file a timely tax return. The provision applies only to individuals and does not apply to the failure to pay penalty, in the case of fraud, or with respect to criminal penalties. Generally, the suspension of interest also does not apply to interest accruing with respect to underpayments resulting from listed transactions or undisclosed reportable transactions.

For IRS notices issued after October 25, 2007, the Small Business and Work Opportunity Tax Act of 2007 provides that the accrual of penalties and interest is suspended starting 36 months after the filing of the tax return.[112] Because the general statute of limitations on assessment of tax is 36 months after the filing of a tax return, the effect of the provision in the Small Business and Work Opportunity Tax Act of 2007 is that interest suspension only applies to tax liabilities that may be assessed more than three years after the filing of a tax return.

REASONS FOR CHANGE

As a result of the provision in the Small Business and Work Opportunity Tax Act of 2007, interest suspension only applies in those cases in which the IRS may assess an additional tax more than three years after the filing of the tax return to which such additional tax liability relates. The Committee believes that the rules regarding the accrual of interest on underpayments of tax should be applied, to the extent possible, in a consistent manner. Thus, the Committee believes the suspension of interest and penalties provision should be repealed. The Committee believes this change is appropriate for effective administration of the tax system.

[112] Pub. L. No. 118–28, sec. 7542 (2007).

EXPLANATION OF PROVISION

The provision repeals the suspension of interest and certain penalties provision.

EFFECTIVE DATE

The provision is effective for IRS notices issued after the date that is 6 months after the date of the enactment of the Small Business and Work Opportunity Tax Act of 2007 (November 25, 2007).

G. Denial of Deduction for Certain Fines, Penalties, and Other Amounts

(Sec. 307 of the bill and sec. 162(f) and new sec. 6050W of the Code)

PRESENT LAW

Under present law, no deduction is allowed as a trade or business expense under section 162(a) for the payment to a government of a fine or similar penalty for the violation of any law (sec. 162(f)). The enactment of section 162(f) in 1969 codified existing case law that denied the deductibility of fines as ordinary and necessary business expenses on the grounds that "allowance of the deduction would frustrate sharply defined national or State policies proscribing the particular types of conduct evidenced by some governmental declaration thereof." [113]

Treasury regulation section 1.162–21(b)(1) provides that a fine or similar penalty includes an amount: (1) paid pursuant to conviction or a plea of guilty or nolo contendere for a crime (felony or misdemeanor) in a criminal proceeding; (2) paid as a civil penalty imposed by Federal, State, or local law, including additions to tax and additional amounts and assessable penalties imposed by chapter 68 of the Code; (3) paid in settlement of the taxpayer's actual or potential liability for a fine or penalty (civil or criminal); or (4) forfeited as collateral posted in connection with a proceeding which could result in imposition of such a fine or penalty. Treasury regulation section 1.162–21(b)(2) provides, among other things, that compensatory damages (including damages under section 4A of the Clayton Act (15 U.S.C. sec. 15a), as amended) paid to a government do not constitute a fine or penalty.

REASONS FOR CHANGE

The Committee is concerned that there is a lack of clarity and consistency under present law regarding when taxpayers may deduct payments made in settlement of government investigations of potential wrongdoing, as well as in situations where there has been a final determination of wrongdoing. If a taxpayer deducts payments made in settlement of an investigation of potential wrongdoing or as a result of a finding of wrongdoing, the publicly announced amount of the settlement payment does not reflect the true after-tax penalty on the taxpayer. The Committee also is concerned that allowing a deduction for such payments in effect shifts

[113] S. Rep. No. 91–552, 91st Cong, 1st Sess., 273–74 (1969), referring to *Tank Truck Rentals, Inc.* v. *Commissioner,* 356 U.S. 30 (1958).

a portion of the penalty to the Federal government and to the public.

EXPLANATION OF PROVISION

The provision modifies the rules regarding the determination whether payments are nondeductible payments of fines or penalties under section 162(f). In particular, the provision generally provides that amounts paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government in relation to the violation of any law, or the investigation or inquiry into the potential violation of any law which is initiated by such government,[114] are nondeductible under any provision of the income tax provisions.[115] The provision applies to deny a deduction for any such payments, including those where there is no admission of guilt or liability and those made for the purpose of avoiding further investigation or litigation. An exception applies to payments that the taxpayer establishes are either restitution (including remediation of property) for damage or harm caused by, or which may be caused by, the violation or potential violation, or amounts paid to come into compliance with any law that was violated or involved in the investigation or inquiry. The exception for restitution does not apply to any amount paid or incurred as reimbursement to the government for the costs of any investigation or litigation [116] unless such amount is paid or incurred for a cost or fee regularly charged for any routine audit or other customary review performed by the government.[117]

In the case of any court order or binding written settlement agreement, if the amounts required to be paid exceed $1 million, then the deduction is not allowed unless such court order or written settlement agreement specifies that the amount is for restitution, for remediation of property, or to come into compliance with the law.[118] The IRS remains free to challenge the characterization of an amount so identified.[119]

The provision does not apply to any amount paid or incurred by order of a court in a suit in which no government is a party.[120]

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[114] The provision does not affect amounts paid or incurred in performing routine audits or reviews such as annual audits that are required of all organizations or individuals in a similar business sector, or profession, as a requirement for being allowed to conduct business. However, if the government or regulator raised an issue of compliance and payment is required in settlement of such issue, the provision would affect that payment.

[115] The provision provides that such amounts are nondeductible under chapter 1 of the Internal Revenue Code.

[116] This exception from deductibility for reimbursements is intended to include payments to reimburse a government for payments to whistleblowers.

[117] The provision does not affect such costs or fees that are a regular charge for a routine audit or customary review, nor does it affect amounts paid or incurred in performing routine audits or reviews that are required of all organizations or individuals in a similar business sector, or profession, as a requirement for being allowed to conduct business. However, if the government or regulator raised an issue of compliance and a payment is required in settlement of such issue, the provision would affect that payment.

[118] The provision does not affect the treatment of antitrust payments made under section 4 of the Clayton Act, which continue to be governed by the provisions of section 162(g).

[119] If a settlement agreement does not specify a specific amount to be paid for the purpose of coming into compliance but instead simply requires the taxpayer to come into compliance, it is sufficient identification to so state. Amounts expended by the taxpayer for that purpose would then be considered identified. However, if an agreement specifies a specific dollar amount that must be paid or incurred, the amount would not be eligible to be deducted without a specification that it is for restitution (including remediation of property) or coming into compliance.

[120] Thus, for example, the provision would not apply to payments made by one private party to another in a lawsuit between private parties merely because a judge or jury acting in the capacity as a court directs the payment to be made. The mere fact that a court enters a judg-

The provision does not apply to any amount paid or incurred as taxes due.[121]

It is intended that a payment will be treated as restitution (including remediation of property) only if substantially all of the payment is required to be paid to the specific persons, or in relation to the specific property, actually harmed by the conduct of the taxpayer that resulted in the payment. Thus, a payment to or with respect to a class substantially broader than the specific persons or property that were actually harmed (e.g., to a class including similarly situated persons or property) does not qualify as restitution or included remediation of property.[122] Restitution and included remediation of property is limited to the amount that bears a substantial quantitative relationship to the harm caused by the past conduct or actions of the taxpayer that resulted in the payment in question. If the party harmed is a government or other entity, then restitution and included remediation of property includes payment to such harmed government or entity, provided the payment bears a substantial quantitative relationship to the harm.

It is intended that a payment will be treated as an amount paid to come into compliance only if it directly corrects a violation with respect to a particular requirement of law that was under investigation. For example, if the law requires a particular emission standard to be met or particular machinery to be used, amounts required to be paid under a settlement agreement to meet the required standard or install the machinery are deductible to the extent otherwise allowed. Similarly, if the law requires certain practices and procedures to be followed and a settlement agreement requires the taxpayer to pay to establish such practices or procedures, such amounts would be deductible. However, amounts paid for other purposes not directly correcting a violation of law are not deductible. For example, amounts paid to bring other machinery that is already in compliance up to a standard higher than required by the law, or to create other benefits (such as a park or other action not previously required by law), are not deductible if required under a settlement agreement. Similarly, amounts paid to educate consumers or customers about the risks of doing business with the taxpayer or about the field in which the taxpayer does business generally, which education efforts are not specifically required under the law, are not deductible if required under a settlement agreement.

The provision requires government agencies to report to the IRS and to the taxpayer the amount of each settlement agreement or order entered where the aggregate amount required to be paid or incurred to or at the direction of the government under such settlement agreements and orders with respect to the violation, investigation, or inquiry is least $600 (or such other amount as may be specified by the Secretary of the Treasury as necessary to ensure

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ment or directs a result in a private dispute does not cause a payment to be made "at the direction of a government" for purposes of the provision.

[121] Thus, amounts paid or incurred as taxes due are not affected by the provision (e.g., State taxes that are otherwise deductible). The reference to taxes due is also intended to include interest with respect to such taxes (but not interest, if any, with respect to any penalties imposed with respect to such taxes).

[122] Similarly, a payment to a charitable organization benefiting a broader class than the persons or property actually harmed, or to be paid out without a substantial quantitative relationship to the harm caused, would not qualify as restitution. Under the provision, such a payment not deductible under section 162 would also not be deductible under section 170.

the efficient administration of the Internal Revenue laws). The reports must be made within 30 days of the date the court order is issued or the settlement agreement is entered into, or such other time as may be required by Secretary. The report must separately identify any amounts that are restitution or remediation of property, or correction of noncompliance.[123]

The IRS is encouraged to require taxpayers to identify separately on their tax returns the amounts of any such settlements with respect to which reporting is required under the provision, including separate identification of the nondeductible amount and of any amount deductible as restitution, remediation, or required to correct noncompliance.[124]

Amounts paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, any self-regulatory entity that regulates a financial market or other market that is a qualified board or exchange under section 1256(g)(7), and that is authorized to impose sanctions (e.g., the National Association of Securities Dealers) are likewise subject to the provision if paid in relation to a violation, or investigation or inquiry into a potential violation, of any law (or any rule or other requirement of such entity). To the extent provided in regulations, amounts paid or incurred to, or at the direction of, any other nongovernmental entity that exercises self-regulatory powers as part of performing an essential governmental function are similarly subject to the provision. The exception for payments that the taxpayer establishes are paid or incurred for restitution, remediation of property, or coming into compliance; the rules requiring identification of those amounts in a court order or written settlement agreement of $1 million or greater; and all the other requirements of the provision including the requirement of reporting to the IRS and the taxpayer, likewise apply in such cases.

No inference is intended as to the treatment of payments as nondeductible fines or penalties under present law. In particular, the provision is not intended to limit the scope of present-law section 162(f) or the regulations thereunder.

EFFECTIVE DATE

The provision is effective for amounts paid or incurred on or after the date of enactment; however the provision does not apply to amounts paid or incurred under any binding order or agreement entered into before such date. Any order or agreement requiring court approval is not a binding order or agreement for this purpose unless such approval was obtained before the date of enactment.

[123] As in the case of the identification requirement, if the agreement does not specify a specific amount to be expended to come into compliance but simply requires that to occur, it is expected that the report may state simply that the taxpayer is required to come into compliance but no specific dollar amount has been specified for that purpose in the settlement agreement.

[124] For example, the IRS might require such separate reporting as part of, or in addition to, reporting of amounts that are not deducted and that thus create a book tax difference on the schedule M–3.

H. Revision of Tax Rules on Expatriation of Individuals

(Sec. 308 of the bill and new secs. 877A and 2801 of the Code)

PRESENT LAW

In general

Income tax

U.S. citizens and residents generally are subject to U.S income taxation on their worldwide income. The U.S. tax may be reduced or offset by a credit allowed for foreign income taxes paid with respect to foreign source income. Nonresident aliens are taxed at a flat rate of 30 percent (or a lower treaty rate) on certain types of passive income derived from U.S. sources, and at regular graduated rates on net profits derived from a U.S. trade or business.

Certain special rules (sections 671–679) apply to certain trust interests deemed to be owned by the grantor or other person (a "grantor trust"). In that case, the deemed owner must include in income the items of income and deduction (and credits against tax) of the portion of such trust deemed to be owned by such person.

Except to the extent a trust is a grantor trust, a transfer of property by a U.S. person to a foreign estate or trust is treated (under section 684) by the transferor as if the property had been sold to such estate or trust. The same rule applies if a domestic trust becomes a foreign trust.

Estate tax

The estates of U.S. citizens and residents are subject to estate tax on all property, wherever located. The estates of nonresident aliens generally are subject to estate tax on U.S.-situated property (e.g., real estate and tangible property located within the United States and stock in a U.S. corporation).

Gift tax

U.S. citizens and residents generally are subject to gift tax on transfers by gift of any property, wherever situated. Nonresident aliens generally are subject to gift tax on transfers by gift of U.S.-situated property (e.g., real estate and tangible property located within the United States), but excluding intangibles, such as stock, regardless of where they are located.

Income tax rules with respect to expatriates

For the 10 taxable years after an individual relinquishes his or her U.S. citizenship or terminates his or her U.S. long-term residency, unless certain conditions are met, the individual is subject to an alternative method of income taxation than that generally applicable to nonresident aliens (the "alternative tax regime"). Generally, the individual is subject to income tax for the 10-year period at the rates applicable to U.S. citizens, but only on U.S.-source income.[125]

A "long-term resident" is a noncitizen who is a lawful permanent resident of the United States for at least eight taxable years during the period of 15 taxable years ending with the taxable year during

[125] For this purpose, however, U.S.-source income has a broader scope than it does typically in the Code.

which the individual either ceases to be a lawful permanent resident of the United States or commences to be treated as a resident of a foreign country under a tax treaty between such foreign country and the United States (and does not waive such benefits).

A former citizen or former long-term resident is subject to the alternative tax regime for a 10-year period following citizenship relinquishment or residency termination, unless the former citizen or former long-term resident: (1) establishes that his or her average annual net income tax liability for the five preceding years does not exceed $124,000 (adjusted for inflation after 2004) and his or her net worth is less than $2 million, or alternatively satisfies limited, objective exceptions for certain dual citizens and minors who have had no substantial contacts with the United States; and (2) certifies under penalties of perjury that he or she has complied with all U.S. Federal tax obligations for the preceding five years and provides such evidence of compliance as the Secretary may require.

Anti-abuse rules are provided to prevent the circumvention of the alternative tax regime.

Estate tax rules with respect to expatriates

Special estate tax rules apply to individuals who die during a taxable year in which they are subject to the alternative tax regime. Under these special rules, certain closely-held foreign stock owned by the former citizen or former long-term resident is includible in his or her gross estate to the extent that the foreign corporation owns U.S.-situated assets. The special rules apply if, at the time of death, the former citizen or former long-term resident: (1) owns, directly or indirectly, 10 percent or more of the total combined voting power of all classes of stock of the foreign corporation entitled to vote; and (2) is considered to own, directly or indirectly, more than 50 percent of (a) the total combined voting power of all classes of stock of the foreign corporation entitled to vote, or (b) the total value of the stock of such corporation. If this stock ownership test is met, then the gross estate of the former citizen or former long-term resident includes that proportion of the fair market value of the foreign stock owned by the individual at the time of death, which the fair market value of any assets owned by such foreign corporation and situated in the United States (at the time of death) bears to the total fair market value of all assets owned by such foreign corporation (at the time of death).

Gift tax rules with respect to expatriates

Special gift tax rules apply to individuals who make gifts during a taxable year in which they are subject to the alternative tax regime. The individual is subject to gift tax on gifts of U.S.-situated intangibles made during the 10 years following citizenship relinquishment or residency termination. In addition, gifts of stock of certain closely-held foreign corporations by a former citizen or former long-term resident are subject to gift tax, if the gift is made during the time that such person is subject to the alternative tax regime. The operative rules with respect to these gifts of closely-held foreign stock are the same as described above relating to the estate tax, except that the relevant testing and valuation date is the date of gift rather than the date of death.

Termination of U.S. citizenship or long-term resident status for U.S. Federal income tax purposes

An individual continues to be treated as a U.S. citizen or long-term resident for U.S. Federal tax purposes, including for purposes of section 7701(b)(10), until the individual: (1) gives notice of an expatriating act or termination of residency (with the requisite intent to relinquish citizenship or terminate residency) to the Secretary of State or the Secretary of Homeland Security, respectively; and (2) provides a statement to the Secretary of the Treasury in accordance with section 6039G.

Sanction for individuals subject to the individual tax regime who return to the United States for extended periods

The alternative tax regime does not apply to any individual for any taxable year during the 10-year period following citizenship relinquishment or residency termination if such individual is present in the United States for more than 30 days in the calendar year ending in such taxable year. Such individual is treated as a U.S. citizen or resident for such taxable year and, therefore, is taxed on his or her worldwide income.

Similarly, if an individual subject to the alternative tax regime is present in the United States for more than 30 days in any calendar year ending during the 10-year period following citizenship relinquishment or residency termination, and the individual dies during that year, he or she is treated as a U.S. resident, and the individual's worldwide estate is subject to U.S. estate tax. Likewise, if an individual subject to the alternative tax regime is present in the United States for more than 30 days in any year during the 10-year period following citizenship relinquishment or residency termination, the individual is subject to U.S. gift tax on any transfer of his or her worldwide assets by gift during that taxable year.

For purposes of these rules, an individual is treated as present in the United States on any day if such individual is physically present in the United States at any time during that day. The present-law exceptions to the U.S. presence rules for residency purposes [126] generally do not apply. However, for individuals with certain ties to countries other than the United States [127] and individuals with minimal prior physical presence in the United States,[128] a day of physical presence in the United States is disregarded if the individual is performing services in the United States on such day for an unrelated employer (within the meaning of sections 267 and 707(b)), that meets such requirements as the Secretary may prescribe in regulations. No more than 30 days may be disregarded during any calendar year under this rule.

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[126] Secs. 7701(b)(3)(D), 7701(b)(5), and 7701(b)(7)(B)–(D).

[127] An individual has such a relationship to a foreign country if (1) the individual becomes a citizen or resident of the country in which the individual was born, such individual's spouse was born, or either of the individual's parents was born, and (2) the individual becomes fully liable for income tax in such country.

[128] An individual has a minimal prior physical presence in the United States if the individual was physically present for no more than 30 days during each year in the ten-year period ending on the date of loss of United States citizenship or termination of residency. However, for purposes of this test, an individual is not treated as being present in the United States on a day if the individual remained in the United States because of a medical condition that arose while the individual was in the United States. Sec. 7701(b)(3)(D)(ii).

Annual return

Former citizens and former long-term residents are required to file an annual return for each year in which they are subject to the alternative tax regime. The annual return is required even if no U.S. Federal income tax is due. The annual return requires certain information, including information on the permanent home of the individual, the individual's country of residence, the number of days the individual was present in the United States for the year, and detailed information about the individual's income and assets that are subject to the alternative tax regime. This requirement includes information relating to foreign stock potentially subject to the special estate and gift tax rules.

If the individual fails to file the statement in a timely manner or fails correctly to include all the required information, the individual is required to pay a penalty of $10,000. The $10,000 penalty does not apply if it is shown that the failure is due to reasonable cause and not to willful neglect.

REASONS FOR CHANGE

The Committee is aware that each year some individuals relinquish their U.S. citizenship or terminate their long-term U.S. residency for the purpose of avoiding U.S. income, estate, and gift taxes. By so doing, such individuals may reduce their annual U.S. income tax liability and may reduce or eliminate their future U.S. estate or gift tax liability.

The Committee recognizes that citizens and long-term residents of the United States have a right not only to physically leave the United States to live elsewhere, but also to relinquish their citizenship or terminate their residency. The Committee does not believe that the Internal Revenue Code should be used to stop U.S. citizens and long-term residents from relinquishing citizenship or terminating residency; however, the Committee also does not believe that the Code should provide a tax incentive for doing so. In other words, to the extent possible, an individual's decision to relinquish citizenship or terminate long-term residency should be tax-neutral.

The Committee recognizes that the American Jobs Creation Act of 2004 altered prior law regarding expatriation in a number of respects, including replacing the subjective "principal purpose of tax avoidance test" with objective rules. Notwithstanding these changes, the Committee remains concerned that the present-law expatriation tax rules (as modified in 2004) could be made more effective. In addition, the Committee is concerned that the alternative method of taxation under section 877 can be avoided by postponing the realization of U.S.-sourced income for 10 years.

Consequently, the Committee believes that the present-law expatriation tax rules should be augmented by a new tax regime applicable to former citizens and long-term residents. Because U.S. citizens and residents who retain their citizenship or residency generally are subject to income tax on accrued appreciation when they dispose of their assets, as well as estate tax on the full value of assets that are held until death, the Committee believes it fair to tax individuals on the appreciation in their assets when they relinquish their citizenship or terminate their long-term residency. The Committee believes that an exception from such a tax should be

provided for individuals with a relatively modest amount of income and net worth, or appreciated assets. The Committee also believes that, where U.S. estate or gift taxes are avoided with respect to a transfer of property to a U.S. person by reason of the expatriation of the donor, it is appropriate for the recipient to be subject to a transfer tax similar to the avoided transfer taxes.

EXPLANATION OF PROVISION

In general

In general, the provision imposes tax on certain U.S. citizens who relinquish their U.S. citizenship and certain long-term U.S. residents who terminate their U.S. residency. Such individuals are subject to income tax on the net unrealized gain in their property as if the property had been sold for its fair market value on the day before the expatriation or residency termination ("mark-to-market tax"). Gain from the deemed sale is taken into account at that time without regard to other Code provisions. Any loss from the deemed sale generally is taken into account to the extent otherwise provided in the Code, except that the wash sale rules of section 1091 do not apply. Any net gain on the deemed sale is recognized to the extent it exceeds $600,000. The $600,000 amount is increased by a cost of living adjustment factor for calendar years after 2008. Any gains or losses subsequently realized are to be adjusted for gains and losses taken into account under the deemed sale rules, without regard to the $600,000 exemption.

The mark-to-market tax described above applies to most types of property interests held by the individual on the date of relinquishment of citizenship or termination of residency, with certain exceptions. Deferred compensation items, interests in nongrantor trusts, and specified tax deferred accounts are excepted from the mark-to-market tax but are subject to the special rules described below.

In addition, the provision imposes a transfer tax on certain transfers to U.S. persons from certain U.S. citizens who relinquished their U.S. citizenship and certain long-term U.S. residents who terminated their U.S. residency, or from their estates.

Individuals covered

The provision applies to any U.S. citizen who relinquishes citizenship and any long-term resident who terminates U.S. residency, if such individual ("covered expatriate") (1) has an average annual net income tax liability for the five preceding years ending before the date of the loss of U.S. citizenship or residency termination that exceeds $124,000 (as adjusted for inflation after 2004—$136,000 in 2007 [129]); (2) has a net worth of $2 million or more on such date; or (3) fails to certify under penalties of perjury that he or she has complied with all U.S. Federal tax obligations for the preceding five years or fails to submit such evidence of compliance as the Secretary may require.

Exceptions to an individual's classification as a covered expatriate due to (1) or (2) above (but not (3)) are provided in two situations. The first exception applies to an individual who was born with citizenship both in the United States and in another country; provided that (1) as of the expatriation date the individual con-

[129] Rev. Proc. 2006–53, sec. 3.29, 2006–48 I.R.B. 996.

tinues to be a citizen of, and is taxed as a resident of, such other country, and (2) the individual has been a resident of the United States (under the substantial presence test of section 7701(b)(1)(A)(ii)) for not more than 10 taxable years during the 15-year taxable year period ending with the taxable year of expatriation. The second exception applies to a U.S. citizen who relinquishes U.S. citizenship before reaching age 18½, provided that the individual was a resident of the United States (under the substantial presence test of section 7701(b)(1)(A)(ii)) for no more than 10 taxable years before such relinquishment.

The definition of "long-term resident" under the provision is generally the same as that under present law. As under present law, an individual is considered to terminate long-term U.S. residency when the individual ceases to be a lawful permanent resident of the United States (i.e., loses his or her green card status through revocation or has been administratively or judicially determined to have abandoned such status). Under the provision, however, an individual ceases to be treated as a lawful permanent resident of the United States for all tax purposes (including for purposes of section 877) if such individual commences to be treated as a resident of a foreign country under a tax treaty between the United States and such foreign country, does not waive the benefits of the treaty applicable to residents of such foreign country, and notifies the Secretary of the commencement of such treatment.

The provision provides that, for all tax purposes (including for purposes of section 877), a U.S. citizen continues to be treated as a U.S. citizen for tax purposes until that individual's citizenship is treated as relinquished under the rules of the immediately preceding paragraph. However, under Treasury regulations, relinquishment may occur earlier with respect to an individual who became at birth a citizen of the United States and of another country. For purposes of the provision, an individual is treated as having relinquished U.S. citizenship on the earliest of four possible dates: (1) the date that the individual renounces U.S. nationality before a diplomatic or consular officer of the United States (provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (2) the date that the individual furnishes to the State Department a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act (again, provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality); (3) the date that the State Department issues a certificate of loss of nationality; or (4) the date that a U.S. court cancels a naturalized citizen's certificate of naturalization.

In the case of a long-term resident, the date that long-term residency is terminated is the "expatriation date." In the case of a citizen, the date that the individual relinquishes citizenship is the "expatriation date."

The foregoing rules replace the present-law rules that provide that an individual continues to be treated as a U.S. citizen or long-term resident for U.S. Federal tax purposes until the individual gives notice of an expatriating act or termination of residency.

If an individual who is a covered expatriate becomes subject to tax as a citizen or resident of the United States for any period beginning after the expatriation date, the individual is not treated as

a covered expatriate during that period for purposes of applying the withholding rules relating to deferred compensation items, the rules relating to interests in nongrantor trusts, and the rules relating to gifts and bequests from covered expatriates. If the individual again relinquishes citizenship or terminates long-term residency (after meeting anew the requirements to become a long-term resident), the mark-to-market tax and other provisions are re-triggered with the new expatriation date.

Deferral of payment of mark-to-market tax

Under the provision, an individual may elect to defer payment of the mark-to-market tax imposed on the deemed sale of property. Interest is charged for the period the tax is deferred at the rate normally applicable to individual underpayments. The election is irrevocable and is made on a property-by-property basis. Under the election, the deferred tax attributable to a particular property is due when the return is due for the taxable year in which the property is disposed (or, if the property is disposed of in a transaction in which gain is not recognized in whole or in part, at such other time as the Secretary may prescribe). The deferred tax attributable to a particular property is an amount which bears the same ratio to the total mark-to-market tax as the gain taken into account with respect to such property bears to the total gain taken into account for the mark-to-market tax. The deferral of the mark-to-market tax may not be extended beyond the due date of the return for the taxable year which includes the individual's death.

In order to elect deferral of the mark-to-market tax, the individual is required to furnish a bond to the Secretary. The bond must be conditioned upon payment of the amount of tax due, plus interest thereon, and must be in accordance with such requirements relating to terms, conditions, form of the bond, and sureties, as may be specified by regulations. The bond must be accepted by the Secretary. Other security mechanisms, including letters of credit, are permitted provided that they meet such requirements as the Secretary may prescribe. In the event that the security provided with respect to a particular property subsequently fails to meet the requirements of these rules and the individual fails to correct such failure, the deferred tax and the interest with respect to such property will become due. As a further condition to making the election, the individual is required to consent to the waiver of any treaty rights that would preclude the assessment or collection of the tax.

Deferred compensation items

The provision contains special rules for interests in deferred compensation items. For purposes of the provision, a "deferred compensation item" means any interest in a plan or arrangement described in section 219(g)(5), any interest in a foreign pension plan or similar retirement arrangement or program, any item of deferred compensation, and any property, or right to property, which the individual is entitled to receive in connection with the performance of services to the extent not previously taken into account under section 83 or in accordance with section 83.

The plans and arrangements described in section 219(g)(5) are (i) a plan described in section 401(a), which includes a trust exempt from tax under section 501(a); (ii) an annuity plan described in sec-

tion 403(a); (iii) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, but excluding an eligible deferred compensation plan (within the meaning of section 457(b)); (iv) an annuity contract described in section 403(b); (v) a simplified employee pension (within the meaning of section 408(k)); (vi) a simplified retirement account (within the meaning of section 408(p)); and (vii) a trust described in section 501(c)(18).

If a deferred compensation item is an eligible deferred compensation item, the payor must deduct and withhold from a "taxable payment" to the covered expatriate a tax equal to 30 percent of such taxable payment. This withholding requirement is in lieu of any withholding requirement under present law. A taxable payment is subject to withholding to the extent it would be included in gross income of the covered expatriate if such person were subject to tax as a citizen or resident of the United States. A deferred compensation item is taken into account as a payment when such item would be so includible. A deferred compensation item that is subject to the 30 percent withholding requirement is subject to tax under section 871.

If a deferred compensation item is not an eligible deferred compensation item, an amount equal to the present value of the covered expatriate's deferred compensation item is treated as having been received on the day before the expatriation date. In the case of a deferred compensation item that is subject to section 83, the item is treated as becoming transferable and no longer subject to a substantial risk of forfeiture on the day before the expatriation date. Appropriate adjustments shall be made to subsequent distributions to take into account the foregoing treatment. In addition, these deemed distributions are not subject to early distribution tax. For this purpose, "early distribution tax" means any increase in tax imposed under section 72(t), 220(e)(4), 223(f)(4), 409A(a)(1)(B), 529(c)(6), or 530(d)(4).

An "eligible deferred compensation item" means any deferred compensation item with respect to which (i) the payor is either a U.S. person or a non-U.S. person who elects to be treated as a U.S. person for purposes of withholding and who meet the requirements prescribed by the Secretary to ensure compliance with the withholding requirements, and (ii) the covered expatriate notifies the payor of his status as a covered expatriate and irrevocably waives any claim of withholding reduction under any treaty with the United States.

The foregoing taxing rules regarding eligible deferred compensation items and items that are not eligible deferred compensation items do not apply to deferred compensation items that are attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States.

Specified tax deferred accounts

There are special rules for interests in specified tax deferred accounts. If a covered expatriate holds any interest in a specified tax deferred account on the day before the expatriation date, such covered expatriate is treated as receiving a distribution of his entire interest in such account on the day before the expatriation date.

Appropriate adjustments are made for subsequent distributions to take into account this treatment. As with deferred compensation items, these deemed distributions are not subject to early distribution tax.

The term "specified tax deferred account" means an individual retirement plan (as defined in section 7701(a)(37)), a qualified tuition plan (as defined in section 529), a Coverdell education savings account (as defined in section 530), a health savings account (as defined in section 223), and an Archer MSA (as defined in section 220). However, simplified employee pensions (within the meaning of section 408(k)) and simplified retirement accounts (within the meaning of section 408(p)) of a covered expatriate are treated as deferred compensation items and not as specified tax deferred accounts.

Interests in trusts

Grantor trusts

In the case of the portion of any trust for which the covered expatriate is treated as the owner under the grantor trust provisions of the Code, as determined immediately before the expatriation date, the assets held by that portion of the trust are subject to the mark-to-market tax. If a trust that is a grantor trust immediately before the expatriation date subsequently becomes a nongrantor trust, such trust remains a grantor trust for purposes of the provision.

Nongrantor trusts

Special rules apply to interests in trusts that are not grantor trusts ("nongrantor trusts"). The mark-to-market tax does not apply with respect to the portion of any trust not treated (under the grantor trust provisions of the Code) as owned by a covered expatriate immediately before the expatriation date. Instead, in the case of any direct or indirect distribution from such a portion of a trust to a covered expatriate, the trustee must deduct and withhold from the distribution an amount equal to 30 percent of the portion of the distribution which would be includible in the gross income of the covered expatriate if the covered expatriate continued to be subject to tax as a citizen or resident of the United States. Such portion of such distribution (that is subject to the 30 percent withholding requirement) is subject to tax under section 871. The covered expatriate is treated as having waived any right to claim any reduction in withholding under any treaty with the United States.

In addition, if the nongrantor trust distributes appreciated property to a covered expatriate, the trust must recognize gain as if the property were sold to the covered expatriate at its fair market value.

If a trust that is a nongrantor trust immediately before the expatriation date subsequently becomes a grantor trust of which a covered expatriate is treated as the owner, directly or indirectly, such conversion is treated under the provision as a distribution to such covered expatriate to the extent of the portion of the trust of which the covered expatriate is treated as the owner.

Special rules

Notwithstanding any other provision of the Code, any period for acquiring property which results in the reduction of gain recognized with respect to property disposed of by the taxpayer terminates on the day before the expatriation date. This rule applies to certain incomplete transactions such as deferred like-kind exchanges and involuntary conversions. In addition, notwithstanding any other provision of the Code, any extension of time for payment of tax ceases to apply on the day before relinquishment of citizenship or termination of residency, and the unpaid portion of such tax becomes due and payable at the time and in the manner prescribed by the Secretary.

For purposes of determining the tax imposed under the mark-to-market tax, property that was held by an individual on the date that such individual first became a resident of the United States (within the meaning of section 7701(b)) is treated as having a basis on such date of not less than the fair market value of such property on such date. An individual may make an irrevocable election not to have this rule apply.

In the case of a domestic trust that becomes a foreign trust due to the expatriation of an individual, the general income tax rules pertaining to transfers by U.S. persons to foreign trusts (i.e., section 684) apply before the rules of the provision.

Regulatory authority

The provision authorizes the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the income tax rules of the provision.

Treatment of gifts and bequests from a former citizen or former long-term resident

Under the provision, a special transfer tax applies to certain "covered gifts or bequests" received by a U.S. citizen or resident. A covered gift or bequest is any property acquired (i) by gift directly or indirectly from an individual who is a covered expatriate at the time of such acquisition, or (ii) directly or indirectly by reason of the death of an individual who was a covered expatriate. A covered gift or bequest, however, does not include (i) any property shown as a taxable gift on a timely filed gift tax return by the covered expatriate, and (ii) any property included in the gross estate of the covered expatriate for estate tax purposes and shown on a timely filed estate tax return of the estate of the covered expatriate.

The tax is calculated as the product of (i) the highest marginal rate of tax specified in the table applicable to estate tax (i.e., section 2001(c)) or, if greater, the highest marginal rate of tax specified in the table applicable to gift tax (i.e., section 2502(a)), both as in effect on the date of receipt of the covered gift or bequest; and (ii) the value of the covered gift or bequest.

The tax is imposed upon the recipient of the covered gift or bequest and is imposed on a calendar-year basis. The tax applies to a recipient of a covered gift or bequest only to the extent that the total value of covered gifts and bequests received by such recipient during a calendar year exceeds $10,000. The tax on covered gifts and bequests is reduced by the amount of any gift or estate tax

paid to a foreign country with respect to such covered gift or bequest.

Special rules apply to the tax on covered gifts or bequests made to domestic or foreign trusts. In the case of a covered gift or bequest made to a domestic trust, the tax applies as if the trust is a U.S. citizen, and the trust is required to pay the tax. In the case of a covered gift or bequest made to a foreign trust, the tax applies to any distribution from such trust (whether from income or corpus) attributable to such covered gift or bequest to a recipient that is a U.S. citizen or resident, in the same manner as if such distribution were a covered gift or bequest. Such a recipient is entitled to deduct the amount of such tax for income tax purposes to the extent such tax is imposed on the portion of such distribution that is included in the gross income of the recipient. For purposes of these rules, a foreign trust may elect to be treated as a domestic trust. The election may not be revoked without the Secretary's consent.

Coordination with present-law alternative tax regime

Under the provision, the present-law expatriation income tax rules under section 877 generally continue to apply to a covered expatriate whose expatriation or residency termination occurs before, on, or after the date of enactment.

Information reporting

Certain information reporting requirements under the law presently applicable to former citizens and former long-term residents (sec. 6039G) also apply for purposes of the provision.

EFFECTIVE DATE

The provision generally is effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after the date of enactment. However, the portion of the provision relating to covered gifts and bequests is effective for gifts and bequests received from former citizens or former long-term residents (or their estates) on or after the date of enactment, regardless of when the transferor expatriated.

III. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the revenue provisions of the "American Infrastructure Investment and Improvement Act of 2007" as reported.

ESTIMATED BUDGET, GENERAL FUND, AND TRUST FUND EFFECTS OF THE "AMERICAN INFRASTRUCTURE INVESTMENT AND IMPROVEMENT ACT," [1] AS REPORTED BY THE COMMITTEE ON FINANCE

[Millions of Dollars]

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
I. Airport and Airway Trust Fund Provisions and Related Taxes													
A. Revenue Effects													
1. Extension of Airport and Airway Trust Fund Tax and Expenditure Provisions (sunset 9/30/11)	10/1/07	*No Revenue Effect*											
a. General Fund	---	*No Effect*											
b. Airport and Airway Trust Fund	---	*No Effect*											
2. Increase the 21.9 cents per gallon tax on non-commercial aviation-grade kerosene (jet fuel) to 36.0 cents per gallon, including floor stocks	[2]	112	161	166	170	174	179	184	189	195	200	782	1,729
a. General Fund	---	-37	-54	-55	-57	-58	-60	-61	-63	-65	-67	-261	-576
b. Airport and Airway Trust Fund	---	149	215	221	227	232	239	245	252	259	267	1,044	2,306
3. Increase international departure and arrival tax to $16.65 and index for inflation	ttpa 12/31/07	102	145	155	165	176	186	198	211	223	237	743	1,798
a. General Fund	---	-13	-23	-24	-27	-28	-30	-31	-34	-35	-38	-115	-283
b. Airport and Airway Trust Fund	---	115	168	179	191	203	217	230	244	258	275	856	2,080
4. Air traffic control system modernization sub-account	DOE	*Estimate to be Provided by the Congressional Budget Office*											
a. General Fund	---	*Estimate to be Provided by the Congressional Budget Office*											
b. Airport and Airway Trust Fund	---	*Estimate to be Provided by the Congressional Budget Office*											
5. For fractional ownership arrangements - increase the fuel tax from 4.4 cents per gallon to 36.0 cents per gallon, repeal the ad valorem tax, repeal the segment tax, and impose $58 departure fee (unindexed)	fsoua 12/31/07 & ttpa 12/31/07	43	76	29	15	19	21	25	35	44	53	182	360
a. General Fund	---	-14	-25	-9	-5	-6	-7	-9	-12	-15	-18	-60	-121
b. Airport and Airway Trust Fund	---	57	101	39	20	25	29	34	47	59	71	242	481

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
6. Repeal section 4281 (relating to the exemption for small aircraft operating on nonestablished lines) for all except sightseeing aircraft	ttpa 12/31/07	4	7	7	7	7	8	8	9	9	9	32	75
a. General Fund	---	-1	-2	-2	-2	-2	-3	-3	-3	-3	-3	-9	-24
b. Airport and Airway Trust Fund	---	5	9	9	9	9	11	11	12	12	12	41	99
7. Transparency in Passenger Tax Disclosures	ttpa 12/31/07	*Negligible Revenue Effect*											
a. General Fund	---	*Negligible Revenue Effect*											
b. Airport and Airway Trust Fund	---	*No Effect*											
8. Modification of pension funding rules of certain eligible plans [3]	[4]	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[6]	[6]	[6]	[5]	[6]
a. General Fund	---	[5]	[5]	[5]	[5]	[5]	[6]	[6]	[6]	[6]	[6]	[5]	[6]
b. Airport and Airway Trust Fund	---	*No Effect*											
Total of Revenue Effects		261	389	357	357	376	394	415	444	471	499	1,739	3,962
B. General Fund and Trust Fund Effects													
1. General Fund	DOE	-65	-104	-90	-91	-94	-100	-104	-112	-118	-126	-445	-1,004
2. Airport and Airway Trust Fund	DOE	326	493	448	447	469	496	520	555	588	625	2,183	4,966
Total of General Fund and Trust Fund Effects		261	389	357	357	376	394	415	444	471	499	1,739	3,962
II. Increased Funding for the Highway Trust Fund													
A. Revenue Effects													
1. Replenish emergency spending from the Highway Trust Fund [7]	DOE	*No Revenue Effect*											
a. General Fund	---	-3,400	---	---	---	---	---	---	---	---	---	-3,400	-3,400
b. Highway Trust Fund	---	3,400	---	---	---	---	---	---	---	---	---	3,400	3,400
2. Suspension of transfers from Highway Trust Fund for certain repayments and credits for six months	DOE	*No Revenue Effect*											
a. General Fund	---	-745	---	---	---	---	---	---	---	---	---	-745	-745
b. Highway Trust Fund	---	745	---	---	---	---	---	---	---	---	---	745	745
3. Impose excise tax on certain removals of taxable fuel from foreign trade zones	1/1/08	8	2	2	2	2	2	2	2	2	2	16	26
a. General Fund	---	-3	-1	-1	-1	-1	-1	-1	-1	-1	-1	-5	-9
b. Highway Trust Fund	---	11	3	3	3	3	3	3	3	3	3	21	35

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
4. Clarification of penalty for sale of fuel failing to meet EPA regulations	DOE	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]
a. General Fund	---	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]
b. Highway Trust Fund	---	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]
5. Treatment of qualified alcohol fuel mixtures and qualified biodiesel fuel mixtures as taxable fuel	freosa 12/31/07	4	1	1	1	1	1	1	1	2	2	8	15
a. General Fund	---	-1	[6]	[6]	[6]	[6]	[6]	[6]	[6]	-1	-1	-3	-5
b. Highway Trust Fund	---	5	1	1	1	1	1	1	1	3	3	11	20
6. Exclude volume of denaturants from the alcohol fuels credit	fsoua 12/31/07	59	91	102	32	---	---	---	---	---	---	284	284
a. General Fund	---	59	91	102	32	---	---	---	---	---	---	284	284
b. Highway Trust Fund	---	*No Effect*											
7. Bulk transfer exception not to apply to finished gasoline	freosa 12/31/07	636	18	18	20	22	22	22	22	22	22	714	824
a. General Fund	---	-212	-6	-6	-7	-7	-7	-7	-7	-7	-7	-238	-275
b. Highway Trust Fund	---	848	24	24	27	29	29	29	29	29	29	952	1,099
8. Increase excise tax rate to $0.10 for the Oil Spill Liability Trust Fund (sunset 12/31/17)	[9]	148	250	269	273	276	279	280	283	286	287	1,215	2,630
a. General Fund	---	-49	-83	-90	-91	-92	-93	-94	-94	-95	-96	-405	-877
b. Oil Spill Liability Trust Fund	---	196	333	359	364	368	372	373	377	381	383	1,620	3,506
9. Tax treatment of certain inversion transactions	[10]	109	92	100	108	116	116	136	146	155	163	525	1,241
a. General Fund	---	109	92	100	108	116	116	136	146	155	163	525	1,241
b. Highway Trust Fund	---	*No Effect*											
10. Deny deduction for punitive damages	dpoio/a DOE	37	29	30	31	32	33	34	35	36	37	159	333
a. General Fund	---	37	29	30	31	32	33	34	35	36	37	159	333
b. Highway Trust Fund	---	*No Effect*											
11. Fuel technical corrections	[11]	*No Revenue Effect*											
a. General Fund	---	*No Revenue Effect*											
b. Highway Trust Fund	---	*No Effect*											
12. Motor Fuel Tax Enforcement Advisory Commission	DOE	*No Revenue Effect*											
a. General Fund	---	*No Revenue Effect*											
b. Highway Trust Fund	---	*No Effect*											

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
13. Conform Highway Trust Fund provisions in the Code to include P.L. 110-56	DOE	*No Revenue Effect*											
a. General Fund	---	*No Revenue Effect*											
b. Highway Trust Fund	---	*No Effect*											
Total of Revenue Effects		1,001	483	522	467	449	453	475	489	503	513	2,921	5,353
B. General Fund and Trust Fund Effects													
1. General Fund	DOE	-4,205	122	135	72	48	48	68	79	87	95	-3,828	-3,453
2. Highway Trust Fund	DOE	5,009	28	28	31	33	33	33	33	35	35	5,129	5,299
3. Oil Spill Liability Trust Fund	DOE	196	333	359	364	368	372	373	377	381	383	1,620	3,506
Total of General Fund and Trust Fund Effects		1,001	483	522	467	449	453	475	489	503	513	2,921	5,353
III. Additional Infrastructure Modifications and Revenue Provisions													
A. Revenue Effects													
1. New York Liberty Zone restructuring; tax credit cap $169 million per year (sunset existing provisions date of enactment, credit starts 1/1/08)	DOE & pba 12/31/07	-152	37	-329	-202	-171	-171	-171	-171	-171	-171	-817	-1,672
2. Permit governmental 457(b) plans to adopt accounts that accept elective deferrals that receive Roth treatment	tyba 12/31/07	3	16	37	68	121	151	158	160	161	161	245	1,035
3. Increase information return penalties	irrtbfo/a 1/1/08	---	---	35	85	83	82	81	81	79	78	202	603
4. Exempt from the Harbor Maintenance Tax non-bulk cargo loaded or unloaded at U.S. ports in the Great Lakes Saint Lawrence Seaway System	DOE	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]
a. General Fund	---	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]
b. Harbor Maintenance Trust Fund	---	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]
5. Railroad tax credit bonds (allocation of $900 million per year for 2008, 2009, and 2010)	bia DOE	-10	-60	-110	-143	-146	-136	-127	-117	-107	-98	-469	-1,054
6. Repeal suspension of certain interest and penalties where IRS fails to contact taxpayer	[12]	9	13	13	13	13	13	13	13	13	14	61	128
7. Denial of deduction for certain fines, penalties, and other amounts	generally apoio/a DOE	62	31	15	15	15	15	15	15	15	15	137	210

Provision	Effective	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2008-12	2008-17
8. Impose mark-to-market and 10-year income inclusion rule on individuals who expatriate.....	[13]	50	78	74	75	75	76	77	78	78	79	352	740
Total of Revenue Effects		-38	115	-265	-89	-10	30	46	59	68	78	-289	-10
B. General Fund and Trust Fund Effects													
1. General Fund.....	DOE	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]
2. Harbor Maintenance Trust Fund.....	DOE	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]
Total of General Fund and Trust Fund Effects		[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]	[6]
**NET TOTAL OF REVENUE EFFECTS		**1,224**	**987**	**614**	**735**	**815**	**877**	**936**	**992**	**1,042**	**1,090**	**4,371**	**9,305**
**General Fund		**-4,270**	**18**	**45**	**-19**	**-46**	**-52**	**-36**	**-33**	**-31**	**-31**	**-4,273**	**-4,457**
**Airport and Airway Trust Fund		**326**	**493**	**448**	**447**	**469**	**496**	**520**	**555**	**588**	**625**	**2,183**	**4,966**
**Leaking Underground Storage Tank Trust Fund		**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**-1**
**Highway Trust Fund		**5,009**	**28**	**28**	**31**	**33**	**33**	**33**	**33**	**35**	**35**	**5,129**	**5,299**
**Oil Spill Liability Trust Fund		**196**	**333**	**359**	**364**	**368**	**372**	**373**	**377**	**381**	**383**	**1,620**	**3,506**
**Harbor Maintenance Trust Fund		**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**	**[6]**
**NET TOTAL OF GENERAL FUND AND TRUST FUND EFFECTS ..		**1,261**	**872**	**880**	**823**	**824**	**849**	**890**	**932**	**973**	**1,012**	**4,659**	**9,313**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. Date of enactment is assumed to be October 1, 2007.
Changes to revenues credited to the Highway Account of the Highway Trust Fund would affect the calculation of Revenue Aligned Budget Authority ("RABA"), a type of Contract Authority, a mandatory form of budget authority.

Legend for "Effective" column:

apoio/a = amounts paid or incurred on or after
bia = bonds issued after
DOE = date of enactment
dpoio/a = damages paid or incurred on or after
freosa = fuel removed, entered, or sold after
fsoua = fuel sold or used after
pba = periods beginning after
ttpa = taxable transportation provided after
tyba = taxable years beginning after

[Footnotes for the Table appear on the following page]

Footnotes for the Table:

[1] The estimates do not include potential effects on direct spending that would be estimated by the Congressional Budget Office.
[2] The provision is generally effective for fuel removed, entered, or sold after December 31, 2007. The floor stocks tax provision is effective January 1, 2008.
[3] The revenue estimate does not reflect any potential effects on PBGC premiums. Any effects on PBGC premiums will be provided by the Congressional Budget Office.
[4] Effective as if included in section 402 of the "Pension Protection Act of 2006."
[5] Negligible revenue effect.
[6] Loss of less than $500,000.
[7] Estimate provided by the Congressional Budget Office and should be considered preliminary.
[8] Gain of less than $500,000.
[9] Effective for the first quarter that begins more than 60 days after the date of enactment.
[10] Effective for taxable years beginning after the date of enactment, with respect to certain transactions substantially completed after March 20, 2002.
[11] Effective as if included in the original legislation.
[12] Effective for IRS notices issued to taxpayers after November 25, 2007.
[13] Generally effective for expatriations on or after the date of enactment. The tax on covered gifts and bequests is effective for gifts and bequests received on or after the date of enactment.

B. Budget Authority and Tax Expenditures

Budget authority

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

Tax expenditures

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

C. Consultation With Congressional Budget Office

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office has not submitted a statement on the bill. The letter from the Congressional Budget Office will be provided separately.

IV. VOTES OF THE COMMITTEE

In compliance with paragraph 7(b) of rule XXVI of the standing rules of the Senate, the Committee states that, with a majority and quorum present, the "American Infrastructure Investment and Improvement Act of 2007," as amended, was ordered favorably reported on September 21, 2007 as follows:

The Committee accepted by voice vote an amendment by Senator Kerry authorizing tax credit bonds for rail infrastructure projects.

The bill as amended was ordered favorably reported by a roll call vote of 13 ayes and 0 nays (16 ayes and 5 nays if proxy votes were included in the tally of votes for favorably reporting a bill out of Committee). The vote was as follows:

Ayes: Baucus, Rockefeller, Conrad, Bingaman, Kerry, Lincoln, Wyden (proxy), Schumer, Stabenow (proxy), Cantwell, Salazar, Grassley, Hatch (proxy), Snowe, Crapo, Roberts

Nays: Lott (proxy), Kyl (proxy), Smith (proxy), Bunning (proxy), Ensign (proxy)

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

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

Impact on individuals and businesses, personal privacy and paperwork

The bill increases the tax on aviation-grade kerosene, the international arrival and departure tax, and Oil Spill Trust Fund tax. For individuals and businesses engaged in activities subject to these taxes, the provisions should not result in additional recordkeeping responsibilities beyond that required for present law. The provisions increasing revenues to the Airport and Airway Trust

Fund will fund improvements to the air traffic control system from which individuals and businesses using such system will benefit. The bill does not have any impact on personal privacy.

B. Unfunded Mandates Statement

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104–4).

The Committee has determined that the following tax provisions of the reported bill contain Federal private sector mandates within the meaning of Public Law 104–4, the Unfunded Mandates Reform Act of 1995: (1) increasing the 21.9 cent per gallon tax on non-commercial aviation-grade kerosene to 36 cents per gallon; (2) increasing the international arrival and departure tax to $16.65 and index for inflation; (3) eliminating the bulk transfer exception for finished gasoline, and (4) increasing the excise tax rate to 10 cents per barrel for the Oil Spill Liability Trust Fund.

The tax provisions of the reported bill do not impose a Federal intergovernmental mandate on State, local, or tribal governments within the meaning of Public Law 104–4, the Unfunded Mandates Reform Act of 1995.

The costs required to comply with each Federal private sector mandate generally are no greater than the aggregate estimated budget effects of the provision.

C. Tax Complexity Analysis

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

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

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

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

VII. ADDITIONAL VIEWS OF SENATORS ROCKEFELLER AND LOTT

We recognize the Finance Committee's efforts to fund the modernization of the next generation air transportation system. While we agree that now is the time to promote equity in the funding of our air traffic control system, we remain concerned that the proposal does not move far enough with respect to the contributions of commercial air carriers and general aviation aircraft.

According to current data from the Federal Aviation Administration (FAA), 21.7 percent of expenditures for Air Traffic Control services are attributable to general aviation's usage of our aviation system. However, general aviation only contributes 3.2 percent of taxes paid into the Airport and Airways Trust Fund (AATF). In contrast, 73.5 percent of air traffic costs are attributable to commercial aviation while commercial aviation and airline passengers pay 96.8 percent of the taxes in the Trust Fund. This funding inequity needs to be corrected. The fleet of general aviation jet powered aircraft has been growing faster than the commercial airline fleet over the past decade, and the FAA estimates the fleet of business jets and air taxis will grow at twice the rate of commercial aircraft over the next 14 years. The increase in general aviation jet traffic is already being seen in critical segments of our nation's air transportation system, such as the New York City area airspace, controlled by the FAA's New York Terminal Approach facility. In this airspace, general aviation accounts for more than 30 percent of the air traffic flying under instrument flight rules, and accounts for more than half of all traffic. With few options to address congestion of our nation's airspace in the near-term, we believe that the financing must reflect the significant impact that increased general aviation traffic will have on chokepoints in the National Airspace System.

While we recognize the Finance Committee's steps to address the funding inequity in our aviation system, we believe any final product will need to strike a greater balance. Under the Finance Committee's proposal, general aviation would only be paying 4.4 percent into the Trust Fund, whereas commercial aviation and airline passengers would be paying 95.3 percent. The proposal amounts to a tax increase on the average commercial airline passengers, which we cannot support.

As we move forward, we are committed to continue working with the Chairman, Ranking Member, and the Members of the Finance Committee to resolve the current funding inequities that exist in our aviation system.

JOHN D. ROCKEFELLER.
TRENT LOTT.

VIII. STATEMENT REGARDING SENATE RULE XLIV

Rule XLIV of the Standing Rules of the Senate provides that "it shall not be in order to vote on a motion to proceed to consider a bill or joint resolution reported by any committee unless the chairman of the committee of jurisdiction, or majority leader or his or her designee certifies: (1) that each congressionally directed spending item, limited tax benefit, and limited tariff benefit, if any, in the bill or joint resolution, or the committee report accompanying the bill or joint resolution, has been identified through lists, charts, or other similar means including the name of each senator who submitted the request to the committee; and (2) that the information in clause (1) has been available on a publicly accessible website in a searchable format at least 48 hours before such vote."

In connection with the request for proposed amendments to the Chairman's mark, Senator Schumer filed a proposed amendment to restructure the Liberty Zone tax incentives to provide a tax credit to the City and State of New York against certain withholding taxes required to be paid by the City and State of New York to the Internal Revenue Service. The credit amount is, subject to certain limitations, determined by expenditures on qualifying infrastructure projects in (or connecting with) the New York Liberty Zone. The amendment was incorporated as part of the Chairman's modification.

In making the determination required by Rule XLIV, a memorandum from the Chief of Staff of the Joint Committee on Taxation (set forth below) and other information were considered. In accordance with Rule XLIV, I have determined that section 301 of the bill, relating to the restructuring of New York Liberty Zone tax incentives, is a limited tax benefit.

MAX BAUCUS.

MEMORANDUM

To: Bill Dauster, Deputy Chief of Staff, Senate Finance Committee.
From: Ed Kleinbard.
Date: October 30, 2007.
Subject: Application of Senate Rule XLIV (relating to limited tax benefits) to sec. 301 of the American Infrastructure Investment Improvement Act of 2007 (as passed by the Senate Finance Committee on September 21, 2007).

Request

You have requested that the staff of the Joint Committee on Taxation analyze the application of Senate Rule XLIV's limited tax benefit provision to section 301 of the American Infrastructure Investment and Improvement Act of 2007 ("Section 301"), as passed by the Senate Finance Committee (relating to the restructuring of

New York Liberty Zone tax incentives). I offer this analysis at your request to assist Chairman Baucus in making his determination of this issue, as contemplated by Rule XLIV.

Senate Rule XLIV

Section 521 of the Honest Leadership and Open Government Act of 2007 [130] (the "HLOGA") provides for "earmark" reform. Specifically, HLOGA adds a new Rule XLIV to the Standing Rules of the Senate. Under this rule, "it shall not be in order to vote on a motion to proceed to consider a bill or joint resolution reported by any committee unless the chairman of the committee of jurisdiction, or majority leader or his or her designee certifies: (1) that each congressionally directed spending item, limited tax benefit, and limited tariff benefit, if any, in the bill or joint resolution, or the committee report accompanying the bill or joint resolution, has been identified through lists, charts, or others similar means including the name of each senator who submitted the request to the committee; and (2) that the information in clause (1) has been available on a publicly accessible congressional website in a searchable format at least 48 hours before such vote". Failure to satisfy this requirement makes a bill or joint resolution subject to a point of order until these requirements are satisfied under the rule.

For purposes of the rule, the following definitions apply.

A congressionally directed spending item "means a provision or report language included primarily at the request of a Senator providing, authorizing, or recommending a specific amount of discretionary budget authority, credit authority, or other spending authority for a contract, loan, loan guarantee, grant, loan authority, or other expenditure with or to an entity, or targeted to a specific State, locality, or Congressional district, other than through a statutory or administrative formula-driven or competitive award process."

A limited tax benefit "means any revenue provision that (A) provides a Federal tax deduction, credit, exclusion, or preference to a particular beneficiary or limited group of beneficiaries under the Internal Revenue Code of 1986; and (B) contains eligibility criteria that are not uniform in application with respect to potential beneficiaries of such provision."

A limited tariff benefit "means a provision modifying the Harmonized Tariff Schedule of the United States in a manner that benefits 10 or fewer entities."

Senate Floor Statement

A colloquy [131] between Senators Baucus, Durbin, and Grassley provides some guidance regarding how the new rule will be applied in the case of limited tax benefits. In relevant part the colloquy states:

> For more guidance, we also recommend the interpretative guidelines developed by the staff of the Joint Committee on Taxation in response to the prior-law line item veto. These guidelines may also be applicable to the inter-

[130] Public Law 110–81.
[131] Congressional Record, August 2, 2007 (page S10699).

pretation of the proposed earmark disclosure rules for limited tax benefits in this bill. The Joint Committee on Taxation documents are called, first, the "Draft Analysis of Issues and Procedures for Implementation of Provisions Contained in the Line Item Veto Act, Public Law 104–130, relating to Limited Tax Benefits," that's Joint Committee on Taxation document number JCX–48–96, and second, the "Analysis of Provisions Contained in the Line Item Veto Act, Public Law 104–130, relating to Limited Tax Benefits," that's Joint Committee on Taxation document number JCS–1–97.

The proposed rule in this bill would require the disclosure of limited tax benefits. It would define a limited tax benefit to mean any revenue provision that, first, provides a Federal tax deduction, credit exclusion, or preference to a particular beneficiary or limited group of beneficiaries under the Internal Revenue Code of 1986; and second, contains eligibility criteria that are not uniform in application with respect to potential beneficiaries of such provision.

The proposed rule would apply in most cases where the number of beneficiaries is 10 or fewer for a particular tax benefit. But the Finance Committee will not be bound by an arbitrary numerical limit such as "10 or fewer." Rather, we will apply the standard appropriately within the unique circumstances of each proposal. For example, if a proposal gave a tax benefit directed only to each of the 11 head football coaches in the Big Ten Conference, we may conclude that the rule would nonetheless require disclosure of this benefit, even though the number of beneficiaries would be more than 10.

We will not limit the application of the proposed rule to proposals that result in a reduction in Federal receipts relative to the applicable present-law baseline. We believe that the proposed rule would have application to limited tax benefits that provide a tax cut relative to present law for certain beneficiaries, like, for example, a tax rate reduction for certain beneficiaries. But we also believe that the rule would apply to limited tax benefits that provide a temporary or permanent tax benefit relative to a tax increase provided in the proposal, like, for example, exempting a limited group of beneficiaries from an otherwise applicable across-the-board tax rate increase.

For example, a new tax credit for any National Basketball Association players who scored 100 points or more in a single game would be covered by the rule. And the rule would also cover a new income tax surtax on players in the National Hockey League that exempted from the new income surtax any players who were exempted from the league's requirement that players wear helmets when on the ice.

The rule defines a beneficiary as a taxpayer; that is, a person liable for the payment of tax, who is entitled to the deduction, credit, exclusion, or preference. Beneficiaries in-

clude entities that are liable for payroll tax, excise tax, and the tax on unrelated business income on certain activities.

The rule does not define a beneficiary as the person bearing the economic incidence of the tax. For example, in some instances, a taxpayer may pass the economic incidence of a tax liability or tax benefit to that taxpayer's customers or shareholders. The proposed rule would look to the number of taxpayers. That number is easier to identify than the number of persons who might bear the incidence of the tax.

In determining the number of beneficiaries of a tax benefit, we will use rules similar to those used in the prior-law line item veto legislation. For example, we will treat a related group of corporations as one beneficiary for these purposes. Without such a rule, a parent corporation could avoid application of the disclosure rule by simply creating a sufficient number of subsidiary corporations to avoid classification as a limited tax benefit under the proposed rule.

For example, if a related group of corporations—like parent-subsidiary corporations or brother-sister corporations—owns a football team, then the related group will be considered one beneficiary. That treatment is analogous to the team being one entity, not separate entities, like the coaching staff, offensive unit, defensive unit, specialty unit, and practice squad.

The time period that we will use for measuring the existence of a limited tax benefit will be the same time period that is used for Budget Act purposes. That is the current fiscal year and 10 succeeding fiscal years. Those are also all the fiscal years for which the Joint Committee on Taxation staff regularly provide a revenue estimate.

For purposes of determining whether eligibility criteria are uniform in application with respect to potential beneficiaries of such a proposal, we will need to determine the class of potential beneficiaries. In the case of a closed class of beneficiaries—for example, all individuals who hit at least 755 career home-runs before July 2007—that class is not subject to interpretation, since only Henry Aaron satisfies this criteria. If, instead, the defined class of beneficiaries is all individuals who hit at least 755 career home-runs, then we will determine the class of potential beneficiaries by assessing the likelihood that others will join that class over the time period for measuring the existence of a limited tax benefit.

Whether the eligibility criteria are not uniform in application with respect to potential beneficiaries will be a factual determination. To continue with the previous hypothetical, a proposal that provides a tax benefit to all individuals who hit at least 755 career home-runs may still not require disclosure if it is uniform in application. If the same proposal is altered so as to exclude otherwise eligible career home-run hitters who played for the Pittsburgh Pirates at some point in their career, then that kind of a lim-

ited tax benefit would require disclosure under the proposed rule.

Some of the guidelines in the Joint Taxation Committee's reports numbered JCX–48–96 and JCS–1–97 would not be directly applicable, but may be helpful in determining the class of potential beneficiaries. For example, the same industry, same activity, and same property rules might provide useful analysis.

Provision to restructure the New York Liberty Zone tax incentives

In addition to repealing certain depreciation and expensing provisions previously available in the New York Liberty Zone (the "NYLZ"), Section 301 provides a Federal credit against the tax imposed for any payroll period by Code section 3402 (related to withholding for wages paid) for which a NYLZ governmental unit is liable under Code section 3403. NYLZ governmental units are defined as the State of New York, the City of New York, or any agency or instrumentality of the first two.

The credit may be claimed during the 12–year period beginning on January 1, 2008 and is equal to certain amounts expended by the governmental units on a qualifying project. A qualifying project is any transportation infrastructure project in or connecting with the NYLZ that is designated by the Governor of the State of New York and the Mayor of the City of New York as a qualifying project. The Governor of the State of New York and the Mayor of the City of New York are to allocate to the New York Liberty Zone governmental units their portion of the qualifying expenditure amount for purposes of claiming the credit. The provision is effective on the date of enactment.

Congressionally Directed Spending Item or Limited Tax Benefit

The threshold question is whether Section 301 should be analyzed as a "congressionally directed spending item" or as a "limited tax benefit," because Rule XLIV treats the two somewhat differently. It can be argued that Section 301 essentially constitutes a "congressionally directed spending item," and therefore that the limited tax benefit analysis is irrelevant. The reasoning supporting this reading is that in the ordinary course, Federal withholdings on employee wages are effectively assets of the U.S. Treasury, and the tax credit made available by Section 301 may be claimed (and withholdings on wages therefore retained rather than being transmitted to the U.S. Treasury) only to the extent that the employer/governmental unit in question incurs expenditures for specifically identified projects.

Section 301 unquestionably has the economic effect of an appropriation: money otherwise due the U.S. Treasury will, by virtue of this provision, effectively fund (in light of the fungibility of money) a specific expenditure. Nonetheless, this memorandum proceeds upon the assumption that Section 301 is a "tax benefit" and not a "spending item." We believe that this is an area where legal form, not economic substance, controls. Accordingly, we are of the view that an amendment to the Internal Revenue Code that has an outlay effect is not by virtue of that fact alone a spending item. For

example, we believe that the refundable portions of the child tax credit and earned income credit should be considered tax benefits for these purposes, notwithstanding the fact that these provisions have substantial outlay effects.

Our mode of analysis is dictated by practical necessity: virtually every "tax expenditure" could equally well have been implemented by Congress as an appropriation. We take comfort as well in the observation made in the colloquy quoted above that, for purposes of Rule XLIV, the "beneficiary" of a limited tax benefit is determined by looking to the formal imposition of tax liability (i.e., by determining who is the relevant "taxpayer"), not to the party bearing the economic incidence of the tax. The colloquy makes clear that the reason for doing so is one solely of administrative convenience ("The proposed rule would look to the number of taxpayers. That number is easier to identify than the number of persons who might bear the [economic] incidence of the tax.")

In this case, Section 301 is structured as a tax credit made available under the Internal Revenue Code to certain employers against their otherwise-existing obligation to remit employee withholdings to the U.S. Treasury. In light of our traditional analysis summarized above, we therefore think it appropriate to proceed on the basis that Section 301 should be analyzed under the "limited tax benefit" leg of Rule XLIV.

Limited Group of Current Beneficiaries

A second issue is whether Section 301 currently benefits a limited group of beneficiaries. Applying by analogy the colloquy's reference to treating a related group of corporations as one taxpayer, we believe that the agencies and instrumentalities of New York State and City should be treated as at most two taxpayers for purposes of whether a limited group of beneficiaries is affected by the provision. Accordingly, we believe that the statutory incidence of the provision falls on fewer than 10 beneficiaries (i.e., the State of New York, the City of New York and agencies or instrumentalities of the State or City). The economic incidence of the provision is not determinative for these purposes.

Uniform Application to Potential Beneficiaries

Under Rule XLIV, a tax provision that in practice applies only to a limited number of current beneficiaries nonetheless is not a "limited tax benefit" unless in addition that provision's "eligibility criteria are not uniform in application with respect to the potential beneficiaries of the provision." (Emphasis supplied.) The only direct indication of what constitutes the "uniform application" of a taxing statute to potential beneficiaries is the colloquy described above.[132] In this regard, the colloquy indicates that a tax benefit that applies equally to current and potential future beneficiaries will not constitute a limited tax benefit, just because the number of identifiable beneficiaries today is fewer than 10.

We suggest that the most logical way to read Rule XLIV that is consistent with its obvious intended scope and with the colloquy is

[132] The JCT staff documents on the former line-item veto legislation to which the colloquy refers do not discuss the issue of "uniform application," because that concept was not part of the definition of a "limited tax benefit" under that legislation.

to conclude that Rule XLIV applies a two-step analysis towards "potential" beneficiaries. First, a sponsor of a Bill that has a limited number of current beneficiaries can rely on the existence of a sufficiently large class of reasonably-likely potential beneficiaries to demonstrate that the Bill applies to more than a limited number of taxpayers. In that case, however, Rule XLIV goes on to provide that the statute must be applied uniformly to them and to currently-known beneficiaries. This reading finds direct support in the fact that Rule XLIV's "uniform application" clause applies only with respect to "potential beneficiaries" of a statute.[133]

In other words, a Bill that has a large number of current beneficiaries is not a limited tax benefit provision, because by definition it does not apply to a limited number of taxpayers, without regard to whether future ("potential") taxpayers are treated differently from current ones. If , however, a Bill today applies only to a limited number of beneficiaries, then the Bill's sponsor cannot rely on a sufficient number of "potential" beneficiaries emerging in the future to avoid the application of the limited tax benefit rule unless the statute would treat all current and potential beneficiaries equally.

Under this reading, a statute that has no possible future ("potential") beneficiaries and that applies today to a limited number of current beneficiaries must be a limited tax benefit. It cannot be the case, for example, that a rule identifying a class of taxpayers comprising only Hank Aaron nonetheless is not a limited tax benefit, on the theory that all those taxpayers (a single individual) are treated equally.

Following this mode of analysis, the most important analytical step in applying Rule XLIV to a case (like this) where a statute's current beneficiaries are limited in number is to determine the relevant class of potential (i.e., future) beneficiaries. The colloquy concludes that a statute's class of potential beneficiaries is to be determined "by assessing the likelihood" that beneficiaries beyond those to whom the benefit applies today may appear at a later date.

Thus, to continue with the colloquy's baseball analogy, a permanent tax benefit made available on a uniform basis to all individuals who hit a least 755 major league career home-runs is probably not a limited tax benefit (because the number of individuals who could qualify in the future is unlimited), but a comparable temporary provision expiring December 31, 2008, probably does constitute a limited tax benefit, because the class of individuals who could reasonably be expected to satisfy that test would come down to two identifiable individuals.

Having identified the class of potential beneficiaries, and having determined that they are sufficiently numerous as to overcome the "limited" nature of the tax benefit in question, the final step in the analysis is to ensure that the statute will apply uniformly to all potential and current beneficiaries. In most cases, this determination will be straightforward.

In sum, we acknowledge that the "uniform application" test is both vague and difficult to apply. The "uniform application" leg of

[133] In this regard, it is important to note that clause (A) of Rule XLIV refers to "a particular beneficiary or limited group of beneficiaries." It is only the "uniform application" clause (clause (B)) that refers to "potential" beneficiaries.

the analysis should not be read, however, to undercut the entire purpose of Rule XLIV. If the only taxpayers that can reasonably be expected to satisfy a bill's definition of the class of beneficiaries of a tax benefit are both few in number and known to the Senator proposing the Bill at the time that the legislation is considered, then in our view that Bill must give rise to a Rule XLIV issue. Any other reading would vitiate the Rule of any meaning.

This mode of analysis leads to a straightforward resolution of the present case. In practice, only New York State and New York City (and political subdivisions thereof) can be expected to qualify for the benefits of Section 301. The fact that these two identifiable beneficiaries are treated equally is not enough, in our view, to avoid the reach of Rule XLIV.

Conclusion

While we recognize that colorable arguments can be made in support of the contrary conclusion, we believe that Rule XLIV's disclosure requirement for limited tax benefits is applicable to Section 301.

I would be pleased to discuss this issue further with you, should you wish. In any event, I hope that this memorandum is helpful to the Chairman's decision-making process.

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