United States Senate
Committee on Finance

Following is a summary of the conference agreement of H.R. 6, Title XIII, the *Energy Tax Incentives Act of 2005*.

Wednesday, July 27, 2005

Overview of the Energy Tax Incentives Act of 2005

Oil and Gas Production and Enhanced Refining

Natural gas distribution lines treated as 15-year property. Gas distribution lines must be depreciated over 20 years under present law. Provision shortens the depreciation period to 15 years for any gas distribution lines the original use of which occurred after April 11, 2004 and before January 1, 2011. The provision does not apply to any property which the taxpayer or a related party had entered into a binding contract for the construction thereof or self-constructed on or before April 11, 2005.

Cost: $1.019 billion

Amortization of geological and geophysical expenditures. The provision allows geological and geophysical amounts incurred in connection with oil and gas exploration in the United States to be amortized over two years. In the case of abandoned property, any remaining basis may no longer be recovered in the year of abandonment of a property as all basis is recovered over the two-year amortization period. The provision is effective for geological and geophysical costs paid or incurred in taxable years beginning after the date of enactment.

Cost: $974 million

Expensing for refinery investments. Allows taxpayers to expense (depreciate immediately) 50 percent of the cost of refinery investments which increase the capacity of an existing refinery by at least 5 percent or increase the throughput of qualified fuels by at least 25 percent. Qualified fuels include oil from shale and tar sands. As a condition of eligibility, refineries of liquid fuels must report to the IRS on refinery operations (e.g., production and output).

Cost: $406 million

Determination of small refiner exception to oil depletion deduction. Presently, a producer may qualify as an independent producer for this purpose if its refining operations, runs, do not exceed 50,000 barrels on any day in the taxable year during which independent producer status is claimed. The provision increases the current 50,000-barrel-per-day limitation to 75,000. It also changes the refinery limitation on actual daily production to an average daily production for the taxable year.

Cost: $158 million

Arbitrage rules not to apply to prepayment for natural gas. Arbitrage is the profit that results from investing the proceeds of tax-exempt bonds in higher yielding taxable securities. Tax law generally requires a rebate of arbitrage profits to the U.S. This provision would create a safe harbor exception to the general rule that tax-exempt bond-financed prepayments violate the arbitrage restrictions. The exception applies to certain prepaid natural gas contracts, i.e., any contracts to acquire natural gas for resale by a utility owned by a governmental unit where the amount of gas to be purchased under the contract does not exceed the certain limits. The limit is the sum of (1) the average annual natural gas purchased by customers of the utility within the service area during a 5 year testing period, and (2) the amount of natural gas that is needed to fuel transportation of the natural gas to the governmental utility. This provision would apply to all contracts issued after the date of enactment.

Cost: $53 million

Natural gas gathering lines treated as 7-year property. Uncertainty in the current law concerning what the appropriate recovery period is for natural gas gathering lines has lead to litigation. This provision clarifies the law, establishing a statutory seven-year recovery period and a class life of 14 years for natural gas gathering lines the original use of which commences with the taxpayer after April 11, 2005. In addition, no adjustment will be made to the allowable amount of depreciation with respect to this property for purposes of computing a taxpayer's alternative minimum taxable income.

Cost: $16 million

Cooperative pass-through of the expensing related to costs to comply with EPA sulfur regulations for small refiners. The American Job Creation Act of 2004 included a provision to allow taxpayers to expense certain costs for investments to comply with EPA low sulfur diesel regulations. Provision allows the deduction to be passed-through to members of a cooperative if the cooperative makes an election on their tax return.

Cost: $7 million

Electricity Reliability

Transmission property treated as fifteen-year property. Assets used in the transmission and distribution of electricity for sale and related land improvements are assigned a 20-year recovery period. This provision shortens the recovery period to 15-years for certain assets used in the transmission of electricity for sale and related land improvements. For purposes of the provision, section 1245 property used in the transmission at 69 or more kilovolts of electricity for sale, the original use of which commences with the taxpayer after April 11, 2005, will qualify for the new recovery period. The provision does not apply to any property which the taxpayer or a related party had entered into a binding contract for the construction thereof or self-constructed on or before April 11, 2005.

Cost: $1.239 billion

Nuclear decommissioning. Modifies the rules for qualified nuclear decommissioning funds, which are funds created by a taxpayer, restricted to certain kinds of investments, and used exclusively for payment of decommissioning costs. The proposal repeals the cost of service requirement for contributions to a qualified fund. The proposal permits the transfer of pre-1984 decommissioning costs to a qualified fund. Finally, it requires that new ruling amount be made in any tax year in which the powerplant is granted a license renewal.

Cost: $1.293 billion

Treatment of electric cooperative income (85/15 test). The rules for tax-exempt electric cooperatives require that 85 percent of the cooperative's income consists of amounts collected from members of the cooperative to meet losses and expenses of providing service to its members (85/15 test). This test has made it difficult for cooperatives to participate in electricity market deregulation and open access transmission of electricity. In the Jobs Bill, the 85/15 test was modified to exclude certain income related to electricity restructuring from the 85/15 test. Those changes expire on 12/31/06. The provision makes the Jobs Bill changes permanent.

Cost: $277 million

Sales of electricity transmission property to implement restructuring policy. The Jobs Bill included a provision to allow a longer recognition period for electric utilities that sell their transmission assets to a FERC-approved independent transmission company. Rather than paying tax on any gain from the sale in the year that the sale is completed, utilities will have 8 years to pay the tax on any gain from the sale. The rule expires at the end of 2006. Provision allows sales during 2007 to qualify for the 8-year recognition.

Raises: $19 million

Production tax credit for nuclear power facilities. No tax credit for electricity produced at nuclear power facilities under present law. Provision establishes a production tax credit for new nuclear power facilities. Credit amount is 1.8 cents per kWh for electricity produced over an 8-year period.

Cost: $278 million

5-year NOL for electric transmission equipment. A taxpayer may claim a net operating loss carryback to each of the 5 years preceding the taxable year of such loss up to 20 percent of the cost of electric transmission capital expenditures and pollution control capital expenditures. Applies to losses incurred in 2003, 2004 and 2005.

Cost: $52 million

<u>Renewable and Clean Energy Incentives</u>

Extension and modification of renewable electricity production credit (Section 45). Provision extends placed-in-service date by two years (through December 31, 2007) for qualifying facilities: wind facilities; closed-loop biomass facilities; open-loop biomass facilities; geothermal facilities; small irrigation power facilities; landfill gas facilities; and trash combustion facilities. Placed-in-service dates for solar facilities and refined coal facilities are not altered. Qualifying facilities receive credits per kWh for electricity produced over a 10 year period. Hydropower and Indian coal are added as new qualifying energy resources. Provision is generally effective on date of enactment.

Cost: $2.747 billion

Pass through to cooperatives. Section 45 allows eligible cooperatives to elect to pass any portion of the renewable electricity production credit to their patrons. An eligible cooperative is defined as a cooperative organization that is owned more than 50 percent by agricultural producers or entities owned by agricultural producers.

(included in Section 45 score)

Clean renewable energy bonds. Provision creates new category of tax credit Bonds Clean Renewable Energy Bonds ("CREBs"). CREBs are defined as bond issued by qualified issuer if, in addition to other requirements, 95 percent of proceeds are used to finance capital expenditures incurred for facilities qualifying for tax credit under section 45. Qualified issuers include governmental bodies (including Indian tribal governments) and mutual or cooperative electric companies. Provision is effective for bonds issued after December 31, 2005.

Cost: $411 million

Clean Coal

Credit for investment in clean coal facilities. No tax credit for clean coal facilities under present law. Provision establishes three investment tax credits for clean coal facilities: a 15 percent and 20 percent investment tax credit for clean coal facilities producing electricity; and a 20 percent credit for industrial gasification projects. Integrated gasification combined cycle (IGCC) projects get a 20 percent investment tax credit and other advanced coal-based projects that produce electricity get a 15 percent credit. The Secretary may allocate up to $800 million for IGCC projects and up to $500 million for other advanced coal-based technologies and up to $350 million for industrial gasification. Also clarifies that lignite is a qualifying coal.

Cost: $1.612 billion

84-month amortization for pollution control facilities. This provision provides a 7 year recovery period for the cost of certain certified air pollution control facilities used in connection with an electric generation plant which is primarily coal fired and which was not in operation before January 1, 1976. Under present law, plants that were in operation before January 1, 1976 may amortize these costs over 60 months.

Cost: $1.147 billion

Modification of credit for producing fuel from a nonconventional source. The provision makes the credit for producing fuel from a non-conventional source part of the general business credit, so that unused credits may be carried back one year and forward 20 years.

Cost: $88 million

Extension of credit for producing fuel from a nonconventional source for facilities producing coke or coke gas. Coke is a fuel from the residue of coal left after distillation or other feedstock (such as petroleum). The provision also adds a production credit for qualified facilities that produce coke or coke gas. Qualified facilities must have been placed in service before January 1, 1993, or after June 30, 1998, and before January 1, 2010. The production credit may be claimed beginning on the later of January 1, 2006, or the date such facility is placed in service and ending on the date which is four years after such period began. The credit expires in January 1, 2010 or four years after the facility was placed in service, whichever is later.

Cost: $101 million

Energy Efficiency and Conservation Measures

Alternative technology vehicle credits.
Fuel cell vehicles: the amount of credit for the purchase of a fuel cell vehicle is determined by a base credit amount that depends upon the weight class of the vehicle and in the case of automobiles or light trucks, an additional credit amount that depends upon the rated fuel economy of the vehicle compared to a base fuel economy.
Alternative Fuel Vehicles: The provision permits the credit to offset the excess of the regular tax over the alternative minimum tax
Hybrid vehicles and advanced lean-burn technology vehicles: The amount of credit is the sum of two components: a fuel economy credit amount that varies with the rated fuel economy of the vehicle compared to a 2002 model year standard and a conservation credit based on the estimated lifetime fuel savings of a qualifying vehicle compared to a comparable 2002 model year vehicle.
Effective date – The provision applies to vehicles placed in service after December 31, 2005, in the case of qualified fuel cell motor vehicles, before January 1, 2015; in the case of qualified hybrid motor vehicles that are automobiles and light trucks and in the case of advanced lean-burn technology vehicles, before January 1, 2011; in the case of qualified hybrid motor vehicles that are medium and heavy trucks, before January 1, 2010; and in the case of qualified alternative fuel motor vehicles, before January 1, 2011.

Cost: $874 million

Termination of code section 179A: Repeals section 179A sunsets after December 31, 2005.

Raises: $2 million

Small producer biodiesel and ethanol credit. Adds to the biodiesel fuels credit a small agri-biodiesel producer credit of 10-cents-per-gallon for up to 15 million gallons of agri-biodiesel produced by producers with annual capacity not exceeding 60 million gallons. Effective for taxable years after date of enactment and sunsets December 31, 2008. Limit on production capacity for small ethanol producers increased from 30 million to 60 million gallons, effective for taxable years after date of enactment.

Cost: $181 million

Credit for installing of alternative fuel refueling property. The provision permits taxpayers to claim a 30% credit for the cost of installing clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer. Under the provision clean fuels are any fuel at least 85% of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, and hydrogen and any mixture of diesel fuel and biodiesel containing at least 20% biodiesel.

Effective date. - The provision is effective for property placed in service December 31, 2005 and before January 1, 2010.

Cost: $71 million

Diesel-water fuel emulsion. A special tax rate of 19.7 cents per gallon is provided for diesel fuel blended with water into a diesel-water fuel emulsion to reflect the reduced Btu content per gallon resulting from the water. The diesel-water emulsion fuels eligible for the special rate must consist of at least 14% water. The person claiming entitlement must be registered with the Secretary. Claims for refunds based on the incentive rate may be filed quarterly if such person can claim at least $750. If the person cannot claim at least $750 at the end of quarter, the amount can be carried over to the next quarter to determine if the person can claim at least $750. If the person cannot claim $750 at the end of the taxable year, the person must claim a credit on the person’s income tax return.

Effective date.-The provision is effective on January 1, 2006

Cost: Negligible

Extend excise tax provisions and income tax credit for biodiesel and create similar incentives for renewable diesel. The conference agreement extends the income tax credit, excise tax credit, and payment provisions through December 31, 2008. The conference agreement also creates a similar income tax credit, excise tax credit and payment system for renewable diesel, however there is no credit for small producers of renewable diesel. Renewable diesel means diesel fuel derived form biomass using thermal depolymerization process.

Effective date. – The extension of incentives is effective on the date of enactment. The renewable diesel provisions are effective for fuel sold or used after December 31, 2005.

Cost: $194 million

Credit for residential energy efficient property purchases. Provides credit, equal to 30 percent of qualifying expenditures, for purchase for qualified photovoltaic property and solar water heating property used exclusively for purposes other than heating swimming pools and hot tubs. Provision also provides a 30 percent credit for the purchase of qualified fuel cell power plants and applies to property placed in service after December 31, 2005 and prior to January 1, 2008.

Cost: $31 million

Credit for business installation of qualified fuel cells, stationary microturbine power plants, and solar. Provides a 30 percent business energy credit for purchase of qualified fuel cell power plants for businesses and a 10 percent credit for purchase of qualifying stationary microturbine power plants. Additionally, a 30 percent credit for purchase of qualifying solar energy property is provided. Credits apply to periods after December 31, 2005 and before January 1, 2008.

Cost: $222 million

Credit for energy efficient existing homes. Provides 10% investment tax credit for expenditures with respect to improvements to building envelope. Allows credits for purchases of advanced main air circulating fans, natural gas, propane, or oil furnaces or hot water boilers, and other qualified energy efficient property. Credit applies to property placed in service after December 31, 2005 and prior to January 1, 2008.

Cost: $556 million

Business credit of energy efficient new homes. Provides credit to eligible contractor for construction of a qualified new energy-efficient home. Credit applies to manufactured homes meeting Energy Star Standards and other homes meeting a 50 percent standard. Credit applies to homes which are purchased after December 31, 2005 and prior to January 1, 2008.

Cost: $28 million

Energy efficient commercial building deduction. The provision allows a deduction for energy efficient commercial buildings that reduce annual energy and power consumption by 50 percent compared to the American Society of Heating, Refrigerating, and Air Conditioning Engineers (ASHRAE) standard. The deduction would equal the cost of energy efficient property installed during construction, with a maximum deduction of $1.80 per square foot of the building. In addition, a partial deduction of 60 cents per square foot would be provided for building subsystems.

Cost: $243 million

Energy efficient appliances. Provision establishes tax credit for the manufacture of efficient dishwashers, clothes washers, and refrigerators. Credits vary depending on the efficiency of the unit. Effective for appliances manufactured in 2006 and 2007.

Cost: $180 million

Research and development credit for energy research. Provision modifies the 20% research and development tax credit. Taxpayers' expenditures to qualified research consortia with respect to energy-related research would be eligible for the credit. Other modifications to the credit with respect to energy-related research are included.

Cost: $92 million

NAS study. Provision directs the Treasury Secretary to enter into an agreement with the National Academy of Sciences to conduct a study of the health, environmental, security, and infrastructure costs and benefits associated with production and consumption of energy.

Cost: No score.

Recycling study. Provision directs the Treasury Secretary, in consultation with the Secretary of Energy, to conduct a study to determine and quantify the energy savings, achieved through recycling activities, including electronic waste, and to identify tax incentives to carry out this incentive.

Cost: No score.

Oil Spill Liability Trust Fund. Reinstates the Oil Spill Liability Trust Fund tax. The tax applies on April 1, 2006, or later, if the Secretary estimates that, as of the close of that quarter, the unobligated balance in the Oil Spill Liability Trust fund will be less that $2 billion.

Raises: $2.508 billion

Leaking Underground Storage Tank Trust (LUST)Fund. The LUST Trust Fund tax is extended at the current rate through September 30, 2011. Also, dyed fuel is subject to the LUST tax and without refund.

Raises: $349 million

Section 197 modification. This provision modifies the recapture rules for amortizable section 197 intangibles. Under the provision, if multiple section 197 intangibles are sold or disposed of in a single transaction or series of transactions, the seller must calculate recapture as if all of the section 197 intangibles were a single asset. Thus, any gain on the sale or disposition of the intangibles is recaptured as ordinary income to the extent of ordinary depreciation deductions previously claimed on any of the section 197 intangibles.

Raises: $171 million

Tire excise tax modification and tire study. It clarifies that a super single tire is not designed to steer the vehicle, and is made effective as if included in the JOBS Act.

Raises: negligible effect