DESCRIPTION OF SELECTED FEDERAL TAX PROVISIONS THAT IMPACT LAND USE, CONSERVATION, AND PRESERVATION

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON OVERSIGHT

of the

HOUSE COMMITTEE ON WAYS AND MEANS

On September 30, 1999

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INTRODUCTION

The Subcommittee on Oversight of the House Committee on Ways and Means has scheduled a public hearing on September 30, 1999, on issues relating to the impact of Federal tax law on environmental conservation and preservation. Part I of this document,[1] prepared by the staff of the Joint Committee on Taxation, describes selected provisions of Federal income tax and estate and gift tax law that may have an effect on the way land is used. Part II of the document describes certain introduced bills affecting the tax incentives for land use and energy conservation.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Selected Federal Tax Provisions That Impact Land Use, Conservation, and Preservation* (JCX-68-99), September 28, 1999.

I. DESCRIPTION OF PRESENT-LAW TAX PROVISIONS

A. Cost Recovery for Land

In general

A taxpayer generally must capitalize the cost of property used in a trade or business.[2] The capitalized cost of business property that is subject to exhaustion, wear, tear, or obsolescence may be recovered over time through allowances for depreciation (sec. 167). Depreciation allowances for tangible property placed in service after 1986 generally are determined under the Modified Accelerated Cost Recovery System ("MACRS") of section 168, which provides that depreciation is computed by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property. Intangible property acquired after July 25, 1991, generally is amortized under section 197, which provides a 15-year recovery period and applies the straight-line method to the cost of applicable property.

Under MACRS, depreciable property is divided into ten classes (3-year property, 5-year property, 7-year property, 10-year property, 15-year property, 20-year property, 25-year water utility property, 27.5-year residential rental property, 39-year nonresidential real property, and 50-year railroad grading or tunnel bores). Personal property generally is included in a property class based upon its class life. The class life of certain assets is provided by statute. The class life of other personal property is determined by reference to their class lives.[3] The 200-percent declining balance method of depreciation is used for 3-year, 5-year, 7-year, and 10-year property; the 150-percent declining balance method for 15-year and 20-year property and any property used in a farming business; and the straight-line method for other property, including most depreciable real property.

The Secretary of the Treasury (or his delegate) has been directed to conduct a comprehensive study of the recovery periods under section 168 and to submit the results of such study, together with recommendations for determining such periods and methods in a more rational manner, to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate by March 31, 2000.[4]

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[2] Costs that generally are required to be capitalized include purchase costs and direct costs of constructing property. In most cases, allocable indirect costs of constructing property also must be capitalized (sec. 263A(b)(1)). Interest costs generally must be capitalized in the construction of real property or property with a class life of 20 years or more (sec. 263A(f)).

[3] Class lives have been published by the Secretary of the Treasury in Rev. Proc. 87-56, 1987-2 C.B. 674, as clarified and modified by Rev. Proc. 88-22, l988-1 C.B. 785.

[4] Sec. 2022 of the Internal Revenue Service Restructuring and Reform Act of 1998.

Treatment of land

The cost of land generally may not be depreciated,[5] even if the taxpayer's use of the land may result in its erosion or other type of wear or tear (e.g., in the case of certain farming practices).[6] Any interest in land may not be amortized under section 197 (sec. 197(e)(2)). When a taxpayer acquires both land and other property in a single transaction (e.g. the purchase of an apartment building and the underlying land), the acquisition cost must be allocated between the nondepreciable and depreciable assets.

Some improvements to land (such as sidewalks, roads, landscaping, etc.) may be depreciated.[7] However, certain land improvements may be so "inextricably associated" with the land as to be nondepreciable. Examples of nondepreciable land improvements include certain clearing and grading costs associated with land[8] and golf course improvements.[9] The cost of demolishing any structure generally must be charged to the land on which the demolished structure was located (sec. 280B).

The cost of minerals and other natural resources imbedded in land are recoverable through depletion allowances (sec. 611).

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[5] Treas. reg. sec. 1.167(a)-2.

[6] Treas. reg. sec. 1.167(a)-6(b). See also A. Duda & Sons, Inc. v. United States, 560 F.2d 669 (5th Cir. 1977).

[7] Rev. Proc. 87-56, supra.

[8] Rev. Rul. 65-265, 1965-2 C.B. 52, and Rev. Rul. 68-193, 1968-1 C.B. 79.

[9] Rev. Rul. 55-290, 1955-1 C.B. 320.

B. Income Tax Treatment of Dispositions of Land

Capital gains treatment

In general, gain or loss reflected in the value of an asset is recognized for income tax purposes at the time the taxpayer disposes of the property. On the sale or exchange of capital assets held more than one year, gain generally is taxed to an individual taxpayer at a maximum marginal rate of 20 percent. Losses from the sale or exchange of capital assets are deductible only the extent of the gains from the sale or exchange of such assets, plus, in the case of individuals, $3000.

Land is a capital asset unless held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, or is used in the taxpayer's trade or business. In addition, if the gains from property, including land, used in a taxpayer's trade or business exceeds the losses from such property, the gains and losses are treated as capital gains.

Deferral of gain or loss

Several provisions allow a taxpayer to defer gain when property, including land, is disposed of. For example, if land held for investment or business use is exchanged for property of a like kind (generally defined to include other real estate) gain or loss is deferred (sec. 1031). Likewise if land is condemned and replaced with other property of a like kind, gain or loss is deferred (sec. 1033).

Principal residence

Under present law, an individual taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years prior to the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met (sec. 121).

C. Tax Credit for Rehabilitation Expenditures

In general

An income tax credit is provided for a portion of certain expenditures incurred in the rehabilitation of certified historic structures and certain other buildings first placed in service before 1936. The amount of the credit is 20 percent of the qualified rehabilitation expenditures for a certified historic structure and 10 percent of the qualified rehabilitation expenditures for a qualified rehabilitated building other than a certified historic structure.

In order for a rehabilitation to qualify for the credit applicable to certified historic structures, the rehabilitated building must be listed in the National Register of Historic Places, or be located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district. In addition, the Secretary of the Interior must certify that the rehabilitation is consistent with the historic character of the building or the historic district in which the building is located.

In the case of other rehabilitations, a building (or its structural components) is a qualified rehabilitated building if: (1) the building is substantially rehabilitated; (2) the building was placed in service before the beginning of the rehabilitation; (3) the rehabilitation meets a 75-percent retention test; (4) depreciation is allowable with respect to the building; and (5) the building was first placed in service before 1936.

A building is substantially rehabilitated if the qualified rehabilitation expenditures incurred during the 24-month period selected by the taxpayer exceed the greater of: (1) the adjusted basis of the building (and its structural components) as of the beginning of the period (or as of the holding of the building, if later); or (2) $5,000.

Qualified rehabilitation expenditures generally include any amounts properly chargeable to capital account in connection with the rehabilitation of a building, but do not include the cost of: (1) acquiring the building or any interest in the building; (2) facilities related to a building (e.g., a parking lot); (3) enlarging an existing building; or (4) rehabilitations allocable to a portion of a building that is (or is reasonably expected to be) tax-exempt use property.

The 75-percent retention test requires the retention, in place, of (1) at least 75 percent of the building's existing external walls (including at least 50 percent as external walls) and (2) at least 75 percent of the building's internal structural framework. In general, a building's internal structural framework includes all load-bearing internal walls and any other structural supports, including the columns, girders, beams, trusses, spandrels, and all other items that are essential to the stability of the building.

Other rules

The rehabilitation credit is part of the investment credit which, in turn, is part of the general business credit. The general business credit may offset the first $25,000 of a taxpayer's regular tax liability, plus 75 percent of the taxpayer's regular tax liability in excess of $25,000. The general business credit is not allowed to offset a taxpayer's minimum tax liability.

Taxpayers claiming the credit must reduce their adjusted basis in the building by the amount of the credit. Capitalized rehabilitation expenditures must be depreciated using a straight-line method.

The credit is subject to recapture if the rehabilitated building is disposed of or otherwise ceases to be a qualified property within five years after the property is placed in service.

D. Environmental Remediation Expenditures

Taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred (sec. 198).[10] The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site.

In general, any expenditure for the acquisition of depreciable property used in connection with the abatement or control of hazardous substances at a qualified contaminated site does not constitute a qualified environmental remediation expenditure. However, depreciation deductions allowable for such property, which would otherwise be allocated to the site under the principles set forth in *Commissioner v. Idaho Power Co.*[11] and section 263A, are treated as qualified environmental remediation expenditures.

A "qualified contaminated site" generally is any property that (1) is held for use in a trade or business, for the production of income, or as inventory; (2) is certified by the appropriate State environmental agency to be located within a targeted area; and (3) contains (or potentially contains) a hazardous substance (so-called "brownfields"). Targeted areas are defined as: (1) empowerment zones and enterprise communities as designated under present law; (2) sites announced before February, 1997, as being subject to one of the 76 Environmental Protection Agency ("EPA") Brownfields Pilots; (3) any population census tract with a poverty rate of 20 percent or more; and (4) certain industrial and commercial areas that are adjacent to census tracts with a poverty rate of 20 percent or more. However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 cannot qualify as targeted areas.

In the case of property to which a qualified environmental remediation expenditure otherwise would have been capitalized, any deduction allowed under section 198 is treated as a depreciation deduction and the property is treated as section 1245 property. Thus, deductions for qualified environmental remediation expenditures are subject to recapture as ordinary income upon sale or other disposition of the property.

Eligible expenditures are those paid or incurred before January 1, 2001.

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[10] Section 198 was enacted as part of the Taxpayer Relief Act of 1997.

[11] *Commissioner v. Idaho Power Co.*, 418 U.S. 1 (1974), holding that equipment depreciation allocable to the taxpayer's construction of capital facilities must be capitalized under section 263(a)(1).

E. Use of Tax-Exempt Bonds

In general

The Code exempts interest on certain debt obligations of States (including territories and possessions of the United States) from the regular individual and corporate income taxes (sec. 103). Interest on debt of local governments generally receives identical treatment to that provided for States.[12] The State and local government bond interest exemption applies to two principal types of bonds. First, interest is tax-exempt on bonds issued to finance public activities conducted by[13] or paid for by States and local governments themselves ("governmental bonds"). Examples of activities financed with governmental bonds are schools, courthouses, roads, public mass transit systems, governmentally owned and operated water, sewer, and electric facilities, and State and local park and recreational facilities.

The second major category of State and local government bonds on which interest is tax-exempt consists of bonds issued by these governmental units acting as a conduit to provide financing for private persons ("private activity bonds"). Unlike governmental bonds, tax-exempt private activity bonds generally may only be issued for purposes specified in the Code. The specified purposes include several activities related to private land use and real estate development.

Private activity bonds

Qualified 501(c)(3) bonds

Tax-exempt organizations that are described in Code section 501(c)(3) are permitted to finance the activities forming the basis for tax-exemption of their income with the proceeds of State or local government tax-exempt bonds ("qualified 501(c)(3) bonds"). Land and related property used in the exempt activities of the organizations is eligible for tax-exempt financing. Property which is not used in furtherance of an exempt purpose (i.e., is used in an "unrelated business activity") may not financed with the proceeds of tax-exempt bonds. Management

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[12] Interest on these "State and local government bonds" may, in certain cases, be includible in calculating the individual and corporate alternative minimum taxes. Additionally, State and local government bond interest is included in determining whether a portion of Social Security benefits is taxable under the regular individual income tax.

[13] Activities that are conducted by private businesses under certain shorter-term management contracts are treated as carried out by a governmental unit. On the other hand, activities conducted by private businesses pursuant to longer-term management contracts or contracts providing for profit-based payments generally are treated as private business, as opposed to governmental, activities.

contract rules similar to those applicable to actual State or local governmental activities apply in determining whether property used in activities carried out by taxable private businesses on behalf of section 501(c)(3) organizations may be financed with qualified 501(c)(3) bonds.

Exempt-facility bonds

Exempt-facility bonds are private activity bonds issued to finance certain privately operated transportation facilities (airports, ports, mass commuting facilities, and high-speed intercity rail facilities); municipal service facilities (water, sewage, solid waste, local furnishing of electricity or gas, environmental enhancement of hydroelectric dams, and local district heating and cooling facilities); hazardous waste disposal facilities; and multifamily rental housing.

Bonds for each of these private activities are subject to extensive Federal targeting criteria. For example, developers of housing receiving tax-exempt financing must agree that either (1) 20 percent of the rental housing units will be occupied by tenants having incomes of 50 percent or less of the area median income where the project is located, or (2) 40 percent of the rental housing units will be occupied by tenants having incomes of 60 percent of less of the area median income where the project is located. This low-income tenant occupancy requirement must be continuously satisfied for a minimum period of 15 years after the State and local government bonds are issued. The Code includes extensive rules to ensure that developers comply with this requirement.

Qualified redevelopment bonds

Qualified redevelopment bonds are State and local government bonds issued for the redevelopment of private property in governmentally designated "blighted areas." In addition to any private revenues pledged to repayment of these bonds, the bonds must be backed by a pledge of governmental tax revenues. The term "blighted area" is defined as an area designated by a local government pursuant to a State statute as having excessive vacant or abandoned land and structures, substandard structures, or real property tax delinquencies. Designation of blighted areas is subject to limits on minimum size per area, and aggregate designations may not exceed areas comprising 20 percent of the assessed value of real property in the government's jurisdiction.

Qualified redevelopment bonds may be used for acquisition of property; clearing, rehabilitation, and redevelopment activities; and expenses of relocating area residents. This tax-exempt financing may not be used for new construction or enlargement of existing buildings. Facilities such as golf courses, suntan parlors, racetracks, casinos and other gambling facilities, and liquor stores may not be financed with loans financed with these bonds.

Empowerment zone and enterprise community business bonds

State and local government bonds may be issued to finance capital expenditures of certain businesses that are located in Federal empowerment zones and enterprise communities and that are eligible for other tax incentives provided to empowerment zone businesses. The following types of business are not eligible for this tax-exempt financing: golf courses, country clubs, massage parlors, hot tub facilities, suntan parlors, gambling facilities (including race tracks), and off-site alcoholic beverage stores.

In the case of empowerment zones designated under the original legislation providing tax benefits for such areas and enterprise communities, the amount of these bonds is limited to $3 million per business in any one zone. Businesses receiving this tax-exempt financing further are subject to a $20 million aggregate limit on such bonds for property in all zones. Issuance of these bonds is subject to the aggregate State private activity bond volume limits, described below.

In the case of the additional empowerment zones designated under the 1997 expansion of the program, the amount of bonds issued is subject to aggregate per-empowerment-zone limits rather than the per-business and general State volume limits. These per-empowerment zone limits are $60 million for rural zones; $130 million for urban zones in areas with populations of less than 100,000, and $230 million for urban zones in areas having a population of at least 100,000.

Businesses receiving this tax-exempt financing must continuously qualify as a "zone business" during a prescribed "test period" after the bonds are issued.

Qualified small-issue bonds

Qualified small-issue bonds are tax-exempt State and local government bonds used to finance private business manufacturing facilities or the acquisition of land and equipment by certain farmers. In both instances, these bonds are subject to limits on the amount of financing that may be provided, both for an single borrowing and in the aggregate. In general, no more than $1 million of small-issue bond financing may be outstanding at any time for property of a business (including related parties) located in the same municipality or county. This $1 million limit may be increased to $10 million if all other capital expenditures of the business in the same municipality or county over a six-year period are counted toward the limit. Outstanding aggregate borrowing under this program is limited to $40 million per borrower (including related parties) regardless of where the property is located.

Mortgage revenue bonds

Present law authorizes issuance of two types of tax-exempt bonds for owner-occupied housing: qualified mortgage bonds and qualified veterans' mortgage bonds. Qualified mortgage bonds are bonds issued to provide below-market financing to first-time homebuyers having incomes below prescribed maximums and who purchase homes having purchase prices below prescribed maximums. Only principal residences may be financed with the proceeds of these bonds. If homebuyers sell the bond-financed homes within nine years after the loan is made, a portion of the subsidy provided by the tax-exempt interest rate is recaptured by the Federal Government. In addition to housing purchases, qualified mortgage bonds may be used to finance limited amounts of home improvement and rehabilitation loans.

Only five States are permitted to issue qualified veterans' mortgage bonds.[14] Unlike qualified mortgage bonds, qualified veterans' mortgage bond-financed loans are not restricted to first-time home buyers satisfying income criteria, there is no limit on purchase price of homes that are financed, and there is no recapture of the Federal tax subsidy if property is sold early. Since 1984, issuance of these bonds is being gradually phased out. The phase-out is accomplished by (1) limiting issuance to States that had issued the bonds before 1985, (2) limiting each State's annual issuance to an amount not exceeding its historical issuance of the bonds, and (3) limiting eligibility for bond-financed loans to veterans who served on active duty before 1977 and who apply for a loan within 30 years after leaving active military service (January 31, 1985, if later).

General restrictions on State and local government bond financing for private activities

Like many Federal direct spending programs, issuance of State and local government private activity bonds is subject to general restrictions on amount and use. The following discussion illustrates some of the major restrictions.

State volume limitations.--Issuance of most tax-exempt private activity bonds is subject to annual per-State volume limitations. Each State (including local governments within the State) is allowed to issue an annual amount of these bonds not exceeding the greater of $50 per resident of the State or $150 million.[15] These volume limits are scheduled to increase to $75 per resident of the State or $225 million beginning in calendar year 2007. This increase is phased-in proportionately beginning in calendar year 2003. States may elect to carryover their unused private activity bond volume authority for designated activities for a period of up to three years. Bond authority that is not used within the carryforward period lapses.

The State volume limits do not apply to State and local government bonds for section 501(c)(3) organizations, for airports and ports, for governmentally owned (but privately operated) solid waste disposal facilities, for environmental enhancements of hydro-electric generating

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[14] The States are Alaska, California, Oregon, Texas, and Wisconsin.

[15] A portion of the private business use financed with certain larger (i.e., over $150 million) governmental bond issues also is subject to these volume limitations.

facilities, for governmentally owned (but privately operated) high-speed intercity rail facilities,[16] for qualified veterans' mortgage loans,[17] and to bonds to finance property in “newly designated” empowerment zones.[18]

Other restrictions on private activity bonds.--Among the other Federal restrictions applicable to private activity, but not to governmental, State and local government bonds are the following:

(1) A requirement that public notice be given and a hearing held before issuance of the bonds;

(2) A restriction on the costs of issuance (e.g., bond attorney and underwriter fees) that may be financed with bond proceeds to an amount not exceeding two percent of the bond issue;

(3) A minimum rehabilitation requirement for existing property that is acquired with State and local government bond proceeds;

(4) A limit on the amount of land that may be financed with any single bond issue;

(5) A limit on the maximum maturity of the bonds, determined by reference to the economic life of the property being financed; and

(6) Loss of interest deductions for private borrowers receiving bond proceeds if the bond-financed property ceases to be used in a qualifying use.

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[16] Bonds for privately owned high-speed intercity rail facilities must receive a State volume limit allocation equal to 25 percent of the bond amount.

[17] As noted above, qualified veterans' mortgage bonds are subject to separate volume limits based on historical State issuance as part of the 1984-enacted phase-out of that program.

[18] New empowerment zone bonds are subject to separate aggregate limits based on the type of zone: $60 million for a rural zone; $130 million for urban zones in areas with populations of less than 100,000, and $230 million for urban zones in areas having a population of at least 100,000.

F. Contributions of Qualified Conservation Interests

Charitable contributions generally

Subject to certain limitations, a deduction is permitted for contributions of property to (1) charitable organizations, (2) the United States, or (3) a State or local government. The amount of deduction generally equals the fair market value of the contributed property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes (secs. 170, 2055, and 2522, respectively).

Gifts of certain types of property interests are subject to special restrictions, either as to the amount deductible or as to the types of property interests for which a deduction is permitted. For example, a contribution of less than the donor's entire interest in property generally does not give rise to a charitable deduction (for income, estate, or gift tax purposes) unless the gift takes the form of an interest in a unitrust, annuity trust, or a pooled income fund. In addition, exceptions to the partial interest rule are provided for gifts of remainder interests in farms or personal residences, gifts of undivided portions of the donor's entire interest in the property, and for gifts of qualified conservation interests.

Qualified conservation contributions

Qualified conservation contributions are contributions of real property interests for any of the following conservation purposes:

(1) The preservation of land areas for outdoor recreation by, or for the education of, the general public;

(2) The protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem;

(3) The preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either: (a) for the scenic enjoyment of the general public, or (b) pursuant to a clearly delineated Federal, State, or local governmental conservation policy; or

(4) The preservation of an historically important land area or a certified historic structure (sec. 170(h)).

Deductible conservation interests may take any of three forms. First, the value of a remainder interest is deductible. Second, the value of a restriction (e.g., an easement) granted in perpetuity on the use of the property is deductible. Finally, the contribution of the donee's entire interest in a property is deductible, except that the donor may retain his or her interest in subsurface oil, gas, or other minerals and the right of access to such minerals.

Exclusion for land subject to permanent conservation easement

An executor may elect to exclude, for Federal estate tax purposes, 40 percent of the value of any land subject to a qualified conservation easement, up to a maximum exclusion of $200,000 in 1999, $300,000 in 2000, $400,000 in 2001, and $500,000 in 2002 and thereafter. (Code sec. 2031(c).) If the value of the conservation easement is less than 30 percent of the value of the land without the easement (reduced by the value of any retained development rights), then the exclusion percentage is reduced by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land.

A qualified conservation easement is one that meets the following requirements: (1) the land is located within 25 miles of a metropolitan area (as defined by the Office of Management and Budget) or a national park or wilderness area, or within 10 miles of an Urban National Forest (as designated by the Forest Service of the U.S. Department of Agriculture); (2) the land has been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death; and (3) a qualified conservation contribution (within the meaning of sec. 170(h)) of a qualified real property interest (as generally defined in sec. 170(h)(2)(C)) was granted by the decedent or a member of his or her family. For purposes of the provision, preservation of a historically important land area or a certified historic structure does not qualify as a conservation purpose.

In order to qualify for the exclusion, a qualifying easement must have been granted by the decedent, a member of the decedent's family, the executor of the decedent's estate, or the trustee of a trust holding the land, no later than the date of the election. To the extent that the value of such land is excluded from the taxable estate, the basis of such land acquired at death is a carryover basis (i.e., the basis is not stepped-up to its fair market value at death). Property financed with acquisition indebtedness is eligible for this provision only to the extent of the net equity in the property. The exclusion from estate taxes does not extend to the value of any development rights retained by the decedent or donor.

G. Estate Tax Preferences for Farms and Small Businesses

Special use valuation

A Federal estate tax is imposed on the value of property passing at death. Generally, the value of property is its fair market value, i.e., the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

If certain requirements are met, present law allows family farms and real property used in a closely held business to be included in a decedent's gross estate at their current use value, rather than full fair market value, provided that the gross estate is not reduced more than $750,000 (sec. 2032A).

An estate may qualify for current use valuation if: (1) the decedent was a citizen or resident of the United States at his death; (2) the value of the farm or closely held business assets in the decedent's estate, including both real and personal property (but reduced by debts attributable to the real and personal property) is at least 50 percent of the decedent's gross estate (reduced by mortgages and other secured debts); (3) at least 25 percent of the adjusted value of the gross estate is qualified farm or closely held business real property;[19] (4) the real property qualifying for current use valuation must pass to a qualified heir;[20] (5) such real property must have been owned by the decedent or a member of his family and used or held for use as a farm or closely held business ("a qualified use") for five of the last eight years prior to the decedent's death; and (6) there must have been material participation in the operation of the farm or closely held business by the decedent or a member of his family in five years out of the eight years immediately preceding the decedent's death (sec. 2032A (a) and (b)).[21]

If, within 10 years after the death of the decedent (but before the death of the qualified

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[19] For purposes of the 50-percent and 25-percent tests, the value of property is determined without regard to its current use value.

[20] The term "qualified heir" means a member of the decedent's family, including his spouse, lineal descendants, parents, aunts, and uncles of the decedent and their descendants.

[21] In the case of qualifying real property where the material participation requirement is satisfied, the real property which qualifies for current use valuation includes the farmhouse or other residential buildings and related improvements located on qualifying real property if such buildings are occupied on a regular basis by the owner or lessee of the real property (or by employees of the owner or lessee) for the purpose of operating or maintaining the real property or the business conducted on the property. Qualified real property also includes roads, buildings, and other structures and improvements functionally related to the qualified use.

heir), the property is disposed of to nonfamily members or ceases to be used for farming or other closely held business purposes, all or a portion of the Federal estate tax benefits obtained from the reduced valuation will be recaptured by means of a special "additional estate tax" imposed on the qualified heir.

Deferred payment of estate tax

The estate tax is imposed on transfers at death, and the tax generally is due nine months after the date of the decedent’s death. The Commissioner may extend the time for payment of the estate tax for up to 12 months. (Sec. 6161(a)(1).) There is, however, an additional rule which provides that the Commissioner has discretion to grant an extension to pay estate tax upon a showing of “reasonable cause” for a period not exceeding 10 years (sec. 6161(a)(2)).

Moreover, an executor generally may elect to pay the Federal estate tax attributable to an interest in a closely held business in installments over as many as 14 years (sec. 6166). To qualify for the election, the business must be an active trade or business and the value of the decedent's interest in the closely held business must exceed 35 percent of the decedent's adjusted gross estate. If this election is made, the estate pays only interest during the first five years, then up to ten annual installments of both principal and interest. Interest generally is imposed at a rate equal to 45 percent of the rate applicable to underpayments of tax under section 6621 (i.e., the Federal short term rate plus three percentage points). In addition, a special 2-percent interest rate applies to the amount of deferred estate tax attributable to the first $1,000,000 (adjusted for inflation) in value of the closely-held business (i.e., the amount of estate tax on the first $1,000,000 less the amount of any allowable unified credit). (Sec. 6601(j).)

H. Foreign Investment in U.S. Real Property

In general

Nonresident alien individuals and foreign corporations (referred to herein collectively as "foreign persons") are subject to U.S. tax at a flat rate of 30 percent (or a lower rate pursuant to an applicable tax treaty) on certain types of passive income (but generally not capital gains) derived from U.S. sources. Foreign persons are subject to U.S. tax at the regular graduated rates applicable to U.S. persons on income derived from a U.S. trade or business.

Special U.S. tax rules apply to gains of foreign persons attributable to dispositions of interests in U.S. real property. The rules governing the imposition and collection of tax on such dispositions are contained in a series of provisions that were enacted in 1980 and that are collectively referred to as the Foreign Investment in Real Property Tax Act ("FIRPTA") (secs. 897, 1445, 6039C, and 6652(f)). Prior to the enactment of the FIRPTA provisions, foreign persons could invest in U.S. real property without being subject to U.S. tax upon the eventual disposition of such property.

Imposition of tax

Section 897(a) provides that gain or loss of a foreign person from the disposition of a U.S. real property interest is taken into account for U.S. tax purposes as if such gain or loss were effectively connected with a trade or business within the United States during the taxable year. Accordingly, foreign persons generally are subject to U.S. tax on any gain from a disposition of a U.S. real property interest at the same rates that apply to similar income received by U.S. persons.

In the case of nonresident alien individuals, the alternative minimum tax applies to the lesser of the individual's alternative minimum taxable income or the individual's net real property gains (sec. 897(a)(2)(A)). Losses of nonresident alien individuals are taken into account under the FIRPTA provisions only to the extent that such losses would be taken into account under Code section 165(c), which limits loss deductions to business losses, losses on transactions entered into for profit, and certain casualty or theft losses (sec. 897(b)).

In the case of foreign corporations, the gain from a disposition of a U.S. real property interest may also be subject to the branch profits tax at a 30-percent rate (or a lower treaty rate). If a foreign corporation that holds a U.S. real property interest is entitled to nondiscriminatory treatment with respect to such interest under an applicable treaty, the foreign corporation may elect to be treated as a U.S. corporation for purposes of the FIRPTA provisions (sec. 897(i)). This election may be made only if all shareholders of the corporation consent to the election and specifically agree that any gain upon the disposition of the interest that would be taken into account under the FIRPTA provisions will be taxable even if such taxation would be contrary to a treaty. This election to be treated as a domestic corporation is the exclusive remedy for any person claiming treaty protection against discriminatory treatment as a result of the FIRPTA provisions.

Definition of U.S. real property interest

Under the FIRPTA provisions, U.S. tax is imposed on gains from the disposition of an interest in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the U.S. Virgin Islands. The term "interest in real property" includes, with respect to both land and improvements thereon, fee ownership and co-ownership, leaseholds, options to acquire, and options to acquire leaseholds (sec. 897(c)(6)(A)). Moreover, the term includes partial interests in real property, such as life estates, remainders, and reversions. In addition, the term includes any direct or indirect right to share in the appreciation in the value of, or in the gross or net proceeds or profits generated by, U.S. real property.

Also included in the definition of a U.S. real property interest is any interest (other than an interest solely as a creditor) in any domestic corporation, unless the taxpayer establishes that the corporation was not a U.S. real property holding corporation ("USRPHC") at any time during the five-year period ending on the date of the disposition of the interest (sec. 897(c)(1)(A)(ii)). This general rule does not apply to investments in a publicly-traded USRPHC. Under a special rule, USRPHC stock of a class that is regularly traded on an established securities market is treated as a U.S. real property interest only in the case of a foreign person that, at some time during the five-year period described above, held more than 5 percent of that class of stock (sec. 897(c)(3)). Rules similar to this special rule apply to treat an interest in a publicly-traded partnership as a U.S. real property interest.

A corporation is a USRPHC if the fair market value of such corporation's U.S. real property interests equals or exceeds 50 percent of the sum of the fair market values of (i) its U.S. real property interests, (ii) its interests in foreign real property, plus (iii) any other of its assets which are used or held for use in a trade or business (sec. 897(c)(2)). For purposes of this asset test, a corporation that is a partner in a partnership or a beneficiary of an estate or trust generally takes into account its proportionate share of all assets of such partnership, estate or trust (sec. 897(c)(4)(B)). Look-through rules also apply to a controlling interest (50 percent or more of the fair market value of all classes of stock) held by a corporation in another corporation, whether foreign or domestic (sec. 897(c)(5)).

Special rules applicable to certain transactions

Gain recognized by a foreign person on the disposition of an interest in a partnership, trust, or estate generally is subject to tax under the FIRPTA provisions to the extent that the gain is attributable to any appreciation in the value of any U.S. real property interests of the entity (sec. 897(g)).

As a general rule, nonrecognition provisions apply under the FIRPTA provisions only in the case of an exchange of a U.S. real property interest for an interest the sale of which would be taxable under the Code (sec. 897(e)). This rule is designed to prevent a foreign person from escaping U.S. tax by exchanging a taxable asset for a nontaxable asset in an exchange which would otherwise qualify for nonrecognition treatment under the Code. Specific rules apply to require gain recognition in certain cases. In this regard, foreign corporations are required in certain circumstances to recognize gain upon the distribution (including a distribution in liquidation or redemption) to their shareholders of appreciated U.S. real property interests (sec. 897(d)(1)). Moreover, gain generally is recognized by a foreign person under the FIRPTA provisions on the transfer of a U.S. real property interest to a foreign corporation if the transfer is made as paid-in surplus or as a contribution to capital.

Withholding on dispositions by foreign persons of U.S. real property interests

The Code generally imposes a withholding obligation when a U.S. real property interest is acquired from a foreign person (sec. 1445). The withholding obligation generally is imposed on the transferee; however, in certain limited circumstances, an agent of the transferor or transferee is required to withhold. Any tax imposed on a foreign person under the FIRPTA provisions in excess of the amount withheld remains the liability of the foreign person.

The amount required to be withheld on the sale by a foreign person of a U.S. real property interest generally is 10 percent of the amount realized on the transaction (i.e., the gross sales price) (sec. 1445(a)). However, a certificate for reduced withholding may be issued by the IRS such that the amount required to be withheld will not exceed the transferor's maximum tax liability (sec. 1445(c)(1)).

There are several exemptions from the obligation to withhold on a disposition of a U.S. real property interest. First, withholding by the transferee generally is not required if the transferor furnishes to the transferee an affidavit stating, under penalty of perjury, that the transferor is not a foreign person and providing the transferor's taxpayer identification number (sec. 1445(b)(2)). Second, withholding is not required on the disposition of an interest in a domestic corporation if the corporation furnishes an affidavit to the transferee stating, under penalty of perjury, that the corporation is not a USRPHC and has not been a USRPHC during the five-year period ending on the date of disposition (sec. 1445(b)(3)). Third, withholding may be reduced or eliminated if the transferee receives a qualifying statement issued by the IRS that the transferor is exempt from tax or either the transferor or the transferee has provided adequate security or has made other arrangements for payment of the tax (sec. 1445(b)(4)). Fourth, withholding is not required if the transferee intends to use the transferred real property as a residence, and the amount realized by the transferor on the disposition of the property is $300,000 or less (sec. 1445(b)(5)). Fifth, withholding is not required on a disposition of stock of a class that is regularly traded on an established securities market (sec. 1445(b)(6)).

Special withholding rules apply in the case of certain dispositions of U.S. real property interests by partnerships, trusts, and estates; certain distributions by foreign or domestic corporations, partnerships, trusts and estates; and certain dispositions of interests in partnerships, trusts, and estates.

Reporting requirements and penalties for noncompliance

Section 6039C of the Code authorizes the IRS to require reporting by foreign persons holding direct investments in U.S. real property interests, and imposes penalties for failure to file any required reports. However, to date no such requirements have been imposed.

II. DESCRIPTION OF INTRODUCED BILLS

A. H.R. 1630, the "Brownfields Cleanup Act"
(Mr. Coyne and others)

Present Law

As described in I.D., above, under present law, taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred (sec. 198).[22] The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. Eligible expenditures ("qualified Brownfields expenses") are those paid or incurred before January 1, 2001.

Description of the Bill

The bill permanently extends the deduction for qualified brownfields expenses.

Effective Date

The bill would be effective on the date of enactment.

[22] Section 198 was enacted as part of the Taxpayer Relief Act of 1997.

B. H.R. 1863, the "Community Forestry and Agriculture Conservation Act of 1999" (Ms. Dunn and others)

Present Law

As described in I.E., above, property used in carrying out the exempt activities of organizations described in Code section 501(c)(3) may be financed with tax-exempt bonds ("qualified 501(c)(3) bonds").

Description of the Bill

H.R. 1863 would modify the rules applicable to tax-exempt financing for certain section 501(c)(3) organizations to allow (1) longer-term bonds and (2) more liberal private management contract rules for property financed with qualified 501(c)(3) bonds. The liberalized tax-exempt financing rules would apply to bonds used to finance the acquisition of land and renewable resources (typically timber) located on the land if the land was subject to an easement granted in perpetuity to a section 501(c)(3) organization which met the requirements of Code section 170 (relating to certain easements for conservation purposes).

Under the bill, the maximum maturity date of qualified 501(c)(3) bonds used to finance property subject to these qualified easements would be 120 percent of the economic life that was "commensurate with the economic and ecological feasibility of the financing of such land or renewable resource" rather than 36 years. Further, the economic life of timber located on the land when it was acquired would be deemed to be the same as the life of the land. This last provision would eliminate the present-law requirement that the maturity of bonds allocable to the value of standing timber be determined relative to the age of the timber being acquired, and that bonds allocable to the timber be redeemed when the timber is severed or sold.

The bill also would permit section 501(c)(3) organizations to enter into longer-term contracts for the management or the standing timber or other renewable resource and "up front" contracts for the sale or severance of such timber or resource with unaffiliated[23] private, for-profit businesses than are permitted under the general tax-exempt bond private business use rules. These contracts could not result in activities constituting an unrelated trade or business use under the general Code limits on exempt activities of section 501(c)(3) organizations.

Effective Date

The provisions of the bill would apply to bonds issued after the date of enactment.

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[23] A private, for-profit business would not be treated as affiliated with the tax-exempt organization provided that the for-profit business controlled no more than 20 percent of the governing body of the section 501(c)(3) organization.

C. H.R. 2263 (Mrs. Johnson and others)

1. Charitable contribution deduction for qualified conservation contributions

Present Law

As described in I.F., above, an income tax deduction is permitted for a contribution of a qualified real property interest to "qualified organizations" exclusively for conservation purposes. "Qualified organizations" for purposes of such qualified conservation contributions include governmental units, certain public charities that qualify as publicly supported organizations, and certain organizations that support public charities (sec. 170(h)(3)). A gift of a qualified conservation contribution to a qualified organization generally may be deducted by the donor up to 30 percent of the donor's "contribution base," which is typically the donor's adjusted gross income for a taxable year computed without a net operating loss carryback deduction. Any amount in excess of the 30-percent limit may be carried forward and deducted until exhausted in the five years following the year of the contribution, subject in each year to a maximum deduction of 30 percent of the donor's contribution base for that year.[24]

Description of the Bill

Section 1 of H.R. 2263 would modify the rules governing charitable contribution deductions for income tax purposes of donations of qualified conservation contributions and capital gain real property for conservation purposes. Specifically, section 1 of the bill would provide that any contribution of a qualified conservation contribution, as defined in I.G. above, is deductible up to 50 percent of the donor's contribution base. In addition, section 1 of the bill would provide that any other contribution of real property is subject to the 50-percent contribution base limit as long as the contribution (1) qualifies as capital gain property, (2) constitutes the donor's entire interest in such property, and (3) is made to a qualified organization (as defined above), which is organized for a conservation purpose and which provides the donor with a letter acknowledging that the property is intended to be used for conservation purposes. Section 1 of the bill also would eliminate the 5-year limitation on carryforwards of excess qualified conservation contributions and contributions of capital gain real property for conservation purposes.

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[24] The 30-percent contribution base limit applicable to gifts of qualified conservation contributions (and other gifts of capital gain property to public charities) is effectively a sublimit of a separate 50-percent contribution base limit that applies to contributions of cash by individuals to public charities, private operating foundations, and certain private non-operating foundations. The 30-percent and 50-percent limits are not cumulative; thus, cash gifts made in the current year or carried forward to the current year may reduce a donor's ability to deduct a contribution of capital gain property up to the 30-percent limit.

Effective Date

The bill would be effective for contributions made in taxable years beginning after the date of enactment.

2. Exclusion from gross estate for qualified conservation easement

Present Law

As described in I.F., above, an executor may elect to exclude from the gross estate 40 percent of the value of any land subject to a qualified conservation easement.

Description of the Bill

H.R. 2263 would repeal the restrictions on where land subject to the easement must be located in order to be considered "land subject to a qualified conservation easement" under section 2031(c)(8)(A). Under the bill, land which is located in the United States or any possession of the United States would be considered "land subject to a qualified conservation easement."[25]

The bill also would repeal the maximum exclusion limitations. Thus, the executor would be permitted to elect to exclude from the taxable estate 40 percent of the value of any land subject to a qualified conservation easement (reduced by the amount of any estate tax charitable deduction with respect to such land). If the value of the easement is less than 30 percent of the value of the land without the easement, then the exclusion percentage would continue to be reduced by two percentage points for each percentage point by which the value of the conservation easement is less than 30 percent of the value of the land. There would be no limit to the amount of qualified conservation easement which could be excluded.

Moreover, the bill would provide that the date for determining the value of the land and the conservation easement would be the value as of the date of the contribution.

Under the bill, certain commercial recreational uses would be permitted (i.e., deemed to be de minimis commercial activity). Rights retained in the conservation easement to lease the land for hunting and fishing shall be deemed to be de minimis use (so long as such leases are not inconsistent with the conservation purpose of the easement). Furthermore, easements qualifying

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[25] The bill would not eliminate the requirements that the land have been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death and that a qualifying easement have been granted by the decedent, a member of the decedent's family, the executor of the decedent's estate, or the trustee of a trust holding the land, no later than the date of the election.

under present law will be deemed to allow no more than de minimis commercial use unless by their terms they expressly provide for commercial recreational activity in excess of that otherwise allowed. In addition, if the executor of an estate and every individual with an interest in the land execute an agreement to amend or extinguish any right under the easement of commercial activity in the land to ensure that such land is used for no more than de minimis commercial activity, then such agreement will be treated as in effect as of the date of the election made with the estate tax return.

Finally, the bill would provide that the sale of a qualified real property interest would not fail to be treated as a qualified conservation easement if such interest would meet the requirements were it donated to the purchaser.

Effective Date

The provisions of the bill would be effective as if enacted in section 508 of the Taxpayer Relief Act of 1997 (i.e., with respect to estates of decedents dying and easements granted after December 31, 1997).

D. H.R. 2380, the "Energy Efficient Technology Tax Act" (Mr. Matsui and others)

1. Energy credits

<u>Present Law</u>

No income tax credit is currently provided for investment in energy-efficient building equipment.

A 10-percent energy credit is allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage, and which meet performance and quality standards prescribed by the Treasury Department. Public utility property does not qualify for the credit (sec. 48(a)).

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

<u>Description of the Bill</u>

The bill would provide tax credits for businesses for solar and geothermal energy property, photovoltaic property, "20-percent" energy-efficient building property, "10-percent" energy-efficient building property, and combined heat and power system property. For individuals, the bill would provide personal tax credits for solar water heating property, photovoltaic property, "20-percent" energy-efficient building property, "10-percent" energy-efficient building property, and certain energy-efficient new homes.

<u>Solar and geothermal energy property</u>

The bill would provide a business tax credit of 10 percent of the purchase price of solar energy property (other than elected solar hot water property and photovoltaic property) and geothermal property. The 10-percent energy credit would be allowed for the cost of new property that is equipment (1) that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage, and which meet performance and quality standards prescribed by the

Secretary of the Treasury. Public utility property would not qualify for the credit (sec. 48(a)). There would be no maximum credit, though the general limitations on business credits would apply.

A business could elect to treat certain solar energy property as "elected solar hot water property." The election would be available for solar energy property that is used to heat or cool a structure, or to provide hot water for use in the structure. Elected solar hot water property would be eligible for a 15-percent credit up to a maximum credit of $1,000 for each item of property elected.

For individuals, the bill would provide a 15-percent credit for property installed in connection with a structure that uses solar energy for the purpose of providing hot water for use within such structure. The maximum credit would be $1,000 for each item of property.

Effective date.--The business credit for solar energy property (other than elected solar hot water property and photovoltaic property) and geothermal property would apply to property placed in service on or after January 1, 2000. The business credit for elected solar hot water property would apply to property placed in service on or after January 1, 2000 and before January 1, 2005. The personal credit for solar water heating property would apply to property placed in service on or after January 1, 2000, and before January 1, 2007.

Photovoltaic property

A credit of 15 percent of the purchase price (up to a maximum of $2000 per unit) of photovoltaic property. Photovoltaic property would be defined as solar energy property that used a solar photovoltaic process to generate electricity.

Effective date.--The business credit for photovoltaic property would apply to property placed in service on or after January 1, 2000, and before January 1, 2005. The personal credit for photovoltaic property would apply to property placed in service on or after January 1, 2000, and before January 1, 2007.

Combined heat and power ("CHP") systems

The bill would establish an 8-percent investment credit for businesses for qualified CHP systems with an electrical capacity in excess of 50 kilowatts or with a capacity to produce mechanical power in excess of 67 horsepower (or an equivalent combination of electrical and mechanical energy capacities). CHP property would be defined as property comprising a system that uses the same energy source for the simultaneous or sequential generation of (1) electricity or mechanical shaft power (or both) and (2) steam or other forms of useful thermal energy (including heating and cooling applications). A qualified CHP system would be required to produce at least 20 percent of its total useful energy in the form of thermal energy and at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof) and would also be required to satisfy an energy-efficiency standard. For CHP systems with an electrical capacity in excess of 50 megawatts (or a mechanical energy capacity in excess of 67,000 horsepower), the total energy efficiency of the system would have to exceed 70 percent. For smaller systems, the total energy efficiency would have to exceed 60 percent. For this purpose, total energy efficiency would be calculated as the sum of the useful electrical, thermal, and mechanical power produced by the system at normal operating rates, measured on a Btu basis, divided by the lower heating value of the primary fuel source for the system supplied. The credit would be allowed with respect to qualified CHP property only if its eligibility was verified under regulations prescribed by the Treasury Department.

Investments in qualified CHP assets that would otherwise be assigned cost recovery periods of less than 15 years would be eligible for the credit, provided that the taxpayer elected to treat such property as having a 22-year class life. Thus, regular tax depreciation allowances would be calculated using a 15-year recovery period and the 150-percent declining balance method.

Effective date.--The credit would apply to investments in CHP equipment placed in service after December 31, 1999, but before January 1, 2003.

10-percent energy-efficient building property

A credit of 10 percent of the purchase price (up to a maximum of $250 per unit) would be allowed for the purchase of the following building equipment:

- Electric heat pumps (equipment using electrically powered vapor compression cycles to extract heat from air in one space and deliver it to air in another space) with a heating efficiency of at least 7.5 HSPF (Heating Seasonal Performance Factor) and a cooling efficiency of at least 13.5 SEER (Seasonal Energy Efficiency Rating);

- Central air conditioners with an efficiency of at least 13.5 SEER; and

- Advanced natural gas water heaters (equipment using a variety of mechanisms to increase steady-state efficiency and reduce standby and vent losses) with an Energy Factor of at least 0.65 in the standard Department of Energy (DOE) test procedure.

The credit would be nonrefundable and subject to the dollar caps as specified. For businesses, the credit would be subject to the limitations on the general business credit and would reduce the basis of the equipment.

Effective date.--The 10-percent credit would be available for final purchases from unrelated third parties after December 31, 1999, and before January 1, 2002.

20-percent energy-efficient building property

A credit of 20 percent of the purchase price would be allowed for the purchase of the following building equipment:

- Fuel cells (equipment using an electrochemical process to generate electricity and heat) with an electricity-only generation efficiency of at least 35 percent and a minimum generating capacity of 5 kilowatts. The maximum credit would be $500 per kilowatt of capacity.

- Electric heat pump hot water heaters (equipment using electrically powered vapor compression cycles to extract heat from air and deliver it to a hot water storage tank) with an Energy Factor of at least 1.7 in the standard DOE test procedure. The maximum credit would be $500 per unit.

- Electric heat pumps with a heating efficiency of at least 9 HSPF and a cooling efficiency of at least 15 SEER. The maximum credit would be $500 per unit.

- Central air conditioners with an efficiency of at least 15 SEER. The maximum credit would be $500 per unit.

- Advanced natural gas water heaters with an Energy Factor of at least 0.80 in the standard DOE test procedure. The maximum credit would be $500 per unit.

- Natural gas heat pumps (equipment using either a gas-absorption cycle or a gas-driven engine to power the vapor compression cycle to extract heat from one source and deliver it to another) with a coefficient of performance for heating of at least 1.25 and for cooling of at least 0.70. The maximum credit would be $1,000 per unit.

The credit would be nonrefundable and subject to the dollar caps as specified. For businesses, it would be subject to the limitations on the general business credit and would reduce the basis of the equipment.

Effective date.--The 20-percent credit would be available for final purchases from unrelated third parties after December 31, 1999, and before January 1, 2004.

Energy-efficient new homes

A nonrefundable personal tax credit of up to $2,000 would be available to purchasers of new homes that meet energy-efficiency standards for heating, cooling and hot water that significantly exceed those of the International Energy Conservation Code (the “IECC”). A taxpayer could claim the credit only if the new home was the taxpayer's principal residence, was located in the United States, and reduced energy use by prescribed amounts as compared to the

IECC for single family residences. The tax credit would be $1,000 for new homes at least 30 percent more energy efficient than the IECC standard; $1,500 for new homes at least 40 percent more energy efficient than the IECC standard; and $2,000 for new homes at least 50 percent more energy efficient than the IECC standard.

Effective date.--The credit would be available for new homes purchased after December 31, 1999.

2. Electric and hybrid vehicles credit

Present Law

A 10-percent tax credit is provided for the cost of a qualified electric vehicle, up to a maximum credit of $4,000 (sec. 30). A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electrical current, the original use of which commences with the taxpayer, and that is acquired for the use by the taxpayer and not for resale. The full amount of the credit is available for purchases prior to 2002. The credit phases out between 2002 and 2005.

Certain costs of qualified clean-fuel vehicle property may be expensed and deducted when such property is placed in service (sec. 179A). Qualified clean-fuel vehicle property includes motor vehicles that use certain clean-burning fuels (natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity and any other fuel at least 85 percent of which methanol, ethanol, any other alcohol or ether. The maximum amount of the deduction is $50,000 for a truck or van with a gross vehicle weight over 26,000 pounds or a bus with seating capacities of at least 20 adults; $5,000 in the case of a truck or van with a gross vehicle weight between 10,000 and 26,000 pounds; and $2,000 in the case of any other motor vehicle. Qualified electric vehicles do not qualify for the clean-fuel vehicle deduction. The deduction phases out in calendar years 2002 through 2004.

No credit is currently provided for hybrid vehicles.

Description of the Bill

The bill would extend the present credit for qualified electric vehicles and provide temporary tax credits for two types of fuel-efficient hybrid vehicles.

Electric vehicles

The phase down of the credit for electric vehicles would be eliminated and the credit would be extended through December 31, 2006. Thus, the maximum $4,000 credit would be available for purchases before 2007.

Effective date.--The tax credit for electric vehicles would be effective for vehicles placed in service after the date of enactment of the bill.

Qualified hybrid vehicles

The bill would provide tax credits for qualified hybrid vehicles that draw propulsion energy from both a consumable fuel and a rechargeable energy storage system. The credit amount would depend on the percentage of the vehicle's maximum available power that is provided by the rechargeable energy storage system. The credit would be equal to $500 for a percentage greater than or equal to 5 but less than 10; $1,000 for a percentage greater than or equal to 10 but less than 20; $1,500 for a percentage greater than or equal to 20 but less than 30; and $2,000 for a percentage greater than or equal to 30.

An additional credit would be available if the qualifying hybrid vehicle used a regenerative braking system that would recover the applicable percentage of the energy in a typical 60-0 braking event. The additional credit would be equal to $250 for a percentage greater than or equal to 20 but less than 40; $500 for a percentage greater than or equal to 40 but less than 60; and $1,000 for a percentage greater than or equal to 60.

A qualifying vehicle would have to meet all emission requirements applicable to gasoline-powered automobiles. These credits would be available for all qualifying light vehicles including cars, minivans, sport utility vehicles, and light trucks. Taxpayers who claim one of these credits would not be able to claim the qualified electric vehicle credit or the deduction for clean-fuel vehicle property for the same vehicle.

Effective date.--The credit for qualified hybrid vehicles would be effective for such vehicles placed in service on or after January 1, 2003, and before January 1, 2007.

3. Tax credit for electricity produced from wind and biomass

Present Law

An income tax credit is allowed for the production of electricity from either qualified wind energy or qualified "closed-loop" biomass facilities (sec. 45). The credit is equal to 1.7 cents (1.5 cents plus adjustments for inflation since 1992) per kilowatt hour of electricity produced from these qualified sources during the 10-year period after the facility is placed in service.

The credit applies to electricity produced by a qualified wind energy facility placed in service after December 31, 1993, and before July 1, 1999, and to electricity produced by a qualified closed-loop biomass facility placed in service after December 31, 1992, and before July 1, 1999. Closed-loop biomass is the use of plant matter, if the plants are grown for the sole purpose of being used to generate electricity. The term does not include waste materials (including, but not limited to, scrap wood, manure, and municipal or agricultural waste) or standing timber used to produce electricity. In order to claim the credit, a taxpayer must own the facility and sell the electricity produced by the facility to an unrelated party.

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

Description of the Bill

The bill would reinstate the wind and closed-loop biomass credit, for facilities placed in service before July 1, 2004, and would expand the biomass fuels for facilities eligible for the electricity credit to include non-closed-loop (e.g., a waste product other than unsegregated municipal waste) biomass. In the case of non-closed-loop biomass, the credit would be available only for production from facilities placed in service after June 30, 1999. In addition, the present-law rule that requires that an eligible biomass facility exclusively use a biomass fuel would be modified to allow the credit (at a reduced 1-cent-per-kilowatt rate) for electricity produced from biomass facilities that also use coal as a fuel.

Effective date.--The bill would be effective on the date of enactment, for facilities placed in service before July 1, 2004.

E. H.R. 2446, the "Better America Bonds Act of 1999"
(Mr. Matsui and others)

Present Law

Tax-exempt bonds

As described in I.E., above, interest on debt incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds ("governmental bonds"). These bonds may include bonds used to finance the acquisition of land (or interests in land) and buildings. Interest on bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person ("private activity bonds") is taxable unless the purpose of the borrowing is approved specifically in the Code or in another provision of a revenue Act. These specified purposes include, but are not limited to, privately owned and/or operated: (1) sewage facilities; (2) solid waste disposal facilities; and (3) water systems. Issuance of most private activity bonds is subject to annual state volume limits, currently the greater of $50 per resident, or $150 million if greater.

Tax credits for interest on bonds

A nonrefundable tax credit in an amount equal to a credit rate (set monthly by the Treasury Department) multiplied by the face amount of certain qualified zone academy bonds is allowed to certain financial institutions (i.e., banks, insurance companies, and corporations actively engaged in the business of lending money). The credit rate applies to all bonds issued in a month. A taxpayer holding a qualified zone academy bond on the credit allowance date (i.e., the annual anniversary of the bond's issuance) is entitled to a credit. The credit is includible in gross income (as if it were an interest payment on the bond), and may be claimed against regular income tax liability and alternative minimum tax liability. A qualified zone academy bonds is 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 entities 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.

Expensing of certain environmental remediation expenses

Taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred (sec. 198). The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. A qualified contaminated site generally is any property that: (1) is held for use in a trade or business, for the production of income, or as inventory; (2) is certified by the appropriate State environmental agency to be located within certain targeted areas; and (3) contains (or potentially contains) a hazardous substance (so-called "brownfields"). In the case of property to which a qualified environmental remediation expenditure otherwise would have been capitalized, any qualified environmental remediation expenditure deductions are subject to recapture as ordinary income upon sale or other disposition of the property (sec. 1245). The provision applies only to eligible expenditures paid or incurred in taxable years ending after August 5, 1997, and before January 1, 2001.

Description of the Bill

In general

The bill would provide a tax credit to holders of a new category of bonds, Better America Bonds ("BABs"),[26] issued by a State government (including the District of Columbia, any possession of the United States, or any Indian tribal government within the meaning of section 7871) or local government (including a combination of local governments) for certain qualified purposes. Like holders of present-law qualified zone academy bonds, the holders of BABs would be allowed an annual Federal income tax credit against regular income tax liability and alternative minimum tax liability. The credit would be in lieu of interest payments. Because the proposed credits would compensate the holder for lending money, such credits would be treated as payments of interest for Federal income tax purposes and, accordingly, would be included in the holder's gross income. As with present-law qualified zone academy bonds, the "credit rate" for BABs would be set by the Secretary of the Treasury so that, on average, such bonds would be issued without interest, discount, or premium.[27] The taxpayer holding a BAB on a credit allowance date (i.e., March 15, June 15, September 15, and December 15th) would be entitled to the credit. The amount of the credit on each credit allowance date would equal one quarter of the amount determined by multiplying that BAB's credit rate (set by the Treasury Department when the BAB was issued) by the face amount of the holder's BABs. In the case of issuance or redemption of BABs between credit allowance dates, the amount of credit would be determined ratably.

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[26] The structure of H.R. 2446 would be similar to the structure in the Administration's fiscal year 2000 budget proposals for Better America bonds, qualified school modernization bonds and qualified zone academy bonds.

[27] To this end, the credit rate would be set equal to a measure of the yield on outstanding corporate bonds, as specified in Treasury regulations, for the business day prior to the date of issue. It is anticipated that the credit rate would be set with reference to a corporate AA bond rate which could be published daily by the Federal Reserve Board or otherwise determined under Treasury regulations.

Authority to issue BABs

The Administrator of the Environmental Protection Agency ("EPA") would be given authority to allocate $1.9 billion dollars of BAB authority to eligible issuers (i.e., States and local governments, including Tribal governments, U.S. Possessions and the District of Columbia) annually for five years beginning in the year 2000. Any amounts unallocated for a year could be allocated in the following year. Any amounts allocated to a State or local government in any year could be used for bond issuance in that year or the following year.

The EPA would be directed to publish guidelines, before January 1, 2000, establishing the criteria to be used in an annual competition for authority to issue the BABs. State and local governments would apply for an allocation of authority to issue the BABs and the EPA would review these applications and allocate authority to issue BABs. Whenever possible, the EPA would make allocations on a per capita basis.

BAB requirements

For an instrument to qualify as a BAB several requirements must be met: (1) the issuer of the BAB must reasonably expect that, on the date of issue, 95 percent of the proceeds of the bond (including any investment earnings on such proceeds) will be spent on qualifying purposes within three years and any property financed with bond proceeds will be used for a qualified purpose for at least a 15-year period; (2) the issuer must incur a binding obligation with a third party to spend at least 10 percent of proceeds of the issue within 6 months of the date of issue; (3) the issuer must reasonable expect that the remaining proceeds of the issue will be spent with due diligence for qualified purposes; (4) the term of each BAB could not exceed 15 years; (5) the issuance of each BAB would also be subject to the public approval rules of section 147(f) generally applicable to tax-exempt bonds (except in the case of certain real property abandoned by the prior owner); and (6) the payment of the principal on the BAB would be secured by taxes of general applicability imposed by a general purpose governmental unit (except in the case of certain real property abandoned by the prior owner).

Issuers of BABs would be required to allow eligible 501(c)(3) organizations to purchase the credit financed property at any time after the end of its qualified use (e.g., at the end of the 15-year period beginning on the date of issuance of the BAB) before selling to another party. An eligible 501(c)(3) organization would have the right, but not the obligation, to purchase the property at that time before the sale to another party. An eligible 501(c)(3) organization must: (1) have exempt purposes which include environmental protection; (2) covenant to maintain the property in qualifying use in perpetuity; and (3) hold an option to purchase the property. The purchase price to the 501(c)(3) under the option would be the price paid in conjunction with the expenditure of bond proceeds at the beginning of the 15-year period. This option would be created when the proceeds of the bond are expended to purchase the property and recorded pursuant to State law as a restrictive covenant binding upon all successors. The actual option could be granted at any time during the 15-year period beginning on the date of issuance and would lapse after a reasonable time after the bonds mature.

Qualifying purposes for BABs

The bill would limit the purposes for which BABs could be issued by State or local governments for: (1) acquisition of land for open space, wetland, public parks or green ways to be owned by the State or local government or 501(c)(3) entity whose exempt purpose includes environmental preservation; (2) the provision of visitors' facilities to be owned by the State or local government or 501(c)(3) entity whose exempt purpose includes environmental preservation; (3) remediation of land, in order to improve water quality, acquired under (1) above, or of publicly owned open space, wetlands, or parks, by restoring hydrology or planting of trees or other vegetation, undertaking reasonable measures to control erosion, restoring wetlands, or remediating conditions caused by prior disposal of toxic or other waste; (4) acquisition of easements on privately owned open land that prevent commercial development and any substantial change in the use or character of the land; or (5) environmental assessment and remediation of contaminated property owned by State or local governments because it was abandoned by the prior owner.

Other rules applicable to BABs

No depreciation for tax purposes would be allowed with respect to property financed with BABs. Also, no expenditures financed with BAB proceeds would be eligible for expensing under the environmental remediation rules of section 198.

Any taxpayer would be able to hold a BAB and thereby claim the tax credit. Treasury would provide regulations regarding the treatment of credits that flow through from a mutual fund to the holder of mutual fund shares. Unused credits would not be carried back, but would be carried forward. The bill would grant regulatory authority to the Secretary to require information returns to be provided with respect to holders (including corporations) that are entitled to credits.

Any property financed with BAB proceeds must be used for a qualifying purpose for at least a 15-year period after the date of issuance. If the use of a bond-financed facility changes to a non-qualifying use within that 15-year period, the bonds would cease to be qualifying bonds and would accrue no further tax credits. Further, the issuer would be required to reimburse the Treasury for all tax credits which accrued in the year of cessation of qualified use and the two prior calendar years. If the issuer fails to make a full and timely reimbursement of tax credits, the Federal government could proceed to collect against current holder(s) of the bond for any remaining amounts.

Effective date

The provisions of the bill would apply to bonds issued after December 31, 1999.

F. H.R. 2497, the "Open Space Preservation Act of 1999" (Mr. Pitts and others)

1. Exclusion for gain on sale or exchange of farmland with qualified covenant

Present Law

Generally, no exclusion from income is provided for gain from the sale or exchange of farmland.

Description of the Bill

Under the bill, operators of farmland could exclude from gross income any gain from the sale or exchange of such farmland, if on the date of such sale or exchange there was a qualified covenant in effect limiting the use of that land to farming. For these purposes, farmland would be any real property located in the United States which is being used as a farm for farming purposes (within the meaning of sec. 2031A(e)). A qualified covenant would be an irrevocable covenant entered into by all persons having a present ownership interest in the land and which is binding on all future owners of the farmland to which such covenant applies. The exclusion would not apply unless the operator of the farmland (1) notifies the Secretaries of the Treasury and Agriculture of the local government in which such covenant is recorded, and (2) submits a copy of the covenant to the Secretary of the Treasury.

Effective Date

The provisions of the bill would be effective for covenants first recorded after December 31, 1999, and to sales or exchanges after such date.

2. Exclusion from gross estate for farmland subject to qualified covenant

Present Law

The value of the gross estate generally is determined by including the value at the time of the decedent's death all property, real or personal, tangible or intangible, wherever situated. To the extent the decedent had an interest at the time of his or her death, property is included in the gross estate. (Sec. 2031(a).)

Description of the Bill

H.R. 2497 would add a new section 2033A, which would provide an exclusion from the gross estate for the adjusted value[28] of farmland which, by covenant, is restricted to use as farmland. The provisions would apply to an estate if (1) the decedent was, at the date of death, a citizen or resident of the United States, and (2) during the eight-year period ending on the date of the decedent's death, there have been periods aggregating five years or more during which (a) the farmland was owned by the decedent or member of his or her family, and (b) there was material participation by the decedent or member of his or her family in the operation of the farmland.[29] "Farmland" refers to any real property which is located in the United States and which is used as a farm or for farming purposes within the meaning of section 2032A(e).[30] A "qualified covenant" means a covenant which may not be revoked which, with respect to farmland to which it applies, is entered into by all persons having ownership in such farmland, and which binds all future owners of the farmland to which the covenant applies.

The provisions of new section 2033A would not apply unless both the Secretary of the Treasury and the Secretary of Agriculture are notified of the political subdivision of the State in which the covenant is recorded and a copy of such covenant is submitted to the Secretary of the Treasury.

Effective Date

The provisions of the bill would apply to covenants first recorded after December 31, 1999, with respect to estates of decedents dying after such date.

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[28] The term "adjusted value" refers to the value of farmland reduced by the amount of claims against or indebtedness in respect of the farmland.

[29] "Material participation" would be defined by reference to section 2032A(e)(6).

[30] Sec. 2032A(e)(4) provides that the term "farm" includes stock, dairy, poultry, fruit, furbearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards and woodlands. Under sec. 2032(A)(e)(5), "farming purposes" generally includes cultivating the soil or raising or harvesting any agricultural or horticultural commodity, handling, drying, packing, grading, or storing any agricultural or horticultural commodity, or the planting, cultivating, caring for, or cutting of trees or preparation of trees for market.

G. H.R. 2880, the "Conservation Tax Incentives Act of 1999" (Mr. Portman and others)

Present Law

Gross income generally includes the gain from the sale or exchange of property.[31]

Description of the Bill

Under the bill, gross income would not include 50 percent of the gain from the sale of land or an interest in land or water (determined without regard to any improvements),[32] if sold to an eligible entity if (1) the land or interest in land or water was owned by the taxpayer or a member of the taxpayer's family[33] during the three-year period ending on the date of the sale, and (2) such land or interest in land or water is being acquired by an eligible entity which provides the taxpayer with a written letter of intent at the time of acquisition, which includes the following statement: "The purchaser's intent is that this acquisition will serve 1 or more of the conservation purposes specified in clause (i), (ii), or (iii) of section 170(h)(4)(A)."

"Eligible entities" include an agency of the United States or of any State or local government or any other organization that meets the "qualified organization" requirements of section 170(h)(3) and is at all times operated principally for one or more of the conservation purposes, which include (1) the preservation of land areas for outdoor recreation by, or the education of, the general public, (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem, (3) the preservation of open space where such preservation is for the scenic enjoyment of the general public or pursuant to a governmental conservation policy, or (4) the preservation of an historically important land area or certified historic structure.[34]

Effective Date

The provisions would apply to sales occurring on or after the date of enactment.

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[31] Sec. 61(a)(3).

[32] The term "land" or "interest in land or water" includes stock in any corporation if the fair market value of the corporation's land or interests in land or water equals 90 percent of the fair market value of all such corporation's assets at all times during the three-year period ending on the date of the sale.

[33] Family members include an ancestor or spouse of an individual, a lineal descendant of such individual, of such individual's spouse, or of a parent of such individual, or the spouse of any such lineal descendant.

[34] Sec. 170(h)(4).