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### HIGHWAY REAUTHORIZATION AND EXCISE TAX SIMPLIFICATION ACT OF 2005

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JUNE 14, 2005.—Ordered to be printed

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

### R E P O R T

[To accompany S. 1230]

[Including cost estimate of the Congressional Budget Office]

The Committee on Finance, having considered an original bill, S. 1230, to amend the Internal Revenue Code of 1986 to provide for the extension of the Highway Trust Fund and the Aquatic Resources Trust Fund expenditure authority and related taxes and to provide for excise tax reform and simplification, and for other purposes, reports favorably thereon and recommends that the bill do pass.

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## I. LEGISLATIVE BACKGROUND

The Senate Committee on Finance marked up an original bill, S. 1230 (the “Highway Reauthorization and Excise Tax Simplification Act of 2005”) on April 19, 2005, and, with a majority and quorum present, ordered the bill favorably reported by a voice vote on that date.<sup>1</sup>

During the 108th Congress, on February 12, 2004, the Senate passed a bill, S. 1072 (the “Safe, Accountable, Flexible, and Efficient Transportation Equity Act of 2004”), which contained provisions to address the same issues addressed by the current bill. Many of the provisions in the current bill are substantially the same as the related provisions contained in S. 1072. On April 2, 2004, the House passed H.R. 3550 (the “Transportation Equity Act: A Legacy for Users”). On May 19, 2004, the Senate amended and passed H.R. 3550, inserting the provisions of S. 1072 in lieu of the body of H.R. 3550. A conference was convened. The House and Senate failed to reach agreement in conference before the adjournment of the 108th Congress.

## II. EXPLANATION OF THE BILL

### TITLE I—TRUST FUND REAUTHORIZATION

#### A. EXTENSION OF HIGHWAY TRUST FUND AND AQUATIC RESOURCES TRUST FUND EXPENDITURE AUTHORITY AND RELATED TAXES

(Secs. 101 and 102 of the bill and secs. 4041, 4051, 4071, 4081, 4221, 4481, 4482, 4483, 6412, 9503, and 9504 of the Code)

##### PRESENT-LAW HIGHWAY TRUST FUND EXCISE TAXES

##### *In general*

Six separate excise taxes are imposed to finance the Federal Highway Trust Fund program. Three of these taxes are imposed on highway motor fuels. Historically, fuel taxes have accounted for 90 percent of Highway Trust Fund receipts. The remaining three are a retail sales tax on heavy highway vehicles, a manufacturers’ excise tax on heavy vehicle tires, and an annual use tax on heavy vehicles. The six taxes are summarized below. Except for 4.3 cents per gallon of the Highway Trust Fund fuels tax rates, and a portion of the tax on certain special motor fuels, all of these taxes are scheduled to expire after September 30, 2005. The 4.3-cents-per-

<sup>1</sup> Subsequent to committee action, on May 31, 2005, the President signed H.R. 2566. Section nine of the Act temporarily extends the authority to make expenditures (subject to appropriations) from the Highway Trust Fund through July 1, 2005. The Act also updates the Highway Trust Fund cross references to authorizing legislation to include expenditure purposes in this Act and prior authorizing legislation as in effect on the date of enactment. It also extends the heavy highway vehicle use tax through September 30, 2006.

gallon portion of the fuels tax rates is permanent.<sup>2</sup> The six taxes are summarized below.

#### *Highway motor fuels taxes*

The Highway Trust Fund motor fuels tax rates<sup>3</sup> are as follows:

Gasoline .....	18.3 cents per gallon
Diesel fuel (including transmix) and kerosene.	24.3 cents per gallon
Special motor fuels .....	18.3 cents per gallon generally <sup>4</sup>

#### *Exemptions*

Present law includes numerous exemptions (including partial exemptions) for specified uses of taxable fuels or for specified fuels. Because the gasoline and diesel fuel taxes generally are imposed before the end use of the fuel is known, many exemptions are realized through refunds to end users of tax paid by a taxpayer earlier in the distribution chain. Exempt uses and fuels include:

- use in State and local government and nonprofit educational organization highway vehicles;
- use in buses engaged in transporting students and employees of schools;
- use in local mass transit buses having a seating capacity of at least 20 adults (not including the driver) when the buses operate under contract with (or are subsidized by) a State or local governmental unit to furnish the transportation; and
- use in intercity buses serving the general public along scheduled routes. (Such use is totally exempt from the gasoline excise tax and is exempt from 17 cents per gallon of the diesel fuel tax.)

In addition, fuels used in off-highway business use or on a farm for farming purposes generally are exempt from these motor fuels taxes.<sup>5</sup> The Highway Trust Fund does not receive excise taxes imposed on fuel used in off-highway activities. Rather, when tax is imposed on off-highway use fuel consumption, it is used to finance other Trust Funds (e.g., motorboat gasoline and special motor fuel taxes from non-business off-highway use dedicated to the Aquatic Resources Trust Fund) or is retained in the General Fund (e.g., tax on diesel fuel used in trains).

<sup>2</sup>This portion of the tax rates was enacted as a deficit reduction measure in 1993. Receipts from it were retained in the General Fund until 1997 legislation provided for their transfer to the Highway Trust Fund.

<sup>3</sup>These fuels also are subject to an additional 0.1-cent-per-gallon excise tax to fund the Leaking Underground Storage Tank ("LUST") Trust Fund (secs. 4041(d) and 4081(a)(2)(B)).

<sup>4</sup>The statutory rate for certain special motor fuels is determined on an energy equivalent basis, as follows:

Liquefied petroleum gas (propane)—13.6 cents per gallon (3.2 cents after September 30, 2005)  
Liquefied natural gas—11.9 cents per gallon (2.8 cents after September 30, 2005)  
Methanol derived from natural gas—9.15 cents per gallon (2.15 cents after September 30, 2005)

Compressed natural gas—48.54 cents per MCF.

See secs. 4041(a)(2), 4041(a)(3) and 4041(m).

The compressed natural gas tax rate is equivalent only to 4.3 cents per gallon of the rate imposed on gasoline and other special motor fuels rather than the full 18.3-cents-per-gallon rate. The tax rate for the other special motor fuels is equivalent to the full 18.3-cents-per-gallon gasoline and special motor fuels tax rate.

<sup>5</sup>Diesel fuel is the same fuel (#2 fuel oil) as that commonly used as home heating oil. Fuel oil used as heating oil is not subject to the Federal excise tax.

*Non-fuel Highway Trust Fund excise taxes*

In addition to the highway motor fuels excise tax revenues, the Highway Trust Fund receives revenues produced by three excise taxes imposed exclusively on heavy highway vehicles or tires. These taxes are:

- A 12-percent excise tax imposed on the first retail sale of heavy highway vehicles, tractors, and trailers (generally, trucks having a gross vehicle weight in excess of 33,000 pounds and trailers having such a weight in excess of 26,000 pounds) (sec. 4051);
- An excise tax imposed on highway tires with a rated load capacity exceeding 3,500 pounds, generally at a rate of 9.45 cents per 10 pounds of excess (sec. 4071(a)); and
- An annual use tax imposed on highway vehicles having a taxable gross weight of 55,000 pounds or more (sec. 4481). (The maximum rate for this tax is \$550 per year, imposed on vehicles having a taxable gross weight over 75,000 pounds.)

PRESENT-LAW HIGHWAY TRUST FUND EXPENDITURE PROVISIONS

*In general*

Dedication of excise tax revenues to the Highway Trust Fund and expenditures from the Highway Trust Fund are governed by provisions of the Code.<sup>6</sup> The Code authorizes expenditures (subject to appropriations) from the Fund through May 31, 2005, for the purposes provided in authorizing legislation, as in effect on the date of enactment of the Surface Transportation Extension Act of 2004, Part V.

Under present law, revenues from the highway excise taxes, as imposed through September 30, 2005, generally are dedicated to the Highway Trust Fund. However, under section 9503(c)(2), certain transfers are made from the Highway Trust Fund into the General Fund, relating to amounts paid in respect of gasoline used on farms, amounts paid in respect of gasoline used for certain non-highway purposes or by local transit systems, amounts relating to fuels not used for taxable purposes, and income tax credits for certain uses of fuels.

*Highway Trust Fund expenditure purposes*

The Highway Trust Fund has a subaccount for Mass Transit. Both the Trust Fund and its sub-account are funding sources for specific programs. Neither the Highway Trust Fund nor its Mass Transit sub-account receive interest on unexpended balances. The Highway Fund's Mass Transit sub-account receives 2.86 cents per gallon of highway motor fuels excise taxes.

Highway Trust Fund expenditure purposes have been revised with each authorization Act enacted since establishment of the Highway Trust Fund in 1956. In general, expenditures authorized under those Acts (as the Acts were in effect on the date of enactment of the most recent such authorizing Act) are approved by the

<sup>6</sup>Sec. 9503. The Highway Trust Fund statutory provisions were placed in the Internal Revenue Code in 1982.

Code as Highway Trust Fund expenditure purposes.<sup>7</sup> Thus, no Highway Trust Fund monies may be spent for a purpose not approved by the tax-writing committees of Congress. The Code provides that authority to make expenditures from the Highway Trust Fund expires after May, 31, 2005. Thus, no Highway Trust Fund expenditures may occur after May 31, 2005.

*Anti-deficit provisions (the “Harry Byrd rule”)*

Highway projects can take multiple years to complete. As a result, the Highway Trust Fund carries positive unexpended balances, a large portion of which are reserved to cover existing obligations.<sup>8</sup> Highway Trust Fund spending is limited by anti-deficit provisions internal to the Highway Trust Fund, the so-called “Harry Byrd rule”. Generally, the Harry Byrd rule prevents the further obligation of Federal highway funds if the current and expected balances of the Highway Trust Fund fall below a certain level. The rule requires the Treasury Department to determine, on a quarterly basis, the amount (if any) by which unfunded highway authorizations exceed projected net Highway Trust Fund tax receipts for the 24-month period beginning at the close of each fiscal year.<sup>9</sup> Similar rules apply to unfunded Mass Transit Account authorizations. If unfunded authorizations exceed projected 24-month receipts, apportionments to the States for specified programs funded by the relevant Trust Fund Account are to be reduced proportionately. Because of the Harry Byrd rule, taxes dedicated to the Highway Trust Fund typically are scheduled to expire at least 24-months after current authorizing Acts.

The Surface Transportation Extension Act of 2003, created a temporary rule (through February 29, 2004) for purposes of the anti-deficit provisions of the Highway Trust Fund. For purposes of determining 24 months of projected revenues for the anti-deficit provisions, the Secretary of the Treasury is instructed to treat each expiring provision relating to appropriations and transfers to the Highway Trust Fund to have been extended through the end of the 24-month period and to assume that the rate of tax during such 24-month period remains at the same rate in effect on the date of enactment of the provision. The temporary rule has been continuously extended since February 29, 2004. The last extension, enacted as part of the Surface Transportation Extension Act of 2004, Part V, extended the rule through May 31, 2005.

*Limitations on transfers to the Highway Trust Fund*

The Code also contains a special enforcement provision to prevent expenditure of Highway Trust Fund monies for purposes not authorized in section 9503.<sup>10</sup> Should such unapproved expenditures

<sup>7</sup> The authorizing Acts which currently are referenced in the Highway Trust Fund provisions of the Code are: the Highway Revenue Act of 1956, Titles I and II of the Surface Transportation Assistance Act of 1982, the Surface Transportation and Uniform Relocation Act of 1987, the Intermodal Surface Transportation Efficiency Act of 1991 and the Transportation Equity Act for the 21st Century, the Surface Transportation Extension Act of 2003, the Surface Transportation Extension Act of 2004; the Surface Transportation Extension Act of 2004, Part II; the Surface Transportation Extension Act of 2004, Part III; the Surface Transportation Extension Act of 2004, Part IV; and the Surface Transportation Extension Act of 2004, Part V.

<sup>8</sup> Congressional Research Service, RL 32226, Highway and Transit Program Reauthorization Legislation in the 2nd Session, 108th Congress (December 15, 2004) at CRS-12.

<sup>9</sup> Sec. 9503(d).

<sup>10</sup> Sec. 9503(b)(5).

occur, no further excise tax receipts will be transferred to the Highway Trust Fund. Rather, the taxes will continue to be imposed with receipts being retained in the General Fund. This enforcement provision provides specifically that it applies not only to unauthorized expenditures under the current Code provisions, but also to expenditures pursuant to future legislation that does not amend section 9503's expenditure authorization provisions or otherwise authorize the expenditure as part of a revenue Act.

*Interrelationship of the Highway Trust Fund and the Aquatic Resources Trust Fund*

The Aquatic Resources Trust Fund is funded by a portion of the receipts from the excise taxes imposed on motorboat gasoline and special motor fuels and on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment. A portion of these taxes are transferred into the Highway Trust Fund and then retransferred into the Aquatic Resources Trust Fund. As a result, transfers to the Aquatic Resources Trust Fund are governed in part by Highway Trust Fund provisions.<sup>11</sup>

A total tax rate of 18.4 cents per gallon is imposed on gasoline and special motor fuels used in motorboats and on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment. Of this rate, 0.1 cent per gallon is dedicated to the Leaking Underground Storage Tank Trust Fund. Of the remaining 18.3 cents per gallon, 4.8 cents per gallon are retained in the General Fund. The balance of 13.5 cents per gallon is transferred to the Highway Trust Fund and then retransferred to the Aquatic Resources Trust Fund and the Land and Water Conservation Fund, as follows.

The Aquatic Resources Trust Fund is comprised of two accounts, the Boat Safety Account and the Sport Fish Restoration Account. Motorboat fuel taxes, not exceeding \$70 million per year, are transferred to the Boat Safety Account. In addition, these transfers are subject to an overall annual limit equal to an amount that will not cause the Boat Safety Account to have an unobligated balance in excess of \$70 million. To the extent there are excess motorboat fuel taxes, the next \$1 million per year of motorboat fuel taxes is transferred from the Highway Trust Fund to the Land and Water Conservation Fund provided for in Title I of the Land and Water Conservation Fund Act of 1965. The balance of the motorboat fuel taxes in the Highway Trust Fund is transferred to the Sport Fish Restoration Account.

The Sport Fish Restoration Account also receives 13.5 cents per gallon of the small-engine fuel taxes from the Highway Trust Fund. This Account is also funded with receipts from an ad valorem manufacturers' excise tax on sport fishing equipment.

The retention in the General Fund of 4.8 cents per gallon of taxes on fuel used in motorboats and in the nonbusiness use of small-engine outdoor power equipment expires with respect to taxes imposed after September 30, 2005.

The expenditure authority for the Aquatic Resources Trust Fund expires after May 31, 2005.

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<sup>11</sup> Secs. 9503(c)(4) and 9503(c)(5).

## REASONS FOR CHANGE

The Committee believes that highway and transit spending sustains and creates jobs, providing valuable new opportunities in communities where the availability of jobs is declining. In addition, a long-term reauthorization provides stability for State transportation programs dependent on Federal funds. Thus, the Committee believes it is appropriate to reauthorize Highway Trust Fund expenditures through September 30, 2009 and to extend current Federal taxes payable to the Highway Trust Fund.

The bill modifies the Harry Byrd rule to require that Highway Account and Mass Transit Account (each separately) unpaid authorizations at the end of a fiscal year be less than or equal to the cash balance of the account at the end of the year plus the projected receipts for the next 48 months, rather than 24 months. Most highway projects are capital projects on which money is spent over a number of years. Given that highway projects, and therefore contract payments, may extend longer than 24 months, the Committee believes it is appropriate to extend the testing period to 48 months to better reflect that some existing obligations will be satisfied by using future tax receipts.

## EXPLANATION OF PROVISION

The expenditure authority for the Highway Trust Fund and Aquatic Resources Trust Fund is extended through September 30, 2009. The Code provisions governing the purposes for which monies in the Highway Trust Fund and Aquatic Resources Trust Fund may be spent is updated to include the reauthorization bill. The provision also extends the motor fuel taxes and all three non-fuel excises taxes at their current rates through September 30, 2011.

The Harry Byrd rule is changed from a 24-month to a 48-month receipt rule. Under the provision, the Harry Byrd rule is not triggered unless unfunded highway authorizations exceed projected net Highway Trust Fund tax receipts for the 48-month period beginning at the close of each fiscal year. This potentially allows a greater obligation of funds than permitted under present law. For purposes of the 48-month rule, taxes are assumed extended beyond their expiration date.

The provision does not extend the retention in the General Fund of 4.8 cents per gallon of taxes on fuel used in motorboats and in the nonbusiness use of small-engine outdoor power equipment.

## EFFECTIVE DATE

The provision is effective on the date of enactment.

## TITLE II—EXCISE TAX REFORM AND SIMPLIFICATION

## A. MODIFY GAS GUZZLER TAX

(Sec. 201 of the bill and sec. 4064 of the Code)

## PRESENT LAW

Under present law, the Code imposes a tax (“the gas guzzler tax”) on automobiles that are manufactured primarily for use on public streets, roads, and highways and that are rated at 6,000



pounds unloaded gross vehicle weight or less.<sup>12</sup> The tax applies to limousines without regard to the weight requirement. The tax is imposed on the sale by the manufacturer of each automobile of a model type with a fuel economy of 22.5 miles per gallon or less. The tax range begins at \$1,000 and increases to \$7,700 for models with a fuel economy less than 12.5 miles per gallon.

Emergency vehicles and non-passenger automobiles are exempt from the tax. The tax also does not apply to non-passenger automobiles. The Secretary of Transportation determines which vehicles are “non-passenger” automobiles, thereby exempting these vehicles from the gas guzzler tax based on regulations in effect on the date of enactment of the gas guzzler tax.<sup>13</sup> Hence, vehicles defined in Title 49 C.F.R. sec. 523.5 (relating to light trucks) are exempt. These vehicles include those designed to transport property on an open bed (e.g., pick-up trucks) or provide greater cargo-carrying than passenger carrying volume including the expanded cargo-carrying space created through the removal of readily detachable seats (e.g., pick-up trucks, vans, and most minivans, sports utility vehicles and station wagons). Additional vehicles that meet the “non-passenger” requirements are those with at least four of the following characteristics: (1) an angle of approach of not less than 28 degrees; (2) a breakover angle of not less than 14 degrees; (3) a departure angle of not less than 20 degrees; (4) a running clearance of not less than 20 centimeters; and (5) front and rear axle clearances of not less than 18 centimeters each. These vehicles would include many sports utility vehicles.

#### REASONS FOR CHANGE

The Committee observes that limousines are the only class of vehicles weighing in excess of 6,000 pounds subject to the gas guzzler tax. The Committee believes that, as equipment essential to a commercial enterprise, the present-law application of the gas guzzler tax to such limousines is inappropriate.

#### EXPLANATION OF PROVISION

The provision repeals the tax as it applies to limousines rated at greater than 6,000 pounds unloaded gross vehicle weight.

#### EFFECTIVE DATE

The provision is effective on October 1, 2005.

#### B. AQUATIC EXCISE TAXES

1. Eliminate Aquatic Resources Trust Fund and transform Sport Fish Restoration Account (sec. 211 of the bill and secs. 9503 and 9504 of the Code)

#### PRESENT LAW

A total tax rate of 18.4 cents per gallon is imposed on gasoline and special motor fuels used in motorboats, and on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power

<sup>12</sup> Sec. 4064.

<sup>13</sup> Sec. 4064(b)(1)(B).

equipment.<sup>14</sup> Of this rate, 0.1 cent per gallon is dedicated to the Leaking Underground Storage Tank Trust Fund. Of the remaining 18.3 cents per gallon, tax collected in excess of 13.5 cents per gallon (i.e., 4.8 cents per gallon) is retained in the General Fund of the Treasury.<sup>15</sup> The balance is transferred to the Highway Trust Fund, and retransferred (except with respect to amounts transferred to the fund for land and water conservation, as described below) to the Aquatic Resources Trust Fund.<sup>16</sup> The taxes on gasoline and special motor fuels used in motorboats and the taxes on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment are collected under the same rules as apply to the Highway Trust Fund collections generally.

The Aquatic Resources Trust Fund is comprised of two accounts.<sup>17</sup> First, the Boat Safety Account is funded by a portion of the receipts from the excise tax imposed on motorboat gasoline and special motor fuels. Transfers to the Boat Safety Account are limited to amounts not exceeding \$70 million per year. In addition, these transfers are subject to an overall annual limit equal to an amount that will not cause the Boat Safety Account to have an unobligated balance in excess of \$70 million.<sup>18</sup>

Second, the Sport Fish Restoration Account receives the balance of the motorboat gasoline and special motor fuels receipts that are transferred to the Aquatic Resources Trust Fund.<sup>19</sup> The Sport Fish Restoration Account is also funded with receipts from an excise tax on sport fishing equipment sold by the manufacturer, producer or importer. The excise tax rate on sport fishing equipment is 10 percent of the sales price; the rate is reduced to 3 percent for electric outboard motors and fishing tackle boxes.<sup>20</sup> Examples of the items of sport fishing equipment subject to the 10-percent rate include fishing rods and poles, fishing reels, fly fishing lines and certain other fishing lines, fishing spears, spear guns, spear tips, items of terminal tackle, containers designed to hold fish, fishing vests, landing nets, and portable bait containers.<sup>21</sup> In addition, import duties on certain fishing tackle, yachts and pleasure craft are transferred into the Sport Fish Restoration Account.

The amounts of taxes on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment that are transferred to the Highway Trust Fund and retransferred to the Aquatics Resources Trust Fund are directed to a separate sub-ac-

<sup>14</sup> Sec. 4081(a)(2).

<sup>15</sup> The retention in the General Fund of the 4.8 cents per gallon of motorboat fuel taxes and taxes on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment expires after September 30, 2005.

<sup>16</sup> See Sec. 9503(b)(4), (c)(4) and (5). The transfer from the Highway Trust Fund to the Aquatic Resources Trust Fund of amounts of taxes on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment expires after September 30, 2005. Between October 1, 2001 and September 30, 2003, the amount transferred to the Aquatic Resources Trust Fund was 13 cents per gallon. Prior to October 1, 2001, the amount transferred was 11.5 cents per gallon. Sec. 9503(b)(4)(D).

<sup>17</sup> Sec. 9504(a).

<sup>18</sup> Sec. 9503(c)(4)(A). Funding of the Boat Safety Account is scheduled to terminate after September 30, 2005.

<sup>19</sup> After funding of the Boat Safety Account, remaining motorboat fuel taxes, not exceeding \$1,000,000 during any fiscal year, are transferred from the Highway Trust Fund into the land and water conservation fund provided in title I of the Land and Water Conservation Fund Act of 1965. Sec. 9503(c)(4)(B). After the transfer to the land and water conservation fund, motorboat fuel taxes remaining in the Highway Trust Fund are transferred to the Sport Fish Restoration Account. See 9503(c)(4)(C).

<sup>20</sup> Sec. 4161(a)(2) and (3).

<sup>21</sup> Items of "sport fishing equipment" are enumerated in section 4162(a).

count of the Sport Fish Restoration Account, the Coastal Wetlands Sub-Account.

Expenditures from the Boat Safety Account are subject to annual appropriations. Amounts transferred, paid, or credited to the Sport Fish Restoration Account (including the Coastal Wetlands Sub-Account) are authorized to be appropriated for the uses authorized in the expenditure provisions.<sup>22</sup>

#### REASONS FOR CHANGE

The Committee believes that the current Boat Safety Account is fully funded and that expenditures for boating safety relating to newly collected funds would be facilitated by treating these collections in the same manner as those currently required for the Sport Fish Restoration Account. The Committee further believes that combining the Boat Safety Account and Sport Fish Restoration Account will facilitate such uniform treatment in the future and better coordinate expenditures for sport fishing and boating safety.

#### EXPLANATION OF PROVISION

The proposal eliminates the Aquatics Resources Trust Fund and future transfers to the Boat Safety Account and transforms the Sport Fish Restoration Account into the Sport Fish Restoration and Boating Trust Fund. After funding of the land and water conservation fund as under present law, the balance of the taxes on motorboat fuels is transferred from the Highway Trust Fund into the Sport Fish Restoration and Boating Trust Fund. In addition, the transfers from the Highway Trust Fund to the Sport Fish Restoration and Boating Trust Fund of amounts of taxes on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment are extended through September 30, 2011.

Existing amounts in the Boat Safety Account, plus interest accrued on interest-bearing obligations of such account, are made available as provided under expenditure provisions.<sup>23</sup> The expenditure provisions also authorize the appropriation of amounts in the Sport Fish Restoration and Boating Trust Fund, including for boating safety, for the uses authorized in the expenditure provisions.

#### EFFECTIVE DATE

The proposal is effective October 1, 2005.

2. Repeal of harbor maintenance tax on exports (sec. 212 of the bill and sec. 4461 of the Code)

#### PRESENT LAW

The Code contains provisions imposing a 0.125-percent excise tax on the value of most commercial cargo loaded or unloaded at U.S. ports (other than ports included in the Inland Waterway Trust Fund system). The tax also applies to amounts paid for passenger transportation using these U.S. ports. Exemptions are provided for (1) cargo donated for overseas use, (2) cargo shipped between the

<sup>22</sup> Act of August 9, 1950, 64 Stat. 430 (codified at 16 U.S.C. sec. 777 et seq.) (“An Act to provide that the United States shall aid the States in fish restoration and management projects, and for other purposes.”)

<sup>23</sup> The expenditure provisions are codified at 16 U.S.C. sec. 777 et seq., as may be amended by the Sportfishing and Recreational Boating Safety Act of 2005.

U.S. mainland and Alaska (except for crude oil), Hawaii, and/or U.S. possessions and (3) cargo shipped between Alaska, Hawaii, and/or U.S. possessions. Receipts from this tax are deposited in the Harbor Maintenance Trust Fund.

The U.S. Supreme Court has held that the harbor maintenance excise tax is unconstitutional as applied to exported cargo because it violates the “Export Clause” of the U.S. Constitution.<sup>24</sup> The tax remains in effect for imported cargo. Imposition of the tax on passenger transportation with respect to passengers on cruises that originate, stop, or terminate, at U.S. ports has been upheld.

#### REASONS FOR CHANGE

The Committee believes the Internal Revenue Code should conform to the law of the land as interpreted by the Supreme Court and, thus, believes the harbor maintenance excise tax as applied to exported cargo should be repealed as deadwood.

#### EXPLANATION OF PROVISION

The provision conforms the Code to the Supreme Court decision and exempts exported commercial cargo from the harbor maintenance tax.

#### EFFECTIVE DATE

The provision is effective before, on, and after the date of enactment.

3. Cap on excise tax on certain fishing equipment (sec. 213 of the bill and sec. 4161 of the Code)

#### PRESENT LAW

In general, the Code imposes a 10-percent tax on the sale by the manufacturer, producer, or importer of specified sport fishing equipment.<sup>25</sup> A three percent rate, however, applies to the sale of electric outboard motors and fishing tackle boxes.<sup>26</sup> Sport fishing equipment subject to the 10-percent tax includes fishing rods and poles, fishing reels, fly fishing lines, and other fishing lines not over 130 pounds test, fishing spears, spear guns, and spear tips, and tackle items including leaders, artificial lures, artificial baits, artificial flies, fishing hooks, bobbers, sinkers, snaps, drayles, and swivels. In addition the following fishing supplies and accessories are subject to the 10-percent tax: fish stringers; creels; bags, baskets, and other containers designed to hold fish; portable bait containers; fishing vests; landing nets; gaff hooks; fishing hook disgorgers; dressing for fishing lines and artificial flies; fishing tip-ups and tilts; fishing rod belts, fishing rodholders; fishing harnesses; fish fighting chairs; and fishing outriggers and downriggers.

Revenues from the excise tax on sport fishing equipment are deposited in the Sport Fishing Account of the Aquatic Resources Trust Fund. Monies in the fund are spent, subject to an existing permanent appropriation, to support Federal-State sport fish enhancement and safety programs.

<sup>24</sup> *United States Shoe Corp. v. United States*, 523 U.S. 360, 118 S. Ct. 1290, 140 L. Ed. 2d 453 (1998).

<sup>25</sup> Sec. 4161(a)(1).

<sup>26</sup> Sec. 4161(a)(2) and (a)(3).

## REASONS FOR CHANGE

The Committee understands that as a tax on the manufacturer, the 10-percent ad valorem tax rate generally is imposed at the time a rod is sold to a wholesaler or retailer and thus the tax as a percentage of the ultimate retail price paid by the consumer is less than 10 percent. However, the Committee understands that most rods priced in excess of \$100 are custom rods produced by businesses that are both the “manufacturer” and the retailer. In this circumstance the 10-percent tax rate would apply to the retail price. The Committee therefore believes that present-law tax does not provide for neutral taxation of different segments of the fishing rod market. The Committee concludes that the tax on rods and poles the manufacturer’s price of which exceeds \$100 should be limited to \$10.00.

## EXPLANATION OF PROVISION

The provision provides that the tax applicable to a fishing rod or fishing pole is the lesser of 10 percent or \$10.00.

## EFFECTIVE DATE

The provision is effective for articles sold by the manufacturer, producer, or importer after September 30, 2005.

## C. AERIAL EXCISE TAXES

1. Clarification of excise tax exemptions for agricultural aerial applicators and exemption for fixed-wing aircraft engaged in forestry operations (sec. 221 of the bill and secs. 4261 and 6420 of the Code)

## PRESENT LAW

Excise taxes are imposed on aviation gasoline (19.4 cents per gallon) and jet fuel (21.9 cents per gallon).<sup>27</sup> All but 0.1 cent per gallon of the revenues from these taxes are dedicated to the Airport and Airway Trust Fund. The remaining 0.1 cent per gallon rate is imposed for the Leaking Underground Storage Tank Trust Fund.

Fuel used on a farm for farming purposes is a nontaxable use. Aerial applicators (crop dusters) are allowed to claim a refund instead of farm owners and operators in the case of aviation gasoline if the owners or operators give written consent to the aerial applicators.<sup>28</sup> This provision applies only to fuel consumed in the airplane while operating over the farm, i.e., fuel consumed traveling to and from the farm is not exempt.

Air passenger transportation is subject to an excise tax equal to 7.5 percent of the amount paid plus \$3.20 per domestic flight segment.<sup>29</sup> The tax on transportation by air does not apply to air transportation by helicopter if the helicopter is used for (1) the exploration, or the development or removal of oil, gas, or hard minerals exploration, or (2) certain timber operations (planting, cultivating, cutting, transporting, or caring for trees, including logging

<sup>27</sup> Sec. 4081.

<sup>28</sup> Sec. 6420(c)(4).

<sup>29</sup> Sec. 4261(a) and (b).

operations).<sup>30</sup> The exemption applies only when the helicopters are not using the Federally funded airport and airway services. Helicopters and fixed-wing aircraft providing emergency medical services also are exempt from the air passenger tax regardless of the type of airport and airway services used.<sup>31</sup>

#### REASONS FOR CHANGE

The Committee believes significant simplification and reduction of administrative burden will be achieved by eliminating the requirements that aerial applicators obtain written consent from the farm owner for exempt fuel use and by allowing exempt fuel use to extend to fuel consumed when flying between the farms where chemicals are applied and the airport where the airplane takes off and lands. In addition, the Committee notes that the purpose of the aviation excise taxes is to generate revenue for the Airport Improvement program, which builds new and retrofits and expands existing public airports. The Committee believes it is appropriate to extend the current exemption for helicopters engaged in timber operations to fixed wing aircraft when such aircraft are not using the Federally funded airport and airway services.

#### EXPLANATION OF PROVISION

With regard to the exemption for aerial applicators, written consent from the farm owner or operator is no longer needed for the aerial applicator to claim exemption for aviation gasoline. The exemption also is expanded to include fuels consumed when flying between the farms where chemicals are applied and the airport where the airplane takes off and lands. The present exemption for helicopters engaged in timber operations is expanded to include fixed-wing aircraft if such aircraft are not using the Federally funded airport and airway services.

#### EFFECTIVE DATE

The provision is effective for fuel use or air transportation after September 30, 2005.

2. Modify the definition of rural airport (sec. 222 of the bill and sec. 4261 of the Code)

#### PRESENT LAW

Air passenger transportation is subject to an excise tax equal to 7.5 percent of the amount paid plus \$3.20 per domestic flight segment.<sup>32</sup> The \$3.20 tax on flight segments does not apply to a domestic segment beginning or ending at a rural airport.

With respect to any calendar year, a rural airport is an airport that had fewer than 100,000 passengers departing by air during the second preceding calendar year for such airport and such airport either (1) is not located within 75 miles of a larger airport (one that had at least 100,000 passengers departing in the second preceding calendar year), or (2) was receiving essential air service subsidy payments as of August 5, 1997.

<sup>30</sup> Sec. 4261(f)

<sup>31</sup> Sec. 4261(g).

<sup>32</sup> Sec. 4261(a) and (b).

## REASONS FOR CHANGE

The Committee notes that the present-law definition of “rural airports” generally encompasses those airports that do not offer potential customers a viable alternative to a larger airport from which a ticket would subject the purchaser to the flight segment tax in addition to the ad valorem tax. The Committee observes that airports located on islands with no direct access by road from the mainland also would not offer potential customers a viable alternative to a larger airport, even if the island airport is within 75 miles of the larger airport.

## EXPLANATION OF PROVISION

The provision expands the definition of qualified rural airport to include an airport that (1) is not connected by paved roads to another airport and (2) had fewer than 100,000 commercial passengers departing by air on flight segments of at least 100 miles during the second preceding calendar year.

## EFFECTIVE DATE

The provision is effective on October 1, 2005.

3. Exempt from ticket taxes transportation provided by seaplanes (sec. 223 of the bill and sec. 4261 of the Code)

## PRESENT LAW

Air passenger transportation is subject to an excise tax equal to 7.5 percent of the amount paid plus \$3.20 per domestic flight segment (“air passenger tax”).<sup>33</sup> A 6.25-percent tax is imposed on amounts paid for transportation of property by air (“air cargo tax”).<sup>34</sup> The air cargo tax applies only to amounts paid to persons engaged in the business of transporting property by air for hire. The air passenger tax and air cargo tax does not apply to amounts paid for the transportation if furnished on an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less unless the aircraft is operated on an established line.<sup>35</sup>

## REASONS FOR CHANGE

The Committee observes that seaplanes do not make as full utilization of Federal Aviation Administration services as do planes that offer passenger service out of traditional airports. The Committee, therefore, believes it is appropriate to exempt such service from the air transportation excise taxes and instead impose only the fuels excise taxes.

## EXPLANATION OF PROVISION

The provision provides that the air passenger tax and the air cargo tax do not apply to transportation by a seaplane with respect to any segment consisting of a takeoff from, and a landing on, water, but only if the places at which such takeoff and landing occur have not received and are not receiving financial assistance from the Airport and Airway Trust Fund.

<sup>33</sup> Sec. 4261(a) and (b).

<sup>34</sup> Sec. 4271.

<sup>35</sup> Sec. 4281.

## EFFECTIVE DATE

The provision is effective for transportation after September 30, 2005.

4. Exempt certain sightseeing flights from taxes on air transportation (sec. 224 of the bill and sec. 4281 of the Code)

## PRESENT LAW

Under present law, taxable aviation transportation is subject to a 7.5-percent excise tax on the price of an airline ticket and a \$3.20 segment tax. An exception to these taxes is provided for transportation by an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less except when the aircraft is operated on an established line. Under the Treasury regulations to be “operated on an established line” means to be operated with “some degree of regularity between definite points. The term implies that the air carrier maintains control over the direction, routes, time, number of passengers carried, etc.” Treasury regulations provide that transportation need not be between two definite points to be taxable: a payment for continuous transportation beginning and ending at the same point is subject to the tax.<sup>36</sup> The IRS position is that the words “between definite points” do not require two separate points for purposes of determining whether an aircraft is operated on an established line. At least one court has agreed.<sup>37</sup>

## REASONS FOR CHANGE

The Committee believes it is appropriate to exempt certain sightseeing flights from the taxes on air transportation. Examples of sightseeing flights include flights of short duration that overlook a glacier, volcano, the Grand Canyon, or other similar attraction and for which the air tour begins and ends at the same point. By short duration, the Committee intends that the tour occur within a calendar day, irrespective of intermittent stops to view the attraction. In addition, all passengers from the initial point of departure must return with the aircraft at the conclusion of the tour. The Committee believes that such flights are primarily for entertainment rather than for transportation from one place to another and so should be treated as noncommercial aviation.

## EXPLANATION OF PROVISION

For purposes of the proposal exemption for small aircraft operated on nonestablished lines, an aircraft operated on a flight, the sole purpose of which is sightseeing, will not be considered as operated on an established line.

## EFFECTIVE DATE

The provision is effective with respect to transportation beginning after September 30, 2005, but does not apply to any amount paid before such date for such transportation.

<sup>36</sup>Treas. Reg. sec. 494261-1(c).

<sup>37</sup>*Lake Mead Air Inc. v. United States*, 991 F. Supp. 1209 (D. Nev. 1997).



## D. TAXES RELATING TO ALCOHOL

1. Repeal special occupational taxes on producers and marketers of alcoholic beverages (sec. 231 of the bill and secs. 5081, 5091, 5111, 5112, 5113, 5117, 5121, 5122, 5123, 5125, 5131, 5132, 5141, 5147, 5148, and 5276 of the Code)

## PRESENT LAW

Under the law in effect prior to July 1, 2005, special occupational taxes are imposed on producers and others engaged in the marketing of distilled spirits, wine, and beer. These excise taxes are imposed as part of a broader Federal tax and regulatory structure governing the production and marketing of alcoholic beverages. The special occupational taxes are payable annually, on July 1 of each year. The tax rates in effect prior to July 1, 2005 are as follows:

*Producers*<sup>38</sup> Distilled spirits and wines (sec. 5081),<sup>39</sup> \$1,000 per year, per premise; Brewers (sec. 5091), 1,000 per year, per premise

*Wholesale dealers (sec. 5111):* Liquors, wines, or beer, \$500 per year

*Retail dealers (sec. 5121):* Liquors, wines, or beer, \$250 per year

*Nonbeverage use of distilled spirits (sec. 5131):* \$500 per year

*Industrial use of distilled spirits (sec. 5276)* \$250 per year

Section 246(a) of the American Jobs Creation Act of 2004<sup>40</sup> suspends the special occupational tax for the period beginning July 1, 2005 and ending June 30, 2008.<sup>41</sup>

Every person engaged in a trade or business on which a special occupational tax is imposed is required to register with the Secretary.<sup>42</sup> In addition, every dealer in liquors, wine or beer is required to keep records of their transactions.<sup>43</sup> A dealer is any person who sells, or offers for sale, distilled spirits, wine, or beer.<sup>44</sup> A delegate of the Secretary of the Treasury is authorized to inspect the records of any dealer during business hours.<sup>45</sup> There are penalties for failing to comply with the recordkeeping requirements.<sup>46</sup> There are also registration and regulation requirements for the nonbeverage use of distilled spirits, and permit and recordkeeping requirements for the industrial use of distilled spirits.<sup>47</sup>

The Code limits the persons from whom dealers may purchase their liquor stock intended for resale. A dealer may only purchase from:

1. a wholesale dealer in liquors who has paid the special occupational tax as such dealer to cover the place where such purchase is made; or

<sup>38</sup> A reduced rate of tax in the amount of \$500.00 is imposed on small proprietors (as defined in the Code) (secs. 5081(b) and 5091(b)).

<sup>39</sup> Proprietors of plants producing distilled spirits exclusively for fuel use, with annual production not exceeding 10,000 proof gallons, are exempt. Secs. 5081(c), 5181(c)(4).

<sup>40</sup> Pub. L. No. 108-357.

<sup>41</sup> See sec. 5148.

<sup>42</sup> Secs. 5141 and 7011. The registration is of such person's name or style, place of residence, trade or business, and the place where such trade or business is to be carried on.

<sup>43</sup> Secs. 5114 and 5124.

<sup>44</sup> Sec. 5112(a). Such definition includes producers and, in general, proprietors of warehouses.

<sup>45</sup> Sec. 5146.

<sup>46</sup> Sec. 5603.

<sup>47</sup> Secs. 5132 and 5275.

2. a wholesale dealer in liquors who is exempt, at the place where such purchase is made, from payment of such tax under any provision chapter 51 of the Code; or

3. a person who is not required to pay special occupational tax as a wholesale dealer in liquors.<sup>48</sup>

Violation of this restriction is punishable by \$1,000 fine, imprisonment of one year, or both.<sup>49</sup> A violation also makes the alcohol subject to seizure and forfeiture.<sup>50</sup>

#### REASONS FOR CHANGE

The special occupational tax is not a tax on alcoholic products but rather operates as a license fee on businesses. The Committee believes that this tax places an unfair burden on business owners. However, the Committee recognizes that the registration and recordkeeping requirements applicable to wholesalers and retailers engaged in such businesses are necessary enforcement tools to ensure the protection of the revenue arising from the excise taxes on these products. Thus, the Committee believes it appropriate to repeal the tax, while retaining present-law recordkeeping requirements.

#### EXPLANATION OF PROVISION

The provision repeals the special occupational taxes on producers and marketers of alcoholic beverages and on the nonbeverage or industrial use of distilled spirits. The registration, recordkeeping and inspection rules applicable to wholesale and retail dealers are retained.<sup>51</sup> For purposes of the recordkeeping requirements for wholesale and retail liquor dealers, the provision provides a rebuttable presumption that a person who sells, or offers for sale, distilled spirits, wine, or beer, in quantities of 20 wine gallons or more to the same person at the same time is engaged in the business of a wholesale dealer in liquors or a wholesale dealer in beer. In addition, the provision retains the present-law rules that make it unlawful for any liquor dealer to purchase distilled spirits for resale from any person other than a wholesale liquor dealer subject to the recordkeeping requirements, or a proprietor of a distilled spirits plant subject to recordkeeping requirements.<sup>52</sup> Existing general criminal penalties relating to records and reports apply to wholesalers and retailers who fail to comply with these requirements.

<sup>48</sup> Sec. 5117. For example, purchases from a proprietor of a distilled spirits plant at his principal business office would be covered under item (2) since such a proprietor is not subject to the special occupational tax on account of sales at his principal business office (sec. 5113(a)). Purchases from a liquor store operated by a State or by a political subdivision of a State would be covered under item (3) (sec. 5113(b)).

<sup>49</sup> Sec. 5687.

<sup>50</sup> Sec. 7302.

<sup>51</sup> The provision also retains the present-law registration and regulation requirements for the nonbeverage use of distilled spirits, and the permit and recordkeeping requirements for the industrial use of distilled spirits.

<sup>52</sup> Proprietors of distilled spirits plants remain subject to present law recordkeeping requirements under section 5207. Under present law, a limited retail dealer in liquors (such as a charitable organization selling liquor at a picnic) may lawfully purchase distilled spirits for resale from a retail dealer in distilled spirits. The provision retains this rule.

## EFFECTIVE DATE

The provision is effective on July 1, 2008. The provision does not affect liability for taxes imposed with respect to periods before July 1, 2008.

2. Modify limitation on rate of rum excise tax cover over to Puerto Rico and Virgin Islands (sec. 232 of the bill and sec. 7652 of the Code)

## PRESENT LAW

A \$13.50 per proof gallon<sup>53</sup> excise tax is imposed on distilled spirits produced in or imported (or brought) into the United States.<sup>54</sup> The excise tax does not apply to distilled spirits that are exported from the United States, including exports to U.S. possessions (e.g., Puerto Rico and the Virgin Islands).<sup>55</sup>

The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.<sup>56</sup> The amount of the cover over is limited under Code section 7652(f) to \$10.50 per proof gallon (\$13.25 per proof gallon during the period July 1, 1999 through December 31, 2005).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are divided and covered over to the two possessions under a formula.<sup>57</sup> Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.<sup>58</sup> All of the amounts covered over are subject to the limitation.

## REASONS FOR CHANGE

The Committee believes that the fiscal needs of Puerto Rico and Virgin Islands justify the extension and the increase to full cover over for calendar year 2006. The Committee further believes that dedicating a small portion of the amount covered over to Puerto Rico to the Puerto Rico Conservation Trust Fund will help to ensure the continued viability of such fund.

## EXPLANATION OF PROVISION

Under the provision, the cover over amount of \$13.25 per proof gallon is modified to \$13.50 for rum brought into the United States after December 31, 2005 and before January 1, 2007. After December 31, 2006, the cover over amount reverts to \$10.50 per proof gallon.

<sup>53</sup> A proof gallon is a liquid gallon consisting of 50 percent alcohol. See sec. 5002(a)(10) and (11).

<sup>54</sup> Sec. 5001(a)(1).

<sup>55</sup> Secs. 5062(b), 7653(b) and (c).

<sup>56</sup> Secs. 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under section 7652(b)(3).

<sup>57</sup> Sec. 7652(e)(2).

<sup>58</sup> Secs. 7652(a)(3), (b)(3), and (e)(1).

The provision additionally requires that Puerto Rico transfers a portion of the amount covered over to Puerto Rico to the Puerto Rico Conservation Trust Fund (the “Fund”).<sup>59</sup> The treasury of Puerto Rico is required to make a transfer to the Fund in an amount equal to 50 cents per proof gallon of the taxes covered over to Puerto Rico, and attributable to rum imported into the United States that was produced neither in Puerto Rico nor the Virgin Islands. The transfer is required to be made within 30 days of each such cover over payment to Puerto Rico. Each transfer payment is to be treated as principal for an endowment, the income from which is to be used by the Fund for the purposes for which the Fund was established. If Puerto Rico fails to make a timely payment to the Trust Fund, the Secretary of the Treasury shall deduct and withhold such unpaid amount from the next cover over payment, plus interest, and shall transfer such amounts directly to the Fund. Such deduction, withholding, and direct payment will not be made if the Secretary of the Interior, after consultation with the Governor of Puerto Rico, finds that the failure of the treasury of Puerto Rico to make the transfer payment was for good cause. The transfer requirement expires after December 31, 2006.

#### EFFECTIVE DATE

The changes in the cover over rate are effective for articles brought into the United States after December 31, 2005. The provision regarding the Puerto Rico Conservation Trust Fund is effective January 1, 2006.

3. Provide an income tax credit for cost of carrying tax-paid distilled spirits in wholesale inventories and in control State bailment warehouses (sec. 233 of the bill and new sec. 5011 of the Code)

#### PRESENT LAW

As is true of most major Federal excise taxes, the excise tax on distilled spirits is imposed at a point in the chain of distribution before the product reaches the retail (consumer) level. The excise tax on distilled spirits produced in the United States is imposed when the distilled spirits are removed from the distilled spirits plant where they are produced. Distilled spirits that are bottled before importation into the United States are taxed on removal from the first U.S. custom bonded warehouse to which they are landed (including a warehouse located in a foreign trade zone). Distilled spirits imported in bulk containers from bottling in the United States may be transferred to a domestic distilled spirits plant without payment of tax; subsequently, these distilled spirits are taxed in the same way as domestically produced distilled spirits.

No tax credits are allowed under present law for business costs associated with having tax-paid products in inventory. Rather, excise tax that is included in the purchase price of a product is treated the same as the other components of the product cost, i.e., deductible as a cost of goods sold.

<sup>59</sup> The Puerto Rico Conservation Trust Fund was established pursuant to a Memorandum of Understanding, dated December 24, 1968, between the United States Department of the Interior and the Commonwealth of Puerto Rico.

## REASONS FOR CHANGE

Under current law, wholesale importers of distilled spirits are not required to pay the Federal excise tax on imported spirits until after the product is removed from a bonded warehouse for sale to a retailer. In contrast, the tax on domestically produced spirits is included as part of the purchase price and passed on from the supplier to wholesaler. It is the Committee's understanding that in some instances, wholesalers can carry this tax-paid inventory for an average of 60 days before selling it to a retailer. The Committee believes it is appropriate to provide an income tax credit to approximate the interest charge—more commonly referred to as float—that results from carrying tax-paid distilled spirits in inventory.

## EXPLANATION OF PROVISION

The provision creates a new income tax credit for eligible wholesalers, distillers, and importers, of distilled spirits. The credit is calculated by multiplying the number of cases of bottled distilled spirits by the average tax-financing cost per case for the most recent calendar year ending before the beginning of such taxable year. A case is 12 80-proof 750-milliliter bottles. The average tax-financing cost per case is the amount of interest that would accrue at corporate overpayment rates during an assumed 60-day holding period on an assumed tax rate of \$25.68 per case of 12 80-proof 750-milliliter bottles.

The wholesaler credit only applies to domestically bottled distilled spirits<sup>60</sup> purchased directly from the bottler of such spirits. An eligible wholesaler is any person that holds a permit under the Federal Alcohol Administration Act as a wholesaler of distilled spirits that is not a State, or agency or political subdivision thereof.

For distillers and importers that are not eligible wholesalers, the credit is limited to bottled inventory in a warehouse owned and operated by, or on behalf of, a State when title to such inventory has not passed unconditionally. The credit for distillers and importers applies to distilled spirits bottled both domestically and abroad.

The credit is in addition to present-law rules allowing tax included in inventory costs to be deducted as a cost of goods sold.

The credit is treated as part of the general business credits.

## EFFECTIVE DATE

The provision is effective for taxable years beginning after September 30, 2005.

4. Quarterly excise tax filing for small alcohol excise taxpayers (sec. 234 of the bill and sec. 5061 of the Code)

## PRESENT LAW

Excise taxes on distilled spirits, wines, and beers are collected on the basis of returns filed in accordance with rules prescribed by the Secretary of the Treasury.<sup>61</sup> Domestic producers of distilled spirits, beer, and wine are generally required to pay alcohol excise taxes within 14 days after the last day of the semi-monthly period during

<sup>60</sup> Distilled spirits that are imported in bulk and then bottled domestically qualify as domestically bottled distilled spirits.

<sup>61</sup> Sec. 5061(a).

which the article is withdrawn under a deferred payment bond.<sup>62</sup> Treasury regulations also permit certain very small wine producers to file and pay on an annual basis.<sup>63</sup> In the case of distilled spirits, wines, and beer which are imported into the United States (other than in bulk containers), the importer is generally required to pay alcohol excise taxes within 14 days after the last day of the semi-monthly period during which the article is entered into the customs territory of the United States.<sup>64</sup> In the case of imported articles entered for warehousing, the taxes are generally due within 14 days after the last day of the semi-monthly period during which the article is removed from the first such warehouse.<sup>65</sup>

Special rules apply to accelerate payments made with respect to taxes allocable to the second half of the month of September.<sup>66</sup>

#### REASONS FOR CHANGE

The Committee believes that the payment of alcohol excise taxes and filing of the related tax returns on a semi-monthly basis are a heavy burden for small businesses engaged in the production and importation of distilled spirits, wines and beers. The Committee wishes to lighten the paperwork load on these taxpayers by permitting filing and payment on a quarterly basis.

#### EXPLANATION OF PROVISION

Under the provision, domestic producers and importers of distilled spirits, wines, and beers with annual excise tax liability of \$50,000 or less attributable to alcohol may file returns and pay taxes within 14 days after the end of the calendar quarter instead of on a semi-monthly basis. In order to qualify, the taxpayer's tax liability for such taxes during the immediately preceding year must have been \$50,000 or less, and, as of the beginning of the current calendar year, the taxpayer must reasonably expect to pay less than \$50,000 in such taxes for that year. The provision does not apply to a taxpayer for any portion of the calendar year following the first date on which the aggregate amount of tax due for that year exceeds the \$50,000 threshold.

The special rules accelerating payments for taxes allocable to the second half of September do not apply to quarterly filers under the proposal.

Very small wine producers may still file and pay on an annual basis as under present law.

#### EFFECTIVE DATE

The provision is effective for quarterly periods beginning January 1, 2006.

<sup>62</sup> Sec. 5061(d)(1).

<sup>63</sup> Annual filing and payment is permitted to a wine producer who has not given a deferred payment bond, and who either paid wine excise taxes in an amount less than \$1,000 during the previous calendar year or is a proprietor of a new bonded wine premise and expects to pay less than \$1,000 in wine excise taxes before the end of the calendar year. 27 CFR sec. 24.273(a).

<sup>64</sup> Sec. 5061(d)(2)(A).

<sup>65</sup> Sec. 5061(d)(2)(B).

<sup>66</sup> Sec. 5061(d)(4).

## E. SPORT EXCISE TAXES

## 1. Custom gunsmiths (sec. 241 of the bill and sec. 4182 of the Code)

## PRESENT LAW

The Code imposes an excise tax upon the sale by the manufacturer, producer or importer of certain firearms and ammunition.<sup>67</sup> Pistols and revolvers are taxable at 10 percent. Firearms (other than pistols and revolvers), shells, and cartridges are taxable at 11 percent. The excise tax for firearms imposed on manufacturers, producers, and importers does not apply to machine guns and short barreled firearms. Sales to the Defense Department of firearms, pistols, revolvers, shells and cartridges also are exempt from the tax.

## REASONS FOR CHANGE

Many custom gunsmiths do not actually make new guns, rather they remodel or refurbish existing firearms. The provision establishes an exemption from the excise tax for manufacturers of fewer than 50 firearms per year. The Committee believes two objectives are accomplished under the provisions. First, this provision eliminates the imposition of the excise tax on custom gunmakers, and second, it eliminates an administrative burden placed on small businesses.

## EXPLANATION OF PROVISION

The provision exempts from the firearms excise tax firearms, pistols, and revolvers manufactured, produced, or imported by a person who manufactures, produces, and imports less than 50 of such articles during the calendar year. Controlled groups are treated as a single person for determining the 50-article limit.

## EFFECTIVE DATE

The provision is effective for articles sold by the manufacturer, producer, or importer after September 30, 2005. No inference is intended from the prospective effective date of this provision as to the proper treatment of pre-effective date sales.

## TITLE III—MISCELLANEOUS PROVISIONS

## A. MOTOR FUEL TAX ENFORCEMENT ADVISORY COMMISSION

(sec. 301 of the bill)

## PRESENT LAW

Present law does not require that there be an advisory commission on motor tax fuel enforcement.

## REASONS FOR CHANGE

The Committee believes that motor fuel tax administration can be improved through the cooperation and shared experiences of the various stakeholders in motor fuel tax enforcement. Therefore, the Committee believes it appropriate to create an advisory commission

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<sup>67</sup>Sec. 4181.

for motor fuel tax enforcement consisting of both Government and private sector members.

#### EXPLANATION OF PROVISION

The provision establishes a “Motor Fuel Tax Enforcement Advisory Commission” (the “Commission”). The purpose of the Commission is to (1) review motor fuel revenue collections, historical and current, (2) review the progress of investigations (3) develop and review legislative proposals with respect to motor fuel taxes, (4) monitor the progress of administrative regulation projects relating to fuel taxes, (5) review the results Federal and State agency cooperative efforts regarding motor fuel taxes, and (6) review the results of Federal interagency cooperative efforts regarding motor fuel taxes. The Commission also is to evaluate and make recommendations regarding (1) the effectiveness of existing Federal enforcement programs regarding motor fuel taxes, (2) enforcement personnel allocation, and (3) proposals for regulatory projects, legislation, and funding.

The Commission is to be composed of the following:

1. At least one representative from each of the following Federal entities: the Department of Homeland Security, the Department of Transportation—Office of Inspector General, the Federal Highway Administration, the Department of Defense, and the Department of Justice.
2. At least one representative from the Federation of State Tax Administrators,
3. At least one representative from any State Department of Transportation,
4. Two representatives from the highway construction industry,
5. Six representatives from industries relating to fuel distribution: refiners (2 representatives), distributors (1 representative), pipelines (1 representative), terminal operators (2 representatives),
6. One representative from the retail fuel industry, and
7. Two representatives each from the staff of the Senate Committee on Finance and the House Committee on Ways and Means.

Members of the Commission are to be appointed by the Senate Committee on Finance and the House Committee on Ways and Means. Representatives from the Department of Treasury and the IRS shall be available to consult with the Commission upon request. The Commission is to terminate after September 30, 2009.

#### EFFECTIVE DATE

The provision is effective on the date of enactment.

#### B. NATIONAL SURFACE TRANSPORTATION INFRASTRUCTURE FINANCING COMMISSION

(Sec. 302 of the bill)

#### PRESENT LAW

Present law does not provide for any advisory commissions related Federal highway or mass transit funding.



## REASONS FOR CHANGE

The Committee observes that, as the fuel economy of the nation's vehicular fleet improves, receipts flowing to the Highway Trust Fund will not grow commensurately with highway use. At the same time, the Committee recognizes that the nation's need for transportation infrastructure improvements are great. The Committee believes now is the time to engage in a review of the nation's long-term transportation infrastructure needs and a thoughtful reassessment of how to finance those needs.

## EXPLANATION OF PROVISION

The provision establishes a "National Surface Transportation Infrastructure Financing Commission" (the "Financing Commission"). The Financing Commission is to be composed of 15 members drawn from among individuals knowledgeable in the fields of public transportation finance or highway and transit programs, policy, and needs. Financing Commission members may include representatives of State and local governments or other public transportation agencies, representatives of the transportation construction industry, providers of transportation, persons knowledgeable in finance, and users of highway and transit systems. The 15 members will be appointed as follows:

1. The Secretary of Transportation, in consultation with the Secretary of the Treasury, will appoint seven members;
2. The chairman of the House Committee on Ways and Means will appoint two members;
3. The ranking minority member of the House Committee on Ways and Means will appoint two members;
4. The chairman of the Senate Committee on Finance will appoint two members; and
5. The ranking minority member of the Senate Committee on Finance will appoint two members.

The Financing Commission will make an investigation and study of revenues flowing into the Highway Trust Fund under present law, including the individual components of the flow of such revenues. The Financing Commission will consider whether the amount of such revenues is likely to increase, decline or remain unchanged absent changes in the law, particularly by taking into account the impact of possible changes in consumers' vehicle choice, fuel use or travel alternatives that could be expected to reduce or increase revenues in to the Highway Trust Fund. The Financing Commission will consider alternative approaches to generating revenues for the Highway Trust Fund, and the level of revenues that such alternatives would yield. The Financing Commission will consider highway and transit needs and whether additional revenues into the Highway Trust Fund, or other Federal revenues dedicated to highway and transit infrastructure, would be required in order to meet such needs. The Financing Commission's study should address the period between the present and through the year 2015.

Based on such investigation and study, the Financing Commission will develop a final report, with recommendations and the bases for those recommendations, indicating policies that the Congress may consider to achieve various levels of annual revenue for the Highway Trust Fund and to enable the Highway Trust Fund

to receive revenues sufficient to meet highway and transit needs. The Financing Commission's recommendations will address: (1) what levels of revenue are required by the Highway Trust Fund in order for it to meet needs to maintain and improve the condition and performance of the nation's highway and transit systems; (2) what levels of revenue are required by the Highway Trust Fund in order to ensure that Federal levels of investment in highways and transit do not decline in real terms; and (3) the extent, if any, to which the Highway Trust Fund should be augmented by other mechanisms or funds as a Federal means of financing highway and transit infrastructure investments.

The Financing Commission will submit its report and recommendations within two years of the date of its first meeting to the Secretary of Transportation, the Secretary of the Treasury, the House Committee on Ways and Means, Senate Committee on Finance, the House Committee on Transportation and Infrastructure, the Senate Committee on Environment and Public Works, and Senate Committee on Banking, Housing, and Urban Affairs. The Financing Commission will hold its first meeting within 90 days of the appointment of the eighth individual to the Financing Commission and the Financing Commission will terminate on the 180th day following the transmittal of its report and recommendations.

#### EFFECTIVE DATE

The provision is effective on the date of enactment.

#### C. EXPAND HIGHWAY TRUST FUND EXPENDITURE PURPOSES TO INCLUDE FUNDING FOR STUDIES OF SUPPLEMENTAL OR ALTERNATIVE FINANCING FOR THE HIGHWAY TRUST FUND

(Sec. 303 of the bill)

#### PRESENT LAW

##### *In general*

Dedication of excise tax revenues to the Highway Trust Fund and expenditures from the Highway Trust Fund are governed by provisions of the Code (sec. 9503).<sup>68</sup> The Code authorizes expenditures (subject to appropriations) from the Fund through May 31, 2005, for the purposes provided in authorizing legislation, as in effect on the date of enactment of the Surface Transportation Extension Act of 2004, Part V.

The Highway Trust Fund has a subaccount for Mass Transit. Both the Trust Fund and its subaccount are funding sources for specific programs.

Highway Trust Fund expenditure purposes have been revised with each authorization Act enacted since establishment of the Highway Trust Fund in 1956. In general, expenditures authorized under those Acts (as the Acts were in effect on the date of enactment of the most recent such authorizing Act) are approved by the Code as Highway Trust Fund expenditure purposes.<sup>69</sup>

<sup>68</sup>The Highway Trust Fund statutory provisions were placed in the Internal Revenue Code in 1982.

<sup>69</sup>The authorizing Acts which currently are referenced in the Highway Trust Fund provisions of the Code are: the Highway Revenue Act of 1956, Titles I and II of the Surface Transportation Assistance Act of 1982, the Surface Transportation and Uniform Relocation Act of 1987, the

*Highway Trust Fund expenditure purposes*

The Highway Trust Fund receives revenues from all non-fuel highway transportation excise taxes and revenues from all but 2.86 cents per gallon of the highway motor fuels excise taxes transferred to the Highway Trust Fund. Programs financed from the Highway Trust Fund (excluding the Mass Transit account) include:

1. Interstate maintenance program;
2. National Highway System;
3. The bridge program (bridge replacement and repair);
4. Surface transportation programs;
5. Congestion mitigation and air quality improvement program;
6. Highway safety programs and research and development, including a share of the cost of National Highway Traffic Safety Administration ("NHTSA") programs and university research centers;
7. Appalachian development highway system program;
8. Recreational trails program;
9. Federal lands highways program;
10. National corridor planning and development and coordinated border infrastructure programs;
11. Construction of ferry boats and ferry terminal facilities;
12. National scenic byways program;
13. Value pricing pilot program;
14. High priority projects program;
15. Highway use tax evasion projects;
16. Commonwealth of Puerto Rico highway program.

Certain administrative costs of the Federal Highway Administration and NHTSA are also funded from the Highway Trust Fund.

*Mass Transit Account expenditure purposes*

The Highway Fund's Mass Transit Account receives revenues equivalent to 2.86 cents per gallon of the highway motor fuels excise taxes. Mass Transit Account monies are available through May 31, 2005, for capital and capital-related expenditures under sections 5338(a)(1) and (b)(1) of Title 49, United States Code, the Intermodal Surface Transportation Efficiency Act of 1991, the Transportation Equity Act for the 21st Century, the Surface Transportation Extension Act of 2003, the Surface Transportation Extension Act of 2004; the Surface Transportation Extension Act of 2004, Part II; the Surface Transportation Extension Act of 2004, Part III; the Surface Transportation Extension Act of 2004, Part IV; and the Surface Transportation Extension Act of 2004, Part V; as those provisions were in effect on the date of enactment of the Surface Transportation Extension Act of 2004, Part V.

## REASONS FOR CHANGE

The Committee notes that the United States has relied primarily on motor fuels taxes as the basis of funding Federal highway programs for more than 50 years. The Committee understands that it

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Intermodal Surface Transportation Efficiency Act of 1991 and the Transportation Equity Act for the 21st Century, the Surface Transportation Extension Act of 2003, the Surface Transportation Extension Act of 2004; the Surface Transportation Extension Act of 2004, Part II; the Surface Transportation Extension Act of 2004, Part III; the Surface Transportation Extension Act of 2004, Part IV; and the Surface Transportation Extension Act of 2004, Part V.

has been at least two decades since the Department of Transportation has attempted an extensive study of an allocation of costs of the Federal highway system. The Committee believes it is important to examine alternative methods of funding highway construction.

#### EXPLANATION OF PROVISION

The provision expands the expenditure authority and authorizes the expenditure of monies from the Highway Trust Fund to fund two comprehensive studies of supplemental or alternative funding sources for the Highway Trust Fund. One study, to receive \$1 million in funding, will review funding mechanisms of other industrialized nations and examine the viability of proposals such as congestion pricing, greater reliance on tolls, privatization of facilities, and other funding proposals. This study would be due no later than December 31, 2006. The other study, to receive \$16.5 million in funding, would report on a long-term field test of a new approach to assessing highway use taxes by use of an on-board computer that links to satellites to calculate road mileage traversed and compute the appropriate highway use tax for each of the Federal, State, and local government as the vehicle makes use of the roads. The vehicle owner would periodically download the data from the on-board computer to a collection center and the collection center would assess highway use taxes due in each jurisdiction traversed. The results of this study would be due no later than December 31, 2011. Each study would be delivered to the Secretary of the Treasury and the Secretary of Transportation.

#### EFFECTIVE DATE

The provision is effective upon date of enactment.

#### D. DELTA REGIONAL TRANSPORTATION PLAN

(Sec. 304 of the bill)

#### PRESENT LAW

The Delta Regional Authority is a Federal-State partnership, serving a 240-county/parish area in an eight-State region.<sup>70</sup> No State is required to participate with the authority. The duties of the authority are to: (1) produce a regional development plan; (2) set priorities for approval of grants in the region; (3) assess the region's needs and assets; (4) inform participating States about interstate cooperation; (5) work with States and local agencies to develop model legislation; (6) enhance the capacity of and support Local Development Districts, as well as the creation of Local Development Districts where none currently exist; (7) encourage private investment in economic development projects in the region; and (8) assist State governments with the States' economic development program.

<sup>70</sup>The covered States and counties are: Alabama—20 counties; Arkansas—42 counties; Illinois, 16 counties; Kentucky—21 counties; Louisiana—46 parishes; Mississippi—45 counties; Missouri—29 counties; and Tennessee—21 counties. Delta Regional Authority, Legislative Matters and Overview, (February 1, 2000)<[www.dra.gov/legislation.php](http://www.dra.gov/legislation.php)>.

## REASONS FOR CHANGE

The Committee believes that integrated transportation planning for the States comprising the Delta region is an important objective. The Committee believes it is appropriate to charge the Delta Regional Authority with studying the transportation needs of the region and preparing a plan to address those needs.

## EXPLANATION OF PROVISION

The provision directs the Delta Regional Authority to conduct a comprehensive study of transportation assets and needs in the eight states comprising the Delta region (Alabama, Arkansas, Illinois, Kentucky, Louisiana, Mississippi, Missouri, and Tennessee). Upon completion of the study, the Delta Regional Authority is to create a regional strategic plan to achieve efficient transportation systems in the Delta region.

The study and plan is to include but is not limited to the following transportation modes and systems: transit, rail, highway, interstate, bridges, air, airports, waterways and ports. The Delta Regional Authority is to work with local planning and development districts, local and regional governments, metropolitan planning organizations, State transportation entities, and Federal transportation agencies to develop a regional strategic transportation plan.

The provision authorizes the Delta Regional Authority to receive \$500,000 in fiscal year 2005, and \$500,000 in fiscal year 2006 to conduct a comprehensive study and plan. These funds are to remain available until spent.

## EFFECTIVE DATE

The provision is effective on the date of enactment.

## E. ESTABLISH BUILD AMERICA CORPORATION

(Sec. 305 of the bill)

## PRESENT LAW

There is no provision in Federal law establishing a nonprofit corporation dedicated to providing financing or other financial support for transportation infrastructure projects.

## REASONS FOR CHANGE

The Committee believes that the establishment, maintenance, and improvement of the national transportation network are a national priority. Investing in transportation infrastructure creates long-term capital assets for the nation that will help address its enormous infrastructure needs and improves its economic productivity. The Committee believes that financing for long-term infrastructure capital investments are not currently being met by existing investment programs. Thus, the Committee believes it is important to establish a corporation dedicated to providing financial support to transportation and infrastructure projects.

## EXPLANATION OF PROVISION

The provision establishes a nonprofit corporation, to be known as the "Build America Corporation." The Build America Corporation is

not an agency or establishment of the United States Government. The Build America Corporation generally shall be subject to the laws of the State of Delaware applicable to corporations not for profit.

The purpose of the corporation is to provide financial support for qualified projects. Under the provision a “qualified project” generally is defined as any transportation infrastructure project of any governmental unit or other person that is proposed by a State, including a highway project, a transit system project, a railroad project, an airport project, a port project, and an inland waterways project. The provision imposes additional requirements if a qualified project is financed by debt issued by the Build America Corporation.

#### EFFECTIVE DATE

The provision is effective on the date of enactment.

#### F. INCREASE IN DOLLAR LIMITS FOR QUALIFIED TRANSPORTATION FRINGE BENEFITS

(Sec. 306 of the bill and sec. 132(f) of the Code)

#### PRESENT LAW

Under present law, qualified transportation benefits are excludable from gross income and wages for employment tax purposes. Qualified transportation benefits are: (1) transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee’s residence and place of employment (“van pooling”); (2) transit passes; and (3) qualified parking. For purposes of the exclusion for van pooling benefits, a commuter highway vehicle is any highway vehicle: (1) the seating capacity of which is at least six adults (excluding the driver); and (2) at least 80 percent of the mileage use of which can reasonably be expected to be (a) for purposes of transporting employees in connection with travel between their residences and their place of employment and (b) on trips during which the number of employees transported for such purposes is at least one-half of the adult seating capacity of such vehicle (not including the driver).

The maximum amount of qualified parking that is excludable from income and wages is \$200 per month (for 2005). The maximum amount of transit passes and van pooling benefits that are excludable from income and wages per month is \$105 (for 2005). These dollar amounts are indexed for inflation.

#### REASONS FOR CHANGE

The Committee believes that the use of van pooling and mass transit should be encouraged. Thus, the Committee believes that the maximum amount of excludable van pooling and transit pass benefits should be increased. The Committee also believes that it is appropriate to use consistent inflation adjustments in the determination of the amount of qualified transportation fringe benefits.

#### EXPLANATION OF PROVISION

Under the provision, the maximum dollar amount of excludable van pooling and transit pass benefits is increased to \$155 per

month. The maximum amount of excludable qualified parking is \$200 per month. The dollar amounts are indexed for inflation after 2008 (with 2007 as a base year).

#### EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2005.

### TITLE IV—FUELS-RELATED TECHNICAL CORRECTIONS

#### A. FUELS-RELATED TECHNICAL CORRECTIONS TO AMERICAN JOBS CREATION ACT OF 2004 (“AJCA”)

The provision includes two technical corrections to AJCA, described below. Such technical corrections take effect as if included in the section of AJCA to which the correction relates.

1. Volumetric ethanol excise tax credit (sec. 401 of the bill, sec. 301 of AJCA, and sec. 6427 of the Code)

AJCA repealed the reduced tax rates for alcohol fuels and taxable fuels to be blended with alcohol. The technical correction makes a conforming amendment to eliminate the refund provisions based on those reduced rates (secs. 6427(f) and 6427(o)).

2. Aviation fuel (sec. 401 of the bill, sec. 853 of AJCA, and sec. 4081 of the Code)

Section 853 of the AJCA moved the taxation of jet fuel (aviation-grade kerosene) from section 4091 to section 4081 of the Code and repealed section 4091. The termination date for the 21.8 cent per gallon rate for noncommercial aviation jet fuel was inadvertently omitted from the Act. The technical correction clarifies that after September 30, 2007, the rate for jet fuel used in noncommercial aviation will be 4.3 cents per gallon (sec. 4081(d)(2)).

An additional technical correction clarifies that users of aviation fuel in commercial aviation are required to be registered with the IRS in order for the 4.3-cents-per-gallon rate to apply (including for purposes of the self-assessment of tax by commercial aircraft operators) (sec. 4081(a)(2)(C)).

#### B. FUELS-RELATED TECHNICAL CORRECTIONS TO TRANSPORTATION EQUITY ACT FOR THE 21ST CENTURY (“TEA 21”)

The provision includes a technical correction to TEA 21, described below. The technical correction takes effect as if included in the section of TEA 21 to which it relates.

1. Coastal Wetlands sub-account (sec. 401 of the bill, sec. 9005 of TEA 21, and sec. 9504 of the Code)

Section 9005(b)(3) of TEA 21 redesignated Code section 9504(b)(2)(B), referring to the purposes of the Coastal Wetlands Planning, Protection and Restoration Act, as 9504(b)(2)(C), but did not cross reference the limitation for such purposes of taxes on gasoline used in the nonbusiness use of small-engine outdoor power equipment. The technical correction makes a conforming cross-reference amendment (sec. 9504(b)(2)).

## TITLE V—REVENUE OFFSET PROVISIONS

## A. TREATMENT OF CONTINGENT PAYMENT CONVERTIBLE DEBT INSTRUMENTS

(Sec. 501 of the bill and sec. 1275 of the Code)

## PRESENT LAW

Under present law, a taxpayer generally deducts the amount of interest paid or accrued within the taxable year on indebtedness issued by the taxpayer. In the case of original issue discount (“OID”), the issuer of a debt instrument generally accrues and deducts, as interest, the OID over the life of the obligation, even though the amount of the OID may not be paid until the maturity of the instrument.

The amount of OID with respect to a debt instrument is equal to the excess of the stated redemption price at maturity over the issue price of the debt instrument. The stated redemption price at maturity includes all amounts that are payable on the debt instrument by maturity. The amount of OID with respect to a debt instrument is allocated over the life of the instrument through a series of adjustments to the issue price for each accrual period. The adjustment to the issue price is determined by multiplying the adjusted issue price (i.e., the issue price increased or decreased by adjustments prior to the accrual period) by the instrument’s yield to maturity, and then subtracting any payments on the debt instrument (other than non-OID stated interest) during the accrual period. Thus, in order to compute the amount of OID and the portion of OID allocable to a particular period, the stated redemption price at maturity and the time of maturity must be known. Issuers of debt instruments with OID accrue and deduct the amount of OID as interest expense in the same manner as the holders of such instruments accrue and include in gross income the amount of OID as interest income.

Treasury regulations provide special rules for determining the amount of OID allocated to a period with respect to certain debt instruments that provide for one or more contingent payments of principal or interest.<sup>71</sup> The regulations provide that a debt instrument does not provide for contingent payments merely because it provides for an option to convert the debt instrument into the stock of the issuer, into the stock or debt of a related party, or into cash or other property in an amount equal to the approximate value of such stock or debt.<sup>72</sup> The regulations also provide that a payment is not a contingent payment merely because of a contingency that, as of the issue date of the debt instrument, is either remote or incidental.<sup>73</sup>

In the case of contingent payment debt instruments that are issued for money or publicly traded property,<sup>74</sup> the regulations provide that interest on a debt instrument must be taken into account (as OID) whether or not the amount of any payment is fixed or determinable in the taxable year. The amount of OID that is taken

<sup>71</sup>Treas. Reg. sec. 1.1275-4.

<sup>72</sup>Treas. Reg. sec. 1.1275-4(a)(4).

<sup>73</sup>Treas. Reg. sec. 1.1275-4(a)(5).

<sup>74</sup>Treas. Reg. sec. 1.1275-4(b).



into account for each accrual period is determined by constructing a comparable yield and a projected payment schedule for the debt instrument, and then accruing the OID on the basis of the comparable yield and projected payment schedule by applying rules similar to those for accruing OID on a noncontingent debt instrument (the “noncontingent bond method”). If the actual amount of a contingent payment is not equal to the projected amount, appropriate adjustments are made to reflect the difference. The comparable yield for a debt instrument is the yield at which the issuer would be able to issue a fixed-rate noncontingent debt instrument with terms and conditions similar to those of the contingent payment debt instrument (i.e., the comparable fixed-rate debt instrument), including the level of subordination, term, timing of payments, and general market conditions.<sup>75</sup>

With respect to certain debt instruments that are convertible into the common stock of the issuer and that also provide for contingent payments (other than the conversion feature)—often referred to as “contingent convertible” debt instruments—the IRS has stated that the noncontingent bond method applies in computing the accrual of OID on the debt instrument.<sup>76</sup> In applying the noncontingent bond method, the IRS has stated that the comparable yield for a contingent convertible debt instrument is determined by reference to a comparable fixed-rate nonconvertible debt instrument, and the projected payment schedule is determined by treating the issuer stock received upon a conversion of the debt instrument as a contingent payment.

#### REASONS FOR CHANGE

The Committee is aware that, in recent years, several corporate taxpayers have issued convertible debt instruments that also include a separate contingent feature, usually consisting of an interest rate reset provision. The Committee understands that the primary intent of these corporations is simply to issue straight convertible debt instruments, and that the contingency is unlikely to have any meaningful impact on either the stated interest rate or overall economic yield of the debt instrument. Rather, the contingency is incorporated into the financing for the purpose of subjecting the debt instrument to the contingent payment OID regulations, which would not otherwise apply solely on the basis of the conversion feature. As with straight convertible debt instruments, the stated interest rate on contingent payment convertible debt instruments typically is substantially less than the stated interest rate would be on a nonconvertible debt instrument, usually less than 400 basis points.

The Committee is aware that, in determining the comparable yield on contingent payment convertible debt instruments under the contingent payment OID regulations, borrowers and their advisors take the position that the regulations call for using a comparable noncontingent debt instrument that is also nonconvertible. The net effect of applying the contingent payment OID regulations in this manner (i.e., determining the comparable yield on the basis of a noncontingent, nonconvertible—rather than noncontingent,

<sup>75</sup>Treas. Reg. sec. 1.1275-4(b)(4)(i)(A).

<sup>76</sup>Rev. Rul. 2002-31, 2002-1 C.B. 1023.

convertible—debt instrument), is to significantly and artificially enhance the interest deductions generated by what is essentially a straight convertible debt instrument. Because the corresponding interest income inclusions to holders of these debt instruments likewise is significantly and artificially enhanced, the Committee understands that the debt instruments almost exclusively are sold to and purchased by tax indifferent holders.

Notwithstanding the endorsement of the taxpayer position by the IRS in Rev. Rul. 2002–31, the Committee believes that applying the contingent payment OID regulations in this manner is inappropriate, from an economic standpoint and based upon a reasonable interpretation of the plain meaning of the regulations. Furthermore, applying the regulations in this manner creates disparate tax treatment between contingent payment convertible debt instruments and straight convertible debt instruments that differ only on the basis of an economically meaningless contingency.

The Committee believes that the methodology mandated by this provision would require the comparable yield on a contingent payment convertible debt instrument to be based upon a truly comparable noncontingent debt instrument (i.e., one that is convertible, like the actual debt instrument issued by the taxpayer). This methodology would provide parity between straight convertible debt instruments and contingent payment convertible debt instruments, and eliminate the unwarranted tax benefits that are currently attained merely by incorporating an essentially meaningless contingency into an otherwise ordinary convertible debt instrument.

In its ruling, the IRS indicated that determining the comparable yield on contingent payment convertible debt instruments based upon a contingent nonconvertible debt instrument is more consistent with the overall economic rationale of the contingent payment OID regulations. However, the Committee believes that this view incorrectly assumes that the economic rationale of these regulations deviates from the rest of the OID rules—and, for that matter, general tax principles—in giving tax significance to a conversion feature in a debt instrument. The Committee recognizes that contingent payment convertible debt instruments highlight a potential flaw in the current tax system whereby both the Code and general tax principles typically disregard the economic yield provided by convertibility features in debt instruments. However, the Committee believes that this issue should be addressed legislatively through comprehensive reform of the tax treatment of financial products, rather than through administrative acquiescence in taxpayer self-help that is achieved using a particular financial product designed specifically to obtain a favorable tax result, particularly if that result is in conflict with the current operation of the Code and general tax principles.

#### EXPLANATION OF PROVISION

The provision provides that, in the case of a contingent convertible debt instrument,<sup>77</sup> any Treasury regulations which require OID to be determined by reference to the comparable yield of a noncontingent fixed-rate debt instrument shall be applied as re-

<sup>77</sup> Under the provision, a contingent convertible debt instrument is defined as a debt instrument that: (1) is convertible into stock of the issuing corporation, or a corporation in control of, or controlled by, the issuing corporation; and (2) provides for contingent payments.

quiring that such comparable yield be determined by reference to a noncontingent fixed-rate debt instrument which is convertible into stock. For purposes of applying the provision, the comparable yield shall be determined without taking into account the yield resulting from the conversion of a debt instrument into stock. Thus, the noncontingent bond method in the Treasury regulations shall be applied in a manner such that the comparable yield for contingent convertible debt instruments shall be determined by reference to comparable noncontingent fixed-rate convertible (rather than nonconvertible) debt instruments.

#### EFFECTIVE DATE

The provision is effective for debt instruments issued on or after date of enactment.

#### B. FRIVOLOUS TAX SUBMISSIONS

(Sec. 502 of the bill and sec. 6702 of the Code)

#### PRESENT LAW

The Code provides that an individual who files a frivolous income tax return is subject to a penalty of \$500 imposed by the IRS.<sup>78</sup> The Code also permits the Tax Court<sup>79</sup> to impose a penalty of up to \$25,000 if a taxpayer has instituted or maintained proceedings primarily for delay or if the taxpayer's position in the proceeding is frivolous or groundless.<sup>80</sup>

#### REASONS FOR CHANGE

Effective tax administration is hindered by the significant number of tax returns and other submissions the IRS routinely receives that are based on frivolous arguments. Despite constant efforts by the IRS to provide public notice and guidance debunking frivolous arguments, these arguments have become tax lore—such as arguments that the income tax is unconstitutional, that taxes may be withheld as a protest against government programs, and that taxpayers may obtain a refund of all Social Security taxes paid by waiving their right to Social Security benefits. Injecting frivolous arguments into existing procedures for collection due process hearings, offers-in-compromise, installment agreements, and taxpayer assistance is a common means to impede and delay tax administration. IRS administrative procedures are intended to provide assistance to taxpayers genuinely seeking to resolve legitimate disputes with the IRS, and the abuse of these procedures as described diverts scarce IRS resources away from resolving genuine disputes.

The Committee believes the IRS needs a more significant penalty to deter the routine assertion of frivolous tax filings and other submissions. The Committee believes that frivolous returns and submissions consume resources at the IRS and in the courts that can better be utilized in resolving legitimate disputes with taxpayers. Expanding the scope of the penalty to cover all taxpayers and tax

<sup>78</sup> Sec. 6702.

<sup>79</sup> Because the Tax Court generally is the only pre-payment forum available to taxpayers, it hears most of the frivolous, groundless, or dilatory arguments raised in tax cases.

<sup>80</sup> Sec. 6673(a).

returns promotes fairness in the tax system. The Committee believes that this provision will improve effective tax administration.

#### EXPLANATION OF PROVISION

The provision modifies the IRS-imposed penalty by increasing the amount of the penalty to up to \$5,000 and by applying it to all taxpayers and to all types of Federal taxes.

The provision also modifies present law with respect to certain submissions that raise frivolous arguments or that are intended to delay or impede tax administration. The submissions to which this provision applies are requests for a collection due process hearing, installment agreements, offers-in-compromise, and taxpayer assistance orders. First, the provision permits the IRS to dismiss such requests. Second, the provision permits the IRS to impose a penalty of up to \$5,000 for such requests, unless the taxpayer withdraws the request after being given an opportunity to do so.

The provision requires the IRS to publish a list of positions, arguments, requests, and submissions determined to be frivolous for this purpose.

#### EFFECTIVE DATE

The provision is effective with respect to submissions made and issues raised after the date on which the Secretary first prescribes the required list of frivolous positions.

#### C. INCREASE IN CERTAIN CRIMINAL PENALTIES

(Sec. 503 of the bill and secs. 7201, 7203, and 7206 of the Code)

##### PRESENT LAW

##### *Attempt to evade or defeat tax*

In general, section 7201 imposes a criminal penalty on persons who willfully attempt to evade or defeat any tax imposed by the Code. Upon conviction, the Code provides that the penalty is up to \$100,000 or imprisonment of not more than five years (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of \$500,000.

##### *Willful failure to file return, supply information, or pay tax*

In general, section 7203 imposes a criminal penalty on any person required to make estimated tax payments, pay taxes, keep records, or supply information under the Code who willfully fails to do so. Upon conviction, the Code provides that the penalty is up to \$25,000 or imprisonment of not more than one year (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of \$100,000.

##### *Fraud and false statements*

In general, section 7206 imposes a criminal penalty on persons who make fraudulent or false statements under the Code. Upon conviction, the Code provides that the penalty is up to \$100,000 or imprisonment of not more than three years (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of \$500,000.

*Uniform sentencing guidelines*

Under the uniform sentencing guidelines established by 18 U.S.C. 3571, a defendant found guilty of a criminal offense is subject to a maximum fine that is the greatest of: (a) the amount specified in the underlying provision, (b) for a felony<sup>81</sup> \$250,000 for an individual or \$500,000 for an organization, or (c) twice the gross gain if a person derives pecuniary gain from the offense. This Title 18 provision applies to all criminal provisions in the United States Code, including those in the Internal Revenue Code. For example, for an individual, the maximum fine under present law upon conviction of violating section 7206 is \$250,000 or, if greater, twice the amount of gross gain from the offense.

## REASONS FOR CHANGE

Criminal tax penalties for the three basic tax crimes have not been updated since 1982. Since then, tax evasion, fraud, and other abusive schemes have steadily increased in magnitude and sophistication. Additionally, non-filing has consistently remained a major component of the tax gap. The Committee believes it is important to strengthen the criminal tax penalties as a means to maintain an appropriate deterrent to these crimes, punish more harshly the most egregious tax violators, and contribute towards closing the tax gap. The Committee also believes the creation of an enhanced penalty for aggravated failures to file is appropriate to address egregious instances of noncompliant behavior.

## EXPLANATION OF PROVISION

*Attempt to evade or defeat tax*

The provision increases the criminal penalty under section 7201 of the Code for individuals to \$500,000 and for corporations to \$1,000,000. The provision increases the maximum prison sentence to ten years.

*Willful failure to file return, supply information, or pay tax*

The provision increases the criminal penalty under section 7203 of the Code from a misdemeanor to a felony for aggravated failures to file. Under the provision, an aggravated failure to file is any case in which the taxpayer fails to file returns for three or more consecutive years and the aggregated tax liability during such years is \$100,000 or greater. The provision imposes a penalty for an aggravated failure to file up to \$500,000 for individuals and up to \$1,000,000 for corporations. The provision also imposes a maximum prison sentence of ten years.

In misdemeanor cases, the provision increases the criminal penalty under section 7203 of the Code for individuals to \$50,000.

*Fraud and false statements*

The provision increases the criminal penalty under section 7206 of the Code for individuals to \$500,000 and for corporations to \$1,000,000. The provision increases the maximum prison sentence to five years. The provision also provides that in no event shall the

<sup>81</sup>Section 7206 states that making fraudulent or false statements under the Code is a felony. In addition, this offense is a felony pursuant to the classification guidelines of 18 U.S.C. 3559(a)(5).

amount of the monetary penalty under this provision be less than the amount of the underpayment or overpayment attributable to fraud.

#### EFFECTIVE DATE

The provision is effective for actions and failures to act occurring after the date of enactment.

#### D. DOUBLING OF CERTAIN PENALTIES, FINES, AND INTEREST ON UNDERPAYMENTS RELATED TO CERTAIN OFFSHORE FINANCIAL ARRANGEMENTS

(Sec. 504 of the bill)

#### PRESENT LAW

##### *In general*

The Code contains numerous civil penalties, such as the delinquency, accuracy-related, fraud, and assessable penalties. These civil penalties are in addition to any interest that may be due as a result of an underpayment of tax. If all or any part of a tax is not paid when due, the Code imposes interest on the underpayment, which is assessed and collected in the same manner as the underlying tax and is subject to the respective statutes of limitations for assessment and collection.

##### *Delinquency penalties*

*Failure to file.*—Under present law, a taxpayer who fails to file a tax return on a timely basis is generally subject to a penalty equal to 5 percent of the net amount of tax due for each month that the return is not filed, up to a maximum of five months or 25 percent. An exception from the penalty applies if the failure is due to reasonable cause. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax.

*Failure to pay.*—Taxpayers who fail to pay their taxes are subject to a penalty of 0.5 percent per month on the unpaid amount, up to a maximum of 25 percent. If a penalty for failure to file and a penalty for failure to pay tax shown on a return both apply for the same month, the amount of the penalty for failure to file for such month is reduced by the amount of the penalty for failure to pay tax shown on a return. If a return is filed more than 60 days after its due date, then the penalty for failure to pay tax shown on a return may not reduce the penalty for failure to file below the lesser of \$100 or 100 percent of the amount required to be shown on the return. For any month in which an installment payment agreement with the IRS is in effect, the rate of the penalty is half the usual rate (0.25 percent instead of 0.5 percent), provided that the taxpayer filed the tax return in a timely manner (including extensions).

*Failure to make timely deposits of tax.*—The penalty for the failure to make timely deposits of tax consists of a four-tiered structure in which the amount of the penalty varies with the length of time within which the taxpayer corrects the failure. A depositor is subject to a penalty equal to 2 percent of the amount of the under-

payment if the failure is corrected on or before the date that is five days after the prescribed due date. A depositor is subject to a penalty equal to 5 percent of the amount of the underpayment if the failure is corrected after the date that is five days after the prescribed due date but on or before the date that is 15 days after the prescribed due date. A depositor is subject to a penalty equal to 10 percent of the amount of the underpayment if the failure is corrected after the date that is 15 days after the due date but on or before the date that is 10 days after the date of the first delinquency notice to the taxpayer (under sec. 6303). Finally, a depositor is subject to a penalty equal to 15 percent of the amount of the underpayment if the failure is not corrected on or before the date that is 10 days after the date of the day on which notice and demand for immediate payment of tax is given in cases of jeopardy.

An exception from the penalty applies if the failure is due to reasonable cause. In addition, the Secretary may waive the penalty for an inadvertent failure to deposit any tax by specified first-time depositors.

#### *Accuracy-related penalties*

*In general.*—The accuracy-related penalties are imposed at a rate of 20 percent of the portion of any underpayment that is attributable, in relevant part, to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, and (4) any reportable transaction understatement. The penalty for a substantial valuation misstatement is doubled for certain gross valuation misstatements. In the case of a reportable transaction understatement for which the transaction is not disclosed, the penalty rate is 30 percent. These penalties are coordinated with the fraud penalty. This statutory structure operates to eliminate any stacking of the penalties.

No penalty is to be imposed if it is shown that there was reasonable cause for an underpayment and the taxpayer acted in good faith, and in the case of a reportable transaction understatement the relevant facts of the transaction have been disclosed, there is or was substantial authority for the taxpayer's treatment of such transaction, and the taxpayer reasonably believed that such treatment was more likely than not the proper treatment.

*Negligence or disregard for the rules or regulations.*—If an underpayment of tax is attributable to negligence, the negligence penalty applies only to the portion of the underpayment that is attributable to negligence. Negligence means any failure to make a reasonable attempt to comply with the provisions of the Code. Disregard includes any careless, reckless or intentional disregard of the rules or regulations.

*Substantial understatement of income tax.*—Generally, an understatement is substantial if the understatement exceeds the greater of (1) 10 percent of the tax required to be shown on the return for the tax year or (2) \$5,000. In determining whether a substantial understatement exists, the amount of the understatement is reduced by any portion attributable to an item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return.

*Substantial valuation misstatement.*—A penalty applies to the portion of an underpayment that is attributable to a substantial valuation misstatement. Generally, a substantial valuation misstatement exists if the value or adjusted basis of any property claimed on a return is 200 percent or more of the correct value or adjusted basis. The amount of the penalty for a substantial valuation misstatement is 20 percent of the amount of the underpayment if the value or adjusted basis claimed is 200 percent or more but less than 400 percent of the correct value or adjusted basis. If the value or adjusted basis claimed is 400 percent or more of the correct value or adjusted basis, then the overvaluation is a gross valuation misstatement.

*Reportable transaction understatement.*—A penalty applies to any item that is attributable to any listed transaction, or to any reportable transaction (other than a listed transaction) if a significant purpose of such reportable transaction is tax avoidance or evasion.

#### *Fraud penalty*

The fraud penalty is imposed at a rate of 75 percent of the portion of any underpayment that is attributable to fraud. The accuracy-related penalty does not apply to any portion of an underpayment on which the fraud penalty is imposed.

#### *Assessable penalties*

In addition to the penalties described above, the Code imposes a number of additional penalties, including, for example, penalties for failure to file (or untimely filing of) information returns with respect to foreign trusts, and penalties for failure to disclose any required information with respect to a reportable transaction.

#### *Interest provisions*

Taxpayers are required to pay interest to the IRS whenever there is an underpayment of tax. An underpayment of tax exists whenever the correct amount of tax is not paid by the last date prescribed for the payment of the tax. The last date prescribed for the payment of the income tax is the original due date of the return.

Different interest rates are provided for the payment of interest depending upon the type of taxpayer, whether the interest relates to an underpayment or overpayment, and the size of the underpayment or overpayment. Interest on underpayments is compounded daily.

#### *Offshore Voluntary Compliance Initiative*

In January 2003, Treasury announced the Offshore Voluntary Compliance Initiative (“OVCI”) to encourage the voluntary disclosure of previously unreported income placed by taxpayers in offshore accounts and accessed through credit card or other financial arrangements. A taxpayer had to comply with various requirements in order to participate in the OVCI, including sending a written request to participate in the program by April 15, 2003. This request had to include information about the taxpayer, the taxpayer’s introduction to the credit card or other financial arrangements and the names of parties that promoted the transaction. Taxpayers entering into a closing agreement under the OVCI will not be liable for civil fraud, the fraudulent failure to file



penalty or the civil information return penalties. The taxpayer will pay back taxes, interest and certain accuracy-related and delinquency penalties.<sup>82</sup>

*Voluntary disclosure policy*

A taxpayer's timely, voluntary disclosure of a substantial unreported tax liability has long been an important factor in deciding whether the taxpayer's case should ultimately be referred for criminal prosecution. The voluntary disclosure must be truthful, timely, and complete. The taxpayer must show a willingness to cooperate (as well as actual cooperation) with the IRS in determining the correct tax liability. The taxpayer must make good-faith arrangements with the IRS to pay in full the tax, interest, and any penalties determined by the IRS to be applicable. A voluntary disclosure does not guarantee immunity from prosecution. It creates no substantive or procedural rights for taxpayers.<sup>83</sup>

REASONS FOR CHANGE

The Committee is aware that individuals and corporations, through sophisticated transactions, are placing unreported income in offshore financial accounts accessed through credit or debit cards or other financial arrangements in order to avoid or evade Federal income tax. Such a phenomenon poses a serious threat to the efficacy of the tax system because of both the potential loss of revenue and the potential threat to the integrity of the self-assessment system. The IRS estimates there may be several hundred thousand taxpayers using offshore financial arrangements to conceal taxable income from the IRS, costing the government billions of dollars in lost revenue. However, only 1,235 applications to participate in the OVCI initiative were received. From these cases, the IRS expects to identify millions of dollars of uncollected tax. At the start of the program, the clear message to taxpayers was that those who failed to come forward would be pursued by the IRS and would be subject to more significant penalties and possible criminal sanctions. The Committee believes that doubling the civil penalties, fines and interest applicable to taxpayers who entered into these arrangements and did not take advantage of OVCI will provide the IRS with the significant sanctions needed to stem the promotion of, and participation in, these abusive schemes.

EXPLANATION OF PROVISION

The provision increases by a factor of two the total amount of civil penalties, interest, and fines applicable to taxpayers who were eligible to participate in, but did not participate in, the OVCI and did not otherwise voluntarily disclose their underpayment of U.S. income tax liability through the use of certain offshore financial arrangements. Under the provision, the determination of whether any civil penalty is to be applied to such underpayment is made without regard to whether a return has been filed, whether there was reasonable cause for such underpayment, and whether the taxpayer acted in good faith.

<sup>82</sup> Rev. Proc. 2003-11, 2003-4 C.B. 311.

<sup>83</sup> Internal Revenue News Release 2002-135, IR-2002-135 (December 11, 2002).

## EFFECTIVE DATE

The provision generally is effective with respect to a taxpayer's open tax years on or after date of enactment.

E. MODIFICATION OF COORDINATION RULES FOR CONTROLLED FOREIGN CORPORATION AND PASSIVE FOREIGN INVESTMENT COMPANY REGIMES

(Sec. 505 of the bill and sec. 1297 of the Code)

## PRESENT LAW

The United States employs a “worldwide” tax system, under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income generally is deferred. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F<sup>84</sup> and the passive foreign investment company rules.<sup>85</sup> Deferral of U.S. tax is considered appropriate, on the other hand, with respect to most types of active business income earned abroad. A foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign-source income, whether earned directly by the domestic corporation, repatriated as an actual dividend, or included under one of the anti-deferral regimes.<sup>86</sup>

Subpart F,<sup>87</sup> applicable to controlled foreign corporations and their shareholders, is the main anti-deferral regime of relevance to a U.S.-based multinational corporate group. A controlled foreign corporation generally is defined as any foreign corporation if U.S. persons own (directly, indirectly, or constructively) more than 50 percent of the corporation's stock (measured by vote or value), taking into account only those U.S. persons that own at least 10 percent of the stock (measured by vote only).<sup>88</sup> Under the subpart F rules, the United States generally taxes the U.S. 10-percent shareholders of a controlled foreign corporation on their pro rata shares of certain income of the controlled foreign corporation (referred to as “subpart F income”), without regard to whether the income is distributed to the shareholders.<sup>89</sup>

Subpart F income generally includes passive income and other income that is readily movable from one taxing jurisdiction to another. Subpart F income consists of foreign base company income,<sup>90</sup>

<sup>84</sup> Secs. 951–964.

<sup>85</sup> Secs. 1291–1298.

<sup>86</sup> Secs. 901, 902, 960, 1291(g).

<sup>87</sup> Secs. 951–964.

<sup>88</sup> Secs. 951(b), 957, 958.

<sup>89</sup> Sec. 951(a).

<sup>90</sup> Sec. 954.

insurance income,<sup>91</sup> and certain income relating to international boycotts and other violations of public policy.<sup>92</sup> Foreign base company income consists of foreign personal holding company income, which includes passive income (e.g., dividends, interest, rents, and royalties), as well as a number of categories of non-passive income, including foreign base company sales income and foreign base company services income.<sup>93</sup>

In effect, the United States treats the U.S. 10-percent shareholders of a controlled foreign corporation as having received a current distribution out of the corporation's subpart F income. In addition, the U.S. 10-percent shareholders of a controlled foreign corporation are required to include currently in income for U.S. tax purposes their pro rata shares of the corporation's earnings invested in U.S. property.<sup>94</sup>

The Tax Reform Act of 1986 established an additional anti-deferral regime, for passive foreign investment companies. A passive foreign investment company generally is defined as any foreign corporation if 75 percent or more of its gross income for the taxable year consists of passive income, or 50 percent or more of its assets consists of assets that produce, or are held for the production of, passive income.<sup>95</sup> Alternative sets of income inclusion rules apply to U.S. persons that are shareholders in a passive foreign investment company, regardless of their percentage ownership in the company. One set of rules applies to passive foreign investment companies that are "qualified electing funds," under which electing U.S. shareholders currently include in gross income their respective shares of the company's earnings, with a separate election to defer payment of tax, subject to an interest charge, on income not currently received.<sup>96</sup> A second set of rules applies to passive foreign investment companies that are not qualified electing funds, under which U.S. shareholders pay tax on certain income or gain realized through the company, plus an interest charge that is attributable to the value of deferral.<sup>97</sup> A third set of rules applies to passive foreign investment company stock that is marketable, under which electing U.S. shareholders currently take into account as income (or loss) the difference between the fair market value of the stock as of the close of the taxable year and their adjusted basis in such stock (subject to certain limitations), often referred to as "marking to market."<sup>98</sup>

Under section 1297(e), which was enacted in 1997 to address the overlap of the passive foreign investment company rules and subpart F, a controlled foreign corporation generally is not also treated as a passive foreign investment company with respect to a U.S. shareholder of the corporation. This exception applies regardless of the likelihood that the U.S. shareholder would actually be taxed under subpart F in the event that the controlled foreign corporation earns subpart F income. Thus, even in a case in which a controlled foreign corporation's subpart F income would be allocated to

<sup>91</sup> Sec. 953.

<sup>92</sup> Sec. 952(a)(3)–(5).

<sup>93</sup> Sec. 954.

<sup>94</sup> Secs. 951(a)(1)(B), 956.

<sup>95</sup> Sec. 1297.

<sup>96</sup> Sec. 1293–1295.

<sup>97</sup> Sec. 1291.

<sup>98</sup> Sec. 1296.

a different shareholder under the subpart F allocation rules, a U.S. shareholder would still qualify for the exception from the passive foreign investment company rules under section 1297(e).

#### REASONS FOR CHANGE

The Committee is aware that section 1297(e) may enable a U.S. shareholder (like Enron in the “Project Apache” transaction)<sup>99</sup> to claim exemption from the passive foreign investment company rules with respect to ownership of controlled foreign corporation stock on the basis of mere status as a U.S. shareholder, despite the fact that the U.S. shareholder may have implemented a structure intended to render it impossible for such shareholder to recognize any income under subpart F in connection with the stock. The Committee believes that the passive foreign investment company rules should be available to serve as a backstop to subpart F in such circumstances, and thus believes that the exception to the passive foreign investment company rules for U.S. shareholders of controlled foreign corporations should be geared more closely to the U.S. shareholder’s potential taxability under subpart F, as opposed to mere status as a U.S. shareholder under subpart F.

#### EXPLANATION OF PROVISION

The provision adds an exception to section 1297(e) for U.S. shareholders that face only a remote likelihood of incurring a subpart F inclusion in the event that a controlled foreign corporation earns subpart F income, thus preserving the potential application of the passive foreign investment company rules in such cases.

#### EFFECTIVE DATE

The provision is effective for taxable years of controlled foreign corporations beginning after March 2, 2005, and for taxable years of U.S. shareholders in which or with which such taxable years of controlled foreign corporations end.

#### F. DECLARATION BY CHIEF EXECUTIVE OFFICER RELATING TO FEDERAL ANNUAL CORPORATE INCOME TAX RETURN

(Sec. 506 of the bill and sec. 6062 of the Code)

#### PRESENT LAW

The Code requires<sup>100</sup> that the income tax return of a corporation must be signed by either the president, the vice-president, the treasurer, the assistant treasurer, the chief accounting officer, or any other officer of the corporation authorized by the corporation to sign the return.

The Code also imposes<sup>101</sup> a criminal penalty on any person who willfully signs any tax return under penalties of perjury that that person does not believe to be true and correct with respect to every material matter at the time of filing. If convicted, the person is guilty of a felony; the Code imposes a fine of not more than

<sup>99</sup> See Joint Committee on Taxation, Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations (JCS-3-03), February 2003, vol. I at 255, 258–59.

<sup>100</sup> Sec. 6062.

<sup>101</sup> Sec. 7206.

\$100,000<sup>102</sup> (\$500,000 in the case of a corporation) or imprisonment of not more than three years, or both, together with the costs of prosecution.

#### REASONS FOR CHANGE

Recent incidents of corporate and accounting malfeasance resulting in criminal charges and convictions demonstrate that Chief Executive Officers (CEO) are not immune from noncompliant behavior. The Committee believes that requiring the CEO of a corporation to personally certify that he or she has received reasonable assurance that the material aspects of the corporation's tax return are accurate and that processes and procedures are in place to assure compliance with tax laws will reduce the likelihood that abusive transactions and unintended application of the tax laws will appear on a tax return. The Committee believes that CEO certification will effectively eliminate the opportunity to claim ignorance or lack of involvement in material issues involving the company's financial activities.

A CEO is responsible for the company he or she runs. The CEO influences who sits on the Board of Directors, who the company auditors will be, and the business strategy of the company. Similarly, the CEO should have accountability for the corporate tax return. This concept has already been codified in the Sarbanes-Oxley Act of 2002, in which CEO and Chief Financial Officer certification requirements regarding the appropriateness of financial statements and disclosures, and the fair presentation of the operations and financial condition of the issuer, were established. The Committee believes this provision complements the requirements of Sarbanes-Oxley and should not impose significant additional burden on a CEO.

#### EXPLANATION OF PROVISION

The provision requires that a corporation's Federal annual income tax return include a declaration signed under penalties of perjury by the chief executive officer of the corporation that the corporation has in place processes and procedures to ensure that the return complies with the Internal Revenue Code and that the CEO was provided reasonable assurance of the accuracy of all material aspects of the return. This declaration is part of the income tax return. The provision is in addition to the requirement of present law as to the signing of the income tax return itself. Because a CEO's duties generally do not require a detailed or technical understanding of the corporation's tax return, it is anticipated that this declaration of the CEO will be more limited in scope than the declaration of the officer required to sign the return itself.

The provision provides that the Secretary of the Treasury shall prescribe the matters to which the declaration of the CEO applies. It is intended that the declaration help insure that the preparation and completion of the corporation's tax return be given an appropriate level of care. For example, it is anticipated that the CEO would declare that processes and procedures have been implemented to ensure that the return complies with the Internal Rev-

<sup>102</sup>Pursuant to 18 U.S.C. 3571, the maximum fine for an individual convicted of a felony is \$250,000.

enue Code and all regulations and rules promulgated thereunder. Although appropriate processes and procedures can vary for each taxpayer depending on the size and nature of the taxpayer's business, in every case the CEO should be briefed on all material aspects of the corporation's tax return by the corporation's chief financial officer (or another person authorized to sign the return under present law).

If the corporation does not have a chief executive officer, the IRS may designate another officer of the corporation; otherwise, no other person is permitted to sign the declaration. It is intended that the IRS issue general guidance, such as a revenue procedure, to: (1) address situations when a corporation does not have a chief executive officer; and (2) define who the chief executive officer is, in situations (for example) when the primary official bears a different title, when a corporation has multiple chief executive officers, or when the corporation is a foreign corporation and the CEO is not a U.S. resident.<sup>103</sup> It is intended that, in every instance, the highest ranking corporate officer (regardless of title) sign this declaration.

The provision does not apply to the income tax returns of mutual funds;<sup>104</sup> they are required to be signed as under present law.

#### EFFECTIVE DATE

The provision applies to Federal annual tax returns for taxable years ending after the date of enactment.

#### G. GRANT TREASURY REGULATORY AUTHORITY TO ADDRESS FOREIGN TAX CREDIT TRANSACTIONS INVOLVING INAPPROPRIATE SEPARATION OF FOREIGN TAXES FROM RELATED FOREIGN INCOME

(Sec. 507 of the bill and sec. 901 of the Code)

#### PRESENT LAW

The United States employs a "worldwide" tax system, under which residents generally are taxed on all income, whether derived in the United States or abroad. In order to mitigate the possibility of double taxation arising from overlapping claims of the United States and a source country to tax the same item of income, the United States provides a credit for foreign income taxes paid or accrued, subject to several conditions and limitations.

For purposes of the foreign tax credit, regulations provide that a foreign tax is treated as being paid by "the person on whom foreign law imposes legal liability for such tax."<sup>105</sup> Thus, for example, if a U.S. corporation owns an interest in a foreign partnership, the U.S. corporation can claim foreign tax credits for the tax that is imposed on it as a partner in the foreign entity. This would be true under the regulations even if the U.S. corporation elected to treat the foreign entity as a corporation for U.S. tax purposes. In such a case, if the foreign entity does not meet the definition of a controlled foreign corporation or does not generate income that is sub-

<sup>103</sup> With respect to foreign corporations, it is intended that the rules for signing this declaration generally parallel the present-law rules for signing the return. See Treas. Reg. sec. 1.6062-1(a)(3).

<sup>104</sup> The proposal does, however, apply to the income tax returns of mutual fund management companies and advisors.

<sup>105</sup> Treas. Reg. sec. 1.901-2(f)(1).

ject to current inclusion under the rules of subpart F, the income generated by the foreign entity might never be reported on a U.S. return, and yet the U.S. corporation might take the position that it can claim credits for taxes imposed on that income. This is one example of how a taxpayer might attempt to separate foreign taxes from the related foreign income, and thereby attempt to claim a foreign tax credit under circumstances in which there is no threat of double taxation.

#### REASONS FOR CHANGE

The Committee believes that the foreign tax credit is a mechanism to relieve double taxation and that appropriate measures should be taken to ensure such mechanism is not being abused. The Committee therefore believes that it is necessary to expand existing regulatory authority to provide the Treasury Department additional mechanisms to address abusive foreign tax credit schemes that involve the inappropriate separation of foreign taxes from the related foreign income.

#### EXPLANATION OF PROVISION

The provision provides regulatory authority for the Treasury Department to address transactions that involve the inappropriate separation of foreign taxes from the related foreign income in cases in which taxes are imposed on any person in respect of income of an entity. Regulations issued pursuant to this authority could provide for the disallowance of a credit for all or a portion of the foreign taxes, or for the allocation of the foreign taxes among the participants in the transaction in a manner more consistent with the economics of the transaction.

#### EFFECTIVE DATE

The proposal generally is effective for transactions entered into after the date of enactment.

### III. BUDGET EFFECTS OF THE BILL

#### A. COMMITTEE ESTIMATES

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the revenue provisions of the “Highway Reauthorization and Excise Tax Simplification Act of 2005” as reported.

**ESTIMATED BUDGET EFFECTS OF THE  
THE "HIGHWAY REAUTHORIZATION AND EXCISE TAX SIMPLIFICATION ACT OF 2005,"  
AS REPORTED BY THE COMMITTEE ON FINANCE**

Fiscal Years 2005 - 2015

[Millions of Dollars]

Provision	Effective	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2005-10	2005-15
<b>I. Extend Highway Trust Fund and Aquatic Resources Trust Fund Expenditure Authority Through September 30, 2009, and Related Taxes Through September 30, 2011 [1]</b>														
DOE														
<b>II. Excise Tax Reform and Simplification</b>														
A. Modify Gas Guzzler Tax	10/1/05	---	-3	-4	-4	-4	-4	-5	-5	-5	-5	-6	-20	-46
B. Aquatic Excise Taxes														
1. Eliminate Aquatic Resources Trust Fund and Transform Sport Fish Restoration Account	10/1/05	---	-3	-3	-4	-4	-4	-4	-4	-4	-4	-4	-20	-40
2. Repeal harbor maintenance tax on exports [2]	boas DOE													
3. Cap excise tax on certain fishing equipment [3]	[4]	---	-3	-3	-4	-4	-4	-4	-4	-4	-5	-5	-17	-41
C. Aerial Excise Taxes														
1. Clarify excise tax exemptions for agricultural aerial applicators and exempt certain fixed-wing aircraft engaged in forestry operations	fuosa 9/30/05	---	-4	-4	-4	-4	-4	-4	-4	-4	-4	-4	-20	-40
2. Modify the definition of rural airport	10/1/05	---	-3	-3	-4	-4	-4	-4	-4	-4	-5	-5	-18	-40
3. Exempt from ticket taxes transportation provided by seaplanes	ta 9/30/05	---	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-5	-11
4. Exempt certain sightseeing flights from taxes on air transportation	[5]	---	-7	-7	-7	-7	-7	-8	-8	-9	-9	-9	-36	-79
D. Taxes Relating to Alcohol														
1. Repeal special occupational taxes on producers and marketers of alcoholic beverages	7/1/08	---	---	---	-50	-59	-59	-59	-59	-59	-59	-59	-167	-459
2. Modify limitation on rate of rum excise tax cover over to Puerto Rico and Virgin Islands [6]	abIUSA 12/31/05	-11	-58	-18	---	---	---	---	---	---	---	---	-87	-87
3. Provide income tax credit for cost of carrying tax-paid distilled spirits in wholesale inventories and in control State balmant warehouses	tyba 9/30/05	---	-9	-17	-19	-20	-20	-20	-20	-21	-21	-21	-84	-188
4. Quarterly filing by small alcohol producers	qpb 1/1/06	---	-5	[7]	[7]	[7]	[7]	[7]	[7]	[7]	[7]	[7]	-5	-6
E. Sports Excise Taxes														
1. Provide exemption for certain custom gunsmiths [8]	[4]	---	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-4	-8
<b>Total of Excise Tax Reform and Simplification</b>		-11	-94	-58	-94	-104	-106	-106	-106	-109	-110	-111	-463	-1,005
<b>Miscellaneous Provisions</b>														
A. Establish a Motor Fuel Tax Enforcement Advisory Commission	DOE													
B. Establish a National Surface Transportation Infrastructure Financing Commission	DOE													
C. Expand Highway Trust Fund Expenditure Purposes to Include Funding for Studies of Supplemental or Alternative Financing for the Highway Trust Fund	DOE													



Provision	Effective	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2005-10	2005-15
D. Delta Regional Transportation Plan.....	DOE													
E. Establish the Build America Corporation.....	DOE													
F. Increase Dollar Limits for Employer-Provided Transit and Varpooling Benefits.....	tyda 12/31/05	---	-6	-6	-8	-5	-7	-11	-13	-14	-19	-23	-33	-113
<b>Total of Miscellaneous Provisions.....</b>		---	-6	-6	-8	-5	-7	-11	-13	-14	-19	-23	-33	-113
<b>Fuels-Related Technical Corrections.....</b>														
<b>Revenue Offset Provisions</b>														
A. Treatment of Contingent Convertible Debt														
B. Instruments [9].....	diola DOE	6	32	65	95	98	101	103	106	109	113	117	397	945
C. Frivolous Tax Submissions.....	[10]	---	3	3	3	3	3	3	3	3	3	3	15	30
D. Increase in Certain Criminal Penalties.....	asialaea DOE	---	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	1	5
E. Double Counting Relief, and Relief on Unsettled Claims Related to Certain Offshore Financial Arrangements.....	oyola DOE	1	2	1	[11]	[11]	[11]	[11]	[11]	[11]	[11]	[11]	5	7
F. Declaration by Chief Executive Officer Relating to Federal Annual Corporate Income Tax Return [12].....	rf tyda DOE	2	4	5	6	8	10	12	15	17	19	21	35	119
G. Grant Treasury Regulatory Authority to Address Foreign Tax Credit Transactions Involving Inappropriate Separation of Foreign Taxes from Related Foreign Income.....	teia DOE	[11]	[11]	1	1	2	2	2	2	2	2	2	6	16
<b>Revenue Offset Provisions.....</b>		9	41	75	105	111	116	120	126	131	137	143	459	1,122
<b>NET TOTAL.....</b>		-2	-59	11	3	2	3	3	7	8	8	9	-37	4

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:

asialaea = articles brought into the United States after

booa = before, on, and after

diola = debt instrument issued on or after

DOE = date of enactment

fuolate = fuel use or air transportation after

oyola = open tax years on or after

qyb = quarterly periods beginning

rf = returns for

teia = transportation after

tyda = transactions entered into after

tyda = taxable years beginning after

tyda = taxable years ending after

[1] Any possible outlay effects will be estimated by the Congressional Budget Office ("CBO").

[2] Estimate provided by the Congressional Budget Office.

[3] Estimate does not include a decrease in outlays of \$38 million for the fiscal years 2005 through 2015.

[4] Effective for articles sold by the manufacturer, producer, importer, or exporter of such goods after September 30, 2005, but does not apply to any amount paid before that date for such transportation.

[5] Estimate provided by the Congressional Budget Office and is subject to change.

[6] Preliminary outlay estimate provided by the Congressional Budget Office and is subject to change.

[7] Loss of less than \$500,000.

[8] Estimate does not include a decrease in outlays of \$7 million for the fiscal years 2005 through 2015.

[9] This estimate was corrected when this bill moved to the Senate floor. The corrected estimate, provided for Senate floor passage of this bill on May 17, 2005, was that this proposal would raise \$462 million during the fiscal year 2005-2015 period.

[10] Effective for submissions made and issues raised after the first list is prescribed under section 6702(c).

[11] Gain of less than \$1 million.

[12] Effective for taxable years of foreign corporations beginning after March 2, 2005, and for taxable years of U.S. shareholders in which or with which such taxable years of such foreign corporations end.

## B. BUDGET AUTHORITY AND TAX EXPENDITURES

*Budget authority*

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the provisions of section 304 of the bill as reported involves new or increased budget authority with respect to the funding of a study and plan by the Delta Regional Authority.

*Tax expenditures*

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

## C. CONSULTATION WITH CONGRESSIONAL BUDGET OFFICE

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

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, April 26, 2005.*

Hon. CHARLES E. GRASSLEY,  
*Chairman, Committee on Finance,*  
*U.S. Senate, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for the Highway Reauthorization and Excise Tax Simplification Act of 2005.

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

Sincerely,

ELIZABETH M. ROBINSON  
(For Douglas Holtz-Eakin, Director).

Enclosure.

*Highway Reauthorization and Excise Tax Simplification Act of 2005*

Summary: The Highway Reauthorization and Excise Tax Simplification Act of 2005 would make numerous changes to the Internal Revenue Code, most of which would modify various excise taxes. The affected excise taxes include several dedicated to the Highway Trust Fund (HTF) and the Aquatic Resources Trust Fund (ARTF). In addition, the bill would raise revenues mainly by changing the rules for deductibility of interest for certain debt instruments and by increasing certain penalties. Enacting the legislation would increase direct spending by allocating additional amounts to the ARTF (which would be renamed the Sport Fishing Restoration and Boating Trust Fund).

On net, CBO and Joint Committee on Taxation (JCT) estimate that enacting provisions of the bill would increase federal revenues by \$9 million in 2005, \$36 million over the 2006–2010 period, and \$71 million over the 2006–2015 period. JCT is in the process of revising its portion of the estimate downward, however. JCT indi-

cates that the change in estimated revenues may be large enough to result in an estimated net revenue loss under the bill as ordered reported by the Senate Committee on Finance. CBO estimates that the provisions affecting spending would increase direct spending by \$103 million in 2006, by \$506 million over the 2006–2010 period, and by \$1.2 billion over the 2006–2015 period.

JCT has reviewed the tax provisions of the bill and determined that they contain no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA).

CBO has reviewed the non-tax provisions of the bill and determined that they contain no intergovernmental mandates and would impose no costs on state, local, or tribal governments.

JCT has determined that the tax provisions contain private-sector mandates as defined in UMRA. CBO has reviewed the non-tax provision and determined that the declaration required by the chief executive officer, or other designated officer, relating to tax returns would be a new private-sector mandate as defined in UMRA. CBO estimates that the direct cost of the mandate would be minimal. In aggregate, the costs of all the mandates contained in the bill would fall below the annual threshold established by UMRA for private-sector mandates (\$123 million in 2005, adjusted annually for inflation).

Estimated cost to the Federal Government: The budgetary impact of the bill over the 2005–2015 period is shown in the following table.

By fiscal year, in millions of dollars—											
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>CHANGES IN REVENUES</b>											
Trust Fund Reauthorization .....	0	0	0	0	0	0	0	0	0	0	0
Excise Tax Provisions .....	0	-36	-40	-94	-104	-106	-106	-106	-109	-110	-111
Miscellaneous Provisions .....	0	-6	-6	-8	-5	-7	-11	-13	-14	-19	-23
Revenue-raising Provisions <sup>1</sup> .....	9	41	75	105	111	116	120	126	131	137	143
Estimated Revenues .....	9	-1	29	3	2	3	3	7	8	8	9
On-budget .....	9	1	31	6	4	5	7	12	13	15	17
Off-budget <sup>2</sup> .....	0	-2	-2	-3	-2	-2	-4	-5	-5	-7	-8
<b>CHANGES IN DIRECT SPENDING</b>											
Changes in Spending and Deposits From Sport and Conservation Funds:											
Estimated Budget Authority .....	0	92	120	128	134	140	145	147	151	154	157
Estimated Outlays .....	0	28	57	90	111	125	133	138	142	145	150
Cover Over (Payment) of Tax on Distilled Spirits:											
Estimated Budget Authority .....	0	75	20	0	0	0	0	0	0	0	0
Estimated Outlays .....	0	75	20	0	0	0	0	0	0	0	0
Total Changes:											
Estimated Budget Authority .....	0	167	140	128	134	140	145	147	151	154	157
Estimated Outlays .....	0	103	77	90	111	125	133	138	142	145	150
<b>CHANGES IN SPENDING SUBJECT TO APPROPRIATION</b>											
Alternative Financing Studies:											
Estimated Authorization Level .....	0	18	0	0	0	0	0	0	0	0	0
Regional Transportation Plan:											
Estimated Authorization Level .....	0	2	2	3	3	4	4	0	0	0	0
Estimated Outlays .....	0	1	0	0	0	0	0	0	0	0	0
Total Changes:											
Estimated Authorization Level .....	0	19	0	0	0	0	0	0	0	0	0
Estimated Outlays .....	0	3	2	3	3	4	4	0	0	0	0

<sup>1</sup>The Joint Committee on Taxation is revising the estimate downward for the provision that changes the rules for deductibility of interest for certain debt instruments.

<sup>2</sup>Increasing the maximum amount of tax-free, employer-provided commuting benefits contains both on- and off-budget revenue effects.

Sources: Joint Committee on Taxation and Congressional Budget Office.

## Basis of estimate

*Revenues*

Most of the estimated revenue effects of the bill were provided by JCT. CBO estimated the impact of two provisions affecting revenues: repealing the harbor maintenance tax on exports and capping the excise tax on certain fishing equipment. Pending an anticipated revision in JCT's estimates, CBO and JCT estimate that enacting provisions of the bill would increase federal revenues by \$9 million in 2005, \$36 million over the 2006–2010 period, and \$71 million over the 2006–2015 period. However, JCT is likely to revise its portion of that estimate, which could result in the bill having an estimated net loss of revenue.

**Trust Fund Reauthorization.** The bill would extend the authority to collect all excise taxes that are deposited into the Highway Trust Fund and the Aquatic Resources Trust Fund. Under current law, excise taxes are imposed on motor fuels, certain vehicles, and tires. Most of those taxes are set to expire on September 30, 2005. Among these levies is a tax of 18.3 cents per gallon that is imposed on gasoline and special motor fuels used in motorboats and certain small engines. The bill would distribute all revenues collected from the tax on those fuels to the Aquatic Resources Trust Fund (ARTF). Under current law, only 13.5 cents per gallon is deposited in the ARTF; the balance of 4.8 cents per gallon remains in the general fund. JCT estimates that extending the expiring tax provisions would have no effect on federal revenues because the baseline already includes those revenues. Under section 257 of the Balanced Budget and Emergency Deficit Control Act, excise taxes dedicated to trust funds, if set to expire, are assumed to be extended in CBO's baseline at the current rates in place just before scheduled expiration.

**Excise Tax Reform and Simplification.** In total, JCT and CBO estimate that enacting title II would reduce federal revenues by \$376 million over the 2006–2010 period and \$918 million over the 2006–2015 period. Half of the decrease in receipts—\$459 million over the 2006–2015 period—would result from repealing special occupational taxes on producers and marketers of alcoholic beverages. The remaining provisions modify various excise taxes and other taxes related to alcohol and would reduce receipts by \$459 million over the 2006–2015 period.

**Miscellaneous Provisions.** JCT estimates that the remaining revenue-reducing provisions of the bill would decrease receipts by \$33 million over the 2006–2010 period and \$113 million over the 2006–2015 period. All of this change would result from increasing the maximum amount of tax-free, employer-provided commuting benefits. (Of this reduction, \$41 million would apply to off-budget receipts.)

**Revenue-Raising Provisions.** In total, JCT estimates that the revenue provisions in title V would increase revenues by \$9 million in 2005, about \$450 million over the 2006–2010 period, and by about \$1.1 billion over the 2006–2015 period. Most of that increase (\$945 million over the 2005–2015 period) would result from changing the rules for deductibility of interest for certain debt instruments. (JCT is in the process of revising the estimate for that provision; the new estimate is likely to indicate a substantially smaller revenue gain.)

Additional revenue increases would come from increasing certain penalties, including fines for frivolous tax submissions.

#### DIRECT SPENDING

Changes in Spending and Deposits From the Aquatic Resources Trust Fund. Changes made to the ARTF by this legislation would increase direct spending by \$28 million in 2006 and about \$1.1 billion over the 2006–2015 period.

Enacting this legislation would increase direct spending from the ARTF by allocating to that fund the entire tax of 18.3 cents per gallon of fuels used in motorboats and small engines rather than the 13.5 cents per gallon portion of the tax it currently receives. Because all revenues deposited to the trust fund are available to be spent in the following year without further appropriation, raising such deposits by 4.8 cents per gallon of fuel used in motorboats and small engines would increase direct spending by an estimated \$29 million in 2007 and by \$1.1 billion through 2015. The additional deposits would be used for sport fish and coastal wetlands conservation activities and for boating safety grants.

Enacting the legislation also would increase direct spending by making available without further appropriation the existing balance of the boating safety account of the ARTF (about \$92 million) and any interest earned on the balance until it is expended (an estimated \$5 million). CBO estimates that the provision would increase direct spending by \$28 million in 2006, by \$96 over the 2006–2010 period, and by \$97 million over the 2006–2015 period.

Finally, CBO estimates that capping the excise tax on certain fishing equipment would reduce direct spending for sport fish and wildlife conservation grants. The modifications would reduce the amount of excise taxes deposited to the ARTF and to the Federal Aid-Wildlife Fund beginning in 2006. Because amounts deposited to those funds are available without appropriation (in the following year), cutting such deposits would reduce direct spending by an estimated \$1 million in 2007 and by about \$40 million over the 2007–2015 period.

Cover Over (Payment) of Tax on Distilled Spirits. Under current law, an excise tax of \$13.50 per proof gallon is assessed on distilled spirits produced or brought into the United States. Until December 31, 2005, the treasuries of Puerto Rico and the Virgin Islands will receive \$13.25 per proof gallon of the excise tax on rum imported into the U.S. from any country or those possessions (that amount is known as the tax cover over). Section 232 would increase the cover over to \$13.50 per proof gallon for assessments made between January 1, 2006, and December 31, 2006. Those payments to Puerto Rico and the Virgin Islands are recorded in the budget as outlays. Based on recent tax and payment data, CBO estimates that this provision would increase direct spending by \$95 million over the 2006–2007 period (with an additional \$4 million in outlays after 2010).

#### SPENDING SUBJECT TO APPROPRIATION

Alternative Financing Studies. Section 303 would authorize the appropriation of \$1 million to Montana State University and \$17 million to the University of Iowa for studies to be completed in fiscal year 2006 and fiscal year 2012 on supplemental or alternative

funding sources for the Highway Trust Fund. Assuming the appropriation of the specified amounts, CBO estimates that implementing this provision would cost \$14 million over the 2006–2010 period.

Regional Transportation Plan. Section 304 would authorize the appropriation of \$1 million in fiscal year 2005 and 2006 for the Delta Regional Commission to study transportation needs in eight states in the Mississippi delta. Assuming the appropriation of the specified amount, CBO estimates that implementing this provision would cost \$1 million over the 2006–2007 period.

Impact on state, local, and tribal governments: JCT has determined that the tax provisions of this legislation contain no intergovernmental mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

CBO has determined that the non-tax provisions contain no intergovernmental mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

Impact on the private sector: JCT has determined that the tax provisions contain private-sector mandates as defined in UMRA.

CBO has reviewed the non-tax provisions of the bill and determined that section 506 would impose a new private-sector mandate on the chief executive officer (CEO), or other designated officer, of certain companies. The provision would require a CEO or other officer to include a signed declaration with the federal annual income tax return of certain companies. The declaration would state that the company has processes and procedures in place to ensure compliance with the Internal Revenue Code and that the CEO was provided reasonable assurance of the accuracy of all material aspects of such return. CBO expects that the cost to comply with the mandate would be minimal.

In aggregate, the direct costs of all the mandates in the bill would fall below the annual threshold established by UMRA for private-sector mandates (\$123 million in 2005, adjusted annually for inflation.)

Estimate prepared by: Federal Revenues: Annabell and Laura Hanlon. Federal Costs: Matthew Pickford and Deborah Reis. Private Sector Impact: Paige Piper/Bach. Impact on State, Local, and Tribal Governments: Teri Gullo.

Estimate Approved By: G. Thomas Woodward, Assistant Director for Tax Analysis; Peter H. Fontaine Deputy Assistant Director for Budget Analysis.

#### **IV. VOTES OF THE COMMITTEE**

In compliance with paragraph 7(b) of rule XXVI of the standing rules of the Senate, the Committee states that, with a majority and quorum present, the “Highway Reauthorization and Excise Tax Simplification Act of 2005” was ordered favorably reported by a voice vote on April 19, 2005.

#### **V. REGULATORY IMPACT AND OTHER MATTERS**

##### **A. REGULATORY IMPACT**

Pursuant to paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement con-

cerning the regulatory impact that might be incurred in carrying out the provisions of the bill.

*Impact on individuals and businesses, paperwork and personal privacy*

The bill modifies several miscellaneous excise tax provisions. These provisions generally do not impose increased regulatory burdens on individuals or businesses. Taxpayers who elect to take advantage of certain provisions of the bill will need to keep records in order to demonstrate that they qualify for the tax treatment provided by the bill. For example, the bill contains a provision limiting the tax on a fishing rod or fishing pole to the lesser of 10 percent or \$10. The present-law tax is 10 percent. Affected taxpayers will be required to calculate tax separately for each such item, rather than in aggregate, and to keep records supporting such calculations.

The bill contains provisions to curtail tax shelters, including provisions arising from the investigative report by the staff of the Joint Committee on Taxation relating to Enron Corporation undertaken at the request of the Committee,<sup>106</sup> and other corporate governance provisions. In general, these provisions will have an impact on taxpayers that engage in certain tax avoidance transactions. Taxpayers that have not undertaken or planned to undertake such transactions generally are not affected by these provisions of the bill.

The provisions of the bill do not impact personal privacy.

#### B. UNFUNDED MANDATES STATEMENT

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

The Committee has determined that the tax provisions of the reported bill contain no Federal private sector mandates within the meaning of Public Law 104-4, the Unfunded Mandates Reform Act of 1995, and do not impose a Federal intergovernmental mandate on State, local, or tribal governments.

#### C. TAX COMPLEXITY ANALYSIS

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

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

<sup>106</sup> See Joint Committee on Taxation, Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations (JCS-3-03), February 2003.



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

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

