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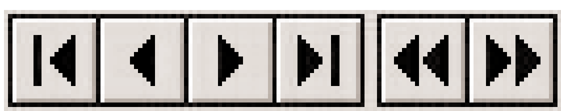

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CHADBOURNE & PARKE LLP

PROJECT FINANCE NEWSWIRE

March 1999

Clinton Proposes Tax Changes Affecting Project Finance

by Keith Martin, in Washington

The Clinton administration proposed a series of tax law changes in February that, if enacted, would affect project finance.

Cogenerator Tax Credit

Clinton wants an energy tax credit to promote investment in new "combined heat and power systems." These are facilities that produce steam and either electricity or mechanical shaft power. The owner of the project would be able to claim 8% of the cost of the project as a credit against his federal income taxes.

The administration made basically the same proposal last year as part of a plan to reduce greenhouse gas emissions that contribute to global warming, except the credit was 10%.

Projects would qualify only if placed in service during the period 2000 through 2002. At least 20% of the output from the project must be in the form of useful thermal energy. This compares to the 5% threshold to be a "qualifying facility" under the Public Utility Regulatory Policies Act, or PURPA. In addition, the project must have an energy conversion ratio greater than 70%, in the case of projects that exceed 50 megawatts, and 60% in small projects. The energy conversion ratio is the Btu content of the output divided by the Btu content of the fuel that went into the power plant.

Section 45

The US government offers a tax credit of 1.7¢ per kWh for generating electricity from wind or

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POWER COMPANIES IN THE UNITED KINGDOM FEAR A LEGAL MINEFIELD when they are forced to unravel "contracts for differences" as early as next year.

Electricity generators in the United Kingdom must sell most output into a central power pool. Distribution companies and other large wholesale purchasers of electricity buy from the pool. Pool prices are set by auction and change every half hour. In the case where a generator wants to sell directly to an industrial, the parties enter into a difference contract that sets a contract price for the electricity and requires a payment by one of the

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"closed-loop biomass." The credits can be claimed for 10 years from when the power plant starts commercial operation. Projects must be in service by June 1999 to qualify.

Clinton wants to allow another five years until June 2004 for projects to be put into service. He would also add the following types of biomass to the list of eligible fuels:

> "solid, nonhazardous, cellulosic waste material, that is segregated from other waste materials, and that is derived from the following forest-related resources: mill residues, pre-commercial thinnings, slash and brush, but not including old growth timber, waste pallets, crates, and dunnage, and landscape or right-of-way tree trimmings, and biomass derived from agriculture sources, including orchard tree crops, vineyard grain, legumes, sugar, and other crop by-products or residues."

Municipal solid waste, or garbage, would not qualify.

Section 45 credits are almost certain to be extended this year by Congress. The only question is the list of fuels that will qualify. Rep. Bill Thomas (R.-Calif.) introduced a bill last month with 16 members of the House tax-writing committee as cosponsors to extend the credit, but only for wind.

Senator Charles Grassley (R.-Iowa) introduced an identical bill in the Senate. The Senate Finance Committee chairman, Bill Roth (R.-Del.), favors adding chicken litter to the list of eligible fuels. There is less support for adding biomass fuels. Companies that produce landfill gas and synthetic fuels from coal hope also to add their fuels to the list, but these fuels currently lack a strong sponsor in Congress.

The Thomas and Grassley bills would deny tax credits for electricity from "qualifying facility" projects where the electricity is sold to a utility under a contract signed before 1987, unless the contract has been amended to reduce the contract price for electricity to avoided cost at time of delivery for any increase in output above a base period.

Aggressive Tax Schemes

There is a growing consensus in Washington that the government must take action against aggressive tax schemes by corporations. Clinton proposes five measures that go beyond what Congress is likely to enact, but some action is expected.

His proposals would take effect from the date of "first committee action" in Congress, which could be sometime this spring.

Clinton would impose a 25% excise tax on fees earned by law and accounting firms and investment banks for tax advice or for implementing any "tax avoidance transaction." This is "an entity, plan or arrangement" that reduces or defers a corporation's taxes and that is expected to generate insignificant profits in relation to the net tax benefits. Michael Graetz, a law professor at Yale, said the definition distills to "a deal done by very smart people that, absent tax considerations, would be very stupid." Fees paid by a corporation in connection with such a transaction would not be deductible.

There is a growing consensus in Washington that the government must take action against aggressive tax schemes by corporations.

The administration's budget said, "In addition, a tax avoidance transaction would be defined to cover certain transactions involving the improper elimination or significant reduction of tax on economic income." No one is sure what this means. The government is aware of the problem and is "working furiously" to refine the definition, a Treasury lawyer said on March 4.

There would be a separate 25% excise tax in tax avoidance transactions where there is a right to unwind the transaction, a guarantee of tax benefits or "[an]other arrangement that has the same economic effect." The tax would be 25% of the maximum amount of money the corporation could get back under the unwind or indemnity. It would be collected at closing.

Tax schemes often involve a transaction between a US taxpayer and a foreign corporation, municipality, Indian tribe or other tax-exempt entity, or a domestic corporation with net operating loss carryfowards. Clinton wants these "tax-indifferent parties" to pay US income taxes on any income that is shifted to them in the transaction. If the US cannot collect the taxes from the tax-indifferent party, then it will look to the US taxpayer whose tax shelter it is to pay the taxes.

The government already has authority under section 269 of the US tax code to deny tax benefits in transactions where a US taxpayer acquires control of a corporation with the principal purpose of securing a tax benefit. Clinton wants the IRS to have similarly broad authority to deny tax benefits in tax avoidance transactions.

Finally, Clinton would increase the penalty for substantial understatements of tax from 20% to 40% for tax understatements linked to tax avoidance transactions. "Substantial understatement" is defined under current law as a shortfall in total taxes of least 10% or $5,000, whichever is greater. Clinton would change this to a shortfall of at least $10 million. A company could reduce its penalty back to 20% (instead of 40%), but only by submitting documents pertaining to the transaction to the IRS within 30 days after closing and by highlighting any book-tax differences from the transaction on its tax return.

Lease Financing

Clinton wants to prevent lessors in leasing transactions involving "tax-exempt use property" from

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parties to the other to the extent pool prices vary from the contract price.

The UK government announced plans last October to scrap the pool by April 2000. At the same time it placed a ban on construction of any new gas-fired power plants following a year of crisis for British coal companies. Representatives of industry, pool advisers and consumers' groups, told the energy minister, John Battle, in late January that the April deadline is impossible and that legislation will be required because many of the parties involved in the pool are unlikely to endorse the reform.

Differences contracts will have to be rewritten when the reforms occur.

US MULTINATIONALS WITH UK SUBSIDIARIES SHOULD CONSIDER DISTRIBUTING EARNINGS to the US as dividends before April 6.

A dividend of $15 million paid before April 6 will generate a tax credit refund in the United Kingdom of over $1 million. The same dividend paid April 6 or later will generate a refund of less than $42,000. This is due to interaction between the US-UK tax treaty and the "advance corporations tax," or ACT, in the United Kingdom. The ACT has been repealed effective April 6.

However, before paying dividends, US multinationals should consider whether the benefits outweigh possible detriments. For example, a US multinational that is not in a position to use foreign tax credits in the US may find the US taxes it must pay on the dividend exceed any tax savings in the UK.

A recent private letter ruling suggests there may be a way to distribute earnings that is considered a dividend in the UK but not in the US. This would trigger UK refunds without triggering taxes in the US. (See "IRS Provides Roadmap for Hybrids" in the November 1998 issue of the NewsWire.*)*

CHINA RUMORS . . . Unconfirmed reports from China are that the government has declared a moratorium on

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claiming net losses from the transactions. Any net losses would have to be carried forward and offset against income from the lease transaction in later years. "Tax-exempt use property" is equipment leased to a lessee who is not a US taxpayer. An example would be where a US equity leases a power plant to a Dutch utility. The proposal would apply to leases entered into after enactment, which is expected to be sometime this fall.

A coalition of big-ticket lessors and lease arrangers has retained Ken Kies, until recently chief of staff of the Joint Tax Committee in Congress, and has raised a huge war chest to fight the proposal.

Tracking Stock

Top executives at US utilities sometimes complain that the market undervalues their unregulated businesses. Some utilities have looked at possible direct public offerings of shares in their independent power subsidiaries. Others have considered issuing tracking stock, which is stock in the parent company that tracks economic performance of the subsidiary. The advantage of tracking stock is it lets the parent continue to file a consolidated tax return with the subsidiary.

The IRS is still unsure when it will treat tracking stock as stock in the subsidiary directly. In the meantime, Clinton wants to treat a company issuing tracking stock as if it had sold part of the subsidiary and collect a tax on any gain.

The market has already moved beyond simple tracking stock to "reverse tracking stock." An example is where a US company wants to acquire a Canadian target. It might have the owners of the target exchange their existing shares for new shares in the target that track economic results in the US parent. This is done to qualify for tax-free reorganization treatment in Canada and to avoid withholding taxes on dividends at the US border, since any dividends on the shares would be paid entirely within Canada.

Fresh Start

Clinton wants companies to "mark to market" all assets and entities when they enter the US tax net. This would have the effect of eliminating any tax attributes in the entity and of resetting the tax basis in assets to market value. For example, a fresh start would be triggered when a foreign corporation becomes a CFC, or "controlled foreign corporation," because it is suddenly more than 50% US-owned. The US Treasury figures that US taxpayers already plan around situations where bringing entities or assets into the US tax net would trigger a gain. It hopes the proposal will put an end to transactions where losses are imported for use on US tax returns.

Other Proposals

There are at least a dozen more proposals in the Clinton budget that affect different segments of the project finance community. The administration has been criticized for the sheer number of new tax proposals this year. The summary of them issued by the US Treasury is 201 pages. ■

Congress Considers Rewards For Reducing Greenhouse Gas Emissions

By Roy S. Belden, in Washington

The US Senate is starting work this month on legislation to reward companies that take voluntary actions to reduce greenhouse gas emissions or sequester carbon.

The US has committed to the international community to reduce greenhouse gas emissions to a level seven percent below 1990 emissions by the 2008 to 2012 time frame. It is expected eventually to have to take strong measures to reach this goal. The legislation addresses how to ensure that companies that take early voluntary actions receive credit against any mandatory measures that are put in place later. Credits would be awarded for such activities as fuel switching, derating or shutting down power plants, or reforestation projects.

Background

The United States and 76 other countries committed in a Kyoto protocol to the "United Nations Framework Convention on Climate Change" to specific deadlines for reducing gas emissions below a 1990 baseline. The targets vary by country. The US target is for average annual emissions during the period 2008 to 2012 to be at a level that is seven percent below 1990 emissions. This actually translates into a 37% reduction in US emissions after taking into account the increase in emissions that would otherwise be expected to occur due to growth in the economy. The US signed the protocol in November 1998 but has not yet formally ratified it. Ratification requires a vote in the US Senate.

Many US companies have already taken steps to reduce greenhouse gas emissions or have pledged to take such action in future in response to a voluntary US government climate change action plan. The US Department of Energy keeps track of any voluntary reductions that are reported to it under section 1065(b) of the "Energy Policy Act of 1992." Many companies are seeking legally binding assurances that these early actions will receive credit and that they will not be penalized if a future greenhouse gas regulatory program is put in place.

The overall concept of awarding credit for voluntary early actions has wide support in the business and environmental communities. However, there is a significant divergence of opinion on how to implement any such program. Key issues include 1) what activities qualify for credit

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construction of new thermal power plants for the next three years. There is no information on whether the moratorium affects proposed projects that use fuels other than coal.

Meanwhile, the State Power Corporation — the successor to the former Ministry of Electric Power — has declared that new power purchase agreements may no longer contain minimum power purchase obligations. Power projects that have received final approval from the State Development Planning Commission are expected to be grandfathered under the prior regulations that allowed such "minimum take" provisions. This latest action is expected to launch China into a full economic dispatch environment within the next few years.

US COAL COMPANIES MAY BE OWED TAX REFUNDS by the federal government to the extent they export coal.

The government collects excise taxes of $1.10 a ton on coal from surface mines and 55¢ a ton on coal from underground mines. A federal district court said recently that the tax is unconstitutional to the extent it applies to coal that is exported. The "export clause" of the US Constitution bars the federal government from interfering with exports from the states. The federal government is expected to appeal.

Pittston Companies, which was the plaintiff in the case, was awarded $678,948 for taxes on export sales during just one quarter in 1997.

A DECISION BY THE NETHERLANDS SUPREME COURT IN FEBRUARY SUGGESTS A WAY TO STRIP EARNINGS FROM DUTCH HOLDING COMPANIES without paying a withholding tax at the border.

Holland collects a 25% withholding tax on dividends paid by Dutch companies to foreign shareholders. The tax is reduced to 5% by the US-Dutch tax treaty. There is no withholding tax on amounts paid out as interest.

The Netherlands Supreme Court confirmed in a

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Congress Considers Rewards

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— for example, whether carbon sequestration and "business as usual" reductions should qualify — 2) from what baseline to calculate reductions, 3) how growth industries, such as the computer industry, can qualify for credit, and 4) what federal agency will run the program.

Senate Action

Senators John Chafee (R.-Rhode Island), chairman of the Senate Environment Committee, and Max Baucus (D.-Mont.), the ranking democrat on the committee, introduced a bill on March 4 to award credits for voluntary actions to reduce greenhouse gas emissions and sequester carbon through 2007. The bill is S. 547. The committee has scheduled a hearing on it for March 22. A similar measure is expected to be introduced in the House. The bill deals only with credit for early actions and does not address the broader issue of how the US should reach its emissions target.

Many companies are seeking legally binding assurances that they will receive credit for early actions to reduce greenhouse gas emissions.

Key Concerns

Many view the bill as merely a starting point for the debate on several critical issues. First, some members of Congress see it as a sign of support for the Kyoto protocol, which has been widely criticized as too costly and unfair to US businesses. While the bill was expressly drafted to be "Kyoto-free," the underlying assumption is that some form of greenhouse gas emission reduction program will be enacted in the future. Second, the US General Accounting Office has identified the following four issues that need to be resolved: 1) Should reductions in emissions be measured against an historical baseline or a projected-growth baseline? 2) How should ownership of the emissions reductions be determined? 3) Should the emissions reduction claims be reported at the organization, project, or some other level? 4) How should emissions reduction claims be verified? Each of these issues is fairly complex.

Environmental groups support the overall concept of an early credit program, but they oppose S. 547 as being too generous to industry. In particular, they object to language that awards credits for activities that take place outside the United States, grants credit for activities reported under section 1605(b) without prior screening, provides credits for certain carbon sequestration activities without other emissions reductions, and potentially awards credits for "business as usual" activities. Environmental groups are also pushing to incorporate requirements for interim reductions in greenhouse gas emissions from the electric utility sector.

It is still early in the debate. A consensus bill may emerge after hearings in the House and Senate later this year. ■

Mexico: The Morning After

by John B. O'Sullivan, in Washington

Mexico has been attracting a lot of attention from independent power plant developers recently, both in bidding on requests for proposals from the national utility, the CFE, and in pursuing inside-the-fence projects.

The announcement by President Zedillo last month that the government intended to restructure the electric industry so as to greatly enhance the opportunities for foreign investors and operators seemed at first blush as though it would only further increase that number of players and scope of interest by developers and, therefore, lenders, even in the face of volatile Latin American financial markets. However, a better appreciation of the difficulty of the process on which the government is embarking, aggravated by the opposition to the plan by some important forces in Mexico, and a reflection on how a good plan for the long run may complicate matters in the short run have somewhat tempered the reaction of many developers and other observers inside and outside of Mexico.

The Plan and the Schedule

The plan requires three significant actions. First, amend Mexico's constitution, which requires action by both state and federal legislatures. Second, enact a package of legislation to authorize the split-up of the Comisión Federal de Electricidad and Luz y Fuerza del Centro and the creation of a number of new distribution companies and generation companies and a transmission company, establish transmission access and a framework for contracts between generators and distribution companies or large industrial customers, expand the regulatory powers and responsibilities of the Comisión Reguladora de Energía and reform the legal framework for independent power, establish a bulk power market in Mexico, and authorize private (and foreign) involvement in distribution and perhaps transmission. Third, implement some or all of these measures.

The administration seems reconciled to the idea that, at best, it can accomplish only the first two of these objectives before the election of a new president late in the summer of 2000. The opposition of CFE's powerful union and of political parties to both the left and the right of the ruling political party, the PRI, has led a number of knowledgeable observers to question whether even this can be achieved. There is even a question of whether the PRI candidate for president, who gains power

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decision on February 17 that ABN-Amro Bank NV could deduct interest paid on "perpetual bonds." The bonds had four key characteristics. First, they were perpetual. Repayment of principal was due in case of bankruptcy or liquidation of the borrower or, at the option of the borrower, at 10-year intervals starting in 2004. Second, the bonds carried a fixed interest rate of 8.5%. Interest was cumulative if not paid. Third, payment of interest was deferred in years when no dividend was payable by the borrower. Fourth, the bonds were subordinated to other debts of the borrower.

The issue was whether the lenders "participated to a certain extent in the business enterprise" of the borrower. In that case, the borrower would not have been able to deduct his interest payments as interest on "debt." Last year, the Supreme Court said it would recharacterize an instrument as equity only when three conditions are present. One is the payments on the instrument are contingent on profits of the borrower. Another is the instrument is subordinated to all other debts. Finally, the instrument is issued for an indefinite period of time — for example, where repayment may be demanded only in case of bankruptcy or liquidation of the borrower. All three conditions must be present to rechararacterize.

In this case, the instrument did not meet the requirement that payments be contingent on profits of the borrower. The fact that interest was deferred in years when the borrower was not paying dividends did not make the interest contingent on profits, the court said.

DISCUSSIONS WITH AN INVESTMENT BANK ABOUT A TAX PLANNING IDEA HAD TO BE DISCLOSED TO THE IRS ON AUDIT, a federal appeals court said on February 26.

Goldman Sachs approached Paramount in 1989 with an idea how to generate capital losses to shelter a large gain the company had from sale of a subsidiary. Paramount ultimately did the transaction with Merrill

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within the country just as the lame duck president's power wanes, will support these measures if the opposition has done a good job of raising public concern about them and the election seems to be close. And, of course, it is unknown whether President Zedillo's successor, whether from PRI or another party, will share his enthusiasm for the restructuring.

The Transition

Even if it is ultimately carried out, the ambitious restructuring program will take at least two years to make any headway on actual implementation, and the program itself may have to be revised in order to attract enough political support. What is not yet clear is what will happen in the interim. Mexico needs continued expansion of its generation base to support economic growth.

Even though there seems to be increasing differentiation between Mexico and Brazil, based in part on the realization that the two economies are not closely tied, these are not the easiest of times to finance a power plant in Mexico. It would be ironic if the administration's ambitious plans for increased foreign investments and increased efficiency in energy markets in the long run were, in the interim, to hinder the continuation or even growth of the present programs — primarily CFE's requests for proposals from independent power companies. (Cogeneration and self-supply projects should not be seriously affected.)

It would be ironic if the Mexican reform plans hinder development in the short run.

There is no sign that CFE will not continue to solicit offers from greenfield independent power projects under long-term contracts. However, if this program should slow down or stop in anticipation of the restructuring, there could be a hiatus in the growth of power supply that Mexico can ill afford. Less directly, but to the same effect, would be uncertainty as to the legal or commercial structure — with potential developers asking themselves who their customer will be, and whether it will be creditworthy (or, if not, backed up by government guarantees or other support). These concerns can be addressed, at least in part, by adequate assurances in power purchase agreements or early legislation for grandfathering of new contracts from effects of restructuring that would jeopardize their promised revenue stream. ■

Off To The Races In Europe

by Stephanie Conaghan, in London

The European electricity market opened in theory to competition on February 19, but the reality is more complicated.

European countries were required by February 19 to implement national legislation adopting common rules for their internal markets in electricity. The rules are found in a European Union directive, 96/92/EC. The directive has already prompted some movement among developers active in the EU, and should offer significant investment opportunities to energy companies seeking to enter the market. On paper, some 60% of EU power markets are now open to competition. However, a few important facts should be borne in mind as one analyzes the situation.

First, the nature of EU directives is to set principles and goals but allow member states freedom, albeit limited, as regards the manner in which targets should be reached. The purpose of the directive is for the various electricity systems to share the same principles regarding competition and market access. Different competitive models and ways of ensuring access to the grids can be chosen. This means that, though there are significant similarities across countries, individual countries have different structures. Second, several issues remain unsettled, including open access to the transmission grid, transmission pricing and the question of recovery of stranded costs. Finally, the directive allows individual countries to restrict competition under certain conditions. This article, after a short description of the directive's effect so far, briefly discusses these issues.

Background

Directive 96/92/EC, adopted by the Council of Ministers in 1996, provides for phased competition in the European electricity sector. As a first step, member states must permit large industrial and commercial customers using more than 40 gWh on an annual basis to select their electricity suppliers. Such customers account for approximately 26% of the EU electricity demand. By 2003, countries must have opened at least a third of their electricity market to competition, with the consumption threshold being lowered to 9 gWh. Although Ireland, Belgium, and Greece were granted extensions to comply with the directive, they have opted to open their markets now.

The majority of European countries have chosen to open their markets beyond what is demanded in the directive. In the UK, for example, freedom to select a power supplier will be extended to all retail customers later this year. The German market also will be 100% open at the outset, with all consumers being able to select a power supplier. Spain intends to open 40% of its market by October 1999, starting with 30% in February.

France has not yet transposed the directive into national law. France is reluctant to liberalize its electricity sector and will likely implement a restricted version of the directive. A bill imple-

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Lynch, but not before Eugene Meyers, Paramount senior vice president and tax counsel, had a number of meetings with David Ackert, an investment banker at Goldman Sachs, to understand how the transaction would be structured and the tax risks. Paramount eventually paid Goldman Sachs $1.5 million for bringing the idea to it.

On audit, the IRS issued a summons to Ackert. Paramount claimed its conversations with Ackert were protected by attorney-client privilege. The US court of appeals for the 2d circuit said they were not. The communications between Meyer and Ackert were not between an attorney and client.

Congress extended a form of attorney-client privilege last year to communications about tax planning with accountants. However, the privilege does not apply to advice concerning "corporate tax shelters." The IRS is expected to issue a definition sometime this spring.

AN INTERESTING TAX ANGLE . . . A foreign corporation contributed securities on which it had a loss to its US subsidiary.

This let it claim the loss in its home country. However, the US treated the transfer as a capital contribution. Thus, the US subsidiary took a carryover basis in the securities. It sold the securities later and claimed a loss on its US return.

The IRS discussed the transaction in an old "field service advice" that was released to the public in early March. It considered whether to try to invoke US transfer pricing rules in section 482 to deny the US tax loss, but decided against it. It suggested to the IRS agent who had raised the issue that he try to "settle this case on the best basis possible or concede the case if necessary," unless he could prove the transaction was purely tax motivated. "[I]t may be that distortion will have to be tolerated in certain circumstances in order to achieve proper results in the vast majority of cases."

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menting the EU directive is under discussion in the Assemblée Nationale, but probably will not become law until October 1999. Along with France, Italy has not passed enabling legislation, but it is expected that competition will be introduced in stages over the next five years. The first stage has been approved by the cabinet, meaning that 30% of the market will be subject to market forces this year.

On paper, some 60% of EU power markets are now open to competition, but the reality is more complicated.

Structure of Directive

For the construction of new capacity, member states are allowed to choose between two different competitive models or a mix of the two models: 1) the authorization procedure and 2) the tendering procedure.

Under the authorization procedure, applications that conform with certain objective criteria determined by the member state for granting authorization would be authorized. Such criteria may relate to the security of the electricity system, the protection of the environment, and energy efficiency. The need for new capacity would not be taken into account.

In contrast, the tendering procedure envisages central planning, but no generation monopoly for the incumbent utility. The incumbent utility could elect to participate in the competitive tendering of the new capacity.

The overwhelming majority of member states will use an authorization procedure to introduce competition. Even when the need for capacity is centrally planned, the directive requires that it must be possible for self-producers and independent power companies satisfying the objective criteria defined by the member states to obtain authorization outside of a tendering procedure.

The directive requires the incumbent utilities to separate their wires business from generation, through separate management and separate accounts. They also must offer non-discriminatory, open access transmission service to third parties based on negotiated or regulated third party access, or the single buyer model. The latter involves the supply of power through a central purchaser, which is in charge of the grid. The single buyer would be obliged either to carry out contracts between producers and consumers or to give such producers and consumers access to the system. Ten EU states out of the 15 have opted for regulated third party access, whereby a generation provider and consumer contract directly with each for power supplies, but access to the grid is governed by published and regulated tariffs. Only Germany and Greece have opted for negotiated third party access, in which the supplier and consumer engage in a bilateral transaction for the supplies and negotiate access to the network with its operator. Italy and Portugal have opted to use a system that combines negotiated third party access and the single buyer model. Importantly, the directive authorizes the operator of the transmission or distribution network to refuse access to the grid if there is insufficient capacity on the grid.

Impact

The directive already has prompted a rise in cross-border acquisitions, mergers, joint ventures and strategic positionings, with companies seeking to break into neighboring markets. Electricité de France has bought London Electricity owned by U.S.-based Entergy in a deal worth $3.2 billion. IVO, a Finnish power group, has bought Stockholm Energi, for $1.95 billion. Also, Vattenfall of Sweden, RWE of Germany, Tractebel of Belgium, National Power and PowerGen of the UK and Endesa and Iberdrola of Spain have bought or are seeking acquisitions and joint ventures in other EU countries. In addition, utilities are looking to diversify their businesses: in the U.K., British Gas and Eastern Energy are offering customers dual fuel, electricity and gas contracts. ScottishPower offers gas, electricity, water and telecommunications to its customers. Utilities in other member states are following a similar approach.

Power trading markets, offering spot and futures contracts, are being developed to meet the increasingly sophisticated demands of European customers. The Amsterdam Power Exchange, which is modeled on NordPool, is being prepared to start trading electricity this quarter. NordPool, the Scandinavian electricity market, which has been in operation for some time, consists of a highly liquid spot market for physical trading and a futures market for trading. A power exchange is expected to be up and running in Germany by the end of the year. The UK is exploring new trading arrangements for its power pool in light of "gaming" of the system by large generators.

Open Issues

While competition is set to be implemented, a number of issues remain, including the award of stranded costs to the incumbent utilities, precise terms and conditions of access to the transmission grid by third parties, pricing for transmission service, and the right of member states to deviate from the directive under certain circumstances. Energy companies seeking to enter the European market should keep the following in mind:

Non-discriminatory Third Party Access to Transmission Grid: Germany has proven the early testing ground for the effectiveness of the open access requirement in the directive. The German energy law implementing the directive requires regional transmission companies to provide non-discriminatory access to grids. However, no regulations were passed to ensure such access. Prior to the directive coming into force, Enron filed a

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NEW YORK IS CONSIDERING TAX CHANGES THAT WOULD AFFECT INDEPENDENT POWER COMPANIES doing business in the state.

New York taxes utilities differently than other companies. Corporations "formed for or principally engaged in business of supplying…gas…, or electricity" are subject to taxes on their gross receipts. There are two levels of gross receipts taxes: an additional percentage of tax applies to electricity suppliers that are subject to rate regulation by the New York Public Service Commission. Meanwhile, other companies not in the utility business pay net income taxes rather than tax on their gross receipts.

Governor Pataki asked the state legislature in January to repeal the gross receipts tax. Power companies would be subject to the same net income tax in future as other companies, with the exception that the additional percentage tax on gross receipts of utilities that are subject to rate regulation by the PSC would be phased out by gradually by reducing the tax rate between now and 2003.

Separately, power marketers have complained about a letter from the deputy commissioner of taxes in New York asserting that sales taxes must be paid on unbundled transmission or distribution charges for delivering electricity to a consumer. The governor proposed in his budget to let power marketers credit against net income taxes any sales taxes they pay on transmission or distribution services during the one-year transition period April 1, 1999 through March 31, 2000. Power marketers had hoped to avoid such sales taxes altogether by separately stating the transmission and distribution charges and contracting separately for such services.

GAS PIPELINE COMPANIES ARE BATTLING THE IRS OVER TAX DEPRECIATION on their assets.

The IRS publishes a list of asset guideline classes by industry. For example, assets used in the pipeline transportation business come under asset class 46.0 and are depreciated over 15 years. Pipeline companies

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complaint with Germany's competition authorities, the Federal Cartel Office, alleging that it had been denied access unfairly to Hagen-based regional supplier Elektromark's transmission grid in violation of Germany's energy law. Enron was attempting to supply a municipal utility when access was denied by Electromark, the regional grid operator, on the grounds that a network constraint would hinder the transmission of the Enron power supplies to the municipal utility. The FCO dropped the proceedings after Elektromark and Enron were able to agree to a negotiated transmission tariff. It is worth noting that Germany, as an interim measure, is also allowing its hundreds of municipally-controlled distributors to adopt single buyer status and maintain control of the distribution grid, which may limit the ability of competitors to penetrate local markets.

The ability to trade in spot and futures markets will contribute to making an investment in Europe successful.

Pricing for Transmission Service: Transmission pricing requires an overhaul in Europe. The directive fails to provide for a uniform system of transport fees, which complicates the creation of a pan-European competitive power market. Under the present regime, pancaked rates, or a series of rates, are being charged for transmission service, which will stifle competition. A working party of grid operators is attempting to establish a uniform cross-border electricity tariff, which should ensure transparency of prices for transmission, as well as transparency and uniformity in the rules relating to access to the grid and grid management. The recent German proceeding, together with disparate national treatment of transmission service, may highlight the need for a European-wide regulator, with certain similar powers to those exercised by the Federal Energy Regulatory Commission in the US. Individual member states are exploring the creation of commissions for electricity regulation to handle issues in connection with liberalization.

Stranded Costs: The EU commission is not expected to rule on country plans for stranded cost recovery until later this year. The UK, Greece and Sweden are the only countries that have not requested compensation for stranded assets. The compensation determination will affect pricing for supply in the competitive market, which could result in a market barrier to new entrants and thwart competition. Plans by Spain to deal with stranded costs have already led to complaints of unfair competition from companies seeking to break into the Spanish market. The government has proposed to authorize utilities to securitize approximately $8.0 billion of stranded costs resulting from the move to competition. The national commission for the electricity sector, appointed by the previous socialist government, argued that the compensation paid via the securitization package was overly generous to the utilities and prevented increased savings for consumers. The government dismissed the commission's criticisms. The EU competition commissioner has warned the Spanish government not to grant stranded asset relief prior to full commission scrutiny, as this is an EU-wide issue.

Public Service Obligations: Under the directive, member states are allowed to restrict competition due to "public service" obligations, which are defined by the member states and relate to issues of security of supply, regularity, quality and price of supplies, or environmental protection. For example, Spain and Germany have authorized transitional arrangements designed to protect German and Spanish coal markets. The UK also has imposed curbs on building gas-fired power stations to protect its coal market. In addition, the European nations are allowed to impose a reciprocity requirement, which can last no longer than nine years, if there is unequal implementation of the directive in different member states. If State A supports reciprocity, such as Spain for example, it can exclude generators from State B from gaining access to the customers of State A because the generators of State A are not allowed to supply equivalent customers in State B. Test cases on reciprocity are anticipated in future. In accordance with the directive, the EU commission will monitor the development of the markets in light of the reciprocity provision and may recommend to the EU council and parliament a further opening of the markets, based on experience gained.

Future of European Power Market

It is important to note that the purpose of the directive is for the various electricity systems to share the same principles regarding competition and market access, even though they may be different in structure. The impact of the directive will depend greatly on the level of support of individual governments and the effectiveness of the regulatory regimes in enforcing competitive principles. Opening of the electricity market to date in Europe has given rise to increasing investment by independent power companies, such as Enron, and the trend is likely to continue. In the UK, for example, where privatization of the electricity sector was initiated in 1990, US companies have invested billions of dollars. Smaller investments by US utilities and independent power companies have been made in Spain, Italy, the Netherlands, Germany and elsewhere. Further investment by independent power companies is likely to be encouraged by industrial customers seeking an alternative to their current monopoly supplier. In the Netherlands, for example, Enron has begun supplying power to several large Dutch companies.

In future, the ability to trade in spot and futures markets and take advantage of pricing differentials will contribute to making an invest-

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have gathering lines at oil and gas fields to collect fuel from individual wells to a point where it can be batched and transferred to trunk lines for transportation to market. Many pipeline companies put these gathering systems in a separate asset class 13.2 for assets used in the “exploration for and production of petroleum and natural gas deposits.” The IRS insists that this is improper because the pipeline companies are not in the exploration business. However, a federal district court in Wyoming held for the taxpayer in November 1997. The IRS has appealed.

Other cases are pending. Duke Energy Natural Gas Corp. filed a petition in the US Tax Court a few days before Christmas. Meanwhile, Rep. Sam Johnson (R.-Texas) introduced a bill in Congress last month to clarify the rules. The bill would allow 7-year depreciation on pipes and other equipment used to deliver natural gas from the wellhead to a processing plant, or to an interconnection point with an interstate gas company or intrastate transmission pipeline.

Congress is expected to start work on a tax-cut bill in the late spring. Johnson is a member of the House tax-writing committee.

LOCKHEED MARTIN CORPORATION FILED A REVISED POLICY ON HIRING FOREIGN BUSINESS CONSULTANTS with the US Securities and Exchange Commission in February.

Lockheed was enjoined in 1976 from violating the Foreign Corrupt Practices Act. The filing makes interesting reading for anyone wondering what the US government views as good practices when hiring foreign agents.

For example, Lockheed requires all foreign consultants to sign a written agreement promising to comply with US law on corrupt practices and spelling out what conduct is prohibited. It does not hire anyone holding a government position, any officer of a foreign political party or any candidate for political office. It does not hire persons who are linked to a potential customer unless

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ment in the deregulated European power market successful. Also, control of gas facilities will be a significant factor, as gas-fired generation capacity is expected to grow in the European nations because of its low cost, efficiency and cleaner environmental characteristics than other fuel sources. This is particularly relevant as phased competition in gas starts in 2000 pursuant to another EU directive, which will create convergence and arbitrage opportunities for investors involved in the electricity and gas markets. As in the US, competition in the European power market will likely gain a momentum of its own. The competitive European electricity sector is likely to experience the normal growing pains we are witnessing in the US, but there is no putting the genie back into the bottle. ■

Dutch Green Incentives Offer Possible Financing Angle

by Waldo Kapoen and Harmen Zeven, with Loyens & Volkmaars in The Hague

Two tax incentives for Dutch companies to make "green" investments may offer an angle for financing projects in Holland and eastern Europe. The two incentives are a discretionary accelerated depreciation facility, called "VAMIL," and a special deduction from taxable profit for energy-saving investments, called "EIA."

VAMIL

Regulations implementing the VAMIL program have been in effect since September 1991. "VAMIL" is an acronym for a phrase that translates from Dutch as "discretionary depreciation of ecological investments." The depreciation can be all at once, accelerated or also more gradual as desired by the investor. As soon as the equity participant enters into commitments or pays production costs, discretionary depreciation is possible. However, before actual use of the asset commences, only costs actually paid can be depreciated. The VAMIL regulation is aimed primarily at encouraging domestic investment. However, the state secretary in Holland indicated in a state resolution that investments in assets in certain countries in central and eastern Europe also qualify potentially.

The assets must appear on the so-called VAMIL list published in a ministerial regulation. They must have an important environment-improving effect. They must be based on new technologies that are not currently in use in Holland. It is sometimes possible to add other assets to the list. For certain assets, additional conditions are imposed. The assets must not have been used already.

In the case of investments outside Holland, the investment must have the effect of reducing air or water pollution in Holland. If only part of the investment qualifies, it is possible to make use of the discretionary depreciation method for the qualifying part. Intangible assets, like licenses, patents or software, do not qualify. There is no minimum investment amount required.

Within three months after entering into commitments or paying production costs, the investment must be submitted to the Ministry of VROM (Public Housing, Physical Planning and Environment) together with an auditor's report confirming the amount of the investment and that the assets are on the VAMIL list. The inspector has the right to deny benefits if the three months have already run. However, foreign investments must be submitted first to the Ministry of Finance for a determination that the investment contributes to an improvement of the environment in Holland.

EIA

An extra deduction for energy-saving investments has been available since January 1997. The owner of the project can deduct a certain percentage of his investment from taxable income. The percentage is 40% for investments between ƒ495,000 and ƒ205 million.

Unlike VAMIL benefits, the EIA benefit is available only for new projects situated in Holland.

The taxpayer must in fact run the enterprise that owns the project for its own account, although sale-leaseback transactions have sometimes been used to transfer the EIA benefit to another company that has the tax base to use it. Such transactions require an advance ruling.

The assets must not have been used already. The taxpayer must apply for a declaration from the Ministry of Economic Affairs that the investment is on an approved list. Certain assets are excluded from EIA by law. The program is subject to budget limits, so it is possible that in a year when the budget threshold is breached, the deduction percentage will be smaller than 40%. It is not clear whether the adjustment will only affect projects at the end of the queue for a year or all projects during the year. ■

Water Projects Present Different Risks Than Power

By Neil Golden and James Scarrow, in Washington

The water industry is the final major utility sector to be opened to the rigors of private competition, following in the footsteps of the telecommunications, power, and gas industries. Estimates put the value of the international water market at $300 billion a year, with infra-

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this is allowed by local law and the CEO of the customer consents to the arrangement in writing. However, it does let its foreign agents pay for meals for foreign officials.

US law makes it a crime for a US national or company to give anything of value to a foreign government official in an effort to win or retain business.

Congress broadened the statute last fall also to outlaw actions "to secure any improper advantage." It also added employees of international public organizations, like the Asian Development Bank or International Finance Corporation, to the list of persons to whom things of value cannot be given.

THE IRS IS STILL TARGETING DEBT-EQUITY SWAPS involving foreign government debt.

An example of a swap is where a US company buys government debt issued by a Latin American government at a discount to face value in the market. It then trades the debt for shares in a utility that the government has put up for sale in a privatization. If the US company is credited with greater value in the trade than it paid in the market for the government bonds, then the IRS will require that tax be paid on the gain.

The IRS lost a case in September 1997 called *GM Trading* involving a swap of Mexican government debt for pesos to be used by a maquiladora.

The IRS released a "field service advice" last month in which it rejected a refund claim from a company with similar facts to the taxpayer in *GM Trading*. The agency said it disagrees with the decision in *GM Trading*. It also cited another argument it plans to use in litigation with the taxpayer seeking the refund that it had not used in *GM Trading*. The taxpayer appears to have had its US parent buy the Mexican government debt. The parent then contributed it to a Mexican subsidiary before the swap with the Mexican government. The US collects toll charges whenever appreciated property is transferred offshore. Thus, even if the swap did not trigger a tax, the IRS intends to argue that the outbound transfer of the debt instruments did.

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Water Project Risk Profile

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structure investment needs approaching $60 billion a year over the next decade in developing countries alone. Although the water market is still considered relatively immature, the World Bank reports that the number of financial closings in this sector increased by tenfold between 1990 and 1997, with approximately one hundred closings reported during this eight-year period.

The water sector needs $60 billion in new investment over the next decade.

Water projects offer obvious attractions to project finance veterans interested in new frontiers. However, it is important to appreciate the economic, financial and technical characteristics that distinguish the water and power sectors.

Monopolistic Characteristics

Monopolies abound in water. While the unbundling of generation, transmission and distribution assets revolutionized the power industry, the same thing is unlikely to occur in water.

There are several reasons for this. First, water systems typically are local in nature and are not usually interconnected to regional or national grids. Thus, it is hard to imagine a realistic scenario in which residential or commercial customers could be given the option of choosing among multiple wastewater treatment providers. Second, the localized nature of water monopolies means that there may be limited economic gains to be achieved by unbundling water services, particularly since such "localized unbundling" can result in high transaction costs and losses of economies of scale. (Even though there are numerous examples of wastewater treatment plants being unbundled — that is, owned or operated by entities other than the owners of the water distribution and wastewater collection networks — it should be recognized that the great majority of investments in water systems are associated with collection and distribution networks, not treatment plants. Therefore, the limited unbundling that has occurred to date does not go to the heart of the water sector.) Finally, even where a water system might be large enough to allow some form of unbundling, each component of the system would continue to be a natural monopoly and not be subject to marketplace competition.

Because the water sector probably will retain its monopolistic nature, companies entering this sector can expect to reap steady, long-term investment returns free from marketplace risks. However, these companies can also expect that a relatively high degree of government regulation will continue, even as the water sector matures over the next twenty years. As a consequence, a reasonable expectation for internal rates of return in the water sector may be in the range of 10-15%, with perhaps higher returns going to industry pioneers. On a risk-adjusted basis, however, such returns may exceed the nominally higher returns that have been available in the power sector

Subsidies

In almost every country, water companies continue to receive significant government subsidies. These subsidies have prevented or retarded the development of commercial pricing for water services. Therefore, the success of a water sector privatization program frequently depends upon the private sector's ability to improve operational efficiencies to such an extent that reasonable investment returns can be achieved even after the subsidies are eliminated.

In many cases, such improvements are achievable. For example, during the first three years following privatization of water and wastewater services in greater Buenos Aires, labor productivity nearly tripled, and network rehabilitation significantly reduced water losses, allowing water distribution coverage to increase by 10 percent without any corresponding increase in water production.

In the event that efficiency gains cannot eliminate the need for subsidies, then either tariffs must be raised or some form of subsidy must continue even after privatization. There are risks associated with either course. A dramatic rise in tariffs can result in public backlash and reduction in bill collection rates. Meanwhile, reliance on continued government subsidies — as occurs, for example, where the government enters a contract for wastewater treatment services but does not collect adequate fees from end-users to cover contract fees — would raise both political and credit concerns. These risks can be reduced by encouraging governments to implement tariff reform prior to private participation in the sector, and by taking steps to ensure that whatever subsidies remain are phased out as quickly as reasonably possible.

Credit Concerns

Water sector privatization programs frequently require the private water service provider to accept payment from the local government (or its publicly-owned water company), rather than directly from residential or commercial end-users. Such structures can raise serious credit risks. For example, a Brazilian state-owned water company proposed issuing a sub-concession in which the private sub-concessionaire would be responsible for major capital investments and all operations within the service area. The sub-concessionaire was to have the right to a large portion of tariffs generated within the sub-concession area. However, tariffs were to be paid in the first instance to the water company by end-users, with the water company paying the sub-concessionaire from its own account. Because the sub-concessionaire would be relying on payment from a water company with a poor credit rating, and not directly from end-users, potential investors had serious concerns with the project even though

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US COMPANIES MAY UNWITTINGLY CREATE "STRADDLES," with adverse tax results, by borrowing in a foreign currency and on lending in the same currency to a foreign affiliate.

A "straddle" is where a company has two offsetting positions in foreign currency, a commodity or similar property. US companies use the dollar as their functional currency. If the foreign currency appreciates in value against the dollar, then the US company has a loss on its own borrowing. The loss might be triggered when the parent refinances. However, the US parent has an offsetting gain from the on lending to its foreign affiliate. The US tax laws deny losses in straddle transactions until the offsetting gain is reported.

The IRS addressed the situation in an old "field service advice" it made public in early March. A US company refinanced its own foreign currency borrowing. In the process, it had an exchange rate loss. However, the IRS said it could not claim the loss because of on offsetting loan in the same currency to an affiliate.

Congress enacted the straddle rules in 1982 to prevent games in the commodity markets. A taxpayer would go "short" and "long" in the same commodity. He would liquidate the loss position on December 31 and then liquidate the offsetting gain position a few days later. In the process, he was able to roll income forward to the next tax year.

AUSTRALIA AWARDED A$71 MILLION IN TAX REBATES TO FOUR INFRASTRUCTURE PROJECTS, including A$32.6 million to Duke Energy for development of an 800-kilometer gas pipeline from New South Wales to Victoria and A$10.4 million to Japanese trading company Itochu for development of a cogeneration plant in New South Wales. The rebates represent approximately 8% of the total cost of the projects and are taken over five years. They are the first rebates under an "Infrastructure Borrowings Tax Offset Scheme" established last year.

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there was a general consensus that the project would generate sufficient tariff revenues to provide an attractive return on investment.

In some instances, credit support for local governments (including municipal or state-owned water companies) may be available from state governments or through domestic or multi-lateral development banks. In other cases, the local government may agree that tariff receipts will not be co-mingled with other funds and instead will be deposited in a dedicated account in which the service provider has priority rights.

A private investor may not be able to capture the full gain from renovations that reduce leakage, but there is room for creativity.

Evaluation of Assets

Participants in water sector privatization programs often face the difficult task of evaluating the condition of buried water distribution and wastewater collection networks for which there are no as-built drawings or maps. These networks can be decades old and, in the case of water distribution networks, may be losing through leakage 10, 20 or even 50% of the flow passing through them. While there is no simple way to address the challenge of buying or leasing assets "site unseen," there may be innovate approaches to mitigating the associated risks. For example, because detailed metering information is frequently not available, it is often difficult to determine what percentages of a system's water losses are respectively caused by leakage (technical losses) and unmetered or illegal connections (commercial losses).

In situations where bulk water supplies are government owned and sold to the water utility at a subsidized, non-commercial price, a private investor may not be able to capture the full economic gain of system renovations that reduce leakage and other technical losses. Therefore, a potential investor that mistakenly believes that most of the system's losses are commercial losses may be at risk of overestimating the potential for increasing revenues through improved metering.

There may be creative ways to reduce this type of risk. For example, the owner of the bulk water supply may be willing to agree to share a portion of the economic benefits derived from any reductions in technical losses achieved by the investor in the distribution system. (Such agreements would be loosely analogous to electric utilities profiting from "demand side" management programs.) The appropriate time for discussing this and other types of innovative arrangements is during the formal or informal communications that occur with government authorities prior to formal initiation of the privatization program.

The value of wastewater collection networks not only depends on the physical condition of the infrastructure, but also on the quantity and quality of wastewater generated within the service territory. To evaluate these flows, a wide variety of demographic and hydrologic factors must be considered. Also of central importance is the scope and effectiveness of the local government's industrial "pretreatment" program, requiring local industries to remove hazardous substances from their wastewater prior to its discharge into the wastewater collection system. If these programs do not remain effective following privatization, there could be a significant risk of disruptions to the wastewater treatment plant, in addition to damage to the wastewater collection pipes and other assets. Therefore, unlike the power sector, where the government may have little or no responsibility for ensuring the quality of fuel or other inputs to a power plant, in the water sector, the government must continue to be an active partner with the service provider. ■

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FLORIDA SAID SALES TAXES DO NOT HAVE TO BE PAID on equipment for a gas-fired power plant.

A private contractor is building the plant for a municipal utility. The state exempts from sales taxes equipment used to produce electricity or steam, but there are two conditions. First, the boiler fuel must not be a residual oil. Second, the electricity or steam must be "primarily used in manufacturing . . . tangible personal property for sale." The state appears to have decided in this case that steam will be used to manufacture electricity — an item of "tangible personal property." The Department of Revenue said, "It is the established position of the Department that the electrical energy is the tangible personal property that is produced for sale." The advice is in a technical assistance advisement issued in December.

US BANKS CAN CLAIM FOREIGN TAX CREDITS IN THE US for withholding taxes tied to loans to the Brazilian central bank, according to a recent federal appeals court decision.

Riggs Bank made "net loans" to the Brazilian central bank in the 1980's. The borrower agreed to "gross up" its interest payments to Riggs for any Brazilian taxes Riggs would have to pay on the interest. Riggs claimed it was entitled to foreign tax credits in the US for Brazilian taxes paid on its behalf by the central bank.

The IRS argued that any taxes that had to be paid on the interest were purely voluntary. The US does not allow foreign tax credits for voluntary taxes. Interest paid on borrowing by the Brazilian central bank is normally exempted from withholding taxes, but a tax was imposed in this case by special ruling by the Brazilian tax authorities. According to the IRS, Brazil realized that by shifting money from one pocket to another — from the central bank to the Brazilian tax collector — it might reduce Riggs' US tax liability. Riggs shared the benefit with the central bank by charging a lower interest rate.

The US court of appeals for the DC circuit said, "the opportunistic nature of the Brazilian government's action is particularly vexing . . . [but the IRS] has not yet fashioned a legitimate legal challenge to Riggs' use of the foreign tax credit in this case."

The case was sent back to the US Tax Court to confirm the taxes were in fact paid by the central bank.

GERMAN LEASE STRUCTURES HAVE COME UNDER FIRE FROM THE GERMAN GOVERNMENT.

The government proposed a series of tax changes late last year that would take much of the juice out of the structures. German leases shift the lessor profit to lease expiration. The lessor can qualify for capital gains rates at one half the normal tax rate on the profit by liquidating when the lease expires. The government proposes to kill off the half tax rate from the beginning of 1999.

German law limits investors in lease transactions from using net losses during early years of the lease term to shelter more income from other transactions than the amount of equity they have invested in the lease deal. However, the leasing industry has found a way around this limit by moving the debt up one tier so that the investor contributes the borrowed funds to the lessor entity as equity. The government hit back in a draft tax bill last November by proposing a new minimum tax that would prevent individuals from using passive losses from leasing and other loss-making structures to reduce taxable income by more than half. This will reduce the amount of available lease equity in the market.

The finance ministry also issued a draft tax guideline recently that would bar leasing funds from using the regular tables to calculate tax depreciation. They would have to accept a longer life for the assets linked to the high residual value usually claimed in the prospectuses for leasing deals.

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CAPITAL CONTRIBUTIONS BY US PERSONS TO FOREIGN CORPORATIONS AND FOREIGN PARTNERSHIPS MUST BE REPORTED to the IRS under new rules issued last month.

The new rules require the following. All capital contributions to foreign corporations in which the US person owns at least a 10% interest must be reported, regardless of amount. A separate statement is required for each cash transfer. The information required is in Temp. Treas. Regs. § 1.6038B-1T(c). It is *not* reported on Form 926. Reporting is also required for capital contributions of at least $100,000 in amount to foreign corporations in which the US taxpayer owns less than a 10% interest. These rules apply to capital contributions in tax years beginning after February 5, 1999.

The regulations are silent on when to report. The assumption is it is with the annual tax return for the US parent.

Capital contributions to foreign partnerships must also be reported. These reports are due once a year with the US person's tax return and are made on Form 8865. The reports are required only if the US person owns at least a 10% interest in the partnership immediately after the transfer or the US person has contributed at least $100,000 to the partnership in the 12 months ending with the most recent contribution. The partnership reporting rules apply to capital contributions from January 1, 1998.

BRIEFLY NOTED: Lobbyists for coal interests are trying to persuade Congress to authorize approximately $1.5 billion in tax subsidies for new power plants that use clean coal technologies. Only the first 6,000 megawatts of generating capacity would qualify. The Department of Energy would choose among competing applicants . . . . Treasury officials have tentatively offered the airlines a "safe harbor" that would let them expense the cost of periodic engine overhauls provided the cost is not more than 15% of the original cost of the engine. The safe harbor might influence where lines are drawn in the utility industry when overhauling turbines . . . . Tractebel has secured a 75% property tax abatement for seven years for a 350-mw gas-fired combined-cycle power plant that the company plans to build in Ennis, Texas just outside Dallas. Developers of greenfield projects in the US usually try to negotiate concessions on property taxes before committing to a site . . . . The US Senate Finance Committee voted on March 4 to reduce the carryback period for unused foreign tax credits from two years to one. The change would apply to foreign tax credits generated in tax years after 2001. The House rejected the same change last year . . . . Brazil is expected by March to renew the CPMF tax and increase the rate from 0.2% to 0.38%. The tax applies to all financial transactions. It expired in January . . . . Hearings on rewriting US international tax rules will get under way in the Senate on March 11. They are expected to last several months. Meanwhile, the Treasury Department is at work on a "white paper" with its own proposals to be issued sometime this summer . . . . American Landfill, Inc. failed in January to have a federal court set aside discriminatory taxes in Ohio on landfills that accept garbage from outside the local refuse district. Federal courts are barred by the "Tax Injunction Act" from restraining collection of any state tax "where a plain, speedy and efficient remedy may be had in the courts of such State."

— contributed by Keith Martin, Heléna Klumpp and Ken Hayduk in Washington, Kerin Cantwell in Hong Kong, and Waldo Kapoen and Harmen Zeven with Loyens & Volkmaars in The Hague.

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