DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

February 5, 2002

Number: **200211043**
Release Date: 3/15/2002
POSTF-153290-01/CC:PSI:8
UILC: 451.08-00

INTERNAL REVENUE SERVICE
NATIONAL OFFICE CHIEF COUNSEL ADVICE

MEMORANDUM FOR AREA COUNSEL
NATURAL RESOURCES

FROM: Richard A. Kocak
Chief, Branch 8
Office of Associate Chief Counsel
(Passthroughs and Special Industries) CC:PSI:8

SUBJECT: Mining - Export Coal Excise Tax
POSTF-153290-01

This Chief Counsel Advice responds to Issue 1 of your September 28, 2001, memorandum. In accordance with § 6110(k)(3) of the Internal Revenue Code, this Chief Counsel Advice should not be used or cited as precedent. Please call if you have any further questions about this matter.

ISSUE

When a producer of coal that uses the accrual method of accounting claims a refund of coal excise tax that is income under the tax benefit rule, in what year does that refund and the interest thereon become properly accruable in income?

CONCLUSION

In the fact patterns described below, a refund of coal excise tax and the interest thereon generally will be properly accruable in income in the year in which the IRS makes the determination that a taxpayer is entitled to a refund.

BACKGROUND

The coal tax

Section 4121 imposes a manufacturers excise tax on coal from mines located in the United States sold by the producer. The producer selling the coal is liable for the tax. The coal tax is reported and paid for each calendar quarter on Form 720, Quarterly Federal Excise Tax Return, and producers generally must make deposits of the tax twice a month.

Most of the statutory rules generally applicable to manufacturers excise taxes apply to the coal tax. However, the Congress specifically provided that the exemptions usually afforded to manufacturers excise taxes, including sales for export, do not apply to the coal tax. See the introductory text of § 4221(a). Similarly, the credits and refunds usually allowed for manufacturers excise taxes do not apply to the coal tax. See the flush language of § 6416(b)(2).

The Export Clause

The Export Clause of the U.S. Constitution (Art. I, § 9, cl. 5) provides that "no tax or duty shall be laid on articles exported from any state." Recent judicial activity under the Export Clause began with United States v. IBM, 517 U.S. 843 (1996). There the Court held that the foreign insurance tax imposed by § 4371 is invalid with respect to insurance premiums paid for goods that are in the stream of export. This decision was followed by United States v. U.S. Shoe Corp., 523 U.S. 360 (1998), in which the Court held the harbor maintenance tax imposed by § 4461 violated the Export Clause as applied to goods loaded at U.S. ports for export. Both of these cases are consistent with the Court's earlier decision in A.G. Spalding & Bros. v. Edwards, 262 U.S. 66 (1923). There, in a case with facts very similar to the facts in some of the current coal export cases, the Court held that a tax violated the Export Clause when the taxable event occurred at the same moment that the goods entered the stream of exportation.

The coal tax itself was held unconstitutional as applied to exports in Ranger Fuel Corp. v. United States, 33 F. Supp. 2d 466 (E.D. Va. 1998), amended, 1999 U.S. Dist. LEXIS 2141 (E.D. Va. Feb. 10, 1999). Notice 2000-28, 2000-21 I.R.B. 1116, acquiesces, in effect, to Ranger.

In Ranger, the court held that even though the coal tax is unconstitutional as applied to exports, the plaintiffs still had to meet the conditions of § 6416(a)(1) (discussed in detail below) before the IRS could issue the refunds. The court noted that the "plaintiff seeking the refund bears the burden of proving that the statute is satisfied." 33 F. Supp. 2d at 468. The Ranger plaintiffs met the § 6416(a)(1) requirements by obtaining the written consents of the ultimate purchaser of the coal and thus did not have to prove that they had absorbed the economic burden of the tax. There are more than 50 cases currently in refund litigation in the U.S. Court of Federal Claims relating to exports of coal. One of the issues in dispute is whether the plaintiffs included the amount of the tax in the price of the coal.

Coal tax overpayments

Under Notice 2000-28, the tax paid on coal is an overpayment for purposes of § 6402 if the coal is (1) in the stream of export when sold by the producer, and (2) actually exported. Section I of the Notice gives examples of the type of sales of coal by a producer that are in the stream of export and the evidence that is needed to prove exportation. The options for proof of export are derived from § 48.4221-3(d) of the Manufacturers and Retailers Excise Tax Regulations. Although § 6416(c) and Notice 2000-28 allow claims by exporters if the producer waives its right to claim, to our knowledge no such claims have been filed.

Conditions to allowance of claims relating to manufacturers excise taxes

Manufacturers usually pass on the total cost of articles sold, including tax costs, to their customers. Thus, manufacturers would receive a windfall if they later received a credit or refund of excise tax paid with respect to the sale. To prevent this, in 1932 the Congress enacted what currently is § 6416(a)(1). This provision generally provides that a manufacturer may be allowed a credit or refund only if it has borne the economic burden of the tax or has received the written consent of the ultimate purchaser of the article to the allowance of the claim.

Specifically, § 6416(a)(1) provides that no credit or refund of any overpayment of tax imposed by chapter 32 (including the coal tax) shall be allowed or made unless the person that paid the tax establishes one of the following:

> (a) It neither included the tax in the price of the article with respect to which it was imposed nor collected the amount of the tax from its buyer.
>
> (b) It has repaid the amount of the tax to the ultimate purchaser of the article.
>
> (c) It received the written consent of the ultimate purchaser of the article to the allowance of the claim.

With regard to testing whether a person has borne the economic burden of the tax, the factors described in Tenneco, Inc. v. United States, 17 Cl. Ct. 345 (1989), aff'd, 899 F.2d 1227 (table) (Fed. Cir. 1990) are instructive. With regard to whether the written consents must be received by the manufacturer by the time the claim is filed, see Rev. Rul. 58-563, 1958-2 C.B. 892.

Summary of requirements

The following must have occurred in order for the IRS to allow a coal tax claim under the Code based on exported coal:

- The coal was in the stream of export when sold by the producer.
- The coal was actually exported.
- The producer paid the tax to the government.
- The producer has filed a timely claim.
- The conditions to allowance of § 6416(a)(1) have been met.

COMMON FACT PATTERNS FOR COAL TAX CLAIMS

Most of the sales of the coal in question were made before Ranger was decided, and most of the refund claims were filed before Notice 2000-28 was issued. The IRS is now reviewing the claims of each producer to determine if the claims are allowable. If a claim meets all the factual and legal requirements, including the requirements of § 6416(a)(1)), the IRS will allow that claim.

Fact Pattern 1

A producer alleges the following:

- The producer sold coal directly to foreign purchasers for export and that its selling price was at the "world price."
- The world price, set by coal buyers in other countries, does not include a U.S. coal tax component. If the producer finds the world price to be unacceptable, the producer is not in a position to negotiate a higher price; rather, the producer usually must forego making the sale.
- The producer's costs do not enter into its price negotiations with its buyers.
- Because the world price does not include an excise tax component the producer did not pass on the amount of the tax to its customer.

Fact Pattern 2

The facts are the same as Fact Pattern 1 except that the producer's contract with the foreign purchaser provides that the amount of the tax is included in the price to the foreign purchaser. In these cases, the producer received the written consent of the foreign purchaser to the allowance of the claim. It should be noted that the foreign purchaser is under no legal obligation to provide the written consent.

Fact Pattern 3

The facts are the same as Fact Pattern 1 except that the producer sold the coal to a domestic broker for export. In these cases, it may be more difficult for the producer to establish that the § 6416(a)(1) requirements have been met. This is because the producers generally have alleged that they sold the coal to the broker at the world price, which is alleged not to include an amount representing coal tax. IRS agents have been asked to examine the producers' claims carefully because both the producer and the broker probably did not sell the coal at issue at the world price. Also, at least one broker has claimed that it bought coal at a tax-included price, which would invalidate the producer's claim unless it repaid the amount of the tax or received the written consent of the ultimate purchaser.

LAW

Section 451(a) provides the general rule that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, the amount is to be properly accounted for as of a different period.

Section 1.451-1(a) of the Income Tax Regulations provides, in part, that gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Under an accrual method of accounting, income is includible in gross income when all the events have occurred that fix the right to receive that income and the amount thereof can be determined with reasonable accuracy.

Rev. Rul. 62-160, 1962-2 C.B. 139, states that an accrual method taxpayer should accrue interest on a credit or refund of tax as of the date the right to receive the credit or refund is determined. Generally, this will occur on the date that an authorized IRS officer first certifies the allowance of an overassessment in respect of the tax. Exceptions to the general rule arise in those cases in which a right to receive a refund or credit is in fact duly established otherwise than by the certification of the overassessment. For example, in a case where a refund is made after settlement and administrative closing of the case as mutually agreed upon by the taxpayer and the IRS, the date the agreement is duly executed by both parties or the effective date of the agreement, whichever is the later, is the date that interest on the overpayment accrues as income. Additional exceptions to the general rule will apply in cases involving litigation. See also Household Products, Inc. v. Commissioner, 24 B.T.A. 594 (1931) (stating that the language of the statute indicates that prior to the allowance of the refund there was no liability for interest running from the government to a taxpayer), acq., 1962-2 C.B. 4, and Pacific Coast Biscuit Co. v. Commissioner, 32 B.T.A. 39 (1935), acq. on this issue, 1962-2 C.B. 5.

Under the facts of Rev. Rul. 65-190, 1965-2 C.B. 150, New York State permitted a net operating loss deduction for state corporation franchise tax purposes that was "presumably the same," with certain adjustments, as that allowed under § 172 of the Internal Revenue Code of 1954. In order to obtain such a refund, a taxpayer had to file a claim with the state tax authority. The revenue ruling holds that a refund of state corporation franchise taxes resulting from a net operating loss carryback is properly accruable in the income of an accrual method taxpayer in the taxable year of the loss which gives rise to the refund, rather than in a later year in which the claimed refund is approved or received. The revenue ruling states that the inclusion in gross income will be required even though it may be necessary for additional acts to be performed by third persons, if it is reasonable to expect that these acts will be performed. The revenue ruling states that the amount of the net operating loss can be calculated with reasonable accuracy from the books and accounts of the taxpayer. Assuming the validity of the taxpayer's transactions and the correctness of the figures so established, the net operating loss incurred will be approved by the state tax authority if the claim is properly submitted.

In Rev. Rul. 69-372, 1969-2 C.B. 104, Colorado permitted a net operating loss deduction for state income tax purposes in the same manner that it is allowed under the Internal Revenue Code of 1954. In order to obtain a refund, a taxpayer had to file a claim for refund (or an application for a tentative carryback adjustment) with the state tax authority. The revenue ruling holds that a refund of Colorado State income tax resulting from a net operating loss carryback is properly accruable in the income of an accrual method taxpayer in the taxable year of the loss which gives rise to the refund, rather than in a later year in which the claimed refund is approved or received.

In Rev. Rul. 70-419, 1970-2 C.B. 5, the taxpayer was a national bank that used the accrual method of accounting. The taxpayer paid state sales and use taxes for 1967 and deducted these items on its federal income tax return for 1967. In 1968, it was determined that national banks were exempt from such state taxes. The taxpayer was entitled to a refund of the state taxes, but instead chose to treat the taxes paid as a contribution to the state. The revenue ruling holds that the previously deducted taxes were includible in gross income in 1968 and were deductible, subject to certain limitations, as a charitable contribution in 1968.

Rev. Rul. 73-385, 1973-2 C.B. 151, addresses the issue of when banks that used the accrual method of accounting had to accrue refunds of Virginia sales and use taxes. Banks located in Virginia filed claims for refund of state sales and use taxes. Even though there was a 1968 Supreme Court decision holding that national banks were exempt from similar taxes in Massachusetts, the Virginia tax authority would not honor any refund claim until the disposition of a case decided against a bank in New York State court, which occurred in 1969. However, affirmative action was not taken by the Virginia tax authority to process refunds until 1970. The revenue ruling, distinguishing Rev. Rul. 70-419, holds that the refunds of Virginia sales and use taxes were accruable in income in 1970. The revenue ruling expressly states that the furnishing of the evidence required by the Virginia tax authority was merely an administrative procedure so that the claims could be processed.

In Doyle, Dane, Bernbach, Inc. v. Commissioner, 79 T.C. 101 (1982), nonacq., 1988-2 C.B. 1, the Tax Court addressed the issue of when an accrual method taxpayer must include in its gross income amounts representing claimed refunds of New York State franchise taxes and New York City general corporate taxes resulting from a net operating loss carryback. Under New York State law, the New York State Tax Commission had the right to examine any refund claim before allowing it. A similar procedure existed for New York City. The taxpayer argued that, because the claimed refunds could have been disallowed in whole or in part as a result of an examination by the state, city, or federal tax authorities, all events fixing the right to such refunds had not occurred and similarly that the amount could not be determined with reasonable accuracy. The government argued the position set forth in Rev. Rul. 65-190. The court noted that there was nothing inconsistent with applying a standard of including income in an accrual method taxpayer's gross income if only additional mechanical acts by third parties need to be completed. However, the court found it arbitrary for the government to assert that it was reasonable to expect the state taxing authority's and city taxing authority's certifications of the claimed refunds under the facts of the case. Consequently, the court rejected Rev. Rul. 65-190 and held that the taxpayer need not include in income refunds of New York State franchise taxes and New York City corporate taxes resulting from a net operating loss carryback until the year the right to those refunds is ultimately determined.

In Yapp Corp. v. Commissioner, T.C. Memo. 1992-348, the Tax Court addressed the issue of whether a taxpayer should accrue Illinois State income and replacement tax refunds attributable to net operating loss carrybacks in either (1) the year of the loss that gave rise to the respective refund, or (2) the year the state revenue department reviews the claim and concludes that the taxpayer is entitled to the refund. The court stated that the case involved essentially the same circumstances as Doyle, Dane, Bernbach, Inc.. The government urged the court to reconsider its decision in Doyle, Dane, Bernbach, Inc., and the government contended that the review performed by the state revenue department was essentially ministerial. The court found otherwise and held that the refunds were accruable in income when the state revenue department determined that the taxpayer had a right to a refund. Later, in Yapp Corp. v. Commissioner, T.C. Memo. 1993-323, the court determined that the government's position in the prior proceeding was not substantially justified and awarded the taxpayer administrative and litigation costs.

ANALYSIS

Before Notice 2000-28 was issued, a taxpayer did not know whether the IRS would follow Ranger. In Notice 2000-28 the IRS acquiesced, in effect, to the legal conclusion that the coal tax was unconstitutional as applied to exports. However, the fact that the IRS is no longer contesting that specific issue does not necessarily mean that there are no other issues, either legal or factual, that might be contested by the IRS before it would allow a claim. Notice 2000-28 also established the rules for obtaining a refund when tax had been paid with respect to a nontaxable sale of exported coal. A taxpayer could not reasonably assume that the IRS would routinely or automatically grant the refunds at issue; in fact, the IRS generally did not begin to pay these claims until the last months of 2001, which was over a year after the Notice was issued. Furnishing the evidence required by the Notice is not merely an administrative procedure so that the claims could be processed, making this situation distinguishable from Rev. Rul. 73-385.

We do not believe it is necessary in the context of this Chief Counsel Advice to resolve any conflict between the position set forth in the revenue rulings and the position of the Tax Court. Rev. Rul. 65-190 states that an item may be required to be included in gross income even though it may be necessary for additional acts to be performed by third persons, if it is reasonable to expect that these acts will be performed. Although the Tax Court rejected Rev. Rul. 65-190 in Doyle, Dane, Bernbach, Inc., the Tax Court noted that the ruling assumes the validity of the transactions and the correctness of the amount and there was nothing inconsistent with applying a standard of including income in an accrual method taxpayer's gross income if only additional mechanical acts by third parties need to be completed.

Under the Fact Patterns described above, the validity of the transactions and the correctness of the amount of the refund have not been clearly established. It is not reasonable for a taxpayer to expect that the IRS would grant a refund without thoroughly reviewing and possibly contesting the factual or legal issues. Of course, the facts of a specific case may vary from the Fact Patterns described above and, consequently, may result in a different conclusion with respect to when to include a refund in income.

With regard to the accrual of interest, Rev. Rul. 62-160 provides that an accrual method taxpayer should accrue interest on a credit or refund of tax as of the date the right to receive the refund or credit is determined. This generally will occur on the date that an authorized IRS officer first certifies the allowance of an overassessment in respect of the tax, assuming the circumstances of Fact Patterns described above do not involve an administrative settlement or litigation.

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS

[redacted]

[redacted]