

DESCRIPTION OF TAX BILLS
(S. 1911 and S. 2642)

Relating to

ACCOUNTING FOR MINING RECLAMATION RESERVES

Scheduled for a Hearing
Before the
Subcommittee on Energy and Agricultural Taxation
of the
Senate Committee on Finance
on December 7, 1982

Prepared by the Staff
of the
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INTRODUCTION

The bills described in this document are scheduled for a hearing on Tuesday, December 7, 1982, before the Senate Finance Subcommittee on Energy and Agricultural Taxation. There are two bills scheduled for the hearing: (1) S. 1911 and (2) S. 2642 (both relating to the accounting for mining reclamation reserves).

The first part of the document is a summary of the bills. This is followed in the second part by a more detailed description of the bills, including present law, issues, explanation of provisions, effective dates, and estimated revenue effects.

I. SUMMARY

1. S. 1911¹ - Senators Specter and Byrd (W. Va.)

The Mining Reclamation Reserve Act of 1981

The Surface Mining Control and Reclamation Act of 1977 and similar State laws require surface mine operators to restore land that is disturbed by the mining process. Present law is unclear as to when surface mining reclamation expenses may be accrued.

S. 1911 would provide that a taxpayer may elect, on a property-by-property basis, to deduct the estimated expenses of surface mining reclamation ratably over the life of the mine. Cash basis taxpayers would be permitted to elect this method of accounting for reclamation costs.

The provisions of this bill would apply to taxable years ending after the date of the enactment of this Act.

2. S. 2642 - Senators Wallop and Symms

The Comprehensive Mining Reclamation Reserve Act of 1982

The Surface Mining Control and Reclamation Act of 1977 and similar State laws require surface mine operators to restore land that is disturbed by the mining process. Present law is unclear as to when surface mining reclamation expenses may be accrued.

S. 2642 would provide that a taxpayer may elect, on a property-by-property basis, to deduct the estimated expenses of surface mining reclamation either ratably over the life of the mine or in the year the land is disturbed. Cash basis taxpayers would be permitted to elect to use either of these methods of accounting for reclamation costs.

The provisions of this bill would apply to taxable years ending after the date of the enactment of this Act.

¹ S. 1911 is substantially similar to H.R. 4815 introduced by Congressmen Bailey (Pa.) and Murphy.



II. DESCRIPTION OF TAX BILLS

1. S. 1911 - Senators Specter and Byrd (W. Va.)
The Mining Reclamation Reserve Act of 1981
2. S. 2642 - Senators Wallop and Symms
The Comprehensive Mining Reclamation Reserve Act of 1982

Present law

The Surface Mining Control and Reclamation Act of 1977 and similar State laws impose specific reclamation requirements on surface mine operators. Mine operators must guarantee their compliance with these requirements by posting bonds or otherwise proving their financial responsibility. The time at which reclamation expenses may be deducted in computing taxable income is determined under the generally applicable tax rules. Thus, for a taxpayer using the cash method of accounting, these expenses may be deducted when paid. For an accrual method taxpayer, items may be deducted in the year in which all events have occurred which determine the fact of liability and the amount thereof can be determined with reasonable accuracy. When surface mining reclamation expenses may be accrued under the general rules for accrual is unclear.

Prior to 1978, the mining industry assumed that a surface mining operator should accrue the estimated expenses of reclamation as mining operations progressed. This assumption was based primarily on the court decisions in Harrold v. Commissioner, 192 F.2d 1002 (4th Cir. 1951) and Denise Coal Co. v. Commissioner, 271 F.2d 930 (3rd Cir. 1959) which permitted State-mandated reclamation expenses to be accrued as mineral was extracted. In 1978, the Internal Revenue Service issued a private letter ruling which did not follow the Harrold and Denise line of cases. This private letter ruling stated that reclamation expenses cannot be accrued until the year in which reclamation occurs. Since then, the Tax Court has decided Ohio River Collieries v. Commissioner, 77 T.C. 1369 (1981). In that case, the court held that surface mining reclamation costs that could be estimated with reasonable accuracy were properly accrued when the overburden was removed.

Issues

The first issue is whether the costs should be deducted (a) in the year the land is disturbed, (b) as minerals are extracted or (c) when the reclamation occurs.

The second issue is whether the taxpayer should be given the opportunity to elect which of the three methods to use (i.e., to deduct the costs when the land is disturbed, the minerals extracted or the reclamation occurs) and whether the election should be on a property-by-property basis or should apply to all properties consistently.

The third issue is whether cash basis taxpayers should be permitted to elect to use these methods for reclamation costs.

Explanation

General

Both bills would allow a taxpayer engaged in surface mining to elect, on a property-by-property basis, to deduct in computing its taxable income a reasonable addition to reserves established for the estimated expenses of surface mining land reclamation. Estimated expenses would be allocated to the minerals extracted. Thus, the accrued reclamation expenses would be deducted ratably over the life of the mine. S. 2642 would also allow the taxpayer to elect to allocate estimated expenses to the property rather than to production. In this instance, the accrued reclamation expenses would be deducted, to the extent of disturbance, in the year that the portion of the land is disturbed. Under both bills, cash basis taxpayers would be allowed to use the accrual method for reclamation costs. These bills do not affect the tax treatment of expenditures for the extraction of oil or gas, or for the extraction of minerals from brines or seawater.

Estimated expenses

Estimated expenses of surface mining land reclamation are amounts deductible by the taxpayer under the income tax rules that (1) are attributable to qualified reclamation activities (as defined in the bill) to be conducted in future taxable years, (2) are subject to estimation with reasonable accuracy, and (3) are allocable to minerals extracted before the end of the taxable year. In addition, S. 2642 permits the taxpayer the option of allocating estimated expenses on the basis of the portion of the property disturbed by surface mining rather than on the basis of minerals extracted. Taxpayers could elect to use different methods for different properties.

Qualified reclamation activities are defined as land reclamation activities conducted under a reclamation plan submitted as part of a surface coal mining permit application under the Surface Mining Control and Reclamation Act of 1977 or under a plan submitted pursuant to a Federal or State law imposing substantially similar surface mining land reclamation requirements. Thus, a qualifying plan would have to have been submitted to obtain a surface mining permit and would include the items specified in section 508 of the Surface Mining Control and Reclamation Act of 1977. If the reclamation plan is revised, only the activities described in the revised plan are subject to the reserve provision.

Nonqualified land reclamation expenses (i.e., expenses for reclamation activities other than those described in the plan) would be deductible in the manner prescribed by regulations.

Excessive reserve for estimated expenses

The bills also provide that if the amount in any reserve for estimated expenses of surface mining land reclamation is determined to be excessive at the close of any taxable year, then the excess shall be taken into account in computing taxable income for that year. Thus, if at the conclusion of reclamation activities the reserves were not entirely expended, the excess would be included in the taxpayer's income for that year unless the excess resulted from an unreasonable addition to the reserve in a prior year, in which case the prior year's income would be increased.

Elections

The provisions of the bills are elective on a property-by-property basis. A taxpayer may elect reserve accounting without the consent of the Secretary if the election is made not later than the time for filing the income tax return of the first taxable year ending after enactment in which the taxpayer is engaged in surface mining on the property and for which there are estimated expenses of surface mining land reclamation. Consent of the Secretary is required to elect reserve accounting beginning in any taxable year after the first post-enactment taxable year in which the taxpayer is engaged in mining on a property and has estimated reclamation expenses. The consent of the Secretary is also required to terminate the reserve accounting election. Furthermore, the provision in S. 2642 to allocate estimated costs to the property as overburden is removed rather than to the minerals extracted is elective on a property-by-property basis.

Transition rules

Estimated expenses of surface mining and reclamation that are attributable to mining activities occurring before the first taxable year for which reserve accounting is elected and which have not been previously deducted are treated as deferred expenses and may be deducted ratably over a 60-month period beginning the first month of the first taxable year for which reserve accounting is elected. If mining of a property with respect to which there are deferred expenses will be completed in less than 60 months, then the expenses can be deducted ratably over that shorter period. If any amount deducted under this 60-month rule is determined to be excessive, then under the general rules, that amount will be taken into account in computing the taxpayer's taxable income for the year in which the excess is determined.

The bills provide that if a taxpayer elects reserve accounting for the first taxable year ending after enactment and has used an accrual method of accounting, which resulted in a deduction for the reclamation expenses prior to the taxable year in which the expenses were paid, for a continuous period of one or more taxable years ending before enactment, then the taxpayer may elect to have that method treated as a valid method of accounting for that period. This election can be made with respect to only one such continuous period.

Effective date

The provisions of these bills would apply to taxable years ending after the date of the enactment of this Act.

Revenue effect

S. 1911 would reduce fiscal year budget receipts by less than \$5 million annually for the fiscal years 1983 through 1987.

S. 2642 would reduce fiscal year budget receipts by \$15 million in fiscal year 1983, \$6 million in 1984, and \$5 million annually in 1985, 1986, and 1987.

