[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS
(S. 237 and S. 1006)

RELATING TO

ACCOUNTING FOR MINING RECLAMATION RESERVES; REPEAL OF REDUCTION IN IRON ORE AND COAL PERCENTAGE DEPLETION DEDUCTION

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

OF THE

SENATE COMMITTEE ON FINANCE
ON MAY 23, 1983

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

MAY 20, 1983

U.S. GOVERNMENT PRINTING OFFICE

20-576 O WASHINGTON : 1983 JCS-14-83

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INTRODUCTION

The Subcommittee on Energy and Agricultural Taxation of the Committee on Finance has scheduled a public hearing on May 23, 1983, on the accounting for mining reclamation reserves (S. 237—introduced by Senator Wallop), and the treatment of the tax preference for percentage depletion on iron ore and coal production (S. 1006—introduced by Senator Specter).

The first part of this pamphlet 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. 237—Senator Wallop

"The Comprehensive Mining Reclamation Reserve Act of 1983"

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. The mining industry and the IRS disagree as to when surface mining reclamation expenses may be accrued.

S. 237 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.

2. S. 1006—Senator Specter

Repeal of Reduction in Iron Ore and Coal Percentage Depletion Deduction

The Tax Equity and Fiscal Responsibility Tax Act of 1982 (TEFRA) reduced by 15 percent the excess of percentage depletion deduction otherwise allowable for iron ore and coal (including lignite) production by a corporation over the adjusted basis of the property. In addition, TEFRA provided that only 71.6 percent of the excess of the allowable depletion deduction for these minerals over the adjusted basis of the property will be treated as a corporate tax preference under the minimum tax.

S. 1006 would repeal these TEFRA provisions.

These provisions would be effective for taxable years beginning after 1983.

II. DESCRIPTION OF BILLS

1. S. 237—Senator Wallop

"The Comprehensive Mining Reclamation Reserve Act of 1983"

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.

In hearings on similar bills (S. 1911 and S. 2642 (97th Congress)), the Treasury testified that in their view *Ohio River Collieries* was incorrectly decided and that the "all events" test for accruing deductions does not mandate the accrual of estimated reclamation expenses. In addition, the Treasury testified that a current deduction for an expense to be paid in the future fails to take into account the time value of money and, thus, overstates the amount of the current deduction.

Issues

The first issue is whether the mining reclamation 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, when the minerals are extracted, or when 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 taxpayers using the cash method of accounting should be permitted to elect to use these methods for reclamation costs.

Explanation of the Bill

In general

The bill 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. Under the bill, the taxpayer would be allowed to elect to allocate the estimated expenses on the basis of either the minerals extracted or the property disturbed by surface mining. Accrued reclamation expenses allocated on the basis of minerals extracted, i.e., to production, would be deducted ratably over the life of the mine. In contrast, accrued reclamation expenses allocated on the basis of property disturbed would be deducted, to the extent of disturbance, in the year that the portion of the land is disturbed. In addition, cash basis taxpayers would be allowed to use the accrual method for reclamation costs. This bill does 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 either to minerals extracted before the end of the taxable year or to the portion of the property disturbed by surface mining which occurs before the close of the taxable year. Taxpayers could elect to use different methods of allocating estimated expenses 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 bill would 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 bill are elective on a property-by-property basis. A taxpayer may, without the consent of the Secretary, elect reserve accounting 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. Included in the provisions of the bill that are elective on a property-by-property basis is the provision that permits taxpayers to elect to allocate estimated costs either to the minerals extracted or to the property as the overburden is removed.

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 would be treated as deferred expenses and could 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 could 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 would be taken into account in computing the taxpayer's taxable income for the year in which the excess is determined.

The bill would 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 could elect to have that method treated as a valid method of accounting for that period. This election could be made with respect to only one such continuous period.

Effective Date

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

Revenue Effect

It is estimated that the bill would reduce fiscal year budget receipts by $15 million in fiscal year 1984, $6 million in 1985, and $5 million annually in 1986, 1987, and 1988.

2. S. 1006—Senator Specter

Repeal of Reduction in Iron Ore and Coal Percentage Depletion Deduction

Present Law

Depletion deduction

Under present law, a holder of an economic interest in iron ore or coal (as well as other natural deposits) may deduct an allowance for depletion in computing taxable income. A taxpayer determines its depletion deduction for iron ore or coal under either the percentage depletion method or cost depletion method, whichever results in the greater allowance for depletion for the taxable year.

Under the percentage depletion method, a fixed statutory percentage of the taxpayer's gross income from the property is allowed as a deduction. The percentage is 15 percent in the case of domestic iron ore; 14 percent in the case of foreign iron ore; and 10 percent in the case of coal (including lignite). The deduction may not exceed 50 percent of the taxpayer's taxable income from the property.

The allowance for cost depletion may not result in recovery of more than the taxpayer's basis in the property. The percentage depletion allowance is computed without regard to the taxpayer's basis in the property and may, therefore, exceed the taxpayer's basis in the property.

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) reduced the percentage depletion deduction otherwise allowable to corporations for iron ore and coal (including lignite) by 15 percent of the amount that such deduction would otherwise exceed the adjusted basis of the property.

Minimum tax

In general, the excess of the percentage depletion deduction allowable with respect to any property, over that property's adjusted basis at the close of the taxable year (determined without regard to the depletion deduction for the taxable year), is an item of tax preference for purposes of the corporate minimum tax. In order to prevent the combination of the minimum tax and the 15-percent preference reduction from reducing the tax benefit from the taxpayer's marginal dollar of preference by more than it was reduced under prior law, TEFRA provided that only 71.6 percent of the excess percentage depletion deduction allowable for iron ore and coal (including lignite) is treated as a corporate tax preference item.

The TEFRA provisions are effective for taxable years beginning after 1983.

Issue

The issue is whether the TEFRA provision reducing the deduction otherwise allowable with respect to the tax preference portion of percentage depletion on iron ore and coal mines by 15 percent (and the corresponding provision reducing the portion of the excess percentage depletion which is treated as an item of tax preference for the add-on minimum tax to 71.6 percent of the total preference item) should be repealed and prior law reinstated.

Explanation of the Bill

The bill would repeal the 15-percent reduction in the tax preference portion of the percentage depletion deduction applicable to iron ore and coal (including lignite) by a corporation. In addition, the bill would repeal the reduction (to 71.6 percent) in the amount of such preference which is taken into account as an item of tax preference for corporations.

Thus, under the bill, the entire amount of percentage depletion deductions otherwise allowable for iron ore and coal (including lignite) owned by a corporation would be deductible (subject to the taxable income limitation), but the entire amount of the excess of such percentage depletion during the taxable year over the adjusted basis of the property for that taxable year (determined without regard to the depletion deduction for that taxable year) would be treated as an item of tax preference.

Effective Date

The bill would be effective for taxable years beginning after 1983. Thus, the TEFRA provisions would never take effect.

Revenue Effect

It is estimated that this bill would reduce fiscal year budget receipts by $47 million in 1984, $52 million in 1985, $56 million in 1986, $60 million in 1987, and $63 million in 1988.

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