Office of Chief Counsel
Internal Revenue Service
Memorandum

Release Number: **20161102F**
Release Date: 3/11/2016
CC:LB&I:HMP:NEW:2:FPetrino
Postf-123803-15

date: November 4, 2015

to: Howard Pluskalowski, Team Manager, LB&I:HMP:1519

from: Frederick Petrino
Senior Attorney (Newark, Group 2)
(Large Business & International)

---

subject:

Tax years ending December 31, Year 1 through December 31, Year 3 (in this document, the tax years at issue are referred to as year XXX1, XXX2 and XXX3, respectively).
Index (UIL) No. 45O.00-00

This memorandum responds to your request for advice regarding whether the taxpayer is entitled to the Agricultural Chemicals Security Credit for the tax years at issue. The advice in this memorandum is conditioned on the accuracy of the facts you presented to us. If you determine that these facts are incorrect, you should not rely on this advice.

[redacted]

I. Facts

During the course of the examination, (the "taxpayer") filed a claim for refund claiming entitlement to the Agricultural Chemicals Security Credit for the XXX1 , XXX2 and XXX3 tax years under the provisions of I.R.C. § 45O. The refund claim was based on a study performed by

on behalf of the taxpayer. The study concluded that the taxpayer qualified for the credit for the tax years at issue.

The taxpayer is in the trade or business of manufacturing and distributing

The taxpayer asserts that it manufactures and distributes specified agricultural chemicals as defined in I.R.C. § 450(f). More specifically, the taxpayer manufactures the following chemicals (the "Chemicals"):
. The taxpayer believes that each of these chemicals is a "specified agricultural chemical" as defined under Section 450(f). Accordingly, the taxpayer takes the position that is in the business of manufacturing and distributing "specified agricultural chemicals," and that it is an "eligible agricultural business" under I.R.C. § 450.

The company manufactured the chemicals at various locations across the United States and distributed them to users. The taxpayer operated production facilities and that
. During tax years XXX1 , XXX2 and XXX3 , the Company operated , respectively. The

The

The produce chemicals that can be stored as in storage tanks on site and are distributed via . Each production location varies in size and consists of a processing center and a number of storage tanks. Each processing center is an independent unit owned or operated by the Company.

From tax years XXX1 through XXX3 , the taxpayer also maintained storage tanks and storage tanks at its manufacturing locations. The taxpayer believes that each storage tank and is a separate integrated unit requiring their own security measures. The taxpayer also transports these chemicals in various types of transportation

units (

which the taxpayer also considers separate integrated units. Accordingly, the taxpayer believes that each processing center, storage tank and transportation unit is a qualified "facility" under Section 450.

The taxpayer incurred security expenses with respect to the processing centers and storage tanks that store the chemicals. The taxpayer also claims that they incurred security expenses for the various types of transportation units used in transporting these chemicals. The taxpayer indicates that each transportation unit was dedicated to the conveyance of the specific chemical for which it was designated.

The taxpayer incurred expenses for security expenditures and background checks, for maintenance and rehabilitation, for tank maintenance, for security expenses, for occupation health supplies, for general site safety, for information system expenditures and GPS tracking system expenditures. Attached as Exhibit A is a summary of the total expenditures that the taxpayer incurred and for which it is claiming a credit. Most of these expenditures would have been incurred regardless of whether the taxpayer was a qualified agricultural business or whether it produced specified agricultural chemicals.

It appears that the only chemical that the company distributes and sells with the intention that it will be used in pesticide applications is . The taxpayer provided documentation showing that was registered with the Environmental Protection Agency (EPA) as a pesticide on XXX2. Registration with the EPA is required by law if the chemical is intended for use as a pesticide. The taxpayer registered with the EPA, supporting the taxpayer's position that it distributes or sells with the intention that it be used as an active or inert ingredient in pesticides. The company did not register or

with the EPA. It follows that the company did not distribute or sell these other chemicals with the intention that they be used as an active or inert ingredient in pesticides. The taxpayer does not sell any of its products to ranchers or farmers but as stated above,

alleges that it does sell , an active ingredient in pesticides, for agricultural pesticide use.

As part of its claim, the taxpayer also maintains that the and versions of also qualify because they are listed in the Pesticide Action Network (PAN) database. The taxpayer explains that the PAN database contains information that has been peer reviewed by scientists and lists over 6,400 pesticide active ingredients as well as inert ingredients used in pesticide products.

II. Issues

(a) Whether the taxpayer is an eligible agricultural business under the provisions of I.R.C. § 45O(e)?

(b) Whether the chemicals that the taxpayer is manufacturing, storing, or distributing are specified agricultural chemicals as defined in I.R.C. § 45O(f)?

(c) Whether the taxpayer's storage facilities, its and its individual transportation units qualify as independent facilities for purposes of computing the agricultural chemicals security credit and for imposing the limitation of $100,000.00 per facility under I.R.C. § 45O(b)?

(d) Whether the taxpayer qualifies for the agricultural chemicals security credit under the provisions of I.R.C. § 45O?

III. Conclusion

(a) The evidence supports the position that the taxpayer became an eligible agricultural business for the XXX2 and XXX3 tax years as of XXX2, since as of that date it manufactured, stored and distributed one specified agricultural chemical pursuant to the provisions of I.R.C. § 45O. The taxpayer, however, was not an eligible agricultural business prior to XXX2 as it did not provide any evidence indicating that any of the chemicals it produced were intended for use as a pesticide prior to that date.

(b) The taxpayer is manufacturing and/or distributing only

one specified agricultural chemical, , under the provisions of I.R.C. § 45O(f) for the XXX2 and XXX3 tax years. The remaining chemicals do not qualify as specified agricultural chemicals since there is no objective evidence indicating that they were intended to be used or actually used as pesticides, or as an active or inert ingredient thereof.

(c) The taxpayer's storage and processing facilities which store or process qualify as independent facilities for purposes of computing the agricultural chemicals security credit and imposing the limitation of $100,000.00 per facility but only to the extent that they are used to process or store during part of XXX2 (after only) and for the XXX3 tax year. An allocation of enhanced security expenses will be required if the individual storage tanks and processing facilities are also used for the storage or processing of other chemicals as well as , unless the taxpayer can show that such enhanced security expenses are directly attributable to facilities. The transportation units, however, do not qualify as a facility for purposes of computing the credit under the provisions of I.R.C. § 45O.

(d) The taxpayer does qualify for the agricultural chemicals security credit under the provisions of I.R.C. § 45O but only to the extent of enhanced security costs associated with processing and storage facilities used to process and store for part of the XXX2 tax year and for the XXX3 tax year, but not for tax year XXX1 . An allocation must be made if any of these processing or storage facilities are also used to store or process other chemicals unless the taxpayer can show that the expenses are directly attributable to security expenses related to the manufacture or storage of .

IV. Discussion

LAW

I.R.C § 45O(a) provides in relevant part that for purposes of section 38, in the case of an eligible agricultural business, the agricultural chemicals security credit for the taxable year

is 30 percent of the qualified security expenditures for the taxable year. The amount of the credit determined under this subsection with respect to any facility for any taxable year shall not exceed (1) $100,000, reduced by (2) the aggregate amount of credits determined under this subsection with respect to such facility for the 5 prior taxable years. I.R.C § 45O(b) The amount of the agricultural security credit cannot exceed $2,000,000.00 for any tax year. I.R.C § 45O(c).

The term "qualified chemical security expenditure" means, with respect to any eligible agricultural business for any tax year, any amount paid or incurred by such business during such tax year for--

(1) employee security training and background checks,

(2) limitation and prevention of access to controls of specified agricultural chemicals stored at the facility,

(3) tagging, locking tank valves, and chemical additives to prevent the theft of specified agricultural chemicals or to render such chemicals unfit for illegal use,

(4) protection of the perimeter of specified agricultural chemicals,

(5) installation of security lighting, cameras, recording equipment, and intrusion detection sensors,

(6) implementation of measures to *increase* computer or computer network security,

(7) conducting a security vulnerability assessment,

(8) implementing a site security plan, and

(9) such other measures for the protection of specified agricultural chemicals as the Secretary may identify in regulation.

The above expenditures are taken into account only to the extent that such amounts are paid or incurred for the purpose of protecting specified agricultural chemicals. I.R.C § 45O(d).

I.R.C § 45O(e) provides that "eligible agricultural business" means any person in the trade or business of--

(1) selling agricultural products, including specified agricultural chemicals, at retail predominantly to farmers and ranchers, or

(2) manufacturing, formulating, distributing, or aerially applying specified agricultural chemicals."

A "specified agricultural chemical" is defined as--

(1) any fertilizer commonly used in agricultural operations ....., and

(2) any pesticide (as defined in section 2(u) of the Federal Insecticide, Fungicide, and Rodenticide Act), including all active and inert ingredients thereof, which is customarily used on crops grown for food, feed, or fiber." I.R.C § 45O(f).

The Chemicals

Since the taxpayer is asserting that all three chemicals, , , and , qualify as pesticides under I.R.C § 45O(f)(2), it is necessary to look at the definition contained in Section 2(u) of the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA or the Act). FIFRA defines a pesticide as "(1) any substance or mixtures of substances *intended* for preventing, destroying, repelling or mitigating any pest, (2) any substance or mixture of substances *intended* for use as a plant regulator, defoliant, or desiccant, and (3) any nitrogen stabilizer."

One of the most important words in interpreting the FIFRA definition of a pesticide is the word "intended." The EPA's Office of Pesticide Programs (OPP) determines intent by examining claims on the label, advertising, composition/use, and/or mode of action of the product as distributed or sold. Section 40 CFR 152.15 sets forth the criteria to establish intent. A substance is considered to be intended for pesticidal purposes, and thus to be a pesticide requiring registration, if:

(a) The person who distributes or sells the substance claims, states, or implies (by labeling or otherwise):

(1) That the substance (either by itself or in combination with any other substance) can or should be used as a pesticide; or
(2) That the substance consists of or contains an active ingredient and that it can be used to manufacture a pesticide; or

(b) The substance consists of or contains one or more active ingredients and has no significant commercially valuable use as distributed or sold other than (1) use for pesticidal purposes (by itself or in combination with any other substance), (2) use for manufacture of a pesticide; or

(c) The person who distributes or sells the substance has actual or constructive knowledge that the substance will be used, or is intended to be used, for a pesticidal purpose. If the regulatory criteria are met, the product is a pesticide and must be registered with the EPA. [1]

In the instant case, the evidence demonstrates that the taxpayer manufactures and distributes as a product to be used as a pesticide since it registered the product with the EPA on XXX2.[2] The taxpayer claims that the chemical is used to destroy microorganisms which would otherwise damage or destroy crops. Consequently, it appears that the taxpayer qualifies as an eligible agricultural business beginning

tax year 2 and continuing for the entire XXX3 tax year because the taxpayer manufactured, stored and distributed a specified agricultural chemical in accordance with I.R.C § 45O(e) and (f).

While the taxpayer may be considered an eligible agricultural business from tax year XXX2 through tax year

[1] EPA registration requirements. See 40 CFR 152.10.
[2] Note that the taxpayer did not claim the credit on its original income tax returns. The taxpayer claimed the credit at a much later date by filing a claim for refund upon the advice of a tax adviser, during the late stages of an examination. Therefore, at the time the taxpayer registered the chemical, the taxpayer's decision to register the chemical as a pesticide with the EPA was based on its objective belief that the chemical was intended to be used as a pesticide and not for the purpose of obtaining favorable tax consequences. Therefore, the taxpayer's decision to register the product, while not determinative, provides reliable evidence regarding the intent for use of as a pesticide.

XXX3 , the evidence also suggests that the taxpayer did not intend the other chemicals that it manufactures, namely the , for use as a pesticide. FIFRA defines a pesticide as a substance "intended" for use as a pesticide. If the or versions of did qualify as a pesticide (or active or inert ingredient thereof) under the Act, the taxpayer would have been required to register the chemical under FIFRA. It is undisputed that the taxpayer did not register the chemical with the EPA. The taxpayer has not produced any other evidence supporting the fact that meets the definition contained in FIFRA, such as labeling the pesticide as such, showing that the chemical had no other significantly commercial valuable use, or that the taxpayer had constructive or actual knowledge that would be used as a pesticide by its customers. In fact, according to the taxpayer's website, the chemicals at issue have many other significant commercially valuable uses.[3] Consequently, we believe that any costs associated with security for the facilities that contain the or versions of do not qualify for the credit under I.R.C § 45O.

The taxpayer asserts that all of the chemicals qualify because they are listed in the PAN database as chemicals used for pesticide applications. Section 45O, however, states that the chemicals must meet the definition of a pesticide contained in the Act. The taxpayer cannot substitute the PAN database for this definition. There is no legislative authority for such a position and in fact it is contrary to the provisions contained in I.R.C. § 45O(f)(2).

In any event, the taxpayer's position is that the statute is not limited to those chemicals that are actually (or intended to be) used as fertilizers or pesticides. Rather, the taxpayer argues that by virtue of the words "commonly used" and "customarily used" in I.R.C. § 45O(f), the statute should be afforded an expansive view. In short, the taxpayer maintains that chemicals which could be, and actually are, used for other applications qualify as a specified agricultural chemical.

The taxpayer also asserts that it should not have to determine the use of its chemicals by the end users (i.e., its customers) in order to qualify for the credit. The taxpayer fails to recognize, however, that the taxpayer has the burden of

---

[3] See http://www. , last visited on .

proving its entitlement to the credit. As such, the taxpayer must produce objective and reliable evidence to substantiate qualification for the credit, which evidence may, or may not, include evidence regarding the actual end use.

Tax Credits are a matter of legislative grace, are only allowed as clearly provided by statute, and are narrowly construed. Helvering v. Nw. Steel Rolling Mills, Inc., 311 U.S. 46, 49 (1940); New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934); U.S. v. McFerrin Stinson, 570 F.3d 672, 676 (5th Cir. 2009); Stinson Estate v. United States, 214 F.3d 846, 848 (7th Cir.2000). Tax Statutes are not to be interpreted in a broad and creative manner as suggested by the taxpayer. Narrow construction is required. Id.

By cross-referencing the Act, the statute insures that the chemical for which the taxpayer is claiming a credit is indeed intended for agricultural use; and also provides an objective standard and definition for making such determinations. This objective standard is consistent with EPA registration requirements.[4] If this objective definition were not cross-referenced in the statute, any company that produces a chemical that could potentially be a pesticide, or an active or inert ingredient thereof, could be entitled to a credit even if the chemical is used exclusively for non-pesticide purposes. For example, there are many chemicals that may be used in the manufacture of pesticides but are actually used for more commercially valuable purposes such as in the manufacture of cleaning solutions, plastics, resins, shampoos, toothpaste, detergents and many other products. These products are never applied to crops. We do not believe the credit was intended to extend to such products.

Instead, it is clear that the statute was intended to provide relief to the agricultural industry only. The taxpayer's position would provide a credit to every business that manufactures or distributes any chemical that could potentially be used as a pesticide. The definition in the statute is narrowly drafted to encompass only chemicals that may otherwise require registration pursuant to FIRFA. If the chemical is used exclusively for commercially valuable non-agricultural applications, such as for a shampoo or a plastic

[4] There are few exceptions to registration of pesticides with the EPA, none of which are applicable here. In the vast majority of cases, registration is required when the definition contained in FIFRA is met.

shelving unit, registration with the EPA would not be required and the chemical would not qualify for the Agricultural Chemicals Security Credit.

Congressman Lewis, who proposed the legislation, specifically stated that the statute is designed to help defray the high costs agricultural businesses now face enhancing on-site security. 153 Cong. Rec. E728-02 (2007). In other words, it is geared toward farm-use chemical production. It was designed to help farmers and agricultural businesses. It was not enacted to help any business that might produce what could potentially be an active or inert ingredient in a pesticide, even though its intended use is completely unrelated to pesticides or any other agricultural use.

The following is an excerpt from the congressional record which contains the speech of the HON. Ron Lewis of Kentucky, dated March 30, 2007, and which reflects his intent in proposing this legislation:

> "The legislation that I have proposed, The Agricultural Business Security Tax Credit Act, extends tax initiatives to help defray the high costs *agricultural businesses* now face enhancing *on-site* security. I have introduced similar legislation in the past two Congresses.
>
> Farm-use chemical production is unique in its use, distribution and security needs. Pesticides and fertilizers, while important to farmers and agricultural businesses, can also be used as agents for manufacturing illegal drugs such as methamphetamine. Some chemicals can even be used to develop explosive devises, making these sites a potential target for foreign and domestic terrorists.
>
> I believe the incentives offered in The Agricultural Business Security Tax Credit Act will promote improved security at *agricultural facilities* that handle chemicals and fertilizers, helping them take the necessary steps to better protect U.S. agriculture and the American public from potential threats and other illegal activity. I urge my colleagues to consider supporting this bill." 153 Cong. Rec. E728-02. *(emphasis added)*

In addition, on May 23, 2008, Congressman Sullivan, in his

personal explanation speech, commented regarding the legislation as follows:

> "This bill does take necessary steps to help the *agriculture industry* that is vital to the State of Oklahoma. I look forward to voting on this measure to ensure that it becomes law." 154 Cong. Rec. E1087-01 (2008). *(emphasis added)*

Furthermore, I.R.C. § 45O(d) provides that qualified security expenditures "shall be taken into account *only to the extent* that such amounts are paid or incurred for the purpose of protecting specified agricultural chemicals." (emphasis added.) The Bluebook provides the following explanation for the enactment of § 45O.

> The Congress believes that a security tax credit would help the agricultural industry to properly safeguard agricultural pesticides and fertilizers from the threat of terrorists, drug dealers and other criminals. These safeguards are necessary to help alleviate a heightened concern as to the vulnerability of chemical storage facilities. This credit will help ease the substantial increase in production costs faced by agriculture related to installing improved security measures that will better protect the American public from the potential threat of terrorism or other illegal activities.[5]

It is clear from the legislative record that the law was enacted to assist the agricultural industry, and not to assist every corporation that might manufacture or distribute any chemical that could potentially be used as a pesticide or as an active or inert ingredient thereof. The primary supporters of this bill were from states where a large number of constituents are engaged in agricultural businesses and the credit was designed to provide relief to those constituents. To suggest that any inert ingredient that could potentially be used in a pesticide should qualify for the credit is unsound. Under such an argument, inert ingredients such as water could qualify for the credit providing the taxpayer otherwise qualifies as an

---

[5] Staff of the Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 110th Congress, p.117 (March 2009) (emphasis added).

eligible agricultural business. The taxpayer's overly broad interpretation of what should qualify for the credit must be rejected. Credits are a matter of legislative grace and should only be allowed as clearly provided by statute.

The Facilites

The taxpayer's claim includes expenses for security related to processing centers, storage tanks,
and . Taxpayer argues that they are all separate integrated units capable of operating independently and that therefore, these transportation units qualify as facilities for purposes of Section 45O. The taxpayer acknowledges that there is no guidance or authority which supports their position under Section 45O, so the taxpayer looks to analogous law and related guidance. The taxpayer cites one revenue ruling and one IRS notice in support of its position that the costs incurred to maintain security at all of the foregoing "facilities" qualify for the credit.

In Revenue Ruling 94-31, the IRS interpreted the meaning of "qualified facility" as applied to electricity produced from wind energy under I.R.C § 45(d)(1). In this ruling, a wind turbine together with its tower and supporting pad comprised the property on the windfarm necessary for the production of electricity from wind energy. Moreover, each wind turbine on the windfarm could be separately operated and metered and could begin producing electricity when it is mounted atop a tower. Thus, the term "facility" in this ruling meant the wind turbine, together with the tower on which the wind turbine is mounted and the pad on which the tower is situated. Rev. Rul. 94-31, 1994-21 I.R.B. 4.

In IRS Notice 2008-60, the IRS set out guidelines for what constitutes a "facility" under I.R.C. § 45 in relation to electricity produced from open-loop biomass. Similar to Revenue Ruling 94-31, each biomass power plant that is operated as a "separate integrated unit" is considered a "facility" under I.R.C. § 45(d)(3). This additional source supports the interpretation that each asset or group of assets capable of operating independently in a specific capacity is a separate facility. IRS Notice 2008-60, Section 3.01.

The above mentioned notices and revenue rulings, however, are not particularly useful in interpreting the meaning of

facility within the context of the Agricultural Chemical Security Credit. They were intended as guidance regarding the determination of when a separate unit located on a taxpayer's physical plant or location qualifies as a facility. They do not address the issue of what constitutes a facility with regard to mobile units located off-site.

Though not cited by the taxpayer,[6] the Service recently addressed the issue of what qualifies as a facility under I.R.C. § 45O. See I.R.S. Tech. Adv. Memo. 201532034 (August 7, 2015). In this memorandum (the TAM), the Service determined that a did not constitute a facility for purposes of determining a credit under the provisions of I.R.C. § 45O. In reaching this conclusion, the TAM concluded that a was not capable of transporting goods independently since it could not locomote itself. Consistent with Rev. Rul. 94-31, Notice 2008-60 and Notice 2013-29, the was not an integrated unit that could operate independently in a specific capacity and therefor does not qualify as a facility under the statute.

The TAM did not specifically address whether other types of transportation units, such as barges, would qualify as facilities under the statute. While an [redacted] that because these units self-locomote, they qualify as facilities under the reasoning of the TAM, we believe that these transportation units do not so qualify. There is simply no authority under the statute for expanding the plain meaning of "facility". Due to the lack of guidance and due to the fact that the service has yet to publish regulations with respect to I.R.C. § 45O, we believe the [redacted] is a narrow construction of the definition of "facility" in the context of the Agricultural Chemicals Security Credit.[7] [redacted]

[6] While a TAM is not considered precedential, [redacted]. The taxpayer did not previously reference the TAM because the TAM had not yet been published at the time that the taxpayer filed their claim for refund during the examination.

[7] As previously discussed, in the case of Tax Credits, they are a matter of legislative grace, are only allowed as clearly provided by statute, and are narrowly construed.

[redacted]

Our approach is supported by the legislative history as reflected in Congressman's Lewis remarks which specifically refer to enhancement of *on-site* security, and not to security costs related to transportation units. Therefore, it is not reasonable to consider each transportation unit as a separate facility under I.R.C. § 45*O* since to do so would expand the commonly used definition of a facility and consequently, expand the scope of the statute.

The nature of the qualifying expenses listed in the statute are also indicative of the intent of the statute and are consistent with Congressman's Lewis remarks relating to the enhancement of *on-site* security. The statute describes costs incurred in implementing a *site* security plan, for the limitation and prevention of access to controls of specified agricultural chemicals stored at the facility, for protection of the perimeter of the facility, for installation of security lighting, cameras, recording equipment, and intrusion detection sensors all of which are typically associated with on-site security measures. See I.R.C § 45*O*(d). Such costs involve security measures for protecting on-site facilities located at the taxpayer's physical location. Therefore, the transportation units utilized by the taxpayer in transporting chemicals do not qualify as facilities under the provisions of I.R.C. § 45*O* and the costs of security measures taken with respect to such transportation units do not qualify for the credit.

Based on the standards outlined above, each facility used to process and store qualifies as an asset capable of operating independently and therefore qualifies as a "facility" under I.R.C. § 45*O*. This chemical, however, was not registered with the EPA until XXX2. Therefore, only the costs of enhanced security measures associated with facilities that store or process that were incurred after XXX2 are qualified expenditures for purposes of computing the credit under I.R.C. § 45*O*. The cost of security measures associated with and storage facilities that manufacture and/or store any other chemicals do not qualify for the credit.[8]

[8] Please also note that security measures that were already in place prior to XXX2 do not qualify for the credit. Many of the security measures that the taxpayer is now claiming were already in place during the XXX1 tax year, a year

If you should have any additional questions regarding this matter, please contact Frederick Petrino at (973) 645-6631.

MICHAEL P. CORRADO
Area Counsel (Heavy Manufacturing & Transportation)
(Large Business & International)

By: _____
Frederick Petrino
Senior Attorney (Newark, Group 2)
(Large Business & International)

---

in which the taxpayer was not an eligible agricultural business. Also, expenses related to tank maintenance, general site safety, and occupational health do not qualify because they involve routine maintenance and safety measures that the taxpayer would have incurred anyway.