INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE-MIS No: TAM-136056-14

Taxpayer's Name:
Taxpayer's Address:
Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Taxpayer =
Sub =
X =
a =
Agency A =
Agency B =
Association =
Industry =
b =
c =
d =

ISSUE(S):

1) Is Sub an eligible agricultural business in the trade or business of distributing specified agricultural chemicals under § 45O(e)(2) of the Internal Revenue Code?

2) May Sub treat certain expenditures it incurs as qualified chemical security expenditures on the basis that a X is a "facility" that is used by its lessees to transport specified agricultural chemicals for purposes of § 45O(b)?

3) Do certain product manufacturing expenditures incurred by Sub in compliance with Department of Transportation (DOT) and Association rules, regulations, and specifications constitute qualified chemical security expenditures under § 45O(d)?

4) May Sub treat certain expenditures incurred with respect to its Xs that are not used to transport specified agricultural chemicals as qualified chemical security expenditures under § 45O(d)?

5) Must the basis of assets be reduced by the amount allowable under § 45O before a depreciation deduction is determined for the taxable year for which the § 45O credit is claimed?

CONCLUSION(S):

1) The determination of whether Sub is an eligible agricultural business in the trade or business of distributing specified agricultural chemicals under § 45O(e)(2) is inherently factual, accordingly, we decline to rule on this issue.

2) Sub may not treat certain incurred expenditures as qualified chemical security expenditures on the basis that a X is a "facility" that is used by its lessees to transport specified agricultural chemicals for purposes of § 45O(b).

3) Product manufacturing expenditures incurred by Sub in compliance with DOT and Association rules, regulations, and specifications do not constitute qualified chemical security expenditures under § 45O(d).

4) Sub may not treat expenditures incurred with respect to its Xs that are not used to transport specified agricultural chemicals as qualified chemical security expenditures under § 45O(d).

5) The basis of assets must be reduced by the amount allowable under § 45O before a depreciation deduction is determined for each taxable year for which the § 45O credit is claimed.

FACTS

Sub, a subsidiary of Taxpayer, is a X manufacturer that leases, maintains, services, and repairs the Xs that it owns. Chemical manufacturers make up approximately a% of Sub's X leasing customer base.

Sub manufactures, leases, maintains, services, and repairs Xs in accordance with the applicable rules and requirements of DOT, Agency A,[1] Agency B,[2] and the Association.[3] Additionally, Sub collaborates with DOT and Agency A on several projects undertaken to enhance the safe and secure transportation of highly hazardous chemicals. Sub also coordinates with its lessees and others involved with the Industry to ensure the safe transportation of chemicals and other hazardous materials.

Under the terms of its full-service leases, Sub maintains, services, repairs, and fulfills all testing requirements for its Xs through its headquarters and network of repair shops. If a X needs any of these services, the lessee notifies Sub, and Sub arranges to have the X delivered to one of Sub's repair shops.

Sub's Xs are leased in accordance with the terms and conditions detailed in the Lease. The Lease describes the general terms and agreements between Sub and the lessee. In general, under the terms of the Lease, Sub is responsible for maintaining and repairing its Xs in accordance with all applicable rules and regulations. Sub also is responsible for ensuring that any maintenance or repair work is completed and inspected before the X can be used to transport chemicals again.

The Lease requires the lessee to visually examine the X before shipping and provides that the lessee has sole responsibility for determining that each X is in the proper condition for loading and shipment. It also provides that the lessee and the lessee's shipper are responsible for securing any chemicals transported in the X.

The Lease states that Sub shall not be liable for any loss or damage to any commodity loaded or shipped in any X, regardless of how such loss or damage may be caused. It also makes the lessee liable for all damage to the X caused by the negligence or misconduct of lessee, its agents, or customers, regardless of the cause. Finally, the Lease requires the lessee to indemnify Sub against, and hold Sub harmless from all claims, liabilities, losses, damages, expenditures and expenses arising out of or resulting from the loss of or damage to such commodity, or the loading, unloading, spillage, leakage, emission or discharge of the commodity in or from the X, including without limitation, any liability for injury, death, property damage or environmental pollution.

Sub never has title to the goods shipped in its Xs, including specified agricultural chemicals. In fact, federal law prohibits Sub from accessing a X's travel logs that specify the goods carried by that X on a daily basis. Therefore, Sub is unaware of

[1] Within DOT, Agency A promulgates safety standards for equipment used by the Industry.
[2] Within DOT, Agency B issues rules and regulations for Xs.
[3] Association is a trade group that works on safety standards, maintenance, operations, leasing, servicing and repair rules for the Industry.

what goods are being carried by a X and it cannot monitor or participate in the distribution of the goods being carried by a X.

Taxpayer amended its b and c tax returns to claim credits under § 45O for expenditures incurred during those taxable years for repair shops and certain X manufacturing expenditures on the basis that Sub is in the trade or business of distributing specified agricultural chemicals, and that it incurred expenditures to protect the perimeter of chemicals, commodities, hazardous substances and agricultural chemicals, and for cameras and other security equipment.

LAW

Section 38 provides a nonrefundable credit against income tax after all other nonrefundable credits are claimed.

For purposes of § 38, § 45O(a) provides a 30 percent credit for qualified chemical security expenditures paid or incurred after June 18, 2008, and before January 1, 2013. Section 45O(b) provides that the amount of the § 45O credit determined with respect to any facility for any taxable year shall not exceed $100,000, reduced by the aggregate amount of credits determined under § 45O(a) with respect to such facility for the five prior taxable years. Section 45O(c) limits the amount of the credit to $2 million for any taxable year.

Section 45O(d) provides that the term “qualified chemical security expenditure” means, with respect to any eligible agricultural business for any taxable year, any amount paid or incurred by such business during such taxable 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.

Amounts described in the preceding sentence shall be taken into account only to the extent that such amounts are paid or incurred for the purpose of protecting specified agricultural chemicals.

Section 45O(e) provides that the term "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.

The term "specified agricultural chemical" is defined under § 45O(f) to mean--

(1) any fertilizer commonly used in agricultural operations which is listed under--

(A) section 302(a)(2) of the Emergency Planning and Community Right-to-Know Act of 1986,

(B) section 101 of part 172 of title 49, Code of Federal Regulations, or

(C) part 126, 127, or 154 of title 33, Code of Federal Regulations, 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.

Section 280C(f) provides that no deduction shall be allowed for that portion of the expenses otherwise allowable as a deduction taken into account in determining the credit under § 45O for the taxable year which is equal to the amount of the credit determined for such taxable year under § 45O(a).

ANALYSIS

Issue 1: Is Sub an eligible agricultural business in the trade or business of distributing specified agricultural chemicals under § 45O(e)(2)?

The issue of whether Sub is an eligible agricultural business in the trade or business of distributing specified agricultural chemicals under § 45O(e)(2) is inherently factual. Accordingly, we decline to rule on this issue.

Issue 2: May Sub treat certain expenditures it incurs as qualified chemical security expenditures on the basis that a X is a "facility" that is used by its lessees to transport specified agricultural chemicals for purposes of § 45O(b)?

Section 45O(b) provides a limit on the amount of credit that may be claimed with respect to any facility for any taxable year. Thus, the § 45O credit is accrued on a per facility basis.

Although the Service has not issued guidance concerning what constitutes a facility for purposes of § 45O specifically, the Service has issued guidance regarding what constitutes a facility for purposes of other credits under § 38 that we believe may be applied to § 45O. In Rev. Rul. 94-31,[4] the Service interpreted the term "facility" in the context of a wind farm for purposes of the § 45 credit. The revenue ruling concludes that a wind turbine together with its tower and supporting pad comprise the property on a wind farm necessary for the production of electricity from wind energy. The revenue ruling states that each wind turbine on the wind farm could be separately operated and metered and could begin producing electricity when it is mounted atop a tower. Thus, the revenue ruling concludes that for purposes of a wind farm, the term "facility" means the wind turbine, together with the tower on which the wind turbine is mounted and the pad on which the tower is situated. Under this revenue ruling, for purposes of the § 38 credit, a facility is a unit of integrated property that can function independently.

In Notice 2008-60,[5] the Service provided guidelines for what constitutes an open-loop biomass facility for purposes of § 45. The notice states that for purposes of § 45(d)(3) "an open-loop biomass facility is a power plant consisting of all components necessary for the production of electricity from open-loop biomass (and, if applicable, other energy sources)."[6] The notice concludes that "each power plant that is operated as a separate integrated unit" is treated as a facility for purposes of § 45(d)(3).[7] Similarly to Rev. Rul. 94-31, Notice 2008-60 treats each integrated unit that is capable of operating independently in a specific capacity as a "facility."

Most recently, in Notice 2013-29,[8] the Service interpreted the term "facility" for purposes of §§ 45 and 48. The notice provides that "[a] facility (within the meaning of § 45(d)) generally includes all components of property that are functionally interdependent."[9] It also states that "[e]ach such facility can be separately operated and metered and can

[4] Rev. Rul. 94-31, 1994-1 C.B. 16.
[5] Notice 2008-60, 2008-2 C.B. 178.
[6] *Id.* at section 3.01.
[7] *Id.*
[8] Notice 2013-29, 2013-1 C.B. 1085, *as clarified by* Notice 2013-60, 2013-2 C.B. 431, *as clarified and modified by* Notice 2014-46, 2014-36 I.R.B. 520, *as updated by* Notice 2015-25, 2015-13 I.R.B. 814.
[9] *Id.* at section 4.04.

begin producing electricity separately."[10] Therefore, this notice confirms that a facility is an integrated unit that may be operating independently in a specific capacity.

Similar to § 45O, the §§ 45 and 48 credits are part of the general business credit under § 38. Therefore, rules regarding what constitutes a facility for purposes of §§ 45 and 48 should inform what constitutes a facility for purposes of § 45O. In this case, Sub leases Xs to its customers for the customers to transport goods. A X cannot transport goods on its own. While it may be used to hold goods, it cannot locomote by itself and therefore, cannot accomplish the transportation of goods independently. Therefore, a X is not an integrated unit capable of operating independently within the meaning of the term "facility" for purposes of the § 38 credit, including for purposes of § 45O. Therefore, it is not a facility for purposes of the § 45O credit.

Finally, tax credits are a matter of legislative grace. They are allowed only as clearly provided by statute and the applicable statute is narrow in this regard.[11] Since a narrow interpretation of the statute is required, we believe that categorizing a X as a facility is too far reaching under a strict interpretation of this statute and the commonly used meaning of the term facility. Therefore, it is not reasonable to consider each X as a separate facility under § 45O since to do so would expand the commonly used definition of a facility and consequently, expand the scope of the statute. Therefore, we conclude that Sub may not treat certain expenditures incurred as qualified chemical security expenditures under § 45O(d) because a X is not a facility for purposes of § 45O.

> **Issue 3:** Do certain product manufacturing expenditures incurred by Sub in compliance with DOT and Association rules, regulations, and specifications constitute qualified chemical security expenditures under § 45O(d)?

Section 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.[12]

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[10] *Id. citing* Rev. Rul. 94-31, 1994-1 C.B. 16.
[11] *Helvering v. Northwest Steel Rolling Mills, Inc.*, 311 U.S. 46, 49 (1940); see also *New Colonial Ice, Co. v. Helvering*, 292 U.S. 435, 440 (1934); *U.S. v. McFerrin Stinson*, 570 F.3d 672, 675 (5th Cir. 2009).
[12] Staff of the Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 110th

Sub manufactures its inventory of Xs in compliance with DOT and the Association's applicable rules, regulations, and specifications. Sub did not incur a "substantial increase in production costs" to produce its Xs because Sub was already required to manufacture the X's to certain standards in order to lease its Xs for operation in the United States. Therefore, the expenditures that Sub incurred to manufacture its Xs were not incurred for the specific purpose of protecting specified agricultural chemicals.

Based on the explicit statutory language of § 45O(d) and the relevant Bluebook language, we believe that *only* substantially increased expenditures for installing improved security measures incurred to protect specified agricultural chemicals, and not for other purposes, are qualified chemical security expenditures for purposes of the § 45O credit.

> **Issue 4:** May Sub treat certain expenditures incurred with respect to its Xs that are not used to transport specified agricultural chemicals as qualified chemical security expenditures under § 45O(d)?

Section 45O(f) specifically identifies the chemicals that a taxpayer must incur costs to protect to be eligible for the credit. In no case would Sub be entitled to treat certain expenditures incurred with respect to its entire inventory of Xs as qualified chemical security expenditures under § 45O(d) because d% of Sub's Xs are not used to transport chemicals, including specified agricultural chemicals. As noted above, only a% of Sub's customers are chemical manufacturers. Accordingly, only the Xs leased by a% of Sub's customers are used to transport chemicals, including, in some cases specified agricultural chemicals.

Based on the explicit statutory language of § 45O(d) and the relevant Bluebook language, we interpret the statute to mean that *only* substantially increased expenditures incurred for protecting agricultural chemicals and not for other purposes are qualified chemical security expenditures for purposes of the § 45O credit. Sub's Xs are not used exclusively to transport specified agricultural chemicals. In fact, d% of Sub's customers are not chemical manufacturers and are not in the trade or business of distributing specified agricultural chemicals. Accordingly, the expenditures incurred by Sub are not specifically incurred for protecting specified agricultural chemicals and are not qualified chemical security expenditures eligible under § 45O(d). Therefore, we conclude that Sub cannot claim the § 45O credit for certain expenditures incurred with respect to Xs that are not used to transport specified agricultural chemicals.

Congress, p.117 (March 2009) (emphasis added).

Issue 5: Must the basis of assets be reduced by the amount allowable under § 45O before a depreciation deduction is determined for the taxable year for which the § 45O credit is claimed?

Section 280C addresses the tax treatment of certain expenses for which credits are allowable. The Food, Conservation, and Energy Act of 2008 amended this section by inserting new language at § 280C(f) regarding the § 45O credit.[13] Section 280C(f) (credit for security of agricultural chemicals) provides that "[n]o deduction shall be allowed for that portion of the expenses otherwise allowable as a deduction taken into account in determining the credit under section 45O for the taxable year which is equal to the amount of the credit determined for such taxable year under section 45O(a)." The Bluebook also includes a statement that for purposes of § 45O, "[t]he taxpayer's deductible expense is reduced by the amount of the credit claimed."[14]

Language found in other portions of § 280C, unlike that found in § 280C(f), provides a separate rule for taxpayers who capitalize rather than deduct expenses. In those cases, if the amount of the credit allowable for the taxable year exceeds the amount allowable as a deduction for the taxable year for the qualified expenses, "the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess."[15]

While the language relating to capitalization is absent from § 280C(f), the express language of § 45O(f) prevents a taxpayer from taking a deduction for expenses that are taken into account in determining the § 45O credit. Therefore, we conclude that the basis of assets must be reduced by the amount allowable under § 45O before a depreciation deduction is determined for each taxable year for which the § 45O credit is claimed.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) provides that it may not be used or cited as precedent.

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[13] Pub. L. 110-246, 122 Stat. 1664, 2280 [HR 6124] (June 18, 2008) (Act). This amendment was made by section 15343(c) of the Act entitled "Denial of Double Benefit."

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

[15] I.R.C. § 280C(b)(2) (credit for qualified clinical testing expenses for certain drugs); I.R.C. § 280C(g)(2) (qualifying therapeutic discovery project credit).