OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
October 26, 1999

Number: **200003038**
Release Date: 1/21/2000
CC:DOM:FS:P&SI
TL-N-3509-99
UILC: 468.02-00
481.00-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL

FROM: Deborah A. Butler
Assistant Chief Counsel CC:DOM:FS

SUBJECT: Solid Waste Reclamation and Closing Costs

This Field Service Advice responds to your memorandum dated July 20, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Taxpayer =

County =

Date 1 =

Year 1 =

Year 2 =

ISSUE(S):

(1) Is the Taxpayer required to recapture the balance of its reserve for reclamation costs with respect to tracts that were totally reclaimed by date 1?

(2) Does the Taxpayer's reserve for "removal excess" constitute qualified reclamation costs or closing costs that can be deducted under I.R.C. section 468 before economic performance?

(3) If the amounts designated as "removal excess" are not deductible under section 468, are the amounts deducted in year 2 and previous years subject to recapture in year 2 as a change of accounting method under section 481?

CONCLUSION:

(1) The taxpayer is required to recapture the balance of its reserve for reclamation costs on the completion of closing with respect to those tracts regardless of when reclamation was complete.

(2) The Taxpayer's reserve for "removal excess" does not constitute qualified reclamation costs or closing costs that can be deducted under section 468 before economic performance provided all the requirements of section 468 are met.

(3) The amounts designated as "removal excess" are not deductible under section 468. Thus, the amounts deducted in year 2 and previous years are subject to recapture in year 2 as a change of accounting method under section 481.

FACTS:

The taxpayer operates a construction and demolition debris landfill in the County. The landfill is divided into 10 acre tracts. The taxpayer's revenues are derived from fees paid for dumping debris on the tracts. This waste is later processed to separate wood, metal, tires, and other environmentally hazardous materials from the other waste. The recyclable materials are then sold to third parties.

The taxpayer elected to deduct qualified reclamation and closing costs before economic performance pursuant to section 468. The taxpayer created reserves for reclamation costs, closing costs and "removal excess." The "removal excess" reserve is for costs expected to be incurred for certain tracts that have been overfilled by the taxpayer. The facts presented do not indicate the number of separate properties or sites for which accounts were established.

The County inspected the landfill in year 1 and discovered that (a) several tracts were inactive, but not properly closed out, (b) these tracts were overfilled and had

excessive levels of nitrogen-ammonia in water samples, and (c) solid waste such as vegetation, lumber, metal and plastic was stockpiled on the tracts. The taxpayer maintains that the County required it to accept excess construction debris as a result of a natural disaster. The County issued an inspection report which required the taxpayer to dispose of the waste. Later, the County and the taxpayer entered into a consent agreement requiring the taxpayer to remove the excess debris stockpiled on the tracts, to restore the landfill height to flood criteria for the site, and to perform groundwater restoration and monitoring. The taxpayer submitted and the County approved a Remedial Action Plan/Closure Plan (Plan). The Plan provided for each affected tract to be mined to the clean fill base and the material removed to be sent to a recycling plant for processing. Recyclable material was to be sold, contaminated material was to be shipped to an approved site and the acceptable residue was to replaced in the site. No mined material will be mixed with new material. The taxpayer established the "removal excess" reserve by which it has deducted under section 468 the anticipated cost of complying with its Plan.

LAW AND ANALYSIS

Section 468(a) provides:

> (1) if a taxpayer elects the application of this section with respect to any mining or solid waste disposal property, the amount of any deduction for qualified reclamation or closing costs for any taxable year to which such election applies shall be equal to the current reclamation or closing costs allocable to--
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> (A) in the case of qualified reclamation costs, the portion of the reserve property which was disturbed during such taxable year, and
>
> (B) in the case of qualified closing costs, the production from the reserve property during such taxable year.

Section 468(d)(2)(B)(i) defines solid waste disposal and closing costs as any expenses incurred for any land reclamation or closing activity in connection with any solid waste disposal site which is conducted in accordance with any permit issued pursuant to

> (I) any provision of the Solid Waste Disposal Act (as in effect on January 1, 1984) requiring such activity, or
>
> (II) any other Federal, State, or local law which imposes requirements substantially similar to the requirements imposed by the Solid Waste Disposal Act (as so in effect).

Under section 468(d)(2)(B), the definition of the term "qualified reclamation and closing costs" includes any expenses incurred for any land reclamation or closing activity in connection with any solid waste disposal site which is conducted in accordance with any permit issued pursuant to any provision of the Solid Waste Disposal Act (as in effect on January 1, 1984) requiring such activity, or any other Federal, State, or local law which imposes requirements substantially similar to the requirements imposed by the Solid Waste Disposal Act (as so in effect).

The Solid Waste Disposal Act, as amended by the Resource Conservation and Recovery Act of 1976 (RCRA), Pub. L. No. 94-580, 90 Stat. 2795 (codified as amended at 42 U.S.C. sections 6901-6992 (1993)) (the Act) requires the Environmental Protection Agency (EPA) to issue and enforce regulations governing the disposal of various solid wastes including hazardous wastes. Since 1976, RCRA has been amended to require additional legal obligations in the waste disposal area. H.R. Conf. Rep. No. 98-1133, at 116-7 (1984), reprinted in 1984 U.S.C.C.A.N. 5651, 5687-8.

In 1984, the Deficit Reduction Act of 1984, section 91(a), 1984-3 C.B. (Vol. 1) 1, 106 added section 461(h) to the Code. This amendment added the economic performance requirement to the all-events test contained in the regulations under section 461. Under Treas. Reg. section 1.461-1(a)(2), a taxpayer on the accrual method of accounting may deduct an expense in the taxable year in which all the events have occurred that establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. However, section 461(h) provides that in determining whether an amount has been incurred with respect to any item during the taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

The Deficit Reduction Act of 1984, section 91(b), 1984-3 C.B. (Vol. 1) 1, 109 also added section 468 to the Code as an exception to the new economic performance requirement of section 461(h). Congress believed that, in the case of mine reclamation and closing costs and solid waste disposal site reclamation and closing costs, more liberal rules were appropriate. S. Rep. No. 98-169, Vol. 1, 264, 274. (April 2, 1984). Therefore, taxpayers electing the application of section 468 may deduct their reasonably estimated "qualified reclamation and closing costs" prior to economic performance. Taxpayers not electing the application of section 468 are subject to the economic performance requirements imposed by section 461(h). See GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, STAFF OF THE JOINT COMMITTEE ON TAXATION (Committee Print 1984).

Solid waste disposal site operators electing the application of section 468 may currently deduct a portion of the current reclamation or closing costs before economic performance. Because section 468 is merely an exception to the

economic performance doctrine of section 461(h), costs eligible for the election under section 468 must meet the other requirements for deductibility under section 461.

In the case of qualified closing costs, the amount allowable as a current deduction is equal to the portion of the reasonably estimated current closing costs allocable to production from the reserve property during the tax year or to units of the reserve property utilized during the tax year. Section 468 (a)(2)(C). Section 468(d)(1)(B) defines the term "current closing costs" to mean the amount which the taxpayer would be required to pay for qualified closing costs if the closing activities were performed currently. In the case of a solid waste disposal site, the estimated closing costs are computed on a unit-of-capacity basis. Section 468(d)(1)(B)(ii)(II).

Section 468(a)(5) specifically sets forth three events which would trigger the recapture of the balance in a reserve. First, if a taxpayer revokes an election under section 468(a)(1), the balances in the site's reclamation and closing reserves must be included in the taxpayer's income in that tax year. Section 468(a)(5)(A). Second, in the tax year that site reclamation or closure is completed, the remaining balances (if any) in that site's reclamation and closing costs sinking funds must be recaptured. Section 468(a)(5)(B). Finally, if the reserve property or any portion of the property is disposed of by the taxpayer, the balance of the reserve funds will be included in the taxpayer's income. Section 468(a)(5)(B). Lacking regulations or other dispositive interpretation of section 468, we see no basis for requiring recapture of reclamation costs prior to completion of the reclamation of the entire property, except that the provisions of section 468(a)(4) specifically require income inclusion when certain limits are reached. section 468(a)(4) provides that a determination of the current costs to close the property be made yearly. This estimation, adjusted to reflect the portion of the solid waste facility filled, is compared to the taxpayer's reserve which has been decreased for expenditures actually made and increased by the interest factor. To the extent the adjusted reserve exceeds the adjusted determined current costs the taxpayer recognizes income.

When the taxpayer conducts closing activities (such as closing a tract within the facility), the cost of those activities will decrease the reserve and will lower the current year's estimated closing costs to the extent that it is an activity that no longer must be done and therefore will not be a cost in the estimate. Thus, the closing of some of the tracts may or may not result in the taxpayer having to recapture income depending on whether or not each tract is a separate property as described in section 468(d)(3).

Section 468 permits a deduction for additions to reserves for both solid waste site reclamation and site closing costs. In this case, the cost to remove the stockpiled material appears to be more properly allocated to the cost of receiving and

recycling the material prior to actually placing it in the landfill. As such those costs cannot be considered reclamation or closing costs as those terms are used in section 468 and cannot be properly the subject of a section 468 reserve. Further, the corrective actions were required to bring the landfill site to the maximum site elevation permitted by the County and were done pursuant to a "Remedial Action Plan/Closure Plan" approved by the County. Regardless of whether overburdening is an appropriate form of landfill compaction, the remediation actions detailed in the plan far exceed the mere removal of excess fill. We do not believe that they can properly be classified as reclamation or closing costs.

Under the general rule for the year of deductibility, a taxpayer may deduct an otherwise allowable expense in the taxable year in which the "all events" test has been met. The all events test is satisfied when (1) all events have occurred that determine the fact of the taxpayer's liability, and (2) the amount of the liability can be determined with reasonable accuracy, but not before economic performance has occurred. sections 461(h)(4), (h)(1). Notwithstanding the above, section 468 permits taxpayers engaged in mining and solid waste disposal to elect to deduct certain qualifying reclamation and closing costs prior to economic performance. If a taxpayer makes a section 468 election and the Service subsequently determines that the costs deducted do not qualify under section 468, it follows that the question of the proper timing of the deduction reverts to the default rule of section 461(h).

It appears from the facts provided that taxpayer's claimed deductions for 1995 relate to reserves accrued for liabilities for which economic performance had not yet occurred at the end of the taxable year. Therefore, because the claimed deductions qualify under neither section 468 nor section 461, they are not allowable for taxable year 1995, even though the other prongs of the all events test have been met, but must be deferred until economic performance has occurred. Thus, the deductibility of these costs is a question of timing.

The rules for proper timing of a deduction depend upon a taxpayer's "method of accounting," which, for tax purposes, generally must be the method by which the taxpayer regularly computes income in keeping its books. section 446(a). A change in method of accounting involves, inter alia, the treatment of any material item, which in turn is defined as any item involving the proper time for including the item in income or claiming it as a deduction. Treas. Reg. section 1.446-1(e)(2)(ii); Rev. Proc. 97-27, section 2.01(1). If the taxpayer's practice does not permanently affect its lifetime income, but does (or could) change the taxable year in which income is reported, the practice involves timing and is therefore a method of accounting. Rev. Proc. 97-27, section 2.01(1). If a taxpayer's method of accounting does not, in the opinion of the Secretary, clearly reflect income, the taxpayer may be subject to an involuntary change of its method of accounting. section 446(b).

In general, an adjustment under section 481 is required in conjunction with a change in accounting method in order to prevent the items being changed from being duplicated or omitted in a subsequent year. section 481(a). In the case of an involuntary change in method of accounting imposed by the Service under section 446(b), the Service has discretion to impose the entire section 481 adjustment in the taxable year under examination. Capital Federal Savings and Loan Association v. Commissioner, 96 T.C. 204, 225 (1991).

In this case, taxpayer consistently deducted the removal excess reserves under section 468 in both the year under examination (1995) and earlier years. Further, the removal excess reserves disallowed as 1995 deductions presumably will be deductible under the normal "economic performance" rule in a future taxable year. Accordingly, taxpayer's practice of deducting these reserves constitutes an accounting method adopted by taxpayer, and any change to its practice would affect the timing of the deductions, rather than taxpayer's lifetime income. Therefore, the Service may impose a change in taxpayer's accounting method under section 446(b). Additionally, the Service may impose a section 481 adjustment during taxable year 1995 in order to prevent taxpayer from enjoying the benefit of duplicating its 1991-1994 deductions of this item in some future taxable year.

[redacted]

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