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The Baby

Every American Born Will Need . . .

1.319 lbs. Copper
1.648 Troy oz. Gold
23,435 lbs. Phosphate Rock
588,906 lbs. Coal
5,975 lbs. Bauxite (Aluminum)
21,418 lbs. Clays
776 lbs. Zinc
32,980 lbs. Iron Ore
72,994 lbs. Cement
1.71 million lbs. Stone, Sand, & Gravel
83,296 gallons Petroleum
854 lbs. Lead
466,891 lbs. Other Minerals & Metals
5.78 million cu. ft. Natural Gas

3.7 million pounds of minerals, metals, and fuels in their lifetime

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The Mining Team

The designated Mining Industry Technical Advisory team is comprised of the following personnel:

<table>
<thead>
<tr>
<th>NAME</th>
<th>POSITION</th>
<th>ADDRESS</th>
</tr>
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<tbody>
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<th>ADDRESS</th>
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<tbody>
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</tbody>
</table>
Industry Overview

The industry program includes issues and trends in coal, metal and non-metal segments of the U.S. mining industry. These mining operations include prospecting, exploration, development, production, mineral processing, environmental restoration and reclamation, and marketing of mineral products.

An ore is a mineral or combination of minerals from which useful substances, such as metals, can be economically recovered. The naturally occurring substances are usually divided into metalliferous ores such as gold, iron, and copper, and non-metalliferous ores such as coal, quartz, and bauxite. Industrial minerals, which form a separate group, include building and ornamental stones such as slate, marble, limestone, and granite.

Minerals are found in veins, sedimentary layers, or seams. Minerals can be found as large masses, or ore bodies of irregular shape standing at any angle. Gold, tin, silver, diamonds, and platinum are often found in "placers", or deposits of sand and gravel containing particles of the mineral.

Mining operations generally progress through four stages: (1) exploration, or the work involved in assessing the size, shape, location, and economic value of the deposit; (2) development, or the work of preparing access to the deposit so that the minerals can be extracted from it; and (3) exploitation, the work of extracting the minerals, and (4) reclamation and restoration of the disturbed land areas.

Current Industry Trends

The estimated value of all mineral materials mined and processed (Including coal) in the United States during 2005 totaled $500.3 billion. The non-fuel (non-coal) portion estimated value of all mineral materials processed in the United States during 2005 totaled $478 billion, 8% more than in 2004. The total value of U.S. raw non-fuel mineral production alone was about $51.6 billion, $6 billion (13%) more than in 2004. The value of metals accounted for about 32% of the total, an increase of about 33% compared with the value of metal mine production in 2004. The value of industrial minerals mine production increased by nearly 6% from the 2004 level. The value of net imports of raw and processed mineral materials during 2005 increased by about 6% from the 2004 level. The unit values and tonnages of many metal exports were up significantly, and the overall value of mineral exports increased by 21% to about $56 billion. The United States is increasingly reliant on foreign sources for raw and processed mineral materials. Imports of raw and processed mineral materials increased by more than 14% from the previous year’s level to a value of about $103 billion. As in recent years, aluminum, copper, and steel were among the leading imports in terms of value. The value of imports of metal ore and concentrates and raw industrial minerals was about $5 billion; the value of exports was about $4.8 billion.1

1 2006 USGS Mineral Commodity Survey
Role of Non-Fuel Mineral in the US Economy

2005 Value of Mined Raw (Unprocessed) Materials
Total: $74 Billion

- Coal: 30%
- Industrial Minerals: 48%
- Metals: 22%

THE ROLE OF NONFUEL MINERALS IN THE U.S. ECONOMY (ESTIMATED VALUES IN 2005)

Value Added to Gross Domestic Product by Major Industries That Consume Processed Mineral Materials:

- Value: $2,140 billion

Net Imports of Processed Mineral Materials
- Metals, Chemicals, etc.
  - Imports: $8 billion
  - Exports: $5 billion
  - Net Imports: $3 billion

Net Exports of Old Scrap
- Gold, Steel, etc.
  - Imports: $2.5 billion
  - Exports: $7.4 billion
  - Net Exports: $4.9 billion

Value of Domestic Shipments
- $47.9 billion

Mineral Materials Processed Domestically
- Aluminum, Brick, Cement, Copper, Fertilizers, Steel, etc.

Domestic Mineral Raw Materials from Mining
- Copper ore, Iron ore, Sand and gravel, Stone, etc.
  - Value: $31.6 billion

Net Imports of Mineral Raw Materials
- Gold, Soda Ash, Zinc Concentrates, etc.
  - Imports: $5.3 billion
  - Exports: $4.9 billion
  - Net Imports: $0.4 billion

Industry Associations and Contacts

National Mining Association (NMA)
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### Specific Industry Related Tax Law

<table>
<thead>
<tr>
<th>Effective Date</th>
<th>Code Section</th>
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<td>1954</td>
<td>611</td>
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<td>Mine Development Expenditures</td>
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<td>1964</td>
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<td>Disposal of Coal or Domestic Iron Ore</td>
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<td>Sales &amp; Exchanges of Timber, Coal, or Domestic Iron Ore</td>
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<td>1969</td>
<td>636</td>
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<td>2004</td>
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<td>Income Attributable to Domestic Production Activities</td>
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<td>2005</td>
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<td>Qualifying Advanced Coal Project Credit</td>
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<td>2005</td>
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The Phases of Mining

- Acquisition - The mineral can be acquired by fee simple or by a leasing arrangement. Fee simple includes: Land/mineral purchase, an asset acquisition, a stock acquisition, an exchange of property via partnership, joint venture, or via patent. Leasing arrangement includes: rentals, royalties, lease bonus delay rentals or unpatented claims.

- Exploration – expenditures paid or incurred by the taxpayer for ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral for which a deduction for depletion is allowable.

- Development – all expenditures paid or incurred during the taxable year for the development of a mine or other natural deposit if paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed.

- Production: (1) the major portion of the mineral production is obtained from workings other than those opened for development, or (2) the principal activity of the mine is the production of developed ores rather than the development of additional ores.

- Processing: the making and shaping of a raw mineral into a saleable mineral.

- Reclamation: the act of returning the land to its original shape and or contour.

- Abandonment and or disposition: the relinquishment of the property by sale or contribution or abandonment.

General Tax Accounting Principles in the Mining Industry

The mining industry maintains certain accounting practices and principles that are somewhat unique to the industry. The following descriptions attempt to briefly describe these principles.

Mineral Property Concepts

The term "minerals" is used to describe all natural substances subject to extraction. Ownership of land in the United States can encompass both surface and subsurface rights in a clearly defined tract. At times, the owner of the minerals does not own the surface of the land under which the minerals lie. Therefore, ownership of the minerals carries with it the right to make reasonable use of the surface, as necessary, to develop the property for production of ores or minerals.

The owner of the minerals has the right to extract the minerals and remove them from the property. The owner of the minerals, not the surface owner, has the right to grant a mineral lease, and is also the party who is entitled to any lease bonus that may be payable in connection with the lease.

Mineral Interest

The term "interest" is defined in the regulations as an economic interest in a mineral deposit." Treasury Regulation section 1.614-1(a)(2) also provides that "the term includes working or
operating interests, royalties, overriding royalties, net profits interests, and, to the extent not treated as loans under section 636, production payments."

Royalties and Other Lease Payments

A mineral royalty represents a right to the owner of the minerals in place to a fraction of the value from the production of those minerals, without having to incur the expense for the development and operation of the production activities.

Royalty interests in mineral properties are generally created by assignment of an economic interest via a leasing arrangement between the owner/lessor of the mineral rights and a grantee/lessee who is burdened with the requirement of development and production of the mineral property. At the expiration of the lease, the assigned leasehold interest of the lessee reverts back to the owner of the mineral rights.

Leasing arrangements may contain various types of payment provisions depending upon the negotiations of the parties involved. These payment provisions can have significantly different Federal tax treatments for both the lessor and lessee depending upon their nature and structure. Some examples of lease payment provisions include production royalties, advance royalties, advance minimum royalties, leasehold bonuses, and rentals or delay rentals.

Internal Revenue Code section 612 and the regulations thereunder provide the regulatory guidance for the proper Federal tax treatment of mineral royalties and other leasehold payments.

Exploration

For Federal tax purposes, exploration expenditures are defined as those necessary "for ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral for which a deduction for depletion is allowable under section 613 (other than oil or gas) paid or incurred by the taxpayer before the beginning of the development stage of the mine or other natural deposit". (Treas. Reg. section 1.617-1(a)) Section 617 and the regulations thereunder provide the statutory and regulatory guidance for the proper Federal tax treatment of mine exploration expenditures.

Mine Development

After a commercially exploitable deposit of ore or mineral has been established through exploration activities, it must then be prepared or developed for full scale production. This is known as the development stage of a mining operation and is defined as the time when, in consideration of all the facts and circumstances (including the actions of the taxpayer), deposits of ore or other minerals are disclosed in sufficient quantity and quality to reasonably justify commercial exploitation by the taxpayer. IRC section 616 and the regulations thereunder provide the statutory and regulatory guidance for the proper federal tax treatment of mine development expenditures.
Depletion

Depletion allows the owner of the mine or mineral interest to recover basis in the minerals just as depreciation allows a manufacturer to recover the cost of equipment and buildings.

There are two methods of computing depletion. Cost depletion allows the recovery of the mineral basis over the life of the mine on a units-of-production basis. Percentage depletion provides a deduction of a specified percentage of gross income from the property, not to exceed 50 percent of net income from the property. The allowable depletion deduction is the greater of cost or percentage depletion.

Internal Revenue Code section 611 establishes the depletion allowance. IRC section 612 defines basis of mineral property. Section 613 defines the percentage depletion rates, gross income from mining and taxable income from mining. Section 614 defines property and related rules. Associated regulation sections provide additional direction.

General Rules

Taxpayers are not given the option to select the method of computing the depletion deduction. The depletion deduction must be computed both ways, with the larger of the two amounts claimed as a deduction. (Treas. Reg. section 1.611(a)(1)) Thus, the method may change from year to year. Further, the basis of the mineral property will be reduced by the amount of depletion (computed under either method) claimed.

Allowable depletion is not restricted to the recovery of the taxpayer's basis. Taxpayers may continue to claim percentage depletion based on income from the property after the basis in the property has been fully recovered. Any depletion claimed in excess of basis becomes a tax preference item for purposes of computing Alternative Minimum Tax (IRC 57(a)(1)).

IRC section 611 allows the deduction for depletion. Treas. Reg. section 1.611-2 describes the computation of cost depletion. IRC section 612 and the regulations thereunder define basis for computing cost depletion. Percentage depletion is allowed by IRC section 613.

Mining Reclamation and Closing

Taxpayers are allowed to deduct and establish reserve accounts for qualified reclamation expenses required by sections 511 or 512 of the Surface Mining Control and Reclamation Act of 1977 (SMCRA). Mine reclamation costs are the costs to restore the area disturbed by mining. Closing costs are related to the expenditures necessary to close mine plant areas. The work must be required under a surface mining and reclamation permit granted under Title V of SMCRA. Reclamation required under other federal or state laws, which are similar to the requirements of Title V of the SMCRA, is also acceptable.

Under IRC section 468, mine operators are allowed to accrue and deduct expenses for mining reclamation and closing costs in the current year (in advance of economic performance). The code requires that separate reserve accounts be established for mine reclamation and closing costs. The taxpayer must elect to accrue these expenses. Interest is accrued on the reserve account balances under the Federal Short Term Rate determined by IRC section 1274. If the election is revoked, the taxpayer must recapture the reserve account in income.
Government Regulatory Requirements in the Mining Industry

The mining industry is a heavily regulated industry. Operations at any quarry or mine are usually governed by its operating permit, which in most instances is issued by a State Regulatory Agency. Quarries such as sand and gravel pits may be permitted at the county level. In each case, the operating permit will establish the details of the mine operations such as blasting requirements, reclamation plans, surface and groundwater controls, etc., and will include extensive detailed maps of past, current and future areas to be mined and surface facilities.

Federal Requirements

Mining Law of 1872

The General Mining Law, or Hardrock Mining Act, of 1872 was passed by Congress and signed by President Ulysses S. Grant to protect and encourage mining and settlement in the Western territories. The act is one of the major statutes of Federal land management policy. According to law professor Charles Wilkinson, "From its inception, hard rock mining has been the highest and most preferred use of the public lands, and the old law extends to mining companies a 'right to mine.'" In his book, Crossing the Next Meridian, he also states that the hardrock mining system is "still a miner's law -- built on open access, free minerals, unlimited tenure, and rights to land as well as minerals."

In the past 134 years, the law itself has been subjected to minimal change, but its scope has been greatly limited. The most significant change to the 1872 Mining Act was the removal of some Federal lands and mineral resources from its jurisdiction. The creation of the National Park system and National Historic Sites established Federal lands that are protected from mining. Indian reservations, military reservations, wilderness areas, and water and power projects have also removed land from the purview of the Hardrock Mining Act. The Act originally applied to all minerals except coal. In 1920 the Mineral Leasing Act set new policies for the mining of oil and gas, oil shale, phosphate, and sodium on public lands, removing them from control of the Hardrock Mining Act. Other mineral resources were later added to this list.

"The law grants free access to individuals and corporations to prospect for minerals in public domain lands, and allows them, upon making a discovery, to stake a claim on that deposit." Miners can freely prospect on public land. They pay a $100 annual holding fee per claim (under legislation enacted by the 102nd Congress) and then complete $500 worth of assessment work in labor or improvements. Finally, individual miners or corporations pay $2.50 to $5 per acre for the claim. The 1999 CRS report states that as the law currently applies to claims, "There is no limit on the number of claims a person can locate. There is no requirement that mineral production ever commence. Timing or pattern of development is not regulated. Mineral production can take place without a patent or revenue payments to the federal government. Claims can be held indefinitely with or without mineral production."

Surface Mining Control and Reclamation Act (SMCRA)

Coal Mining is regulated pursuant to the Surface Mining Control and Reclamation Act of 1977, (SMCRA). Protecting the environment during coal mining and making sure the land is reclaimed afterwards have been national requirements since 1977, when America's Surface Mining Law was signed by President Carter. Making sure those requirements are met is the responsibility of the Interior Department's Office of Surface Mining (OSM).

US EPA

The industry is subject to many environmental laws and regulations which are administered by the US EPA and the State Authorized Environmental Agencies. These laws and regulations impact virtually every aspect of the industry, including plant operations, permitting requirements, environmental remediation, and waste handling and disposal. The industry is subject to the following:

- Federal Clean Water Act
- Federal Clean Air Act
- The Resource Conservation and Recovery Act (RCRA)
- Comprehensive Environmental Response Compensation & Liability Act, (CERCLA
- US EPA Solid Waste Disposal Act
- US EPA regulations on Under Storage Tanks
- Toxic Substance Control Act (TOSCA)

Mine Safety and Health Administration (MSHA)

The mission of the Mine Safety and Health Administration (MSHA) is to administer the provisions of the Federal Mine Safety and Health Act of 1977 (Mine Act) and to enforce compliance with mandatory safety and health standards as a means to eliminate fatal accidents; to reduce the frequency and severity of nonfatal accidents; to minimize health hazards; and to promote improved safety and health conditions in the Nation's mines. MSHA carries out the mandates of the Mine Act at all mining and mineral processing operations in the United States, regardless of size, number of employees, commodity mined, or method of extraction.

State and Local Requirements

Each state regulates mining by way of the permitting process through a responsible agency or department. An example of such a regulatory agency is a State Department of Natural Resources. Local governmental authorities may also require permitting for mining or quarry operations
Industry Coordinated Issues

Strike Costs   Effective Date: May 24, 1993

ISSUE:

Whether certain administrative and overhead expenses incurred by a mining company during an employee strike as well as depreciation on idled plant and equipment are deductible from gross income from the property for purposes of the 50% taxable income limitation on percentage depletion under I.R.C. § 613(a).

FACTS:

During an employee strike, a mining company will incur substantial expenses even though mine production has ceased. The Service has found that some mining companies are taking the position that such expenses are therefore unrelated to mining activity and should not be subtracted from taxable income from the property in computing the 50% limitation for percentage depletion. The treatment of strike-related expenses as not attributable to mineral production when incurred during a strike and, thus, not deductible from taxable income, will increase allowable depletion.

CONCLUSION:

It is our position that such strike expenses must be taken into account in determining the taxable income from the property under I.R.C. § 613(a).

Excise Tax on Coal Excess Moisture   Revision Date: April 2, 1999

ISSUE:

What testing methods or procedures are acceptable to the Service as competent evidence of the existence and amount of excess moisture in coal for determining the permissible reduction to the taxable weight of such coal for excess moisture for purposes of the tax imposed under I.R.C. section 4121.

CONCLUSION:

The Service accepts the testing method outlined in ASTM D1412 for high rank coal and for low rank coal when adjusted with a correction factor as competent evidence of the existence and amount of excess moisture for purposes of I.R.C. section 4121.

Receding Face Deductions   Effective Date: October 22, 2001

Issue:

Do X’s expenditures for various conveyor system components, as described in scenarios A through D below, qualify for the receding face deduction as provided by Treas. Reg. section 1.612-2(a)?
As a general rule, the cost of mine improvements and equipment are capitalized and recovered through depreciation over their useful lives. Section 1.612-2(a) of the regulations, however, provides that certain expenditures, although capital in nature, shall be deducted as ordinary and necessary business expenses. The particular expenses (for equipment, its installation and housing) that can be deducted are those that are required to maintain the normal output of the mine and are necessitated solely because of the recession of the working face. The latter requirement means that there must be a direct and exclusive causal relationship between the expenditure and the recession of the working face.

Section 1.612-2(a) further provides that the expenses cannot

1) increase the value of the mine;
2) decrease the cost of production of mineral units; nor
3) represent an amount for restoration of the property or making good the exhaustion thereof for which an allowance has been made.

Four factual scenarios related to the installation of conveyor belt systems are presented along with guidance describing the correct application of the Receding Face Doctrine.

**Tier II Issue - Claims for refund under section 172(f)**

In 2005 LMSB and SBSE became aware of an increased number of claims for refund using the provisions of §172(f). The claims have been associated with NOL reviews conducted by some of the top four accounting firms. The claims are generated as informal claims on examination, formal filings of 1120X and formal filings of Form 1139 Corporate Application for Tentative Refund. On June 24, 2005, this issue became a designated emerging issue by LMSB and SBSE. On January 27, 2006, this issue became a designated emerging issue in Appeals. LMSB NRC established an Emerging Issue Team (EIT) in accordance with IRM 4.51.2 to address this issue in a pro-active manner. The EIT met in August of 2006 in preparation of finalizing the EIT actions to date and to determine the next steps required by IRM 4.51.2 in order for the EIT to finalize the team’s actions, prepare a Final Report, prepare an issue resolution tool, discuss the final report presentation, discuss the venue for communication of the team’s product, and prepare the Compliance Initiative Project (CIP) termination report.

Section 172(f) provides special rules for the portion of an NOL that is identified as a specified liability loss (SLL) and as such is allowed a ten year carry back as opposed to the two years generally allowed for NOL’s. Section 172(f) was amended in 1998 to restrict the types of expenses that qualify as SSL’s and therefore now only applies to a narrow set of liabilities.

IRC §172(b)(1)(C) allows taxpayers to carry specified liability losses back ten years.

IRC §172(f) defines specified liability losses to include the following:

1) Deductible product liability amounts or expenses incurred in investigating or settling a product liability;
2) Deductible expenses incurred in satisfaction of Federal or State laws in connection with-
   a) Reclamation of land [IRC §172(f)(1)(B)(i)(I)],
   b) Decommissioning of a nuclear power plant,
Mining Industry Overview

The SSL identified in §172(f)(1)(B) may only be taken into account if the acts or failure to act giving rise to such liability occurred at least three years before the beginning of the taxable year in which the amount is allowable as a deduction and the taxpayer used an accrual method of accounting throughout the periods during which such act or failure to act occurred.

The claims identified in the Natural Resource Industries have primarily dealt with expenditures relating to land reclamation and/or environmental site remediation; however, these principles could easily apply to other manufacturing industries that have environmental cleanup or similar type costs.

The nature of the issue identified pertains to whether or not the claimed expenditures are indeed qualified specified liability losses under §172. This analysis includes:

1. Whether the incurred costs are allowable deductions, as opposed to capital expenditures, and
2. Whether or not the costs were incurred in satisfaction of a Federal or State law requiring the expenditure, as opposed to company policy or other mandate and
3. Whether or not the act or failure to act that gave rise to the liability occurred at least three years prior to the beginning of the taxable year in which the amount is allowable as a deduction, as opposed to a normal current business operating expense.

The claims identified to date tend to overstate the amounts of qualified SLL’s. This requires the Field to examine the details of the taxpayer’s claim and adjust for any identified non qualifying SLL’s.

The Compliance Initiative Project for this issue had AIIMS Project Code: 0047 and ERCS Tracking Code: 7942.

Significant and Potential Issues in the Mining Industry

AMT/ACE Adjustments
Adjustments are required pursuant to IRC §56(g)(4)(C)(i) to increase a taxpayer’s Alternative Minimum Taxable Income, (AMTI) for Adjusted Current Earnings (ACE) adjustments for depletion, if the taxpayer’s deduction for depletion under IRC §611(a) is in excess of the adjusted basis of the mining property for cost depletion purposes.

For purposes of computing the IRC § 57(a)(1) depletion preference amount, a taxpayer includes mine development and mine exploration costs in its IRC § 1016 adjusted basis.

For purposes of cost depletion, the IRC §612 basis in a mineral property does not include the capitalized mine development and exploration costs.

As a result of including mine development and exploration costs in the adjusted basis of the property, taxpayers, in computing AMTI, are claiming deductions for depletion under IRC...
section 611(a) that are not completely offset by its IRC section 57(a)(1) depletion preference amount.

Section 56(g)(4)(C)(i) specifically states that, in computing ACE, a deduction is not allowed for any item that is not deductible for any taxable year for purposes of computing the corporation's earnings and profits. Section 1.312-6(c)(1) of the Income Tax Regulations provides that in the case of a corporation in which depletion or depreciation is a factor in the determination of income, the only depletion or depreciation deductions to be considered in the computation of the total earnings and profits are those based on cost or other basis.

Because the determination of earnings and profits for pre-1990 properties must be based on cost depletion and therefore can not include percentage depletion, the computation of ACE must exclude excess percentage depletion.

Deferred Costs
Two Technical Advice Memorandums (TAM's) were released November 14, 2005 which involve the method of allocating certain mining costs among different production methods for a mined product, and the appropriateness of IRC section 481 adjustments.

TAM 200545043 and TAM 200545044 concluded that metal mining companies are required to capitalize, under section 263A, and allocate the costs for drilling, blasting, loading, and hauling related to a particular metal that they produce using a leaching process. In the mining industry, leaching processes are used frequently to extract metal from lower grade ore. Many taxpayers utilize two different mining production processes: a concentration process for higher graded ore and a leaching process for the lower graded ore, followed by the solvent-extraction/electro-winning (SX/EW) process. The two TAMs focused on pre-SX/EW processes for the lower graded ore.

Taxpayers are required under IRC section 263A to capitalize drilling, blasting, loading, and hauling costs related to the metal to be produced from the leach piles. The TAMs stated that the costs for removing low grade ore from the mine and piling it for later extraction by a leaching process did not fall into the category of 'development expenditures' under IRC section 616. The TAMs also stated that taxpayers are required to allocate capitalized drilling, blasting, loading, and hauling costs to the metal that will be produced from the leach piles. The drilling, blasting, loading, and hauling costs are recovered through cost of goods sold as the related metal is sold.

This application will result in adjustments to current methods being used for many taxpayers in the mining industry. The Mining Technical Advisors will be monitoring this issue as taxpayers do or do not make the change.

FASB 04-6 – Overburden Stripping Costs
In the mining industry, the costs of removing overburden and waste materials to access mineral deposits are referred to as "stripping costs." It is the accounting for costs incurred during the production stage of the mine, or the post-production stripping costs, that are addressed in Issue 04-6.

Based upon this consensus, post production stripping costs should be considered costs of the extracted minerals under a full absorption costing system and recognized as a component of inventory to be recognized in costs of sales in the same period as the revenue
from the sale of the inventory. Additionally, capitalization of such costs would be appropriate only to the extent inventory exists at the end of a reporting period. This consensus may represent a significant change in practice for those companies that currently expense post production stripping costs as incurred or capitalize post production stripping costs and amortize those deferred costs over the life of the mine or another determinative period.

Initial reaction to this announcement suggests that mine development costs for tax purposes should be reflected on Schedule M-3. However, if a taxpayer is deducting these costs as production costs for book purposes, it could be difficult to identify them as mine development for tax purposes. There could be potential compliance issues related to the 30% reduction under IRC section 291, as well as the required 10 year amortization of mine development expenditures for AMT purposes for any costs treated as production expenses under the FASB rule but are indeed mine development costs for tax purposes. Furthermore, a taxpayer's change in its method of accounting to comply with this new consensus will necessitate the filing of Form 3115 to request a change in method of accounting.

Section 29 Nonconventional Fuel Credits

The I.R.C. §29 Nonconventional Fuel Tax Credit (newly re-designated as I.R.C. section 45K) is a non-refundable credit against federal income tax for the production and sale of qualified fuels. Section 29 applies to numerous types of fuels, including oil and gas to biomass and solid synthetic fuels produced from coal or lignite. The credit cannot be used to generate a refund in excess of the taxpayer's regular tax (reduced by other income tax credits), nor can it be used to offset alternative minimum tax. For taxable years ending after December 31, 2005, the Section 29/45K credit has also been re-designated as a general business credit under the provisions of IRC 38.

At present, solid synthetic fuels from coal generate a §29 tax credit of approximately $25.00-27.00 per ton depending upon the synthetic fuel product BTU content. Solid synthetic fuels from coal have the same end-uses as conventional coal and often sell at a price lower than conventional coal. Conventional coal sells for approximately $40 per ton and is not eligible for the credit. There are an estimated 55 to 85 synfuel plants in operation nationwide.

A joint notice of extension of the section 29 credit to facilities that produce coke or coke gas if the subject facilities were placed in service before January 1, 1993, or after June 30, 1998 and before January 1, 2010. The credit is allowable on coke or coke gas produced and sold beginning on January 1, 2006 or the date the facility is placed in service and ending on the date which is 4 years after the date the period began.

The section also imposes an average daily limit of allowable credit for any facility. This daily limitation is equal to an average barrel of oil equivalent, (BOE), of 4,000 barrels per day. The barrel of oil equivalency is determined using a figure of 5,800,000 BTU’s per barrel of oil.

The credit generated from the production and sale of coke and coke gas is also subject to the phase out requirements of section 29(b)(2); however, for purposes of coke and coke gas, the Inflation Adjustment Factor, (IAF), is to be computed using the GNP implicit price deflator for the calendar year 2004 as opposed to 1979.

The credit attributable to coke or coke gas is also subject to a denial of double benefit. The credit cannot be claimed for coke or coke gas production if the facility used to produce coke or coke gas was used to produce other qualified fuels and a credit for those fuels was allowed by reason of section 29(g) for this tax year or any preceding tax year.
The effective date for this provision changes applies to fuel produced and sold after December 31, 2005 in taxable years ending after such date.

Section 199 Potential Issues in the Mining Industry

Contract Miners – There is a potential issue involving the use of contract miners in the production and extraction of minerals from a mineral property. Contract miners have no economic interest in the mineral property on which they conduct their income producing activities. The contract miners are traditionally paid a set fee to operate the mine. The contractor typically does not have the benefits and burdens of ownership. There could be a conflict between who qualifies for the deduction, the mineral property owner or the contract miner. There could also be issues relating to the determination of Qualified Production Activities Income (QPAI). Should the activities of the contract miner be attributed to the principal mineral owner? If so, the mineral owner, claiming the section 199 deduction may have only minimal W-2 wages in determining the limitation. Would the W-2 wages of the contract miner be attributed to the mineral property owner?

Mine Development in the case of Joint Ventures. A potential issue exists in the case where a third party enters into a JV agreement with a mineral property owner. Payments are made by the third party to acquire an interest in the venture and property. Some portion of the payment could be designated or allocated to the mine development that will be required. The taxpayer could treat payment by the third party as income derived from the mine development and thus a qualified construction activity subject to section 199 as oppose to the sale of a mineral property interest.

Mine Development – Contracting out. The new section 199 deduction may cause a change in industry practices creating a larger amount of contracting out for mine development. Traditionally, a miner/taxpayer would undertake its own mine development. As such it would not generate any qualified income. Contracting this activity to a third party would be qualified income to the contractor conducting the mine development activities.

Do deductions for percentage depletion under IRC section 611 have to be included in the determination of QPAI? To determine its QPAI for the taxable year, a taxpayer must subtract from its DPGR the amount of CGS allocable to DPGR, the other deductions, expenses, and losses (deductions) directly allocable to DPGR, and a ratable portion of other deductions that are not directly allocable to DPGR or another class of income. A taxpayer's costs must be determined using the taxpayer's methods of accounting for Federal income tax purposes. Taxpayers in the mining industry that compute allowable depletion under IRC section 613 (percentage depletion) may argue that this deduction is unrelated to the production of DPGR since it is a computational deduction not based on actual costs to produce the property.

Are mine development deductions under IRC section 616 included in the determination of QPAI? Except for the election of IRC section 616, mine development would be considered capital expenditure and is exempt from capitalization under IRC section 263A. Furthermore, mine development activities have been separately identified as qualified construction in their own right and are a Qualified Production activity subject to the 199 deduction in cases where DPGR is generated from the mine development activity. Taxpayers may argue that since mine development is a qualified construction activity it should not be related to the DPGR from mining the property and exclude mine development in the determination of QPAI.
Publications & Subscriptions

The team has the following Publications and Subscriptions

Engineering & Mining Journal
InfoMine Subscription
Taxation of Mining Operations
Keystone Coal Industry Manual
Appendix A  Metal Mineralized Locations in the United States
Appendix B  Coal Mine Locations
Appendix C  Precious Metal Mine Locations