Proskauer

Recent Updates from the IRS and Treasury on the Superfund Chemical Tax

Tax Talks on **February 23, 2024**

I. *Executive Summary*

On February 15, 2024, the IRS and Treasury issued a supplemental notice to a prior notice from December 2022, to correct a petition requesting that the Superfund Chemical Tax apply to polyphenylene sulfide. While the supplemental notice is narrow in scope, the IRS and Treasury have requested public comments by April 15, 2024 on the corrected petition more generally.

The Superfund Chemical Tax, which went into effect on July 1, 2022, reinstated an excise tax imposed on manufacturers, producers, and importers of certain chemicals and chemical substances. (Please see our earlier blog post on the Superfund Chemical Tax here.) In March 2023, the Internal Revenue Service (the "IRS") and the Department of Treasury ("Treasury") published a notice of proposed rulemaking that provides additional clarification and interpretive guidance for taxpayers subject to the renewed Superfund Chemical Tax. A high-level primer of the categories covered and the major types of clarification provided by the new guidance published by the IRS follows in this executive summary. A more comprehensive overview of the notice of proposed rulemaking is contained in the full blog post further below.

The guidance specifically addresses: (i) the treatment of combinations of chemicals (including ores and metals); (ii) the characterization of international transactions; (iii) the mechanics of calculating the amount of tax owed; (iv) the definitions of certain terms referenced in the underlying statutes; (v) the applicability of exceptions to the tax; (vi) the procedures for obtaining credits and refunds, and (vii) the procedures for modifying the Taxable Substances List.

Regarding the treatment of combinations of chemicals, the guidance offers an analytical framework for categorizing such combinations and elucidates a procedure for the application of the Superfund Chemical Tax to those combinations. For international transactions, the focus of the guidance is to clarify how and when the tax liability attaches to such transactions, which party to the transaction bears the burden of such tax liability, and the process for evidencing compliance. In addition, the guidance demonstrates the necessary steps for determining the amount of the tax liability under the Superfund Chemical Tax, including for quantifying the relevant amounts of the taxable chemicals themselves. The guidance also provides robust definitions for the technical terms referenced by the statutes, in an effort to resolve potential areas of uncertainty and to clarify the treatment of certain specially situated taxpayers. Finally, the guidance also details the available exceptions to the Superfund Chemical Tax, outlines the procedures for obtaining credits and refunds for taxes paid, and specifies the steps for modifying the Taxable Substances List.

As noted above, an in-depth summary of the guidance contained in the notice of proposed rulemaking continues below.

II. *Supplemental Notice*

The supplemental notice corrects the stoichiometric material consumption equation for polyphenylene sulfide set forth in a petition that requested that polyphenylene sulfide (a high-performance thermoplastic used to manufacture filters, appliance, machine and automobile parts) be added to the list of taxable substances in Section 4672(a). The IRS and Treasury had issued a notice in December 2022, which summarized the petition and requested public comments. The petition states that taxable chemicals constitute 90% by weight of the materials used to produce polyphenylene sulfide and calculates a rate of tax of $14.50 per ton of polyphenylene sulfide. No public comments were provided with respect to the prior notice.

In the supplemental notice, the IRS and Treasury have requested public comments and requests for a public hearing on the corrected petition by April 15, 2024. Comments and requests for a public hearing may be submitted:

- ???Electronically at http://www.regulations.gov (indicating public docket number “IRS-2022-0037” or “polyphenylene sulfide”); or

- ???By mail to Internal Revenue Service, Attn: CC:PA:01:PR (Supplemental Notice of Filing for Polyphenylene Sulfide), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington DC 20044.

III. *Notice of Proposed Rulemaking*

On March 29, 2023, the IRS and Treasury released a notice of proposed rulemaking pertaining to the reimposed Superfund Chemical Tax. The notice of proposed rulemaking (the "Notice") contains several proposed regulations under Sections 4661, 4662, 4671, and 4672 of the Internal Revenue Code of 1986, as amended (the "IRC" or the "Code") and amendments to the Environmental Tax Regulations (collectively, the "Proposed Regulations").[1] The purpose of the Notice and the Proposed Regulations is to offer guidance to taxpayers and to clarify areas of uncertainty regarding the reintroduction of the Superfund Chemical Tax regime. The Notice solicits comments to the Proposed Regulations from experts, industry, and the public, as well as requests for a public hearing, which were both due by May 30, 2023.[2] The Proposed Regulations would not take binding effect until and unless they are officially adopted as final by a Treasury decision that is published in the Federal Register; however, in the interim, the Notice states that taxpayers may "rely on the provisions of these proposed regulations prior to that date provided that they follow the proposed regulations in their entirety (as applicable) and in a consistent manner."

The Proposed Regulations seek to address many of the unanswered questions and unresolved issues generated in response to the initial re-implementation of the Superfund Chemical Tax. In particular, the Proposed Regulations clarify the rules: (i) governing combinations of chemicals (including ores and metals); (ii) applicable to international transactions; (iii) for calculating the amount of tax owed; (iv) regarding the definition of certain terms referenced in the statute; (v) for determining the applicability of exceptions to the tax; (vi) prescribing the procedures for obtaining credits and refunds, as well as (vii) for modifying the Taxable Substances List. An overview of the new guidance reflected in the Proposed Regulations is provided below.

Combinations of Chemicals (including Ores and Metals)

The Proposed Regulations help to clarify the treatment of certain combinations of chemicals and distinguish “chemical mixtures” from “chemical compounds.” A chemical mixture is defined as “generally any substance composed of two or more physically-combined components that are not chemically bonded,” including solutions, suspensions, and alloys. Under the framework contemplated by the Notice, taxable chemicals contained in chemical mixtures retain their “taxable” character while part of the mixture. On the other hand, a “chemical compound” is defined as “generally any substance composed of identical molecules, each of which consists of two or more atoms of the same or different elements held together by chemical bonds.” In contrast to the approach taken for chemical mixtures, the Proposed Regulations provide that a taxable chemical used to create a chemical compound “does not retain its individual properties.” This is significant because a domestic manufacturer of a chemical compound produced from one or more taxable chemicals would be liable under section 4661 for its taxable “use” of such chemicals as part of the production process. However, because a taxable chemical used to produce a chemical compound does not preserve its individual identity, an imported chemical compound manufactured from one or more taxable chemicals would escape liability under sections 4661 and 4662 entirely – potentially benefitting non-U.S. producers of chemical compounds and putting the domestic industry’s competitiveness at a disadvantage.[3]

An additional, related point of clarification pertains to taxable chemicals (e.g., nickel, phosphorus, cobalt, etc.) that are derived from ores. Proposed Regulation Section 52.4661-1(c)(4) provides that the Superfund Chemical Tax is triggered upon the first sale or use of the taxable chemical by the manufacturer, producer, or importer after the taxable chemical has been extracted from the underlying ore. The Notice also states that in these circumstances, a "manufacturer" is the person who extracts the taxable chemical from the ore, and the term "extraction of a taxable chemical from the ore" means the first process in the United States that a person uses to separate the taxable chemical from the ore. With respect to chromite, which is a taxable chemical that is itself an ore (as opposed to a taxable chemical derived from an ore), the Proposed Regulations provide that the tax attaches to the first sale or use of chromite by the manufacturer, producer, or importer after the chromite is mined. The Proposed Regulations further provide that the tax treatment prescribed for taxable chemicals derived from ores would also govern taxable chemicals derived from metals; however, the Treasury Department and IRS have requested further comments as to whether an additional or alternative rule for metals would be appropriate or warranted.

International Transactions

Under Proposed Regulation Section 52.4661-1(c), the tax imposed by Section 4661 attaches to the first sale or use of a taxable chemical by the manufacturer, producer, or importer. This means that in situations involving non-U.S. manufacturers of taxable chemicals, no tax is imposed on that manufacturer's sale of the taxable chemical to the importer. The tax would instead be applied to the first subsequent sale or use by that importer. The Notice acknowledges that this clarification is consistent with Congress' intent to avoid double taxation under the Superfund Chemical Tax regime, as well as with the definition of "taxable chemical" in Section 4661 and "with the overall statutory scheme of excise taxes and relevant case law."[4] The Proposed Regulations also discuss how this general rule intersects with certain specific factual scenarios relating to imports and exports of taxable chemicals, such as transactions involving customs brokers, agents, and "drop shippers" located outside the United States.[5]

As provided for under Section 4662(e)(1), the Superfund Chemical Tax does not apply to sales of taxable chemicals for export (or for resale by a purchaser to a second purchaser for export). Proposed Regulation Section 52.4662-5(b) sets forth the process by which such tax-free sales are to be effectuated, and includes a model exemption certificate and a model statement of export.[6] Proposed Regulation Sections 52.4662-5(c) and 52.4662-5(d) provide general guidelines relevant to an exporter's claims for credit or refund of Superfund Chemical Tax already paid, as well as a procedural mechanism for an exporter to pursue such claims.[7]

Calculating Tax Liability

Proposed Regulation Section 52.4661-1(f) offers guidance for how to calculate the amount of the Superfund Chemical Tax owed, applying the specified rates per ton provided under Section 4661(b). As a practical matter, Proposed Regulation Section 52.4661-1(f)(2)(ii) also clarifies that for those taxable chemicals that are measured in volumetric units, the volumetric units must be converted to weight units in order for the taxpayer to properly determine the Superfund Chemical Tax liability.

Certain Definitions

The Proposed Regulations Section 52.4661-1 define several terms referenced in the Code including the terms "manufacturer," "importer," "sale," and "use," as well as other terms "necessary to provide clarity with regard to the application of" the Superfund Chemical Tax.[8]

For example, an area of uncertainty had involved the tax treatment of recyclers of taxable chemicals, as opposed to "original" manufacturers or producers, and to what extent recycling activity would implicate the Superfund Chemical Tax. Proposed Regulation Section 52.4662-1(c)(6)(i) clarifies that the definition of "manufacturer" for this purpose also encompasses producers of taxable chemicals "from scrap, salvage, waste, or recycled substances." The Proposed Regulations further clarify that the definition extends to activities: that (i) produce chemicals through the mining process; (ii) extract, isolate, separate, or otherwise remove chemicals from ores or from another substance; and (iii) produce chemicals by processing or manipulating a substance, such as through the oxidation process. However, the Proposed Regulations explicitly exclude from the definition of manufacturer "a person that dilutes a chemical mixture comprised of one or more tax-paid chemicals with a solvent that is not a taxable chemical."[9]

Proposed Regulation Section 52.4662-1(c)(15) adopts a broad definition for "use" in the Superfund Chemical Tax context, providing that a taxable chemical is "used when it is consumed, when it functions as a catalyst, when its chemical composition changes, when it is used in the manufacture or production of a chemical mixture or other substance (including by mixing or combining the taxable chemical with other substances), or when it is put into service in a trade or business for the production of income."[10]

The rules governing taxable substances under Sections 4671 and 4672 each make reference to the substance in question's "predominant mode of production," but this term is not defined by either of the statutes. Proposed Regulation Section 52.4672-1(b)(4) resolves this potential uncertainty by defining predominant mode of production to mean "the method used to produce the greatest number of tons of a particular substance worldwide, relative to the total number of tons of the substance produced worldwide." [11]

The Proposed Regulations also provide some more detailed guidance applicable to particular situations. For example:

• Proposed Regulations Sections 52.4661-1(d) and 52.4671-1(d) clarify that each business unit that has, or is required to have, a separate employer identification number (an "EIN") is treated as a separate "person" for purposes of filing the Superfund Chemical Tax excise tax returns, making semimonthly deposits of the excise tax, making payments of excise tax, and applying for the registration required under Sections 4662(b)(10)(C) and (c)(2)(b).

• Proposed Regulation Section 52.4662-1(b)(2) specifies that the list of taxable substances provided in Section 4661(b) encompasses all isomeric forms of such substances, which are treated as having the same name and molecular formula.[12]

• Proposed Regulation Section 52.4662-1(c)(6)(ii) provides a special rule applicable to "contract manufacturers," or persons that manufacture or produce a taxable chemical for a second person pursuant to a contract, order, or agreement (and in accordance with the second person's specifications), stating that the Superfund Chemical Tax liability is borne by the customer and not by the contract manufacturer.

Applicability of Exceptions & Special Rules

The Proposed Regulations offer more details to explain the exceptions to the Superfund Chemical Tax and the special rules that apply to certain taxpayers. For example, there is additional, specific guidance regarding the exceptions for: (i) methane or butane used as fuel;[13] (ii) qualified fertilizer, fuel, and animal feed substances;[14] (iii) sulfuric acid produced as a byproduct of air pollution control equipment;[15] (iv) taxable chemicals produced from coal;[16] and (v) organic taxable chemicals thatare part of an "intermediate hydrocarbon stream containing one or more organic taxable chemicals." [17]

In response to the requests to delay implementation of the Superfund Chemical Tax until January 1, 2023, the IRS and Treasury noted that the July 2022 effective date was imposed by the legislation itself, and that they do not have the authority to amend the language of the statute. However, on March 27, 2023, the IRS released an advance version of Notice 2023-28, which extends the relief from the deposit requirements provided for in Notice 2022-15 (please see previous blog post) through the second, third, and fourth calendar quarters of 2023.

Procedures for Obtaining Credits, for Obtaining Refunds, and for Modifying the Taxable Substances List

Proposed Regulation Section 52.4662-4 clarifies the rules governing claims for credit and refund under Section 4662(d), providing the general framework, the conditions limiting applicability, and the supporting information that will be required to evidence claims, including a "model certificate" to support a claim for credit or refund. Proposed Regulation Section 52.4671-2(c) likewise offers guidance regarding claims for refund or credit under Section 4671(d)(2), which are similar to those proposed under Section 52.4662-4.

Under the prior iteration of the Superfund Chemical Tax, Notices 89-61 and 95-39 provided rules and a determination process by which modifications to the Taxable Substances List could be requested; however, Notice 2021-66 suspended these procedures for purposes of the reinstated version of the Superfund Chemical Tax. Proposed Regulation Section 52.4672-1(b) incorporates the rules of, and codifies the determination procedure contained in, Notices 89-61 and 95-39 for modification of the Taxable Substances List, in conjunction with Revenue Procedures 2022-26 and 2023-20. [18]

Takeaway

Overall, the additional guidance contained in the Notice should be a welcome clarification for taxpayers potentially subject to the Superfund Chemical Tax. While the IRS and Treasury have not yet provided an updated timeline for when the Proposed Regulations are expected to become final, given the more particularized and sector-specific nature of the Proposed Regulations, companies should pay close attention to the proposed rules and definitional clarifications affecting their industry or their operations. For example, companies involved in the import or export of taxable chemicals and taxable substances, companies that may be entitled to exceptions from the Superfund Chemical Tax or eligible for tax-free sales, and recyclers would particularly benefit from developing familiarity with the applicable guidance.

More broadly, it would be prudent for all companies to revisit previous determinations of their Superfund Chemical Tax exposure, as well as the compliance procedures that they initially established to ensure ongoing compatibility with the Superfund Chemical Tax, as clarified by the Proposed Regulations.

---

[1] 26 C.F.R. Part 52. All references to "Section" or "§" herein are to the IRC, unless otherwise noted.

[2] A total of 20 substantive comments were received from the public. These comments may be viewed via the Federal eRulemaking Portal here.

[3] The Notice indicates that the Treasury Department and IRS seek comments "on possible ways to mitigate the disadvantage to domestic manufacturers within the constraints of the statutory scheme."

[4] As an example of the relevant case law in question, the Notice cites to *Indian Motorcycle Co. v. United States*, 283 U.S. 570 (1931) (excise tax is not imposed on the importation of a taxable motorcycle, but rather on the first sale by the importer).

[5] The Notice clarifies that "if the person entering the taxable chemical for consumption, use, or warehousing is merely acting as an agent or a customs broker for another person, then the agent or customs broker is not the importer, and the importer is the first person in the United States to sell or use the taxable chemical after entry of the taxable chemical for consumption, use, or warehousing."

[6] The Notice indicates that these procedures are modeled after the rules contained in § 48.4221-3 of the Manufacturers and Retailers Excise Tax Regulations.

[7] While § 4662(e)(2) provides for a credit or refund for Superfund Chemical Tax paid with regard to taxable chemicals "used as a material in the manufacture or production of a substance which . . . at the time of export, was a taxable substance (as defined in § 4672(a))," there is a potential 180-day delay between a substance satisfying § 4672(a)(2)'s 20% weight-or-value test and that substance's inclusion on the list under § 4671(a)(1). Despite acknowledging the concerns raised by the commenters, the Notice explains that the requirement that the substance be "listed" at the time of export in order to qualify for a credit or refund is statutory and cannot be overridden by agency rulemaking. However, the Treasury Department and IRS have requested additional comments exploring possible ways to mitigate the impact of this express statutory requirement.

[8] Prop. Treas. Reg. § 52.4672-1 similarly provides definitions applicable to the "taxable substance" rules under §§ 4671 and 4672. The Notice provides that "[t]o the extent there is overlap, the definitions [in the Proposed Regulations] with respect to the § 4671 tax track the definitions in Prop. Reg. § 52.4662-1 with respect to the § 4661 tax."

[9] The IRS and Treasury note that in § 4662(b)(8)(A), there is already a narrow exclusion from the Superfund Chemical Tax for any chromium, cobalt, or nickel "which is diverted or recovered in the United States as part of a recycling process (and not as part of the original manufacturing or production process)." This explicit reference to recycling activities together with the absence of a general exception in the text of the statute lead to the conclusion that such a general exception was not intended.

[10] The definition also states that the loss or destruction of a taxable chemical through spillage, fire, natural degradation, or other casualty is not a use. Likewise, the "mere manufacture or production of a taxable chemical is not a use of that chemical."

[11] The IRS and Treasury requested comments from the public regarding the predominant method of production of, and any other relevant information for, a specific subset of taxable substances listed in § 4672(a)(3). That subset consists of the following 13 taxable substances (out of the initial listed total of 50, and current 151): ferronickel, formaldehyde, hydrogen peroxide, methanol, nickel powders, nickel waste and scrap, polystyrene resins and copolymers, styrene-butadiene (SNPF), synthetic rubber (not containing fillers), unwrought nickel, vinyl resins, vinyl resins (NSPF), and wrought nickel rods and wires.

[12] There is an exception for xylene, as provided for in § 4662(b)(7): “Except in the case of a substance imported into the United States or exported from the United States, the term xylene does not include any separated isomer of xylene.”

[13] Prop. Treas. Reg. § 52.4662-2(a)(2).

[14] Prop. Treas. Regs. §§ 52.4662-2(b) (qualified fertilizer substances), 52.4662-2(e) (qualified fuel substances), and 52.4662-2(f) (qualified animal feed substances).

[15] Prop. Treas. Reg. § 52.4662-2(c).

[16] Prop. Treas. Reg. § 52.4662-2(d).

[17] Prop. Treas. Reg. § 52.4662-2(g) (including addressing the applicability to multi-step isolation processes).

[18] Rev. Proc. 2022-26 (released by the IRS on July 1, 2022), together with and as modified by Rev. Proc. 2023-20 (released by the IRS on March 23, 2023), provides the exclusive process by which importers, exporters, and other interested persons may petition to add a substance to or remove a substance from the Taxable Substances List. Rev. Proc. 2023-20 softens some of the timing rules contained in Rev. Proc. 2022-26, which has particular relevance in the context of seeking refunds.

View original.

Related Professionals

???Amanda H. Nussbaum
Partner

???Aliza R. Cinamon
Partner