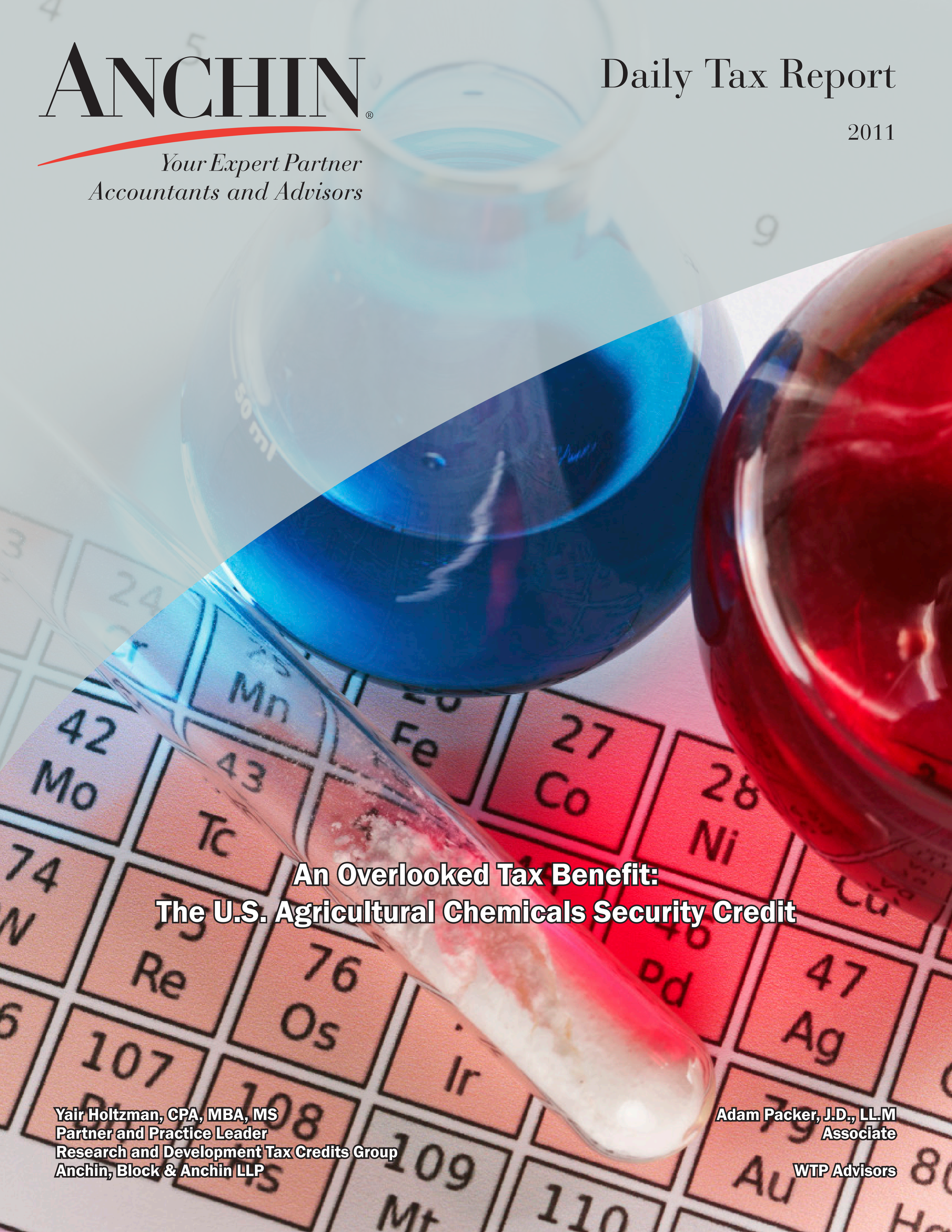

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An Overlooked Tax Benefit: The U.S. Agricultural Chemicals Security Credit

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BY YAIR HOLTZMAN AND ADAM PACKER

Introduction

The 110th Congress passed the Food, Conservation, and Energy Act of 2008 (Pub. L. No. 110-246), popularly known as the ''Farm Bill,'' in May 2008 over the veto of President George W. Bush.

Buried in this legislation is a wide-ranging tax credit called the Agricultural Chemicals Security Credit.[1] One of the primary drivers underlying the need for this credit is safety from possible terrorist attacks.

Terrorist attacks of recent years have had a serious impact on Americans' view of their own vulnerability. Whether the threat is from a domestic or foreign source, the situation has important implications for all aspects of American society, including agriculture. In particular, agricultural chemicals have been used in some of the most devastating attacks. In April 1995, the Alfred P. Murrah Federal Office Building in Oklahoma City was attacked, and the weapon of choice was fertilizer containing ammonium nitrate mixed with racing fuel to create a bomb. The massive explosion killed 168 people and wounded more than 500.

After the Sept. 11, 2001, attacks, it was found that some of the perpetrators had tried to gain access to crop dusters and other light aircraft in southwest Florida. Crop dusters are designed to spray toxins and the Sept. 11 terrorists wanted to misuse these aircraft to spray pesticides or other toxins on a human population center.

As a result, legislators have adopted a tax credit that would reward taxpayers who take appropriate measures to keep harmful chemicals secure. Despite the potentially broad nature of this tax credit, it is possible that many eligible businesses that could qualify for the credit are not claiming it for a variety of reasons. The credit is designed to offset 30 percent of the cost of cer-

[1] Internal Revenue Code Section 45O.

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tain types of security expenses that ‘‘eligible agricultural businesses’’ have spent after May 22, 2008.[2]

Businesses from all stages in the production of fertilizers and pesticides likely will qualify for this credit, from the initial manufacture of input chemicals to distribution and transportation of the final product.

The credit only extends to ‘‘qualified chemical security expenditures’’ that relate to the purpose of protecting ‘‘specified agricultural chemicals.’’[3] Nevertheless, the statutory definitions of what constitute an ‘‘eligible agricultural business’’ and a ‘‘specified agricultural chemical’’ are very broad. As a result, businesses from all stages in the production of fertilizers and pesticides likely will qualify for this credit, from the initial manufacture of input chemicals to distribution and transportation of the final product.[4]

Mechanics of the Tax Credit

The dollar value of the tax credit is equal to 30 percent of the taxpayer's qualified chemical security expenditures for the tax year.[5] The tax credit is nonrefundable and, like other general business credits, may be carried back one year and may be carried forward 20 years.[6] The credit is limited to $100,000 per facility and $2 million per taxpayer annually (on a controlled group basis).[7]

Also, the taxpayer may only claim the $100,000 amount per facility once every five years.[8] In other words, if a taxpayer spent $60,000 on qualified security measures during 2008 at Facility A, the taxpayer would qualify for a 30 percent credit in the amount of $18,000 with respect to that facility. Later, during the next four years, the maximum combined credit available for that facility during those four years would be $82,000.

The Internal Revenue Service has not issued significant guidance with regard to what constitutes a facility, or how taxpayers should apply the facility limitation. The method of applying the per-facility limitation can make an important difference in the eventual amount of the credit the taxpayer can claim.[9]

The most detailed portion of the statute relating to the Agricultural Chemicals Security (ACS) Credit is the definition of what constitutes a ‘‘qualified chemical security expenditure.’’[10] Section 45O(d) provides a detailed list of the kinds of facility security upgrades that can be included in the tax credit. Such security features will qualify under the statute only to the extent that they are paid or incurred for the purpose of protecting specified agricultural chemicals.[11]

Qualified chemical security expenditures include[12]:

- employee security training and background checks;
- limitation and prevention of access to controls of specified agricultural chemicals stored at the facility;
- tagging, locking tanks valves, and chemical additives to prevent the theft of specified agricultural chemicals or to render such chemicals unfit for illegal use;
- protection of the perimeter of specified agricultural chemicals;
- installation of security lighting, cameras, recording equipment, and intrusion detection sensors;
- implementation of measures to increase computer or computer network security;
- conducting a security vulnerability assessment; and
- implementing a site security plan.

The two most important requirements of the ACS credit are also the two most vague requirements. The first of these requirements is that a business only may be eligible for this tax credit if it qualifies as an ‘‘eligible agricultural business.’’[13] Under Section 45O(e)(1), businesses that sell specific agricultural chemicals at retail ‘‘predominantly to farmers or ranchers’’ will qualify. Retail businesses that sell agricultural chemicals might wonder how to determine whether they ‘‘predominantly’’ sell to ranchers or farmers.

In addition, any business that manufactures, formulates, distributes, or aerially applies specified agricultural chemicals will qualify for the credit.[14] It is important to highlight that this extends to a very broad range of businesses, especially with regard to the manufacturing and distributing sectors. Any business that plays a role in the manufacturing or distribution of certain types of fertilizer and pesticides, including all the component parts of pesticides, will qualify as an eligible agricultural business.

The second of these requirements, and the most critical, is that security expenditures only will qualify to the extent they protect ‘‘specified agricultural chemicals.’’[15] Naturally, this leads taxpayers to wonder whether an agricultural chemical will qualify.

Specified agricultural chemicals, in the context of this tax credit, are divided between fertilizers and pesticides. With respect to fertilizers, the statute first requires that the fertilizer be one that is ‘‘commonly used in agricultural operations,’’ but IRS has not issued any guidance on the topic of which fertilizers are commonly used and which are not.[16] Second, the fertilizer must be included on one of several statutory lists of hazardous chemicals, such as Section 302(a)(2) of the Emergency Planning and Community Right-to-Know Act of 1986

[2] I.R.C. Section 45O(a); See also Staff, Finley & Cook, *IRS releases form for claiming new agricultural chemicals security credit*, Nov. 7, 2008.

[3] I.R.C. Section 45O(d); I.R.C. Section 45O(f).

[4] See Mas Kuwana, J.D. and Gary Hecimovich, *Growing Opportunities: The Agricultural Chemical Security Credit*, Journal of Accountancy, March 15, 2010.

[5] I.R.C. Section 45O(a).

[6] I.R.C. Section 39(a)(1).

[7] I.R.C. Section 45O(b)-(c); I.R.C. Section 45O(g).

[8] I.R.C. Section 45O(b)(2).

[9] See Kuwana and Hecimovich, *Growing Opportunities*, supra note 4.

[10] I.R.C. Section 45O(d).

[11] I.R.C. Section 45O(d).

[12] I.R.C. Section 45O(d)(1)-(d)(9).

[13] I.R.C. Section 45O(e).

[14] I.R.C. Section 45O(e)(2).

[15] I.R.C. Section 45O(f).

[16] I.R.C. Section 45O(f)(1).

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(Pub. L. No. 99-499), among others.[17] This adds a significant amount of complexity to the process of claiming the ACS credit because of the length and detail of these statutory lists.

One major area that taxpayers could explore is the possibility of claiming the credit for security expenses designed to protect the component parts of fertilizer, such as methane and ammonia, in the same manner that the credit applies to pesticides.

However, with respect to pesticides, there is no additional requirement that the chemicals appear on a separate statutory list.[18] The pesticides must be used for food, feed, or fiber, and must qualify as pesticides under Section 2(u) of the Federal Insecticide, Fungicide, and Rodenticide Act (Pub. L. No. 95-516), as amended by the Farm Bill.[19] This statute simply defines pesticides to include substances that are ''intended for preventing, destroying, repelling, or mitigating any pest,'' in addition to other minor limitations.[20]

Most importantly, the ACS credit covers not only pesticides in their finished form, but also the active and inert component ingredients in pesticides.[21] This element of the tax credit establishes the breadth of the credit because taxpayers can claim credit for security expenditures that protect not only finished pesticides, but also for security designed to protect any of the inert ingredients that form part of the final pesticide product at any point in the development of the product.

For some unknown reason, the ACS credit does not include specific language that extends the tax credit to the component parts of fertilizer in the same manner that it covers the component parts of pesticides.[22] One major area that taxpayers could explore is the possibility of claiming the credit for security expenses designed to protect the component parts of fertilizer, such as methane and ammonia, in the same manner that the credit applies to pesticides.

Given that the purpose of the tax credit is to provide taxpayers an incentive to purchase additional security infrastructure to protect volatile, explosive, or toxic chemicals from a security breach, the credit should extend to cover the component parts of fertilizer. Methane, for example, is highly explosive. Additionally, ammonia is a critical component of many explosives. The same reasons for encouraging security measures at locations where pesticide ingredients are manufactured or distributed should also extend to manufacturing and distribution of dangerous fertilizer ingredients.

Tax Experts and Chemistry Experts

One striking characteristic of this tax credit is the absence of legislative history surrounding its enactment. The reports of the congressional committee hearings during passage of the Food, Conservation, and Energy Act of 2008 do not include any discussion of the history of this tax credit, its purpose, or how Congress intended the various definitions within the tax credit to be interpreted.

While the legislation provides the secretary of the Treasury Department with authority to issue regulations on the subject,[23] including how to determine whether a security expenditure relates to a specified agricultural chemical, or how to solve the nagging question of what constitutes a separate ''facility'' for purposes of the credit's facility limitation, the Treasury has not done so.[24]

This leaves taxpayers wondering whether the credit applies to them, and if so, how to appropriately apply the credit's various limitations and definitions. IRS has provided Form 8931 to calculate the ACS credit, which includes one page of limited instructions, but the form does not provide additional information beyond what is already included in the statutory framework.

As a result, taxpayers are somewhat on their own in making the difficult determinations involved in this credit. This may explain why the ACS credit has fallen into relative obscurity.

As discussed previously, in order for fertilizers to qualify under the definition of ''specified agricultural chemical,'' the statute requires that the fertilizer be ''commonly used'' and that it also be on one of the five statutory lists that are separate from the credit itself.[25] These statutes include extensive lists of complex chemical names that include both fertilizers and non-fertilizers.[26] Realistically, this requires a chemist to analyze the statutory lists and determine whether the fertilizer products that a taxpayer manufactures or distributes are also present on the approved list.

This presents a problem: Most individuals that are well-versed in tax matters may not have the technical expertise to look at complex chemical names and to know whether these are included in any kind of commonly used fertilizers. As a result, tax professionals probably shy away from this credit, because it is really hard to identify what will qualify, especially given the lack of guidance from IRS.

Additionally, agricultural industry chemists that are well-acquainted with the chemicals typically used in common fertilizer may not have had the opportunity to acquaint themselves with an obscure tax credit that has barely received any congressional attention. Therefore, agricultural chemists are not likely to bring up the ACS credit because they are probably not familiar with it.

[17] I.R.C. Section 45O(f)(1)(A) – (f)(1)(C)f; See also Finley & Cook, supra note 2.
[18] I.R.C. Section 45O(f)(2).
[19] I.R.C. Section 45O(f)(2).
[20] Federal Insecticide, Fungicide, and Rodenticide Act, Pub. L. No. 110-246, Section 2(u), (Amended 2008).
[21] I.R.C. Section 45O(f)(2).
[22] I.R.C. Section 45O(f)(1).
[23] I.R.C. Section 45O(h).
[24] See Kuwana and Hecimovich, *Growing Opportunities*, supra note 4.
[25] I.R.C. Section 45O(f)(1).
[26] See Emergency Planning and Community Right-to-Know Act Section 302(a)(2); 49 C.F.R. Section 172; 33 C.F.R. Section 126-127; 33 C.F.R. Section 154.

By contrast, the treatment of pesticides under the ACS credit is different. Since the statute does not require pesticides to appear on other statutory lists of hazardous chemicals, the credit is somewhat easier for pesticide manufacturers to claim. However, eligible taxpayers still may not be claiming the credit (if they are aware of it) because they are under the mistaken impression that it only applies to pesticide manufacturers, rather than the manufacturers of both the active and inert ingredients that go into food-use pesticides, which is much broader.

Conclusion

As of result of the vague and complex structure of the ACS credit, tax professionals with knowledge of the mechanics of the credit and a chemistry background need to work closely with businesses and chemists from the fertilizer and pesticide industries to accurately determine whether a taxpayer qualifies for the credit. This opens up the possibility that a wide range of taxpayers could benefit from the incentives embedded in this credit.

If manufacturers or distributors of fertilizers, pesticides, and their component parts have spent significant amounts of money ensuring the security of their operations, whether through the use of security infrastructure or other security planning such as background checks and security assessments, Congress has determined that these taxpayers should receive financial support for these investments. Although the tax credit's structure leaves some questions unanswered, informed tax planners can assist eligible taxpayers in claiming this valuable credit.

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