OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR
ASSOCIATE DISTRICT COUNSEL

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

SUBJECT: Coal Transportation Costs

This Field Service Advice responds to your memorandum dated August 19, 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

A =

B =
C =

D =

ISSUES

In the two situations described below, is the cost of transporting raw coal from the mine to the cleaning plant excludible from the price of the coal for purposes of computing the coal excise tax on sales of the coal?

CONCLUSIONS

In the two situations described below, is the cost of transporting raw coal from the mine to the cleaning plant is excludible from the price of the coal for purposes of computing the coal excise tax on sales of the coal.

FACTS

Situation 1 A is a producer/seller of coal. It sells coal to B under a coal supply contract. The contract provides that specified amounts of raw coal will be delivered to B's cleaning plant at A's expense. B has the right to reject any truck load of raw coal that does not meet contract specifications. A is to be paid for the raw coal delivered based on a specified clean coal price. Clean coal is defined in the contract as raw coal weighed pursuant to the contract less the weight of reject material removed by washing as determined by sampling.

Situation 2 C is a producer/ seller of coal. It sells run of mine coal to D under a coal supply contract. The contract provides for a set price per ton for "direct ship" coal (coal that does not need to be washed prior to resale) and a schedule of clean coal prices based on mine source for "wash plant" coal (coal that needs to be washed prior to resale). The contract provides that the clean equivalent coal will be determined based on the raw coal tonnage delivered multiplied by the float percentage minus a 3 percent for theoretical plant loss amount. The float percentage is to be derived by daily sampling. The contract affirms that the parties recognize that the payment formula does not reflect the actual amount of marketable coal recovered b\from the raw coal sold. The contract further provides that title and risk of loss will pass when the coal is delivered to the purchaser.

LAW AND ANALYSIS

Internal Revenue Code section 4121(a)

> (1) imposes on coal from mines located in the United States sold by the producer, a tax equal to the rate per ton determined under subsection (b).
>
> (2) The amount of the tax imposed by paragraph (1) with respect to a ton of coal shall not exceed the applicable percentage (determined under subsection (b)) of the price at which such ton of coal is sold by the producer.
>
> I.R.C. section 4121(b) provides for purposes of subsection (a)--
>
> (1) the rate of tax on coal from underground mines shall be $1.10,
> (2) the rate of tax on coal from surface mines shall be $.55, and
> (3) the applicable percentage shall be 4.4 percent.

Treas. Reg. section 48.4121-1(d)(4) provides, in part, that for purposes of determining both the amount of coal sold by a producer and the sales price of the coal, the point of sale is f. o. b. mine, or f. o. b. cleaning point if the producer cleans

the coal before selling it. This is true even if the producer sells the coal on the basis of a delivered price.

Treas. Reg. section 48.0-2(A)(5) provides the term 'sale' means an agreement whereby the seller transfers the property (that is, the title or the substantial incidents of ownership) in goods to the buyer for a consideration called the price, which may consist of money, services, or other things.

Treas. Reg. section 48.0-2(b) provides (1) the manufacturers excise tax generally attaches when the title to the article sold passes from the manufacturer to a purchaser, and the retailers excise tax generally attaches when the title to the article sold passes from the retailer to a purchaser.

(2) When title passes is dependent upon the intention of the parties as gathered from the contract of sale and the attendant circumstances. In the absence of expressed intention, the legal rules of presumption followed in the jurisdiction where the sale is made govern in determining when title passes.

In situation 1, the contract does not specify when title passes. The applicable local law provides that unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods. We find nothing in the contract that is inconsistent with that rule of law. The contract provides for delivery of the raw coal to B at its cleaning plant and it provides that B may reject at the time of delivery any shipment that does not meet the contract specifications. We find nothing inconsistent with the presumption in using a price for the raw coal that is calculated on its clean coal equivalent. The pricing mechanism in the contract can be explained as a means of adjusting the price of the raw coal to account for the amount of extraneous material it contains. We do not believe that payment for the coal on a clean coal basis by itself can be considered an explicit agreement between the parties that the passage of title occurs other than at time of delivery.

In situation 2, the contract specifically provides that title and risk of loss will pass when the coal is delivered to the purchaser. Again, we find nothing inconsistent with the contract provision regarding passage of title in using a price for the raw coal that is calculated on its clean coal equivalent. As in situation 1, the pricing mechanism in the contract can be explained as a means of adjusting the price of the raw coal to account for the amount of extraneous material it contains. We do not believe that payment for the coal on a clean coal basis by itself can be considered an explicit agreement between the parties that the passage of title occurs other than at time of delivery.

Thus, A and C should be considered to be selling raw coal. As such, the regulations prescribe an F.O.B. mine selling price for purposes of determining the amount of tax to be paid on their sales of coal to B and D. Therefore, the cost of transporting the coal from the mine to the buyers' cleaning plants may properly be excluded from the tax base.

In your request, you express concern that Treas. Reg. section 48.4121-1(d)(4) conflicts with the holding in Moose Coal Company, Inc. v. United States, 92-1 U.S. Tax Cas. (CCH) ¶ 70, 014, (W.D. VA, 1991). In Moose Coal, the plaintiff delivered raw coal under oral contracts to Ambrose Branch and Glamorgan Coal Company. The court found that under the terms of the contracts Ambrose Branch and Glamorgan agreed to buy only clean coal from Moose Coal. When necessary, Ambrose Branch and Glamorgan also agreed to clean Moose Coal's coal for a predetermined price. Because Moose Coal was selling only clean coal, it properly paid tax on the tonnage of clean coal sold rather than the tonnage of the raw coal delivered. One may disagree with the court's factual determination that Moose was selling clean coal instead of raw coal. However, assuming the court's determination is correct, its determination that Moose Coal properly paid its tax on the basis of tonnage of clean coal sold is in keeping with the regulations.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

You also reference a TAM you believe is in conflict with the regulations, we do not discuss the TAM in the analysis of the issue because I.R.C. section 6103 provides that TAM's may not be used or cited as precedent. However, for purposes of clarity, we feel constrained to comment on it. In the TAM, A delivered raw coal to B, who cleaned it and sold it to third parties. It was factually determined that the transaction between A and B was a consignment rather than a sale and that title did not pass from A until B sold the clean coal to third parties. Under Treas. Reg. section 48.0-2(b)(4) where a consignor (such as a manufacturer) consigns articles to a consignee (such as a dealer), retaining ownership in them until they are disposed of by the consignee, title does not pass, and the tax does not attach, until sale by the consignee. Where the relationship between a manufacturer and a dealer is that of principal and agent, title does not pass, and the tax does not attach, until sale by the dealer. Thus, under the regulation A was considered to be selling clean coal and the tax was based on the tonnage of clean coal sold.

Please call (202) 622-7830 if you have any further questions.

By: PATRICK PUTZI
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