

Obscure U.S. Excise Taxes on Ozone-Depleting Chemicals and the Montreal Protocol (How it applies to Importing Products to the U.S.)

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Few U.S. companies understand the concept and characteristics of the excise tax imposed with respect to ozone depleting chemicals ("OCDs"). Many do not even know it exists. The tax is a relatively new tax that was implemented during the Clinton Administration as a result of the 1987 Montreal Protocol on Substances that Deplete the Ozone Layer.

Curiously, the IRS excise tax auditors are now coordinating audits on companies worldwide, including importers of products, which might be subject to the OCD excise tax. Technology product importers are particularly impacted, including manufacturers of computers, fiber optical materials and electronics manufacturers are particularly impacted.

All goods imported into the United States are subject to duty or duty-free entry in accordance with their classification under the applicable items in the Harmonized Tariff Schedule ("HTS") of the United States. Many goods that are classified under HTS headings 8400s, 8500s, 8700s, 8800s, 900s (among others) are subject to the OCD excise tax that is imposed on imported taxable products that are sold or used by the importer.¹

The tax also applies to a OCDs that are (1) sold or used by its manufacturer or importer² and, (2) to a floor stocks tax imposed on ODCs that are held by any person other than the manufacturer or importer of the OCD for sale or use in future manufacture.³

The amount and rate of this excise tax is continuing to increase and has increased rather dramatically over the last five years.

You or your company may be subject to this obscure OCD excise tax, without even understanding how or if it applies. If you have not been filing excise tax returns for the OCD excise tax (Forms 720 and 6627), you may be subject to statutory interest, and penalties for "failure to file a return when due" and under IRC "negligence penalties." Additionally, the statute of limitations, which would normally preclude the IRS from auditing you or your company, will never begin to run if you are not filing these OCD excise tax returns.

What is an "Excise Tax"?

The term "excise tax" refers to a tax imposed on the sale, even the use, of certain articles and on certain transactions and occupations.⁴ It is also defined as a "tax which is levied on the purchase of a specific commodity or group of commodities such as tobacco or liquor. This type of tax is frequently referred to as a sin tax because the taxed items are often connected with perceived vices such as drinking and smoking. An excise tax differs from a sales tax in that a sales tax is levied on the purchase of most general items or commodities."⁵

This type of tax does not fall within the classification of a property tax, but rather embraces every form of taxes not laid directly upon persons or property.⁶

Additionally, a "corporation excise tax" is a tax imposed on the conduct of business in a corporate capacity, which is sometimes measured by the income of the corporation, but it does not become an income tax.⁷

"Environmental Tax Regulations" (Treas. Regs. Sections 52.0, 52.4681 and 52.4682)

Treasury Regulations under Section 52 are designated Environmental Tax Regulations, and they refer to chapter 38 of the Internal Revenue Code.⁸

These Regulations provide many of the detailed rules regarding how IRC Sections 4681 and 4682 impose three different type of taxes with respect to ODCs.⁹ First, a tax is imposed on OCDs

that are sold or used by its manufacturer or importer¹⁰. Second, a tax is imposed on imported taxable products that are sold or used by its importer.¹¹ Finally, a floor stocks tax is imposed on ODCs that are held by any person other than the manufacturer or importer of the ODC for sale or use in future manufacture.¹²

The tax is imposed on an ODC when it is first used or sold by either its manufacturer or its importer, so the manufacturer or importer is liable for the tax.¹³ The taxable ODCs and tax rates are described in the instructions to IRS Form 6627.

Use of ODCs

An ODC is considered in use if it is put it into service in a trade or business or for production of income.¹⁴ An ODC is also in use if it is used in the making of an article, including incorporation into the article, chemical transformation, or if it is released into the air. Any loss, destruction, packaging, repackaging, or warehousing of ODCs is not a use of the ODC.¹⁵

Additionally, Publication 510 describes that the creation of a mixture is treated as the use of the ODC contained in the mixture, and that an ODC is contained in a mixture only if the chemical identity of the ODC is not changed.¹⁶ Generally, tax is imposed when the mixture is created and not on its sale or use.¹⁷ However, the taxpayer may choose to have the tax imposed on its sale or use by checking the corresponding box in Part I of Form 6627, and this choice may only be revoked with consent of the IRS.¹⁸

The following activities are exempt from the tax on ODCs¹⁹: metered-dose inhalers,²⁰ recycled ODCs²¹, exported ODCs²², and ODCs used as feedstock.²³

Imported Taxable Products

According to the Regulations, tax is imposed on imported products containing or manufactured with ODCs when the product is first sold or used by its importer.²⁴ In this case the importer is liable for the tax.²⁵ A product is subject to tax if it is entered into the United States for consumption, use, or warehousing and is listed in the Imported Products Table described in Regs. Section 52.4682-3(f)(1). This table of products is a list with the following type of products, among others, as follows:²⁶

1. Mixtures containing ODCs, such as anti-static sprays, automotive products such as "carburetor cleaner," "stop leak" and "oil charge", cleaning solvents and contact cleaners;
2. Products in which ODCs are used for purposes of refrigeration or air conditioning, creating an aerosol or form or manufacturing electronic components and rigid foam insulation, such as household freezers, icemaking machines, drinking water coolers, telephone answering machines, TV cameras, radios, VCRs, loudspeakers, laptops, intercoms, motorcycles and bicycles with seats foamed with ODCs.
3. Products that are not considered to be taxable products, include certain room air conditioners, dishwashers, clothes washers, floppy disk drive units, transformers and toasters.

Additionally, the tax is based on the weight of the ODCs used in the manufacture of the product.²⁷

An imported product is considered in use if it is put into service in a trade or business or for production of income, or if it is used in the making of an article, including incorporation into the article. The loss, destruction, packaging, repackaging, warehousing, or repair of an imported product is not a use of that product.²⁸

Floor Stocks Tax

In the case of ODCs held by someone other than the manufacturer or the importer of the ODC, tax is imposed for sale or use in further manufacturing: "the floor stocks tax is imposed only on an ODC that is held for sale or for use in further manufacture on the date the tax is imposed".²⁹ The

person holding title as determined under local law to the ODCs is liable for the tax, whether or not delivery has been made.³⁰

Under the Regulations, the term "held for sale" includes: "ODCs that will be sold in connection with the provision of services or in connection with the sale of a manufactured article and, in such cases, include ODCs that will be sold without the statement of a separate charge for those ODCs."³¹ Additionally, the Regulations provide that an ODC is held for use in further manufacture if the ODC will be used as a material in the manufacture of an article and such article will be held for sale.³²

Filing of IRS Forms 720 and 6627

Form 720 must be filed for each calendar quarter until the taxpayer files a final Form 720³³. If the taxpayer is not reporting a tax that he or she normally report, a zero should be entered on the line for that tax.³⁴ IRS Form 6627 is used to calculate the amount of the tax. The current rates of ODC excise tax continue to increase.

The general contents of Form 720 are the following:

Part I consists of excise taxes generally required to be deposited;

Part II consists of excise taxes that are NOT required to be deposited; and

Part III consists of the lines for figuring tax liability, showing any adjustments and claims, and indicating the amount of the taxpayer's deposits.

An Employer Identification Number ("EIN") is needed to file Form 720. The excise tax returns on ODCs, communications, and air transportation are due as follows:

QUARTER COVERED	DUE DATES
January, February, March	May 31
April, May, June	August 31
July, August, September	November 30
October, November, December	February 28

Footnotes

1. Regs. Section 52.4681-1(a)(2).

2. Regs. Section 52.4681-1(a)(1).

3. Regs. Section 52.4681-1(a)(3).

4. Ballentine's Law Dictionary; Copyright (c) 1999 Lexis Law Publishing, a division of Reed Elsevier, plc.

5. Modern Dictionary for the Legal Profession, Copyright© 1993 William S. Hein & Co., Kleinrock Tax Expert.

6. Idaho Gold Dredging Co. v Balderston, 58 Idaho 692, 78 P2d 105.

7. Ballentine's Law Dictionary, Copyright (c) 1969 Lexis Law Publishing, a division of Reed Elsevier, plc.

8. Regs. Section 52.0-1.
9. Regs. Section 52.4681-1(a).
10. Regs. Section 52.4681-1(a)(1).
11. Regs. Section 52.4681-1(a)(2).
12. Regs. Section 52.4681-1(a)(3).
13. Publication 510, Taxable ODCS.
14. Regs. Section 52.4681-1(c)(7)(i).
15. Regs. Section 52.4681-1(c)(7)(ii).
16. Publication 510, Use of ODCS
17. Publication 510, Use of ODCS
18. Id.
19. Publication 510, Exceptions.
20. According to Publication 510, there is no tax on ODCs used or sold for use as propellants in metered-dose inhalers. For a sale to be nontaxable, the manufacturer or importer must obtain an exemption certificate from the purchaser that the manufacturer or importer relies on in good faith. The certificate must be in substantially the form set forth in section 52.4682-2(d)(5) of the regulations.
21. There is no tax on any ODC diverted or recovered in the United States as part of a recycling process (and not as part of the original manufacturing or production process). There is no tax on recycled Halon-1301 or recycled Halon-2402 imported from a country that has signed the Montreal Protocol on Substances that Deplete the Ozone Layer (Montreal Protocol).
22. Generally, there is no tax on ODCs sold for export if certain requirements are met: the seller and purchaser must be registered, the seller must obtain an exemption certificate from the purchaser that the seller relies on in good faith. The certificate must be in substantially the form set forth in section 52.4682-5(d)(3) of the regulations. The tax benefit of this exemption is limited.
23. According to Publication 510 there is no tax on ODCs sold for use or used as a feedstock. An ODC is used as a feedstock only if the ODC is entirely consumed in the manufacture of another chemical. The transformation of an ODC into one or more new compounds qualifies, but use of an ODC in a mixture does not qualify.
24. Regs. Section 52.4682-3 (C).
25. Publication 510, Imported Taxable Products.
26. Regs. Section 52.4682-3 (F)(6).
27. Regs. Section 52.4682-3 (D)(1).
28. Publication 510, Use of Imported Products.
29. Regs. Section 52.4682-4 (B)(1)(i).

30. Regs. Section 52.4682-4 (C)(1).

31. Regs. Section 52.4682-4 (B)(1)(ii).

32. Regs. Section 52.4682-4 (B)(1)(iii).

33. A Final Return should be filed if any of the following should occur: the taxpayer goes out of business, the taxpayer stops collecting and paying air transportation and communications taxes, or the taxpayer does not owe excise taxes that are reportable in future quarters.

34. Publication 510, Filing Form 720.