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Could Someone Please Tell the IRS to Follow the Law - IRS Notice 2015-56: A Critique.

Contrary to Evidence in the Legislative History, Guidance on Income Tax Treatment of 2014 Mixture Credits Continues to Proffer the Position that § 6426 is a Reduction in Excise Tax Liability Causing the Excise Tax Credit to be Incorrectly Taxed

Purportedly in response to requests from taxpayers, the IRS recently issued Notice 2015-56 with guidance on the income tax treatment of the 2014 mixture credit. This notice states that the credits should be treated as if they never expired and therefore, even though all taxpayers claim the credit as a payment on IRS Form 8849 (as is the typical scenario when a credit exceeds excise tax liability and is claimed pursuant to § 6427(e)), taxpayers with excise tax liability under §§ 4081 and 4041 are required, for income tax purposes, to treat the portion of credits that would otherwise have been claimed on Form 720 as a reduction in excise tax liability. The IRS then goes on to provide two examples to assist taxpayers. One of these is as follows:

> *"B is a calendar year taxpayer. During each calendar quarter of 2014, B's § 4081 excise tax liability was $25, for a total of $100 for 2014. In addition, during each calendar quarter of 2014 B produced a biodiesel mixture using 20 gallons of biodiesel. B produced the biodiesel mixture for sale or use in its trade or business. B claims the biodiesel mixture credit on Form 8849 pursuant to Notice 2015-3, and is allowed an $80 biodiesel mixture credit for 2014 ($80 = 20 gallons of biodiesel used to produce a mixture x $1.00/gallon credit x 4 quarters). B must apply the $80 credit against B's $100 § 4081 excise tax liability. Thus, for federal income tax purposes, B's § 4081 excise tax liability for 2014 is $20. Therefore, B's federal income tax deduction (or cost of goods sold, where applicable) attributable to § 4081 excise taxes for 2014 is $20."*

In this example, the IRS states that the excise tax liability of the taxpayer is reduced from $100, to $20. This is completely incorrect. As discussed in greater detail below, the tax liability is $100. The credit is $80. The $20 is nothing more than the net balance remitted to the government. Once the tax returns are filed and the credits claimed, Treasury ensures that the total amount of tax reported is allocated to the appropriate fund (in this case the Highway Trust Fund) and the credit is taken out of the General Fund.[1] Notably, in espousing the position that the 2014 mixture credits should be treated as a reduction in excise tax liability, or making a stating a claimant must reduce its income tax deduction by the amount of the §6426(c) credit, the IRS actually avoids addressing the question it purports to answer, namely the income tax treatment of the credit; this is likely because the IRS knows that under the "American Jobs Creation Act of 2004" ("Jobs Act"), Congress clearly intended that the excise tax credits not be included in taxable income.

[1] *See* Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 108th Congress (JCS 5-05), May, 2005 at page 225.

This continued insistence by the IRS that the mixture credit claimed pursuant to § 6426 is to be treated as a reduction in excise tax liability completely misinterprets Congressional intent and the entire legislative history from the inception of the mixture credit in the Jobs Act through the most recent proposed reinstatement. Indeed, the most recent summary of the mixture credit by the Joint Committee on Taxation in connection with the Senate Finance Committee tax extenders proposal (S. 1946, "The Tax Relief Extension Act of 2015") – which is repeated almost verbatim in the Senate Finance Committee report - describes the nature of the mixture credit, when claimed as an excise tax credit rather than an income tax credit, in these terms:

> *"If any person produces a biodiesel fuel mixture in such person's trade or business, the Secretary is to pay such person an amount equal to the biodiesel mixture credit."*

The Joint Committee then goes on to explain the statutory administrative mechanics of claiming the credit; first offsetting excise tax liability and then receiving any excess as a cash payment. It is notable that the Joint Committee summary describes the mixture credit as a payment and not as a reduction in excise tax liability. This is because the Joint Committee on Taxation understands the original Congressional intent and that, contrary to the example set down in Notice 2015-56 and reproduced above, the excise tax liability of the taxpayer claiming the credit is not reduced by the credit. The Joint Committee summary also draws a very clear distinction between the § 40A income tax credit, defined to include the biodiesel mixture credit, the biodiesel fuel credit and the small producer credit, and the § 6426 excise tax credit, defined as the biodiesel mixture excise tax credit. This is a distinction the IRS has acknowledged through issuing a completely different reporting form for the two sections. The Joint Committee notes that the § 40A credit is included in gross taxable income through § 87 but does not make the same statement with respect to the § 6426 credit. In fact, in 2013, the IRS in CCA 201342010 agreed that the § 6426 credit was not simply a reduction in excise tax liability and was not includible in gross taxable income:

> *"Our conclusion is consistent with the intent of Congress when it enacted the biodiesel mixture credit. The American Jobs Creation Act of 2004 (Act), P. L. 108-357, added several new provisions regarding biodiesel fuels to the Code, including §§ 6426(c), 6427, 40A, and 87. The Act's legislative history provides that the § 40A credit must be included in gross income but is silent regarding the § 6426(c) credit and the § 6427 payment. See H.R. Conf. Rep. No. 108-755 at 306-310 (2004). We think the fact that §§ 6426(c), 6427, and 40A were enacted together, yet Congress chose only to specifically provide that the credit under § 40A is includible in gross income, indicates that Congress intended to exclude from gross income the § 6426(c) credit and the § 6427 payment."*

However, despite being in agreement with this position – and having relayed the same to taxpayers – the IRS subsequently - and suddenly - changed its position in its so-called clarification to CCA 201342010 issued in 2014 (CCA 201406001). However, other than vague references to non-binding and non-analogous state income tax guidance, the IRS has never proffered any statutory or other precedential support for its revised position.

The IRS fails to address the fact pattern whereby a biodiesel blender which earns the credit is faced with the scenario where, if the biodiesel blender paid § 4081 tax on gasoline, they would jeopardize the tax free status of their biodiesel blending activities. Congress intended to provide a benefit to persons who blended taxable petroleum based fuel with an alternative fuel to reduce the country's reliance on petroleum based transportation fuels. This continued erroneous interpretation by the IRS is contrary to congressional intent.

Looking back to the original enactment of the credit we see very clearly that the IRS interpretation of the mixture credit as a reduction in excise tax liability is incorrect.

Title III, Subtitle A of the Jobs Act enacted the mixture credits in §§ 40A, 6426 and 6427, the income inclusion for the § 40A credit, but not the § 6426 or § 6427 credit, and amended the Highway Trust Fund – 26 U.S.C. § 9503 – to include language that clearly separates the §§ 6426 and 6427 excise tax credit for alcohol and biodiesel mixtures from the §§ 4041 and 4081 motor fuel excise tax. All of these actions are achieved in only eight (8) pages of text showing that the interactions, inclusions and omissions are not accidental but rather intentional. Indeed, the courts have stated "[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." (*Russello v. United States*, 464 U.S. 16, 23 (1983). With respect to the amendments to the Highway Trust Fund, the Jobs Act states:

> *"For purposes of this paragraph, taxes received under sections 4041 and 4081 shall be determined without reduction for credits under section 6426 and taxes received under section 4081 shall be determined without regard to tax receipts attributable to the rate specified in section 4081(a)(2)(C)."* (§ 9503(b)(1))

The Highway Trust Fund is funded by monies collected from the excise tax imposed under §§ 4041 and 4081. In order to improve the funding of the Highway Trust Fund, the Jobs Act authorized the full amount of federal fuel excise taxes collected under § 4081 and § 4041 be appropriated to the Highway Trust Fund ("The Highway Trust Fund is credited with the full amount of tax imposed on alcohol and biodiesel fuel mixtures."[2]) Notably, the appropriation of the excise taxes to the Highway Trust Fund is "without reduction for amounts equivalent to the excise tax credits allowed for alcohol fuel mixtures and the Trust Fund is not required to reimburse any payments with respect to qualified alcohol fuel mixtures."[3][4] Prior to the enactment of the Jobs Act a portion of the excise tax collected on alcohol based fuels was transferred to the General Fund. Having eliminated reduced tax rates for alcohol blended fuels, the Jobs Act placed all monies collected from excise taxes into the Highway Trust Fund thus increasing funding to the same. The amendment ensured that the Highway Trust Fund would be appropriately funded (in prior years there had been underfunding issues) and would not be in any way impacted by a taxpayer also claiming a credit for creating a biofuel mixture.

In other words, the Highway Trust Fund amendments make clear that irrespective of the mechanics, the IRS collects the full amount of the tax (as reported on Quarterly Federal Excise Tax Return, Form 720) from the taxpayer and deposits that full amount in the Highway Trust Fund. The IRS then separately pays the taxpayer the credit from the General Fund, this payment being received for administrative purpose as either an offset to the actual tax remitted or as a cash payment where the credit exceeds the total excise tax that could be offset. This amendment makes clear that Congress did not intend for the mixture credit to be interpreted as a reduction in excise tax liability and that as managed by the Treasury it is not a reduction in excise tax liability. Instead, having repealed reduced tax rates for alcohol blended fuel Congress intended that the credit be an incentive to taxpayers to continue to produce green fuels.

Moving away from the legislative history of the Jobs Act and looking instead at IRS treatment of similar credits, there is evidence that the IRS assertion that the mixture credit in § 6426 is a reduction in excise tax

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[2] *Id*

[3] *See*, Joint Explanatory Statement of the Committee of Conference for H.R. 4520 at page 54.

[4] The 109th Congress clarified that the mixture credit does not reduce the amount of monies deposited in the Highway Trust Fund from the payment of excise taxes because the mixture credit is paid out of the General Fund. *See* Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 109th Congress* (JCS 1-07), January 17, 2007 at page 92.

liability goes against its interpretation of another tax credit with identical language. Section 4501, imposes excise tax on retail sales of various truck trailers and chassis. Section 4501(d) allows a credit against this tax as follows:

> ***(d) Credit against tax for tire tax***
> *If—*
> ***(1)*** *tires are sold on or in connection with the sale of any article, and*
> ***(2)*** *tax is imposed by this subchapter on the sale of such tires,*
> *there shall be allowed as a credit against the tax imposed by this subchapter an amount equal to the tax (if any) imposed by section 4071 on such tires.*

The use of the phrase "*shall be allowed as a credit against the tax*" is identical to the language used in § 6426(a):

> *There shall be allowed as a credit—*
> ***(1)*** *against the tax imposed by section 4081 an amount equal to the sum of the credits described in subsections (b), (c), and (e), and*
> ***(2)*** *against the tax imposed by section 4041 an amount equal to the sum of the credits described in subsection (d).*

In PLR 201022012 (June 4, 2010), a taxpayer requested a ruling that his § 4501 excise tax liability was not reduced or modified to account for the credit claimed under § 4501(d). The IRS ruled that the excise tax liability is reported in one section of Form 720 and the credit is claimed in a different section of Form 720; the IRS stated that the liability and the credit cannot be netted to come up with an amount reported in the excise tax due section of the form. The IRS went on to say that the tax credit does not reduce the excise tax liability; rather it merely reduced the balance owed to the IRS.

In TAM 200215004 the taxpayer in question reduced the amount of § 4501 excise tax liability reported by the amount of the § 4501(d) credit claimed. The taxpayer did not report or claim the credit anywhere on his Form 720. The IRS determined that the netting of the credit against the tax was incorrect stating "The § 4501(d) credit does not reduce the § 4501 liability; rather, credits are used to reduce the balance due." The IRS concluded that the taxpayer had underreported his excise tax liability by reducing it by the amount of the credit.

Although neither the TAM nor the PLR are binding, the principles can be applied to the mixture credit. Like the § 4501 credit, the mixture credit and the excise tax are reported in separate sections of Form 720 and are not netted against each other to come up with a number to be reported as the excise tax liability in that section of the form. Moreover, when a taxpayer claims a refund of federal excise tax for an exempt use of tax-paid fuel (such as off-highway farming), the taxpayer receives the full amount of the tax ($0.243 per gallon for diesel and $0.183 per gallon for gasoline); the excise tax refund is not reduced by the amount of any mixture credit claimed by that or another taxpayer pursuant to § 6426. It therefore follows that as with the § 4501 credit the correct interpretation is that the § 6426 mixture credit is not a reduction in excise tax liability; rather it merely reduces the tax balance owed.

In sum, the most recent guidance to taxpayers in Notice 2015-56 on how to treat the 2014 mixture credit for income tax purposes clearly flies in the face of Congressional intent as evidenced in the legislative history and even contradicts the IRS' own guidance as to the nature of similar credits enacted by Congress with identical language. The authors of this Critique have been accused of using sophistry and attempting to obfuscate the issue. This Notice and other guidance issued by the IRS points seems to point that finger back to the accuser. Could someone please tell the IRS to follow the law?

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Oscar L. Garza & Associates, P.C. is a Houston-based boutique law firm specializing in transactional tax and trade matters surrounding all aspects of the oil and petroleum industry. With over 20 years of experience counseling clients operating in all aspects of the oil and petroleum sector our lawyers have an in-depth knowledge of the industry, enabling us to provide quality service and creative solutions to our clients. Please visit our website at www.olgarza.com. For more information please contact:

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