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Update on the Mixture Credit Exclusion from Income

Federal Court of Appeals Affirms the Decision of the Court of Federal Claims; Denies Request for Refund and Agrees with the Government that the Credit under § 6426 Constitutes a Reduction in Excise Tax Liability

In a decision dated November 1, 2018, the United States Court of Appeals for the Federal Circuit in Sunoco, Inc. v. The United States (No. 15-587T), affirmed the November 22, 2016 decision of the Federal Court of Claims and denied Sunoco's claim for a refund of federal income taxes paid on the alcohol fuel mixture credit claimed pursuant to 26 U.S.C. § 6426(b). Like the Federal Court of Claims before it, the Court of Appeals found that the mixture credit is a reduction in excise tax liability and nothing more.

Taking a more definitive approach than the Court of Claims, which had stated that the law wasn't "crystal clear" and conceded that both Sunoco's and the government's positions were plausible, the Court of Appeals found the plain meaning of the statute to be clear saying at the outset of its 16 page decision:

> *"Sunoco asks this court to permit it to deduct, as a cost of goods sold, an excise tax expense that it never incurred or paid. Neither the text of the Jobs Act nor its legislative history supports such a reading of the code."*

The Court of Appeals found that the § 6426(a)(1) "explicitly" provides that the Mixture Credit is applied against gasoline excise tax and therefore works to reduce the overall excise tax liability of the taxpayer. The Court of Appeals disagreed with Sunoco's contention that the Mixture Credit is simply a payment of its excise tax liability saying that the Jobs Act treats tax credits and tax payments differently. It cited that language in § 6427(e)(3) in support of this position saying that the language *"No amount shall be payable under paragraph (1)… with respect to which an amount is allowed as a credit under section 6426,"* distinguishes the credit under § 6426 from the payment under § 6427(e)(1). The Court of Appeals determined that Congress intended for the Mixture Credit to have an equivalent benefit to the formerly reduced tax rates; the equivalent benefit being that the Mixture Credit reduces excise tax liability. The Court of Appeals also determined that Congress intended the § 6427 payment to go to the taxpayer only if excise tax liability is zero.

The Court of Appeals went on to say that § 9503 – which directs the entirety of the § 4081 excise tax to be deposited in the Highway Trust Fund, supports a reading of the statute that treats the Mixture Credit as a reduction in excise tax liability. The Court of Appeals said that the language in § 9503(b)(1) requiring the excise taxes be deposited in the Highway Trust Fund without reduction for the § 6426 credits does not mean that the entire excise tax amount is paid by every taxpayer – as Sunoco contended – but rather that the funds deposited in the Highway Trust Fund are not reduced or diminished by any Mixture Credit that might reduce the taxpayer's excise tax liability. In other words, the Court of Appeals interprets the statute as saying that the full $0.183 per gallon gasoline excise tax is deposited in the Highway Trust Fund even if a particular

taxpayer(s) did not actually remit this amount due to the receipt of a Mixture Credit to reduce its liability. The Court of Appeals went on to say that if the full amount of tax was always paid by the taxpayer irrespective of the Mixture Credit, the language in § 9503(b)(1) would be superfluous because there would be no need to explicitly state that the full amount of the excise tax is to be deposited in the Highway Trust Fund without regard to the § 6426 credits.

Addressing §§ 45H and 280C where a taxpayer's excise tax liability is explicitly reduced by the amount of the credit, the Court of Appeals said that both of these provisions concern expenses rather credits. As § 6426 is a credit and not an expense there *"is no need to expressly include a provision prohibiting a taxpayer from deducting"* the credit.

Finally, the Court of Appeals said that to allow Sunoco's position would be to allow both an income tax and excise tax benefit which was not intended by Congress. Curiously, however, the Court of Appeals cites the language in § 40 that coordinates the income and excise tax credits. Sunoco was not trying to claim both an income and excise tax credit for the blending of alcohol with gasoline. Nevertheless, the Court of Appeals uses this language to argue that Sunoco would receive an unintended double benefit if the statute were read in its favor.

The clear and concise interpretation of the statute by the Court of Appeals differed from the Court of Claims which found the legislative history and the practical effect of the mixture credit to be inconsistent, and stated that Congress created a "legal fiction" to allow the government to fully fund the Highway Trust Fund through the movement of funds from the General Fund under the guise of collecting the full amount of excise tax from blenders of alcohol fuel mixtures. However, like the Court of Claims before it, the Court of Appeals completely avoided addressing the question of excise tax refunds and therefore avoided having to reconcile why a taxpayer claiming a refund of tax (for off-highway use for example) with respect to gallons of an alcohol mixture on which the credit was claimed receives the full $0.183 per gallon with the notion that the taxpayer claiming the § 6426 Mixture Credit never paid $0.183 per gallon on that mixture. Perhaps if it had considered this question, this Court of Appeals would not have found the plain meaning of the statute to be clear.

What Does All This Mean?

The IRS strategy of confuse the court and win proved to be successful. Like the Court of Claims before it the Court of Appeals believed – wrongly – that Sunoco didn't pay the full amount of excise tax. Had it given any consideration to the excise tax refund provisions (referenced above), the conclusion that the full amount of excise tax was never paid would have been far less clear cut, if not rejected outright. Similarly, if the Court of Appeals considered at all that the "equivalent benefit" conferred by the creation of the Mixture Credit in the Jobs Act was the credit itself and not a reduced tax rate it would have realized that made sense; why take away a reduced tax rate only to effectively – according to the Court – enact a reduced tax rate, especially if the Highway Trust Fund is going to be funded one way or another at the full $0.183 per gallon rate? Why not leave the reduced tax rates in place and just change the funding mechanism for the Highway Trust Fund? At the very least, had these questions been considered, the Court of Appeals would have found it much more difficult to say that the plain meaning of the statute was clear.

Moreover, by stating that Congress intended that a payment be made under § 6427 only to a taxpayer with no excise tax liability, it becomes clear that had Sunoco, and other similarly situated taxpayers, structured their business so that they had an entity blending and selling eligible mixtures and a separate entity selling these mixtures at the terminal rack, the blending entity would have had no excise tax liability and would therefore have received a tax-free payment under § 6427.

With regards to what happens next, this decision could have consequences beyond just the Mixture Credit. It could lead to the reversal of PLR 201022012 relating to the tire tax credit under § 4051(d). In that case, the taxpayer sold a taxable trailer that included tires of which tax had already been paid under § 4071. The taxable trailer tax is imposed under § 4051(a). The IRS ruled that the tax liability was not reduced by the amount of the credit:

> *"The tax imposed by § 4051(a) is computed on the price for which the article is sold, as that term is used in the Code and regulations. To the extent X is liable for the tax under § 4051, X will report that liability based on the price for which the article is sold on Form 720, IRS No. 33. If X meets the requirements of § 4051(d), X may separately claim a credit on Form 720, Schedule C, in the amount of the tax previously imposed by § 4071. X may not "net" the § 4051(d) credit against its § 4051 liability and report a single amount on Form 720, IRS No. 33.* ***A § 4051(d) credit for a particular transaction does not reduce the § 4051 liability for that transaction; rather, this credit is used to reduce the total balance owed by X to the IRS****." (emphasis added).*

With respect to Sunoco specifically, it's remaining place for appeal is a writ of certiorari to the United States Supreme Court. If such a writ is filed, the Supreme Court would have to consider whether, in its opinion, the legal principle is sufficiently important to grant review.

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