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Update on the Mixture Credit Exclusion from Income

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 filed on November 22, 2016, the Court of Federal Claims in Sunoco, Inc. v. The United States (No. 15-587T), 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). Stating that the statute is not "crystal clear," but purportedly looking at statutory interpretation, the Court ultimately found the government's position – namely that the mixture credit is a reduction in excise tax liability and nothing more – was more persuasive than Sunoco's position that the credit is an incentive that has no impact on the amount of excise tax liability a taxpayer owes under § 4081 and that such liability is fully deductible from gross income.

The crux of the decision appears to lie in the concept of the mixture credit under § 6426(b) reducing a taxpayer's federal excise tax liability. Even in the statement of facts the Court stated the taxpayer *"paid a reduced excise tax."* It does not go without notice that the Court made this statement – one which Sunoco clearly disputed in all Court filed documents - during its discussion of so-called undisputed facts. If the Court mistakenly believed that Sunoco agreed that it paid a reduced excise tax it would seem plausible that this misconception that all parties characterized the credit as a reduction in excise tax liability may have played a role in the Court's decision that the credit reduces excise tax liability and thus its final decision.

Throughout its discussion, the Court concedes that both Sunoco's and the government's interpretations of the statute could be plausible. However, in its analysis of the legislative history the Court determined that, although the American Jobs Creation Act of 2004 ("AJCA") eliminated reduced rates of excise tax on alcohol blended fuels and imposed the full rate of excise tax, the reality is that the full excise tax rates were not imposed. Rather, per the Court, a taxpayer who claims a credit under § 6426(b) pays a reduced rate of excise tax. The Court does note that, in its opinion, the legislative history and the practical effect of the mixture credit are inconsistent, however, instead of concluding that perhaps this need not be the case, the Court states 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. In other words, rather than collecting the full amount of excise tax from a blender and depositing it in the Highway Trust Fund, as was the intent stated in the legislative history of the AJCA, the Court believes that a reduced rate of tax is collected and the shortfall is made up by transferring funds from the General Fund to the Highway Trust Fund. It is unclear from where the Court reaches this "legal fiction" conclusion other than perhaps a desire to find in favor of the government having been persuaded that a "double windfall" couldn't have been intended given the large dollar amounts involved. Indeed, the Court as makes this point on page 10 of its decision when it states:

> *"Sunoco is only one major alcohol fuel blender in the United States, and it is claiming a refund of over $300 million for four tax years. Therefore, if Sunoco were entitled to this subsidy, then similarly situated blenders could claim refunds totaling billions of dollars."*

During its discussion, the Court also separated (or in its words bifurcated) the credit when claimed under § 6426 and the credit when claimed under § 6427(e) saying that -

> *"the Mixture Credit must be treated first as a reduction of the taxpayer's excise tax liability, with any remaining Mixture Credit amount treated as tax-free payment."*

By drawing a distinction between the Code sections based on how the credit is claimed, the Court effectively agreed that a taxpayer could receive both an excise tax and income tax benefit from the mixture credit but only to the extent that he does not owe any excise tax; this distinction seems somewhat odd given that the next sentence of the decision reads:

> *"Had Congress intended, as Sunoco argues, to drastically increase the tax incentives fuel producers receive from blending alcohol into their fuels, one would expect to see at least some inkling of this intent in the legislative history or the Internal Revenue Code. No such inkling appears."*

Although the Court could find no "inkling" that Congress intended both an excise tax and income tax benefit it seemed to accept this exact construct with respect to § 6427(e) apparently because the government agreed that this is how it should operate. The court states in its discussion that the income tax treatment of the credit differs depending on whether the taxpayer claiming the credit has an excise tax liability requiring it to claim the credit under § 6426; the Court appears to get around the inconsistency in this conclusion by relying on a bifurcated approach to the credit, an approach proffered by the government. Curiously, however, the Court did concede that the language of the statute could support both Sunoco's contention that the Code sections describe one credit with different mechanisms for claiming them and the government's position that the credit should be bifurcated.

Finally, addressing the question of the omission of §§ 6426 and 6427 from § 87 (which specifically brings the alcohol mixture income tax credit in § 40 within gross income) the Court states simply that the omission is not necessarily a sign of Congress' intent to exclude the credit from gross income. The Court offered no discussion of the AJCA enacting an excise tax credit to sit alongside the existing income tax credit – an action which itself suggests there may be a distinction between the two, otherwise what would be the point of Congress enacting an excise tax credit and/or not repealing the income tax credit. The Court also ignored § 6427(e) which is omitted from § 87 and on which there is no disagreement that it is excluded from gross income. Instead, the Court states that Congress' omission of § 6426 is not necessarily a sign that Congress intended that the credit be excluded from gross income because, going back to the position that the credit is a reduction in excise tax liability, the credit automatically increases gross taxable income and therefore there is no need for Congress to explicitly state this.

What Does All This Mean? – Looking Forward

In its concluding remarks, the Court stated that as Congress did not explicitly state that it was conferring the benefit sought by Sunoco, that ambiguity coupled with case law and policy considerations necessitated a finding in favor of the government. While the decision by the Court of Claims to deny Sunoco's request for a refund of income taxes is clearly a blow to the portion of the industry that was required to claim the mixture credit under § 6426(b) due to having federal excise tax liability, the story is not over yet. The Federal Court of Claims appeared to be reaching somewhat in describing the changes to the excise tax regime in AJCA as a legal fiction and conceded that many of Sunoco's arguments were plausible. Sunoco

is expected to appeal the decision to the U.S. Court of Appeals where it will be heard *de novo*; this means that both parties can present their cases again and have a different set of judges reach a decision. Moreover, there are currently three other cases pending on this matter, two in U.S. Tax Court and one in Federal District Court in Texas. While these cases may take note of the decision by the Court of Claims, they are not bound by it and therefore can review the enacting statute – including the statements made by Congress regarding fully funding the Highway Trust Fund and noting how the funds are allocated – and reach a different conclusion.

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