

A. Prohibition on Alternative Fuel Credit and Alternative Fuel Mixture Credit for Black Liquor

Present Law

Highway motor fuel excise taxes (sec. 4081 and sec. 4041)

Section 4081 of the Code imposes a tax on gasoline, diesel fuel and kerosene ("taxable fuel"). In general, gasoline is taxed at 18.3 cents per gallon, diesel fuel at 24.3 cents per gallon, and kerosene at 24.3 cents per gallon.¹

Section 4041 serves as a back-up tax for fuels that are not taxed under section 4081. Included among the section 4041 taxes are taxes imposed on alternative fuels and compressed natural gas that are sold for use or used in a motor vehicle or motorboat. In general, these fuels are taxed at a rate of either 18.3 cents per gallon or 24.3 cents per gallon.² Aviation fuel under section 4041 is generally taxed at 21.8 cents per gallon or 4.3 cents per gallon.³

With respect to alternative fuel, the Code provides two per-gallon excise tax credits to be used against the taxes imposed by section 4041 and section 4081: the alternative fuel credit, and the alternative fuel mixture credit.⁴ The Code also provides for the direct payment of the amount of these credits.⁵

Alternative fuel tax credit allowable against section 4041 taxes

The alternative fuel credit is allowed as a credit against the back-up taxes of section 4041. The credit is 50 cents per gallon (or gasoline gallon equivalent) of alternative fuel sold by the taxpayer for use as a fuel in a motor vehicle or motorboat, sold by the taxpayer for use as a fuel in aviation, or so used by the taxpayer.⁶

The term "alternative fuel" means liquefied petroleum gas, P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)), compressed or liquefied natural gas,

¹ Sec. 4081(a)(2). These rates do not include the additional tax of 0.1 cent per gallon imposed on such fuel to fund the Leaking Underground Storage Tank Trust Fund. Unless otherwise indicated, all reference to the Code refer to the Internal Revenue Code of 1986, as amended.

² Sec. 4041(a)(2) and sec. 4041(a)(3)(A).

³ Sec. 4041(c).

⁴ Sec. 6426(d) and sec. 6426(e).

⁵ Sec. 6427(e)(1) and sec. 6427(e)(2).

⁶ Sec. 6426(d)(1).

liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process⁷ (“coal-to-liquids”), compressed or liquefied gas derived from biomass, or liquid fuel derived from biomass. Such term does not include ethanol, methanol, or biodiesel.⁸

The alternative fuel credit does not apply to any sale or use for any period after December 31, 2009 (September 30, 2014, in the case of liquefied hydrogen). No credit is allowed unless the taxpayer is registered with the IRS.

Alternative fuel mixture credit allowable against section 4081 taxes

A credit of 50 cents per gallon of alternative fuel used by the taxpayer in producing an alternative fuel mixture for sale or use in a trade or business of the taxpayer is allowed against the taxes imposed by section 4081. An “alternative fuel mixture” is a mixture of alternative fuel and taxable fuel that contains at least 1/10 of one percent taxable fuel (e.g. gasoline, diesel fuel, or kerosene).⁹ The mixture must be either (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) used as a fuel by the taxpayer producing the mixture.

The alternative fuel mixture credit does not apply to any sale or use for any period after December 31, 2009 (September 30, 2014, in the case of liquefied hydrogen). No credit is allowed unless the taxpayer is registered with the IRS.

Payments with respect to alternative fuel and alternative fuel mixtures when credits exceed tax liability

The alternative fuel credit must first be applied to section 4041 liability, and to the extent the credit exceeds such liability, section 6427(e) permits the person who sold or used the alternative fuel for a qualified purpose to claim a payment for the excess credit. Similarly, the alternative fuel mixture credit must first be applied to section 4081 tax liability, and to the extent the credit exceeds such liability, section 6427(e) permits the person who produced the alternative fuel mixture to claim a payment for the excess credit.¹⁰

⁷ For coal-to-liquids produced after September 30, 2009 through December 30, 2009, the fuel must be certified as having been derived from coal produced at a gasification facility that separates and sequesters 50 percent of such facility’s total carbon dioxide emissions. The sequestration percentage increases to 75 percent for fuel produced after December 30, 2009. (sec. 6426(d)(2)(E) and sec. 6426(d)(4).)

⁸ Sec. 6426(d)(2).

⁹ See Internal Revenue Service, Notice 2006-92, *Alternative Fuel, Alternative Fuel Mixtures; Blood Collector Organizations*, 2006-43 I.R.B. 774 (October 23, 2006).

¹⁰ The payments authorized under section 6427(e) of the Code for alternative fuel mixtures and alternative fuel may be taken as a refundable income tax credit pursuant to section 34 and section 6401(b)(1) of the Code. The section 34 income tax credit is not available for any amount for which a timely claim has been filed under section 6427.

As an example, if an alternative fuel mixture is used as a fuel but for a nontaxable purpose, such as use as a fuel in a furnace, and the person otherwise has no section 4081 liability, the credit will exceed section 4081 tax liability and the producer may make a claim for payment for the full amount of the credit. Recent alternative fuel mixture claims for the burning of black liquor (a byproduct of the manufacturing of pulp and paper) and diesel fuel in recovery boilers have highlighted the fact that the fuel mixture credits are not limited to transportation uses, and that there is no upper limit on the dollar amount that may be claimed.¹¹

Description of Proposal

For purposes of the excise tax credit and payment provisions, the proposal modifies the definition of alternative fuel to exclude any fuel (including lignin, wood residues, or spent pulping liquors) derived from the production of paper or pulp. Thus such fuel would no longer qualify for the alternative fuel credit, alternative fuel mixture credit, and related payment provisions.

Effective Date

The proposal is effective for fuel sold or used after the date of enactment.

¹¹ See, International Paper, *News Release: International Paper Provides Update on Alternative Fuel Credits* (March 24, 2009); Steve Mufson, Washington Post, *Papermakers Dig Deep in Highway Bill to Hit Gold* (March 28, 2009 at p. D.1); Rebecca Penty, New Brunswick Business Journal, *Canada at a Disadvantage: Forestry Industry Contends Credits are Subsidies that Allow U.S. Firms to Better Compete* (April 3, 2009 at p. B.1); and Jad Mouawad and Clifford Krauss, The New York Times, *Lawmakers May Limit Paper Mills' Windfall* (April 18, 2009).