

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: Holly McCann
(Chief, Excise Tax Program)

from: Stephanie Bland
(Senior Technician Reviewer, CC:PSI:7)

subject: Certain Liquids as Alternative Fuels

ISSUES

This responds to your request for advice on the following issues:

1. Whether, for purposes of determining the alternative fuel mixture credit under § 6426 of the Internal Revenue Code (Code), the term “liquid fuel derived from biomass” in § 6426(d)(2)(G) is limited to liquids derived from biomass that are standalone fuels.¹
2. Whether the byproduct from the paper manufacturing process is an “alternative fuel” within the meaning of § 6426(d)(2) if the paper is made from sources other than wood pulp (such as cotton).
3. Whether rejected mouthwash, which contains significant amounts of alcohol and does not meet the production specifications for sale as mouthwash, is an “alternative fuel” as defined in § 6426(d)(2).

LAW

Section 6426(a) provides for certain alternative fuel and alternative fuel mixture credits.

Section 6426(d)(2)(G) defines the term “alternative fuel” to include liquid fuel derived from biomass (as defined in § 45K(c)(3)). Section 45K(c)(3) defines “biomass” to mean any organic material other than (A) oil and natural gas (or any product derived thereof) and (B) coal (including lignite) and any product derived thereof.

¹ For purposes of this CCA, a “standalone fuel” is a liquid that is capable of being used as a fuel without further processing.

Under § 6426(d)(2) the term “alternative fuel” does not include ethanol, methanol, biodiesel, or any fuel (including lignin, wood residues, or spent pulping liquors) derived from the production of paper or pulp.

Section 6426(e)(1) allows a \$.50 credit against a claimant's taxable fuel liability for each gallon of alternative fuel used to produce an alternative fuel mixture that the mixture producer sells for use or uses as a fuel in its trade or business. Any excess is allowed as a payment under § 6427(e) or a refundable income tax credit under § 34.

Section 6426(e)(2) defines an alternative fuel mixture as a mixture of alternative fuel and taxable fuel that is either sold by the taxpayer producing such mixture to any person for use as a fuel or used as a fuel by the taxpayer producing such mixture.

Section 2(f)(1) of Notice 2006-92, 2006-2 C.B. 774, provides that a mixture is used as a fuel when it is consumed in the production of energy. Thus, for example, a mixture is used as a fuel when it is consumed in an internal combustion engine to power a vehicle or in a furnace to produce heat.

ANALYSIS

The first issue is whether, for purposes of the alternative fuel mixture credit under § 6426, the term “liquid fuel derived from biomass” in § 6426(d)(2)(G) is limited to liquids derived from biomass that are standalone fuels.

The plain language of § 6426(d)(2)(G) requires that a product meet the following requirements in order to be considered an “alternative fuel” under § 6426(d)(2): (i) the product must be a liquid; (ii) the product must be fuel; and (iii) the product must be derived from biomass. In order to determine whether a product is a fuel, we must look to the ordinary, everyday meaning of the word “fuel.”² According to *The Free Dictionary*, the word “fuel” means “something consumed to produce energy,” “any substance burned as a source of heat or power,” and “a substance that produces useful energy when it undergoes a chemical or nuclear reaction.” See “fuel,” *TheFreeDictionary.com*, <http://www.thefreedictionary.com/fuel> (14 March 2012). Further, section 2(b) of Notice 2006-92 provides that something is “used as a fuel” when it is consumed in the production of energy.

Based on the foregoing, we conclude that for purposes of the alternative fuel mixture credit, a product is a “liquid fuel derived from biomass,” within the meaning of § 6426(d)(2)(G), only if the product is capable of producing energy. In other words, a liquid derived from biomass that is not a standalone fuel does not meet the requirements of § 6426(d)(2)(G).

² Because the incoming request for legal advice focuses on whether a product must be a standalone fuel in order to meet the definition of “liquid fuel derived from biomass,” this CCA only addresses the fuel prong of the definition.

The second issue is whether the byproduct from the paper manufacturing process is a “liquid fuel derived from biomass” as defined in § 6426(d)(2) if the paper is made from sources other than wood pulp, such as cotton. The flush language of § 6426(d)(2) specifically states that the term “alternative fuel” does not include any fuel (including lignin, wood residues, or spent pulping liquors) derived from the production of paper or pulp. The fact that the paper is derived from a source other than wood pulp is irrelevant. Therefore, such paper byproducts from the paper manufacturing process do not meet the definition of “alternative fuel.” Consequently, the process of combining such products with taxable fuel does not create a mixture that is eligible for the alternative fuel mixture credit.

The third issue is whether rejected mouthwash, which contains significant amounts of alcohol and does not meet the production specifications for sale as mouthwash, is an “alternative fuel” as defined in § 6426(d)(2). The flush language of § 6426(d)(2) specifically states that the term “alternative fuel” does not include ethanol and methanol. Therefore, rejected mouthwash that is derived from ethanol or methanol is not an “alternative fuel” under § 6426(d)(2). Accordingly, rejected mouthwash that is derived from ethanol or methanol and blended with a taxable fuel is not an alternative fuel mixture and is not eligible for the alternative fuel mixture credit. It is possible that rejected mouthwash that is not derived from methanol or ethanol may be an “alternative fuel” if the requirements of § 6426(d)(2) are satisfied, based on the relevant facts and circumstances.

CONCLUSIONS

1. For purposes of the alternative fuel mixture credit, the term “liquid fuel derived from biomass” under § 6426(d)(2)(G) is limited to liquids derived from biomass that are capable of being used as standalone fuels and that are capable of producing energy.
2. The byproduct from the paper manufacturing process is not an “alternative fuel” within the meaning of § 6426(d)(2) regardless of whether the paper is made from wood pulp or sources other than wood pulp.
3. Rejected mouthwash (which does not meet production specifications for sale as mouthwash) that is derived from ethanol or methanol is not an “alternative fuel” as defined in § 6426(d)(2).

This document may not be used or cited as precedent.

Please call Charles J. Langley, Jr. at (202) 622-3130 if you have any further questions.