

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

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to: Director, Specialty Tax
(John Imoff)

from: Associate Chief Counsel
(Passthroughs & Special Industries)

subject: Black Liquor; Excise Tax Credits

ISSUES

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

(1) Whether black liquor, as described below, is a liquid fuel derived from biomass under § 6426(d)(2)(G) of the Internal Revenue Code (the Code).

(2) Whether the process of combining black liquor with diesel fuel described below creates an alternative fuel mixture for purposes of determining the alternative fuel mixture credit under § 6426(e) of the Code.

(3) Whether a registrant may claim the alternative fuel mixture credit under § 6426(e) of the Code for a mixture produced and used before the date the claimant is registered by the IRS under § 4101 of the Code.

(4) Whether black liquor qualifies for the cellulosic biofuel producer credit in § 40(b)(6) of the Code.

CONCLUSIONS

(1) Black liquor, as described above, is a liquid fuel derived from biomass under § 6426(d)(2)(G).

(2) The process of combining black liquor with diesel fuel described above creates an alternative fuel mixture for purposes of determining the alternative fuel mixture credit under § 6426(e).

(3) A registrant may claim the alternative fuel mixture credit under § 6426(e) of the Code for a mixture produced and used before the date the claimant is registered by the IRS under § 4101 for any open past period.

(4) Black liquor may qualify for the § 40(b)(6) cellulosic biofuel producer credit or the § 6426(e) alternative fuel mixture credit, but not both.

FACTS

Based on the facts provided, black liquor is the name given to a byproduct of the paper milling process in kraft mills. Generally, wood chips from debarked tree logs are pulped by using certain chemicals (called white liquor), heat, and pressure to separate lignin and other components of the wood from the cellulose fibers in the wood chips. The cellulose fibers are separated for further processing into paper.

The remaining black liquor (including the lignin and spent chemicals) is an aqueous solution with the consistency of molasses. Its chemical composition often includes approximately 75% organic matter and 25% inorganic matter by weight, depending of the type of wood chips used, but does not include alcohol or biodiesel. Black liquor is generally not stored because of the continuous nature of the kraft milling

process; however, when it is stored, it must be kept in a container and cannot be stored in a pile like sand or wood chips.

After being separated from the cellulose, black liquor is concentrated to remove much of the water content and is blended with at least 0.1 percent (by volume) of diesel fuel.

The temperature of the black liquor and diesel fuel combination is increased before the combination is sprayed into a recovery boiler for combustion. The diesel fuel is added only to support the alternative fuel mixture credit; otherwise, there is no practical reason to add the diesel fuel. In the recovery boiler, the diesel fuel and the organic matter of the black liquor are burned away, generating steam to produce electrical energy. (Most of the inorganic matter is recycled into the kraft milling process as white liquor.) The electricity powers the paper mill and any excess can be sold to third parties, such as power companies.

LAW AND ANALYSIS

Effective October 1, 2006, § 6426(e)(1) of the Code allows a 50 cents 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. Section 6426(e)(2) provides that "alternative fuel mixture" means a mixture of alternative fuel and taxable fuel (that is, gasoline, diesel fuel, or kerosene) that is sold for use or used as a fuel by the mixture producer.

Under section 2(b) of Notice 2006-92, 2006-2 C.B. 774, "alternative fuel mixture" means a mixture of alternative fuel and taxable fuel that contains at least 0.1 percent of taxable fuel. Section 2(f)(1) provides that a mixture is "used as a fuel" when it is consumed in the production of energy, including in a furnace to produce heat.

Under § 6426(d)(2)(G), “alternative fuel” includes liquid fuel derived from biomass (as defined in section 45K(c)(3)). Section 45K(c)(3) defines “biomass” as any organic matter other than oil and natural gas (or any product thereof), and coal (including lignite) or any product thereof.

Claimants that have an alternative fuel mixture credit amount that exceeds their taxable fuel tax liability may claim a payment for the excess under § 6427(e)(1). These claims for payment may also be made as a claim for a refundable income tax credit under § 34 on the claimant’s income tax return.

Under § 6427(e)(4), each alternative fuel mixture claimant must be registered by the IRS before making any claim. But once registered, a claimant may claim for any open past period. Section 6427(i)(3) provides that an alternative fuel mixture credit claim must be made on or before the last day of the first quarter following the following the earliest quarter included in the claim. (For example, a claim that includes January 1 must be made by June 30.) However, if a claimant did not file a timely claim under the rules of § 6427(i)(3) because the claimant was not registered by the IRS, the claim may be made instead under § 34 on a timely filed or amended income tax return after the claimant is registered by the IRS.

Section 15332 of the Food, Conservation, and Energy Act of 2008 (Pub. L. 110-234) added the cellulosic biofuel producer credit to § 40(b)(6) of the Code. As relevant to black liquor, § 40(b)(6) allows a \$1.01 per gallon nonrefundable income tax credit for each gallon of qualified cellulosic biofuel production of the producer for the taxable year. “Cellulosic biofuel” means any liquid fuel that is (1) produced in the United States and used as fuel in the United States, (2) derived from lignocellulosic or hemicellulosic

matter that is available on a renewable or recurring basis and, (3) meets the registration requirements for fuels and fuel additives established by the EPA under section 211 of the Clean Air Act.

Under § 40(b)(6)(G), the producer of the cellulosic biofuel must be registered by the IRS before making any claim. However, once registered, a claimant may claim for any open past period on a timely filed or amended income tax return.

Under § 6426(h), no alternative fuel mixture credit will be determined with respect to any fuel with respect to which credit may be determined under § 40. Therefore, a taxpayer that produces an alternative fuel that is also a qualified cellulosic biofuel may not claim a credit under both § 6426(e) and § 40. However, under § 40(f), the taxpayer may elect out of the § 40 credits. Thus, an alternative fuel mixture credit may be determined under § 6426 for an alternative fuel that meets both § 6426(d)(2)(G) (liquid fuel derived from biomass) and § 40(b)(6)(E) (cellulosic biofuel).

Black liquor, derived from organic matter, is an aqueous solution that has the consistency of molasses at the time it is introduced into the recovery boiler. Black liquor, either with or without the addition of taxable fuel, is consumed in the production of energy to generate electricity in recovery boilers in certain paper mills. Thus, it is a liquid fuel derived from biomass and the addition of taxable fuel described above creates an alternative fuel mixture that is used as a fuel by the mixture producer.

CONTACT INFORMATION

If you have any questions about this, please contact Taylor Cortright at (202) 622-3130.