

United States Court of Appeals for the Federal Circuit

ALTERNATIVE CARBON RESOURCES, LLC,
Plaintiff-Appellant

v.

UNITED STATES,
Defendant-Appellee

2018-1948

Appeal from the United States Court of Federal Claims
in No. 1:15-cv-00155-MMS, Chief Judge Margaret M.
Sweeney.

Decided: September 26, 2019

VIVIAN D. HOARD, Taylor English Duma LLP, Atlanta,
GA, argued for plaintiff-appellant. Also represented by
BRIAN GARDNER, KELLY MULLALLY; WILLIAM SIDNEY
SMITH, Smith & Kramer, PC, Des Moines, IA.

CLINT CARPENTER, Tax Division, United States Depart-
ment of Justice, Washington, DC, argued for defend-
ant-appellee. Also represented by TERESA E. MCLAUGHLIN,
RICHARD E. ZUCKERMAN.

Before O'MALLEY, REYNA, and CHEN, *Circuit Judges*.

O'MALLEY, *Circuit Judge*.

Appellant Alternative Carbon Resources, LLC claimed nearly \$20 million in energy tax credits meant for taxpayers who sell alternative fuel mixtures. The Internal Revenue Service ("IRS") later determined that Alternative Carbon should not have claimed these credits and it demanded repayment (along with interest and penalties). Alternative Carbon paid back the government, in part, and then filed this refund suit in the United States Court of Federal Claims ("Claims Court").

After the parties filed cross-motions for summary judgment, the Claims Court decided that Alternative Carbon failed to establish that it properly claimed the credits or that it had reasonable cause to do so. *Alternative Carbon Res., LLC v. United States*, 137 Fed. Cl. 1 (2018). The Claims Court therefore granted summary judgment for the government.

Alternative Carbon appeals, arguing that it is entitled to claim the credits or that it at least had reasonable cause for claiming them and so it should not have to pay any penalties. Because we conclude that Alternative Carbon cannot show it is entitled to the credits or that it had reasonable cause for claiming them, we affirm.

I. BACKGROUND

A. Alternative Fuel Mixture Credits

We begin with a brief overview of the tax credits that Alternative Carbon claimed. Section 6426(e) allows taxpayers to obtain a credit for "producing any alternative fuel mixture for sale or use in a trade or business of the taxpayer." 26 U.S.C. § 6426(e)(1). The statute then defines an "alternative fuel mixture" as "a mixture of alternative fuel and taxable fuel" that is either "sold by the taxpayer . . . for use as fuel" or "used as a fuel by the taxpayer producing such mixture." *Id.* at § 6426(e)(2)(A)–(B).

As is typical in tax law, this definition of alternative fuel mixture incorporates other parts of the Internal Revenue Code by reference. For example, the statute relies on subsections (A), (B), and (C) of § 4083(a)(1) to supply a definition for “taxable fuel.” *See id.* As relevant here, that definition includes “diesel fuel.” *Id.* at § 4083(a)(1)(B). The statute also defines “alternative fuel” based on a list of examples that includes “liquid fuel derived from biomass (as defined in section 45K(c)(3)).” *Id.* at § 6426(d)(2)(G); *see also id.* at § 45K(c)(3) (broadly defining biomass as “any organic material” besides oil, natural gas, and coal). The statute does not, however, define what it means for a mixture to be “sold by the taxpayer.” *Id.* at § 6426(e)(2)(A).

In 2006, the IRS issued a “notice” regarding § 6426. *See I.R.S. Notice 2006-92, 2006-2 C. B. 774.* Among other things, the IRS interpreted alternative fuel mixture to “mean[] a mixture of alternative fuel and taxable fuel that contains at least 0.1 percent (by volume) of taxable fuel (as defined in § 4083(a)(1)).” *Id.* at § 2(b). It also explained that “[a] mixture producer sells a mixture *for use as a fuel* if the producer has reason to believe that the mixture will be used as a fuel.” *Id.* § 2(f)(2). The notice does not address what it means for an alternative fuel mixture to be sold in the first place.

To put all of this in plain English, a taxpayer can claim the alternative fuel mixture credit under § 6426 by selling a mixture of alternative fuel, *e.g.*, liquid fuel derived from biomass, and taxable fuel, *e.g.*, diesel fuel, so long as the mixture is ultimately sold for use as fuel.¹ The issues in

¹ Section 6426(a) also provides that “[n]o credit shall be allowed in the case of the credits described in subsections (d) and (e) unless the taxpayer is registered under section 4101.” 26 U.S.C. § 6426(a). There is no dispute that Alternative Carbon satisfied this condition. *See Alternative Carbon*, 137 Fed. Cl. at 22.

this appeal are, thus, whether the taxpayer actually sold the fuel mixture here and, if so, whether any such sale was “for use as fuel.”

B. Alternative Carbon’s Business

Alternative Carbon argues that it is entitled to claim this alternative fuel mixture credit because it sold an alternative fuel mixture to third parties who, in turn, used the mixture as fuel in anaerobic digestion tanks. Before addressing this argument, we briefly discuss anaerobic digestion and Alternative Carbon’s business model. *See also Alternative Carbon*, 137 Fed. Cl. at 7–12, 16–19.

Some microorganisms produce methane when they digest organic matter. The input for this process of anaerobic digestion, *i.e.*, the organic material that the microorganisms digest, consists of organic solids called feedstock mixed in a sludge with water.² *Id.* at 8; *see also* J.A. 550 (“[The] microbes basically eat the organics, and a by-product of that is methane gas.”). Anaerobic digester tanks provide a place for the microorganisms to digest the feedstock. J.A. 872–73. Entities that operate these digester tanks then use the resulting methane to generate electricity (among other things). *See, e.g.*, J.A. 552.

Alternative Carbon began operating in 2011. Its business generally involved a few basic steps. First, Alternative Carbon bought feedstock from ethanol production plants. Next, it paid a trucking company to transport the feedstock. Along the way, the trucking company added diesel fuel to the feedstock. The trucking company then delivered this feedstock/diesel mixture to entities that operated

² These organic solids are also sometimes called substrates. For clarity, and consistent with the Claims Court, we will use the term “feedstock” throughout this opinion to describe these organic materials. *Alternative Carbon*, 137 Fed. Cl. at 8 n.6.

anaerobic digestion tanks.³ The digester operators ultimately fed the mixture to methane-producing microorganisms. Each step is discussed in more detail below.

When Alternative Carbon purchased feedstock from its suppliers, the feedstock consisted of organic material that might otherwise be considered waste. For example, the process of distilling ethanol produces water and corn solids (“stillage”) as a by-product. J.A. 1718. This solid stillage is then further distilled through a centrifuge to separate liquid (“thin-stillage”) from other solids. *Id.* Alternative Carbon paid ethanol producers to acquire this thin-stillage. *Id.* In addition to thin-stillage, Alternative Carbon used other organic materials as feedstock. J.A. 1718–20.

After purchasing the feedstock, Alternative Carbon paid a trucking company to mix enough diesel fuel with the feedstock so that the resulting mixture could qualify as an alternative fuel mixture under § 6426. *Alternative Carbon*, 137 Fed. Cl. at 9; *see also* J.A. 814 (“[Y]ou got to put a splash of diesel fuel in it, and here’s why . . . it has a splash of diesel fuel in it before so we can generate tax credits.”). Alternative Carbon’s expert conceded that adding the diesel fuel “did not measurably change the methane production” of the microorganisms. J.A. 616; *see also* J.A. 1026 (“Q. And, in fact, you wouldn’t recommend putting diesel in an anaerobic digester [tank]; is that right? A. Typically, no. I wouldn’t recommend it.”).

Having made the feedstock/diesel mixture, the trucking company delivered the mixture to digester operators. Alternative Carbon paid a fee to the operators based on how much feedstock/diesel mixture they accepted. *See, e.g.*, J.A. 794. In Alternative Carbon’s contract with the Des Moines Wastewater Reclamation Authority

³ For clarity, we will refer to these entities collectively as digester operators.

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