



TaxNewsFlash

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Fifth Circuit: Credit for renewable fuels reduces excise tax, but deduction limited to excise tax actually paid

The U.S. Court of Appeals for the Fifth Circuit issued a decision concerning claims for refund filed by an oil and gas company. The Fifth Circuit held that the taxpayer's credit for renewable fuels reduced its excise tax liability such that it can only deduct the excise tax it paid out of pocket.

The Fifth Circuit also affirmed a federal district court's judgment regarding a lease-versus-sale issue and a penalty assessment.

The case is: *Exxon Mobile Corp. v. United States*, No. 21-10373 (5th Cir. August 3, 2022). Read the Fifth Circuit's [decision](#) [PDF 247 KB]

Summary

Excise tax issue

The taxpayer (an oil and gas company) claimed that it made yet another mistake in its original tax returns regarding the amount of excise tax that can be deducted from gross income as: (1) the lesser amount it actually paid after claiming a renewable-fuel credit; or (2) the greater amount it would have paid without the credit.

In tax years 2008 and 2009, the taxpayer's original excise tax liability was approximately \$6 billion—but the taxpayer also produced renewable fuels and was thus eligible for a \$960 million credit. The taxpayer applied the credit against its original \$6 billion liability and paid a reduced excise tax of approximately \$5 billion.

On its original tax returns, the taxpayer deducted that lesser amount from its gross income (rather than the \$6 billion). The taxpayer subsequently filed amended returns that deducted \$6 billion in excise tax, unreduced by the credit for renewables. In other words, the taxpayer increased its excise tax deduction, and thus reduced its taxable income, by \$960 million which translated to a \$300 million reduction in tax owed.

The IRS disagreed with the taxpayer's position and rejected the refund claim. The Fifth Circuit joined other courts (including the Sixth Circuit and Federal Circuit) to hold that the taxpayer's credit reduced its excise tax liability such that it could only deduct the excise tax it paid out of pocket. Accordingly, the Fifth Circuit concluded that the taxpayer's renewable-fuel credit reduced its excise tax and that it could deduct only the reduced amount.

Lease-versus-sale issue, penalty issue

The taxpayer on its tax returns for years 2006 to 2009 treated mineral transactions with Qatar and Malaysia as leases. The taxpayer, as the transferee, thus did not include in its taxable income the portion of mineral-based income that it paid to Qatar and Malaysia as royalties.

A few years later, the taxpayer amended its returns and filed a refund claim. In the amended returns, the taxpayer treated the mineral transactions as sales. In turn, the taxpayer's taxable income increased because it now included all the income derived from minerals, including the royalties paid to Qatar and Malaysia. The income that would have been taxable to Qatar and Malaysia in the mineral-lease context was now taxable to the taxpayer. In turn, the taxpayer offset a portion of the increase in its taxable income by deducting some of the royalty payments it made to Qatar and Malaysia. The taxpayer requested a refund of \$1 billion.

Because the taxpayer had paid foreign tax on the money that it now included in its U.S. taxable income, it was able to claim credit intended to prevent the double taxation of income. The foreign tax credits generated the \$1 billion refund request.

The IRS rejected the taxpayer's refund claim, and also imposed a \$200 million penalty for the taxpayer's claiming an excessive refund without a reasonable basis.

The taxpayer paid the penalty and filed a refund action in district court. After a bench trial, the district court held in the government's favor on the lease-versus-sale issue. On the penalty issue, however, the court held for the taxpayer and ordered a refund.

The taxpayer appealed the lease-versus-sale issue, and the government cross-appealed the rejection of the penalty. The Fifth Circuit affirmed the district court's decision regarding these two issues.

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