

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

April 2, 2012

Number: **201230022**
Release Date: 7/27/2012

Third Party Communication: None
Date of Communication: Not Applicable

Index (UIL) No.: 6427.00-00
CASE-MIS No.: TAM-100640-12

Chief Excise Tax Operations, SBSE Excise

Taxpayer's Name:
Taxpayer's Address:
Taxpayer's Identification No
Years Involved:
Date of Conference: February 22, 2012

LEGEND:

Taxpayer =

Approved Refinery =

Approved Terminal =

ISSUES:

(1) Is Taxpayer's dyeing of undyed diesel fuel a nontaxable use of undyed diesel fuel for which a payment is allowed under § 6427(l) of the Internal Revenue Code (Code)?

(2) Is Taxpayer the ultimate purchaser of the undyed diesel fuel described in Issue (1)?

CONCLUSION:

(1) Taxpayer's dyeing of undyed diesel fuel is not a nontaxable use of undyed diesel fuel. A payment is not allowed for such activity under § 6427(l) of the Code.

(2) Taxpayer is not the ultimate purchaser of the undyed diesel fuel described in Issue (1).

FACTS:

Taxpayer operates a refinery (Approved Refinery) at which it produces undyed diesel fuel. During the tax periods at issue, Taxpayer did not have the equipment to dye diesel fuel at Approved Refinery. Taxpayer removed undyed diesel fuel from Approved Refinery and transported the fuel by truck and railcar to an approved terminal (Approved Terminal) where Taxpayer was a position holder. Taxpayer dyed the undyed diesel fuel at issue upon removal at the Approved Terminal's rack and sold the product to third-party customers. Tax was imposed under § 4081(a)(1)(A) on Taxpayer's removals of undyed diesel fuel from the Approved Refinery rack.

Taxpayer asserts that dyeing undyed diesel fuel is an off-highway business use of the undyed diesel fuel and Taxpayer, as the ultimate purchaser of such fuel, is entitled to a payment under section 6427(l) with respect to the tax imposed on the undyed diesel fuel.

LAW:

Section 4081(a)(1) generally imposes a tax on (i) the removal of a taxable fuel from any refinery, (ii) the removal of a taxable fuel from any terminal, (iii) the entry into the United States of any taxable fuel for consumption, use, warehousing, and (iv) the sale of a taxable fuel to any person who is not registered under § 4101 unless there was a prior taxable removal or entry of such fuel under clause (i), (ii), or (iii).

Section 6427(l)(1) of the Code generally provides that if any diesel fuel on which tax has been imposed by § 4081 is used by any person in a nontaxable use, the Secretary shall pay (without interest) to the ultimate purchaser of such fuel an amount related to the aggregate amount of the tax imposed on such fuel under § 4081.

Section 6427(l)(2) defines "nontaxable use" as including off-highway business use.

Section 6421(e)(2) generally defines "off-highway business use" as any use by a person in a trade or business of such person or in an income producing activity otherwise than as a fuel in a highway vehicle that is registered or required to be registered for use on public highways.

Section 48.4081-1(c)(2) of the Manufacturers and Retailers Excise Tax Regulations defines diesel fuel, in general, to mean any liquid that, without further processing or

blending, is suitable for use as a fuel in a diesel-powered highway vehicle or diesel-powered train. A liquid is suitable for this use if the liquid has practical and commercial fitness for use in the propulsion engine of a diesel-powered highway vehicle or diesel-powered train. A liquid may possess this practical and commercial fitness even though the specified use is not the liquid's predominant use. However, a liquid does not possess this practical and commercial fitness solely by reason of its possible or rare use as a fuel in the propulsion engine of a diesel-powered highway vehicle or diesel-powered train.

Section 48.6427-8(b)(1) provides that generally, a claim for an income tax credit or payment with respect to diesel fuel is allowed under § 6427(l) only if, among other conditions, tax was imposed on the diesel fuel under § 4081, the claimant produced or bought the diesel fuel and did not sell it in the United States, and the fuel was used in a nontaxable use.

ANALYSIS:

Taxpayer removed undyed diesel fuel from Approved Refinery and transported the fuel by truck and railcar to Approved Terminal where Taxpayer dyed the diesel fuel upon removal and sale of the fuel at the terminal rack. Taxpayer claims that it used the undyed diesel fuel in a "nontaxable use" within the meaning of § 6427(l) when it added dye to the fuel, and, further, that Taxpayer is the ultimate purchaser of such fuel.

Taxpayer does not "use" the undyed diesel fuel other than as a fuel in a registered highway vehicle when it adds dye to the fuel. The diesel fuel is not consumed and it has not lost its identity as diesel fuel. The resulting dyed diesel fuel is still diesel fuel as defined in § 48.4081-1(c)(2).

Taxpayer argues that the Internal Revenue Service (IRS) treats dyed diesel fuel as a product separate from undyed diesel fuel in the IRS's ExStars (Excise Summary Terminal Activity Reporting System) reporting system on Form 720-TO ("Terminal Operator Report"). Among other things, ExStars requires terminal operators to report to the IRS removals of all products from their terminals by prescribed product codes. For example, the instructions for Form 720-TO lists "Diesel Fuel Low Sulfur Dyed" as product code # 227 and "Diesel Fuel # 2 Low Sulfur Undyed" as product code # 167. Thus, Taxpayer argues, the undyed diesel fuel has lost its identity as such (that is, it is "used") when it is dyed.

We disagree. ExStars allows the IRS to track the movement of various fuel products to help determine tax liability. Although undyed diesel fuel and dyed diesel fuel may have different product codes for ExStars purposes, they are still "diesel fuel" for definitional purposes under § 48.4081-1(c)(2). For example, for ExStars purposes, "Diesel fuel # 1 Low Sulfur Undyed" has a different product code than "Diesel Fuel # 2 Low Sulfur

Undyed” (product codes # 161 and # 167, respectively) but if one is added to the other the resulting product is still diesel fuel as defined in § 48.4081-1(c)(2).

Taxpayer did not use the undyed diesel fuel when it added dye. It sold the diesel fuel at the rack of Approved Terminal. Accordingly, Taxpayer is not the ultimate purchaser of the diesel fuel.

CAVEAT:

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.