

Internal Revenue Service  
MEMORANDUM

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date: **FEB 19 1998**

to: National Director  
Excise Taxes

CP:EX:ST:E

from: Chief, Branch 8 (signed) **Richard A. Kozak**  
Office of Assistant Chief Counsel  
(Passthroughs & Special Industries) CC:DOM:PSI:8

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subject: Definition of "held for use...other than a nontaxable use"  
as that term is used in § 6715(a)(2)

[NOTE: The opinions expressed in this memorandum are advisory only and do not represent the views of this office with respect to any particular taxpayer. This memorandum is not to be furnished to taxpayers and is not to serve as the basis for closing a case.]

Your January 7, 1998, memorandum to the Chief, Branch 2, ~~Office of Assistant Chief Counsel (General Litigation)~~, regarding the penalty imposed by § 6715(a)(2), has been referred to this office for reply. You would like to know how to determine the amount of fuel in a user's bulk storage tank that is "held for use...other than a nontaxable use" and thus subject to the § 6715(a)(2) penalty.

Section 6715(a)(2) imposes a penalty if any dyed fuel is held for use or used by any person for a use other than a nontaxable use and such person knew, or had reason to know, that such fuel was so dyed.

Dyed fuel is used when it is placed into the fuel supply tank of a vehicle. Dyed fuel in a user's bulk storage tank is subject to the penalty only if the fuel is held for use other than a nontaxable use.

The following example can be used to illustrate the issue: A Diesel Compliance Officer (DCO) inspects a farmer's registered pick-up truck on the highway and determines that the truck holds 30 gallons of dyed fuel. The DCO then proposes a penalty of \$1,000. The DCO also determines that the farmer fueled the truck

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from the farmer's bulk storage tank that contains 10,000 gallons of dyed fuel. While at the farm, the DCO observes numerous pieces of off-highway farm equipment that are fueled from the same bulk storage tank.

In this example, it is not improper for a Diesel Compliance Officer (DCO) to initially presume that the entire volume of fuel in the tank is held for a taxable use. However, this presumption is rebuttable. Thus, before the penalty is actually assessed, the taxpayer should be allowed to present its case to the DCO, the DCO's manager, or other IRS officials who have authority to determine the matter.

If the taxpayer does not present any evidence of nontaxable use, or if the evidence presented is not credible or otherwise not convincing, it is not unreasonable for the IRS to base its assessment on the entire 10,000 gallons of dyed fuel in the tank.

On the other hand, if the taxpayer does present credible and convincing evidence of its past usage, this evidence can be used by the IRS to infer a pattern of future usage. Thus in the example, if the taxpayer can show that, historically, only 60% of the diesel fuel it dispenses from a bulk tank of dyed fuel is used for nontaxable purposes, it might be reasonable to assess the penalty on 40% (4,000 gallons) of the dyed fuel in the bulk storage tank even though those gallons have not yet been used. Note, however, that this result might not be appropriate if the taxpayer has established a new pattern of usage that is not consistent with its past practices.

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Additionally, another way to use credible and convincing evidence of a taxpayer's past usage is to base the penalty on the use of dyed fuel that the taxpayer has actually used for a taxable purpose. For example, if it is determined that the taxpayer bought and used 100,000 gallons of dyed fuel during the previous year and that, historically, only 60% of the diesel fuel it dispenses from its bulk tank is used for nontaxable purposes, it might be reasonable to assess the penalty on 40% of that amount (40,000 gallons) that was actually used for a taxable use.

Note that the three possible results described in this memorandum are not necessarily the only results that are reasonable in all particular cases. Each case may have different facts and should be resolved on its own merits.

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