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Date:
June 21, 2010

LEGEND:

Taxpayer =

State =

City =

Dear :

This replies to a letter ruling request dated December 11, 2009, together with supplemental information dated May 10, 2010, submitted on your behalf by your authorized representative, requesting rulings under § 4082 and other provisions of the Internal Revenue Code.

The information submitted states that Taxpayer is a State limited liability company that is a registered blender and a Form 720 filer. Taxpayer blends biodiesel with diesel fuel in a facility that is located in City, State, that is several hundred miles from a pipeline, refinery, or terminal. Taxpayer sells fuel to a variety of customers who use the fuel for both taxable and nontaxable uses. Due to its distance from the bulk transfer/terminal system, Taxpayer maintains high minimum inventories. In order to facilitate sales to its customers who are using the fuel for a nontaxable purpose, Taxpayer proposes to purchase undyed diesel fuel at a terminal and store it at its City facility. On a load-by-load basis, Taxpayer proposes to blend biodiesel into the undyed diesel fuel and then dye the mixture by mechanical injection for its customers who use fuel for nontaxable purposes, such as off-highway use and farming. In some instances, Taxpayer also proposes to dye by mechanical injection the undyed diesel fuel that it stores at its City

facility for customers who use the fuel for nontaxable purposes. Taxpayer proposes to sell the dyed fuel to its customers at a tax-exclusive price. Taxpayer then proposes to make a claim with respect to the tax that was imposed upon removal from the terminal for the diesel fuel it mechanically dyes. Such a system would allow Taxpayer to purchase and store only undyed diesel fuel rather than both dyed and undyed diesel fuel.

Taxpayer has requested the following four rulings:

1. Whether Taxpayer is permitted to mechanically inject dye into biodiesel fuel mixtures that it produces (by mixing previously taxed undyed diesel fuel and biodiesel) within its City blending facility prior to sale or removal from that facility, in order to sell the completed blended fuel at a tax-exclusive price to customers who will use the blended fuel for a nontaxable use.

2. Whether Taxpayer is permitted to mechanically inject dye into taxed undyed diesel fuel that it purchases at the terminal rack in order to subsequently sell that fuel at a tax-exclusive price to customers who will use the fuel for a nontaxable use.

3. Whether Taxpayer may make a claim for the tax paid on its purchase of undyed diesel fuel that it uses in its dyed biodiesel mixtures and dyed diesel fuel sales described above.

4. Whether Taxpayer, as a registered ultimate vendor (UV), may claim a credit or payment for its sales of taxed fuels to State and local governments.

LAW

Section 4083(a)(1)(B) provides that the term “taxable fuel” includes diesel fuel.

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

Section 4081(a)(2) provides that the tax rate for diesel fuel is $0.244 per gallon, which includes a $0.001 per gallon Leaking Underground Storage Tank Trust Fund tax (LUST tax).

Section 4081(b)(1) imposes a tax on taxable fuel sold by a blender on the taxable fuel sold or removed by the blender.

Section 48.4081-3(g)(1) of the Manufacturers and Retailers Excise Tax Regulations imposes a tax on the removal or sale of blended taxable fuel by the blender thereof. Tax is computed on the difference between the total number of gallons of blended taxable fuel removed or sold and the number of gallons of previously taxed taxable fuel used to produce the blended taxable fuel. Section 48.4081-3(g)(2) provides that the blender is liable for the tax imposed under § 48.4081-3(g)(1).

Section 4081(e) provides that under regulations prescribed by the Secretary, if any person who paid the tax imposed by § 4081 with respect to any taxable fuel establishes to the satisfaction of the Secretary that a prior tax was paid (and not credited or refunded) with respect to such taxable fuel, then an amount equal to the tax paid by such person shall be allowed as a refund (without interest) to such person in the same manner as if it were an overpayment of tax imposed by § 4081.

Section 4082(a) provides that the tax imposed by § 4081 shall not apply to diesel fuel and kerosene--(1) which the Secretary determines is destined for a nontaxable use, (2) which is indelibly dyed by mechanical injection in accordance with regulations, and (3) which meets such marking requirements (if any) as may be prescribed by the Secretary in regulations.

Section 4082(b)(1) provides that that term “nontaxable use” means any use which is exempt for the tax imposed by § 4041(a)(1) other than by reason of a prior imposition of tax.

Section 4082(f) provides that, except in limited circumstances not relevant here, the exemption from the tax imposed under § 4081 by operation of § 4082 does not include an exemption from the LUST tax.

Section 48.4082-1(b) provides the dye color and concentration requirements for dyeing diesel fuel and kerosene.

Section 48.4082-1T provided guidance on mechanical dye injection requirements. However, application of the temporary regulations was stayed by Section 6 of Notice 2005-80, 2005-2 C.B. 953.

Section 6 of Notice 2005-80 provides temporary guidance for mechanical dye injection requirements. Section 6(b)(1)(i) provides that any means of dyeing by mechanical injection will be deemed to meet the “mechanical injection” requirements of § 4082(a) if the dyeing system includes measures to resist tampering that are consistent with customary business security practices. Section 6(b)(2) provides that a mixture containing diesel fuel or kerosene will be treated as being dyed by mechanical injection if -- (i) the mixture consists of at least 80 percent diesel fuel or kerosene and the remaining portion is a liquid, such as biodiesel, ("other liquid") that is not diesel fuel or kerosene; (ii) the diesel fuel or kerosene in the mixture was dyed by mechanical

injection; (iii) the diesel fuel or kerosene and the other liquid are combined at a facility that is not a terminal; and (iv) the mixture meets the specifications of § 48.4082-1(b) (relating to dye type and concentration) when it is removed from the facility where the diesel fuel or kerosene and the other liquid are combined.

Section 6715 imposes various penalties on the misuse of dyed fuel.

Section 6427(l)(1) provides that except as otherwise provided in §§ 6427(k) and (l), if any diesel fuel or kerosene on which tax has been imposed by § 4041 or § 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 equal to the aggregate amount of tax imposed on such fuel under § 4041 or 4081, as the case may be, reduced by any payment made to the ultimate vendor under § 6427(l)(4)(C)(i).

Section 6427(l)(5)(A) provides that § 6427(l)(1) shall not apply to diesel fuel or kerosene used by a State or local government. Section 6427(l)(5)(C) provides that, except for § 6427(l)(5)(D) (credit card issuers), the amount that would (but for § 6427(l)(5)(A)) have been paid under § 6427(l)(1) with respect to any fuel shall be paid to the ultimate vendor of such fuel, if such vendor (i) is registered under § 4101 and (ii) meets the requirements of § 6416(a)(1)(A), (B) or (D).

Section 48.6427-9 provides rules under which certain registered ultimate vendors of taxed diesel fuel and kerosene may claim the credits or payments allowed by § 6427.

Section 48.6427-9(e)(1)(ii)(B) provides that each claim for credit or payment related to diesel fuel or kerosene that contains visible evidence of dye must include a statement that explains the circumstances under which tax was imposed on that fuel.

ANALYSIS AND CONCLUSIONS

Section 4081(a)(1) imposes a tax on certain removals, entries, and sales of diesel fuel. If tax is paid on the diesel fuel more than once (and not otherwise credited or refunded), a refund may be allowed under § 4081(e) for the “second” tax paid.

The removal or sale of blended diesel fuel by the blender is taxable under § 4081(b). The blender is liable for the tax. Under § 48.4081-3(g), the tax, including the LUST tax, is computed on the difference between the total number of gallons of blended taxable fuel removed or sold and the number of gallons of previously taxed taxable fuel used to produce the blended taxable fuel so that the entire mixture is taxed once.

If a diesel fuel mixture is destined for a nontaxable use, the blender typically purchases diesel fuel that is dyed at the terminal rack. No tax, other than the LUST tax, is imposed upon the removal. The blender then blends the dyed diesel fuel with a previously untaxed liquid and dyes the resulting mixture to the concentration levels specified in

§ 48.4082-1. Under such circumstances, no tax (other than the LUST tax) is imposed when the dyed mixture is sold or removed, provided the requirements of § 4082 are satisfied. Upon the sale or removal of the dyed mixture, the LUST tax applies to the portion of the mixture that was previously untaxed, unless the mixture is destined for a nontaxable use described in § 4082(f)(2).

In this case, Taxpayer has presented two scenarios. Under the first scenario, Taxpayer proposes to dye undyed diesel fuel after it has been removed from the terminal rack and tax has been imposed under § 4081(a)(1)(A). Taxpayer then plans to sell the dyed diesel fuel at a tax-exclusive price. Under the second scenario, Taxpayer proposes to blend undyed diesel fuel (after it has been removed from the terminal rack and tax has been imposed under § 4081(a)(1)(A)) with biodiesel to create a taxable mixture, dye the entire mixture, and then sell or remove the mixture at a tax-exclusive price.

In both scenarios, tax is imposed under § 4081(a)(1)(A) upon removal of the diesel fuel from the terminal rack. Further, in the second scenario, the sale or removal of the diesel fuel mixture will be exempt from the tax imposed under § 4081(b)(1) (except for the LUST tax), provided the requirements of § 4082 are met. We note that in the second scenario, the LUST tax will apply to the portion of the mixture that was previously untaxed, except in limited circumstances not relevant here (See § 4082(f)(2)).

Once tax has been imposed, neither the Code nor the regulations prohibit Taxpayer from adding dye to either diesel fuel or a biodiesel mixture. Accordingly, with regard to Taxpayer's first and second ruling requests, we conclude that Taxpayer may mechanically dye undyed diesel fuel and diesel/biodiesel blends and sell the dyed diesel fuel and dyed blended fuel at whatever price it chooses. However, the dyed diesel fuel and the dyed diesel/biodiesel mixtures will be subject to the penalties under § 6715 if the dyed fuel is sold for use or used in a taxable use.

With regard to Taxpayer's third ruling request, we note that the Code has no mechanism that allows Taxpayer to make a claim for the first tax imposed under § 4081(a)(1)(A) on the removal of diesel fuel from the terminal rack under the scenarios Taxpayer has presented (except for sales to State and local governments, discussed below). Therefore, except as provided below with regard to sales to State and local governments, Taxpayer may not make a claim for the tax imposed under § 4081(a)(1)(A). In addition, Taxpayer may not make a claim under section § 4081(e) because there will be no "second" tax imposed on either the dyed diesel fuel or the dyed diesel/biodiesel mixture.

With regard to Taxpayer's fourth ruling request, we note that § 6427(l)(5)(C) allows registered ultimate vendors to make a claim for a credit or payment for the amount of taxes imposed under § 4081 for its sales of taxed diesel fuel to State and local governments. If the fuel contains dye, § 48.6427-9(e)(1)(ii)(B) requires that each claim

include a statement that explains the circumstances under which tax was imposed on that fuel. In addition, in order to claim a credit or payment, the ultimate vendor must obtain a certification of State use from the State or local government.

In this case, Taxpayer represents that all of the requirements set forth in § 6427(l)(5) will be met. Provided that Taxpayer meets such requirements and provided that, to the extent such fuel is dyed, Taxpayer can establish to the satisfaction of the IRS that such fuel has been taxed, Taxpayer, as an ultimate vendor, may make an excise tax claim on Form 720 or Form 8849 or an income tax claim on Form 4136 for the tax imposed (except the LUST tax) on the fuel sold to State and local governments.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Stephanie N. Bland
Senior Technician Reviewer, Branch 7
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter
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