Section 4081.—Imposition of Tax

26 CFR 48.4081–1: Taxable fuel; definitions.

T.D. 9051

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 40, 48, and 49

Diesel Fuel; Blended Taxable Fuel

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the tax on diesel fuel and the tax on blended taxable fuel. This document also makes clerical and clarifying changes to other excise tax regulations. These regulations affect persons that remove, enter, or sell diesel fuel or remove or sell blended taxable fuel.

DATES: *Effective Date*: These regulations are effective April 2, 2003.

Applicability Date: For date of applicability, see §48.4081–3(g)(2)(ii).

FOR FURTHER INFORMATION CONTACT: Frank Boland, (202) 622–3130 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Manufacturers and Retailers Excise Tax Regulations (26 CFR part 48) relating to the definition of diesel fuel, the definition of refinery, and the application of the tax on blended taxable fuel.

On May 16, 2002, a notice of proposed rulemaking (REG–106457–00, 2002–26 I.R.B. 23 [67 FR 34882]) was published in the **Federal Register**. Written comments were received but no public hearing was requested or held. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

Definition of Diesel Fuel

Existing regulations generally define *diesel fuel* as 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. The proposed regulations would add to existing regulations by providing that a liquid is suitable for use as diesel fuel if the liquid has practical and commercial fitness for use in the propulsion engine of a diesel-powered highway vehicle or diesel-powered train.

One commentator suggested that the final regulations should provide that a liquid does not possess practical and commercial fitness solely by reason of its possible or rare use as a fuel in a vehicle or train. The final regulations adopt this suggestion. The final regulations also provide that a liquid may possess practical and commercial fitness even though the liquid is not predominantly used as a fuel in a vehicle or train.

The commentator also suggested that the final regulations should describe *practical and commercial fitness* in a manner similar to the description of the term in §145.4051–1(a)(4) of the temporary regulations relating to the tax on the retail sale of certain heavy vehicles. The final regulations do not adopt this suggestion because Treasury and the IRS believe that such detail is not required to determine the classification of most liquids.

Definition of Refinery

Under existing regulations, *refinery* generally means a facility used to produce taxable fuel from crude oil, unfinished oils, natural gas liquids, or other hydrocarbons and from which taxable fuel may be removed by pipeline, by vessel, or at a rack. The proposed regulations would remove from the definition the references to the source of materials used to produce taxable fuel.

Taxable fuel includes finished gasoline and certain gasoline blendstocks. One commentator indicated that because gas processing plants and chemical plants produce small amounts of gasoline blendstocks, the plants would be considered refineries under the proposed definition. Thus, the commentator suggested, *refinery* should exclude gas processing plants and chemical plants that mainly produce products other than taxable fuel.

In fact, however, the gas processing plants and chemical plants described by the commentator are refineries under existing regulations. A facility does not lose its status as a refinery simply because it produces only small amounts of gasoline blendstocks. Thus, the final regulations do not adopt the commentator's suggestion.

Liability for Tax on Sale or Removal of Blended Taxable Fuel

Under section 4081(b), tax is imposed on taxable fuel removed or sold by the blender. Blended taxable fuel is taxable fuel that is created by mixing a liquid that has not been taxed with previously taxed taxable fuel. Under existing regulations, the blender is liable for tax on the sale or removal of blended taxable fuel. Generally, the blender is the person that owns the mixture immediately after it is created. Under the proposed regulations, a person would be jointly and severally liable for the tax on blended taxable fuel if the person sells a previously untaxed liquid as a taxed taxable fuel and that liquid becomes a part of a mixture that is blended taxable fuel.

Several commentators suggested that the regulations provide relief for certain unsuspecting blenders. For example, a wholesale distributor of petroleum products might offer to sell undyed diesel fuel (a taxed taxable fuel) to a retailer but actually deliver an untaxed liquid. Even though the retailer bought the liquid in good faith, the retailer would be liable for tax as a blender nevertheless because mixing the untaxed liquid with the preexisting inventory of undyed diesel fuel produces blended taxable fuel. Although the proposed regulations would impose joint and several liability on the dishonest wholesaler, the commentators are concerned that the unsuspecting retailer would still be liable for tax at the discretion of the IRS. To resolve this problem, the commentators generally suggested that the blender should be able to avoid liability for tax if the blender acted reasonably and in good faith when it relied on assurances of the seller as to the status of the liquid it bought.

Treasury and the IRS are concerned that the suggested rule may result in losses to the Highway Trust Fund. If retailers and wholesalers take inconsistent positions regarding the representations made by the wholesaler, the IRS might be unable to establish that either party is liable for the tax. Alternatively, even if the IRS is able to establish the wholesaler's liability, it may be unable to collect the tax from the wholesaler. In either case, the Highway Trust Fund would be inappropriately penalized for the retailer's choice of an untrustworthy supplier. Accordingly, the final regulations do not adopt the suggested rule. Although the final regulations allow the IRS to collect the tax from a person other than the blender in certain circumstances, blenders will remain liable (as under existing regulations) for the tax on the blended fuel.

Other Provisions

The final regulations also make clerical and clarifying changes to other excise tax regulations. For example, in the excise tax procedural regulations, the final regulations remove a redundant sentence. In the regulations relating to the taxes on communication services and air transportation, the final regulations remove obsolete provisions that refer to the district director.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Frank Boland, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, chapter 1 of 26 CFR is amended as follows:

PART 40—EXCISE TAX PROCEDURAL REGULATIONS

1. The authority citation for part 40 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

2. In §40.6302(c)–3, paragraph (d) is amended as follows:

a. The heading is revised.

b. The first sentence is removed.

The revision reads as follows:

§40.6302(c)–3 Special rules for use of Government depositaries under chapter 33.

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(d) *Computation of net amount of tax that is considered as collected during a semimonthly period.* * * *

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PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

3. The authority citation for part 48 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

§48.4041–21 [Amended]

4. Section 48.4041–21, paragraph (b)(1)(i), is amended by adding the language "by the buyer for a taxable use" after "covered by the statement is for use".

5. Section 48.4081–1 is amended as follows:

a. Paragraph (b) is amended by:

1. Removing the language "§48.4041–8(b)" in the definition of *Diesel-powered highway vehicle* and adding "§48.4061(a)–1(d)" in its place.

2. Removing the language "from crude oil, unfinished oils, natural gas liquids, or other hydrocarbons" in the first sentence of the definition of *Refinery*.

b. Paragraph (c)(2)(i) is amended by adding three sentences to the end.

The addition reads as follows:

§48.4081–1 Taxable fuel; definitions.

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(c) * * *

(2) * * * (i) * * * 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.

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6. Section 48.4081–3 is amended by revising paragraphs (g)(2) and (g)(3) to read as follows:

§48.4081–3 Taxable fuel; taxable events other than removal at the terminal rack.

* * * * *

(g) * * *

(2) *Liability for tax*—(i) *Liability of the blender.* The blender is liable for the tax imposed under paragraph (g)(1) of this section.

(ii) *Liability of seller of untaxed liquid.* On and after April 2, 2003, a person that sells any liquid that is used to produce blended taxable fuel is jointly and severally liable for the tax imposed under paragraph (g)(1) of this section on the removal or sale of that blended taxable fuel if the liquid—

(A) Is described in §48.4081–1(c)(1)(i)(B) (relating to liquids on which tax has not been imposed under section 4081); and

(B) Is sold by that person as gasoline, diesel fuel, or kerosene that has been taxed under section 4081.

(3) *Examples.* The following examples illustrate the provisions of this paragraph (g) and the definitions of *blended taxable fuel* and *diesel fuel* in §48.4081–1(c):

Example 1. (i) *Facts.* W is a wholesale distributor of petroleum products and R is a retailer of petroleum products. W sells to R 1,000 gallons of an untaxed liquid (a liquid described in §48.4081–1(c)(1)(i)(B)) and delivers the liquid into a storage tank (tank) at R's retail facility. However, W's invoice to R states that the liquid is undyed diesel fuel. At the time of the delivery, the tank contains 4,000 gallons of undyed diesel fuel, a taxable fuel that has been taxed under section 4081. The resulting 5,000 gallon mixture is suitable for use as a fuel in a diesel-powered highway vehicle because it has practical and commercial fitness for use in the propulsion engine of a diesel-powered highway vehicle. The mixture does not satisfy the dyeing requirements of §48.4082–1. R sells the mixture from the tank to a construction company for off-highway business use.

(ii) *Analysis*—(A) *Production of blended taxable fuel.* R is a blender within the meaning of §48.4081–1 because R has produced blended taxable fuel, as defined in §48.4081–1, by mixing 1,000 gallons of a liquid that has not been taxed under section 4081 with 4,000 gallons of diesel fuel that has been taxed under section 4081. The mixing occurs outside of the bulk transfer/terminal system and the resulting product is diesel fuel because it is suitable for use as a fuel in a diesel-powered highway vehicle.

(B) *Imposition of tax.* Under paragraph (g)(1) of this section, tax is imposed on R's sale of the 5,000 gallons of blended taxable fuel to the construction company. Even though the blended taxable fuel is sold for off-highway business use, which is a nontaxable use as defined in section 4082(b), the sale is not exempt from tax because the blended taxable fuel does not satisfy the dyeing requirements of §48.4082–1. Tax is computed on 1,000 gallons, which is the difference between the number of gallons of blended taxable fuel R sells (5,000) and the number of gallons of previously taxed taxable fuel used to produce the blended taxable fuel (4,000).

(C) *Liability for tax.* R, as the blender, is liable for this tax under paragraph (g)(2)(i) of this section. W is jointly and severally liable for this tax under paragraph (g)(2)(ii) of this section because the blended taxable fuel is produced using an untaxed liquid that W sold as undyed diesel fuel (that is, as diesel fuel that was taxed under section 4081).

Example 2. (i) *Facts.* W, a wholesale distributor of petroleum products, buys 7,000 gallons of diesel fuel at a terminal rack. The diesel fuel is delivered into a tank trailer. Tax is imposed on the diesel fuel under §48.4081–2 when the diesel fuel is removed at the rack. W then goes to another location where X, the operator of a chemical plant, sells W 1,000 gallons of an untaxed liquid (a liquid described in §48.4081–1(c)(1)(i)(B)). However, X's invoice to W states that the liquid is undyed diesel fuel. This liquid is delivered into the tank trailer already containing the 7,000 gallons of diesel fuel. The resulting 8,000 gallon mixture is suitable for use as a fuel in a diesel-powered highway vehicle because it has practical and commercial fitness for use in the propulsion engine of a diesel-powered highway vehicle. The mixture does not satisfy the dyeing requirements of §48.4082–1. W sells the mixture to R, a retailer of petroleum products, and delivers the mixture into a storage tank at R's retail facility. R sells the mixture to its customers.

(ii) *Analysis*—(A) *Production of blended taxable fuel.* W is a blender within the meaning of §48.4081–1 because W has produced blended taxable fuel, as defined in §48.4081–1, by mixing 1,000 gallons of a liquid that has not been taxed under section 4081 with 7,000 gallons of diesel fuel that has been taxed under section 4081. The mixing occurs outside of the bulk transfer/terminal system and the resulting product is diesel fuel because it is suitable for use as a fuel in a diesel-powered highway vehicle. Thus, R has bought blended taxable fuel.

(B) *Imposition of tax.* Under paragraph (g)(1) of this section, tax is imposed on W's sale of the 8,000 gallons of blended taxable fuel to R. Tax is computed on 1,000 gallons, which is the difference between the number of gallons of blended taxable fuel W sells (8,000) and the number of gallons of previously taxed taxable fuel used to produce the blended

taxable fuel (7,000). No tax is imposed on R's subsequent sale of the blended taxable fuel because tax is imposed only with respect to a removal or sale by the blender.

(C) *Liability for tax*. W, as the blender, is liable for this tax under paragraph (g)(2)(i) of this section. X is jointly and severally liable for this tax under paragraph (g)(2)(ii) of this section because the blended taxable fuel is produced using an untaxed liquid that X sold as undyed diesel fuel (that is, as diesel fuel that was taxed under section 4081). R has no liability for tax because R is not a blender and did not sell any untaxed liquid as a taxed taxable fuel. R only sold taxed taxable fuel, the blended taxable fuel bought from W.

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§48.6427–8 [Amended]

7. Section 48.6427–8, paragraph (d), introductory text, is amended by adding "or kerosene" after "diesel fuel".

PART 49—FACILITIES AND SERVICES EXCISE TAXES

8. The authority citation for part 49 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

§49.4291–1 [Amended]

9. Section 49.4291–1 is amended as follows:

a. The language "district director" is removed in the three places it appears and "Commissioner" is added in its place.

b. In the fourth sentence, the language "same district conference" is removed and "same conference" is added in its place.

David A. Mader,
Assistant Deputy Commissioner of Internal Revenue.

Approved March 7, 2003.

Pamela F. Olson,
Assistant Secretary of the Treasury.

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