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Diesel Fuel and Kerosene Excise Tax; Dye Injection

SUMMARY:

This document contains regulations relating to the diesel fuel and kerosene excise tax. These regulations reflect changes made by the American Jobs Creation Act of 2004 regarding mechanical dye injection systems for diesel fuel and kerosene. These regulations affect certain enterers, refiners, terminal operators, and throughputters. The text of the temporary regulation also serves as the text of the proposed regulations (REG-154000-04) set forth in the notice of proposed rulemaking on this subject elsewhere in this issue of the Bulletin.

DATES:

Effective Date: These regulations are effective October 24, 2005.

Background

Section 4081 of the Internal Revenue Code (Code) imposes a tax on certain removals, entries, and sales of diesel fuel and kerosene. However, section 4082(a) provides that the tax is not imposed if the diesel fuel or kerosene (1) is destined for a nontaxable use (as defined in section 4082(b)), (2) is indelibly dyed in accordance with regulations that the Secretary shall prescribe, and (3) meets such marking requirements (if any) as may be prescribed by the Secretary in regulations.

Section 4082(a)(2) was amended by the American Jobs Creation Act of 2004 (the Act) to provide that the diesel fuel and kerosene must be indelibly dyed "by mechanical injection." The Act also requires the Secretary to issue regulations regarding mechanical dye injection systems and to include in the regulations standards for making such systems tamper resistant. The amendments to section 4082(a)(2) are effective on the 180th day after the date on which the Secretary issues such regulations.

The Act also adds new section 6715A, which imposes a penalty on any person that tampers with a mechanical dye injection system and any operator of a mechanical injection system that fails to maintain the security standards for such system in accordance with the regulations.

Explanation of provisions

Under these temporary regulations, diesel fuel or kerosene that is removed from a refinery, terminal, or blending facility is exempt from tax under section 4082(a) only if the required type and amount of dye is added to the fuel by means of a mechanical injection system that is approved by the IRS. Manual (or splash) dyeing is not allowed, even in the case of a malfunction of the mechanical injection system.

Application for approval of mechanical injection systems will be made in the form and manner prescribed by the IRS. It is anticipated that the application process will be similar to the process now in place for applications for registrations under section 4101. It is also anticipated that the IRS will act on such applications within a reasonable time.

Under these temporary regulations, the IRS will approve a mechanical injection system only if it contains adequate calibrated measurement devices, shut-off devices, and security equipment to secure these devices and other access points.

Generally, the security equipment must consist of either a "seal" system or a "lock box" system. The "seal" system requires that a seal be attached to each measuring device, each shut-off device, and any other access point to the mechanical injection system. The seals must secure the devices from tampering and, if necessary, may be accompanied by locks to ensure the necessary security. The

alternative to the “seal” system is the “lock box” system, which allows the operator to use one secured container, or box, to control access to each measuring device, each shut-off device, and any other access point to the mechanical injection system. Such container may be transparent for ease of satisfying the inspection requirements. If the “lock box” system is used, the container must be secured by a seal that satisfies all of the “seal” requirements. Each seal, whether it secures a “lock box” or attaches to an access point, must be separately identifiable by a numbering or coding system maintained by the terminal operator. In all cases, the type of allowable seal may be prescribed by the IRS. These temporary regulations also set out ongoing duties of the operator of an approved mechanical injection system to maintain the system’s security standards and to keep certain records. However, no particular form for the records is prescribed.

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 flexibility 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. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 48 and 602 are amended as follows:

PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Paragraph 1. The authority citation for part 48 is amended by adding an entry in numerical order to read, in part, as follows:

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

Section 48.4082-1T also issued under 26 U.S.C. 4082(a). * * *

Par. 2. Section 48.4082-1 is amended by revising paragraphs (d) and (e) to read as follows:

§48.4082-1 Diesel fuel and kerosene; exemption for dyed fuel.

* * * * *

(d) [Reserved]. For further guidance, see §48.4082-1T(d).

(e) Effective date—(1) Except as provided in paragraph (e)(2) of this section, this section is applicable March 14, 1996.

(2) [Reserved] For further guidance, see §48.4082-1T(e)(2).

Par. 3. Section 48.4082-1T is added to read as follows:

§48.4082-1T Diesel fuel and kerosene; exemption for dyed fuel (temporary).

(a) through (c) [Reserved]. For further guidance, see §48.4082-1(a) through (c).

(d) Time and method for adding dye—(1) In general. Except as provided by paragraph (d)(6) of this section, diesel fuel or kerosene satisfies the dyeing requirements of this paragraph (d) only if the dye required by §48.4082-1(b) is combined with the diesel fuel or kerosene by means of a mechanical injection system that is approved by the Commissioner for use at the facility where the dyeing occurs. Application for approval must be made in the form and manner required by the Commissioner. Rules similar to the rules of §48.4101-1(g) apply to the Commissioner’s action on the applications.

(2) Mechanical injection system; requirements. The Commissioner will approve a mechanical injection system only if—

- (i) The system has features that automatically inject an amount of dye that satisfies the concentration requirements of §48.4082-1(b) into diesel fuel or kerosene as the diesel fuel or kerosene is delivered from the bulk transfer/terminal system into the transport compartment of a truck, trailer, railroad car, or other means of nonbulk transfer;
 - (ii) The system has calibrated devices that accurately measure and record the amount of dye and the amount of diesel fuel and kerosene that is dispensed for each removal;
 - (iii) The system has automatic shut-off devices that prevent the removal of more than 100 gallons of undyed diesel fuel or kerosene in the case of a system malfunction;
 - (iv) The system is secured by either—
 - (A) Unbroken seals that are issued, installed, and maintained by the terminal operator and secure the measurement devices, shut-off devices, and other access points to the injection system; or
 - (B) A secured container that controls access to the measurement devices, shut-off devices, and other access points and is secured by an unbroken seal issued, installed, and maintained by the terminal operator;
 - (v) Each seal securing the system bears a unique identifying number or code and is produced in a manner that provides adequate assurance against duplication; and
 - (vi) The operator of the facility has written procedures in place for complying with its duty, described in paragraph (d)(4) of this section, to maintain the system's security standards.
- (3) Mechanical injection system; basis for approval. In determining whether to approve a mechanical injection system, the Commissioner will take into account the individual circumstances of each facility, including local fire and safety codes, to ensure that the cost of acquiring and maintaining the appropriate levels of security are reasonable for that facility.
- (4) Mechanical injection system; duty of the operator of a mechanical injection system to maintain the system's security standards. Each operator of a mechanical injection system must—
- (i) Maintain a record for each seal, including its identifying number or code, the location of the seal, the date(s) on which the seal was issued and installed, and the reason for the installation;
 - (ii) Visually inspect each installed seal not less than once during every 24 hour period to ascertain that each seal and lock mechanism, if applicable, has not been physically altered;
 - (iii) Check the identifying number or code for each seal against the records maintained by the terminal operator no less frequently than once during each seven day period and record each inspection and verification;
 - (iv) Promptly notify the Commissioner if inspection of a seal reveals any inconsistency in the records pertaining to that seal, or if the seal has been damaged or removed (other than a removal authorized by the operator for testing or maintenance);
 - (v) Maintain a record of each seal that has been replaced to include the seal number or code, the date the seal was issued, the location of the seal, the date the seal was replaced, and the reason the seal was replaced;
 - (vi) Promptly destroy and replace seals that have been removed from the system;
 - (vii) Restrict access to unused seal inventory to individuals specifically designated by the operator and maintain a record of such individuals;
 - (viii) Maintain a record of each installation, inspection, and destruction described in this paragraph (d)(4), including the name of the individual who conducts the installation, inspection, or destruction;
 - (ix) Make available for the Commissioner's immediate inspection the seals and records described in this paragraph (d)(4); and

(x) Promptly notify the Commissioner if, and when, the dye injection system is placed out of service.

(5) Mechanical injection system; revocation or suspension of approval. The Commissioner may revoke or suspend its approval of a dye injection system if the Commissioner determines that the system does not meet the standards of paragraph (d)(2) of this section or if the operator of the system has not complied with the requirements of paragraph (d)(4) of this section.

(6) Sales and entries. For purposes of determining whether tax is imposed by section 4081 on a sale or entry of diesel fuel or kerosene, such fuel satisfies the dyeing requirements of this paragraph (d) only if the dye required by §48.4082-1(b) is combined with the fuel before the sale or entry and the seller or enterer has in its records evidence (such as a certificate from the terminal operator providing the fuel) establishing that the dye was combined with the fuel by means of a mechanical injection system. Thus, for example, diesel fuel or kerosene that is entered into the United States by means of nonbulk transfer (such as a railroad car) does not satisfy the requirements of this paragraph (d) if the required dye and marker are combined with diesel fuel or kerosene after the diesel fuel or kerosene has been entered into the United States.

(7) Cross reference. For the penalty relating to mechanical dye injection systems, see section 6715A.

(e) and (e)(1) [Reserved]. For further guidance, see §48.4082-1(e) and (e)(1).

(2) This section is applicable on October 24, 2005.

Par. 4. Section 48.4101-1 is amended by revising paragraph (h)(3)(iv) to read as follows:

§48.4101-1 Taxable fuel; registration.

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(h) * * *

(3) * * *

(iv) [Reserved]. For further guidance, see §48.4101-1T(h)(3)(iv).

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Par. 5. Section 48.4101-1T is added to read as follows:

§48.4101-1T Taxable fuel; registration (temporary).

(a) through (h)(3)(iii) [Reserved]. For further guidance, see §48.4101-1(a) through (h)(3)(iii).

(iv) Retention of information. In addition to any other requirement relating to the retention of records, the terminal operator must—

(A) Maintain the information described in §48.4101-1(h)(3)(ii) at the terminal from which the removal occurred for at least 3 months after the removal to which it relates in the case of information relating to removals before January 1, 2006, and at least 12 months after the removal to which it relates in the case of information relating to removals after December 31, 2005; and

(B) Maintain the information described in §48.4101-1(h)(3)(iii) at the terminal where the dye was received for at least 3 months after the receipt in the case of receipts before January 1, 2006, and at least 12 months after the receipt in the case of receipts after December 31, 2005.

(h)(3)(v) through (l) [Reserved]. For further guidance, see § 48.4101-1(h)(3)(v) through (l).