

**DESCRIPTION OF  
“THE HIGHWAY REAUTHORIZATION TAX ACT OF 2004”**

Scheduled for Markup  
By the  
HOUSE COMMITTEE ON WAYS AND MEANS  
on March 17, 2004

Prepared by  
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## CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
I. RESTRUCTURING OF INCENTIVES FOR ALCOHOL FUELS, ETC.....	2
A. Reduced Rates of Tax on Alcohol Fuel Mixtures Replaced With An Excise Tax Credit, Etc. ....	2
II. REDUCTION OF FUEL TAX EVASION .....	9
A. Exemption from Certain Excise Taxes for Mobile Machinery Vehicles.....	9
B. Taxation of Aviation-Grade Kerosene .....	11
C. Dye Injection Equipment .....	17
D. Authority to Inspect On-Site Records.....	20
E. Registration and Reporting Requirements .....	21
1. Registration of pipeline or vessel operators required for exemption of bulk transfers to registered terminals or refineries.....	21
2. Display of registration and penalties for failure to display registration and to register.....	22
3. Penalties for failure to report .....	23
F. Collection from Customs Bond Where Importer Not Registered.....	24
G. Modification of the Use Tax on Heavy Highway Vehicles .....	26
H. Modification of Ultimate Vendor Refund Claims with Respect to Farming.....	27
I. Dedication of Revenue from Certain Penalties to the Highway Trust Fund .....	28
III. OTHER HIGHWAY EXCISE TAX PROVISIONS .....	29
A. Taxable Fuel Refunds for Certain Ultimate Vendors .....	29
B. Two-Party Exchanges .....	31
C. Simplification of Tax on Tires .....	32

## INTRODUCTION

The House Committee on Ways and Means has scheduled a markup on March 17, 2004. This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a description of “The Highway Reauthorization Tax Act of 2004”.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of “The Highway Reauthorization Tax Act of 2004”* (JCX-20-04), March 15, 2004.

## **I. RESTRUCTURING OF INCENTIVES FOR ALCOHOL FUELS, ETC.**

### **A. Reduced Rates of Tax on Alcohol Fuel Mixtures Replaced With An Excise Tax Credit, Etc.**

#### **Present Law**

##### **Alcohol fuels income tax credit**

The alcohol fuels credit is the sum of three credits: the alcohol mixture credit, the alcohol credit, and the small ethanol producer credit. Generally, the alcohol fuels credit expires after December 31, 2007.<sup>2</sup>

A taxpayer (generally a petroleum refiner, distributor, or marketer) who mixes ethanol with gasoline (or a special fuel<sup>3</sup>) is an “ethanol blender.” Ethanol blenders are eligible for an income tax credit of 52 cents per gallon of ethanol used in the production of a qualified mixture (the “alcohol mixture credit”). A qualified mixture means a mixture of alcohol and gasoline, (or of alcohol and a special fuel) sold by the blender as fuel, or used as fuel by the blender in producing the mixture. The term alcohol includes methanol and ethanol but does not include (1) alcohol produced from petroleum, natural gas, or coal (including peat), or (2) alcohol with a proof of less than 150. Businesses also may reduce their income taxes by 52 cents for each gallon of ethanol (not mixed with gasoline or other special fuel) that they sell at the retail level as vehicle fuel or use themselves as a fuel in their trade or business (“the alcohol credit”). The 52-cents-per-gallon income tax credit rate is scheduled to decline to 51 cents per gallon during the period 2005 through 2007. For blenders using an alcohol other than ethanol, the rate is 60 cents per gallon.<sup>4</sup>

A separate income tax credit is available for small ethanol producers (the “small ethanol producer credit”). A small ethanol producer is defined as a person whose ethanol production capacity does not exceed 30 million gallons per year. The small ethanol producer credit is 10 cents per gallon of ethanol produced during the taxable year for up to a maximum of 15 million gallons.

The credits that comprise the alcohol fuels tax credit are includible in income. The credit may not be used to offset alternative minimum tax liability. The credit is treated as a general

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<sup>2</sup> The alcohol fuels credit is unavailable when, for any period before January 1, 2008, the tax rates for gasoline and diesel fuels drop to 4.3 cents per gallon.

<sup>3</sup> A special fuel includes any liquid (other than gasoline) that is suitable for use in an internal combustion engine.

<sup>4</sup> In the case of any alcohol (other than ethanol) with a proof that is at least 150 but less than 190, the credit is 45 cents per gallon (the “low-proof blender amount”). For ethanol with a proof that is at least 150 but less than 190, the low-proof blender amount is 38.52 cents for sales or uses during calendar year 2004, and 37.78 cents for calendar years 2005, 2006, and 2007.

business credit, subject to the ordering rules and carryforward/carryback rules that apply to business credits generally.

**Excise tax reductions for alcohol mixture fuels**

Generally, motor fuels tax rates are as follows:<sup>5</sup>

Gasoline	18.3 cents per gallon
Diesel fuel and kerosene	24.3 cents per gallon
Special motor fuels	18.3 cents per gallon generally

Alcohol-blended fuels are subject to a reduced rate of tax. The benefits provided by the alcohol fuels income tax credit and the excise tax reduction are integrated such that the alcohol fuels credit is reduced to take into account the benefit of any excise tax reduction.

Gasohol

Registered ethanol blenders may forgo the full income tax credit and instead pay reduced rates of excise tax on gasoline that they purchase for blending with ethanol. Most of the benefit of the alcohol fuels credit is claimed through the excise tax system.

The reduced excise tax rates apply to gasohol upon its removal or entry. Gasohol is defined as a gasoline/ethanol blend that contains 5.7 percent ethanol, 7.7 percent ethanol, or 10 percent ethanol. For the calendar year 2004, the following reduced rates apply to gasohol:<sup>6</sup>

5.7 percent ethanol	15.436 cents per gallon
7.7 percent ethanol	14.396 cents per gallon
10.0 percent ethanol	13.200 cents per gallon

Reduced excise tax rates also apply when gasoline is being purchased for the production of “gasohol.” When gasoline is purchased for blending into gasohol, the rates above are multiplied by a fraction (*e.g.*, 10/9 for 10-percent gasohol) so that the increased volume of motor fuel will be subject to tax. The reduced tax rates apply if the person liable for the tax is registered with the IRS and (1) produces gasohol with gasoline within 24 hours of removing or

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<sup>5</sup> These fuels are also subject to an additional 0.1 cent-per-gallon excise tax to fund the Leaking Underground Storage Tank Trust Fund. See secs. 4041(d) and 4081(a)(2)(B). In addition, the basic fuel tax rate will drop to 4.3 cents per gallon beginning on October 1, 2005.

<sup>6</sup> These rates include the additional 0.1 cent-per-gallon excise tax to fund the Leaking Underground Storage Tank Trust Fund. These special rates will terminate after September 30, 2007 (sec. 4081(c)(8)).

entering the gasoline or (2) gasoline is sold upon its removal or entry and such person has an unexpired certificate from the buyer and has no reason to believe the certificate is false.<sup>7</sup>

#### Qualified methanol and ethanol fuels

Qualified methanol or ethanol fuel is any liquid that contains at least 85 percent methanol or ethanol or other alcohol produced from a substance other than petroleum or natural gas. These fuels are taxed at reduced rates.<sup>8</sup> The rate of tax on qualified methanol is 12.35 cents per gallon. The rate on qualified ethanol in 2004 is 13.15 cents. From January 1, 2005, through September 30, 2007, the rate of tax on qualified ethanol is 13.25 cents.

#### Alcohol produced from natural gas

A mixture of methanol, ethanol, or other alcohol produced from natural gas that consists of at least 85 percent alcohol is also taxed at reduced rates.<sup>9</sup> For mixtures not containing ethanol, the applicable rate of tax is 9.25 cents per gallon before October 1, 2005. In all other cases, the rate is 11.4 cents per gallon. After September 30, 2005, the rate is reduced to 2.15 cents per gallon when the mixture does not contain ethanol and 4.3 cents per gallon in all other cases.

#### Blends of alcohol and diesel fuel or special motor fuels

A reduced rate of tax applies to diesel fuel or kerosene that is combined with alcohol as long as at least 10 percent of the finished mixture is alcohol. If none of the alcohol in the mixture is ethanol, the rate of tax is 18.4 cents per gallon. For alcohol mixtures containing ethanol, the rate of tax in 2004 is 19.2 cents per gallon and for 2005 through September 30, 2007, the rate for ethanol mixtures is 19.3 cents per gallon. Fuel removed or entered for use in producing a 10 percent diesel-alcohol fuel mixture (without ethanol), is subject to a tax of 20.44 cents per gallon. The rate of tax for fuel removed or entered to produce a 10 percent diesel-ethanol fuel mixture is 21.333 cents per gallon for 2004 and 21.444 cents per gallon for the period January 1, 2005, through September 30, 2007.<sup>10</sup>

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<sup>7</sup> Treas. Reg. sec. 48.4081-6(c). A certificate from the buyer assures that the gasoline will be used to produce gasohol within 24 hours after purchase. A copy of the registrant's letter of registration cannot be used as a gasohol blender's certificate.

<sup>8</sup> These reduced rates terminate after September 30, 2007. Included in these rates is the 0.05-cent-per-gallon Leaking Underground Storage Tank Trust Fund tax imposed on such fuel. (sec. 4041(b)(2)).

<sup>9</sup> These rates include the additional 0.1 cent-per-gallon excise tax to fund the Leaking Underground Storage Tank Trust Fund (sec. 4041(d)(1)).

<sup>10</sup> These rates include the additional 0.1 cent-per-gallon excise tax to fund the Leaking Underground Storage Tank Trust Fund.

Special motor fuel (nongasoline) mixtures with alcohol also are taxed at reduced rates.

### Aviation fuel

Noncommercial aviation fuel is subject to a tax of 21.9 cents per gallon.<sup>11</sup> Fuel mixtures containing at least 10 percent alcohol are taxed at lower rates.<sup>12</sup> In the case of 10 percent ethanol mixtures, any sale or use during 2004, the 21.9 cents is reduced by 13.2 cents (for a tax of 8.7 cents per gallon), for 2005, 2006, and 2007 the reduction is 13.1 cents (for a tax of 8.8 cents per gallon) and is reduced by 13.4 cents in the case of any sale during 2008 or thereafter. For mixtures not containing ethanol, the 21.9 cents is reduced by 14 cents for a tax of 7.9 cents. These reduced rates expire after September 30, 2007.<sup>13</sup>

When aviation fuel is purchased for blending with alcohol, the rates above are multiplied by a fraction (10/9) so that the increased volume of aviation fuel will be subject to tax.

### **Refunds and payments**

If fully taxed gasoline (or other taxable fuel) is used to produce a qualified alcohol mixture, the Code permits the blender to file a claim for a quick excise tax refund. The refund is equal to the difference between the gasoline (or other taxable fuel) excise tax that was paid and the tax that would have been paid by a registered blender on the alcohol fuel mixture being produced. Generally, the IRS pays these quick refunds within 20 days. Interest accrues if the refund is paid more than 20 days after filing. A claim may be filed by any person with respect to gasoline, diesel fuel, or kerosene used to produce a qualified alcohol fuel mixture for any period for which \$200 or more is payable and which is not less than one week.

### **Ethyl tertiary butyl ether (ETBE)**

Ethyl tertiary butyl ether (“ETBE”) is an ether that is manufactured using ethanol. Unlike ethanol, ETBE can be blended with gasoline before the gasoline enters a pipeline because ETBE does not result in contamination of fuel with water while in transport. Treasury regulations provide that gasohol blenders may claim the income tax credit and excise tax rate reductions for ethanol used in the production of ETBE. The regulations also provide a special election allowing refiners to claim the benefit of the excise tax rate reduction even though the fuel being removed from terminals does not contain the requisite percentages of ethanol for claiming the excise tax rate reduction.

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<sup>11</sup> This rate includes the additional 0.1 cent-per-gallon tax for the Leaking Underground Storage Tank Trust fund.

<sup>12</sup> Secs. 4041(k)(1) and 4091(c).

<sup>13</sup> Sec. 4091(c)(1).

## **Highway Trust Fund**

With certain exceptions, the taxes imposed by section 4041 (relating to retail taxes on diesel fuels and special motor fuels) and section 4081 (relating to tax on gasoline, diesel fuel and kerosene) are credited to the Highway Trust Fund. In the case of alcohol fuels, 2.5 cents per gallon of the tax imposed is retained in the General Fund.<sup>14</sup> In the case of a taxable fuel taxed at a reduced rate upon removal or entry prior to mixing with alcohol, 2.8 cents of the reduced rate is retained in the General Fund.<sup>15</sup>

## **Taxes from gasoline and special motor fuels used in motorboats and gasoline used in the nonbusiness use of small-engine outdoor power equipment**

The Aquatic Resources Trust Fund is funded by a portion of the receipts from the excise tax imposed on motorboat gasoline and special motor fuels, as well as small-engine fuel taxes, that are first deposited into the Highway Trust Fund. As a result, transfers to the Aquatic Resources Trust Fund are governed in part by Highway Trust Fund provisions.<sup>16</sup>

A total tax rate of 18.4 cents per gallon is imposed on gasoline and special motor fuels used in motorboats. Of this rate, 0.1 cent per gallon is dedicated to the Leaking Underground Storage Tank Trust Fund. Of the remaining 18.3 cents per gallon, the Code currently transfers 13.5 cents per gallon from the Highway Trust Fund to the Aquatics Resources Trust Fund and Land and Water Conservation Fund. The remainder, 4.8 cents per gallon, is retained in the General Fund. In addition, the Sport Fish Restoration Account of the Aquatics Resources Trust Fund receives 13.5 cents per gallon of the revenues from the tax imposed on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment. The balance of 4.8 cents per gallon is retained in the General Fund.<sup>17</sup>

## **Description of Proposal**

### **Overview**

The proposal eliminates reduced rates of excise tax for alcohol-blended fuels and imposes the full rate of excise tax on alcohol-blended fuels (18.4 cents per gallon on gasoline blends and 24.4 cents per gallon of diesel blended fuel). In place of reduced rates, the proposal permits the section 40 alcohol mixture credit, with certain modifications, to be applied against excise tax liability. The credit may be taken against the tax imposed on taxable fuels (by section 4081). To the extent a person does not have section 4081 liability, the proposal allows taxpayers to file a claim for payment equal to the amount of the credit for the alcohol used to produce an eligible

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<sup>14</sup> Sec. 9503(b)(4)(E).

<sup>15</sup> Sec. 9503(b)(4)(F).

<sup>16</sup> Sec. 9503(c)(4) and 9503(c)(5).

<sup>17</sup> The Sport Fish Restoration Account also is funded with receipts from an *ad valorem* manufacturer's excise tax on sport fishing equipment.

mixture. Under certain circumstances, a tax is imposed if an alcohol fuel mixture credit is claimed with respect to alcohol used in the production of any alcohol mixture, which is subsequently used for a purpose for which the credit is not allowed or changed into a substance that does not qualify for the credit. The proposal eliminates the General Fund retention of certain taxes on alcohol fuels, and credits these taxes to the Highway Trust Fund.

### **Alcohol fuel mixture excise tax credit and payment provisions**

#### Alcohol fuel mixture excise tax credit

The proposal eliminates the reduced rates of excise tax for alcohol-blended fuels and taxable fuels used to produce an alcohol fuel mixture. Under the proposal, the full rate of tax for taxable fuels is imposed on both alcohol fuel mixtures and the taxable fuel used to produce an alcohol fuel mixture.

In lieu of the reduced excise tax rates, the proposal provides that the alcohol mixture credit provided under section 40 may be applied against section 4081 excise tax liability (hereinafter referred to as “the alcohol fuel mixture credit”). The credit is treated as a payment of the taxpayer’s tax liability received at the time of the taxable event. The alcohol fuel mixture credit is 52 cents for each gallon of alcohol used by a person in producing an alcohol fuel mixture for sale or use in a trade or business of the taxpayer. The credit declines to 51 cents per gallon after calendar year 2004. For mixtures not containing ethanol (renewable source methanol), the credit is 60 cents per gallon. As discussed further below, the excise tax credit is refundable.

For purposes of the alcohol fuel mixture credit, an “alcohol fuel mixture” is a mixture of alcohol and gasoline or alcohol and a special fuel which is sold for use or used as a fuel by the taxpayer producing the mixture. Alcohol for this purpose includes methanol, ethanol, and alcohol gallon equivalents of ETBE or other ethers produced from such alcohol. It does not include alcohol produced from petroleum, natural gas, or coal (including peat), or alcohol with a proof of less than 190 (determined without regard to any added denaturants). Special fuel is any liquid fuel (other than gasoline) which is suitable for use in an internal combustion engine. The benefit obtained from the excise tax credit is coordinated with the alcohol fuels income tax credit. For refiners making an alcohol fuel mixture with ETBE, the mixture is treated as sold to another person for use as a fuel only upon removal from the refinery. The excise tax credit is available through September 30, 2007.

#### Payments with respect to qualified alcohol fuel mixtures

To the extent the alcohol fuel mixture credit exceeds any section 4081 liability of a person, the Secretary is to pay such person an amount equal to the alcohol fuel mixture credit with respect to such mixture. These payments are intended to provide an equivalent benefit to replace the partial exemption for fuels to be blended with alcohol and alcohol fuels being repealed by the proposal. If claims for payment are not paid within 45 days, the claim is to be paid with interest. The provision also provides that in the case of an electronic claim, if such claim is not paid within 20 days, the claim is to be paid with interest. If claims are filed electronically, the claimant may make a claim for less than \$200.

The proposal does not apply with respect to alcohol fuel mixtures sold after September 30, 2007.

### **Alcohol fuel subsidies borne by General Fund**

The proposal eliminates the requirement that 2.5 and 2.8 cents per gallon of excise taxes be retained in the General Fund with the result that the full amount of tax on alcohol fuels is credited to the Highway Trust Fund. The proposal also authorizes the full amount of fuel taxes to be appropriated to the Highway Trust Fund without reduction for amounts equivalent to the excise tax credits allowed for alcohol fuel mixtures and the Trust Fund is not required to reimburse any payments with respect to qualified alcohol fuel mixtures.

### **Motorboat and small engine fuel taxes**

The proposal eliminates the General Fund retention of the 4.8 cents per gallon of the taxes imposed on gasoline and special motor fuels used in motorboats and gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment.

### **Effective Dates**

The proposals generally are effective for fuel sold or used after September 30, 2004. The repeal of the General Fund retention of the 2.5/2.8 cents per gallon of tax regarding alcohol fuels and the repeal of the 4.8 cents per gallon General Fund retention of the taxes imposed on fuels used in motorboats and small engine equipment is effective for taxes imposed after September 30, 2003. The proposal regarding the crediting of the full amount of tax to the Highway Trust Fund without regard to credits and payments is effective for taxes received after September 30, 2004 and payments made after September 30, 2004.

## II. REDUCTION OF FUEL TAX EVASION

### A. Exemption from Certain Excise Taxes for Mobile Machinery Vehicles

#### Present Law

Under present law, the definition of a “highway vehicle” affects the application of the retail tax on heavy vehicles, the heavy vehicle use tax, the tax on tires, and fuel taxes.<sup>18</sup> Section 4051 of the Code provides for a 12-percent retail sales tax on tractors, heavy trucks with a gross vehicle weight (“GVW”) over 33,000 pounds, and trailers with a GVW over 26,000 pounds. Section 4071 provides for a tax on highway vehicle tires that weigh more than 40 pounds, with higher rates of tax for heavier tires. Section 4481 provides for an annual use tax on heavy vehicles with a GVW of 55,000 pounds or more, with higher rates of tax on heavier vehicles. All of these excise taxes are paid into the Highway Trust Fund.

Federal excise taxes are also levied on the motor fuels used in highway vehicles. Gasoline is subject to a tax of 18.4 cents per gallon, of which 18.3 cents per gallon is paid into the Highway Trust Fund and 0.1 cents per gallon is paid into the Leaking Underground Storage Tank (“LUST”) Trust Fund. Highway diesel fuel is subject to a tax of 24.4 cents per gallon, of which 24.3 cents per gallon is paid into the Highway Trust Fund and 0.1 cents per gallon is paid into the LUST Trust Fund.

The Code does not define a “highway vehicle.” For purposes of these taxes, Treasury regulations define a highway vehicle as any self-propelled vehicle or trailer or semitrailer designed to perform a function of transporting a load over the public highway, whether or not also designed to perform other functions. Excluded from the definition of highway vehicle are (1) certain specially designed mobile machinery vehicles for non-transportation functions (the “mobile machinery exception”); (2) certain vehicles specially designed for off-highway transportation for which the special design substantially limits or impairs the use of such vehicle to transport loads over the highway (the “off-highway transportation vehicle” exception); and (3) certain trailers and semi-trailers specially designed to function only as an enclosed stationary shelter for the performance of non-transportation functions off the public highways.<sup>19</sup>

The mobile machinery exception applies if three tests are met: (1) the vehicle consists of a chassis to which jobsite machinery (unrelated to transportation) has been permanently mounted; (2) the chassis has been specially designed to serve only as a mobile carriage and mount for the particular machinery and (3) by reason of such special design, the chassis could not, without substantial structural modification, be used to transport a load other than the particular machinery. An example of a mobile machinery vehicle is a crane mounted on a truck chassis.

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<sup>18</sup> Secs. 4051, 4071, 4481, 4041 and 4081.

<sup>19</sup> See Treas. Reg. sec. 48.4061-1(d).

On June 6, 2002, the Treasury Department put forth proposed regulations that would eliminate the mobile machinery exception.<sup>20</sup> The other exceptions from the definition of highway vehicle would continue to apply with some modifications. Under the proposed regulations, the chassis of a mobile machinery vehicle would be subject to the retail sales tax on heavy vehicles unless the vehicle qualified under the off-highway transportation vehicle exception. Also, under the proposed regulations, mobile machinery vehicles may be subject to the heavy vehicle use tax. In addition, the tax credits, refunds, and exemptions from tax may not be available for the fuel used in these vehicles.

### **Description of Proposal**

The proposal codifies the present-law mobile machinery exemption for purposes of three taxes: the retail tax on heavy vehicles, the heavy vehicle use tax, and the tax on tires. Thus, if a vehicle can satisfy the three-part test, it will not be treated as a highway vehicle and will be exempt from these taxes.

Fuel taxes for mobile machinery vehicles must be paid and then a refund sought if certain conditions are met. Specifically, in addition to the three-part design test, the vehicle must not have traveled more than 5,000 miles over public highways during the owner's taxable year. Refunds of fuel taxes are permitted on an annual basis only. For purposes of this rule, a person's taxable year is his taxable year for income tax purposes.

### **Effective Date**

The proposal generally is effective after the date of enactment. As to the fuel taxes, the proposal is effective for taxable years beginning after the date of enactment.

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<sup>20</sup> Prop. Treas. Reg. sec. 48.4051-1(a), 67 Fed. Reg. 38913, 38914-38915 (2002).

## **B. Taxation of Aviation-Grade Kerosene**

### **Present Law**

#### **In general**

Aviation fuel is kerosene and any liquid (other than any product taxable under section 4081) that is suitable for use as a fuel in an aircraft.<sup>21</sup> Unlike other fuels that generally are taxed upon removal from a terminal rack,<sup>22</sup> aviation fuel is taxed upon sale of the fuel by a producer or importer.<sup>23</sup> Sales by a registered producer to another registered producer are exempt from tax, with the result that, as a practical matter, aviation fuel is not taxed until the fuel is used at the airport. Use of untaxed aviation fuel by a producer is treated as a taxable sale.<sup>24</sup> The producer or importer is liable for the tax. The rate of tax on aviation fuel is 21.9 cents per gallon.<sup>25</sup>

The tax on aviation fuel is reported by filing Form 720 - Quarterly Federal Excise Tax Return. Generally, semi-monthly deposits are required using Form 8109B - Federal Tax Deposit Coupon or by depositing the tax by electronic funds transfer.

#### **Partial exemptions**

In general, aviation fuel sold for use or used in commercial aviation is taxed at a reduced rate of 4.4 cents per gallon.<sup>26</sup> Commercial aviation means any use of an aircraft in a business of transporting persons or property for compensation or hire by air (unless the use is allocable to any transportation exempt from certain excise taxes).<sup>27</sup>

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<sup>21</sup> Sec. 4093(a).

<sup>22</sup> A rack is a mechanism capable of delivering taxable fuel into a means of transport other than a pipeline or vessel. Treas. Reg. sec. 48.4081-1(b).

<sup>23</sup> Sec. 4091(a)(1).

<sup>24</sup> Sec. 4091(a)(2).

<sup>25</sup> Sec. 4091(b). This rate includes a 0.1 cent per gallon Leaking Underground Storage Tank ("LUST") Trust Fund tax. The LUST Trust Fund tax is set to expire after March 31, 2005, with the result that on April 1, 2005, the tax rate is scheduled to be 21.8 cents per gallon. Secs. 4091(b)(3)(B) and 4081(d)(3). Beginning on October 1, 2007, the rate of tax is reduced to 4.3 cents per gallon. Sec. 4091(b)(3)(A).

<sup>26</sup> Sec. 4092(b). The 4.4 cent rate includes 0.1 cent per gallon that is attributable to the LUST Trust Fund financing rate. A full exemption, discussed below, applies to aviation fuel that is sold for use in commercial aviation as fuel supplies for vessels or aircraft, which includes use by certain foreign air carriers and for the international flights of domestic carriers. Secs. 4092(a), 4092(b), and 4221(d)(3).

<sup>27</sup> Secs. 4092(b) and 4041(c)(2).

In order to qualify for the 4.4 cents per gallon rate, the person engaged in commercial aviation must be registered with the Secretary<sup>28</sup> and provide the seller with a written exemption certificate stating the airline's name, address, taxpayer identification number, registration number, and intended use of the fuel. A person that is registered as a buyer of aviation fuel for use in commercial aviation generally is assigned a registration number with a "Y" suffix (a "Y" registrant), which entitles the registrant to purchase aviation fuel at the 4.4 cents per gallon rate.

Large commercial airlines that also are producers of aviation fuel qualify for registration numbers with an "H" suffix. As producers of aviation fuel, "H" registrants may buy aviation fuel tax free pursuant to a full exemption that applies to sales of aviation fuel by a registered producer to a registered producer. If the "H" registrant ultimately uses such untaxed fuel in domestic commercial aviation, the H registrant is liable for the aviation fuel tax at the 4.4 cents per gallon rate.

### **Exemptions**

Aviation fuel sold by a producer or importer for use by the buyer in a nontaxable use is exempt from the excise tax on sales of aviation fuel.<sup>29</sup> To qualify for the exemption, the buyer must provide the seller with a written exemption certificate stating the buyer's name, address, taxpayer identification number, registration number (if applicable), and intended use of the fuel.

Nontaxable uses include: (1) use other than as fuel in an aircraft (such as use in heating oil); (2) use on a farm for farming purposes; (3) use in a military aircraft owned by the United States or a foreign country; (4) use in a domestic air carrier engaged in foreign trade or trade between the United States and any of its possessions;<sup>30</sup> (5) use in a foreign air carrier engaged in foreign trade or trade between the United States and any of its possessions (but only if the foreign carrier's country of registration provides similar privileges to United States carriers); (6) exclusive use of a State or local government; (7) sales for export, or shipment to a United States possession; (8) exclusive use by a nonprofit educational organization; (9) use by an aircraft museum exclusively for the procurement, care, or exhibition of aircraft of the type used for combat or transport in World War II, and (10) use as a fuel in a helicopter or a fixed-wing aircraft for purposes of providing transportation with respect to which certain requirements are met.<sup>31</sup>

A producer that is registered with the Secretary may sell aviation fuel tax-free to another registered producer.<sup>32</sup> Producers include refiners, blenders, wholesale distributors of aviation

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<sup>28</sup> Notice 88-132, sec. III(D). See also, Form 637 - Application for Registration (For Certain Excise Tax Activities). A bond may be required as a condition of registration.

<sup>29</sup> Sec. 4092(a).

<sup>30</sup> "Trade" includes the transportation of persons or property for hire. Treas. Reg. sec. 48.4221-4(b)(8).

<sup>31</sup> Secs. 4041(f)(2), 4041(g), 4041(h), 4041(l), and 4092.

<sup>32</sup> Sec. 4092(c).

fuel, dealers selling aviation fuel exclusively to producers of aviation fuel, the actual producer of the aviation fuel, and with respect to fuel purchased at a reduced rate, the purchaser of such fuel.

### **Refunds and credits**

A claim for refund of taxed aviation fuel held by a registered aviation fuel producer is allowed<sup>33</sup> (without interest) if: (1) the aviation fuel tax was paid by an importer or producer (the “first producer”) and the tax has not otherwise been credited or refunded; (2) the aviation fuel was acquired by a registered aviation fuel producer (the “second producer”) after the tax was paid; (3) the second producer files a timely refund claim with the proper information; and (4) the first producer and any other person that owns the fuel after its sale by the first producer and before its purchase by the second producer have met certain reporting requirements.<sup>34</sup> Refund claims should contain the volume and type of aviation fuel, the date on which the second producer acquired the fuel, the amount of tax that the first producer paid, a statement by the claimant that the amount of tax was not collected nor included in the sales price of the fuel by the claimant when the fuel was sold to a subsequent purchaser, the name, address, and employer identification number of the first producer, and a copy of any required statement of a subsequent seller (subsequent to the first producer but prior to the second producer) that the second producer received. A claim for refund is filed on Form 8849, Claim for Refund of Excise Taxes, and may not be combined with any other refunds.<sup>35</sup>

A payment is allowable to the ultimate purchaser of taxed aviation fuel if the aviation fuel is used in a nontaxable use.<sup>36</sup> A claim for payment may be made on Form 8849 or on Form 720, Schedule C. A claim made on Form 720, Schedule C, may be netted against the claimant’s excise tax liability.<sup>37</sup> Claims for payment not so taken may be allowable as income tax credits<sup>38</sup> on Form 4136, Credit for Federal Tax Paid on Fuels.

### **Description of Proposal**

The proposal changes the incidence of taxation of aviation fuel from the sale of aviation fuel to the removal of aviation fuel from a refinery or terminal, or the entry into the United States of aviation fuel. Sales of not previously taxed aviation fuel to an unregistered person also are subject to tax.

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<sup>33</sup> Sec. 4091(d).

<sup>34</sup> Treas. Reg. sec. 48.4091-3(b).

<sup>35</sup> Treas. Reg. sec. 48.4091-3(d)(1).

<sup>36</sup> Sec. 6427(1)(1).

<sup>37</sup> Treas. Reg. sec. 40.6302(c)-1(a)(3).

<sup>38</sup> Sec. 34.

Under the proposal, the full rate of tax -- 21.9 cents per gallon -- is imposed upon removal of aviation fuel from a refinery or terminal (or entry into the United States). Aviation fuel may be removed at a reduced rate -- either 4.4 or zero cents per gallon -- only if the aviation fuel is: (1) removed directly into the wing of an aircraft (i) that is registered with the Secretary as a buyer of aviation fuel for use in commercial aviation (e.g., a “Y” registrant under current law), (ii) that is a foreign airline entitled to the present law exemption for aviation fuel used in foreign trade, or (iii) for a tax-exempt use; or (2) removed or entered as part of an exempt bulk transfer.<sup>39</sup> An exempt bulk transfer is a removal or entry of aviation fuel transferred in bulk by pipeline or vessel to a terminal or refinery if the person removing or entering the aviation fuel, the operator of such pipeline or vessel, and the operator of such terminal or refinery are registered with the Secretary.

Under the proposal, certain refueler trucks, tankers, and tank wagons are treated as a terminal if the following requirements are met. The truck, tanker, or tank wagon must: (1) be loaded with aviation fuel at a terminal that is located within an airport and from which no vehicle licensed for highway use is loaded with aviation fuel; (2) deliver such fuel directly into the wing of aircraft at such airport for use in commercial aviation; (3) have storage tanks, hose, and coupling equipment designed and used for the purposes of fueling aircraft; (4) not be licensed for highway use; and (5) be operated by the terminal operator (who operates the terminal rack from which the fuel is unloaded) or by a person that makes a daily accounting to such terminal operator of each delivery of fuel from such truck, tanker, or tank wagon.<sup>40</sup> Rules similar to the rules described above apply in the case of removals directly into the fuel tank of an aircraft for a use that is exempt from the tax imposed by section 4041(c).

The proposal does not change the applicable rates of tax under present law, 21.9 cents per gallon for use in noncommercial aviation, 4.4 cents per gallon for use in commercial aviation, and zero cents per gallon for use by domestic airlines in an international flight, by foreign airlines, or other nontaxable use. The proposal imposes liability for the tax on aviation fuel removed from a refinery or terminal directly into the wing of an aircraft for use in commercial aviation on the person receiving the fuel. In that case, the person receiving the fuel self-assesses the tax on a return. The proposal does not change present-law nontaxable uses of aviation fuel, or change the persons or the qualifications of persons who are entitled to purchase fuel at a reduced rate, except that a producer is not permitted to purchase aviation fuel at a reduced rate by reason of such persons’ status as a producer.<sup>41</sup> A person entitled to purchase aviation fuel at a reduced rate may not purchase such fuel at such rate if the person has to remove the fuel to make

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<sup>39</sup> See sec. 4081(a)(1)(B).

<sup>40</sup> The proposal requires that if such delivery information is provided to a terminal operator (or if a terminal operator collects such information), that the terminal operator provide such information to the Secretary.

<sup>41</sup> Accordingly, the present law refund that is provided for a registered producer of aviation fuel that establishes that a prior excise tax was paid, and not credited or refunded, on aviation fuel held by the producer is not allowed under the proposal.

the purchase, unless one of the exceptions above apply. Instead, the person would pay 21.9 cents per gallon and be in a refund position.

Under the proposal, a refund is allowable to the ultimate vendor of aviation fuel if such ultimate vendor purchases fuel tax paid and subsequently sells the fuel to a person qualified to purchase at a reduced rate and who waives the right to a refund. In such a case, the proposal permits an ultimate vendor to net refund claims against any excise tax liability of the ultimate vendor, in a manner similar to the present law treatment of ultimate purchaser payment claims.

As under present law, if previously taxed aviation fuel is used for a nontaxable use, the ultimate purchaser may claim a refund for the tax previously paid. If previously taxed aviation fuel is used for a taxable non aircraft use, the fuel is subject to the tax imposed on kerosene (24.4 cents per gallon) and a refund of the previously paid aviation fuel tax is allowed. Claims by the ultimate vendor or the purchaser that are not taken as refund claims may be allowable as income tax credits.

For example, for an airport that is not served by a pipeline, aviation fuel generally is removed from a terminal and transported to an airport storage facility for eventual use at the airport. In such a case, the aviation fuel will be taxed at 21.9 cents per gallon upon removal from the terminal. At the airport, if the fuel is purchased from a vendor by a person registered with the Secretary to use fuel in commercial aviation, the purchaser may buy the fuel at a reduced rate (generally, 4.4 cents per gallon for domestic flights and zero cents per gallon for international flights) and waive the right to a refund. The ultimate vendor generally may claim a refund for the difference between 21.9 cents per gallon of tax paid upon removal and the rate of tax paid to the vendor by the purchaser. To obtain a zero rate upon purchase, a registered domestic airline must certify to the vendor at the time of purchase that the fuel is for use in an international flight; otherwise, the airline must pay the 4.4 cents per gallon rate and file a claim for refund to the Secretary if the fuel is used for international aviation. If a zero rate is paid and the fuel subsequently is used in domestic and not international travel, the domestic airline is liable for tax at 4.4 cents per gallon. A foreign airline eligible under present law to purchase aviation fuel tax-free would continue to purchase such fuel tax-free.

As another example, for an airport that is served by a pipeline, aviation fuel generally is delivered to the wing of an aircraft either by a refueling truck or by a “hydrant” that runs directly from the pipeline to the airplane wing. If a refueling truck that is not licensed for highway use loads fuel from a terminal located in the airport (and the other requirements of the proposal for such truck and terminal are met), and delivers the fuel directly to the wing of an aircraft for use in commercial aviation, the aviation fuel is taxed at 4.4 cents per gallon upon delivery to the wing and the person receiving the fuel is liable for the tax, which such person would be able to self-assess on a return. If fuel is loaded into a refueling truck that does not meet the requirements of the proposal, then the fuel is treated as removed from the terminal into the refueling truck and tax of 21.9 cents per gallon is paid on such removal. The ultimate vendor is entitled to a refund of the difference between 21.9 cents per gallon paid on removal and the rate paid by a commercial airline purchaser (assuming the purchaser waived the refund right). If fuel is removed from a terminal directly to the wing of an aircraft registered to use fuel in commercial aviation by a hydrant or similar device, the person removing the aviation fuel is liable for a tax of

4.4 cents per gallon (or zero in the case of an international flight or qualified foreign airline) and may self-assess such tax on a return.

Under the proposal, a floor stocks tax applies to aviation fuel held by a person (if title for such fuel has passed to such person) on October 1, 2004. The tax is equal to the amount of tax that would have been imposed before October 1, 2004, if the proposal was in effect at all times before such date, reduced by the tax imposed by section 4091, as in effect on the day before the date of enactment. The Secretary shall determine the time and manner for payment of the tax, including the nonapplication of the tax on de minimis amounts of aviation fuel. Under the proposal, 0.1 cents per gallon of such tax is transferred to the LUST Trust Fund. The remainder is transferred to the Airport and Airway Trust Fund.

#### **Effective Date**

The proposal is effective for aviation fuel removed, entered, or sold after September 30, 2004.

## C. Dye Injection Equipment

### Present Law

#### Statutory rules

Gasoline, diesel fuel and kerosene are generally subject to excise tax upon removal from a refinery or terminal, upon importation into the United States, and upon sale to unregistered persons unless there was a prior taxable removal or importation of such fuels.<sup>42</sup> However, a tax is not imposed upon diesel fuel or kerosene if all of the following are met: (1) the Secretary determines that the fuel is destined for a nontaxable use, (2) the fuel is indelibly dyed in accordance with regulations prescribed by the Secretary,<sup>43</sup> and (3) the fuel meets marking requirements prescribed by the Secretary.<sup>44</sup> A nontaxable use is defined as (1) any use that is exempt from the tax imposed by section 4041(a)(1) other than by reason of a prior imposition of tax, (2) any use in a train, or (3) certain uses in buses for public and school transportation, as described in section 6427(b)(1) (after application of section 6427(b)(3)).<sup>45</sup>

The Secretary is required to prescribe necessary regulations relating to dyeing, including specifically the labeling of retail diesel fuel and kerosene pumps.<sup>46</sup>

A person who sells dyed fuel (or holds dyed fuel for sale) for any use that such person knows (or has reason to know) is a taxable use, or who willfully alters or attempts to alter the dye in any dyed fuel, is subject to a penalty.<sup>47</sup> The penalty also applies to any person who uses dyed fuel for a taxable use (or holds dyed fuel for such a use) and who knows (or has reason to know) that the fuel is dyed.<sup>48</sup> The penalty is the greater of \$1,000 per act or \$10 per gallon of dyed fuel

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<sup>42</sup> Sec. 4081(a)(1)(A). If such fuel is used for a nontaxable purpose, the purchaser is entitled to a refund of tax paid, or in some cases, an income tax credit. See sec. 6427.

<sup>43</sup> Dyeing is not a requirement, however, for certain fuels under certain conditions, *i.e.*, diesel fuel or kerosene exempted from dyeing in certain States by the EPA under the Clean Air Act, aviation-grade kerosene as determined under regulations prescribed by the Secretary, kerosene received by pipeline or vessel and used by a registered recipient to produce substances (other than gasoline, diesel fuel or special fuels), kerosene removed or entered by a registrant to produce such substances or for resale, and (under regulations) kerosene sold by a registered distributor who sells kerosene exclusively to ultimate vendors that resell it (1) from a pump that is not suitable for fueling any diesel-powered highway vehicle or train, or (2) for blending with heating oil to be used during periods of extreme or unseasonable cold. Sec. 4082(c), (d).

<sup>44</sup> Sec. 4082(a).

<sup>45</sup> Sec. 4082(b).

<sup>46</sup> Sec. 4082(e).

<sup>47</sup> Sec. 6715(a).

<sup>48</sup> Sec. 6715(a).

involved. In determining the amount of the penalty, the \$1,000 is increased by the product of \$1,000 and the number of prior penalties imposed upon such person (or a related person or predecessor of such person or related person).<sup>49</sup> The penalty may be imposed jointly and severally on any business entity, each officer, employee, or agent of such entity who willfully participated in any act giving rise to such penalty.<sup>50</sup> For purposes of the penalty, the term “dyed fuel” means any dyed diesel fuel or kerosene, whether or not the fuel was dyed pursuant to section 4082.<sup>51</sup>

## **Regulations**

The Secretary has prescribed certain regulations under this provision, including regulations that specify the allowable types and concentration of dye, that the person claiming the exemption must be a taxable fuel registrant, that the terminal must be an approved terminal (in the case of a removal from a terminal rack), and the contents of the notice to be posted on diesel fuel and kerosene pumps.<sup>52</sup> However, the regulations do not prescribe the time or method of adding the dye to taxable fuel.<sup>53</sup> Diesel fuel is usually dyed at a terminal rack by either manual dyeing or mechanical injection.

## **Description of Proposal**

With respect to terminals that offer dyed fuel, the proposal eliminates manual dyeing of fuel and requires dyeing by a mechanical system. Not later than 180 days after enactment of this proposal, the Secretary of the Treasury is to prescribe regulations establishing standards for tamper resistant mechanical injector dyeing. Such standards shall be reasonable, cost-effective, and establish levels of security commensurate with the applicable facility.

The proposal adds an additional set of penalties for violation of the new rules. A penalty, equal to the greater of \$25,000 or \$10 for each gallon of fuel involved, applies to each act of tampering with a mechanical dye injection system. The person committing the act is also responsible for any unpaid tax on removed undyed fuel. A penalty of \$1,000 is imposed for each failure to maintain security for mechanical dye injection systems. An additional penalty of \$1,000 is imposed for each day any such violation remains uncorrected after the first day such violation has been or reasonably should have been discovered. For purposes of the daily penalty,

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<sup>49</sup> Sec. 6715(b).

<sup>50</sup> Sec. 6715(d).

<sup>51</sup> Sec. 6715(c)(1).

<sup>52</sup> See Treas. Reg. secs. 48.4082-1, -2.

<sup>53</sup> In March 2000, the IRS withdrew its Notice of Proposed Rulemaking PS-6-95 (61 F.R. 10490 (1996)) relating to dye injection systems. Announcement 2000-42, 2000-1 C.B. 949. The proposed regulation established standards for mechanical dye injection equipment and required terminal operators to report nonconforming dyeing to the IRS. See also Treas. Reg. sec. 48.4082-1(c), (d).

a violation may be corrected by shutting down the portion of the system causing the violation. If any of these penalties are imposed on any business entity, each officer, employee, or agent of such entity or other contracting party who willfully participated in any act giving rise to such penalty shall be jointly and severally liable with such entity for such penalty. If such business entity is part of an affiliated group, the parent corporation of such entity shall be jointly and severally liable with such entity for the penalty.

#### **Effective Date**

The proposal requiring the use of mechanical dye injection systems and imposing penalties is effective 180 days after the date that the Secretary issues the required regulations. The Secretary must issue such regulations no later than 180 days after enactment.

## **D. Authority to Inspect On-Site Records**

### **Present Law**

The Internal Revenue Service is authorized to inspect any place where taxable fuel is produced or stored (or may be stored). The inspection is authorized to: (1) examine the equipment used to determine the amount or composition of the taxable fuel and the equipment used to store the fuel; and (2) take and remove samples of taxable fuel. Places of inspection, include, but are not limited to, terminals, fuel storage facilities, retail fuel facilities or any designated inspection site.<sup>54</sup>

In conducting the inspection, the Internal Revenue Service may detain any receptacle that contains or may contain any taxable fuel, or detain any vehicle or train to inspect its fuel tanks and storage tanks. The scope of the inspection includes the book and records kept to determine the excise tax liability under section 4081.<sup>55</sup>

### **Description of Proposal**

The proposal expands the scope of the inspection to include any books, records or shipping papers pertaining to the sale and transportation of taxable fuel, located in any authorized inspection locations or possessed by any carrier.

### **Effective Date**

The proposal is effective on the date on enactment.

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<sup>54</sup> Sec. 4083(c)(1)(A).

<sup>55</sup> Treas. Reg. sec. 48.4083-1(b)(2).

## **E. Registration and Reporting Requirements**

### **1. Registration of pipeline or vessel operators required for exemption of bulk transfers to registered terminals or refineries**

#### **Present Law**

In general, gasoline, diesel fuel, and kerosene (“taxable fuel”) are taxed upon removal from a refinery or a terminal.<sup>56</sup> Tax also is imposed on the entry into the United States of any taxable fuel for consumption, use, or warehousing. The tax does not apply to any removal or entry of a taxable fuel transferred in bulk (a “bulk transfer”) to a terminal or refinery if the person removing or entering the taxable fuel and the operator of such terminal or refinery are registered with the Secretary.<sup>57</sup> For example, if a registered vessel or pipeline operator removes fuel in bulk from a registered refiner and transfers the fuel to a registered terminal operator, tax is not imposed on the bulk transfer. For the bulk transfer exemption to apply, the “position holder” with respect to the taxable fuel, *i.e.*, the person shown on the records of the terminal facility as owning the fuel, must be registered with the Secretary.<sup>58</sup>

Present law does not require that every vessel or pipeline operator that transfers fuel as part of a bulk transfer be registered in order for the transfer to be exempt. For example, a registered vessel or pipeline operator may remove fuel from a registered refiner and transfer the fuel to an unregistered vessel or pipeline operator who in turn transfers fuel to a registered terminal operator. The transfer is exempt despite the intermediate transfer by an unregistered person.

In general, the position holder is liable for payment of tax with respect to taxable removals from the terminal rack and bulk transfers not received at an approved terminal or refinery.<sup>59</sup> The refiner is liable for payment of tax with respect to certain taxable removals from the refinery.<sup>60</sup>

#### **Description of Proposal**

The proposal requires that for a bulk transfer of a taxable fuel to be exempt from tax, any pipeline or vessel operator that is a party to the bulk transfer be registered with the Secretary. Transfer to an unregistered party will subject the transfer to tax.

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<sup>56</sup> Sec. 4081(a)(1)(A).

<sup>57</sup> Sec. 4081(a)(1)(B). The sale of a taxable fuel to an unregistered person prior to a taxable removal or entry of the fuel is subject to tax. Sec. 4081(a)(1)(A).

<sup>58</sup> Treas. Reg. sec. 48.4081-3(d).

<sup>59</sup> Treas. Reg. sec. 48.4081-2; Treas. Reg. sec. 48.4081-3(d) and (e).

<sup>60</sup> Treas. Reg. sec. 48.4081-3(b).

The Secretary is required to publish periodically a list of all registered persons who are required to register.

### **Effective Date**

The proposal is effective on October 1, 2004, except that the Secretary is required to publish the list of registered persons beginning on July 1, 2004.

## **2. Display of registration and penalties for failure to display registration and to register**

### **Present Law**

Blenders, enterers, pipeline operators, position holders, refiners, terminal operators, and vessel operators are required to register with the Secretary with respect to fuels taxes imposed by sections 4041(a)(1) and 4081.<sup>61</sup> A non-assessable penalty for failure to register is \$50.<sup>62</sup> A criminal penalty of \$5,000, or imprisonment of not more than five years, or both, together with the costs of prosecution also applies to a failure to register and to certain false statements made in connection with a registration application.<sup>63</sup>

### **Description of Proposal**

The proposal requires that every operator of a vessel who is required to register with the Secretary display on each vessel used by the operator to transport fuel, proof of registration through an electronic identification device prescribed by the Secretary. A failure to display such proof of registration results in a penalty of \$500 per month per vessel. The amount of the penalty is increased for multiple prior violations. No penalty is imposed upon a showing by the taxpayer of reasonable cause. The proposal authorizes amounts equivalent to the penalties received to be appropriated to the Highway Trust Fund.

The proposal imposes a new assessable penalty for failure to register of \$10,000 for each initial failure, plus \$1,000 per day that the failure continues. No penalty is imposed upon a showing by the taxpayer of reasonable cause. In addition, the proposal increases the present-law non-assessable penalty for failure to register from \$50 to \$10,000 and the present law criminal penalty for failure to register from \$5,000 to \$10,000. The proposal authorizes amounts equivalent to any of such penalties received to be appropriated to the Highway Trust Fund.

### **Effective Date**

The proposal requiring display of registration is effective on October 1, 2004. The proposal relating to penalties is effective for penalties imposed after September 30, 2004.

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<sup>61</sup> Sec. 4101; Treas. Reg. sec. 48.4101-1(a) and (c)(1).

<sup>62</sup> Sec. 7272(a).

<sup>63</sup> Sec. 7232.

### **3. Penalties for failure to report**

#### **Present Law**

A fuel information reporting program, the Excise Summary Terminal Activity Reporting System (“ExSTARS”), requires terminal operators and bulk transport carriers to report monthly on the movement of any liquid product into or out of an approved terminal.<sup>64</sup> Terminal operators file Form 720-TO - Terminal Operator Report, which shows the monthly receipts and disbursements of all liquid products to and from an approved terminal.<sup>65</sup> Bulk transport carriers (barges, vessels, and pipelines) that receive liquid product from an approved terminal or deliver liquid product to an approved terminal file Form 720-CS - Carrier Summary Report, which details such receipts and disbursements. In general, the penalty for failure to file a report or a failure to furnish all of the required information in a report is \$50 per report.<sup>66</sup>

#### **Description of Proposal**

The proposal imposes a new assessable penalty for failure to file a report or to furnish information required in a report required by the ExSTARS system. The penalty is \$10,000 per failure with respect to each vessel or facility (e.g., a terminal or other facility) for which information is required to be furnished. No penalty is imposed upon a showing by the taxpayer of reasonable cause. The proposal authorizes amounts equivalent to the penalties received to be appropriated to the Highway Trust Fund.

#### **Effective Date**

The proposal is effective for penalties imposed after September 30, 2004.

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<sup>64</sup> Sec. 4010(d); Treas. Reg. sec. 48.4101-2. The reports are required to be filed by the end of the month following the month to which the report relates.

<sup>65</sup> An approved terminal is a terminal that is operated by a taxable fuel registrant that is a terminal operator. Treas. Reg. sec. 48.4081-1(b).

<sup>66</sup> Sec. 6721(a).

## **F. Collection from Customs Bond Where Importer Not Registered**

### **Present Law**

Gasoline, diesel fuel, and kerosene are taxed when the fuels are removed from a refinery or registered pipeline or barge terminal.<sup>67</sup> Typically, these fuels are transferred by pipeline or barge in large quantities (“bulk”) to terminal storage facilities that geographically are located closer to destination retail markets. A fuel is taxed when it “breaks bulk,” *i.e.*, when it is removed from the refinery or terminal, typically by truck or rail car, for delivery to a smaller wholesale facility or a retail outlet. The party liable for payment of the taxes is the “position holder,” *i.e.*, the person shown on the records of the terminal facility as owning the fuel.

Tax is also imposed on the entry into the United States of any taxable fuel for consumption, use, or warehousing.<sup>68</sup> This tax does not apply to any entry of a taxable fuel transferred in bulk to a terminal or refinery if the person entering the taxable fuel and the operator of such terminal or refinery are registered. The “enterer” is liable for the tax. An enterer generally means the importer of record (under customs law) with respect to the taxable fuel. However, if the importer of record is acting as an agent (a broker for example), the person for whom the agent is acting is the enterer. If there is no importer of record for taxable fuel entered into the United States, the owner of the taxable fuel at the time it is brought into the United States is the enterer. An importer’s liability for Customs duties includes a liability for any internal revenue taxes that attach upon the importation of merchandise unless otherwise provided by law or regulation.<sup>69</sup>

As a part of the entry documentation, the importer, consignee, or an authorized agent usually is required to file a bond with Customs. The bond, among other things, guarantees that proper entry summary, with payment of estimated duties and taxes when due, will be made for imported merchandise and that any additional duties and taxes subsequently found to be due will be paid.

As a condition of permitting anyone to be registered with the IRS, under section 4101 of the Code, the Secretary may require that such person give a bond in such sum as the Secretary determines appropriate.

### **Description of Proposal**

Under the proposal, the importer of record is jointly and severally liable for the tax imposed upon entry of fuel into the United States if, under regulations, any other person that is not registered with the Secretary as a taxable fuel registrant is liable for such tax. If the importer of record is liable for the tax and such tax is not paid on or before the last date prescribed for

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<sup>67</sup> Sec. 4081(a)(1).

<sup>68</sup> Sec. 4081(a)(1)(A)(iii).

<sup>69</sup> 19 CFR 141.3.

payment, the Secretary may collect such tax from the Customs bond posted with respect to the importation of the taxable fuel to which the tax relates.

For purposes of determining the jurisdiction of any court of the United States or any agency of the United States, any action by the Secretary to collect the tax from the Customs bond is treated as an action to collect tax from a bond authorized by section 4101 of the Code, not as an action to collect from a bond relating to the importation of merchandise.

**Effective Date**

The proposal is effective for fuel entered after September 30, 2004.

## **G. Modification of the Use Tax on Heavy Highway Vehicles**

### **Present Law**

An annual use tax is imposed on heavy highway vehicles, at the rates below.<sup>70</sup>

Under 55,000 pounds .....	No tax
55,000-75,000 pounds .....	\$100 plus \$22 per 1,000 pounds over 55,000
Over 75,000 pounds .....	\$550

The annual use tax is imposed for a taxable period of July 1 through June 30. Generally, the tax is paid by the person in whose name the vehicle is registered. In certain cases, taxpayers are allowed to pay the tax in installments.<sup>71</sup> Exemptions and reduced rates are provided for certain “transit-type buses,” trucks used for fewer than 5,000 miles on public highways (7,500 miles for agricultural vehicles), and logging trucks.<sup>72</sup> Any highway motor vehicle that is issued a base plate by Canada or Mexico and is operated on U.S. highways is subject to the highway use tax whether or not the vehicles are required to be registered in the United States. The tax rate for Canadian and Mexican vehicles is 75 percent of the rate that would otherwise be imposed.<sup>73</sup>

### **Description of Proposal**

The proposal eliminates the ability to pay the tax in installments. It also eliminates the reduced rates for Canadian and Mexican vehicles. The proposal requires taxpayers with 25 or more vehicles for any taxable period to file their returns electronically. Finally, the proposal permits proration of tax for vehicles sold during the taxable period.

### **Effective Date**

The proposal is effective for taxable periods beginning after the date of enactment.

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<sup>70</sup> Sec. 4481.

<sup>71</sup> Sec. 6156.

<sup>72</sup> See generally, sec. 4483.

<sup>73</sup> Sec. 4483(f); Treas. Reg. sec. 41.4483-7(a).

## **H. Modification of Ultimate Vendor Refund Claims with Respect to Farming**

### **Present Law**

In general, the Code provides that, if diesel fuel, kerosene, or aviation fuel on which tax has been imposed is used by any person in a nontaxable use, the Secretary is to refund (without interest) the amount of tax imposed. The refund is made to the ultimate purchaser of the taxed fuel. However, in the case of diesel fuel or kerosene used on a farm for farming purposes or by a State or local government, refund payments are paid to the ultimate, registered vendors (“ultimate vendors”) of such fuels.

### **Description of Proposal**

In the case of diesel fuel or kerosene used on a farm for farming purposes, the proposal limits ultimate vendor claims for refund to sales of such fuel in amounts less than 250 gallons per claim period.

### **Effective Date**

The proposal is effective for fuels sold for nontaxable use after the date of enactment.

## **I. Dedication of Revenue from Certain Penalties to the Highway Trust Fund**

### **Present Law**

Present law does not dedicate to the Highway Trust Fund any penalties assessed and collected by the Secretary.

### **Description of Proposal**

The proposal dedicates to the Highway Trust Fund amounts equivalent to the penalties assessed under the penalty provisions created by the proposal as well as the existing penalties (as increased by the proposal) for failing to register under section 4101 and as otherwise required by law or regulation.

### **Effective Date**

The proposal is effective for penalties assessed after October 1, 2004.

### **III. OTHER HIGHWAY EXCISE TAX PROVISIONS**

#### **A. Taxable Fuel Refunds for Certain Ultimate Vendors**

##### **Present Law**

The Code provides that, in the case of gasoline on which tax has been paid and sold to a State or local government, to a nonprofit educational organization, for supplies for vessels or aircraft, for export, or for the production of special fuels, a wholesale distributor that sells the gasoline for such exempt purposes is treated as the person who paid the tax and thereby is the proper claimant for a credit or refund of the tax paid. In the case of undyed diesel fuel or kerosene used on a farm for farming purposes or by a State or local government, a credit or payment is allowable only to the ultimate, registered vendors (“ultimate vendors”) of such fuels.

In general, refunds are paid without interest. However, in the case of overpayments of tax on gasoline, diesel fuel, or kerosene that is used to produce a qualified alcohol mixture and for refunds due ultimate vendors of diesel fuel or kerosene used on a farm for farming purposes or by a State or local government, the Secretary is required to pay interest on certain refunds. The Secretary must pay interest on refunds of \$200 or more (\$100 or more in the case of kerosene) due to the taxpayer arising from sales over any period of a week or more, if the Secretary does not make payment of the refund within 20 days.

##### **Description of Proposal**

For sales of gasoline to a State or local government for the exclusive use of a State or local government or to a nonprofit educational organization for its exclusive use on which tax has been imposed, the proposal conforms the payment of refunds to that procedure established under present law in the case of diesel fuel or kerosene. That is, the ultimate vendor claims the refund.

The proposal modifies the payment of interest on refunds. Under the proposal, in the case of overpayments of tax on gasoline, diesel fuel, or kerosene that is used to produce a qualified alcohol mixture and for refunds due ultimate vendors of diesel fuel or kerosene used on a farm for farming purposes or by a State or local government, all refunds unpaid after 45 days must be paid with interest. If the taxpayer has filed for his or her refund by electronic means, refunds unpaid after 20 days must be paid with interest.

Lastly, for claims for refund of tax paid on diesel fuel or kerosene sold to State and local governments or for sales of gasoline to a State or local government for the exclusive use of a State or local government or to a nonprofit educational organization for its exclusive use on which tax has been imposed and for which the ultimate purchaser utilized a credit card, the proposal deems the person extending the credit to the ultimate purchaser to be the ultimate vendor. That is, the person extending credit via a credit card administers claims for refund, and is responsible for supplying all the appropriate documentation currently required from ultimate vendors.

**Effective Date**

The proposal is effective on October 1, 2004.

## **B. Two-Party Exchanges**

### **Present Law**

The person who holds the inventory position to the fuel in the terminal, as reflected on the records of the terminal operator is treated as the position holder. One holds the inventory position by having a contractual agreement with the terminal operator for the use of the storage facilities and terminating services with respect to the fuel. A terminal operator who owns the fuel in its terminal is a position holder. The party liable for payment of the taxes when it leaves the terminal rack is the “position holder.”

It is common industry practice for oil companies to serve customers of other oil companies under exchange agreements, *e.g.*, where Company A's terminal is more conveniently located for wholesale or retail customers of Company B. In such cases, the exchange agreement party (Company B in the example) owns the fuel when the motor fuel is removed from the terminal and sold to B's customer.

### **Description of Proposal**

The proposal amends the Code to modify the regulatory definition of “position holder” to recognize the provisions of two-party terminal exchange agreements among registered parties. In such an exchange, the delivering person is not liable for the tax imposed by section 4081 on the removal of a taxable fuel from any refinery or terminal. The term two-party exchange means a transaction, other than a sale, in which taxable fuel is transferred from a delivering person registered under section 4101 for exempt bulk transfers of taxable fuel to a receiving person registered under section 4101 for exempt bulk transfers of taxable fuel where all of the following occur:

- (1) The transaction includes a transfer from the delivering person, who holds the original inventory position for taxable fuel in the terminal as reflected in the records of the terminal operator.
- (2) The exchange transaction occurs at the same time as completion of removal across the rack from the terminal by the receiving person or its customer.
- (3) The terminal operator in its books and records treats the receiving person as the person that removes the product across a terminal rack for purposes of reporting the transaction to the Internal Revenue Service.
- (4) The transaction is the subject of a written contract.

### **Effective Date**

The proposal is effective on the date of enactment.

### C. Simplification of Tax on Tires

#### Present Law

A graduated excise tax is imposed on the sale by a manufacturer (or importer) of tires designed for use on highway vehicles (sec. 4071). The tire tax rates are as follows:

<u>Tire Weight</u>	<u>Tax Rate</u>
Not more than 40 lbs. ....	No tax
More than 40 lbs., but not more than 70 lbs.....	15 cents/lb. in excess of 40 lbs.
More than 70 lbs., but not more than 90 lbs.....	\$4.50 plus 30 cents/lb. in excess of 70 lbs.
More than 90 lbs.....	\$11.50 plus 50 cents/lb. in excess of 90 lbs.

No tax is imposed on the recapping of a tire that previously has been subject to tax. Tires of extruded tiring with internal wire fastening also are exempt.

The tax expires after September 30, 2005.

#### Description of Proposal

The proposal modifies the excise tax applicable to tires. The proposal replaces the present-law tax rates based on the weight of the tire with a tax rate based on the load capacity of the tire. In general, the tax is 9.4 cents for each 10 pounds of tire load capacity in excess of 3,500 pounds. In the case of a biasply tire, the tax rate is 4.7 cents for each 10 pounds of tire load capacity in excess of 3,500 pounds.

The proposal modifies the definition of tires for use on highway vehicles to include any tire marked for highway use pursuant to certain regulations promulgated by the Secretary of Transportation. The proposal also exempts from tax any tire sold for the exclusive use of the United States Department of Defense or the United States Coast Guard.

Tire load capacity is the maximum load rating labeled on the tire pursuant to regulations promulgated by the Secretary of Transportation. A biasply tire is any tire manufactured primarily for use on piggyback trailers.

#### Effective Date

The proposal is effective for sales in calendar years beginning more than 30 days after the date of enactment.



Joint Committee on Taxation  
March 17, 2004  
JCX-23-04

**DESCRIPTION OF CHAIRMAN'S AMENDMENT  
IN THE NATURE OF A SUBSTITUTE  
TO H.R. 3971  
THE "HIGHWAY REAUTHORIZATION TAX ACT OF 2004"**

The Chairman's amendment in the nature of a substitute would make the following modifications to H.R. 3971, the "Highway Reauthorization Tax Act of 2004":

**1. Modification to reduced rates of tax on alcohol fuel mixtures replaced with an excise tax credit**

The Chairman's amendment provides that the excise tax credit and related payments for alcohol fuel mixtures is extended through December 31, 2010.

**2. Modification to exempt from certain excise taxes for mobile machinery**

The Chairman's amendment provides that to obtain a refund of fuel taxes, the mobile machinery vehicle must not travel more than 7,500 miles over public roads during the owner's taxable year.

**3. Modification to the taxation of aviation-grade kerosene**

Under the bill, certain refueler trucks, tankers, and tank wagons are treated as part of a terminal located within an airport if certain requirements are met. The Chairman's amendment clarifies that the requirement that no vehicle licensed for highway use be loaded with aviation fuel at the terminal in order for the refueling trucks to be treated as part of the terminal does not preclude the loading of highway vehicles in certain exigent circumstances as provided in regulations.

The Chairman's amendment also provides that refueling trucks, tankers, and tank wagons may be treated as part of a terminal located within an airport, regardless of whether the truck, tanker, or tank wagon delivers fuel for commercial or noncommercial aviation, if such truck, tanker or tank wagon otherwise satisfies all the other requirements of the proposal. For example, if a refueling truck at an airport served by pipeline delivers fuel from the airport terminal rack directly into the wing of noncommercial aircraft, the point of taxation will be the delivery of the fuel into the wing of the aircraft, rather than when the fuel is dispensed into the refueling truck.

**ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 3971,  
THE "HIGHWAY REAUTHORIZATION TAX ACT OF 2004,"  
SCHEDULED FOR MARKUP BY THE COMMITTEE ON WAYS AND MEANS ON MARCH 17, 2004**

Fiscal Years 2004 - 2013

[Millions of Dollars]

Provision	Effective	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2004-08	2004-13
<b>Restructuring of Incentives for Alcohol Fuels, Etc.</b>													
1. Provide excise tax credit (in lieu of reduced tax rate on gasoline) to certain blenders of alcohol fuel mixtures (sunset 12/31/10) .....	fsoua 9/30/04	----- No Revenue Effect -----											
2. Provide that all alcohol fuels excise tax credits and payments are paid from the General Fund [1].....	tra 9/30/04 & apa 9/30/04	---	---	---	---	---	---	---	1,131	1,559	1,586	---	4,276
3. Repeal reduced-rate sales of gasoline for blending with alcohol and reduced-rate sales of alcohol fuel blends .....	fsoua 9/30/04	---	22	23	23	23	22	22	22	21	21	91	199
4. Provide outlay payments (in lieu of excise tax credits and refunds) to producers of alcohol fuel mixtures:													
a. Outlay effects [2] [3] .....	fsoua 9/30/04	---	-105	-114	-116	-117	-119	-121	-38	---	---	-451	-730
b. Revenue effects.....	fsoua 9/30/04	---	105	114	116	117	119	121	38	---	---	451	730
5. Transfer full amount of alcohol fuel excise taxes to the Highway Trust Fund (i.e., repeal 2.5/2.8 cents transfer to General Fund).....	tia 9/30/03	----- No Revenue Effect -----											
6. Transfer full amount of motorboat fuel taxes and certain small engine fuel taxes to the Aquatic Resources Trust Fund .....	tia 9/30/03	----- No Revenue Effect -----											
<b>Total of Restructuring of Incentives for Alcohol Fuels, Etc. ....</b>		---	<b>22</b>	<b>23</b>	<b>23</b>	<b>23</b>	<b>22</b>	<b>22</b>	<b>1,153</b>	<b>1,580</b>	<b>1,607</b>	<b>91</b>	<b>4,475</b>
<b>Reduction of Fuel Tax Evasion</b>													
A. Exemption From Certain Excise Taxes for Mobile Machinery Vehicles .....	DOE [4]	---	76	95	95	95	95	95	95	95	95	360	833
B. Taxation of Aviation-Grade Kerosene.....	[5]	---	395	423	426	427	427	425	421	417	413	1,671	3,774
C. Dye Injection Equipment, Security Standards, and Related Penalties.....	[6]	---	20	45	45	45	45	45	45	45	45	155	380
D. Authority to Inspect On-Site Records.....	DOE	----- Negligible Revenue Effect -----											
E. Registration and Reporting Requirements													
1. Registration of pipeline or vessel operators required for exemption of bulk transfers to registered terminals or refineries [7].....	10/1/04	---	115	123	124	124	124	124	124	123	122	486	1,103
2. Display of registration and penalty for failure to display.....	[8]	----- Revenue Effects Included in Line E.1. Above -----											
3. Penalties for failure to register and failure to report.....	pia 9/30/04	---	2	2	2	2	2	2	2	2	2	8	18
F. Collection From Customs Bonds Where Importer Not Registered.....	fea 9/30/04	2	7	8	8	8	8	8	8	8	8	33	73

Provision	Effective	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2004-08	2004-13
G. Modifications to Heavy Vehicle Use Tax.....	tpba DOE	106	121	124	126	128	131	131	133	135	137	606	1,273
H. Modification of Ultimate Vendor Refund Claims With Respect to Farming.....	fsfnua 9/30/04	----- <i>Negligible Revenue Effect</i> -----											
I. Dedication of Revenue From Certain Penalties to the Highway Trust Fund.....	paa 10/1/04	----- <i>No Revenue Effect</i> -----											
<b>Total of Reduction of Fuel Tax Evasion .....</b>		<b>108</b>	<b>736</b>	<b>820</b>	<b>826</b>	<b>829</b>	<b>832</b>	<b>830</b>	<b>828</b>	<b>825</b>	<b>822</b>	<b>3,319</b>	<b>7,454</b>
<b>Other Highway Excise Tax Provisions</b>													
A. Taxable Fuel Refunds for Certain Ultimate Vendors.....	10/1/04	----- <i>Negligible Revenue Effect</i> -----											
B. Two-Party Exchanges.....	DOE	----- <i>Negligible Revenue Effect</i> -----											
C. Simplify the Heavy Truck Tire Tax [9].....	[10]	----- <i>Negligible Revenue Effect</i> -----											
<b>Total of Other Highway Excise Tax Provisions .....</b>		----- <i>Negligible Revenue Effect</i> -----											
<b>NET TOTAL .....</b>		<b>108</b>	<b>758</b>	<b>843</b>	<b>849</b>	<b>852</b>	<b>854</b>	<b>852</b>	<b>1,981</b>	<b>2,405</b>	<b>2,429</b>	<b>3,410</b>	<b>11,929</b>

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:

- |  |                                 |  |
|--|---------------------------------|--|
| apa = amounts paid after                     | fsoua = fuel sold or used after | tia = taxes imposed after              |
| DOE = date of enactment                      | paa = penalties assessed after  | tpba = taxable periods beginning after |
| fea = fuel entered after                     | pia = penalties imposed after   | tra = taxes received after             |
| fsfnua = fuels sold for nontaxable use after |                                 |  |

- [1] The bill provides that the excise tax credit expires after December 31, 2010. If this bill is enacted, the Congressional Budget Office's subsequent baseline would not assume extension of the excise tax credit beyond its expiration because the requirement to assume extension of excise taxes dedicated to trust funds does not apply to excise tax credits paid from the General Fund. For purposes of this revenue estimate, therefore, it is assumed that the excise tax credit would expire as scheduled. This treatment generates changes in revenues after December 31, 2010.
- [2] Estimate provided by the Congressional Budget Office. Negative numbers indicate an increase in outlays.
- [3] The outlay payments for ethanol expire after December 31, 2010.
- [4] As to fuel taxes, effective for taxable years beginning after the date of enactment.
- [5] Effective for aviation fuel removed, entered into the United States, or sold after September 30, 2004.
- [6] Generally effective 180 days after the date on which the Secretary issues the regulations, which are required no later than 180 days after the date of enactment.
- [7] Bulk transfers to unregistered parties would be taxed at the time of the transfer. The Secretary would be required to publish a list of certain registered persons beginning on July 1, 2004.
- [8] The display of registration provision is effective on October 1, 2004, and the penalty provision is effective for penalties imposed after September 30, 2004.
- [9] The revenue neutral tax rate on each ten pounds of tire capacity above 3,500 pounds is 9.4 cents on tires in general and 4.7 cents for biasply tires. Estimate does not include potential outlay effects, which are the responsibility of the Congressional Budget Office.
- [10] Effective for sales in calendar years beginning more than 30 days after the date of enactment.