

# VFDA Compliance Bulletin

## **State and local governments may burn dyed diesel fuel in highway vehicles under IRS regulations.**

There is no provision in the IRS code that specifically authorizes such a use, but according to the IRS Chief Counsel, two IRS Code sections taken together, **authorizes** states to burn dyed diesel fuel in highway vehicles.

Section 4041 of the IRS Code **exempts** state and local governments (or a political subdivision thereof such as a school district, transportation authority, etc) from the 24.4 cpg federal motor fuel excise tax on diesel.

Section 6715 of the IRS Code imposes a penalty on the sale of **dyed** diesel fuel to any user who is **not exempt** from the tax under Section 4041. Therefore, according to the IRS, since state or local governments are exempt users under the Code, dyed diesel fuel may be sold to them and used in highway vehicles.

State and local governments have been allowed to burn dyed diesel fuel in highway vehicles since the dyeing requirements were first established in 1993. Most marketers across the country sell dyed diesel fuel to state and local governments for use in highway vehicles as it saves everyone the bother of filing for a credit or refund of the federal motor fuel excise taxes paid on clear fuel sold to a tax exempt party.

Under federal regulations, diesel fuel is dyed red *for one purpose and one purpose only* - to indicate whether or not federal motor fuel excise tax has been paid on the fuel at the terminal rack. Under the IRS regulations all diesel fuel that passes over the terminal rack must be taxed or be dyed and untaxed. Dyed diesel fuel may be sold without the federal motor fuel excise tax to exempt parties - including state or local governments. What is confusing to many is that IRS regulations do not specifically say that state and local governments may use dyed fuel on the highway, even though such use has long been recognized by the IRS. Instead, the regulations limit the use of dyed fuel to off road use for some tax exempt parties by narrowing the scope of the tax exemption itself. For example, farmers are tax exempt parties, but their exemption under the IRS regulations is narrow - it only extends to uses *on a farm for farming purposes* (in harvesting equipment, but not for use in a farmers pick-up truck that travels on the highway). Likewise, private businesses are tax exempt from federal diesel fuel excise taxes, but only for *an off-highway business use* (in bulldozers and other heavy construction equipment but not for dump trucks that travel back and forth from the site on the highway).

However, the IRS regulations put no such limitations on the tax exempt status of state and local governments. The regulations define the exemption broadly as *exclusive use by a state, a political subdivision of a state* (County, towns, school systems etc) *or the District of Columbia*. As long as the use is exclusive by the state or local government, then the dyed fuel can be used both in highway vehicles and off-road vehicles.

*This VFDA Regulatory Memo was researched by Mark Morgan, a Washington, D.C. attorney who works for the New England Fuel Institute (NEFI) and the Petroleum Marketers Association for America (PMAA). Mark specializes in federal IRS and EPA regulations involving motor fuel and works with over 8,000 petroleum marketers nationwide concerning federal motor fuel excise tax and environmental regulation. Mark is also a graduate of Vermont Law School and frequent speaker at VFDA conferences.*

*If you have any questions, please contact VFDA.*