Office of Chief Counsel
Internal Revenue Service
memorandum

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CC:PSI:7:CJLangley
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Third Party Communication: None
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date: September 14, 2010

to: Holly McCann
Chief, Excise Tax Program

from: Frank Boland
Chief, CC:PSI:7

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subject: Section 6715 Penalty on Canadian Dyed Diesel Fuel

This memorandum responds to your request for Chief Counsel Advice dated June 17, 2010, requesting our legal opinion on applying the penalty under § 6715 of the Internal Revenue Code to dyed diesel fuel from Canada. This advice may not be used or cited as precedent.

According to your memorandum, the Service has identified several potential dyed diesel fuel violations near the border between the United States (U.S.) and Canada. The drivers claimed that the dyed diesel fuel in the fuel supply tanks of their registered highway vehicles was purchased in Canada. Although Canada generally has a dyed fuel program similar to that of the U.S., some Canadian provinces allow registered highway agricultural vehicles to use dyed diesel fuel. These vehicles have special license plates that identify them as agricultural vehicles. The Service has found dyed diesel fuel in these specialty plated agricultural vehicles as well as U.S. and Canadian vehicles with standard issue plates.

You asked us to advise you on whether the § 6715 penalty applies to dyed diesel fuel purchased in Canada and found in the fuel supply tank of (1) Canadian vehicles with agricultural specialty plates, (2) Canadian vehicles with standard issue plates, and (3) U.S. vehicles with standard issue plates. You further ask whether the Service has the authority to request that drivers provide proof that such fuel was purchased in Canada in the event we determine the § 6715 penalty does not apply to dyed diesel fuel that is delivered into the fuel supply tanks of vehicles in Canada.

Section 4081(a)(1)(A) generally imposes a tax on certain removals, entries, and sales of taxable fuel. Taxable fuel means gasoline, diesel fuel, and kerosene.

Section 4082(a) generally exempts from tax diesel fuel and kerosene that is dyed under prescribed standards. Section 6715(a)(2) imposes a penalty if any dyed fuel is held for use or used by any person for a use other than a nontaxable use and such person knew, or had reason to know, that such fuel was so dyed. Generally, use of a registered diesel-powered highway vehicle is not a nontaxable use. Section 6715(c)(1) defines dyed fuel as any dyed diesel fuel or kerosene, whether or not the fuel was dyed pursuant to § 4082.

Section 6001 provides that every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever in the judgment of the Secretary it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title.

Section 6671 provides that the penalties and liabilities provided by subchapter B of Chapter 68 shall be paid upon notice and demand by the Secretary, and shall be assessed and collected in the same manner as taxes. Except as otherwise provided, any reference in the Code to “tax” imposed by the Code shall be deemed also to refer to the penalties and liabilities provided by Chapter 68. Section 6715 falls under subchapter B of Chapter 68.

Section 4041(a)(1) generally imposes a back-up tax on dyed diesel fuel when the fuel is sold for use or used in a registered diesel-powered highway vehicle. The regulations implementing this provision, § 48.4082-4(a)(1) of the Manufacturers and Retailers Excise Tax Regulations, provide generally that the fuel is “used” upon the delivery into the fuel supply tank of the propulsion engine of the vehicle.

Similarly, for purposes of the § 6715 penalty, dyed fuel is “used” when it is delivered into the fuel supply tank of a diesel-powered highway vehicle. In the scenario provided, dyed diesel fuel is purchased and placed in the fuel supply tank of a registered diesel-powered vehicle in Canada before the vehicle is driven over the border to the U.S. Because the fuel is not “used” in the U.S. for purposes of the penalty, the penalty for use of dyed fuel for a use other than a nontaxable use does not apply regardless of whether the vehicle has any of the license plates listed above. See also Rev. Rul. 69-150, 1969-1 C.B. 286, holding that fuel in the fuel supply tank of a vehicle driven from Canada into the U.S. is not imported for purposes of § 4081.

Section 6001 requires that a person keep records to show whether or not such person is liable for tax and § 6671 treats a § 6715 penalty as a tax. Additionally, when the Service assesses a penalty, the assessment is presumptively correct and the taxpayer

who sues for a refund has the burden of persuading the fact finder by a preponderance of the evidence that the assessment is not correct. Apollo Fuel Oil v. U.S., 195 F.3d 74 (2nd Cir. 1999). Therefore, the Service can require proof from a person that shows person is not liable for a penalty that would normally apply in the U.S.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please contact Charles J. Langley, Jr. at (202) 622-3130 if you have any further questions.