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ISSUE BRIEF

Biodiesel Tax Credit Implementation and Request for Comments January 24, 2005

As was noted in the December 22, 2004 NBB memo, the IRS issued a guidance document on December 16, 2004 and it is available at: http://www.nbb.org/news/taxincentive/IRS_Fuel_Tax_Guidance_Document_121604.pdf The IRS guidance document is the only official document that can be conclusively relied upon until a later guidance document is issued. This issue brief is NBB's interpretation of that document to help clarify certain basic issues based on recent discussions by the IRS-Biodiesel Industry task force. This issue brief should not be construed by anyone as offering tax advice. NBB will continue to reiterate to entities intending to claim the credit that they should seek the services of a qualified tax professional.

1. Biodiesel Producer and Blender Registration

- Everyone producing biodiesel, or importing biodiesel, must be registered by the Service by July 1, 2005.
- Application for registration is to be done via IRS Form 637. The Service is presently developing two (2) new Activity Letters under which a producer/importer will register as either one or both depending on whether they produce "biodiesel" and/or "agri-biodiesel".
 - a. Final determination of the new Activity Letter designations has not been completed to date.
 - b. Therefore, biodiesel producers should hold off on registering with the IRS until the new Activity Letter designations are finalized and made public.
 - c. It is anticipated the new Activity Letter designations will be completed/made public by the end of January.
- Companies who are both: biodiesel producers and blenders of biodiesel/agri-biodiesel into diesel fuel will have a combination of Activity Letters on their Form 637 registration that denotes production and blending.
- Blenders must receive a 637 M designation by applying for it on Form 637.

2. Certificate For Biodiesel

- The JOBS Act states that a biodiesel mixture credit is not allowed unless the producer of the mixture (i.e. blender) obtains a certificate from the biodiesel producer that identifies the product as "biodiesel" or "agri-biodiesel", that it is properly registered as a fuel with the EPA and that it meets the requirements of ASTM D 6751.
- Due to time constraints, the recently published *IRS Notice 2005-04* does not provide guidance for all of the various distribution and inventory storage scenarios that may be encountered.

- a. The Notice provides a *Certificate for Biodiesel* to be utilized until further guidance is provided.
- b. Until further guidance is given, a blender must get a Certificate directly from the producer of the B100. The Notice does not say a Certificate is transferable.
 1. The Industry task force recognizes the importance to the industry of having a system that allows transferability of the certificates through intermediaries in the distribution chain between the producer and blender and that the taskforce must work through all of the issues and ensure proper controls are in place first.
- c. In making a claim to the Service for credits and/or refund, the claiming entity must have the necessary certificates in hand prior to making a claim.
 1. The claim must contain a statement that the claimant has in his possession an unexpired certificate from the producer. Therefore, the claimant should retain the certificate as a part of their business records in support of the claim.

3. Claiming Credits & Receiving Payment for Excess Credits

- The excise tax credit and income tax credit for biodiesel/agri-biodiesel are in effect as of January 1, 2005.
- The Definition of a “mixture” as it applies to the “mixture credit”. The understanding would be that any quantity of biodiesel or agri-biodiesel that is blended into diesel fuel or heating oil would qualify the mixture for credit (ie 1%, 11%; 20%, 50%, 99%, etc.).
- Eligible entities are currently able to file claims with the Service for credits and/or payments. Until further guidance is provided, claimants must follow the procedures outlined in *Notice 2005-04* which includes the following mandatory steps:
 - a. Blenders must use Form 720, Quarterly Federal Excise Tax Form; and Form 8849 to claim their credit(s) and payment for the excess sum of their credit(s) above their excise tax liability.
 - b. Blenders must use Form 4136, Credit for Federal Tax Paid on Fuels when claiming an income tax credit.
- Receiving payment for excess credits. Until additional guidance is given, payments will be issued to claimants making claims in accordance with the process as proscribed in *Notice 2005-04*. Timing for payments is consistent to those outlined in the JOBS Act:
 - a. Within 45 days (paper claims) w/out interest accruing.
 - b. Within 20 days (electronic claims) w/out interest accruing.
- Given the IRS is revising Form 720, Form 8849 and the accompanying Schedules to accommodate the changes necessary to account for the biodiesel credits:
 - a. Potential filers claiming payments utilizing an 8849 should hold their claims until the revised 8849 Form and Schedules are completed. These forms are anticipated to be available by early February.
 - b. Form 720's are required to be filed on a quarterly basis. The revised Form 720 is anticipated to be available by early February, well in advance of the filing deadline.

4. Application of These “Understandings” to a Practical Scenario

- When a blender reports a tax liability (ie. blending into undyed diesel), they would utilize Form 720 reporting the gallons of biodiesel/agri-biodiesel blended, calculate the total tax, and claim the entire value of their Biodiesel Mixture Credit. If the value of credit exceeds the total tax, they would show a negative balance and request a refund on their Form 720.

- When a blender has no tax liability to report (ie. blending only into dyed diesel), they would utilize Form 8849 to make a claim for their excess biodiesel mixture credits.

IMPORTANT - Blending undyed biodiesel/agri-biodiesel into dyed diesel fuel:

- **Blenders must take necessary action to ensure the finished blend meets required federal dye concentration specifications. If not, the blended fuel would be subject to taxation.**
- **New fuel fraud provisions passed in the JOBS Act under Section 854(c) require that all dye added to diesel fuel must be blended via “mechanical injection”. This provision becomes effective 180 days after the regulations are issued, which is expected in April. We encourage stakeholders to submit comments about this issue as it pertains to downstream blending of biodiesel.**

General Example:

Producer P sells 1,000 gallons of agri-biodiesel to Blender B. P provides B with a certification of the fuel. B blends 400 gallons of the agri-biodiesel into dyed diesel fuel and 600 gallons into undyed fuel at various blend levels. B also adds dye to the dyed mixtures to maintain dye concentration requirements.

B carefully maintains consistent inventory records of incoming and outgoing volumes of biodiesel as well as the certifications on inventories in accordance with generally accepted accounting principles. B reports on Form 720 a tax liability of \$146.40 (600 gallons x \$.244). B also reports on Form 720 a total tax credit of \$1,000 (1000 gallons agri-biodiesel x \$1). B files Form 720 claiming a refund due of \$853.60.

5. Other Items of Understanding

- **Heating Oil.** Heating oil is considered a taxable fuel that is exempt from taxation. Because of this, blending biodiesel and agri-biodiesel into heating oil would be considered as an eligible activity upon which the blender could make a Biodiesel Mixture Credit claim.
- **B100 used as a fuel.** The IRS guidance document addresses this in section 2 (e) on page 4. The guidance states that use of unblended B100 as a fuel qualifies for the income tax credit but not the excise tax credit. This is another area where we emphasize stakeholders to submit specific comments. Entities should refer to Rev. Rul. 2002-76 for additional information regarding taxation of biodiesel. As is noted in that ruling, biodiesel is not included in the definition of a taxable diesel fuel (because it contains less than 4% normal paraffins). Tax is imposed on biodiesel when it is either a) blended into non-exempt taxable diesel fuel, or b) when B100 is delivered as fuel directly into the tank of a diesel-powered highway vehicle or a diesel-powered train. An entity that delivers B100 as a fuel directly into the tank of a vehicle may claim a nonrefundable income tax credit.
- It is important to note that entities that blend biodiesel into undyed diesel fuel **MUST** report and remit the 24.4 cent per gallon tax on Form 720. As mentioned previously, the claimant may claim the applicable credit against their tax liability. Failure to report and remit taxes could result in substantial penalties including fines and imprisonment.
- **Public Comments.** The Service is requesting public comment regarding the *Notice 2005-04*. Comments should be submitted by February 14th. The NBB will be

preparing comments, as well as encouraging others within the industry and stakeholders to review the *Notice* and provide the Service with recommendations on how to answer many of the questions posed to date and any other scenarios that they may see as problematic.