

IRS Guidance for Alternative Fuel Credit

On September 29, 2006, the Internal Revenue Service (IRS) issued guidance (IRS Notice 2006-92) for what is referred to as the Volumetric Excise Tax Credit for Alternative Fuels (VEETC).

Background

VEETC was enacted as part of 2005 Highway Bill (P.L. 109-59). In brief, the legislation required a modest increase in the federal excise tax on various alternative motor fuels while at the same time providing a 50 cent per gallon credit for those same alternative fuels sold for use in motor vehicles and motor boats. The provision goes into effect on October 1, 2006.

Specifically with respect to propane, the federal motor fuel tax on propane will increase from 13.6 cents per gallon to 18.3 cents per gallon. At the same time, registered propane retailers may be able to claim a 50 cent per gallon credit for each gallon of propane sold for use in a motor vehicle or motor boat.

IRS Notice 2006-92

IRS Notice 2006-92 provides guidance on the excise tax and the credit, and includes details regarding the mechanics for filing to claim the credit.

IRS Notice 2006-92 is fairly technical and makes numerous references to various sections of the Internal Revenue Code requiring the reader to cross reference and refer to those sections in order to understand the mechanics of the alternative fuel credit. What follows is an attempt to explain the Notice in plain English. Note that this explanation and the IRS Notice do not answer all the questions that have been asked with respect to the credit and continued dialogue with the IRS will be necessary to do so.

The Tax and the Credit in a Nutshell

Federal Excise Tax on Propane -- with respect to the excise tax on the sale of propane used in motor vehicles, the change in law does not change who is liable for tax. Thus, those of you have been paying the tax on various sales transactions must continue to do so. As indicated above, the rate of federal tax on propane used in motor vehicles increases from 13.6 cents/gallon to 18.3 cents/gallon effective October 1, 2006. IRS Form 720 (Quarterly Federal Excise Tax Return) is the form that must be used to report this tax. Further explanation of who is liable for the tax is provided below under the section entitled "Tax Test."

The Credit – Who Qualifies -- in order to obtain the 50 cent/gallon credit on the propane that you have sold for use in motor vehicles you must meet the following requirements:

- (1) Tax Test – you must be liable for the tax on propane sold for use or used as fuel in a motor vehicle, or you would have been liable for tax but for application of exemption. The following examples of sales transactions will

help clarify who is liable for tax and thus who is able to claim the credit. In general, if you are a propane retailer and deliver propane that you sell directly into the fuel tank, you are liable for the tax and also able to claim the credit on the transaction. If the sale is in bulk form and the buyer certifies to the propane retailer that the entire purchase will be used for a taxable purpose as a motor fuel, again the retailer is liable for the tax and also able to claim the credit. If the sale is in bulk and the buyer cannot certify the entire volume of propane is being used for a taxable purpose as a motor fuel for motor fuel, then the buyer will be liable for the tax on that portion of the propane that is used for a taxable purpose as a motor fuel and the buyer, user, would be able to claim the credit for the fuel used in a motor vehicle.

- (2) Registration Test – you must register with the IRS and be classified as an “Alternative Fueler.” In order to be so classified you need to complete and mail IRS Form 637 entitled “Application for Registration for Certain Excise Tax Activities.” The IRS will then notify you when you are registered. If you already have either a Certificate of Registry or a Letter of Registration, you are grandfathered in and do not have to register immediately and thus you may start to claim the credit on your Form 720 filings; however, we recommend that you go ahead and file Form 637 as everyone must be registered as an “Alternative Fueler” by July 1, 2007 in order to take the credit.

The Credit – How to Claim the Credit

Once you are properly registered you may start claiming the credit. First, the 50 cent credit must be claimed as a credit against your propane or other special fuel tax liability under Section 4041 of the IRC on Form 720. On Form 720 you will report 18.3 cents per gallon in tax on Part 1 and then claim 18.3 cents of the 50 cents as a credit on Schedule C. In this manner, your net tax liability for these filings should typically be zero.

In order to receive the remainder of the 50 cent/gallon credit (31.7 cents) you must file IRS Form 4136 at the end of the taxable year. Form 4136 allows you to claim a credit against your income tax liability. If your income tax liability is less than the credit, the IRS will send you a check for the difference. In other words, this is a **refundable** credit and is due to you even if you have no further federal tax liability.

Tax Exempt Sales, Forklifts and Airport Tugs

In some cases, where the sale of propane is exempt from tax (sale to a government or nonprofit educational organization, or off highway business use such as forklifts and airport tugs), the filing of Form 720 will not be required as no tax is owed. However, according to sources at the IRS, **these sales will be eligible to receive the 50 cent/gallon credit.**

The question is who receives the credit. In such a sale, only if the retailer delivers the fuel directly into the fuel supply tank (fueling system) of the tax exempt vehicle will the retailer be able to claim the credit. Otherwise it is the tax exempt entity that receives the credit.

For those who may be thinking that providing replaceable tanks to forklift operators may constitute “putting fuel directly into the fueling system of the vehicle,” the IRS ruled on this matter 40 years ago. The 1965 IRS ruling stated: “[T]he delivery of the fuel in the general purpose portable containers does not constitute delivery into the fuel supply tank of a motor vehicle...” Therefore, it is the forklift operator that receives the credit—**not** the propane provider.

Further NPGA Legislative Activity on the Credit

The National Propane Gas Association (NPGA) is working with Congress in order to make a technical change in the tax law that would allow those taxpayers to claim payment for the remainder (the 31.7 cents) of the credit periodically throughout the year rather than having to wait until the end of the year. The Senate has incorporated this change in a technical correction tax bill which we hope will be passed during the lame duck session of Congress. In the meantime, one way in which you can account for the fuel credit sooner is to factor it into your estimated income tax payments. That is, you may reduce your estimated quarterly income tax payment by the amount you expect to generate that quarter in credits for your propane sales for use in motor vehicles.

Finally, while NPGA cannot provide specific legal or tax advice and we advise you to consult your tax professional, we would note that NPGA is continuing to communicate with the IRS in order to answer additional questions related to the credit that have not been clarified in IRS Notice 2006-92. Should we receive information that we think will be of interest to the membership we will most certainly pass it along.

IRS Forms and Publications

The following list of IRS publications and forms relate to the alternative fuel tax credit and should be referenced/used if one is intending to qualify for and receive the 50 cent/gallon credit. These forms and publications can be found on the IRS website (www.irs.gov):

Publication 510 -- Excise Taxes for 2006 – a publication that provides information on various federal excise taxes and fuel credits.

Form 637 – Application for Registration – form for registering with the IRS as a fuel provider.

Form 720 – Quarterly Federal Excise Tax Return -- form for determining excise taxes owed and providing the opportunity to take a portion of the fuel credit against the excise tax owed.

Form 4136 – Credit for Federal Tax Paid on Fuels – form filed at the end of the tax year to claim excise tax credit otherwise not allowed or claimed during the year (Form 720).

IRS Notice 2006-92 -- For an online copy go to <http://www.irs.gov/pub/irs-drop/n-06-92.pdf>.

IRS Contact Information

The principal author of the IRS Notice is Susan Athy of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding the IRS notice, please contact Ms. Athy at 202-622-3130.