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Fuel Tax Refund Implementation Encounters Appropriation Hurdles

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Section 6435's fuel tax refund for downstream parties stalls due to appropriation limitations.

The One Big, Beautiful Bill Act introduced a long-awaited fuel tax refund provision, §6435, to the Internal Revenue Code, allowing refunds of fuel excise taxes imposed on fuel that is subsequently dyed for a non-taxable use, notably permits "a person" (including both the original taxpayer or downstream parties) to claim these refunds. The Department of the Treasury and IRS announced such claims however will not be processed pending further guidance, due to a technical glitch in how refunds are appropriated. The OBBBA does not provide a specific appropriation for §6435 payments so refunds must be issued through the general refund appropriation, which is available only to the extent the claimant is the same person that paid the fuel tax to which the claim relates. *See* §4081, §6402; 31 U.S.C. §1324(b)(1). Absent a statutory change, Treasury and the IRS lack the authority to pay §6435 claims to anyone other than the person that paid the fuel tax on the dyed fuel to which the claim relates. This article provides historical context of the issue and discusses the current guidance.

Overview of the Federal Excise Tax System for Taxable Fuels

The federal excise tax system for taxable fuels is governed by several provisions of the Code, the corresponding Treasury regulations, and various Revenue Rulings, Revenue Procedures, and Notices. These provisions, taken together, explain how the various parties in the motor fuels supply chain will be liable for, or exempt from, federal excise taxes on taxable fuels.

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Generally, tax is imposed on the removal, entry, or sale of taxable fuels (specifically, gasoline, diesel fuel, and kerosene) in addition to other less common taxable events. The standard point of taxation is the removal of taxable fuel from a terminal rack. Significantly, removal at the terminal rack is the point at which the fuel is transferred from inside the bulk transfer/terminal system ("bulk system") into a truck or railcar for distribution, known as "breaking bulk." Conceptually, fuel moves through the bulk system in a tax-free manner but is always taxed upon breaking bulk.

Exemption for Dyed Fuel and Requirements for Non-Taxable Use

Several exemptions apply, most notably for fuel that is both dyed and intended for non-taxable uses, such as certain farming uses or off-highway business uses. These exemptions allow dyed fuel to be removed from the bulk system without payment of motor fuels excise tax. The exemption applies only to diesel or kerosene that has been indelibly dyed with red dye. The dye causes the fuel to be visually distinguishable from clear fuel. Dye is added while the fuel is still within the bulk system, providing a visual cue that the fuel is not taxed on removal but should only be sold for use in a non-taxable manner.

Once fuel breaks bulk, there is no need to dye it. Instead, if tax was imposed on undyed ("clear") fuel that is then used in a non-taxable manner, refund provisions generally allow the downstream purchaser to claim a refund—sometimes called a "payment"—of the fuel tax. Thus, the system has historically allowed a person other than the taxpayer to claim a refund, or payment, of tax based on a subsequent use of tax-paid clear fuel.

For various reasons, tax can be imposed more than once on the same fuel, typically involving fuel that re-enters the bulk system. Generally, the Code provides a mechanism to recover the second tax paid, ensuring that tax ultimately has been imposed only once on the same fuel. Historically, if clear fuel was taxed and then subsequently dyed in the bulk system, there was no way to recover the first tax paid, resulting in an anomaly in the fuel distribution system.

Historical Context: Temporary Relief for Wisconsin West Shore Pipeline

In 2016, the West Shore Pipeline in Wisconsin experienced significant operational disruptions, affecting fuel suppliers' ability to deliver fuel to customers in the region. The pipeline segment that connected Milwaukee and Green Bay was temporarily shut down for repairs and safety inspections. After initial testing, the pipeline was shut down on a temporary, but indefinite, basis and ultimately shut down permanently, causing fuel shortages in the area. Without a pipeline serving that part of Wisconsin, fuel was removed at the rack from the Milwaukee terminal (a taxable event), delivered to the Green Bay area via truck or railcar, discharged into the Green Bay terminal, and subsequently removed from the Green Bay terminal rack (a second taxable event).

The Code generally allows a refund of the second tax paid (for clear fuel), such that the tax is imposed only once on the fuel. However, if tax was imposed on clear fuel upon removal from the Milwaukee fuel terminal, and then indelibly dyed

in the Green Bay terminal, there was no mechanism to recoup the excise tax imposed on the first removal in Milwaukee, even though the dyed fuel is ostensibly tax-free.

Recognizing these challenges, from 2017 to 2021, the IRS issued a series of emergency temporary relief notices, limited in application to the West Shore Pipeline. Notice 2017-30; Notice 2018-39; Notice 2019-4; Notice 2020-04; Notice 2021-4. These notices provided a mechanism to claim a refund of the tax imposed on the first removal of fuel that was subsequently dyed for tax-free uses. The temporary relief ended Dec. 31, 2021, however, in part because technically there was no statutory authority for the relief.

Section 6435 and IRS Announcement 2026-1

Section 6435 was enacted to provide statutory authority for refund claims in scenarios similar to the West Shore Pipeline situation, but on a nationwide basis. Hence, any tax paid on clear fuel that is later indelibly dyed and removed from a terminal is now eligible for a refund. Under §6435, the claimant must establish that it removed indelibly dyed fuel from a terminal, that tax had been imposed on the fuel and paid to the government, and that there was no credit or refund of the previous tax. In addition, there is a 200% penalty for excessive claims.

Procedurally, if these claims follow the historical procedures for fuel tax refunds associated with non-taxable uses, a downstream party would be the claimant, not the original taxpayer. Nevertheless, a statutory anomaly, described below, has caused the government administrative difficulties in processing these refund claims.

As a result, the Treasury Department and the IRS released Announcement 2026-1 on Jan. 20, to announce that such claims will not be processed, pending further guidance. The announcement explains:

- Section 6435 is functionally similar to other rules providing for excise tax payments.
- Section 6435 differs from those provisions in that it lacks a directive to treat the payments as if they constitute refunds of overpayments of the underlying tax.
- The statute does not provide a specific appropriation for §6435 payments.
- The only existing appropriation for paying §6435 claims is the general refund appropriation, which is available only to the extent the claimant is the same person that paid the tax to which the claim relates; and
- Absent a statutory change, the Treasury and the IRS lack the authority to pay §6435 claims to anyone other than the person that originally paid §4081 tax on the dyed fuel to which the claim relates.

In light of this issue, the IRS announced that additional guidance will be forthcoming, requested that claimants wait to file any §6435 claims until such further guidance is issued, and stated that it will not process such claims until the guidance is issued.

Takeaways

The taxable fuel distribution system generally is set up to allow dyed fuel to be sold in a tax-free manner. There are situations, however, in which tax is imposed on clear diesel that is subsequently dyed. In those situations, purchasers of dyed fuel reasonably expect to purchase the fuel at a tax-excluded price. Similarly, the dealers of the dyed fuel understandably do not want to bear the economic burden of the original tax. Nevertheless, historically there was no mechanism to claim a refund in this situation.

Section 6435 provides such a refund mechanism, similar to the temporary relief that had been provided in connection with the West Shore Pipeline in Wisconsin. The temporary relief allowed the downstream party to file the claim for refund, consistent with longstanding refund authority related to fuel taxes. In contrast, under §6435, only the original taxpayer appears to be the eligible claimant, due to the wording of the statute and the relevant appropriation authority. As a result, the Treasury Department and the IRS have paused processing §6435 claims, pending further guidance.

In theory, §6435 would have harmonized the administration of fuel tax refunds with the practical realities of fuel distribution and supply, ensuring consistent treatment of dyed fuel and claims for refund. In practice, affected parties must continue to wait for further guidance to file their claims for refund.