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VIA ELECTRONIC SUBMISSION

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CC:PA:LPD:PR (REG-153838-04)
Room 5203
Internal Revenue Service
POB 7604
Ben Franklin Station
Washington, DC 20044

Re: Biodiesel Excise Tax Credit and Biodiesel Income Tax Credit

Dear Commissioner:

I am writing on behalf of a broad constituency of organizations, which are listed below as signatories to this letter. As you may know, the organizations listed below are stakeholders in the biodiesel industry throughout the nation, many of whom have played a key role in advancing the use of neat biodiesel (100% biodiesel or B100) as a renewable transportation fuel. The current tax regulations with respect to biodiesel are geared primarily toward taxation of biodiesel blends. However, the use of B100 as a highway fuel is growing exponentially, in parallel with the growth of the biodiesel industry in general. Thus, we feel the regulations should clarify the applicability of tax credits to the use of B100.

In response to Internal Revenue Bulletin 2005-2, dated January 10, 2005, we would like to raise the following concerns:

1. B100 should be eligible for the Excise Tax Credit under Section 6426
2. All biodiesel blends should be eligible for the Excise Tax Credit
3. The definition of a "retail sale" for tax and credit purposes should be consistent
4. The Biodiesel Income Tax Credit should be able to be carried forward
5. Calculation of the credit for agri-biodiesel and all other biodiesel should be clarified
6. Section 4041(a)(1) tax should not be imposed on a biodiesel mixture

B100 should be eligible for the Excise Tax Credit under Section 6426

We understand that the Service has initially interpreted Section 6426 in a manner that would exclude B100 from the Excise Tax Credit. We believe that interpretation is unfortunate for several reasons and respectfully request that the Service take a more expansive interpretation of Section 6426.

The spirit of the Biodiesel Excise Tax Credit created by the American Jobs Creation Act of 2004 is to encourage growth of the biodiesel industry through financial incentives that bring down the cost of biodiesel for the consumer. A growing segment of consumers see value in the ability of biodiesel to completely displace petroleum fuels, and they choose to use biodiesel in the form of B100. The most direct and effective way to reduce the cost of biodiesel to all consumers and encourage growth of the biodiesel industry is for the Excise Tax Credit to apply to all blends of biodiesel up to and including B100.

We believe the Service should broadly interpret the reference to “Biodiesel Mixture Credit” in Section 6426(c) to include all biodiesel blends from B1 to B100.

First, if a producer were to blend one batch of biodiesel with another batch of biodiesel, the resulting mixture of the two biodiesels technically fits the definition of a “biodiesel mixture” established in Section 6426(c)(3)). If a mixture of biodiesel and biodiesel technically qualifies for the Excise Tax Credit, all B100 should qualify. Section 6426(c)(3) states “[f]or purposes of this section, the term ‘biodiesel mixture’ means a mixture of biodiesel and diesel fuel (as defined in section 4083(a)(3)) . . .” Section 4083(a)(3) states that “[t]he term “diesel fuel” means any liquid (other than gasoline) which is suitable for use as a fuel in a diesel-powered highway vehicle or a diesel-powered train.” Biodiesel is “suitable for use as a fuel in a diesel-powered highway vehicle or diesel-powered train” and thus, is “diesel fuel” as defined in Section 4083(a)(3). Since biodiesel is “diesel fuel” (as defined in Section 4083(a)(3)), it follows that a mixture of biodiesel and biodiesel fits the definition of “biodiesel mixture” in Section 6426(c)(3) and thus qualifies for the Excise Tax Credit. And if a mixture of biodiesel and biodiesel qualifies for the Excise Tax Credit, then all B100 should be eligible for the Excise Tax Credit.

Second, we believe it is appropriate for the Service to broadly interpret the term “biodiesel mixture” to include all biodiesel blends, including B100, because biodiesel is both legally and commonly referred to as a “blend stock” or “blend.” The common terminology in the industry is to refer to blends of biodiesel – B20, B50, B100; similar to grades of gasoline – regular, unleaded, premium. The ASTM specification for biodiesel, D6751, is titled “Standard Specification for Biodiesel Fuel (B100) Blend Stock for Distillate Fuels.” Since biodiesel is both legally and commonly referred to as a “blend stock” or “blend” it seems appropriate that the Service broadly interpret “biodiesel mixture” to include all biodiesel blends from B1 to B100.

We further believe the Service should take an expansive interpretation of Section 6426(a) so that it includes B100 as eligible for the Excise Tax Credit. Section 6426(a) states “[t]here shall be allowed as a credit against the tax imposed by Section 4081 an amount equal to . . .” As outlined in Rev. Rul. 2002-76, biodiesel is taxed pursuant to Section 4041(a)(1) when used as or sold for use as a highway fuel. Section 4041(a)(1) imposes tax on any liquid other than gasoline sold for use or used as a fuel in a diesel-powered highway vehicle, unless tax was imposed on the liquid by Section 4081 and not credited or refunded. Section 4041(a)(1)(C) provides that “the rate of the tax imposed by this paragraph (4041(a)(1)) shall be the rate of tax specified in section 4081(a)(2)(A) on diesel fuel which is in effect at the time of such sale or use”. Thus, the excise tax imposed on biodiesel by Section 4041(a)(1) is identical to the excise tax imposed by 4081 and thus should qualify for the Excise Tax Credit. The wording of Section 6426(a) appears to be an oversight in the fact that it did not specifically include excise taxes levied by Section

4041(a)(1). Again we feel that strict interpretation of 6426(a) to not include excise tax levied by Section 4041(a)(1) was not the intent of Congress, and that the guidelines should permit the Excise Tax Credit for the case where the tax rate is based on Section 4081, whether it is imposed by Section 4081(a) or 4041(a)(1).

One of the most unfortunate implications of the B100 not qualifying for the Excise Tax Credit is the disincentive this would provide to non-income tax paying entities such as 501(c)(3)s, municipalities, and state government agencies to use B100. After talking to Renee Kramer at the Service, we understand that government agencies are subject to the diesel excise tax in some cases and not in others and that 501(c)(3)s are generally subject to the diesel excise tax, but not always. If our understanding is correct, we are concerned that unless the Excise Tax Credit is available for B100 these non-income tax paying entities receive no tax benefit from using B100. These non-income tax paying entities are key biodiesel consumers and, consistent with Congress' intent, the Service should be looking for ways to provide incentives to these key consumers to use biodiesel. If B100 is not eligible for the Excise Tax Credit, and these non-income tax paying entities cannot make use of the Income Tax Credit by virtue of the fact that they do not pay income tax, the cost of B100 for such users will remain prohibitively high. Without the Excise Tax Credit for B100, it will place an undue financial burden on non-income tax paying entities to use cleaner burning B100.

Furthermore, not allowing the Excise Tax Credit for B100 would create perverse incentives. The B100 community will have a strong financial incentive to add the minimum amount of diesel fuel to the B100 in order to qualify for the Excise Tax Credit. This limits consumer choice and harms air quality, as B100 is better for the environment than any biodiesel blend that includes petroleum diesel fuel ("petro-diesel"). Widespread acceptance of biodiesel requires a certain level of consumer education. Proponents of biodiesel have expended much time and effort to clearly educate the public about the use of biodiesel. B100 has a definite meaning as pure biodiesel, the most renewable alternative diesel fuel available. Failure to include B100 in the Excise Tax Credit will artificially create a market demand for B99 or other high biodiesel blends. This will lead to confusion in terminology, and may hinder growth of the biodiesel market. We feel that excluding B100 from the Excise Tax Credit penalizes those who want to use biodiesel in its purest form, and thus is not in the spirit of the American Jobs Creation Act.

Finally, we are concerned about the complexity of compliance if the Excise Tax Credit does not include B100. If a distributor purchases 10,000 gallons of biodiesel and sells a portion of it as B100 and blends the rest with petro-diesel, two separate records must be kept. The distributor must keep one set of records to claim the Excise Tax Credit for the blended portion of the biodiesel and another set of records for the portion of the biodiesel sold as B100 for the Income Tax Credit. Such complexity generally adds costs to the taxpayer's business and leads to noncompliance. We believe it would be poor public policy to have the taxation of biodiesel turn on whether or not the biodiesel was used as fuel in the form of B100 or blended with petro-diesel. It would be far simpler if all biodiesel, including B100, were eligible for the Excise Tax Credit, as is the case with the Income Tax Credit. Then the taxpayer could choose what credit was best for them, which in turn would provide the greatest stimulus to the biodiesel industry, which was Congress' intent in including the biodiesel tax credits in the American Jobs Creation Act.

We kindly request that the Service consider a broad interpretation of Section 6426 consistent with the above and allow B100 to be eligible for the Excise Tax Credit.

All biodiesel blends should be eligible for the Excise Tax Credit

The Treasury and Service specifically invited comments regarding the definition of “diesel fuel” and “diesel fuel blendstocks” that should be classified as diesel fuel. We believe the following framework should be used for diesel fuel and diesel fuel blendstocks.

Section 6426(c)(3) defines a “biodiesel mixture” as “. . . a mixture of biodiesel and diesel fuel (as defined in Section 4083(a)(3)) . . .” Accordingly, we believe it was Congress’ intent that any biodiesel mixture, irrespective of the percentage of diesel and biodiesel (and irrespective of the percentage of paraffin), would qualify for the Biodiesel Mixture Credit.

The alternative framework that we have heard articulated is that the biodiesel mixture itself must be a “diesel fuel” as defined in Section 48.4081-1(c)(2) of the Manufacturers and Retailers Excise Tax Regulations in order for the biodiesel mixture to qualify for the Excise Tax Credit. Such a rule would require that the biodiesel mixture contain at least 4% normal paraffins, or else the biodiesel mixture would be an excluded liquid under Section 48.4081-1(b). This approach seems contrary to the clear intent of Congress.

We believe the bright line rule set forth by Congress in Section 6426(c)(3) provides the better framework for determining what is diesel and what biodiesel mixtures qualify for the Excise Tax Credit. The alternative framework outlined above would create unnecessary uncertainty and confusion for the biodiesel blenders, who would constantly have to determine the paraffin level of the mixture under such a system.

The definition of a “retail sale” for tax and credit purposes should be consistent

Section 40A(b)(2) specifies that in order for a sale of B100 to qualify for the Biodiesel Income Tax Credit, the B100 “(i) is used by the taxpayer as a fuel in a trade or business, or (ii) is sold by the taxpayer at retail to a person and placed in the fuel tank of such person’s vehicle.” The requirement that the fuel be “placed in the fuel tank of such person’s vehicle” does not reflect the way B100 is often sold to the public and appears to be inconsistent with IRS Rev. Rul. 2002-76 regarding the taxation of biodiesel. These inconsistencies need to be resolved.

First, biodiesel is often sold to the public in intermediate portable storage containers, such as five-gallon containers or 55-gallon drums. The purchaser then places the fuel into his or her own fuel tank at some later time.

Second, Rev. Rul. 2002-76 states that biodiesel is taxed pursuant to Section 4041(a)(1) “. . . sold for use or used as a fuel in a diesel-powered highway vehicle . . .” There is no requirement that the biodiesel be “placed in the fuel tank of such person’s vehicle.” Thus, there appears to be an inconsistency in how biodiesel is taxed and how the Biodiesel Income Tax Credit operates. This inconsistency creates a situation where the sale of biodiesel in intermediate storage containers is

taxable pursuant to Section 4041(a)(1), but is not eligible for the Income Tax Credit because it was not placed into the tank of the person's vehicle at the time of sale.

We would greatly appreciate clarification on when the Section 4041(a)(1) tax is applicable and when the Income Tax Credit is applicable for retail sales of biodiesel where the fuel is not placed into the fuel tank of the person's vehicle.

The Biodiesel Income Tax Credit should be able to be carried forward

It is not clear to us whether or not the Biodiesel Income Tax Credit can be carried forward. In a phone conversation with Susan Athy on February 10, 2005, she was unable to answer whether or not the Biodiesel Income Tax Credit can be carried forward. Ms. Athy kindly referred me to Susan Reman, in department 5 of passthroughs, but as of today, I have not heard back from Ms. Reman. We believe the Biodiesel Income Tax Credit should be able to be carried forward. Many of the businesses selling biodiesel are small businesses, and like many new businesses, they initially have limited or no taxable income. Thus, if the Biodiesel Income Tax Credit cannot be carried forward, it would not provide the incentive Congress intended when it passed the Biodiesel Income Tax Credit as part of the American Jobs Creation Act of 2004, because it would be of limited use to the nascent biodiesel industry.

Calculation of the credit for agri-biodiesel and all other biodiesel

It is unclear from the Bulletin how the credit for a mixture that included both agri-biodiesel and non-agri-biodiesel would be calculated. We believe that the credit should be based on the individual credits of each fuel. This should be administratively easy, since a certificate from the producer of the biodiesel is required to claim the credit.

For example, in a 10,000 gallon mixture comprised of 5,000 gallons of diesel, 2,500 gallons of agri-biodiesel and 2,500 gallons of non-agri-biodiesel, the calculation of the tax incentive should be $2,500g \times \$1.00 + 2,500g \times \0.50 for a total Excise Tax Credit of \$3,750.

Section 4041(a)(1) tax should not be imposed on a biodiesel mixture

Section 4041(a)(1) imposes tax on any liquid other than gasoline sold for use as a fuel in a diesel-powered highway vehicle, unless tax was imposed on the liquid by Section 4081 and not credited or refunded. Since Section 6426 provides a credit against the tax imposed by Section 4081 for a biodiesel mixture, it seems that the biodiesel mixture may be taxable under Section 4041(a)(1). We do not believe that this was the intent of Congress. There may be a provision in Section 4041 or Section 6426 that addresses this issue, but if there is we were unable to find it. Please confirm that a biodiesel mixture, which is taxed pursuant to Section 4081 and which receives a credit pursuant to Section 6426 is not taxable pursuant to Section 4041.

Thank you for consideration of these important matters. If you have any questions or need anything further please contact me at 415-218-3766.

Sincerely,

/s/ Eric M. Bowen

Eric M. Bowen
Attorney-at-Law

On behalf of:

Advanced Biofuel Technologies -CA
AgriFuels LLC - CA
Alameda Biofuel Coop - CA
Ann Arbor Area Clean Cities - MI
ApolloPower - CA
Bay Area Biofuel - CA
Berkeley Biodiesel Coop - CA
Biodiesel Council of California - CA
BioFuel Oasis - CA
Biofuel Station - CA
Blue Ridge Biofuels - NC
Blue Ridge Clean Fuels - VA
Borrego Solar Systems - CA
Carolina Biodiesel Inc. - NC
Central Oklahoma Clean Cities Coalition - OK
Centralina Clean Fuels Coalition - NC
Chico Biofuels - CA
Colorado Biodiesel - CO
Community BioFuels LLC - NY
CoopPlus - MA
CoopPower – MA
CU Biodiesel - CO
Denver Biodiesel - CO
Dr. Dan's Alternative Fuelwerks - WA
Earthship Biodiesel - NM
Eastern Tennessee Clean Fuels Coalition - TN
Ecology Center - CA
Florida Space Coast Clean Cities Coalition - FL
Florida Gold Coast Clean Cities Coalition - FL
FryAway Veggie Fuels - MN
Gardner, O'Connor Inc. - MD
Greater New Haven Clean Cities Coalition - CT
Greater Philadelphia Clean Cities Program - PA
Green Energy Network - CA
Green Means Go - CA
Green Trust - NY

Harbec Plastics, Inc. – NY
Healthfuel - CA
Honolulu Clean Cities - HI
Mack Biodiesel - NY
Mexican Bus - CA
Middle Georgia Clean Cities Coalition - GA
National Clean Cities, Inc. - Washington, DC
National Cooperative Business Assoc. - Washington, DC
NC Solar Center Clean Transportation Program - NC
Northeast Biodiesel Co. - MA
Northeast Ohio Clean Cities/Earth Day Coalition - OH
Northern Development, LLC. - NY
Ocean State Clean Cities, Inc. - RI
Off The Grid Consulting- CA
Pacific Biofuel - CA
Paul's Landscaping - OR
Peoples Power & Light –RI
Philadelphia Fry-O-Diesel - PA
Piedmont Biofuels - NC
Rochester Biodiesel, Inc. - NY
Salt Lake Clean Cities - UT
San Francisco Biofuels Cooperative – CA
San Joaquin Valley Farm Fuels - CA
Sequential Biofuels - OR
Seven-Star: Planners, Producers, Consultants - NC
Simple Fuels, LLC - NV
Sonoma County Biodiesel Coop - CA
St. Louis Clean Cities - MO
Sun Light & Power - CA
The Energy Cooperative - PA
Triangle Clean Cities Coalition - NC
Twin Cities Biodiesel Collective - MN
Utah Biodiesel Cooperative - UT
Valley of the Sun Clean Cities Coalition - AZ
Warren Wilson College Transportation Dept. - NC
Western New York Clean Cities - NY
Yokayo Biofuels - CA