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The IRS Is Wrong: Butane Is an Alternative Fuel

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In this article, the authors discuss a recent revenue ruling that they argue incorrectly assumes that a substance cannot be both a taxable fuel and an alternative fuel.

In Rev. Rul. 2018-2, 2018-2 IRB 277, the IRS stated that butane-gasoline mixtures do not qualify for the now-expired alternative fuel mixture credit found at section 6426(e). That ruling is based on the theory that butane is a gasoline blendstock and thus a "taxable fuel," not an "alternative fuel." Despite that pronouncement, butane is an alternative fuel that can qualify for the credit when mixed with gasoline. The ruling incorrectly assumes that a substance cannot be both a taxable fuel and an alternative fuel. It also fails to address the circumstances in which butane is a taxable fuel.

The Alternative Fuel Mixture Credit

Section 6426(e) allows a credit of 50 cents per gallon of alternative fuel that a taxpayer uses in producing an alternative fuel mixture for sale or for use in the taxpayer's trade or business. A taxpayer claims the credit against the 18.3-cents-per-gallon excise tax on "taxable fuel" found in section 4081. The credit expired as of December 31, 2016.[1]

An "alternative fuel mixture" requires a mixture of "alternative fuel" and "taxable fuel." Alternative fuel is defined in section 6426(d)(2)(A) to include "liquefied petroleum gas." Butane is universally regarded as a liquefied petroleum gas (LPG) in the petroleum industry, and a regulation relating to the tax imposed on special motor fuel unambiguously refers to it as such.[2]

Taxable fuel, the other component of an alternative fuel mixture, is defined to include gasoline.[3] The statute also provides that gasoline includes gasoline blendstocks, to the extent prescribed in regulations.[4] The "term 'gasoline blend stock' means any petroleum product component of gasoline."[5] The regulations state that butane is a gasoline blendstock included in the definition of gasoline.[6]

The IRS's Position

The IRS's position is that butane is a gasoline blendstock under the regulations, and thus gasoline and a taxable fuel. According to the IRS, a gasoline-butane blend "is a mixture of two taxable fuels" and, for that reason, "it is not an alternative fuel mixture and does not qualify for the alternative fuel mixture credit."[7]

Rev. Rul. 2018-2 does not take issue with the statutory definition of "alternative fuel" that includes any LPG.[8] However, the revenue ruling attempts to distinguish reg. section 48.4041-

[1] On December 20, 2017, Senate Finance Committee Chair Orrin G. Hatch, R-Utah, introduced a bill that would, if enacted, extend the alternative fuel mixture credit through 2018. Tax Extenders Act of 2017, S. 2256, 115 Cong., section 315(a)(1) (Dec. 20, 2017).

[2] *See* reg. section 48.4041-8(f)(1)(i).

[3] Section 4083(a)(1)(A).

[4] Section 4083(a)(2)(B)(i).

[5] Section 4083(a)(2)(B) (flush language).

[6] *See* reg. section 48.4081-1(b) (definition of "gasoline"), (c)(3)(i)(B) (defining butane as a "gasoline blendstock").

[7] *See* Rev. Rul. 2018-2, 2018-2 IRB, at 278.

[8] *See* section 6426(d)(2)(A).

8(f)(1)(i), which includes butane in the definition of LPG. The revenue ruling argues that this definition should be ignored because the next subsection of the regulation, reg. section 48.4081(f)(2), states that "'special motor fuel' does not include any product taxable under the provisions of section 4081."[9] Thus, the IRS claims that "the language in section 48.4041-8(f) that suggests that butane is a type of LPG also contains an express exception for products taxable under section 4081."

More significantly, the core of the IRS's argument is that because butane is a gasoline blendstock and "because gasoline blendstocks are taxable under section 4081 . . . butane is a taxable fuel and not an alternative fuel." In other words, the IRS's view is that if butane is a taxable fuel, it cannot be an alternative fuel.

Butane Is Alternative Fuel Under the Statute

LPGs are unquestionably alternative fuels under section 6426(d)(2)(A). Butane is broadly considered by science and industry to be an LPG, which is highly significant for purposes of statutory interpretation.[10] Further, as noted above, butane is included as an LPG in reg. section 48.4041-8(f)(1)(i), which relates to the taxation of special motor fuels under section 4041(a)(2).

The IRS's Argument Misses the Mark

Rev. Rul. 2018-2 does not contest that butane is generally considered an LPG in the relevant science and industry. The IRS's only point regarding whether butane is an LPG is to note that reg. section 48.4041-8(f) "also contains an express exception for products taxable under section 4081." It is true that the regulation excepts LPGs (and other fuels) taxable under section 4081 from being "special motor fuel," which, again, are the fuels taxed under section 4041. That makes perfect sense, because a fuel should not be taxed under both sections 4081 and 4041. However, even though butane is sometimes excepted from being a special motor fuel because it can be taxed under section 4081, nothing in the regulation excepts butane *from being an LPG* under any circumstances. To the contrary, the regulation flatly states that butane is an LPG. In short, whatever else might be said about butane, it is always an LPG.

Taxable Fuel Can Also Be Alternative Fuel

Perhaps because the IRS cannot credibly argue that butane is not an LPG, the crux of the IRS's position is that butane is a taxable fuel. That alone, says the IRS, means that butane cannot be an alternative fuel. As the IRS put it in the revenue ruling, "because gasoline blendstocks are taxable under section 4081 . . . butane is a taxable fuel and not an alternative fuel." But the IRS offers no persuasive authority for that proposition. Moreover, even if the IRS were correct that butane is a taxable fuel in all circumstances, a point we do not concede, that would not preclude butane from also being an alternative fuel.

On the contrary, the IRS has agreed that a substance can be both a taxable fuel and a credit-qualifying fuel. It did just that with the biodiesel mixture credit found in section 6426(c). That credit operates similarly to the alternative fuel mixture credit and requires a "biodiesel mixture," which is a "mixture of biodiesel and diesel fuel." Diesel is a taxable fuel.[11] In Notice 2007-37, 2017-29 IRB 89, the IRS stated that renewable diesel is treated as biodiesel for purposes of the credit, even though renewable diesel is also, as the IRS likewise acknowledged in Notice 2007-37, diesel and thus a taxable fuel. Thus, "a mixture of

[9] Section 4041(a)(2) imposes a "back-up" excise tax on any liquid (other than gas oil, fuel oil, or any product taxable under section 4081) used or sold for use by any person for use in a motor vehicle or motor boat. Although the subheading for section 4041(a)(2) currently refers to these fuels as "alternative fuels," in the past they were referred to as "special motor fuels." *See* section 11113(a)(3) of the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (P.L. 109-59) (amending the subheading for section 4041(a)(2) by striking "Special Motor Fuels" and inserting "Alternative Fuels"). The term "alternative fuel" does not appear in section 4041's statutory text. The regulations under that section, including reg. section 48.4041-8, use the phrase "special motor fuel." We adopt that terminology to avoid confusion with "alternative fuel" under section 6426.

[10] *See Corning Glass Works v. Brennan*, 417 U.S. 188, 202 (1974) ("where Congress has used technical words or terms of art, it [is] proper to explain them by reference to the art or science to which they [are] appropriate") (internal quotations omitted); *see also* LAFA 2015100F (citing similar language in interpreting the meaning of "compressed natural gas" for purposes of the definition of "alternative fuel" under section 6426(d)).

[11] *See* section 4083(a)(1)(B).

renewable diesel and diesel fuel (other than renewable diesel)" qualifies as a "renewable diesel mixture."[12]

In a chief counsel advice memorandum issued several years later, the Office of the Chief Counsel followed Notice 2007-37.[13] The memorandum explained that Notice 2007-37 "distinguishes between the treatment of renewable diesel for purposes of credits and the treatment of renewable diesel for purposes of the fuel excise tax provisions." On one hand, "renewable diesel is a taxable fuel under section 4083(a)(1) and is therefore taxed in the same manner as petroleum-based diesel fuel" meaning that "tax is imposed on certain removals, entries, and sales of renewable diesel under section 4081(a)(1)(A)." On the other hand, "renewable diesel is treated as biodiesel for purposes of credits" under section 6426. Similarly, butane can be an alternative fuel under section 6426 and, at the same time, a taxable fuel under sections 4081 and 4083.

In support of its conclusion that butane being a taxable fuel precludes it from being an alternative fuel, Rev. Rul. 2018-2 cites Notice 2006-92, 2006-2 C.B. 774, which states that a "liquid alternative fuel . . . is a liquid other than . . . taxable fuel."[14] The notice offers no support for the IRS's position. First, if Notice 2006-92 were read to exclude taxable fuel LPGs from section 6426(d)(2)'s definition of alternative fuel, it would be inconsistent with the plain meaning of the statute, which contains no such exclusion.

Second, the cited statement in Notice 2006-92 refers to fuels that are taxable under section 4041(a)(2), not fuels that are eligible for the alternative fuel or alternative fuel mixture credits. That is, in section 6(a)(1) the notice is simply using the term alternative fuel as a synonym for special motor fuel, which, as noted above, is the type of fuel taxable under section 4041(a)(2).[15] Notably, the notice elsewhere contains a separate definition of "alternative fuel" as that term is used in section 6426: "Alternative fuel means liquefied petroleum gas," among other substances.[16] This definition tracks the language in section 6426(d)(2) and does not exclude LPGs that are taxable fuels. It is that part of Notice 2006-92 — which directly addresses the question of what an "alternative fuel" is for purposes of section 6426(d) — that should govern.

Third, the cited portion of Notice 2006-92, which uses the term taxable fuel, misstates the relevant law from section 4041(a)(2) and reg. section 48.4041-8(f)(2). Those provisions state that "any product taxable under" section 4081 cannot be subject to tax under section 4041(a)(2); they do *not* use the statutorily defined term "taxable fuel." In other words, section 4041(a)(2) and the regulation thereunder simply ensure that a particular batch of fuel is not subject to tax under both sections 4081 and 4041. They say nothing about whether a taxable fuel, as defined in section 4083, can also be an alternative fuel.

Further, if the IRS were correct that special motor fuels taxable under section 4041(a)(2) cannot be "taxable fuel," that would undercut, not support, Rev. Rul. 2018-2's conclusion. That is because butane clearly can be taxable under section 4041(a)(2). Were that not the case, Treasury would have no reason to include butane in the definition of special motor fuel.[17] Under the IRS's logic, that butane can be subject to tax under section 4041(a)(2) means that it is not always "taxable fuel." But when does it become a taxable fuel?

Timing Is Everything

Rev. Rul. 2018-2 fails to address an important issue: Is butane always a taxable fuel and, if not, when does it become one? As noted, the flush language at section 4083(a)(2)(B) states that "the term 'gasoline blend stock' means any petroleum product component of gasoline." This can be read to mean that unless and until stand-alone butane

[12] Notice 2007-37.

[13] *See* CCA 201144024.

[14] Notice 2006-92, section 6(a)(1).

[15] *See* section 4041(a)(2); and reg. section 48.4041-3(a), (b).

[16] Notice 2006-92, section 2(a).

[17] *See* reg. section 48.4041-8(f)(1)(i) (LPG, including butane, can be special motor fuel subject to tax under section 4041(a)(2)); *see also* Rev. Rul. 2018-2, 2018-2 IRB 277 ("Section 4041(a) generally imposes a tax on the sale or use of certain liquids, including LPG.").

is actually mixed with gasoline, it is not a blendstock and thus not a taxable fuel.

In places, Rev. Rul. 2018-2 appears to adopt that view. For example, it concludes that "since Producer used butane in the production of finished gasoline, the butane is a gasoline blendstock." The implication is that had butane not been used in that manner, it would not be a gasoline blendstock. Similarly, the very notice on which Rev. Rul. 2018-2 relies states that fuels "subject to the tax imposed by section 4041(a)(2)" include liquids "other than . . . taxable fuel."[18] As also discussed above, butane is sometimes taxed under section 4041(a)(2), not section 4081.[19] If fuel taxable under section 4041(a)(2) is not "taxable fuel," and if butane is sometimes taxable under that section, then butane is not inherently "taxable fuel."

Once butane is mixed with gasoline, it can be said to be a "component of gasoline" and thus a gasoline blendstock and taxable fuel.[20] But that would not disqualify the resulting blend from being an alternative fuel mixture.[21] For Rev. Rul. 2018-2's conclusion to be valid (assuming, *arguendo*, that it is correct that a substance cannot be simultaneously a taxable fuel and an alternative fuel), butane would have to be a taxable fuel *before* it is mixed with gasoline. The revenue ruling makes no effort to explain why that should be the case.

Conclusion

Section 6426(d)(2)(A) defines alternative fuel to include LPG. Butane is undoubtedly an LPG, as the petroleum industry and Treasury's own regulation recognize. Thus, under the plain language of the statute, butane is an alternative fuel. Rev. Rul. 2018-2 fails to address this fundamental point. It likewise does not consider that, even assuming the IRS is correct that butane is a taxable fuel, it simultaneously can be an alternative fuel. The revenue ruling also fails to explain the basis for its apparent position that butane is a taxable fuel even before it is mixed with gasoline. No matter how these issues are resolved, one truth remains: Butane is an LPG and thus an alternative fuel under the statute. ■

[18] Notice 2006-92, section 2(a)(1).

[19] *See* reg. section 48.4041-8(f)(1)(i); *see also* reg. section 48.4081-4(a) ("Generally, under prescribed conditions, tax is not imposed [under section 4081] on gasoline blendstocks that are not used to produce finished gasoline or that are received at an approved terminal or refinery.").

[20] Section 4083(a)(2)(B).

[21] *See, e.g.*, Notice 2006-92, section 6(b)(1) (noting that "an alternative fuel mixture" might be "taxable fuel" that "is subject to tax imposed by section 4081").