

July 26, 2005

CC:PA:LPD:PR (REG-154000-04)
Room 5203
Internal Revenue Service
POB 7604, Ben Franklin Station
Washington, DC 20044

Re: Diesel Fuel and Kerosene Excise Tax; Dye Injection
26 CFR Part 48; REG-154000-04; RIN 1545-BEO4

Dear Sir or Madam:

The Independent Liquid Terminals Association (ILTA) is pleased to submit the following comments on the above-referenced proposed rule. ILTA is an international trade association that represents 74 owners and operators of bulk liquid terminals, aboveground storage tank facilities, and pipeline facilities located throughout the United States and in 40 other countries. ILTA members operate 542 facilities consisting of 10,362 tanks with a total storage capacity of 533 million barrels. About 325 million barrels of capacity is in storage facilities located in the United States. The terminal facilities operated by ILTA members are an essential component of our nation's bulk liquid transportation system. They provide storage, loading and unloading services for oceangoing tankers, barges, tank trucks, railcars and pipelines. The commodities handled include diesel fuel and other petroleum products, crude oil, and a large variety of chemicals, as well as fertilizers, animal fats and oils, spirits, vegetable oils and molasses.

Location of Mechanical Dye Injection Systems

The proposed regulations provide that one of the conditions for IRS approval of a mechanical injection system is that the system automatically inject dye into diesel fuel or kerosene "as the diesel fuel or kerosene is delivered from the bulk/transfer terminal system into the transport compartment of a truck, trailer, railroad car, or other means of nonbulk transfer." 26 CFR 48.4082-1T(d)(2). This language effectively prohibits the transfer of dyed diesel fuel or kerosene from a petroleum product pipeline into a bulk liquid terminal. It also effectively prohibits a terminal from dyeing fuel before the fuel is transferred by pipeline to another terminal or transferred through piping to a dock where it can be loaded onto a barge.

Restricting the location of mechanical dyeing systems to terminal loading racks for trucks or railcars has the potential for causing major disruptions in the distribution of diesel fuel for non-road uses, such as farm operations and construction projects. About one-third of the diesel fuel consumed in the United States is used in non-road engines. Petroleum product pipeline operators dye significant amounts of these non-road volumes just before the diesel fuel leaves the pipeline system and enters a terminal. If these pipelines were compelled by IRS regulations to terminate this service, then the receiving terminals that have loading racks but do not already have mechanical dye injectors would have to either purchase the injectors or cease handling dyed

diesel fuel received from pipelines. It is highly likely that some terminals would choose the latter option, due to the cost of mechanical injection systems and the lack of adequate time for obtaining IRS approval of the systems and then installing them prior to the October 24, 2005 deadline.

Disruptions of the diesel distribution system could also occur if terminals that now receive dyed diesel fuel by barge (for storage and subsequent loading into tank trucks) find that they will no longer receive dyed fuel. It cannot be reasonably presumed that these terminals would all acquire the necessary mechanical dye injection equipment. Similarly, for terminals that receive dyed fuel from pipelines and transfer it by a facility piping system or small-diameter pipeline to a barge dock rather than a truck or railcar loading rack, a reasonable choice as a compliance option may be to stop handling dyed fuel.

These potential adverse consequences can be easily avoided by deleting from the final rule the language requiring that mechanical dye injection systems can only be used at the truck or railcar loading racks of bulk liquid terminals. The benefits of prohibiting manual dyeing could still be retained if mechanical injection systems continued to be used at refineries and at pipeline-terminal delivery points, as well as terminal loading racks.

The Service has the statutory discretion to make this change in the final regulations. As amended by the American Jobs Creation Act of 2004, Section 4082 of the Internal Revenue Code provides in subsection (a)(2) that the tax imposed by section 4081 shall not apply to diesel fuel and kerosene that is indelibly dyed by mechanical injection in accordance with regulations prescribed by the Secretary. The amendment added the words, “by mechanical injection.” It did not specify where the mechanical injection should occur. Thus, there is no statutory requirement that mechanical dye injection occur only at the loading racks of bulk terminals.

Approval Process for Mechanical Injection Systems

The proposed regulations in subsection (d)(2) include a set of specified physical features for a mechanical injection system that serve as separate conditions for IRS approval of that system. By including these mandatory features, the Service has created a highly inflexible set of requirements that go far beyond what Congress required in the American Jobs Creation Act of 2004. Congress merely required that the implementing regulations include “standards for making such systems tamper resistant.” Congress did not *require* the IRS to specify a set of physical features for each approved system. Nevertheless, the proposed regulations impose requirements pertaining to location, automatic shut-off devices, unbroken seals or secured containers, and a unique identifying number for each seal.

There is no need for this set of complex and burdensome requirements. Automated dye injection systems typically have safeguard features that can detect and prevent tampering. For example, the systems monitor the flow volumes of both the dye additive and the fuel that is dyed. If discrepancies in set ratios are detected, an out-of-tolerance alarm will sound and the system will automatically shut down. Also, if a mechanical malfunction cuts off the flow of dye or fuel, a no-flow alarm will be triggered and the system will automatically shut down. Automated systems already have tamper protection seals for the controls that adjust the frequency and

volume of dye injection. The use of these seals, together with reliance on the automatic shutdown features, virtually eliminates the possibility that someone could use an automated dye injection system to load clear fuel that should have been dyed.

The use of a complex pre-approval process for specific features of injection systems would add very little to the benefits already derived from eliminating manual dyeing and from the fact that Congress itself has mandated new statutory penalties for tampering with or failing to maintain security requirements for mechanical dye injection systems. These new penalties, which were included in the American Jobs Creation Act of 2004, have a substantial deterrent effect. For example, tampering with a system triggers a minimum penalty of \$25,000.

In addition, the pre-approval process established in the proposed regulations is not a practical way to impose the security standards required by Congress. There is insufficient time for the process to be completed prior to October 24, 2005, the effective date of the mechanical dye injection requirement. ILTA has already received inquiries from member companies about the availability of the application forms that need to be submitted. The forms are not yet available, in spite of the fact that less than three months remain before the regulations take effect. It seems clear that there is not enough time for the IRS to review and approve hundreds of written applications, and there is not enough time for the bulk liquid terminal industry to then procure, install and test the equipment prior to the deadline.

Therefore, as a time-saving alternative to pre-approval of injection systems that have specified equipment and features, ILTA recommends that the Service prescribe a performance-based standard that simply requires each system to have the capability to shut down in the event of tampering or a mechanical malfunction. It would also be reasonable for the Service to require terminals to maintain appropriate records demonstrating that the equipment in each injection system has been properly inspected and calibrated.

Inspection of Mechanical Injection Systems

The proposed regulations require each operator of a mechanical injection system to “visually inspect each installed seal not less than once during every 24 hour period to ascertain that each seal and lock mechanism, if applicable, has not been physically altered.” 26 CFR 48.4082-1T(d)(4)(ii). This provision would impose an unreasonable economic burden on the hundreds of small distribution terminals that are located throughout the country and are not manned on weekends. These terminals would have to pay the added labor costs of two trips to a terminal each weekend. In rural areas, the workers assigned to conduct the inspections may live an hour’s drive away from the terminal. A weekend inspection requirement would undoubtedly prompt some terminals to eliminate the loading of dyed fuel during weekends or to eliminate the handling of dyed fuel altogether.

There is no need for weekend inspections of mechanical injection systems at terminals. Tampering of the seals or systems by persons with authorized access is highly unlikely during unmanned hours. The only people with access to the terminal during those periods would be the drivers of the trucks that come in to load fuel. The identities of these individuals are easily determined through electronic key-card entry systems, other automated ID systems associated

with the loading of trucks, and the records of the trucking companies. The entry of unauthorized persons into unmanned terminals is also highly unlikely. In the very rare instances when that occurs, vandalism is usually the primary objective, not tampering with the mechanical dye injection system. For these reasons, ILTA recommends that paragraph (4)(ii) be removed from the final rule.

Out-of-Service Notification

The proposed regulations require that terminals promptly notify the IRS if, and when, the dye injection system is placed out of service. 26 CFR 48.4082-1T(d)(4)(x). ILTA recommends that this provision be deleted from the final rule. It amounts to an unnecessary intrusion into the routine operations of bulk liquid terminals. A dye injection system may be temporarily “placed out of service” for repairs, maintenance or an upgrade. It may be permanently placed out of service if it is replaced by another system, if the dye injection service is eliminated at a particular loading rack, or if the terminal decides to cease handling dyed diesel fuel. There is no nexus between notifying the IRS of these developments and eliminating non-compliance with the federal excise tax on fuels. Moreover, as a practical matter, the IRS is not likely to commit the manpower needed to investigate every instance when an injection system is taken out of service. Without such an investigation, the notification is relegated to a procedural step with no real value. If the information has no practical use for the IRS, then requiring notification is, by definition, an undue burden on terminals.

Thank you for your consideration of these comments.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "E. David Doane", with a long horizontal flourish extending to the right.

E. David Doane
President, ILTA