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August 19, 2008

Opinion No. 08-142

Applicability of Tennessee diesel tax to transfers between or among licensed suppliers and exporters

QUESTIONS

1. Are sales of diesel fuel between licensed diesel fuel suppliers over the terminal rack in Tennessee subject to the diesel tax under Tenn. Code Ann. § 67-3-202 (2006)?

2. Can a licensed supplier sell diesel fuel tax free to another licensed supplier if the purchase is for export outside the state of Tennessee based on the fact that the purchasing supplier holds a supplier license rather than an exporter license?

3. If a destination state other than Tennessee is indicated on the bill of lading, is the destination state's tax the correct tax to be charged by a position holder even if the position holder's customer is not the party actually exporting the product from the state of Tennessee?

OPINIONS

1. Yes. The transfer is not a "bulk transfer" and there is no exemption from the tax under Tenn. Code Ann. §§ 67-3-401 *et seq*. (2006 & Supp. 2007) merely because the transferor and transferee are both licensed suppliers.

2. Yes, assuming the other requirements of the exemption under Tenn. Code Ann. § 67-3-405 (2006) are satisfied. The exemption is limited to transferees who are "licensed" in Tennessee, but does not specify that the license must be an exporter's license instead of a supplier's license.

3. No. The Tennessee diesel tax is the correct tax to be charged by the position holder because the position holder's customer does not immediately export the diesel fuel to another state.

ANALYSIS

1. Pursuant to Tenn. Code Ann. § 67-3-202(a) (2006), a use tax is imposed on diesel fuel:

> (a) Subject to exemptions provided in part 4 of this chapter, a use tax of seventeen cents (17¢) per gallon is imposed upon all diesel fuel and all fuel other than gasoline that is suitable for

> use in a diesel-powered vehicle or that is used or consumed in this state to produce power for propelling motor vehicles[.]

Tenn. Code Ann. § 67-3-302(a) (2006) provides for the measurement of the diesel tax:

> (a) The tax imposed by § 67-3-202 shall be measured by taxable gallons removed, other than through a bulk transfer, by a licensed supplier:
>
> > (1) From the bulk transfer/terminal system or from a qualified terminal or refinery within this state;
> >
> > (2) From the bulk transfer/terminal system or from a qualified terminal or refinery outside this state for delivery to a location in this state as represented on the shipping papers; provided, that the supplier imports such taxable motor fuel for the supplier's own account, or such supplier has made a tax pre-collection election under § 67-3-503;
> >
> > (3) Upon sale in a qualified terminal or refinery in this state to an unlicensed supplier; or
> >
> > (4) In other cases in the same manner as the tax imposed by section 4081 of the Internal Revenue Code of 1986 or the Code of Federal Regulations.

The diesel tax is imposed upon the removal of diesel fuel by a licensed supplier from the terminal system unless the transfer is made through a bulk transfer or is otherwise exempt from the tax. Tenn. Code Ann. §§ 67-3-202(a), -3-302(a)(1), and -4-401 *et seq.* (2006 & Supp. 2007). A bulk transfer is a "transfer of a petroleum product within the bulk transfer/terminal system from one location to another by pipeline or marine delivery[.]" Tenn. Code Ann. § 67-3-103(12) (Supp. 2007). The transfer of diesel fuel "over the rack" is a transfer from within the bulk transfer/terminal system to outside of the system. Tenn. Code Ann. § 67-3-103(56) (Supp. 2007). Thus, an "over the rack" transfer is not a bulk transfer and the diesel tax is imposed on the transaction under Tenn. Code Ann. § 67-3-302(a)(1) (2006).

Tenn. Code Ann. §§ 67-3-401 *et seq.* (2006 & Supp. 2007) exempt certain transactions from the diesel tax, but none of these exemptions would apply to an "over the rack" transfer of diesel fuel merely because the transferor and transferee are both licensed suppliers. Therefore, a transfer of diesel fuel between licensed suppliers over the terminal rack in Tennessee is subject to the diesel tax under Tenn. Code Ann. § 67-3-202 (2006).

2. The second question is whether the Tennessee diesel tax is imposed where a licensed supplier transfers diesel fuel to another licensed supplier for export outside of Tennessee even

though the transferee does not have an exporter's license. Tenn. Code Ann. § 67-3-405 (2006) provides a diesel tax exemption for the exportation of diesel fuel to another state:

> There shall be exempt from the taxes and fees imposed in part 2 of this chapter, with the exception of the export tax imposed by § 67-3-205, taxable petroleum products:
>
> (1) Exported by a supplier; or
>
> (2) Sold by a supplier to a person, who is licensed in this state, for immediate export to a state for which the destination state motor fuel tax has been paid to the supplier;
>
> provided, that the supplier shall be licensed to remit tax to such destination state, and that the supplier shall maintain for inspection by the department satisfactory proof of export in the form of a terminal-issued, destination state shipping paper.

The exemption under Tenn. Code Ann. § 67-3-405(2) (2006) is limited to transferees who are "licensed" in Tennessee but does not specify that the license must be an exporter's license instead of a supplier's license. Additionally, pursuant to Tenn. Code Ann. § 67-3-604 (2006), "[p]ersons who hold a supplier's license . . . shall have the same privileges and responsibilities as those holding an exporter's license." Thus, even if the exemption were limited to transferees who are licensed as exporters, suppliers have the same privileges as exporters and still fall within the exemption. Therefore, assuming the other requirements of the exemption are satisfied, it is not necessary for the transferee to have an exporter's license where the transferee is a licensed supplier.

3. The third question involves the following fact scenario:

> In Tennessee, Company A is a position holder and transfers diesel fuel to Company B within the terminal and pursuant to a two-party exchange. Company B then transfers the same diesel fuel to Company C within the same terminal and pursuant to a two-party exchange. Company C then transfers the same diesel fuel to Company D over the rack for immediate export to another state.

As stated above in the analysis of the first question, Tenn. Code Ann. § 67-3-302(a) (2006) provides for the measurement of the diesel tax. Among other instances, the tax is measured "in the same manner as the tax imposed by section 4081 of the Internal Revenue Code of 1986 or the Code of Federal Regulations." Tenn. Code Ann. § 67-3-302(a)(4) (2006).

Pursuant to 26 U.S.C. § 4105 (West Supp. 2007), the person delivering diesel fuel pursuant to a two-party exchange is not liable for the diesel tax:

> (a) In general.--In a two-party exchange, the delivering person shall not be liable for the tax imposed under section 4081(a)(1)(A)(ii).
>
> (b) Two-party exchange.--The term "two-party exchange" means a transaction, other than a sale, in which taxable fuel is transferred from a delivering person registered under section 4101 as a taxable fuel registrant to a receiving person who is so registered where all of the following occur:
>
> > (1) The transaction includes a transfer from the delivering person, who holds the inventory position for taxable fuel in the terminal as reflected in the records of the terminal operator.
> >
> > (2) The exchange transaction occurs before or contemporaneous with completion of removal across the rack from the terminal by the receiving person.
> >
> > (3) The terminal operator in its books and records treats the receiving person as the person that removes the product across the terminal rack for purposes of reporting the transaction to the Secretary.
> >
> > (4) The transaction is the subject of a written contract.

Pursuant to 26 C.F.R. § 48.4081-2(c)(1) (2007), "the position holder with respect to the taxable fuel is liable for the" diesel tax. However, because the transfer between Company A and Company B is a two-party exchange, Company A is not liable for the diesel tax. 26 U.S.C. § 4105(a) (West Supp. 2007).

Company B is liable for the Tennessee diesel tax and must collect it from Company C. The fact scenario provides that the transfer between Company B and Company C is a "two-party exchange." However, that transfer cannot constitute a "two-party exchange" because Company B does not "hold[] the inventory position" with regard to the diesel fuel. 26 U.S.C. § 4105(b)(1) (West Supp. 2007).[1] Furthermore, the transfer between Company B and Company C is not exempt from the diesel tax under Tenn. Code Ann. § 67-3-405(2) (2006) because it was not "[s]old . . . to a person . . . for immediate export[.]" This language suggests that, after receiving the diesel fuel from

[1]Company A still holds the inventory position because its transfer to Company B was a "two-party exchange." If Company A had transferred the inventory position to Company B, the transfer would not have constituted a "two-party exchange" because a transfer of the inventory position would mean the transfer was a "sale" as defined in 26 C.F.R. 48.4081-1 (2007). As provided in 26 U.S.C. § 4105(b) (West Supp. 2007), a "'two-party exchange' [is] a transaction[] other than a sale[.]"

Company B, Company C must export the fuel in the next transfer. Instead, Company C transfers the fuel "over the rack" to Company D, which then exports it. The fact that the diesel fuel is exported by Company D after the first transfer "over the rack" is immaterial. There is no language in the statute indicating that the phrase "for immediate export" concerns only the first "over the rack" transfer and not any transfers that occur within the rack. To read the language otherwise would allow the exemption to apply in instances where there are numerous transfers of the fuel within the rack before it is finally transferred over the rack and then exported. The export of the fuel under those circumstances would not be "immediate." Thus, Company B must collect the Tennessee diesel tax from Company C.

Company C then collects the Tennessee diesel tax from Company D, the exporter of the fuel to another state. When Company D pays the diesel tax to the other state for the exported fuel, Company D may submit a claim for refund of the Tennessee tax pursuant to Tenn. Code Ann. § 67-3-412 (2006).

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