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FISCAL IMPACT STATEMENT

LS 7000
BILL NUMBER: SB 378

NOTE PREPARED: May 5, 2005
BILL AMENDED: Apr 26, 2005

SUBJECT: Biodiesel and Ethanol Tax Incentives.

FIRST AUTHOR: Sen. Weatherwax
FIRST SPONSOR: Rep. Woodruff

BILL STATUS: Enrolled

FUNDS AFFECTED: X **GENERAL**
X **DEDICATED**
FEDERAL

IMPACT: State

Summary of Legislation: *Biodiesel/Ethanol Tax Credits:* The bill provides that the Indiana Economic Development Corporation (IEDC) reviews and approves applications for the biodiesel, blended biodiesel, and ethanol production income tax credits. The bill also provides standards that the IEDC must apply in the application process.

The bill creates a $20,000,000 overall cap for the biodiesel, blended biodiesel, and ethanol production tax credits. The bill also allows the IEDC to allocate the maximum credits for all taxpayers for all taxable years so long as each credit is allocated a minimum of $4,000,000. The bill establishes a credit cap for a particular producer of biodiesel, blended biodiesel, or ethanol at $3,000,000 for all taxable years, but allows the IEDC to increase this cap to $5,000,000 for a producer of biodiesel or ethanol. The bill allows credit carryovers for six taxable years. The bill extends the blended biodiesel retailer tax credit to dealers that distribute blended biodiesel at retail by a means other than a metered pump. The bill also provides for the expiration of the blended biodiesel retailer tax credit as of January 1, 2007.

Coal Gasification Technology Investment Tax Credit: The bill provides a tax credit for a taxpayer who places into service an integrated coal gasification powerplant, and requires the taxpayer to enter into an agreement with the IEDC requiring the taxpayer to use Indiana coal and satisfy other requirements relating to the operation of the powerplant. The bill provides for allocating the credit among co-owners of a integrated coal gasification powerplant or owners of a pass through entity. It also corrects an internal reference and makes other related changes.

Effective Date: Upon passage; January 1, 2005 (retroactive); January 1, 2006.

<u>Explanation of State Expenditures:</u> *IEDC:* The bill provides for the IEDC to administer the application and approval process for: (1) the existing Biodiesel, Blended Biodiesel, and Ethanol Income Tax Credits; and (2) the Coal Gasification Technology Investment Tax Credit (created by the bill). The IEDC also must monitor compliance of recipients of the Coal Gasification Technology Investment Credit with the provisions of the tax credit agreement between the IEDC and the credit recipient. The IEDC should be able to implement these administrative tasks with its current staffing and resource levels.

Department of State Revenue (DOR): The DOR would incur administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the Coal Gasification Technology Investment Tax Credit. The DOR should be able to implement these changes with its current staffing and resource levels.

Indiana Utility Regulatory Commission (IURC): The IURC would have to make determinations relating to the public necessity for new integrated coal gasification powerplants proposed to the IEDC for the Coal Gasification Technology Investment Tax Credit.

<u>Explanation of State Revenues:</u> *Biodiesel/Ethanol Tax Credits:* <u>Summary</u>: The bill makes several changes relating to the current tax credits for biodiesel, blended biodiesel, and ethanol production, and for blended biodiesel sales effective beginning in 2005.

(1) The bill requires a taxpayer who wants to claim the biodiesel, blended biodiesel, or ethanol production tax credits to obtain certification of credits from the IEDC. The taxpayer must provide the certification to the DOR in order to claim the credit. A noncode section of the bill provides that the changes by the bill to the biodiesel, blended biodiesel, and ethanol production tax credits, and the blended biodiesel sales credit, are effective beginning in 2005. In addition, the noncode section requires that a taxpayer who is eligible in 2005 under current law for any of the production tax credits is eligible for these credits under the bill only if the taxpayer complies with the new requirements of the bill. This requirement, however, does not apply to taxpayers eligible for the blended biodiesel sales credit under the current law.

(2) The bill provides that the credit for sales of blended biodiesel by Indiana retailers may not be taken for amounts distributed at retail after December 31, 2006. In addition, the bill changes the applicability of the credit. Under current law, the sales must be by a dealer operating a service station at which the blended biodiesel is dispensed through metered pumps. The bill eliminates these requirements and provides that the credit is applicable to blended biodiesel distributed at retail by the taxpayer in the taxable year. This change would increase the number of vendors who could obtain the credit, but only up to the current law limit of $1.0 M for all taxpayers and all taxable years.

(3) The bill establishes a new taxpayer and aggregate credit limits for the ethanol production, biodiesel production, and blended biodiesel production credits. The three credits combined would be limited to $20 M for all taxpayers and all taxable years. Within this overall limit, the IEDC must determine the maximum amount under each credit that may be claimed by all taxpayers. However, the amount allowed by the IEDC under each credit must be at least $4 M. In addition, the taxpayer limit for each credit would be set at $3 M. However, the taxpayer maximum for the ethanol production tax credit and the biodiesel production tax credit may be increased to $5 M with the approval of the IEDC. Currently, the biodiesel production tax credit and blended biodiesel production tax credit are each limited to $1.0 M for all taxpayers and all taxable years. The ethanol production credit is currently limited to $5 M per taxpayer, and $10 M for all taxpayers and all taxable years.

As sufficient data is unavailable relating to production and sales of biodiesel and blended biodiesel in Indiana, the potential utilization of these credits in future years is indeterminable. It is important to note that the National Biodiesel Board (NBB) reports that there are currently 25 active biodiesel production plants operating in the U.S., with an annual production capacity of about 150 M gallons. The NBB also reports that 20 additional production plants have been proposed around the U.S. However, none of the active or proposed plants are in Indiana. The NBB also reports that a total of 24 biodiesel retailers currently operate in Indiana. Data from the Renewable Fuels Association suggests that about 95 M gallons of ethanol are produced annually in Indiana. If credits are claimed on this annual production total, they could total about $11.9 M in a single year.

(4) The bill provides that the tax credits may be claimed by shareholders, partners, or members of a pass through entity that produces biodiesel, blended biodiesel, or ethanol and receiving the production tax credits.

(5) The bill eliminates the provision in current law requiring the biodiesel production credit and the blended biodiesel production credit to be reduced by any federal tax credit a taxpayer receives for such production. Recently, federal legislation was enacted providing federal excise tax and income tax credits for biodiesel production.

(6) The bill also specifies that the biodiesel and blended biodiesel credits may not be carried forward for more than six taxable years; and that a taxpayer may not sell or assign the credits.

Background: Current statute provides credits against a taxpayer's Sales and Use Tax, AGI Tax, Financial Institutions Tax, or Insurance Premiums Tax liability for the production of biodiesel, blended biodiesel, and ethanol, and for the sale of blended biodiesel. The tax credits are as follows:

(1) A credit equal to $1.00 for each gallon of biodiesel manufactured in Indiana and used to produce blended biodiesel.

(2) A credit equal to $0.02 per gallon of blended biodiesel produced in Indiana and using biodiesel produced in Indiana.

(3) A credit equal to $0.01 per gallon of blended biodiesel sold by Indiana retailers.

(4) A credit equal to $0.125 per gallon of ethanol produced at an eligible facility in Indiana.

Coal Gasification Technology Investment Tax Credit: Summary: The investment tax credit could potentially reduce revenue from the Adjusted Gross Income (AGI) Tax, the Financial Institutions Tax, the Insurance Premiums Tax, and the Utility Receipts Tax when a taxpayer undertakes qualified investment in an integrated coal gasification powerplant. The potential amount of tax credits that may be granted under this program is indeterminable and will depend upon review and approval of creditable powerplant investment by the IEDC; and determinations by the IURC that the public convenience and necessity requires the construction of integrated coal gasification powerplants. The net revenue impact of the tax credit also depends on the extent that tax collections on powerplant employees and other taxable activities attributable to such powerplants are less than or exceed the credits granted to taxpayers for powerplant investment. However, if powerplant investment would have occurred in the absence of the tax credit, the net impact would be the total credits claimed by taxpayers.

The tax credit would be effective beginning in tax year 2006. However, since a review by the IEDC and the IURC is required, and since the credit may not be taken initially until the year a coal gasification plant is placed in service, a fiscal impact from this credit potentially might not arise for several years.

Background: The bill establishes a tax credit against a taxpayer's tax liability arising under the AGI Tax, Financial Institutions Tax, Insurance Premiums Tax, and Utility Receipts Tax for qualified investment in an integrated coal gasification powerplant. The credit is equal to 10% of the first $500 M in qualified investment, and 5% of the qualified investment exceeding $500 M. The taxpayer may take the credit in 10 annual installments beginning with the year in which the taxpayer places the integrated coal gasification powerplant into service. The annual credit installment that a taxpayer may claim is equal the lesser of the amounts described below in (1) and (2) multiplied by the percentage of the coal utilized during the taxable year in the powerplant that was Indiana coal.

(1) 10% of the total credit amount.

(2) The greater of (a) 25% of the taxpayer's *total state tax liability* for the taxable year; or (b) the taxpayer's Utility Receipts Tax liability for the taxable year.

Thus, if the taxpayer's qualified investment totals $1,000 M, the total credit amount would be $75 M. If 100% of the coal utilized each taxable year in the powerplant is Indiana coal, the 10 annual credit installments would be equal to $7.5 M, unless the greater of the amounts described above in (2)(a) and (b) are less than $7.5 M. However, if the only 90% of the coal used in the powerplant each year is Indiana coal, the annual installment would be $6.75 M.

The taxpayer's *total state tax liability* is the total of the liabilities under the AGI Tax, Financial Institutions Tax, Insurance Premiums Tax, and Utility Receipts Tax for the taxable year. The bill allows credits obtained by a pass through entity to be taken by shareholders, partners, or members of the pass through entity. In addition the bill allows certain electric cooperatives to pass the credit through to their members.

To qualify for the tax credit, the taxpayer must make qualified investment in an integrated coal gasification powerplant located in Indiana. The investment includes expenditures in real and tangible personal property incorporated in such a powerplant, and transmission equipment located at the powerplant site and used to serve the powerplant. The powerplant must (1) be newly constructed; (2) convert coal into synthesis gas that can be used as a fuel to generate energy; (3) use the synthesis gas as a fuel to generate electric energy; and (4) be dedicated primarily to serving Indiana retail electric utility consumers. Credits would be approved by the IEDC upon entering into a tax credit agreement with the taxpayer. The provisions of the agreement would include:

(1) a requirement that the taxpayer obtain from the IURC a determination that public convenience and necessity requires the construction of the powerplant;

(2) a requirement that the taxpayer maintain operations at the powerplant for at least 10 years during the time the tax credit is available;

(3) a requirement that the taxpayer pay an average wage each taxable year that the credit is available at least 125% of the average wage in the county where the powerplant is located;

(4) a requirement that the taxpayer maintain at the location of the powerplant, during the term of the tax credit,

a total payroll at least equal to the payroll when the powerplant was placed into service;

(5) a requirement that the taxpayer use Indiana coal at the integrated coal gasification powerplant.

Distribution of Affected Taxes: Revenue from the corporate AGI tax, the Insurance Premiums Tax, the Financial Institutions Tax, and Utility Receipts Tax is deposited in the state General Fund. The revenue from the individual AGI Tax is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%). Sales Tax revenue is deposited in the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Fund (0.033%).

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Indiana Economic Development Corporation; Department of State Revenue; Indiana Utility Regulatory Commission.

Local Agencies Affected:

Information Sources: National Biodiesel Board; Renewable Fuels Association; Congressional Joint Committee on Taxation.

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