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FISCAL IMPACT STATEMENT

LS 7187
BILL NUMBER: HB 1722

NOTE PREPARED: Apr 4, 2007
BILL AMENDED: Apr 3, 2007

SUBJECT: Coal Gasification Tax Credits and Cost Recovery.

FIRST AUTHOR: Rep. Stilwell
FIRST SPONSOR: Sen. Hershman

BILL STATUS: 2nd Reading - 2nd House

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

IMPACT: State & Local

Summary of Legislation: (Amended) *Ethanol Production Tax Credit:* The bill provides that the total amount of Ethanol Production Tax Credits for taxpayers that produce at least 20,000,000 gallons of cellulosic ethanol in a year may not exceed $20,000,000 for all taxpayers for all taxable years. It also provides that a taxpayer may not sell, assign, convey, or otherwise transfer an Ethanol Production Tax Credit.

Indiana Fueled Energy Investment Tax Credit: The bill creates the Indiana Fueled Energy Investment Tax Credit for taxpayers that place a new energy production facility that utilizes Indiana fuel into service. It specifies that the total amount of Indiana Fueled Energy Investment Tax Credits may not exceed $50,000,000 for all taxpayers and all taxable years. The bill specifies that for the proposed Indiana Fueled Energy Investment Tax Credit, the IEDC is required to enter into an agreement with an applicant for a credit only if the IEDC decides to award a tax credit to the applicant.

Coal Gasification Technology Investment Tax Credit: The bill specifies that for the existing Coal Gasification Technology Investment Tax Credit, the IEDC is required to enter into an agreement with an applicant for a credit only if the IEDC decides to award a tax credit to the applicant. It provides that a facility that produces synthesis gas as a substitute for natural gas is eligible for a Coal Gasification Technology Investment Tax Credit. It also allows a taxpayer to assign part or all of a Coal Gasification Technology Investment Tax Credit to an electric utility that has entered a contract to purchase electricity or substitute natural gas from the taxpayer.

Cost Recovery for Substitute Natural Gas: The bill requires the Utility Regulatory Commission (IURC) to allow a utility that purchases substitute natural gas (SNG) to recover any costs arising under the purchase contract through rate adjustments. The bill amends the definition of clean coal and energy projects to include a project using coal to produce substitute natural gas.

Substitute Natural Gas Property Interests: The bill also defines an SNG property interest as a right, title, and interest that: (1) is held by an energy utility; (2) is created by a qualified order of the IURC; and (3) entitles the energy utility to recover certain costs incurred in purchasing substitute natural gas under a qualified contract. The bill sets forth provisions governing: (1) the assignment of an SNG property interest; (2) the rights of assignees, financing entities, and SNG sellers; (3) the perfection of a lien and security interest in an SNG property interest; and (4) the obligations of an energy utility after the assignment of an SNG property interest.

Effective Date: (Amended) Upon passage; July 1, 2007; January 1, 2008.

Explanation of State Expenditures: *IURC:* This bill will increase the administrative costs of the IURC by requiring amendment to current procedures for conducting cost recovery rate adjustment hearings. The amount of the increase in costs is indeterminable, but it is estimated that the IURC could implement these provisions through the use of existing staff and resources.

Background: The operating budgets of the IURC and OUCC are funded by regulated utilities operating in Indiana. The IURC determines the rate at which to bill the utilities based on the two agencies' budgets, less reversions, divided by the total amount of gross intra-state operating revenue received by the regulated utilities for the previous fiscal year. Based on this formula, utilities are currently billed approximately 0.15% of their gross intra-state operating revenues to fund the IURC and OUCC. In FY 2006, fees from the utilities and fines generated approximately $11.8 M.

Cost Recovery for Substitute Natural Gas: This bill allows facilities that generate substitute natural gas to apply to the IURC for a rate adjustment to recover costs. The bill also adds production facilities to the definition of eligible business in IC 8-1-8.8-6 and the definition of new generating facility under IC 8-1-8.8-8. The bill, by adding these facilities to these definitions, is allowing these facilities to seek rate adjustments for cost recovery and financial incentives from the IURC currently provided by statute to clean coal and energy projects, construction or repower of a new energy generating facility, and development of alternative and renewable energy resources.

By allowing these rate adjustments for cost recovery this bill will impact the state if it purchases utility service from a facility that produces substitute natural gas. The amount of the increase in costs is indeterminable, and could be offset by the possible increase in Utility Receipts Tax (URT) and Utility Services Use Tax collections (USUT) from the increase in receipts by these utilities increasing rates.

Background: The rate for both the URT and USUT is 1.4%. The URT is calculated on the gross receipts of all entities providing the retail sale of utility services in Indiana. The USUT is imposed on the retail consumption of utility services in Indiana.

(Revised) *Department of State Revenue (DOR):* The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the Fueled Energy Investment Tax Credit and the expansion of the Coal Gasification Technology Investment Tax Credit. The DOR's current level of resources should be sufficient to implement these changes.

(Revised) *Indiana Economic Development Corporation (IEDC):* The bill will require the IEDC to accept and review applications for the Fueled Energy Investment Tax Credit, and make determinations as to tax credit awards. The bill requires the IEDC to enter into an agreement with tax credit recipients specifying project information and operational information relating to the energy facility to be constructed. The bill requires the Office of Energy and Defense Development to provide any technical assistance requested by the IEDC. The funds and resources required to implement this tax credit program could be supplied through a variety of sources, including the following: (1) existing staff and resources not currently being used to capacity; (2) existing staff and resources currently being used in another program; (3) authorized, but vacant, staff positions, including those positions that would need to be reclassified; (4) funds that, otherwise, would be reverted; or (5) new appropriations. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will depend upon legislative and administrative actions. The April 2, 2007, state vacant position report indicates that the IEDC has 32 vacant full-time positions.

Explanation of State Revenues: (Revised) *Ethanol Production Tax Credit:* The bill provides for a separate tax credit for cellulosic ethanol production, provided the taxpayer produces at least 40 M gallons of cellulosic ethanol in a taxable year. Under the credit, the Indiana Economic Development Corporation (IEDC) would be able to determine the maximum credit for a taxpayer, but the bill would limit the total credits awarded to $20 M for all taxpayers for all taxable years. The bill also specifies that the current $50 M aggregate limit on all tax credits for grain ethanol production and biodiesel production does not apply to the new tax credit for cellulosic ethanol production.

(Revised) *Fueled Energy Investment Tax Credit:* The bill establishes a nonrefundable tax credit for "qualified investment" in facilities to produce and transmit energy from: (1) gasified, liquified, or methanized biomass produced in Indiana, Indiana coal, petroleum coke produced in Indiana, or oil shale located in Indiana; or (2) coal mine methane when used in the production of power. The credit may be claimed by individual and corporate taxpayers against the Adjusted Gross Income (AGI) Tax, Insurance Premiums Tax, Financial Institutions Tax, or Utility Receipts Tax liability. The tax credit is equal to 10% of the qualified investment and must be taken by the taxpayer in equal installments over 10 years. The bill limits the total credits awarded under the tax credit to $50 M for all taxpayers and all taxable years. The potential fiscal impact of this tax credit is indeterminable and depends on tax credit approvals by the IEDC.

(Revised) *Coal Gasification Technology Investment Tax Credit:* The bill makes the following two changes to this tax credit.

(1) The bill expands the tax credit to include investment in a facility that converts coal into synthesis gas which is then used as a substitute for natural gas. As the change is effective upon passage, the expansion of the tax credit would be effective beginning in tax year 2007. Current statute limits the tax credit to investment in a facility that converts coal to synthesis gas and then uses the synthesis gas to generate electric energy. The potential amount of tax credits that may be granted for coal gasification facilities for the purpose of producing a substitute for natural gas is indeterminable and will depend upon review and approval of creditable investment by the IEDC; and determinations by the IURC that the public convenience and necessity requires the installation of the facilities.

(2) The bill allows a taxpayer receiving the tax credit to assign part or all of the credit to a utility that has entered into a contract: (1) approved by the IURC; (2) providing for the purchase of electricity or substitute natural gas by the utility from the taxpayer under provisions of the bill; and (3) expressly allowing the assignment of the tax credits. The utility would be able to apply the assigned credits against the tax liability arising under the Adjusted Gross Income (AGI) Tax, Financial Institutions Tax, Insurance Premiums Tax,

and Utility Receipts Tax. The bill requires the utility to take the credit in 20 annual installments. The bill also limits the annual amount that the utility may claim to the greater of: (1) 25% of the utility's state tax liability under the taxes listed above; or the utility's total Utility Receipts Tax liability for the taxable year.

Cost Recovery for Substitute Natural Gas: By allowing rate adjustments for more facilities to recover costs this bill could increase URT and USUT collections. Any increase in collections will ultimately be determined by the increase in receipts for a utility that is permitted the IURC to adjust their rates for cost recover under the bill.

Background Information: Ethanol Production Tax Credit: Current statute provides credits against a taxpayer's Sales and Use Tax, AGI Tax, Financial Institutions Tax, or Insurance Premiums Tax liability for production of ethanol, biodiesel, and blended biodiesel. The tax credits are: (1) $1.00 for each gallon of biodiesel manufactured in Indiana and used to produce blended biodiesel; (2) $0.02 per gallon of blended biodiesel produced in Indiana using biodiesel produced in Indiana; and (3) $0.125 per gallon of ethanol produced at an eligible facility in Indiana. The maximum credit that may be awarded to a taxpayer for ethanol production are specified below:

Ethanol Production Credit	
Maximum Credit	**Annual Production Level**
$2 M	At least 40 M gallons, but less than 60 M gallons.
$3 M	At least 60 M gallons.

In addition, the taxpayer limit for the biodiesel and blended biodiesel production credits is $3 M, with provision for the IEDC to increase this limit to $5 M for the biodiesel production credit. Current statute also limits the total ethanol and biodiesel production credits for all taxpayers and all taxable years to $50.0 M, with allocations of at least $4.0 M under this cap to each tax credit. The IEDC has awarded a total of $50.0 M in ethanol and biodiesel tax credits at this time - $32.0 M for 12 ethanol production facilities; $14.0 M for four biodiesel production facilities; and $4.0 M for two blended biodiesel production facilities.

Grain ethanol and cellulosic ethanol are the same product, but are produced utilizing different feedstocks and processes. Grain ethanol is produced from corn, wheat, or soybeans. Cellulosic ethanol can be produced from agricultural plant waste, plant wastes from industrial processes, and energy crops grown specifically for fuel production, such as switchgrass.

Fueled Energy Investment Tax Credit: The tax credit is nonrefundable and may not be carried back or carried forward. In addition, the tax credit is not assignable. The bill specifies the manner in which the credit may be taken by a member of an affiliated group of corporations filing a consolidated corporate tax return or by shareholders, partners, or members of the pass through entity. Since the credit is effective beginning in tax year 2008 and dependent on IEDC approval, the fiscal impact likely would not commence before FY 2009.

To obtain the tax credit, a taxpayer must apply to the IEDC before making the investment. Upon determination by the IEDC that the proposed investment satisfies the tax credit requirements, it must enter into an agreement with the taxpayer. The bill requires a taxpayer to be in compliance with the agreement each year to receive an annual installment of the tax credit.

Coal Gasification Technology Investment Tax Credit: The coal gasification technology investment tax credit may be taken against a taxpayer's tax liability arising under the Adjusted Gross Income (AGI) Tax, Financial Institutions Tax, Insurance Premiums Tax, and Utility Receipts Tax. The tax credit is for qualified investment in an integrated coal gasification power plant which converts coal to synthesis gas and uses the synthesis gas to generate electric energy. The credit is equal to 10% of the first $500 M in qualified investment, and 5% of the qualified investment exceeding $500 M. Current statute also provides for a separate and lesser tax credit for qualified investment in fluidized bed combustion technology. This credit would be equal to 7% of the first $500 M in qualified investment, and 3% of the qualified investment exceeding $500 M. A taxpayer may take the credit in 10 annual installments beginning with the year in which the taxpayer places the integrated coal gasification power plant or fluidized bed combustion unit into service. The annual credit installment that a taxpayer may claim is equal to the lesser of the percentage of the coal utilized during the taxable year in the facility that is Indiana coal multiplied by: (1) 10% of the total credit amount; or (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.

Pertinent Taxes: Sales Tax revenue is distributed to 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%). Revenue from the Individual AGI Tax is distributed to the state General Fund (86%) and the Property Tax Replacement Fund (14%). Revenue from the Corporate AGI Tax, the Financial Institutions Tax, the Insurance Premiums Tax, and the Utility Receipts Tax is distributed to the state General Fund.

Explanation of Local Expenditures: *Cost Recovery for Substitute Natural Gas:* By allowing these rate adjustments for cost recovery this bill will impact local units of government which purchase utility service from a facility that produces substitute natural gas. The amount of the increase in costs is indeterminable.

Explanation of Local Revenues:

State Agencies Affected: All; Utility Regulatory Commission; Indiana Economic Development Corporation; Office of Energy and Defense Development.

Local Agencies Affected: All.

Information Sources:

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