Federal And New York

Tax Incentives For Alternative Fuels

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I. Interesting Facts

- U.S. ethanol industry now has the capacity to produce an estimated 7 billion gallons per year of clean burning motor fuel. This is expected to reach 10 billion gallons by 2008.
- Over $10 billion has been invested in ethanol production facilities. In 2007 there are 115 plants operating in 19 states. Over one-half of these facilities are either owned by farmers cooperatives or private investment partnerships.
- In 2006, ethanol was blended into 46% of America's gasoline
- Six million flexible fuel vehicles are on the road that can now use E85.
- By 2008 the automobile industry is expected to produce over 800,000 FFV per year. Pending legislation would require automakers to produce 50% FFV by 2012, increasing by 10% annually thereafter until 80% is reached by 2015.
- Renewable Fuel Standard, enacted in 2005, requires an increasing use of ethanol and biodiesel between 2006 and 2012. Six billion gallons in 2006 and 7.5 billion gallons in 2012. Designed to guaranty base line market.
- In 2007, production is expected to exceed 7.5 billon gallons. Now RFS serve as a safety net as opposed to guaranty market.
- Legislation is pending to greatly increase to RFS.

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II. Incentive Programs

- Loans & Loan Guarantees
  - Department of Energy
  - Department of Agriculture
  - State Programs

- Governmental Grants
  - Tax Issues

- Tax Incentives

III. Tax Incentives

- Two Types
  - Designed to Stimulate use of Ethanol
    - Excise Tax Credits
  - Designed to Stimulate Production
    - Small Producers Tax Credit
    - Alternative Fuel Refueling Credit
    - Expensing of Refining Equipment

IV. Volumetric Ethanol Tax Credit

Prior to the American Jobs Creation Act of 2004, ethanol was subject to a reduced excise tax. This had been true since 1982.

- Of the 18.4 cents per gallon gas tax, ethanol blenders had paid at a reduced rate of 13.2 cents on E10
- 10.7 cents of that amount went into the Highway Trust Fund (“HTF”)
- 2.5 cents of that amount went into the General Fund.

The old reduced rate system had a number of problems.

- Less money went into the HTF. New rules will result in an extra $3 billion annually going to the HTF.
- Reduced rate was irrelevant on sales to exempt entities like state and local governments which did not pay the federal gas tax.
- Penalized States with high ethanol production.

IV. Volumetric Ethanol Tax Credit (Continued)

Given these problems the new law

- replaced the reduced rate with a credit of $.51 per gallon of ethanol used in a blend.
- Now E10 which is by far the most common blend (99% of America’s ethanol is marketed as E10) receives a credit of $.051 per gallon.
- E85 (used in FFV) receives a credit of $.4335 per gallon.
- The full federal motor fuels tax of 18.4 cents per gallon is now collected on all ethanol sold.
- The credit is fully refundable.

IV. Volumetric Ethanol Tax Credit (Continued)

- The credit is scheduled to sunset on December 31, 2010. There are numerous Bills pending which would eliminate or extend this sunset date.
- Bill in the Senate which would reduce the credit to $.46 per gallon when overall ethanol production reaches 7.5 billion gallons which likely would be 2008 if not earlier.
- House recently passed a bill that would allow a “cellulosic producer” an additional excise tax credit in addition to and not in lieu of the $.51 credit.   Designed to offset high cost of producing cellulosic ethanol.

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V. Biodiesel Exise Tax Credit

- Credit is $.50 per gallon of biodiesel used by the taxpayer in the production of a qualified biodiesel mixture.
- To be eligible for credit, biodiesel must be a mixture containing at least .1% diesel fuel.
- For agri-biodiesel, the credit is $1.00 per gallon.
- Agri-diesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, or animal fat.
- Notice 2005-62 clarified that this list is not exclusive and thus biodiesel derived solely from virgin oils includes esters derived from palm oil and fish oil.
- For renewable diesel, the credit is also $1.00 per gallon. Renewable diesel is diesel derived from biomass using a thermal depolymerization process. Current dispute involves co-processed renewable diesel. IRS Notice 2007-37.
- The biodiesel excise tax credit is fully refundable.
- Excise tax credit for biodiesel is scheduled to sunset on December 31, 2008.
- Bill pending in Congress would extend the sunset to 2010.

VI. Small Ethanol Producer Credit

- *Income* tax credit available to small producers of ethanol can be used to offset the AMT.
- Credit is $.10 per gallon on the first 15 million gallons of ethanol production.
- Only allowed for small producers which is currently defined as a producer with a production capacity of 60 million gallons or less per year.
- Cooperative is allowed to pass this credit through to its patrons.
- Limited partnerships and limited liability companies pass the credit through to their partners or members.
- As an income tax credit, the credit is not refundable.
- Unused credits may be carried back one year and forward for up to twenty (subject to the sunset provision).
- Scheduled to sunset on December 31, 2010.
- House passed legislation which would expand the credit for producers of sucrose and cellulosic ethanol.

VII. Small Agri-Biodiesel Producer Credit

- The Energy Tax Act added a new income tax credit for small agri-biodiesel producers.
- The credit is an income tax credit
- Cannot be taken against the excise tax and is not refundable.
- Any unused credit may be carried back one year and carried forward for up to twenty years (subject to sunset provisions).
- The credit is a 10 cents per gallon credit for up to 15 million gallons of agri-biodiesel produced by a small producer.
- Small producer is a producer whose does not exceed 60 million gallons.
- The credit is scheduled to sunset on December 31, 2008. A bill recently passed by the House would extend this through December 31, 2010.

VIII. Credit for Installation of Alternative Fuel Refueling Property

The ETA added new Section 30C to the Code.

- Allows a 30 percent income tax credit for the cost of installing qualified alternative fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the taxpayer's principal residence.
- Scheduled to sunset on December 31, 2009.
- If the property is used in a trade or business the credit may not exceed $30,000.
- If the property is installed at a residence, the credit is limited to $1,000. The credit applies to property placed in service after December 31, 2005 and before December 31, 2009.
- A recent bill passed by the House would extend the sunset date until December 31, 2010 and increase the credit to 50% (with a cap of $50,000)

VIII. Credit for Installation of Alternative Fuel Refueling Property (Continued)

Qualified alternative fuel refueling property is property which is used for the storage or dispensing of clean fuel. Clean fuel is defined as:

(1) any fuel at least 85 percent of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas and/or hydrogen; or

(2) any mixture of diesel fuel and biodiesel containing at least 20 percent biodiesel.

If the qualified property is installed on property owned or used by a tax exempt person, the taxpayer that installs the property may generally claim the credit.

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VII. Credit for Installation of Alternative Fuel Refueling Property (Continued)

Notice 2007-43. This Notice makes the following points:

a. The property on which the credit is claimed must be subject to the allowance for depreciation or installed at the taxpayer's principal residence.

b. The original use of the property must begin with the taxpayer (i.e., no used property).

c. The costs of property includes the costs of acquiring or construction of the refueling property or of converting conventional refueling property into qualified property.

d. Qualified costs do not include any costs allocated to land or to a building and its structural components.

VII. Credit for Installation of Alternative Fuel Refueling Property (Continued)

Example 1:

X a fuel wholesaler acquires additional storage tanks to store E85 at its principal place of business and a fuel tanker to transport the E85 to retail service stations. Neither the storage tank nor the fuel truck will qualify for the credit.

Example 2.

The facts are the same as example 1 except that the taxpayer also acquires a pump that is used to dispense the E85 into its tanker trucks. The storage tank has the same capacity it would have had if it had merely been used to store the E85 for delivery to the retail customers. The pump qualifies because it is used to dispense the E85 into the fuel tanks of the delivery vehicles. Although the tank is used to store the E85 at the point where it is dispensed into the fuel tank it is considered dual use property. It will qualify for the credit only to the extent the cost exceeds the cost of the storage tank that would have been used for the sole purpose of storing the E85 that is supplied to retail customers. Here there was no increase in storage capacity so the tank does not qualify for the credit.

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VII. Credit for Installation of Alternative Fuel Refueling Property (Continued)

Example 3.

The taxpayer is a seller of gasoline at a retail station. In 2000 the taxpayer acquires and places in service conventional refueling property consisting of gasoline storage tanks. In 2007 the taxpayer spends $10,000 to convert the storage tanks into alternative fuel storage tanks. If the conversion is treated as a reconditioned or rebuilt property, the $10,000 will qualify for the credit. If the converted storage tank is treated as put to its original use when converted, the basis of the property immediately before conversion will also qualify.

IX. Expensing of Equipment Used in Refining

- General Rule petroleum refining assets depreciated over 10 years
- Qualified Property – Can elect to expense 50% of costs and depreciate balance over 10 year.
- Qualified Property
  - Binding contract to acquire before November 1, 2008 and placed in service by January 12, 2012.
  - Increases capacity by 5% or increases throughput of qualified fuels to such that it equals or exceeds 25% of total throughput.

X. New York State Incentives

a. Alternative Fuel Refueling Infrastructure Tax Credit. A state tax credit is available for the installation of clean vehicle refueling infrastructure located within the State. The credit is equal to 50% of the cost.

b. Sales Tax Exemption. E85, compressed natural gas and hydrogen used to operate a motor vehicle is exempt from state sales and use tax. This exemption is scheduled to sunset on September 1, 2011.

c. Fuel Exclusivity Contracts Prohibited. Motor fuel franchise dealers are permitted to obtain alternative fuels from a dealer other than the franchisor. Any provision in a franchise agreement that prohibits or discourages the dealer from obtaining the alternative fuel from other than the franchisor is null and void.

X. New York State Incentives (Continued)

d. Empire Zone Benefit. Clean energy enterprise will qualify for

- Wage Credits
- Real Property Tax Credit
- Credits against Franchise or Income Tax
- Investment Tax Credits
- Lower utility costs

Clean Energy Enterprise – business engaged in research, development or manufacturing of renewable energy.

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Questions & Answers