

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Florez Analyst: John Pavalasky Bill Number: SB 74
Related Bills: See Legislative History Telephone: 845-4335 Introduced Date: January 17, 2007
Attorney: Daniel Biedler Sponsor: _____

SUBJECT: Biodiesel Fuel Qualified Costs Credit

SUMMARY

This bill would allow a tax credit for the costs related to the manufacturing, processing, production, delivery, or sale of biodiesel fuel. In addition, this bill would create a biodiesel equipment and fuel exemption from state sales and use taxes.

This analysis will only address the provisions of the bill that would impact the department.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to encourage fuel manufacturers, processors, producers, distributors, and retailers to invest in additional infrastructure to manufacture, process, produce, deliver, or sell biodiesel fuel, thereby increasing availability, as well as potential demand, over time.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on January 1, 2008, and before January 1, 2013.

POSITION

Pending.

SUMMARY OF SUGGESTED AMENDMENTS

Technical amendments are necessary and are provided. Department personnel are available to work with the author to resolve the implementation issues discussed in this analysis as well as any other issues that arise as the bill moves through the legislative process.

Board Position:

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Department Director

Date

Lynette Iwafuchi
for Selvi Stanislaus

3/13/07

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). Generally, these credits are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current federal law allows a credit for installing alternative fuel vehicle refueling property. Fueling stations are eligible to claim a 30% credit for the cost of installing clean-fuel vehicle refueling equipment. Under federal law, clean-fuel means any fuel that (1) consists of at least 85% (by volume) of one or more of the following:

- ethanol,
- natural gas,
- compressed natural gas,
- liquefied natural gas,
- liquefied petroleum gas,
- and hydrogen

or (2) starting in 2006, includes any mixture of biodiesel fuel that contains at least 20% biodiesel. This federal credit is available through December 31, 2010.

Current state law does not provide a comparable credit.

THIS BILL

For taxable years beginning on or after January 1, 2008, this bill would provide a credit equal to an unspecified percentage of qualified costs paid or incurred to manufacture, process, deliver, or sell biodiesel fuel, including the purchase of property, equipment, buildings, or facilities.

This bill would define biodiesel fuel as any motor fuel or mixture of motor fuels that is derived wholly or partly from agricultural products, vegetable oils, recycled greases, or animal fats, or the wastes of those products or fats and is advertised, offered for sale, suitable for use, or used as a motor fuel in an internal combustion engine.

This bill would allow any unused credit to be carried over until exhausted and specifies that as of January 1, 2013, the credit is repealed.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- This bill uses terms that are undefined, including "all costs allocable to that item," as well as "manufacturing, processing, producing, delivering, or selling biodiesel." The absence of definitions to clarify terms could lead to disputes with taxpayers and would complicate the administration of this credit.
- The definition of "biodiesel fuel" in this bill does not require that the blend stock contain a minimum percentage of biodiesel fuel or that the fuel mixture meet the American Society for Testing and Materials specification D6751-02 for biodiesel fuel (B100) blend stock for distillate fuels. The lack of these requirements could allow the claiming of credits for fuel mixtures with only minor amounts of biodiesel and even those that would never meet standards or be used as fuel. Typically, credits involving areas that the department does not possess expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer.
- The definition of "qualified costs" does not restrict the total amount eligible for credit to property in California and thus, this bill would be subsidizing activities in other states.
- This bill allows the credit in the taxable year the "qualified costs" are paid or incurred by the qualified taxpayer to acquire, purchase, construct, renovate, or equip property, buildings, structures, facilities, or related infrastructure.

The date "qualified costs" are paid or incurred may be earlier than the taxable year in which the property, buildings, structures, facilities, or related infrastructure is actually placed in service (i.e., used). Most credits involving the acquisition and subsequent use of an item of property allow the credit to be claimed in the taxable year the property is first placed in service for depreciation purposes. It is possible that a taxpayer could purchase the property, claim the credit, and resell the property to a third party that may also claim the credit. If this bill were to require that the equipment be placed in service in California, with an appropriate recapture provision to ensure continued operation in California for a specified (recapture) period, this potential problem would be avoided. The recapture provision should require the taxpayer to use the equipment for a certain length of time in this state and add all or some portion of the credit amount back to the tax liability.

- The authority to make regulations contained in the bill is silent on a specific grant of legislative authority needed for those regulations to be considered "legislative regulations" in a manner similar to the "legislative regulations" authorized in Revenue and Taxation Code section 18152.5(k), relating to small business stock. Without a grant of "legislative regulation" authority, the statutory provisions themselves would need to detail all the rules necessary to implement these credits.

- This bill leaves unclear whether partners or shareholders in pass-through entities (partnerships, including limited liability companies classified as partnerships, and S corporations) that are “qualified taxpayers” under the definition of that term contained in the bill could be eligible to claim the credit. The lack of guidance could cause disputes between taxpayers and the department.
- This bill does not limit the number of years for the carryover period. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

TECHNICAL CONSIDERATIONS

The bill would allow a qualified taxpayer a credit for taxable years beginning on or after January 1, 2008, and before January 1, 2013. Therefore, the last fiscal year that a credit would be allowed would be for the period beginning December 1, 2012, and ending on November 30, 2013. However, the repeal date in the bill is January 1, 2013, eleven months before the end of the last taxable year the credit is allowed. The attached amendments resolve this issue by changing the repeal date to January 1, 2014.

LEGISLATIVE HISTORY

SB 73 (Florez, 2007/2008) would allow a credit of \$.30 for each gallon of biodiesel fuel produced or manufactured during the taxable year at any facility located in California. SB 73 is in the Senate Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The laws of *Florida*, *Illinois*, *Minnesota* and *New York* were reviewed because their tax laws are similar to California's income tax laws. For tax years beginning on or after January 1, 2007, *Florida* allows a credit against either the corporate income tax or the franchise tax in an amount equal to the eligible costs in connection with an investment in the production, storage, and distribution of biodiesel, including the costs of constructing, installing, and equipping such technologies in Florida. Credits that exceed the corporation's tax liability can be carried forward until the expiration date of December 31, 2012.

Illinois, *Minnesota* and *New York* do not have a comparable credit for the costs of purchasing a facility to produce, store, distribute, or manufacture biodiesel fuel.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved but are anticipated to be significant.

This bill would require additional audit resources to determine the amount of the credit allowed, as well as a new form or worksheet to be developed for the calculation of the credit. As a result, this bill would impact the department's audit, printing, processing, and storage costs for tax returns. The additional costs have not been determined at this time. If the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested.

ECONOMIC IMPACT

Revenue Estimate

This bill does not specify the percentage of costs that would qualify for the credit, and therefore, the revenue impact is unknown.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 74
As Introduced January 17, 2007

AMENDMENT 1

On page 5, line 9, after "until" strikeout "January 1, 2013" and insert:
January 1, 2014

AMENDMENT 2

On page 5, line 11, after "before" strikeout "January 1, 2013" and insert:
January 1, 2014

AMENDMENT 3

On page 6, line 6, after "until" strikeout "January 1, 2013" and insert:
January 1, 2014

AMENDMENT 4

On page 6, line 8, after "before" strikeout "January 1, 2013" and insert:
January 1, 2014