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HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TAX POLICY

HEARING ON POST TAX REFORM EVALUATION OF RECENTLY EXPIRED TAX PROVISIONS

WEDNESDAY, MARCH 14, 2018

Chairman Buchanan, Ranking Member Doggett, and Members of the Subcommittee:

My name is Michael McAdams and I am the President of the Advanced Biofuels Association (ABFA). I appreciate the opportunity to appear before you today to urge the extension of the tax incentives for biodiesel and renewable diesel.

My testimony today is not only on behalf of the ABFA, but also the National Association of Truckstop Operators (NATSO), National Association of Convenience Stores, Petroleum Marketers Association of America, Society of Independent Gasoline Marketers of America, and the American Trucking Associations. Together, these organizations represent every segment of the biodiesel supply chain, from feedstock grower to producer, to blender to retailer to end-user.

This coalition of organizations has previously written this Committee to urge the extension of the existing the biodiesel and renewable diesel tax incentives. I am here today on behalf of my colleagues to express our support for extending the current biodiesel and renewable diesel blenders tax credit for 2018 and into the future.

Before I begin, on behalf of our coalition, I want to thank Representatives Diane Black and Ron Kind for their strong support and introducing legislation last year to extend current law. In addition, I also want to thank Congressman George Holding for his support of those efforts.

I would note for the Committee's attention that consistent with the legislation introduced by Representatives Black and Kind, as well as Congress's treatment of other energy tax extenders, my testimony will reiterate our coalition's support for phasing down the credit over a period of several years. Our coalition also strongly opposes converting the biodiesel blenders' credit to a producers' credit.

I. History and Benefits of the Biodiesel Tax Incentive

The tax incentives for biodiesel and renewable diesel are among the expiring tax benefit provisions that have regularly been extended.[1]

The biodiesel tax incentives enacted in 2004 were originally scheduled to expire on December 31, 2006. However, the provisions have been extended by Congress seven times. In some cases, the extensions were enacted just before the scheduled expiration, but the last few extensions

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[1] The most recent extension of these provisions was contained in section 40407 of the Bipartisan Budget Act of 2018. What follows is a brief description of the provisions as they applied through December 31, 2017:

Biodiesel. Present law provides an income tax credit for biodiesel fuels (the ''biodiesel fuels credit''). The biodiesel fuels credit is the sum of three credits: (1) the biodiesel mixture credit, (2) the biodiesel credit, and (3) the small agri-biodiesel producer credit. The biodiesel fuels credit is treated as a general business credit. The credit does not apply to fuel sold or used after December 31, 2017.

Biodiesel mixture credit. The biodiesel mixture credit is $1.00 for each gallon of biodiesel (including agri-biodiesel) used by the taxpayer in the production of a qualified biodiesel mixture. A qualified biodiesel mixture is a mixture of biodiesel and diesel fuel that is (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) used as a fuel by the taxpayer producing such mixture.

Biodiesel credit (B–100). The biodiesel credit is $1.00 for each gallon of biodiesel that is not in a mixture with diesel fuel (100 percent biodiesel or B–100) and which during the taxable year is (1) used by the taxpayer as a fuel in a trade or business or (2) sold by the taxpayer at retail to a person and placed in the fuel tank of such person's vehicle.

Small agri-biodiesel producer credit. The Code provides a small agri-biodiesel producer income tax credit is 10 cents per gallon for up to 15 million gallons of agri-biodiesel produced by small producers, defined generally as persons whose agri-biodiesel production capacity does not exceed 60 million gallons per year.

Biodiesel mixture excise tax credit. The Code also provides an excise tax credit for biodiesel mixtures. The credit is $1.00 for each gallon of biodiesel used by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of the taxpayer. The credit is not available for any sale or use for any period after December 31, 2017. This excise tax credit is coordinated with the income tax credit for biodiesel such that credit for the same biodiesel cannot be claimed for both income and excise tax purposes.

Payments with respect to biodiesel fuel mixtures. If any person produces a biodiesel fuel mixture in such person's trade or business, the Secretary is to pay such person an amount equal to the biodiesel mixture credit. The biodiesel fuel mixture credit must first be taken against tax liability for taxable fuels. To the extent the biodiesel fuel mixture credit exceeds such tax liability, the excess may be received as a payment. The Secretary is not required to make payments with respect to biodiesel fuel mixtures sold or used after December 31, 2017.

Renewable diesel. Renewable diesel is liquid fuel that (1) is derived from biomass (as defined in section 45K(c)(3)), (2) meets the registration requirements for fuels and fuel additives established by the EPA under section 211 of the Clean Air Act, and (3) meets the requirements of the ASTM D975 or D396, or equivalent standard established by the Secretary. For purposes of the Code, renewable diesel is generally treated the same as biodiesel. Like biodiesel, the incentive may be taken as an income tax credit, an excise tax credit, or as a payment from the Secretary. The incentive for renewable diesel is $1.00 per gallon. There is no small producer credit for renewable diesel. The incentives for renewable diesel expired after December 31, 2017.

were enacted after the provisions had expired. The latest extension, in February, was enacted retroactively more than 13 months after the provisions had expired.[2]

The credit was initially established to encourage the market to displace petroleum-based fuels with renewable substitutes that have more favorable emissions characteristics. In conjunction with the Environmental Protection Agency's ("EPA's") Renewable Fuel Standard ("RFS"), the tax credit stimulates consumption of these fuels by reducing fuel prices for the millions of truck drivers that move two-thirds of the country's freight. The credit therefore also serves to lower the price of all goods that are moved by truck.

The current blenders' credit for biofuels incentivizes fuel marketers to invest in the blending infrastructure necessary to bring these fuels to market. If extended, it would continue to do so, as there is ample room for growth.

II. Need for 2018 Extension and Transition Relief

The coalition that I represent today is aware that the Ways and Means Committee, in examining other expiring tax incentives, has determined to phase them out rather than abruptly terminate them. While we believe the biodiesel and renewable diesel tax incentives should be made permanent, we understand that there may not be a consensus to do so.

Handled responsibly, our coalition believes that a multi-year phase out of the tax incentive can achieve the same economic and environmental benefits that the $1.00 credit has achieved for more than a decade. We are eager to work with the Committee on identifying a responsible path forward in this respect.

Although our coalition would support phasing out the credit over a period of years, it is imperative that the credit be extended at $1.00 per gallon for 2018. Given that Congress has frequently extended the credit retroactively, including most recently in February 2018 for all of 2017, market participants have come to reasonably rely on the credit being retroactively extended when undertaking business and investment decisions. This includes decisions made

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[2] The biodiesel tax incentives were originally enacted as part of the American Jobs Creation Act of 2004 and were originally scheduled to expire on December 31, 2006. The Energy Tax Incentives Act of 2005 (Pub. L. 109-58, enacted August 8, 2005) extended the provisions through December 31, 2008. The Energy Improvement and Extension Act of 2008 (Pub. L. 110-343, enacted October 3, 2008) extended them through December 31, 2009. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. 111-312, enacted December 17, 2010) extended them retroactively and through December 31, 2011. The American Taxpayer Relief Act of 2012 (Pub. L. 112-240, enacted January 2, 2013) extended them retroactively and through December 31, 2013. The Tax Increase Prevention Act of 2014 (Pub. L. 113-295, enacted December 19, 2014) extended them retroactively and through December 31, 2014. The Protecting Americans from Tax Hikes Act of 2015 (Pub. L. 114-113, enacted December 18, 2015) extended them retroactively and through December 31, 2016. And, the Bipartisan Budget Act of 2018 (Pub. L. 115-123, enacted February 9, 2018) extended them retroactively through December 31, 2017.

already in 2018. To protect these market participants from unanticipated changes in policy, the existing provisions should be extended in full for at least this year.

Consistent with that approach, our coalition is prepared to work with Congress on developing an appropriate phasedown of the tax incentives after the full extension period. Any such phasedown must be enacted well in advance in order to allow market participants to include the phasedown in their planning and make necessary adjustments. This would provide a smooth transition period and reduce negative impacts, particularly on the smaller producers and distributors most likely to be affected.

A. RINs and the RFS

Biodiesel fuel is more expensive to produce than its petroleum-derived counterpart. However, a number of federal and state policies – including the biodiesel tax credit and the RFS – have encouraged biodiesel production, blending, and sales. This has yielded material benefits for American consumers.

Under the RFS, fuel refiners and importers are required to generate an increasing volume of renewable fuel annually. These "obligated parties" must attain a particular number of renewable fuel credits, known as "RINs", to show that they are in compliance with the RFS program. RINs are essentially an artificial commodity that can be bought and sold in an open, transparent market. Certain obligated parties have chosen not to directly generate their mandatory volume of renewable fuel, but instead rely on others to introduce renewable fuel into commerce for them. Many fuel marketers perform this function in a manner that enables them to sell fuel at a lower price.

The biodiesel blenders' credit is designed to work in conjunction with the RFS: Despite its turbulent history, the biodiesel blenders' credit has made producing, buying, blending, and selling biodiesel more attractive to all respective segments of the supply chain. The credit, in conjunction with RINs under the RFS, in effect close the price gap between what a blender would be willing to pay for the energy value of a gallon of biodiesel and the price for which a biodiesel producer is able to sell it and still earn a profit. <u>The more long-term certainty and value that Congress can provide via the tax credit, the less money refiners will need to pay to acquire the requisite RINs under the RFS.</u>

For this reason, the ABFA and the members of the coalition on whose behalf I am testifying today strongly support legislation (H.R. 3264) introduced by Representatives Diane Black (R-TN) and Ron Kind (D-WI) that would extend and phase out the biodiesel blenders' tax credit. This legislation, or any similar effort, would provide the long-term certainty necessary to allow the market to properly value the renewable fuel, enable new market entrants to properly analyze costs of market entry and returns on investment, and ultimately *increase* the production, blending, and consumption of biodiesel.

B. Impact of Retroactive Extensions

Like other tax incentives, the biodiesel and renewable diesel tax incentives are intended to influence economic behavior. The credits have been effective in doing so. Some observers question whether extending expired tax benefits retroactively can create incentives for behavior during the past period for which the provisions are extended. While at first blush, it makes sense to say that a law enacted today can't impact behavior that occurred in the past, such a statement fails to consider market participants' reasonable expectations.

Because Congress has regularly extended the biodiesel and renewable diesel incentives, markets have internalized the expectation that the provisions will be extended retroactively. This market belief can be seen in the fluctuation of the RIN values under the RFS. Through all of last year, the expectation that tax credits for 2017 would be renewed resulted in lower overall RIN prices. The same phenomenon is occurring today as a result of the ongoing discussion surrounding renewal of credits for 2018.

When the tax credit is not in place, most in the biodiesel market believe the RIN value must do more work to make the fuels economic in the marketplace. For most of last year, due to the expectation the credit would be extended for 2017, the RIN values were between 20 and 40 cents less than necessary to make biodiesel's value proposition attractive for consumers. This had a significant impact on cash flows, particularly for smaller players in the market, when selling fuels for less than cost while waiting for restoration of the tax credit to put them in the black. It most certainly diminishes the likelihood of investing in more blending capacity until after the tax credits are collected.

Thus, the biodiesel and renewable diesel tax incentives are continuing to influence economic behavior – even though they are no longer in effect as a matter of law – because market participants believe they will be extended. However, the incentive effect is not as efficient as it would be if the tax benefits had a prospective expiration date.

C. Recommended Extension

We are once again in the position of having the biodiesel and renewable tax incentives expired. Following the February Bipartisan Budget Act, the provisions have now been expired for two and one-half months. Our coalition, representing the entire biodiesel supply chain, recommends that Congress enact a further extension at the earliest possible opportunity. We believe the provisions continue to benefit the economy in their present form and that they should be extended permanently.

However, we understand that there is a more significant revenue cost in making the provisions permanent and that there may not be a consensus in Congress for a permanent extension. As we noted previously, though, market participants have come to rely on the existence of these tax incentives, including that Congress would extend them retroactively when they have expired.

To protect market participants from the adverse economic effects of unanticipated policy changes, we believe strongly that the existing provisions should be extended in full for at least 2018. Consistent with the approach Congress has followed in phasing out other tax incentive

provisions, ABFA and the coalition members are prepared to work with Congress on developing an appropriate phasedown of the biodiesel and renewable tax incentives after the full extension period. Any such phasedown must be gradual and be enacted well in advance in order to allow market participants to include the phasedown in their planning.

III. The Credit Should Remain a Blender Credit, and Not be Converted to a Producer Credit

We note that some in Congress have previously proposed converting the credit from one for blenders (those who make biodiesel mixtures) to one for those who produce biodiesel and renewable diesel, thereby denying the tax credit American companies that import biodiesel or renewable diesel. We oppose this approach and note that our position is buttressed by the Department of Commerce's recent imposition of significant duties against Indonesia and Argentina, eliminating all imports from those countries for the foreseeable future.

The debate over whether to convert the biodiesel blenders' tax credit to a producers' credit represents the effort of a small number of domestic biodiesel producers and their representatives in Congress to disincentivize imports of biodiesel into the United States. Indeed, the reality is that the largest recipients of the biodiesel blenders' tax credit have historically been biodiesel *producers*, who blend nominal quantities of diesel into their supply (*i.e.*, convert B100 to B99), claim the credit, and then sell their product to customers.[3]

The benefit of a blenders' tax credit is that it applies to all biodiesel blended in the United States regardless of where it is produced. A biodiesel producers' credit, on the other hand, would only be available to domestic producers, and would be available regardless of whether the product ultimately made it into a U.S. motor vehicle. This change in policy would substantially reduce U.S. fuel marketers' *access* to biodiesel that can be sold to customers at a price that is competitive with the diesel fuel it is designed to displace.

Put more simply, a blenders' credit results in lower fuel prices in the United States; a producers' credit would result in higher fuel prices in the United States.

In certain regions of the U.S. – including the Gulf, the Northeast, the Carolinas and the Western Coast – it is simply more economic to acquire biodiesel by boat from overseas than by rail or truck from domestic plants, which are predominantly in the Midwest. (Biodiesel cannot be shipped via pipeline.) It is frequently so inefficient to move biodiesel from domestic plants to these regions of the country that fuel marketers in these regions would likely refrain from incorporating biodiesel into their fuel supply at all if they could not acquire biodiesel from overseas.

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[3] Even in 2017, when the blenders' credit had not been in place, biodiesel producers consistently converted B100 to B99 to become the "blender of record" in the hope that they would obtain the credit if and when it was retroactively extended. Producers generally include so-called "50-50 split" clauses in their supply agreements, whereby they agree to provide the purchaser with $0.50 for every gallon purchased in the event the credit is extended. Notably, blenders of record in these scenarios receive the $1.00/gallon credit *tax free*, whereas their counter-parties must treat the $.50/gallon they receive in the transaction as taxable revenue.

To illustrate, to ship biodiesel by rail from Iowa to Houston costs approximately $0.25/gallon; to import biodiesel from overseas to Houston can cost as little as $0.11-$0.12/gallon. There are a number of reasons for this. Rail cars can only hold approximately 25,000 gallons of biodiesel, whereas ocean-going vessels can hold approximately 9,000,000 gallons. Beyond quantity, moving product by rail is a more expensive endeavor because rail operates on an origin-destination fare, meaning a biodiesel plant must be on the same rail-line as where the purchaser wants to receive the product (or else the purchaser will have to pay significantly more for the product). Rail cars are also more difficult to track and predict their arrival; one can never know with certainty when a rail car will arrive. Ocean-going vessels, on the other hand, have GPS tracking associated with them and their arrival dates can be measured with precision.

In addition, removing biodiesel from a train and placing it onto a truck for delivery to a retail outlet is a more complicated, expensive endeavor than removing product from vessels that are docked in fuel-like terminals. Further, biodiesel that is imported comes to shore in close proximity to many retail fuels outlets where marketers are best able to blend it into their fuel supply; U.S. ports tend to be located near fuel demand centers (*e.g.*, Houston, TX; Mobile, AL; Savannah, GA; Wilmington, NC; and Jacksonville, FL).

For all of these reasons, acquiring biodiesel via rail is only 80% efficient (*i.e.*, 20 percent of the time the product cannot be received and blended with diesel fuel before the fuel is sold to a truck driver); biodiesel acquired via oceangoing vessels, on the other hand, is more than 95% efficient.

Cutting off access to foreign supply, as a producers' credit would do, would not change any of these facts. A biodiesel blenders' credit, on the other hand, treats all biodiesel on a level playing field regardless of where it is sourced. This provides domestic fuel marketers access to the global biodiesel market and thus facilitates an environment where biodiesel can be acquired efficiently and blended with diesel to enhance the value proposition to truck drivers (*i.e.*, to lower their fuel costs as much as possible).

A biodiesel producers' tax credit, on the other hand, would place biodiesel produced overseas at a competitive disadvantage relative to domestic product. In many parts of the country, the costs of acquiring and transporting biodiesel would be so great that consumers would find neat diesel fuel to be a greater value proposition and fuel marketers would respond accordingly.

Shifting the tax credit to a producer credit would also raise the price of heating oil in the Northeast. Just as the tax credit enhances the value proposition of biodiesel-diesel fuel blends, so too does it enhance the value proposition of biodiesel blended with heating oil. Given the logistical challenges associated with transporting domestic biodiesel into the Northeast from elsewhere in the U.S., more than 75 percent of biodiesel brought into New England is imported from Canada and other U.S. allies and trade partners. Converting the credit to a producer credit would could dramatically undercut the value proposition of biodiesel-heating oil blends (known as "bioheat") in the Northeast, and equally dramatically raise the price millions of Americans pay to heat their homes.

IV. Conclusion

Again, we thank you for the work on the tax reform bill and extending the credits for 2017. We would urge you to consider extending these credits to continue to build this industry.

Thank you for the opportunity to testify.