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Senate Finance Committee Extenders Package Includes Biodiesel Mixture Credit

KEY POINTS

- **Credits are extended unmodified through 2015**
- **§40A income tax credits are correctly stated as included in gross income while the summary of the legislation remains silent with respect to §6426 and §6427 excise tax credits**
- **Credit transitions to §40A Producer / Discretionary Blender income tax credit in 2016 – appears from the summary that the excise tax credits in §6426 and §6427 will not be extended beyond 2015 and effective 2016 the only credit will be the income tax credit under §40A**
- **Biodiesel becomes a taxable fuel in January 2016 with the person eligible to claim the credit being the taxpayer.**

On July 21, 2015 the Senate Finance Committee approved a bill to extend certain expiring tax provisions. This bill included the biodiesel credits. We are advised by Senate Finance Committee staff that the language of the bill has not yet been fully drafted hence it is not available for public view. The Finance Committee has published several descriptions of the proposed legislation and its amendments; however, these documents may raise more questions than they provide answers. However the Joint Committee on Taxation has issued JCX-101-15, July 17, 2015 which provides a description of the Senate Finance Committee Chairman's mark of a bill extending certain expired tax provisions.

Briefly, the proposal would extend the credits in their current form through the end of 2015. The IRS is instructed to issue guidance on a one-time filing for periods in 2015 that have passed by the time the legislation is enacted. The proposal would transition the credit over to a producer credit beginning January 1, 2016. With respect to the extension of the current credits, the Joint Committee on Taxation's description of the Finance Committee legislation sets down the current law, separating what it terms the "biodiesel fuels credit" in IRC § 40A from the biodiesel mixture excise tax credit in §§ 6426 and 6427. Notably, with respect to the ongoing matter of whether or not the biodiesel mixture excise tax credit (and its alcohol and alternative fuel counterparts) are includible in gross income, the Joint Committee Report makes no reference but specifically notes with respect to the § 40A credit that "[T]he amount of the biodiesel fuels credit is includible in gross income." This specific reference to the § 40A credit comes as no surprise as the credit under this section is includible in gross income under § 87. By saying nothing with respect to the excise tax credit, the Joint Committee at worst leaves the question open and ambiguous and at best acknowledges that the credit is not includible in gross income. Either way, silence by Congress does not

further the IRS' position that under current law the excise tax credit is intended to be includible in gross income.

With respect to transitioning to a producer credit, the Finance Committee legislation includes as an amendment, the "Biodiesel Tax Incentive Reform Act," which from its description and title appears to be a modified version of the Grassley-Cantwell proposal that has been introduced in every Congress for the past several years and which until this year has never made it out of Committee. As described, the amendment converts the biodiesel fuels credit – the § 40A income tax credit – to a $1.00 per gallon production credit for fuel produced in the United States. Unlike under current law where the credits are available for domestically produced and imported biodiesel (provided the imported biodiesel is not subsequently exported), the amended producer credit appears to limit the credit to only B100 that is produced in the United States; all imported B100 will not be eligible for the credit from 2016. This change may cause a significant reduction in imported B100 to be replaced with imported "bio-oils" which are then used to produce biodiesel in the US. The amendment does allow an "eligible discretionary blender" – defined as "a diesel fuel blender registered with the IRS that blended 10 million of more gallons of biodiesel or renewable diesel in the previous calendar year" – to claim the mixture credit if the producer provides the blender with documentation that the producer is foregoing the production credit. This change would take effect on January 1, 2016 therefore presumably changing the original proposal to reinstate the credits in the current form through 2016 and instead only reinstate them through 2015.

While it is not entirely clear, it appears from the amendment that the intent is to pull all the credits into § 40A and allow the credits in §§ 6426 and 6427 to expire. The description of the amendment refers to a "biodiesel mixture credit" (which is the § 40A credit) and a "biodiesel mixture excise tax credit" (which is the §§ 6426 and 6427 credit). It changes the credit to a production credit and allows an "*eligible discretionary blender*" to claim the mixture credit; the amendment does not appear to allow the "*eligible discretionary blender*" to claim the mixture excise tax credit. If the text of the bill follows what the description appears to be saying, the only credit available from 2016 will be an income tax credit and for all prospective periods the question of how to treat the credit for income tax purposes will be resolved.

In addition to moving the credit away from the blender and seemingly eliminating the excise tax credit altogether, the amendment converts biodiesel to a taxable fuel, effective 2016. The amendment states that the tax is paid by the taxpayer eligible to elect the credit. As this would be either the producer or the "*eligible discretionary blender*," it is unclear whether the point of taxation for biodiesel is going to be the same as for diesel and other taxable fuels under the Internal Revenue Code, or whether it will differ. If it is to be the same, it seems biodiesel would be taxed when removed at the production facility - presumably if biodiesel becomes a taxable fuel biodiesel production facilities will be required to become registered IRS facilities - and placed into a railcar which is the predominate mode of biodiesel transportation. This would mean the incidence of taxation would occur soon after production as there are no biodiesel pipelines to move biodiesel from production facility to terminals. Consequently, as the proposal seems to tie the credit and tax together, there seem to be two options for how the tax would be imposed: either (1) the producer remits the tax when he sells the biodiesel across the (biodiesel) refinery rack; or (2) the producer sells the biodiesel within his production facility and the tax is paid by the entity that subsequently removes it, that entity also being the blender of biodiesel based on the description of the proposal. It would seem that a third party removing biodiesel from a production facility could not be the taxpayer without also being the blender and if the point of taxation is removal from a refinery or terminal it follows that the entity removing

biodiesel who is not the producer must be the blender. Given the current set up in the industry whereby many biodiesel production facilities have limited storage it would seem that the incidence of tax will occur either with the producer or his immediate purchaser.

It is clear that the Senate is proposing significant changes to biodiesel regime as we currently know it. Until the legislation is finalized, however, it appears that the proposals carry with them more questions than answers.

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Oscar L. Garza & Associates, P.C. is a Houston-based boutique law firm specializing in transactional tax and trade matters surrounding all aspects of the oil and petroleum industry. With over 20 years of experience counseling clients operating in all aspects of the oil and petroleum sector our lawyers have an in-depth knowledge of the industry, enabling us to provide quality service and creative solutions to our clients. Please visit our website at www.olgarza.com. For more information please contact:

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