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Submitted to the U.S. House Committee on Ways and Means  
Hearing Regarding Energy Tax Incentives and the Green Job Economy  
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**Executive Summary:** Biodiesel is a renewable, low carbon diesel replacement fuel that is widely accepted in the marketplace. It is the only commercial scale Advanced Biofuel produced in the U.S. The biodiesel tax incentive has allowed the U.S. to achieve the significant economic, environmental and energy security benefits associated with expanded domestic production and use of biodiesel.

Due to volatile commodity prices; unfavorable market conditions; difficulty accessing operating capital; and uncertainty regarding federal policy; the U.S. biodiesel industry is facing severe economic challenges. In particular, the lapse of the biodiesel tax incentive on December 31, 2009 has had a detrimental impact on the industry, and the domestic production and consumption of biodiesel has been significantly curtailed. Plants nationwide have already ceased production, trimmed payrolls and laid-off employees, and the 23,000 jobs nationwide supported by the industry will be in increasing jeopardy the longer the tax incentive is allowed to lapse. Accordingly, the U.S. biodiesel industry asks Congress to address this immediate issue and act in a timely manner to retroactively extend the biodiesel tax incentive.

In addition, it is difficult for entrepreneurs and investors to make long-term business decisions based on year to year extensions of the biodiesel tax incentive. Thus, a multiple year extension of the incentive is needed to provide certainty and stability in the marketplace. In addition, the U.S. biodiesel industry supports reforming the biodiesel tax incentive by changing the current blenders excise tax credit to a production excise tax credit. This will improve administration of the incentive, eliminate potential abuses and enhance tax compliance.

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Chairman Levin, Ranking Member Camp and Members of the Committee, I thank you for the opportunity to submit written testimony on behalf of the National Biodiesel Board (NBB) regarding the need to retroactively extend and reform the biodiesel tax incentive.

**About NBB:** NBB is the national trade association representing the biodiesel industry as the coordinating body for research and development in the U.S. It was founded in 1992 by state soybean commodity groups who were funding biodiesel research and development programs. Since that time, the NBB has developed into a comprehensive industry association which coordinates and interacts with a broad range of cooperators including industry, government and academia. NBB's membership is comprised of biodiesel producers; state, national and international feedstock and feedstock processor organizations; fuel marketers and distributors; and technology providers.

**Background and Industry Overview:** Biodiesel is a diesel replacement fuel that is an Advanced Biofuel under the Renewable Fuels Standard (RFS2) program. The fuel is made from agricultural oils, fats and waste greases and is refined to meet a specific commercial fuel definition and specification. The fuel is produced by reacting feedstock with an alcohol to remove the glycerin and meet the D6751 fuel specification set forth by the American Society for Testing and Materials (ASTM International). Biodiesel is one of the best-tested alternative fuels in the country and the only alternative fuel to meet all of the testing requirements of the 1990 amendments to the Clean Air Act. There are currently 173 biodiesel plants in the U.S. with a combined production capacity of 2.69 billion gallons.

Biodiesel is primarily marketed as a five percent (B5) blending component with conventional diesel fuel, but can be used in concentrations up to twenty percent (B20). It is distributed utilizing the existing fuel distribution infrastructure with blending occurring both at fuel terminals and “below the rack” by fuel jobbers. Biodiesel is beginning to be distributed through the petroleum terminal system. To date, biodiesel is available in over 72 fuel distribution terminals. Last year, two major pipeline companies successfully tested B5 blends in pipelines, and the biodiesel industry has committed funds to continue to study the technical needs required for moving biodiesel through U.S. pipelines. Already, biodiesel is moved through pipelines in Europe and expanding that capability in the U.S. would significantly increase biodiesel penetration in the U.S. diesel fuel market.

**Status and Background on the Biodiesel Tax Incentive:** The biodiesel tax incentive was enacted in 2004 as part of the American Jobs Creation Act (P.L. 108-357). The incentive was subsequently extended through December 31, 2008 as part of the Energy Policy Act of 2005 (P.L. 109-190). H.R. 1424, the Emergency Economic Stabilization Act of 2008 (P.L. 110-343), again extended the incentive for one year through December 31, 2009. The biodiesel tax incentive has expired, and the current lapse in the biodiesel tax incentive has had a detrimental impact on the domestic biodiesel industry.

On December 9, 2009, the U.S. House of Representatives approved H.R. 4213, *the Tax Extenders Act of 2009* by a 241-181 margin. This legislation, among its provisions, provides a one year extension of the biodiesel tax incentive. The U.S. Senate voted to approve its version of H.R. 4213, *the American Workers, State, and Business Relief Act of 2010*, on March 10, 2010 by a 62-36 margin. H.R. 4213 as approved by the U.S. Senate provides a one year retroactive extension of the biodiesel tax incentive.

The biodiesel tax incentive is designed to encourage the production and use of biodiesel by making the fuel price competitive with conventional diesel fuel. In general, current law allows taxpayers to claim the biodiesel tax incentive as either a \$1.00 per gallon general business income tax credit or as a \$1.00 per gallon blenders excise tax credit. To qualify for the biodiesel tax incentive, the fuel must by statute meet both the ASTM D6751 fuel specification and the Environmental Protection Agency’s (EPA) registration requirements under Section 211 of the Clean Air Act. The income tax credit can be claimed either as a biodiesel mixture credit, which provides the incentive for each gallon of biodiesel that is blended with conventional diesel fuel, or as a B100 biodiesel credit for each gallon of pure biodiesel that is used as a fuel.

The biodiesel tax incentive also provides a biodiesel blenders excise tax credit. The credit is \$1.00 for each gallon of biodiesel that is blended with conventional diesel fuel. The blenders excise tax credit differs from the biodiesel mixture income tax credit and the B100 biodiesel income tax credit in that the blenders credit can be used to offset excise tax liability, and is refundable to the degree that the credit exceeds excise tax owed by a taxpayer. The B100

biodiesel credit and biodiesel mixture income tax credit are coordinated to take into account amounts claimed via the blenders credit. The vast majority of biodiesel tax incentives are claimed as a blenders excise tax credit.

Lastly, current law provides for a small agri-biodiesel producer income tax credit. The credit is 10 cents per gallon and can be claimed by taxpayers with less than 60 million gallons of cumulative annual production capacity. The credit is limited to the first 15 million gallons of annual production. To qualify for the small producer credit, fuel must be produced from either virgin vegetable oils or animal fats.

**Biodiesel Public Policy Benefits:** The biodiesel tax incentive has helped achieve the worthwhile policy goal of increasing the production and use of biodiesel in the U.S. In 2004, when the incentive was initially enacted, the U.S. produced 25 million gallons. In 2009, that number rose to 545 million gallons. There are compelling public policy benefits associated with the enhanced production and use of biodiesel in the U.S.

*The Biodiesel Industry is Creating Green Jobs and Making a Positive Contribution to the Economy:* In 2009, the U.S. biodiesel industry supported 23,000 jobs in all sectors of the economy. This added \$4.1 billion to the nation's Gross Domestic Product (GDP) and generated \$828 million in tax revenue for federal, state and local governments.

By conservative estimates, there is domestic feedstock available to support 1.77 billion gallons of annual biodiesel production in the U.S. The domestic industry has the capacity to support this level of production. The production of 1.77 billion gallons of fuel would support 78,619 jobs; add \$6.660 billion to the GDP; generate \$1.345 billion in revenue for federal, state and local governments; and reduce greenhouse gas emissions by 27.4 billion pounds - the equivalent of removing 2.38 million passenger vehicles from U.S. roads.

*Biodiesel Reduces our Dependence on Foreign Oil:* Biodiesel plays a constructive role in expanding domestic refining capacity and reducing our reliance on foreign oil. The 1.9 billion gallons of biodiesel produced in the U.S. since 2005 has displaced an equivalent amount of diesel fuel with a clean-burning, efficient fuel that reduces lifecycle carbon dioxide emissions by as much as 86 percent compared to petroleum diesel fuel and creates 4.56 units of energy for every unit of energy that is required to produce the fuel.

*Biodiesel is Good for the Environment:* Biodiesel is an environmentally safe Advance Biofuel, and is the most viable transportation fuel when measuring its carbon footprint, life cycle and energy balance. The U.S. Department of Agriculture (USDA)/Department of Energy (DoE) life cycle study shows that biodiesel yields a 78 percent reduction in direct lifecycle CO<sub>2</sub> emissions compared to petroleum diesel fuel. The EPA's RFS2 life cycle analysis shows that biodiesel reduces greenhouse gas emissions by as much as 86 percent. 1 billion gallons of biodiesel will reduce current life cycle greenhouse gas emissions by 16.12 billion pounds, the equivalent of removing 1.4 million passenger vehicles from U.S. roads. In 2009 alone, biodiesel's contribution to reducing greenhouse gas emissions was equal to removing over 774,000 passenger vehicles from America's roadways.

Biodiesel's emissions significantly outperform petroleum diesel. Biodiesel emissions have decreased levels of all target polycyclic aromatic hydrocarbons (PAH) and nitrated PAH compounds, as compared to petroleum diesel exhaust. These compounds have been identified as potential cancer causing agents.

Biodiesel is the only alternative fuel to voluntarily perform Environmental Protection Agency (EPA) Tier I and Tier II testing to quantify emission characteristics and health effects. That study found that B20 (20 percent biodiesel blended with 80 percent conventional diesel fuel) provided significant reductions in total hydrocarbons; carbon monoxide; and total particulate matter. Research also documents the fact that the ozone forming potential of the hydrocarbon emissions of pure biodiesel is nearly 50 percent less than that of petroleum fuel. Pure biodiesel typically does not contain sulfur and therefore reduces sulfur dioxide exhaust from diesel engines to virtually zero.

***The Biodiesel Industry Stimulates Development of New Low-Carbon Feedstocks:*** The feedstock used to produce U.S. biodiesel has increasingly diversified, with waste products such as animal fat and used restaurant grease (yellow grease) making up a larger portion of the feedstock used to produce fuel. Biodiesel production is currently the most efficient way to convert lipids into low-carbon diesel replacement fuel, and as a result, industry demand for less expensive, reliable sources of fats and oils is stimulating promising public, private and non-profit sector research on second generation feedstocks such as algae.

Algae's potential as a source of low carbon fuel has been well documented, and a stable, growing biodiesel industry is necessary if the U.S. is to eventually benefit from the commercial scale production of algal-based biofuels. The NBB estimates that for every 100 million gallons of biodiesel that is produced from algae, 16,455 jobs will be created and \$1.461 billion will be added to the GDP.

**U.S. Biodiesel Industry is Facing Severe Economic Hardship:** Despite recent growth, the industry is in the midst of an economic crisis. Plants are having difficulty accessing operating capital. Volatility in commodity markets and reduced demand for biodiesel in both domestic and global markets are making it difficult for producers to sell fuel. Lastly, uncertainty relating to federal policy that is vital to the industry's survival – in particular the current lapse of the biodiesel tax incentive - is sending inconsistent signals to the marketplace and undermining investor confidence in the industry.

If prolonged, this downturn will lead to a severe retraction in U.S. biodiesel production capacity. Because of the lapse in the biodiesel tax incentive, the price of biodiesel is significantly higher than petroleum diesel. This has made it nearly impossible for biodiesel plants to produce fuel at a profit, and as a result, U.S. production and consumption of biodiesel has been severely curtailed. If this situation is allowed to persist, the energy security, environmental, and job creation benefits that the nation realizes from biodiesel production will be lost.

**Multiple Year Extension of a Reformed Biodiesel Tax Incentive is Consistent with Sound Tax and Energy Policy:** The biodiesel tax incentive has helped the nascent U.S. biodiesel industry reach commercial scale production of renewable, low carbon diesel replacement fuel. This in turn has allowed the nation to realize the energy security, economic and environmental benefits associated with the domestic production and use of biodiesel. It is, however, difficult for entrepreneurs and investors to make long-term business decisions based on year to year extensions of the biodiesel incentive. Thus, a multiple year extension of the biodiesel tax incentive is needed to provide certainty and stability in the marketplace.

NBB also supports a structural reform of the tax incentive. Specifically, the U.S. biodiesel industry supports changing the current blenders excise tax credit to a production excise tax credit of equal value. This change will streamline administration of the credit and promote tax compliance while preserving the elements of the existing incentive that have effectively

incentivized the production and use of biodiesel. This reform proposal is encompassed in H.R. 4070, legislation introduced by U.S. Representative Earl Pomeroy (D-ND) and U.S. Representative John Shimkus (R-IL) and S. 1589, *the Biodiesel Reform and Extension Act of 2009*, introduced in the U.S. Senate by Senator Maria Cantwell (D-WA) and Senator Charles Grassley (R-IA).

There are several shortcomings associated with the current structure of the biodiesel blenders excise tax credit that would be remedied by restructuring the incentive as a production excise tax credit. Specifically:

*Current Blenders Excise Tax Credit Structure Presents Administrative Difficulties:* Blending biodiesel with diesel fuel, the event that triggers the blenders credit, can occur at multiple stages in the fuel distribution chain. This significantly increases the number of registrants eligible to claim the credit and makes it difficult to ensure that only fuel that qualifies for the benefit claims the incentive. Changing the blenders excise tax credit to a production excise tax credit would allow the incentive to be claimed at either a biodiesel plant or at an Internal Revenue Service (IRS) registered terminal, making it easier to ensure that only fuel meeting the ASTM D6751 fuel specification receives the tax incentive while preserving the incentive's underlying economic benefits.

*Existing Blenders Excise Tax Credit Does Not Work Well with the U.S. Department of Treasury's Excluded Liquids Rule:* Under existing regulations, for purposes of the 24.3 cents per gallon diesel fuel excise tax, diesel fuel does not include "excluded liquids." Among other things, liquids with less than 4 percent paraffin content are considered an excluded liquid. Existing IRS regulations allow B99.9 biodiesel blends and other blends to qualify for the biodiesel blenders excise tax credit, even if the blend is an excluded liquid not subject to the federal diesel fuel excise tax. B99.9 blends do not have 4 percent paraffin content, and thus, are not currently subject to the diesel fuel excise tax. Because biodiesel is typically used as a lower level blend component in the marketplace that is eventually subject to the federal diesel fuel excise tax, this leads to a situation where excise tax liability is triggered at varying points "below the rack." This makes collection of the 24.3 cents per gallon diesel fuel excise tax burdensome for both taxpayers and IRS.

In an attempt to address this issue, the IRS issued a proposed rule on July 29, 2008 that would modify the Excluded Liquids rule in a manner that would subject B99.9 biodiesel blends to the federal diesel fuel excise tax. This change, however, would further complicate the taxation and distribution of biodiesel in fuel terminals. For example, under the proposed rule, a B99.9 blend sold by a biodiesel producer to a position holder in an IRS registered terminal would be subject to the 24.3 cents per gallon diesel fuel excise tax. When the B99.9 fuel is further blended to a B5 through B20 level and is sold at the terminal in a taxable sale, the biodiesel component of the blend would again be subject to the diesel fuel excise tax. Though there is an existing regime that would allow for the refunds, this system is not timely and is difficult for taxpayers to navigate. As a result, this change would again have the unintended consequence of artificially inflating the price of biodiesel in the marketplace on account of the fuel being subject to double taxation and could cause cash flow issues for fuel marketers and terminal operators who sell and promote biodiesel in the marketplace. Further, terminal operators who handle both B100 and B99.9 biodiesel blends would be forced to expend capital to purchase additional storage tanks and other infrastructure to handle biodiesel, again serving as a deterrent to the expanded use and sale of biodiesel through the nation's fuels terminals.

The IRS is also in the midst of a process that would incorporate biofuels, including biodiesel, in the existing ExStars fuel reporting system. ExStars is a fuel excise tax compliance reporting system that tracks the flow of fuel through IRS registered terminals. In an effort to collect the 24.3 cents per gallon diesel fuel excise tax owed on biodiesel blends “below the rack,” IRS envisions significantly expanding the number of taxpayers that must file reports under the ExStars system to include small “below the rack” fuel marketers. This would impose an onerous regulatory burden on small businesses.

To remedy this issue, H.R. 4070 and S. 1589 would treat pure biodiesel as diesel fuel for tax purposes. In general, the reform proposal would provide that the biodiesel tax incentive would be claimed and the diesel fuel excise tax would be paid when biodiesel was sold by the plant. The proposal would also allow for the sale on tax-exempt, non-credit claimed fuel to an IRS registered terminal, and the credit would be claimed and excise tax paid at the terminal. This structure would avoid the complexities associated with subjecting B99.9 blends to the diesel fuel excise tax under the current structure of the biodiesel tax incentive. In addition, this would significantly improve tax compliance and remove the need for the IRS to impose onerous below the rack ExStars reporting requirements on fuel distributors and marketers.

*Change to Production Excise Tax Credit Would Stop Potential Transshipment Schemes:* P.L. 110-343 contained a provision designed to give IRS the statutory authority to stop so-called “splash and dash” transactions. A “splash and dash” transaction occurs when biodiesel produced in a foreign country is sent to the U.S.; splash blended with diesel fuel to claim the U.S. biodiesel blenders excise tax credit; and then sent to a third country for final use as biodiesel or diesel fuel at any blend level. P.L. 110-343 clarified that effective May 15, 2008, fuel produced outside the U.S. for use outside the U.S. does not qualify for the biodiesel tax incentive. There is clearly no energy or tax policy justification for this sort of transaction, and the NBB was fully supportive of efforts to close this unjustified and unforeseen tax loophole.

Though Congress closed the “splash and dash” loophole, the current law blenders credit could inadvertently allow for other potential abuses associated with the transshipment of foreign fuel through the U.S. to claim the blenders credit. In addition, further refinements to the blenders excise credit to address these issues are likely to run contrary to U.S. WTO commitments. A change to a production excise tax credit would thwart any potential transshipment abuses in a WTO-consistent manner.

*Transition to Production Excise Tax Credit Could be Accomplished with Minimal Marketplace Disruption:* Under current law, a blend of 99.9 percent biodiesel and .1 percent diesel qualifies for the biodiesel blenders excise tax credit. Biodiesel plants are currently permitted to claim the incentive. Thus, for practical purposes, the current incentive in these instances functions as a production credit. A change to a production excise tax credit would preserve the incentive’s liquidity and could be easily administered by both taxpayers and the IRS.

**Conclusion:** The biodiesel tax incentive has helped achieve the desired goal of increasing the domestic production and use of biodiesel, and in turn has helped the U.S. realize the energy security, economic and environmental benefits associated with displacing petroleum with domestically produced renewable fuels. These benefits, however, will be lost if Congress does not act in a timely manner to address the immediate issue facing the industry and retroactively extend the biodiesel tax incentive. In addition, to provide certainty and improve the incentive, the U.S. biodiesel industry urges Congress to reform the biodiesel tax incentive as a production excise tax incentive and provide a multiple year extension of the reformed incentive.

Chairman Levin, Ranking Member Camp and Members of the Committee, I again appreciate having the opportunity to submit written testimony on this issue of significant importance to the U.S. biodiesel industry.