ECONOMIC DEVELOPMENT TAX INCENTIVE STUDY - BIODIESEL FUEL CREDITS

Pursuant to North Dakota Century Code Section 54-35-26, created by 2015 Senate Bill No. 2057, a variety of economic development tax incentives are to be reviewed by a Legislative Management interim committee over the ensuing six-year period. The study is aimed at ensuring that economic development tax incentives are serving their intended purposes in a cost-effective and equitable manner. This memorandum has been provided to assist in the review of biodiesel fuel credits and provides an explanation of the incentives, the perceived goals of the Legislative Assembly in creating or altering the incentives, and the data and testimony that will be required to conduct an effective analysis of the incentives.

EXPLANATION OF BIODIESEL FUEL CREDITS

A variety of income tax credits are available to taxpayers for the production or sale of biodiesel fuel. Section 57-38-30.6 provides for a biodiesel fuel production facility construction or retrofit credit. The incentive is available to corporate income taxpayers and allows for a credit against state income tax liability in the amount of 10 percent per year for five years of the taxpayer's direct costs incurred after December 31, 2002, to adapt or add equipment to retrofit an existing facility or to construct a new facility in this state for the purpose of producing or blending diesel fuel containing at least 2 percent biodiesel fuel or green diesel fuel by volume. Credit amounts exceeding a taxpayer's liability may be carried forward to each of the five succeeding taxable years but a taxpayer is limited to claiming no more than $250,000 in credits over any combination of taxable years. Eligible costs incurred by a taxpayer before a facility begins producing or blending diesel fuel containing at least 2 percent biodiesel fuel or green diesel fuel by volume may not be claimed for purposes of the credit until the taxable years on or after production or blending begins.

Section 57-38-01.22 provides for an income tax credit for blending biodiesel fuel or green diesel fuel. The incentive is available to a taxpayer licensed by the Tax Commissioner as a fuel supplier who blends biodiesel fuel or green diesel fuel in this state. The incentive allows for a credit against state income tax liability in the amount of five cents per gallon of biodiesel fuel or green diesel fuel of at least a 5 percent blend. Any credit amount exceeding a taxpayer's liability may be carried forward to each of the five succeeding taxable years. A passthrough entity entitled to the credit must be considered the taxpayer for purposes of the credit and the amount of credit allowed must be determined at the passthrough entity level and passed through to the partners, shareholders, or members in proportion to their respective interests in the passthrough entity.

Section 57-38-01.23 provides for an income tax credit for adapting a facility to allow for sales of biodiesel or green diesel fuel. The incentive is available to a taxpayer licensed by the Tax Commissioner as a fuel retailer. The incentive allows for a credit against state income tax liability in the amount of 10 percent per year for five years of the direct costs incurred by the fuel retailer to adapt or add equipment to a facility to enable the facility to sell diesel fuel containing at least 2 percent biodiesel fuel or green diesel fuel by volume. Credit amounts exceeding a taxpayer's liability may be carried forward to each of the five succeeding taxable years, but a taxpayer is limited to claiming no more than $50,000 in credits over any combination of taxable years. A passthrough entity entitled to the credit must be considered the taxpayer for purposes of the credit and the amount of credit allowed must be determined at the passthrough entity level and passed through to the partners, shareholders, or members in proportion to their respective interests in the passthrough entity. Eligible costs incurred by a taxpayer before a facility begins selling biodiesel or green diesel fuel containing at least 2 percent biodiesel or green diesel fuel by volume may not be claimed for purposes of the credit until the taxable years on or after sales of biodiesel or green diesel fuel begin.

PERCEIVED GOALS OF THE LEGISLATIVE ASSEMBLY IN CREATING OR ALTERING BIODIESEL FUEL CREDITS

Section 57-38-30.6 was created through the passage of 2003 House Bill No. 1309 and, as originally enacted, provided for a corporate income tax credit for costs incurred to adapt or add equipment to retrofit an existing facility or construct a new facility in this state for the purpose of producing or blending diesel fuel containing at least 2 percent biodiesel fuel by volume. Upon a review of the legislative history pertaining to 2003 House Bill No. 1309, the perceived goal of the Legislative Assembly in creating this credit was to encourage the development of biodiesel production or blending facilities. It was noted the credit would assist in reducing dependence on foreign energy sources and dependence on farm subsidies as the credit would likely result in increased demand for the state's plentiful soybean crops. The credit was viewed as a tool to help stimulate the development of a new industry in North Dakota. The estimated fiscal effect of the corporate income tax credit for biodiesel production and blending equipment costs could not be determined during the 2003 legislative session.

The credit was expanded during the 2009 legislative session, through the passage of House Bill No. 1489, to apply to the costs incurred to adapt or add equipment to retrofit an existing facility or construct a new facility in this state for the purpose of producing crushed soybeans or canola. The most recent change to Section 57-38-30.6 occurred through the passage of 2011 Senate Bill No. 2034, which served to further expand the credit to apply to costs incurred to adapt or add equipment to retrofit an existing facility or construct a new facility in this state for the purpose of producing or blending diesel fuel containing at least 2 percent green diesel fuel by volume.

Information provided to the Political Subdivision Taxation Committee by the Tax Department on July 29, 2015, and later amended on August 12, 2015, indicates the number of corporate income tax returns on which the credit was claimed and the total amount claimed is as follows:

- In tax year 2006, the credit was not claimed on any corporate income tax returns;
- In tax year 2007, the amount claimed cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five returns;
- In tax years 2008 through 2011, the credit was not claimed on any corporate income tax returns;
- In tax years 2012 and 2013, the amount claimed cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five returns; and
- In tax year 2014, the credit was not claimed on any corporate income tax returns.

Additional biodiesel credits were added during the 2005 legislative session through the passage of Senate Bill No. 2217. The bill offered a package of tax incentives relating to biodiesel fuel and served to create Sections 57-38-01.22 and 57-38-01.23. As originally enacted, Section 57-38-01.22 provided for an income tax credit to biodiesel blenders, in the amount of five cents per gallon of biodiesel fuel of at least a 5 percent blend, and Section 57-38-01.23 provided an income tax credit to biodiesel retailers. The credit available to retailers was equal to 10 percent per year for five years of the direct costs incurred by the fuel retailer to adapt or add equipment to a facility to enable the facility to sell diesel fuel containing at least 2 percent biodiesel fuel by volume. Upon a review of the legislative history pertaining to 2005 Senate Bill No. 2217, the perceived goal of the Legislative Assembly in creating these credits was to incentivize development of the renewable fuels industry in North Dakota. The bill was seen as a significant step toward biodiesel production in this state. The estimated fiscal effect of the income tax credits for biodiesel blenders and retailers could not be determined during the 2005 legislative session.

Sections 57-38-01.22 and 57-38-01.23 received minor changes during the 2009 legislative session through the passage of House Bill No 1324. The changes made by the bill were merely technical in nature and served to eliminate the optional long-form filing method (Form ND-2) and replace it with a simplified filing method. The first substantive changes to each section occurred during the 2011 legislative session through the passage of Senate Bill No. 2034, which was recommended by the 2009-10 interim Energy Development and Transmission Committee. The bill served to expand both credits to pertain to the blending or sale of green diesel fuel in addition to biodiesel fuel. The most recent changes made to Sections 57-38-01.22 and 57-38-01.23 were again technical in nature and occurred during the 2013 legislative session with the passage of House Bill No. 1106. The bill simply served to streamline the lengthy description of a passthrough entity by providing a definition of the term at the outset of the income tax chapter. The bill also clarified that a licensed fuel supplier must blend biodiesel fuel or green diesel fuel in this state in order to qualify for the credit.

Information provided to the Political Subdivision Taxation Committee by the Tax Department on July 29, 2015, and later amended on August 12, 2015, regarding the income tax credit provided to fuel blenders pursuant to Section 57-38-01.22 indicates a combined total of $52,660 was claimed on seven individual income tax returns in tax year 2006 and the amount claimed in tax years 2007 through 2014 cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five individual income tax returns in each tax year.

The number of corporate income tax returns on which the fuel blender credit was claimed and the total amount claimed is as follows:

- In tax year 2006, the credit was not claimed on any corporate income tax returns;
- In tax years 2007 through 2013, the amount claimed cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five returns; and
- In tax year 2014, the credit was not claimed on any corporate income tax returns.

Information provided regarding the income tax credit provided to fuel retailers pursuant to Section 57-38-01.23 indicates the number of individual income tax returns on which the credit was claimed and the total amount claimed is as follows:

- In tax year 2006, a total of $869 was claimed over five returns;
- In tax year 2007, the amount claimed cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five returns;
- In tax years 2008 and 2009, the credit was not claimed on any individual income tax returns; and
- In tax years 2010 through 2014, the amount claimed cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five returns.

The number of corporate income tax returns on which the fuel retailer credit was claimed and the total amount claimed is as follows:

- In tax year 2006, the credit was not claimed on any corporate income tax returns;
- In tax year 2007, the amount claimed cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five returns;
- In tax years 2008 and 2009, the credit was not claimed on any corporate income tax returns;
- In tax year 2010, the amount claimed cannot be disclosed due to confidentiality restrictions as the credit was claimed on fewer than five returns; and
- In tax years 2011 through 2014, the credit was not claimed on any corporate income tax returns.

DATA AND TESTIMONY REQUIRED TO CONDUCT AN EFFECTIVE ANALYSIS OF BIODIESEL FUEL CREDITS

Data pertaining to the following items will need to be collected to effectively analyze the incentives:

1. The number of claimants;
2. The fiscal impact of the incentives;
3. Employment opportunities, business growth, or diversity in the state's economy resulting from the availability of the incentives;
4. Negative impacts created as a result of the incentives;
5. Benefits that flow to out-of-state concerns resulting from the incentives; and
6. The use of these types of incentives in other states.

Testimony will need to be solicited from the following parties to effectively analyze the incentives:

1. The Department of Commerce;
2. The Tax Department; and
3. The North Dakota Economic Development Foundation.