



Biodiesel: Points to Consider Relative to Fuel Tax Administration (2007)

Introduction

Biodiesel as defined by the FTA Motor Fuel Tax Section Uniformity Committee is “a fuel comprised of mono-alkyl esters of long chain fatty acids generally derived from vegetable oils or animal fats, designated B100, and meeting the requirements of ASTM D6751”.

Biodiesel Blend as defined by the FTA Motor Fuel Tax Section Uniformity Committee is “a blend of Biodiesel fuel meeting the ASTM D6751 with petroleum based diesel fuel, designated BXX, where XX represents the volume percentage of Biodiesel fuel in the blend, i.e. B20 is 20% Biodiesel and 80% petroleum diesel”.

According to the National Biodiesel Board, in 2004 there were 22 biodiesel production facilities in the United States capable of producing 157 million gallons of biodiesel. As of April 2007, there are 105 plants with a capacity of 864 million gallons of biodiesel.

In the United States, soybean oil, canola oil, palm oil, and animal fats derived from poultry and swine, are most commonly used as feedstock in the production of biodiesel. Biodiesel is also produced from “yellow grease” or re-cycled cooking oil.

It is important to note that biodiesel, unlike petroleum based fuels, can be produced by an individual in a backyard setting with minimal monetary investment in equipment and feedstock. As a result, it is extremely difficult for any regulatory authority to license producers, enforce quality standards, and track the movement of the fuel for taxation purposes.

Licensing Issues

Biodiesel may fall within a taxing authority’s statutory guidelines associated with diesel fuel. If this is the case, licensing requirements, tax return filing requirements, tax payment requirements, associated fee application requirements, dyeing regulations, and refund application procedures may not need to be changed in order to apply to the sale or use of biodiesel as a motor fuel. Additional licenses may be required.

Biodiesel is most often sold at retail as B20. A blender license will provide a mechanism for the payment of the motor fuel tax due on the B100 portion of the product blended with the petroleum diesel in the B20 blend. A manufacturer/producer license may be required if the biodiesel is considered to be a taxable motor fuel at the time it is produced. This will reduce the amount of untaxed biodiesel available for use in a jurisdiction. It may be helpful to statutorily distinguish “backyard producers” from biodiesel manufacturing concerns based on productivity levels. “Backyard producers” are often making biodiesel for their own use with no intention of selling the product. In the interest of increasing voluntary compliance, a permitting system could be developed for “backyard producers” in lieu of licensing and tax return filing requirements. Penalties should be available for imposition if sales were made by individuals without the proper permit and/or license.

Biodiesel marketing internet sites as well as the IRS 637 registrant database may be useful in identifying producers/importers/blenders that should be licensed in a specific state.



Quality Standards

An adopted definition of biodiesel may refer to adherence to the current ASTM (American Society for Testing and Materials) specifications. If so, product testing should be available, and appropriate penalties should be in place should the standards not be met. A biodiesel product may not meet ASTM standards and can still be used to power a diesel engine. In order to apply motor fuel tax to the use of this product, it may be necessary to define it as a “biofuel” that would be subject to motor fuel tax. Incentives or refunds may be linked to the adherence to ASTM standards as is the case with the IRS.

Tax Evasion Opportunities

Biodiesel is transported by railcar or transport truck in the United States. It is not shipped via pipeline as is petroleum diesel. The movement of biodiesel is difficult to track as both paper and electronic fuel reporting focus on the barge/pipeline/terminal fuel distribution system. The infusion of the “backyard producer” biodiesel product into the market further complicates the challenge of tracking the product to determine if all applicable taxes have been remitted. The first step in developing a tracking system is to require in-state manufacturers to report all sales and out-of-state manufacturers to report all biodiesel imports. An electronic registration system similar to the FTA Diversion Registry system could be considered for import/export reporting of biodiesel.

Many jurisdictions have dyed fuel inspection programs in place to discourage the illegal use of non-taxed diesel fuel in highway vehicles. These programs should be enhanced to include testing for blends of untaxed, undyed biodiesel with clear petroleum diesel for use in highway vehicles.

Incentives

Several states offer incentives to retailers who sell biodiesel blends of a specific percentage, i.e. B02, B05, or B20. These retailers are required to maintain documentation to substantiate that the product contains the necessary percentage of B100; however, the accuracy of the reported blend percentage is difficult to verify, presenting the potential for fraudulent claims. Incentives are available in some states in the form of income tax credits for production costs associated with a biodiesel manufacturing facility and/or the production cost of constructing additions to a current retail outlet in order to offer biodiesel at the facility. There are states that have a reduced fuel tax rate in place for biodiesel. Another option is to offer an incentive to the producer based on production levels. The IRS offers a refund to blenders of biodiesel of \$1.00 per gallon on “agri” (virgin source) product and \$.50 per gallon on “non-agri” or recycled product.