

# Alternative Fuels

**Overview** – As fuel prices have risen in the past few years, states have increased spending on alternative fuels and mandated minimum amounts of alternative fuels sold. Similar mandates are in place at the federal level. In particular, ethanol and biodiesel are touted as practical alternatives that can be blended with gas and diesel. This sheet will provide an overview of tax incentives and programs for alternative fuels.

**Tax Incentives** - The Legislature, particularly since 2003, has enacted several tax preferences for the production and distribution of alternative fuels. Below is a high-level summary of the major tax preferences available to alternative fuel businesses. The Washington Department of Revenue also has brochures and informational materials on many of these tax incentive programs.

## Tax Incentives for Production of Alternative Fuels

- Preferential 0.138% B&O tax rate for production of biodiesel fuel and feedstock, alcohol fuel, and wood biomass fuel – expires July 1, 2009 (RCW 82.04.260)
- Preferential 0.2904% B&O tax rate for manufacturers or wholesalers of solar energy systems – expires June 30, 2014 (RCW 82.04.294)
- Renewable energy cost recovery incentive of up to \$2,000 per year for customer-generated alternative energy from solar, wind, or anaerobic digesters. This incentive is available to individuals, businesses, and local governments not in the light and power business – expires June 30, 2014 (RCW 82.16.120)
- Sales/use tax exemption for machinery, equipment, and associated labor or services rendered that are used directly in the production of energy from wind, sun, fuel cells, or landfill gas. The machinery and equipment and labor must generate at least 200 watts of electricity – expires June 30, 2009 (RCW 82.08.02567)
- Sales/use tax exemption on the construction of biodiesel, alcohol fuel, and wood biomass fuel manufacturing facilities in rural counties under the rural county manufacturing sales tax exemption program (See RCW 82.60)
- Property tax exemption for land (except land used to grow crops for the fuel), buildings, machinery, equipment and other personal property used primarily for manufacturing E85 motor fuel, biodiesel fuel, and wood biomass. The exemption expires six-years after the facility becomes operational – application deadline is December 31, 2009 (RCW 84.36.635 and 84.36.640)
- Leasehold excise tax exemption – same criteria as property tax exemption above (RCW 82.29A.135)
- Property tax and leasehold tax exemption for anaerobic digesters. This exemption was added to the property and leasehold tax exemptions for alcohol fuel, biodiesel fuel, and wood biomass. The exemption expires six-years after initially granted and the deadline application is December 31, 2012 (see SB 6806 – 2008)

## **Tax Incentives for the Distribution of Alternative Fuels**

- B&O tax deduction for amounts received from the retail sale or distribution of biodiesel fuel and feedstock, E85 motor fuel, and wood biomass fuel - expires July 1, 2015 except for wood biomass, which expires July 1, 2009. (RCW 82.04.4334 and 82.04.4335)
- Sales/use tax exemption on machinery and equipment that facilitate the retail sale of or for vehicles used to deliver E85 motor fuel, biodiesel, or wood biomass fuel blends. The exemption also includes services associated with construction of structures to facilitate fuel sales (RCW 82.08.955, 82.08.960, 82.12.955, and 82.12.960) - expires July 1, 2015 except for wood biomass, which expires July 1, 2009.

## **Other Related Tax Incentives**

- Alternative fuel businesses may also be eligible for the high-technology research and development B&O tax credit (RCW 82.04.4452). The Department of Revenue determines eligibility of the business.
- Sales/use tax exemption for sales of anaerobic digesters that primarily treat livestock manure (RCW 82.08.900 and 82.12.900)
- Sales/use tax exemption for the purchase of alternative fuel vehicles, including hybrid vehicles that have an estimated EPA fuel economy of 40 mpg or greater (RCW 82.08.809, 82.08.813, 82.12.809, 82.12.813) – effective from January 1, 2009 through January 1, 2011.

**State Funding** – The 2006 Legislature created a state loan and grant program to provide direct assistance to biofuel facility development. Calling it the “Energy Freedom Program,” the program allows local governments, port districts, Indian tribes, and higher education institutions to apply for low-interest loans, which in many instances, will be used to assist private companies investing in equipment such as seed-crushers and facilities for biofuel production. Each project is eligible for up to \$5 million in state money, provided that the total state assistance is less than 50 percent of the total project cost.

There are continued concerns that this program is a violation of Article VIII, Section 5 of the state constitution, which prohibits the lending of state credit to an individual, association or company. While proponents argue that the money will go to public entities, there is still question whether this loan program is a constitutional use of state funding.

**Alternative Fuel Mandates** – The 2006 Legislature passed new mandates for alternative fuels. At the time, Washington was the second state in the country (Minnesota was the first) to mandate that all gas and diesel sold in the state contain a minimum amount of ethanol and biodiesel. Today, at least 7 states have ethanol and/or biodiesel requirements. Oregon is the most recent state to pass new mandates.

Specifically, Washington's law:

- Requires that at least 2 percent of all gas and diesel sold in Washington be ethanol or biodiesel. The requirement takes effect December 1, 2008 or when the director of agriculture determines that Washington feedstock can satisfy the 2 percent requirement for biodiesel, whichever comes first.
- Requires that at least 5 percent of all diesel sold in Washington be biodiesel when the director of agriculture determines that both in-state crushing capacity and feedstock can satisfy a 3 percent requirement;
- Allows the director of the Department of agriculture in conjunction with the director of the Department of Ecology to increase the minimum ethanol standard to up to 10 percent as long as sufficient raw materials are available in the state and the use of ethanol will not harm air quality;
- Establishes a biofuels advisory committee to advise the director of agriculture on implementation issues;
- Requires all state agencies by June 1, 2009 to use a minimum of 20 percent biodiesel in all diesel-powered vehicles;
- Permits the governor to suspend all or portions of the minimum renewable fuel standards if they are technically or economically infeasible, or pose a risk to public safety; and
- Specifies when the act is no longer applicable.

There are no specific exemptions from the mandates for aircraft or recreational vehicles. While the legislation does not require minimum blends of ethanol or biodiesel, concern exists that a lack of exemptions for certain types of equipment will cause problems in the future.

Proponents argued that the standards are needed for a number of reasons, including assurance for Washington farmers that a market will exist for their crops used in the production of alternative fuels. Opponents cited the fact that this bill is a mandate and government interference in the development of the free market. Concern was also raised that the biofuels industry offers no guarantees of success and could increase, rather than decrease fuel prices for consumers. There was also concern that requiring the use of biodiesel for trucks may lead to voiding of engine warranties, reduce fuel mileage, and raise costs due to the manufacturing and storage of biodiesel.

**Issues and Outlook** – As the biofuel mandates are set to take effect in Washington, an increasing number of scientific studies are critical of biofuels. For example, two studies published in February 2008 examined the environmental impacts of land use changes to grow biofuel crops. These studies concluded that the environmental costs outweigh any emissions benefit of burning biofuels. Other recent studies point out that biofuel mandates are partly responsible for the recent increase in food prices and these requirements could lead to higher gas and diesel prices in the future.

Reports from Oregon's 10% ethanol requirement suggest that the mandate is resulting in lower gas mileage and higher fuel costs for consumers, which means more carbon emissions. While it is not entirely clear that ethanol is the culprit behind lower gas mileage, commuters are blaming it as the cause of higher gas bills and lost fuel economy.