

# HOUSE BILL REPORT

## HB 1240

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**As Reported by House Committee On:**  
Technology, Telecommunications & Energy  
Finance

**Title:** An act relating to tax incentives for biodiesel and alcohol fuel production.

**Brief Description:** Providing tax incentives for biodiesel and alcohol fuel production.

**Sponsors:** Representatives Sullivan, Crouse, Wood, Morris, Grant, Schoesler, Quall, Ruderman and Schindler.

**Brief History:**

**Committee Activity:**

Technology, Telecommunications & Energy: 1/29/03, 2/4/03 [DPS];

Finance: 2/20/03, 2/28/03 [DP2S(w/o sub TTE)].

**Brief Summary of Second Substitute Bill**

- Establishes tax deferrals and exemptions for the manufacture of alcohol fuels and biodiesel fuels and the manufacture of feedstock used for biodiesel fuels.
- Designates the Business and Occupation Tax rate for those engaged in the manufacture of alcohol fuels, biodiesel fuels, and biodiesel feedstock.

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### HOUSE COMMITTEE ON TECHNOLOGY, TELECOMMUNICATIONS & ENERGY

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 16 members: Representatives Morris, Chair; Ruderman, Vice Chair; Sullivan, Vice Chair; Crouse, Ranking Minority Member; Nixon, Assistant Ranking Minority Member; Anderson, Blake, Bush, DeBolt, Hudgins, Kirby, McMahan, Romero, Tom, Wallace and Wood.

**Minority Report:** Do not pass. Signed by 1 member: Representative Delvin.

**Staff:** Pam Madson (786-7166).

**Background:**

Biodiesel is a non-petroleum diesel fuel produced from renewable sources such as

vegetable oils, animal fats, and recycled cooking oils. It can be blended at any percentage with petroleum diesel or used as a pure product (neat diesel). Other states have adopted policies and incentives to encourage the use of biodiesel.

Blended biodiesel is in use in Washington to fuel some passenger cars and municipal vehicles.

Alcohol fuels are made from crops such as corn and sugar cane, and waste products such as waste paper, grasses, or tree trimmings. Methanol and ethanol are two types of alcohol fuels used in vehicles. Methanol is also produced from fossil fuels such as natural gas.

### ***Business and Occupations Tax***

The Business and Occupation (B&O) Tax is Washington's major business tax. The tax is imposed on the gross receipts of business activities conducted within the state. Revenues are deposited in the State General Fund.

Different tax rates apply to six separate categories of business activity. The processing of certain agricultural products is taxed at the rate .138 percent. Manufacturing, wholesaling, and other activities are taxed at the rate of .484 percent.

### ***Property Taxes***

All real and personal property is subject to property tax each year based on its value, unless a specific exemption is provided by law. There are two classes of property. Real property consists of land and the buildings, structures, and improvements that are affixed to the land. Personal property consists of all other property.

### ***Leasehold Excise Tax***

Property owned by federal, state, or local governments is exempt from the property tax. However, private lessees of government property are subject to the leasehold excise tax. The purpose of the leasehold excise tax is to impose a tax burden on persons using publicly-owned, tax-exempt property similar to the property tax that they would pay if they owned the property. The tax is collected by public entities that lease property to private parties.

Cities and counties may impose a local tax which is credited against the state tax. The state tax is deposited into the State General Fund, and county taxes are distributed to taxing districts within the county in the same manner as property taxes.

Holders of a leasehold interest in property prior to January 1, 1993, used primarily for the manufacture of alcohol fuels are exempt from the leasehold excise tax for a period of six years.

### ***Retail Sales and Use Taxes***

The state retail sales tax rate is 6.5 percent and is imposed on the retail sale of most tangible personal property and some services. In addition, local sales taxes apply. Cities and counties may levy a local tax at a rate up to a maximum of 3.1 percent; currently, local rates levied range from 0.5 percent to 2.4 percent. The combined tax rate is between a minimum of 7 percent and a maximum of 8.9 percent depending on the location of the purchase. Sales tax is paid by the purchaser and collected by the seller. Sales tax revenue is deposited in the State General Fund.

The use tax is imposed on the use of an item in this state when the acquisition of the item has not been subject to sales tax. The use tax applies to items purchased from sellers who do not collect sales tax, items acquired from out-of-state, and items produced by the person using the item. Use tax is equal to the sales tax rate multiplied by the value of the property used. Use tax is paid directly to the Department of Revenue. Use tax revenue is deposited in the State General Fund.

***Distressed Area Sales and Use Tax Deferral Program***

The Distressed Area Sales and Use Tax Deferral Program allows deferral of sales and use taxes for buildings, machinery, and equipment of manufacturing businesses as well as research and development businesses locating in specific geographic areas.

The geographic areas include rural counties with a population density of fewer than 100 people per square mile and areas designated as community empowerment zones or counties that contain a community empowerment zone. (Counties that currently do not qualify include Clark, Island, Thurston, and Snohomish.) Businesses that seek the deferral and are located in a community empowerment zone must also satisfy an employment requirement.

If the business requesting the deferral meets certain requirements for a period of eight years, the sales and use taxes are waived. This tax deferral program expires July 1, 2004.

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**Summary of Substitute Bill:**

Tax deferrals and exemptions are established for the manufacture of alcohol fuel from a source other than petroleum or natural gas, biodiesel fuels, and biodiesel feedstock.

***Sales and use tax exemptions***

Investment projects for the manufacture of biodiesel fuel, alcohol fuels, and biodiesel feedstock are eligible for the deferral of sales and use taxes under the same requirements and conditions as the existing Distressed Area Sales and Use Tax Deferral Program. Those requirements and conditions include a determination of eligible geographic areas, eligible investment projects, business reporting, and application requirements. An additional qualifying option includes counties under 225,000 population and over 225,000

square miles in area. Participants in this deferral program will not be accepted after June 30, 2009.

***Property and leasehold excise tax exemptions***

Buildings, machinery, equipment, and other personal property used in the manufacture of biodiesel fuels, alcohol fuels, or biodiesel feedstock, and the land on which this property is located, are exempt from property taxes for six years from the date the facility becomes operational. The amount of the exemption is based on the annual percentage of the total value of all products manufactured that is the value of the alcohol fuels, biodiesel fuels and biodiesel feedstock manufactured.

Biodiesel fuel and biodiesel feedstock are added to the current alcohol fuel exemption of the leasehold excise tax. Participation in the exemption is reinstated for alcohol. No new participants based on either fuel will be accepted after January 1, 2010.

***Business and Occupation Tax***

For purposes of payment of the Business and Occupation Tax, those engaged in the manufacture of alcohol fuel, biodiesel fuel, and biodiesel feedstock pay at the rate of .138 percent on their gross receipts.

**Substitute Bill Compared to Original Bill:**

The substitute bill does the following: (1) Clarifies the definition of biodiesel and adds a definition for biodiesel feedstock; (2) includes counties with under 225,000 population and an area greater than 225,000 square miles as eligible counties for the sales and use tax exemption; (3) removes provisions that would allow the sales and use tax exemption to extend to all areas of the state if the feedstock for the biodiesel production was at least 50 percent recycled oils or fats; and (4) provides that businesses that manufacture oil from agricultural crops, if used for the production of biodiesel fuel, may be eligible for the tax incentives provided in this bill.

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**Appropriation:** None.

**Fiscal Note:** Not Requested.

**Effective Date of Substitute Bill:** The bill contains an emergency clause and takes effect July 1, 2003, except for section 3, which takes effect July 1, 2004.

**Testimony For:** This bill is part of a package of bills that is designed in a comprehensive fashion to help farmers, improve air quality, and create jobs. Diesel fuel is a significant contributor to air pollution. There are fuels and technologies to make diesel fuel dramatically cleaner. By 2006, ultra-low sulfur diesel will replace current diesel fuel for on-highway use. Motor vehicles are the largest source of air pollution and

greenhouse gases. The use of oil fuels increases this country's dependence on imported oil. Alternative fuels produce less pollutants and can be produced domestically. The biggest barrier to the use of biodiesel and ethanol is cost. The cost results from having to transport the product from other states. This bill encourages development of in-state production of the fuels and provides an opportunity to create a new industry. Development of biodiesel manufacturing facilities in rural areas can provide economic development for these areas and stimulate the agricultural economy of Washington. The no-till, direct seeding method of producing crops that can provide the oil results in less land loss and erosion. In-state production from the crop to the end product will reduce costs and make the fuel more available. Use of wood products as biomass can also create a clean-burning fuel which should be considered for inclusion with these tax incentives.

**Testimony Against:** None.

**Testified:** (In support) Representative Sullivan, prime sponsor; Dennis McLerran, Puget Sound Clean Air Agency; Linda Graham, Puget Sound Clean Cities Coalition; Jim Armstrong, Spokane County Conservation District; Graeme Sackrison, citizen; Robert Pregulman, Washington Public Interest Research Group; Sam Bryant, citizen; Donna Ewing, League of Women Voters, Washington; Toni Potter, Global Warming Action; and Heather Rhoads-Weaver, Northwest Sustainable Energy for Economic Development.

(Neutral) Dan Riley, Tesoro.

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## HOUSE COMMITTEE ON FINANCE

**Majority Report:** The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Technology, Telecommunications & Energy. Signed by 9 members: Representatives Gombosky, Chair; McIntire, Vice Chair; Cairnes, Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Ahern, Conway, Morris, Roach and Santos.

**Staff:** Rick Peterson (786-7150).

### **Summary of Recommendation of Committee On Finance Compared to Recommendation of Committee On Technology, Telecommunications & Energy:**

The second substitute makes the following changes to the substitute bill. Penalty and interest applies to the deferred sales tax that is paid when a manufacturer becomes ineligible for the sales tax deferral/exemption. The second substitute bill transfers the sales tax deferral to new ownership if the new owners qualify. Also the deferral debt is not extinguished by insolvency of the applicant. The second substitute corrects a drafting error by replacing 225,000 square miles with 225 square miles. Technical changes are made to the effective dates.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Second Substitute Bill:** The bill contains an emergency clause and takes effect July 1, 2003, except sections 1 through 8 which take effect July 1, 2004.

**Testimony For:** Biodiesel is made from natural products. They are excellent rotation crops for Eastern Washington. Biodiesel has lubricity properties that are beneficial when blended with low sulfur diesel. Biodiesel can be made from crops grown in Eastern Washington that can produce cleaner fuel for use in Western Washington. The biggest down side is the high cost. Currently there are only five stations that sell biodiesel in Washington. Prices will come down with more production and sales. Biodiesel and alcohol fuels provide the following benefits: clean air, public health, energy security, and economic development. Encouraging production and distribution will result in gains from economies of scale. Success in 2009 would be four or five production facilities and a 20 percent market share.

**Testimony Against:** None.

**Testified:** Representative Sullivan, prime sponsor; Linda Graham, Puget Sound Clean Cities Coalition; Jim Armstrong, Spokane County Conservation District; Mark Tegen, Pacific Fluids, LLC; Graeme Sackrison, citizen; and Brian Sayrs, citizen.