



**STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

As Introduced:	<b>02/26/09</b>	Bill No:	<a href="#"><u>AB 922</u></a>
Tax:	<b>Diesel</b>	Author:	<b>Miller</b>
Related Bills:	<b>AB 1547 (Committee on Revenue and Taxation)</b>		

**BILL SUMMARY**

This bill would provide a diesel fuel tax exemption for biomass-based diesel fuel produced from California feedstock in this state.

**ANALYSIS**

**CURRENT LAW**

Under the current Diesel Fuel Tax Law (Part 31 (commencing with Section 60001) of Division 2 of the Revenue and Taxation Code), Section 60022 defines “diesel fuel” as any liquid that is commonly or commercially known or sold as a fuel that is suitable for use in a diesel-powered highway vehicle, including biodiesel and biomass-based diesel fuel. A liquid meets this requirement if, without further processing or blending, the liquid has practical and commercial fitness for use in the engine of a diesel-powered highway vehicle. Additionally, Section 60023 defines “blended diesel fuel” to mean any mixture of diesel fuel with respect to which tax has been imposed and any other liquid on which tax has not been imposed. “Blended diesel fuel” also means any conversion of a liquid into diesel fuel. “Conversion of a liquid into diesel fuel” occurs when any liquid that is not included in the definition of diesel fuel and that is outside the bulk transfer/terminal system is sold as diesel fuel, delivered as diesel fuel, or represented to be diesel fuel. This definition is purposely broad so that any fuel suitable to be used in a diesel-powered highway vehicle would be subject to the excise tax.

Section 60050 imposes an excise tax of \$0.18 per gallon on diesel fuel. Biodiesel fuel is taxed in the same manner as traditional petroleum diesel, in that the state imposes the excise tax at the first point at which the biodiesel fuel is either:

- Imported into California for sale, use, or storage;
- Removed from a California refinery;
- Removed from a terminal rack in California; or
- Blended with tax-paid diesel fuel.

The revenues generated from this excise tax are deposited in the Transportation Tax Fund.

**PROPOSED LAW**

This bill would add Section 60100.2 to the Revenue and Taxation Code to provide an exemption from the diesel fuel tax for biomass-based diesel fuel produced in this state with California feedstock.

“California feedstock” would mean any of the following:

- Used cooking oil collected in California.

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- Trap grease and other FOGs (fat, oil and grease) collected in California.
- Yellow grease produced at a California rendering plant.
- Animal fat produced at a California rendering plant, meat packing plant, or processing plant.
- Brown grease produced at a California rendering plant.
- Plant or fungal crop grown in California.
- Algae or other microorganisms cultivated in California.

Additionally, the California Energy Commission and the Board would cooperate to produce an annual report to the Legislature regarding this excise tax exemption. The report would be posted on the Energy Commission's website and would include the following:

- The effect of the tax incentive program on the consumption of biodiesel by consumers.
- Economic benefits or losses to the state as the result of the program.
- Calculation of greenhouse gas emission reductions.

This act would become effective immediately but be operative from July 1, 2009, through June 30, 2014, and be repealed December 1, 2014.

#### IN GENERAL

Biomass-based diesel fuel was recently defined at the federal level in Section 205 of the Energy Independence and Security Act (EISA) of 2007 (Pub. L. 110-140; codified in § 17021(c)(2) of title 42 of the United States Code (U.S.C.)), which reads: "The term 'biomass-based diesel' means biodiesel as defined in section 312(f) of the Energy Policy Act of 1992 (42 U.S.C. §13220(f))." Section 13220(f) defines biodiesel as "a diesel fuel substitute produced from nonpetroleum renewable resources that meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency" under 42 U.S.C. §7545 and "includes fuel derived from animal wastes, including poultry fats and poultry wastes, and other waste materials" or from "municipal solid wastes and sludges and oils derived from wastewater and the treatment of wastewater."

As provided by the EISA, the Federal Trade Commission (FTC) finalized the rules for automotive fuel ratings, certification, and posting to include biodiesel fuels and biomass-based diesel (see Fed. Reg. 40154, 40162 (July 11, 2008), at <http://ftc.gov/os/2008/06/R811005fuelfrn.pdf>). Under the Final Rule, "biomass-based diesel" is defined as "a diesel fuel substitute produced from nonpetroleum renewable resources that meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency under 42 U.S.C. §7545, and includes fuel derived from animal wastes, including poultry fats and poultry wastes, and other waste materials, or from municipal solid waste and sludges and oils derived from wastewater and the treatment of wastewater, except that the term does not include biodiesel as defined" in Part 306 of title 16 of the Code of Federal Regulations (C.F.R.) (see 16 C.F.R. §306.0(k)). The Final Rule also defined biodiesel as "the monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet" both the federal registration requirements for fuels and fuel additives (40 C.F.R. Part 79) and the American Society for Testing and Materials (ASTM) standards (ASTM D6751-07b). In

other words, the FTC clarified that for the purposes of the Fuel Rating Rule, biodiesel does not fall within the definition of biomass-based diesel fuel.

Biomass-based diesel fuel, unlike most other fuels, is not separately defined in either California's Revenue and Taxation Code or its Business and Professions Code. Those relevant sections in the Business and Professions Code regarding transportation fuels (Article 1 (commencing with Section 13400) of Chapter 14 of Division 5) address the administrative responsibilities of the California Department of Food and Agriculture, Division of Measurement Standards. This agency is responsible for enforcing the quality, advertisement, and labeling standards for most petroleum products offered for sale to the public. Because certain biodiesel blends are considered developmental engine fuels, they are required to meet the specifications set forth in California Code of Regulations, Title 4, Sections 4144, 4147 and 4148. These regulations, which cover the biodiesel blending stock and biodiesel fuel blends, specify that these fuels must meet the standards set by ASTM D975 and ASTM D6751.

## COMMENTS

- 1. Sponsor and Purpose.** This bill is sponsored by the author to encourage the production and use of biomass-based diesel in California.
- 2. Is biomass-based diesel different from biodiesel?** This bill does not define biomass-based diesel fuel, but, generally, biomass-based diesel fuel is derived primarily from waste materials, while biodiesel is derived from plant or animal matter that is not waste material.

This bill defines "California feedstock" and, in effect, specifies that biomass-based diesel must be derived from any of the following sources: (a) used cooking oil collected in California; (b) trap grease and other fat/oil/grease (FOG) collected in California; (c) yellow grease produced at a California rendering plant; (d) animal fat produced at a California rendering plant, meat packing plant, or processing plant; (e) brown grease produced at a California rendering plant; (f) plant or fungal crop grown in California; and (g) algae or other microorganisms cultivated in California.

As provided in the EISA, "biodiesel" is defined as "the monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet" both of the following standards: "(A) the registration requirements for fuels and fuel additives under this section; and (B) the requirements of ASTM standard D6751."

According to the bill, biomass-based diesel fuel could include feedstock from plant crops and algae or other microorganisms, is that not the same as biodiesel? Is it the author's intent to differentiate between biomass-based diesel and biodiesel? If so, how do they differ? If not, then for the purposes of this bill, it would seem biodiesel and biomass-based diesel fuel are the same. It should be noted that, for California tax purposes, biodiesel and biomass-based diesel are both considered diesel fuel.

- 3. What kind of biomass-based diesel would be exempt from the excise tax?** The proposed exemption would only apply to biomass-based diesel fuel that is produced in California from "California feedstock," as defined. However, it does not assign responsibility for determining the feedstock origination. This bill proposes to amend the Revenue and Taxation Code to define biomass-based diesel fuel but makes no changes to the Business and Professions Code (which governs transportation fuels). The Board does not have the resources, expertise, or staff, much less the administrative responsibility, to enforce the quality, advertisement, and labeling of

Moreover, even if a definition is provided in the Business and Professions Code, the Division of Measurement Standards would only regulate those businesses that have obtained a developmental engine fuel variance to distribute the fuels to fleet-type, centrally-fueled vehicles and equipment users and would not affect certain biodiesel users, such as those individuals and producers that recycle used cooking oil for their own self-consumption.

4. **A similar issue would arise in determining biomass-based diesel fuel produced in California from California feedstock.** Currently, the Board does not separately categorize biomass-based diesel fuel produced in this state from California feedstock. Although the Board may be able to identify large producers of biomass-based diesel fuel in California, we would need to develop product listings of biomass-based diesel fuel so that those qualifying fuels considered to be from “California feedstock” would be exempt from the state’s excise tax. The Board would be challenged in identifying individuals that produce the qualified biomass-based diesel fuels, and since biomass-based diesel fuel produced from California feedstock would lose its identity if blended with other non-qualifying diesel fuels the Board would be challenged in tracking the mixed diesel fuel through the distribution chain for audit purposes. Therefore, we may only be able to provide limited sales and revenue information to the Energy Commission for preparation of their annual report to the Legislature.
5. **Reporting requirements would be complicated.** Only that portion of the biomass-based diesel fuel that is produced in this state from California feedstock would be subject to the exemption from the diesel fuel tax. As such, the terminal operator, supplier, retailer, and consumer may see differing tax rates and prices depending on the biomass-based diesel fuel blend or source of the biomass-based diesel fuel. Invoicing and receipt requirements may also need to be changed to show that the exempt portion of the blended diesel was not taxed.

Currently, California does not offer tax breaks or incentives for diesel fuel blended with biomass-based diesel fuel. The diesel fuel blend, regardless of concentration, is considered diesel fuel when sold for use in a diesel-powered highway vehicle.

Reporting requirements could be more complicated for all parties involved since blending of biomass-based diesel fuel can occur at different points in the distribution process. Blending of the diesel and biomass-based diesel fuels could occur at the user’s fuel tank, at the supplier’s tanker trucks, or at the terminal operator’s pipeline or rack. If a previously untaxed biomass-based diesel fuel that was not produced or derived from California feedstock, is mixed with diesel fuel, then the portion of the biomass-based diesel fuel subject to tax is the difference between the total volume and the amount previously taxed.

6. **This bill could make reporting for interstate users more difficult.** Interstate users would be burdened with additional record keeping and segregating for purposes of reporting the correct amount of tax on purchases of biomass-based diesel fuel produced in California from California feedstock. While California may exempt the product without invoices or receipts showing the reduced taxes, it would

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be difficult for the interstate user to document a credit. In addition, other jurisdictions in which the interstate user travels and reports and pays tax may not allow such credits even with an invoice. Accordingly, this bill could complicate reporting for interstate users and could lead to additional reporting errors. Further, if California is not the interstate user's base state for fuel tax reporting, the interstate user may have to report and pay to its reporting state the full tax on gallons of diesel fuel purchased in California and then obtain a refund from the Board for the exempt gallons purchased, increasing the Board's administrative workload.

7. **Is this bill constitutional?** The U.S. Supreme Court has consistently held that when a state grants undue preferential treatment, such as a tax or regulatory preference, to its own state's products or services, such preferential treatment violates the Commerce Clause of the U.S. Constitution. The author may wish to have the Legislative Counsel's office review this issue.
8. **Related legislation.** AB 1547 (Committee on Revenue and Taxation) includes a Board-sponsored provision to clarify that the definition of "diesel fuel" includes biodiesel, other biomass-based diesel fuel, and blends, and defines biodiesel, biomass, biomass-based diesel fuel, petroleum-based diesel fuel, and raw vegetable oil.

## **COST ESTIMATE**

The Board would incur costs related to the administration of a biomass-based diesel fuel exemption. These costs would be attributable to, among other things, identifying and notifying the entities in the diesel fuel manufacturing and supply chain, revising regulations and procedures, auditing claimed amounts, revising diesel fuel tax returns, and computer programming changes.

## **REVENUE ESTIMATE**

This bill would provide an exemption for the specified biomass-based diesel fuel under the Diesel Fuel Tax Law. At this time, given the lack of a clear definition of biomass-based diesel fuel, the Board is unable to identify what percent of the biodiesel produced in this state may qualify for the exemption.

The Board's Fuel Taxes Division indicated that in 2006, suppliers reported 36 million gallons of biodiesel fuel (25 million gallons clear, 11 million gallons dyed) and that this would account for most commercially produced or imported biodiesel diesel. In our discussions with the Energy Commission, they estimated that California biodiesel consumption in 2006 was 43 million gallons. This difference is probably due to tracking fuel in different ways for different purposes. Estimated consumption for 2007 is 100 million gallons.

The Energy Commission provided the following estimate for the period January 1, 2009 to January 1, 2014:

**California Biodiesel Consumption Estimate 2009-2013**  
(millions of gallons)

	In State Production	Imported to CA	Total CA Demand
2009	180	120	300
2010	240	150	390
2011	300	175	475
2012	360	200	560
2013	<u>420</u>	200	<u>620</u>
	1500		2345

*(Due to the volatility of the market, these estimates frequently change.)*

Based on the above five-year period, average annual biodiesel fuel produced in California is estimated to be 300 million gallons (1500 / 5), which translates into \$54 million in excise taxes (\$0.18 x 300 million gallons = \$54 million).

The exemption created by this bill would be an as yet undeterminable percentage of the total in-state biodiesel revenue.

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