

Business Law Update

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Cellulosic Biofuel Producer Credit: Guidelines for Qualification and Registration

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October 19, 2009

The Internal Revenue Code provides tax credits for certain renewable and biofuels. Included in these credit provisions are income tax credits for alcohol fuels and cellulosic biofuel under Section 40 of the Internal Revenue Code (“IRC”), income tax credits for biodiesel under §40A, and excise tax credits and payments under §§6426 and 6427 for alcohol fuel mixtures, biodiesel mixtures, alternative fuels, and alternative fuel mixtures.

The cellulosic biofuel income tax credit was added to the pre-existing §40 alcohol fuel income tax credits by the Food, Conservation, and Energy Act of 2008. IRC §40(b)(6) allows a \$1.01 per gallon nonrefundable income tax credit for each gallon of qualified cellulosic biofuel production of the producer for the taxable year. “Cellulosic biofuel” means any liquid fuel that meets the following requirements:

1. The fuel must be produced in the United States and used as fuel in the United States;
2. The fuel must be derived from lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis and;

3. The fuel must meet registration requirements for fuels and fuel additives established by the EPA Renewable Fuel Standard Program, under §211 of the Clean Air Act (42 USC §7545);
4. The producer must either sell or use the fuel as:
 - a. A mixture with gasoline or other internal combustion engine fuel its a trade or business (other than casual non-farm production),
 - b. A fuel in its trade or business, or
 - c. A retail fuel delivered into the consumer’s fuel tank.

Examples of renewable lignocellulosic or hemicellulosic matter include dedicated energy crops and trees, wood and wood residues, plants, grasses, agricultural residues, fibers, municipal solid waste, and other biomass residue (See Conf. Rep. 110-627). Alcohol may qualify as cellulosic biofuel provided the alcohol meets these requirements, and is at least 150 proof without regard to denaturants.

In order to qualify for cellulosic biofuel producer credit, producers must register under the EPA Renewable Fuel Standard Program. The EPA created the Program pursuant to 42 U.S.C. §7545, which gives the EPA the authority to regulate production of fuels and fuel additives, including those used exclusively in nonroad engines or nonroad vehicles. Under the Program, the EPA specifies the volumes of cellulosic biofuel, biomass-based diesel, advanced biofuel, and total renewable fuel that must be used in transportation fuel each year, with the volumes increasing over time. Designated fuel manufacturers are required to register under the Program. Regulations regarding the Program are contained at 40 C.F.R. Part 80.

Entities potentially affected by the Program are those involved with the production, distribution, and sale of transportation fuels, including gasoline and diesel fuel or renewable fuels such as ethanol and biodiesel. Regulated categories include:

TABLE 1: Businesses Subject to EPA Renewable Fuel Standard Program

Industry Description	NAICS Code	SIC Code
Petroleum Refineries	324110	2911
Ethyl alcohol manufacturing	325193	2869
Other basic organic chemical manufacturing	325199	2869
Chemical and allied products merchant wholesalers	424690	5169
Petroleum bulk stations and terminals	424710	5171
Petroleum and petroleum products merchant wholesalers	424720	5172
Other fuel dealers	454319	5989

*NAICS stands for the North American Industry Classification System.
SIC stands for the Standard Industrial Classification system code.*

TABLE 1 is not exhaustive, but rather provides a guide regarding entities likely to be regulated by the Program. The table lists the types of entities that the EPA is currently aware could potentially be regulated by the Program. Other types of entities not listed in the table could also be regulated.

If a taxpayer meets these requirements of a qualifying cellulosic biofuel producer, it must register with the IRS before it may claim §40 tax credits. Registration is accomplished by filing Form 637, Application for Registration (For Certain Excise Tax Matters). Once registered, a taxpayer may claim credit for any open past period on a timely filed or amended income tax return.

If the biofuel is not alcohol, the entire \$1.01 credit per gallon is generally allowable. If, however, the cellulosic biofuel is alcohol, the \$1.01 per gallon credit is reduced by the following other credits that may be claimed separately on alcohol fuels, as follows:

1. Alcohol mixture credit under IRC §40(b)(1), which for 2009-2010 is 45¢ per gallon for ethanol and 60¢ per gallon for other alcohol (as determined without reduction for lower proof alcohols under IRC §40(b)(3)).
2. Small ethanol producer credit under IRC §40(b)(4), which for 2009-2010 is 10¢ per gallon of ethanol. A producer is “small” if it has an annual alcohol capacity not exceeding 60 million gallons. The small producer credit is normally capped at 15 million gallons of ethanol per year, but this cap does not apply to cellulosic biofuel.

In addition, the cellulosic biofuel credit is coordinated with the biodiesel and alternative fuel credits to prevent double usage. Fuels that qualify as biodiesel (under IRC §40A) or as alternative fuel (under IRC §6426(d)(2)) are excluded from qualifying as cellulosic biofuel. Under § 6426(h), no alternative fuel credit is allowed for fuel with respect to which credit may be determined under §40. Under §40(f), a taxpayer may elect out of the §40 credits in order to claim the excise tax credit.

Producers should carefully consider how to utilize biofuel income tax credits. The Section 40 and 40A income tax credits for alcohol, cellulosic biofuel, and biodiesel are all included in taxable income under IRC §87, irrespective of whether the producer can actually utilize the credits. In some cases the producer may be unable to use income tax credits because, unlike fuel excise tax credits, the fuel income tax credits are nonrefundable and may be limited by tax liability.

Specifically, the Section 40 and 40A income tax credits are part of the Section 38 general business credits. The use of general business credits is normally limited under IRC §38(c)(1) to income tax liability reduced by the greater of either (1) tentative minimum tax, or (2) 25% of net regular tax liability in excess of \$25,000 after reduction for credits contained in Subparts A and B of Part IV of the Internal Revenue Code (which include nonrefundable personal credits contained in IRC §IRC §21 through 26, and other

credits contained in IRC §§ 27 through 30A). However, an exception to the alternative minimum tax limitation exists for these credits. The use of these income tax credits is generally not limited by tentative minimum tax under IRC §38(c)(4). This means basically that the credit limit imposed under IRC §38(c)(1) is the floor of 25% of net regular income tax liability over \$25,000.

The §40(a)(4) cellulosic biofuel credit applies to qualifying fuel produced for years 2009-2012, pursuant to IRC §40(b)(6)(H). The alcohol credits and payments generally expire after 2010, pursuant to IRC §40(e), IRC §6426(b)(6), and IRC §6427(e)(6)(A). If these alcohol credits are not extended, then cellulosic alcohol fuels may be eligible for the full \$1.01 income tax credit without offset for years 2011 and 2012. Of course, non-alcohol cellulosic biofuels are not offset by alcohol fuel credits.

TABLE 2 summarizes the various biofuel income and excise tax credits, including the cellulosic biofuel credit.

TABLE 2: Summary of Federal Biofuel Credits

Incentive Title	Code Section	Specifications	Credit Type	Incentive for 2009	Sunset Date
Alcohol Fuel Credit (Neat)	IRC §40(a)(2)	Alcohol from biomass that is at least 150 proof. Neat fuel must be used as a fuel in producer's business or sold at retail by producer into a motor vehicle tank.	Income Tax	190 Proof Ethanol = 45¢ / Gal 150 Proof Ethanol = 33.33¢ / Gal 190 Proof Methanol = 60¢ / Gal 150 Proof Methanol = 45¢ / Gal	12-31-10
Alcohol Fuel Mixture Credit	IRC §40(a)(1) IRC §6426(b) IRC §6427(e)(1)	Mixture of alcohol from biomass that is at least 190 proof for income tax credit, and 150 proof for excise tax credit, with gasoline or motor fuel that is used as a fuel in producer's business or sold by producer as a fuel.	Income & Excise Tax	190 Proof Ethanol = 45¢ / Gal 150 Proof Ethanol = 33.33¢ / Gal 190 Proof Methanol = 60¢ / Gal 150 Proof Methanol = 45¢ / Gal	12-31-10
Small Ethanol Producer Credit	IRC §40(a)(3)	Small producer of 150 proof ethanol from biomass that producer uses as a fuel or sells as a fuel. May be mixed or neat. Limited to 15 mil. gallons per year. A small producer is generally 60 mil. gallons or less per year.	Income Tax	150 Proof Ethanol = 10¢ / Gal	12-31-10
Cellulosic Biofuel Credit	IRC §40(a)(4)	Liquid fuel from renewable cellulosic matter that meets Clean Air Act IRC §211, and which producer uses as a fuel or sells as a fuel. May be mixed or neat. If alcohol, it must be 150 proof.	Income Tax	\$1.01 / Gal, reduced by alcohol mixture and small ethanol producer credits, if fuel is alcohol	12-31-12
Biodiesel Credit (Neat)	IRC §40A(a)(2)	Fatty acids from plant or animal matter that that meets (i) Clean Air Act IRC §211, and (ii) ASTM Standard D6751. Neat fuel must be used as a fuel in producer's business or sold at retail by producer into a motor vehicle tank.	Income Tax	\$1.00 / Gallon	12-31-09
Biodiesel Mixture Credit	IRC §40A(a)(1) IRC §6426(c) IRC §6427(e)(1)	Mixture of biodiesel and diesel fuel that is used as a fuel in producer's business or sold by producer as a fuel.	Income & Excise Tax	\$1.00 / Gallon	12-31-09
Small Agri-Biodiesel Credit	IRC §40A(a)(3)	Small producer of biodiesel that producer uses as a fuel or sells as a fuel. May be mixed or neat. Limited to 15 mil. gals / year. A small producer is generally 60 mil. gallons or less per year.	Income Tax	10¢ / Gallon of Agri-Biodiesel	12-31-09
Alternative Fuel Credits (Neat)	IRC §6426(d) IRC §6427(e)(2)	Liquid petroleum gas; "P Series" alcohol fuels; Compressed or liquefied natural gas; Liquid hydrogen; Liquid coal fuel; Compressed or liquefied biomass gas; Liquid biomass fuel (excluding ethanol, methanol, or biodiesel). Fuel must be used or sold for use in a motor vehicle.	Excise Tax	50¢ / Gallon	12-31-09
Alternative Fuel Mixture Credits	IRC §6426(e) IRC §6427(e)(1)	Mixture of alternative fuel with diesel fuel, gasoline, or kerosene. The mixture must be sold as a fuel or used as a fuel in the producer's business.	Excise Tax	50¢ / Gallon	12-31-09

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