Renewable Fuels Association

Testimony of

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Before the U.S. Senate
Committee on Finance

August 26, 2003

Mr. Chairman and Members of the Committee, thank you for the opportunity to provide comments on the important role that tax policy has in determining the nation's energy policies and priorities. Tax policy is critically important to the continuing development of rural America. With your strong leadership, Chairman Grassley, we have an opportunity to realize very important tax policy changes that will provide much-needed rural economic stimulus. I will comment on a number of provisions that will assist in the ongoing development of farmer-owned businesses in rural America and specifically enhance the opportunity for the ongoing development of ethanol facilities.

The Renewable Fuels Association (RFA) is the national trade association for the domestic ethanol industry. RFA membership includes ethanol producers and suppliers, gasoline marketers, agricultural organizations and state agencies dedicated to the continued expansion and promotion of fuel ethanol. Today's domestic ethanol industry consists of 73 production facilities located in 20 states with an annual production capacity of 2.9 billion gallons. Production capacity continues to expand, particularly among farmer owned cooperatives, the fastest growing segment of the industry. Indeed, since 1999, the U.S. ethanol industry has expanded by 45%. So far this year, we have opened five new ethanol plants, expanded half a dozen, and are building 13 new facilities. The industry is on pace to produce almost 3.0 billion gallons of ethanol in 2003, processing more than 1 billion bushels of corn. In Iowa, there are 12 ethanol plants in operation and 4 more under construction, most of which are farmer-owned.

Background

Ethanol is a clean, energy efficient, environmentally friendly fuel produced at production facilities that create jobs and economic opportunity in the rural communities in which they are located. Ethanol is an alcohol produced primarily from grain using a process almost as old as civilization itself. Today, however, ethanol production has come a long way from the wineries of ancient Greece or the stills of Prohibition. Fuel ethanol is produced on an industrial scale utilizing millions of bushels of grain annually in a fermentation/distillation process. While the fundamentals of ethanol production have remained constant, the process technology has become quite sophisticated.

The processing of grains for ethanol production provides an important value added market for farmers; helping to raise the value of commodities they produce. As the third largest use of corn, behind only feed and export uses, ethanol production utilizes approximately ten percent of the U.S. corn crop, or over 1 billion bushels of corn.

The production of ethanol has sparked new capital investment and economic development in rural communities across America. There has not been an oil refinery built in this country in 25 years. However, during that same time frame the U.S. ethanol industry has constructed 73 ethanol refineries, stimulating rural economies and creating jobs. USDA estimates that each 100 million bushels of grain used in the production of ethanol increases the national corn price between $0.03 and $0.05. Thus, today the production of ethanol is adding at least 30¢ to each bushel of corn grown in the United States.

Industry growth offers enormous potential for overall economic growth and additional employment in local communities throughout the country. According to a Midwestern Governors' Conference report, the economic impact of the demand for ethanol:

- Adds $4.5 billion to farm revenue annually
- Boosts total employment by 195,200 jobs
- Increases state tax receipts by $450 million
- Improves the U.S. balance of trade by $2 billion, and
- Results in $3.6 billion in net savings to the federal Treasury.

The majority of growth in the industry in the last several years has been the result of farmer ownership of ethanol production facilities. These highly efficient dry mill plants typically go from the drawing board to production in less than two years. Today, farmer-owned facilities account for approximately one-third of all U.S. fuel ethanol production. Farmer-owned ethanol facilities help to ensure farmer members a value-added market for their crops and offer profit sharing dividends as the industry prospers.

The Renewable Fuels Association recently completed a study[1] on the economic impacts of a 40 million gallon ethanol facility on local communities. The results are extraordinary. The study concluded:

- During construction, capital spending generates $142.2 million in gross output to a local economy and $46 million in new household income (one-time impact);
- More than $56 million is spent locally on its daily operations each year;
- The local economy is expanded by $110.2 million each year;
- Local farmers receive an additional 5–10 cents per bushel in increased revenue at the farm gate (whether delivered to the ethanol facility or not);
- The plant creates 41 permanent direct jobs and 694 permanent jobs throughout the entire economy; and,
- The ethanol plant will generate $19.6 million in annual household income for the community.

[1] **ETHANOL AND THE LOCAL COMMUNITY,** John M. Urbanchuk, Executive Vice President, AUS Consultants and Jeff Kapell, Associate Principal, SJH & Company (June, 2002).

Tax Policy and Rural Economic Development

The focus of this hearing is the economic health of rural America. Over the last 20 years, the single most significant contributor to the development of rural America has been ethanol. Today, the ethanol industry is positioned to expand further and to enhance its contribution to the development of rural economies. Congress can help by passing a few minor tax provisions that will unlock the full value of ethanol facilities to their farmer owners, including:

1. "The Volumetric Ethanol Excise Tax Credit Act of 2003" (S. 1548), which would streamline the tax collection process for renewable fuels such as ethanol and biodiesel.

2. Modifications to the Small Ethanol Producer Tax Credit, which would enhance the provision so the entire $1.5 million tax credit can be used by the ethanol facility or passed to the farmer owners of a cooperative.

3. Modifications to the farmer cooperative "dividend allocation rule," which would allow farmer cooperatives to more easily access equity capital.

The Volumetric Ethanol Excise Tax Credit (S. 1548)

The tax incentive program created by Congress to encourage refiners and gasoline marketers to utilize renewable fuels has been a tremendous success. It has created a growing value-added market for farmers that, as stated, will process more than a billion bushels of grain and add more than $4.5 billion to farm income every year.

But the current structure of the tax incentive has an unintended consequence – it reduces federal funds available to states for highway construction. Sound energy, economic and environmental policy need not be mutually exclusive of America's investment in transportation infrastructure.

Today, we urge Congress to reform the alcohol fuels tax credit and create a new "Volumetric Ethanol Excise Tax Credit" (VEETC), as introduced by Senators Grassley and Baucus on July 31, 2003 in S. 1548. Under the VEETC three objectives are accomplished:

1. The tax collection system for renewable fuels is improved;

2. The revenue source for the Highway Trust Fund is increased, because the full amount of user excise taxes levied will be collected and remitted to the Highway Trust Fund (HTF). On average, the proposal would generate more than $2 billion per year in additional HTF revenue, which would improve the ability of the federal government to address the nation's transportation infrastructure needs; and

3. The delivery of renewable fuels in the marketplace will be enhanced because the federal government's tax collection system will work in concert with the petroleum industry's and independent terminal's fuel delivery system.

Specifically, the VEETC will:

- Eliminate any impact of renewable fuels tax incentives on the Highway Trust Fund by assuring the full 18.4¢ per gallon of each gallon of ethanol-blend fuel and 24.4¢ per gallon for diesel and biodiesel blends will be remitted to the U.S. Treasury;

- Eliminate waste, fraud and abuse within the excise tax collection system;

- Provide flexibility to petroleum blenders at the terminal rack because fuel mixtures will not be based on the soon-to-be outdated Clean Air Act blending levels;

- Accelerate the tax refund system for below the rack blenders by requiring IRS to complete refunds within 20 days of filing; and

- Eliminate the need of the alcohol fuels income tax credit that is subject to the alternative minimum tax.

S. 1548 also provides a new tax incentive for biodiesel that is extremely important and will stimulate tremendous new production of biodiesel from both soybeans and other agricultural products, as well as biodiesel from animal fats. The biodiesel provisions mirror the VEETC by providing extraordinary flexibility for gasoline marketers to claim the credit for both on-road and off-road diesel uses, and similarly protects the Highway Trust Fund. The provision also encourages petroleum marketers to blend biodiesel as far upstream as possible, which under a Renewable Fuel Requirement contemplated by the Senate energy bill or Minnesota's 2% biodiesel requirement is critically important.

The Renewable Fuels Association strongly encourages Congress to enact S. 1548 during this Congress, because it eliminates the tax, infrastructure, and fuel delivery impediments that have been problematic throughout the history of the renewable fuels industry.

Modifications to the Small Ethanol Producer Tax Credit:

Under present law, a small ethanol producer (annual production capacity of 30 million gallons or less) is eligible for an income tax credit of 10 cents per gallon on up to 15 million gallons of alcohol production. While intended to stimulate expanded production, particularly by small farmer-owned facilities, the credit is not readily available to cooperatives or their patrons. Furthermore, for all small producers, the credit is subject to a number of limitations that reduce its benefit or limit its availability.

In the current marketplace, ethanol production costs are rising because of unprecedented natural gas and energy prices at the same time several state ethanol programs are being cut or eliminated. The small ethanol producer tax credit is the only program that helps established small ethanol companies compete in the marketplace. It is doubly important to small farmer cooperatives that are not currently eligible for the incentive. Over the past several years, a number of bills have been introduced to address these concerns[2] and, indeed, the Senate has approved modifications to the small producer tax credit on a number of occasions. Legislation

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[2] See H.R. 1999 by Rep. Jim Nussle (R-IA); H.R. 1636 by Rep. John Thune (R-SD); S. 907 by Senator Jean Carnahan (D-MO) and S. 613 by Sen. Peter Fitzgerald (R-IL).

has also been introduced this year,[3] and the provision is included in the Senate's tax title of the current "Energy Policy Act of 2003" (H.R. 6). But these much needed changes have never been included in a bill that was signed into law. Now is the time to assure these much needed changes become law.

The legislation would do the following:

- Allocate the ten-cents-per-gallon production income alcohol fuels credit to the members of a farmer cooperative;
- Change the definition of a "small ethanol producer" from 30 million gallons per year to 60 million gallons per year;
- Allow the credit to be claimed against the alternative minimum tax; and
- Repeal the rule that the amount of the credit is included in the income of the small ethanol producer.

If these modifications were made, each farmer member of a small ethanol-producing cooperative would receive up to a ten-cent per gallon tax credit on his or her share of the company's production in any given year. The effect of the legislation will directly send the benefit of a tax credit to the farmer owners of ethanol processing cooperatives, providing a much needed economic boost to this nation's troubled rural economy.

A letter of support for the Small Ethanol Producer Tax Credit signed by more than 50 companies is attached.

The Renewable Fuels Association enthusiastically supports the effort to address the small ethanol producer tax credit, and encourages Congress to include it in the final energy bill to be enacted this year.

The Farmer Cooperative Dividend Allocation Rule:

Farmer cooperatives are unique in that they are limited in their corporate structure to be owned, used and controlled by their farmer members. A number of the farmer-owned ethanol facilities are either organized as farmer cooperatives or as a Limited Liability Company (LLC) that is owned in part by a farmer cooperative. As such, issues important to farmer cooperatives are important to the ethanol industry. One of the major impediments to the ongoing development of farmer cooperatives is access to equity capital. As a class, cooperatives debt levels are high and due to antiquated rules, they have a difficult time raising capital.

Senator Grassley, you have been working on legislation that will make it easier for cooperatives to raise equity capital by removing the dividend allocation rule from the regulatory regime created by the Department of Treasury.

The Renewable Fuels Association strongly supports your legislation because we are a capital-intensive industry and every new facility constructed requires substantial investment.

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[3] See H.R. 465 by Rep. Steve King (R-IA) and S. 240 by Sen. Peter Fitzgerald (R-IL).

Conclusion

The importance of ethanol as an alternative fuel to the nation's economy has never been greater, and its value promises to grow even larger. Oil prices are again playing havoc with the American economy. The U.S. economy is facing the most significant period of sluggish growth in more than a decade and high oil prices are a major contributor to the current economic slowdown.

With 45 percent growth in the last three years, one of the only economic sectors that is currently posting gains in the economy is the ethanol sector. If Congress adopts the proposals discussed today, the growth in the ethanol industry and the benefits to rural America will continue.

Therefore, we urge Congress to work with you, Chairman Grassley, and Finance Committee Ranking Member Max Baucus (D-MT) to pass "the Volumetric Ethanol Excise Tax Credit Act of 2003" (S. 1548); together with modifications to improve "the Small Ethanol Producer Tax Credit," as contained in H.R. 6 "the Senate's Energy Policy Act of 2003;" and finally, we urge adoption of the modifications to the farmer cooperative "dividend allocation rule," as proposed by Senator Grassley, which would allow farmer cooperatives to more easily access equity capital.

Thank you.