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BILL ANALYSIS



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Senate Bill 1196 (Substitute S-1 as reported)
Sponsor: Senator Jud Gilbert, II
Committee: Agriculture

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RATIONALE

As the price of oil continues to climb, many people believe that renewable fuels such as ethanol are viable alternatives that can help ease supply constraints, reduce dependence on foreign oil, and offer potential environmental benefits. Many vehicles on the road today can burn a blend of 85% ethanol and 15% gasoline, known as E85. The distribution of E85 remains limited, though, because pumps and storage tanks must be modified to handle the blended fuel, and doing so can be expensive. It has been suggested that gas station owners should receive a tax credit to offset a portion of the cost of upgrading their equipment to distribute E85, in order to encourage investment in infrastructure that would expand the availability of the fuel.

CONTENT

The bill would amend the Michigan Business Tax (MBT) Act to permit a service station owner to claim a credit against the MBT equal to 30% of the cost to convert existing fuel delivery systems and to create new fuel delivery systems designed to provide E85 fuel.

("E85 fuel" would mean a fuel blend that contains between 70% and 85% denatured fuel ethanol and gasoline suitable for use in a spark-ignition engine and that meets ASTM D-5798 specifications.)

In determining the amount of the credit under the bill, a taxpayer could not include any costs to convert existing fuel delivery systems to provide E85 fuel or to create new fuel delivery systems designed to provide E85 fuel for which the taxpayer received a grant under the service station matching

grant program created under Section 78 of the Michigan Strategic Fund Act. (That program was created to provide grants to owners and operators of service stations to cover a portion of the cost to convert fuel systems or create new fuel systems to provide E85 fuel or biodiesel blend.)

If the credit under the bill exceeded the taxpayer's liability for the tax year, the taxpayer could elect to have the excess portion refunded or to have the excess carried forward to offset tax liability in subsequent years for 10 years or until it was used up, whichever occurred first.

A taxpayer could not claim a credit unless the Michigan Strategic Fund had issued a certificate to the taxpayer. The taxpayer would have to attach the certificate to the return filed under the MBT Act. The certificate would have to state that the taxpayer was the owner of a service station and had converted existing fuel delivery systems to provide E85 fuel or had created new fuel delivery systems designed to provide E85 fuel, or both, during the tax year for which the credit was sought.

The certificate also would have to state the amount of the costs incurred by the taxpayer during the designated tax year to convert existing fuel systems to provide E85 fuel and to create new fuel systems to provide E85 fuel, and the amount of any grant awarded during the designated tax year to the taxpayer based on the same costs.

The certificate would have to include the taxpayer's Federal employer identification

number or the Michigan Department of Treasury number assigned to the taxpayer.

If a taxpayer that claimed a credit under the bill subsequently stopped using the fuel delivery systems to provide E85 fuel within three years of receiving the credit, the taxpayer's credit could be reduced or terminated or a percentage of the credit amount previously claimed could be added back to the taxpayer's tax liability in the year that the taxpayer stopped using the fuel delivery systems to provide E85 fuel, as determined by the Michigan Strategic Fund.

Proposed MCL 208.1430

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Because ethanol mixes with water more readily than gasoline or diesel, ethanol blends such as E85 must be stored and handled differently than other fuels, to prevent excessive moisture from condensing in tanks or contaminating the product. The necessary equipment is expensive, however. By some estimates, the cost of installing new tanks and pumps or upgrading existing equipment could average \$75,000 or more per gas station. Many station owners who otherwise would like to offer E85 may be unable to afford such a significant investment to install new equipment. The bill would reduce that burden, enabling more gas station owners to offer E85 fuel.

Opposing Argument

Although it is important to encourage the development of alternative fuel infrastructure in the State, the credit proposed by the bill would be an open-ended commitment that could cost the State an unknown amount, depending on the number of gas station owners who took advantage of the credit and the actual cost of the improvements.

Rather than creating a new credit, efforts to encourage alternative fuel infrastructure should focus on established programs, such as the program under the Michigan Strategic Fund Act to provide grants for gas station owners and operators who converted to E85 or biodiesel. Although this program ended in September 2007, it could be reinstated.

The cost of the program could be capped in advance, rather than exposing the budget to unknown future costs. The grant program also would allow for the targeted expansion of E85 pumps in underserved areas. Under the bill, a tax credit would be available to each owner regardless of the location of other E85 pumps, which could lead to concentrated clusters of pumps in some areas and few pumps in other parts of the State. A grant program could encourage more widespread, even growth of E85 infrastructure.

Response: Since the number of cars that can run on E85 is limited, gas station owners would be likely to install E85 equipment gradually, imposing only a modest cost to the State budget. A previous version of the bill also included a credit for installing biodiesel equipment, but those provisions were removed to reduce the scope of the bill and limit the possible expense to the State.

Legislative Analyst: Curtis Walker

FISCAL IMPACT

Cost of the Credit

The cost of this proposed tax credit would depend on how many service stations decided to start selling E85 fuel and the costs they would incur. Because this credit would be refundable, a service station owner would not have to have a Michigan business tax liability in order to receive the financial benefits of the credit. It is difficult to estimate the number of service stations that would decide to start selling E85 during each of the next few years, so to help put the potential fiscal impact into perspective, the following are estimates based on four alternative levels of service stations qualifying for the credit:

- 1) A 10% increase from the current 62 stations selling E85 fuel would reduce Michigan business tax revenue less than \$0.1 million.
- 2) A 50% increase in the number of service stations selling E85 fuel would reduce Michigan business tax revenue an estimated \$0.4 million.
- 3) A 100% increase from existing levels would reduce Michigan business tax revenue an estimated \$0.8 million.

4) If 500 service stations decided to begin selling E85 over the next two years, the cost of this proposed credit would total \$3.2 million in each of the next two fiscal years. This large increase would be somewhat consistent with Governor Granholm's goal of having 1,000 biofuel (E85 and biodiesel fuels) pumps in Michigan by the end of 2008.

While the costs of needed equipment, underground tanks, and other changes to service stations' existing facilities that would be needed to sell E85 fuel would vary widely from station to station, in order to estimate the fiscal impact of this bill it was estimated that the average cost of converting existing equipment to deliver E85 fuel would be about \$10,000 and the average cost of purchasing and installing new equipment to deliver this fuel would be approximately \$75,000. It also was assumed that of the service stations beginning to sell E85 fuel, half would convert existing equipment and half would purchase new equipment.

This proposed credit, along with the existing Federal credit, would provide a significant reduction in the cost for a service station to begin selling E85. For example, the proposed credit together with the Federal credit would cover \$45,000 or 60% of a project to purchase new fuel delivery equipment totaling \$75,000. In addition, the proposed credit, along with both the Federal credit and the current grant program being financed by the Department of Labor and Economic Growth using Federal funds, potentially could provide a service station owner financial assistance in excess of the cost of converting existing fuel delivery equipment to be able to deliver E85 fuel. For example, if a project to convert existing equipment cost \$10,000, the service station owner potentially would qualify for a \$3,000 Federal credit, a \$3,000 State credit, and a \$5,000 grant, totaling \$11,000.

It should also be noted that the bill would exclude from eligible cost the amount of any grant received from the service station matching grant program (created by Public Act 274 of 2006); however, the last year for which grants were distributed under this program was 2007 and this proposed new credit would apply to the 2008 tax year at the earliest.

Administrative Cost

The bill would require the Michigan Strategic Fund (MSF) to create a certificate program

for those gas stations converting to E85 and interested in applying for the tax credit. The certificate program would increase the responsibilities for the MSF, and the cost for administering this program would depend on the level of participation by eligible stations.

Background Information

- Currently, approximately 62 service stations sell E85 fuel in Michigan. In 2007, the number of service stations selling E85 fuel in Michigan increased by about 46%.
- At the present time, the Federal government provides an income tax credit for the costs incurred by service stations to be able to sell E85 or biodiesel fuels. This credit is generally equal to 30% of the costs incurred up to a maximum credit of \$30,000 per location. This credit is available for the 2006 through 2009 tax years.
- In Michigan, Public Act 274 of 2006 created a service station matching grant program to help cover the costs of service stations to convert existing fuel delivery equipment or purchase new equipment to be able to sell E85 or biodiesel fuel. While no State government funds were appropriated to support this program, an abbreviated program was put in place using some Federal funds also intended to help service stations finance these startup costs. This grant program ended in 2007.

A new grant program was recently started by Michigan's Department of Labor and Economic Growth using \$110,000 in Federal funds. Under this program, service stations may receive up to \$5,000 for converting existing equipment to sell E85 fuel. To be eligible for a grant under this program, the project must be completed and operational by September 30, 2008.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.