



MINUTES

Fuel Distribution Percentage Formula Review Committee

Friday, September 20, 2019

MEMBERS PRESENT

Senator Tim L. Kapucian, Co-chairperson
Senator Waylon Brown
Senator Todd E. Taylor

Representative David E. Maxwell, Co-chairperson
Representative Dennis M. Cohoon
Representative Phil Thompson

LSA CONTACTS: Organizational staffing provided by: Nicholas Schroeder, Legal Counsel, 515.725.7323; Minutes prepared by: Mitchell O'Hara, Legal Counsel, 515.725.0479

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Fuel Distribution Percentage Formula Review Committee

I. Procedural Business

Call to Order and Adjournment. The meeting of the Fuel Distribution Percentage Formula Review Committee was called to order by temporary Co-chairperson Kapucian at 10:01 a.m. in Room 103 of the State Capitol. The meeting was adjourned at 11:11 a.m.

Election of Permanent Co-chairpersons. The committee unanimously elected temporary Co-chairpersons Senator Kapucian and Representative Maxwell as permanent Co-chairpersons.

Adoption of Rules. The committee unanimously adopted the proposed committee rules.

Opening Remarks. Co-chairperson Maxwell identified the meeting as the first meeting of the committee since the creation of the committee by statute. He noted that the Iowa Department of Transportation (DOT) does a great job maintaining the state's highways, that the DOT has the support of the General Assembly, and that Iowa has the best roads in the nation for driving. In addition, he stated that the committee's job is to start a discussion and discover what the General Assembly needs to accomplish. Co-chairperson Kapucian echoed Co-chairperson Maxwell's statements and noted that he also appreciates the DOT's work in the face of limited funding. He stated that he looks forward to the committee's recommendation and expects to learn about the issues in this policy area and forward what is learned to the General Assembly.

II. Iowa Department of Transportation — Fuel Distribution Percentage Formula Overview

Mr. Mark Lowe, Director, DOT, and Mr. Shawn Majors, Program Management Bureau, DOT, provided an overview of the variable tax rates for ethanol and biodiesel. Mr. Majors noted that the state fuel tax rates prior to July 1, 2002, were 20 cents per gallon for gasoline and 19 cents per gallon for ethanol-blended gasoline. As more consumers shifted to using ethanol-blended gasoline, there was a corresponding reduction in Road Use Tax Fund (RUTF) revenue. In response, the General Assembly established the variable tax rate in 2002 to incentivize increased use of ethanol-blended gasoline while preventing further RUTF revenue losses. The ethanol variable tax rate became effective on July 1, 2002, and the rate is adjusted annually on July 1 based on the previous calendar year's ethanol distribution percentage. The ethanol distribution percentage is the amount of ethanol-blended gasoline distributed in Iowa as a percentage of the total amount of gasoline and ethanol-blended gasoline that is distributed in Iowa. The ethanol variable tax rate will currently sunset on June 30, 2020, at which point the fuel tax rate will be 30 cents per gallon for all gasoline types.

Mr. Majors presented a table showing the variable tax rates for different distribution percentages. He noted that as the ethanol tax rate increases, the gasoline tax rate decreases, until the distribution percentage is above 95 percent at which point both ethanol and gasoline are taxed at the same rate. Mr. Majors then presented a graph showing the ethanol distribution percentages from 2001 to 2018 that are derived from the monthly delivery reports. He stated that the early years showed growth in ethanol use, which stabilized between 2005 and 2013. This was followed by a slight increase from 2013 to 2014, and then by a decrease from 2015 to 2018.

Mr. Majors discussed the purpose of the biodiesel variable tax rate. As part of the 2015 fuel tax increase legislation, the General Assembly established a biodiesel variable tax rate to incentivize the use of biodiesel at blends of 11 percent or greater (B-11+) and to reduce the impact on RUTF revenue as usage of B-11+ increased. The biodiesel variable tax rate became effective on July 1, 2015, and the rate is adjusted annually on July 1 based on the previous calendar year's biodiesel distribution percentage. The biodiesel variable tax rate will currently sunset on June 30, 2020, at which point the fuel tax rate will be



32.5 cents per gallon for all diesel fuel. Mr. Majors presented a table showing an overview of the biodiesel variable tax rate. He noted that the distribution percentage for B-11+ does not increase the tax rate for other diesel fuel, which is dissimilar from the manner in which the ethanol distribution percentage can increase the tax rate for gasoline. The tax rate for biodiesel increases as usage of biodiesel increases and, at 95 percent usage, both B-11+ and all other diesel fuel are taxed at the same rate. Mr. Majors then presented a graph showing the B-11+ distribution percentages that are derived from the monthly delivery reports. The first reporting year was 2015, which showed a 2.5 percent distribution percentage. The distribution percentage increased to 10 percent by 2018.

Mr. Majors examined the history of the variable tax rate, noting that the ethanol variable tax rate was originally established with a June 30, 2007, sunset date. This was later extended to June 30, 2012, and then extended on a year-by-year basis until 2015, at which point the ethanol variable tax rate sunset date was extended to June 30, 2020. The biodiesel variable tax rate was established in 2015 with a sunset date of June 30, 2020. Mr. Majors stated that language from the 2015 fuel tax increase legislation requires a legislative interim committee to report by January 1, 2020, and at least every six years thereafter. Mr. Majors then discussed legislative efforts in 2019, specifically mentioning legislation that was considered to adjust the ethanol variable tax rate to be based on E-15 and greater blends. Mr. Majors reviewed the impact of the variable tax rate over the previous six fiscal years, noting that over that period the variable tax rate reduced RUTF revenue by approximately \$95 million.

Mr. Majors summarized significant fuel price changes. In 2013, the Magellan pipeline stopped providing 87-octane gasoline and shifted to providing 84-octane gasoline and 91-octane gasoline. This resulted in a new standard fuel, 87-octane ethanol-blended gasoline, which increased ethanol-blended gasoline use and increased the price spread between gasoline and ethanol-blended gasoline. Mr. Majors then discussed advances in technology, specifically in regard to E-15 gasoline. In May 2019, the Environmental Protection Agency removed the regulatory barrier for the use of E-15 blends during the summer season. E-15 can be used in any 2001 or newer vehicle. However, the challenge with E-15 gasoline distribution is that stations generally do not have compatible tank and pump infrastructure. He noted that only a fraction of companies operating stations in Iowa are constructing stations compatible with E-15, because the cost to upgrade existing sites is burdensome, especially in rural areas. However, certain programs exist to help upgrade pump and tank infrastructure, and E-15 pumps in Iowa have quadrupled since 2016. Currently, there are approximately 200 E-15 pumps in Iowa.

III. Iowa Department of Revenue — Fuel Distribution Percentage Formula Overview

Mr. Tim Reilly, Policy Director for Sales and Excise Tax, Iowa Department of Revenue (DOR), and Scott Fitzgerald, Statistical Research Analyst, DOR, presented on the taxation of renewable diesel and the method for determining the fuel distribution percentages. Mr. Reilly stated that a new type of fuel is being used in different parts of the country, which is termed “renewable diesel.” Renewable diesel meets the American Society for Testing and Materials’ standard for petroleum diesel but does not have the same fuel tax rate as biodiesel even though it is made from the same feedstocks. If someone delivered renewable diesel in Iowa, it would be reported and taxed as regular petroleum diesel at the higher fuel tax rate rather than the rate for biodiesel. Today, there is no way to identify and report renewable diesel differently from petroleum diesel.

Mr. Fitzgerald noted that while renewable diesel and biodiesel are both made from the same feedstocks, there is a difference in the process used: hydrotreating (biodiesel) versus transesterification (renewable diesel). He was not aware of any renewable diesel currently being used in Iowa, but noted that it is used



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in western states and presents a potential concern if it ever makes its way to Iowa given that it could be taxed as regular petroleum diesel.

Mr. Fitzgerald summarized the current issues with the method for determining the fuel distribution percentages. The distribution percentage is based on gallons distributed in a calendar year as calculated using the DOR monthly fuel delivery reports. The reports are based on the gross number of gallons of fuel delivered by licensed suppliers, blenders, and importers. These reports showed a significant decrease in ethanol use starting in June 2015. The decrease was caused by the method of reporting rather than a change in consumer use of ethanol. The difference in data from the monthly delivery reports compared to actual consumer use results in inaccurate calculation of the distribution percentage and loss of revenue to the RUTF. An alternative source of information available is the Retailers Fuel Gallons Annual Report, which is also compiled by the DOR. The annual retailers report compiles information and data from sales of fuel at the pump as reported by retailers from across the state. Fuel blending happening downstream from the terminal is accurately represented in the annual retailers report. The annual retailers report has a response rate of approximately 88 percent. Mr. Fitzgerald presented a graph showing a comparison of the ethanol distribution percentage according to the monthly delivery reports versus the annual retailers report. The annual retailers report consistently shows a higher ethanol distribution percentage, which Mr. Fitzgerald stated was a more accurate reflection. He then presented a similar graph for biodiesel, again demonstrating a higher distribution percentage for B-11+ from the annual retailers report versus the monthly delivery reports.

The committee asked about the impact on RUTF revenue based on the different reporting numbers. Mr. Fitzgerald referred to the graphs and noted that the impact to RUTF revenue has been a loss of approximately \$42 million from FY 2014 to FY 2019.

The committee asked whether the federal fuel tax rates are variable. Mr. Fitzgerald noted that the federal fuel tax rate is approximately 24 cents per gallon for diesel and approximately 18 cents per gallon for gasoline, and that the rates do not change based on distribution percentage.

IV. Public Comment

The committee received public comments in the meeting and through submissions in writing. The public comments submitted in writing will be posted on the committee's Internet site.

Ms. Dawn Carlson, President and CEO, Fuellowa, stated that she represents stakeholders in the fuel industry, including tank companies, convenience stores, distributors that blend the fuel, refiners, and biofuel producers. She stated that the lack of E-15 infrastructure is a challenge and that 80 percent of retailers do not have the equipment necessary to sell E-15. However, retailers are excited about switching to E-15. She noted that some larger companies have received state, federal, or private grants to assist in building the proper infrastructure, but that smaller retailers need further assistance in order to offer E-15. The committee asked about the complications involved in switching from E-10 to E-15. Ms. Carlson stated that there are state and federal regulations regarding underground and aboveground storage tanks, and that equipment must be compatible with the fuel dispensed from the equipment. The committee asked whether a station can automatically provide E-85 if the station upgrades in order to provide E-15. Ms. Carlson replied that new infrastructure would cover all blends, but that new infrastructure can cost about \$100,000 per retailer.

Mr. Nathan Hohnstein, Policy Director, Iowa Renewable Fuels Association, stated that with current uncertainties, including closing of plants, tariffs, flooding, and other outside pressures, tax differentials have helped farmers by increasing the need for farmers' crops. Mr. Hohnstein commended the General Assembly for considering Senate File 628, which proposes using the annual retailers report to calculate



the distribution percentage and applies the variable tax rate to E-15 rather than E-10, both of which will likely save money for consumers and increase revenue to the RUTF.

Mr. Monte Shaw, Executive Director, Iowa Renewable Fuels Association, stated that, as of right now, there is no renewable diesel sold or distributed in Iowa and that he does not anticipate it being sold or distributed in Iowa anytime soon. The committee asked about the differences between biodiesel and renewable diesel. Mr. Shaw stated that while they are both made from the same feedstocks, there are two different processes yielding two different products. He further noted that renewable diesel is essentially all going to California due to California's stricter emissions standards.

V. Committee Discussion

The committee inquired about the reasons for determining the distribution percentages using the monthly delivery reports rather than the annual retailers report when the fuel distribution percentage formula was initially instated. Mr. Fitzgerald noted that the annual retailers report was not in existence at the time the law took effect. The committee asked about the 12 percent of retailers that are not submitting information for the annual retailers report, to which Mr. Fitzgerald stated that it is likely smaller stations are not reporting.

The committee stated that it is critical to base the distribution percentage on the most accurate reports in order to protect RUTF revenue. The committee also noted that the sunset date for the variable tax rates is approaching and discussed extending the sunset dates. Committee members opined that the present time is not the appropriate time to allow the variable tax rates to be repealed. The committee noted that the annual retailers report shows an increase in ethanol and biodiesel use and that the reporting requirements need to be updated. Committee members further mentioned that it is important to take the information gathered from the meeting and share it with the other members of the General Assembly.

Co-chairperson Kapucian reviewed several options available to the committee. Co-chairperson Maxwell noted the importance of protecting RUTF revenue.

Mr. Nicholas Schroeder, Legal Services Division, Legislative Services Agency, was asked to summarize Senate File 628. The bill amends the variable tax rate for ethanol to apply to E-15 rather than E-10, alters the ranges for the distribution percentages, strikes the alternative E-85 gasoline excise tax, extends the sunset dates for the variable tax rates to 2026, and adds a requirement that the annual retailers report be used to determine the distribution percentages.

Senator Brown made a motion to forward the committee's final report to the General Assembly for further consideration, which was seconded by Representative Thompson. The motion carried unanimously.

VI. Materials Filed with the Legislative Services Agency

The following materials listed were distributed at or in connection with the meeting and are filed with the Legislative Services Agency. The materials may be accessed from the "Committee Documents" link on the committee's Internet Site: legis.iowa.gov/committees/meetings/documents?committee=33680&ga=ALL

1. Meeting Briefing
2. Committee Rules
3. Presentation: Iowa Department of Transportation and Iowa Department of Revenue
4. Public Comment: Iowa Biodiesel Board
5. Public Comment: Biofuel producers and industry partners



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6. Fuel Excise Tax Rates by Distribution Percentage Reference