Fiscal Note & Local Impact Statement

124 th General Assembly of Ohio

Ohio Legislative Service Commission
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BILL: **Am. Sub. S.B. 144** DATE: **March 5, 2002**

STATUS: **As Enacted-Effective March 21, 2002** SPONSOR: **Sen. Mumper**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Establishes the Ethanol Incentive Board, creates corporate franchise and personal income tax credits for ethanol plants, expands the definition of air quality facilities to include ethanol and biofuels plants, and declares an emergency.**

State Fiscal Highlights

STATE FUND	FY 2002	FY 2003	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	$2.6 to $5.2 million loss	$2.6 to $5.2 million loss and potentially more depending on the number of ethanol plants
Expenditures	- 0 -	- 0 -	- 0 -
Ohio Air Quality Development Authority (AGY Fund 570)			
Revenues	- 0 -	- 0-	- 0-
Expenditures	- 0 -	Potential minimal increase	Potential minimal increase

Note: The state fiscal year is July 1 through June 30. For example, FY 2002 is July 1, 2001 – June 30, 2002.

- The bill decreases revenues to the General Revenue Fund (GRF) from state corporate franchise and personal income taxes. The GRF receives 89.5 percent of personal income tax revenues and 95.2 percent of corporate franchise tax revenues. GRF revenue loss will be dependent on the total number of investors, their investments in the ethanol plants, and their tax liability.

- Estimates of GRF revenue loss are for the establishment of one ethanol plant. In future years, GRF revenue loss will depend on the number of ethanol plants the Ethanol Incentive Board authorizes.

- The Ohio Air Quality Development Authority (OAQDA) may incur minimal additional expenditures to provide grants and loans and to issue revenue bonds for the ethanol plants.

- Plants financed through OAQDA would be exempt from the state sales and use tax, which will also reduce GRF revenues. The GRF receives 95.2 percent of the state sales tax.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2002	FY 2003	FUTURE YEARS
Counties and other local governments			
Revenues	- 0 -	$0.8 million loss	At least $1.0 million loss from the tax credits; Potential loss from sales, tangible and personal property tax exemptions
Expenditures	- 0 -	- 0 -	- 0 -

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- Corporate franchise and personal income tax credits decrease state revenues to the Local Government Fund (LGF), the Library and Local Government Support Fund (LLGSF), and the Local Government Revenue Assistance Fund (LGRAF). The revenue loss to local governments would depend on the total number of investors, their investments in the ethanol plants, and their tax liability.

- Under the Ohio Air Quality Development Authority tax incentives, the ethanol plants would be exempt from local real property and tangible personal property taxes. This would decrease revenues to counties, municipalities, townships, and school districts where the ethanol plants are located.

- Exemptions from the sales and use tax available to projects financed through OAQDA may reduce sales tax revenue under the County Permissive Sales Tax, County Additional Sales Tax and Transit Authority Sales Tax. Also, 4.8 percent of state sales tax revenues are deposited into local government funds. Distributions from the state sales tax to the Local Government Fund (LGF) and the Local Government Revenue Assistance Fund (LGRAF) would be foregone.

Detailed Fiscal Analysis

Am. Sub. S.B. 144 creates an Ethanol Incentive Board and authorizes nonrefundable personal income and corporation franchise tax credits for capital investments in ethanol plants approved by the Ethanol Incentive Board. The tax credits are available beginning in tax year 2002 and ending in tax year 2012. The five-member Ethanol Board is to serve without compensation and will cease to exist on January 1, 2014. Ethanol plants would be constructed and operated by organizations that are majority-owned by Ohio farmers. The nonrefundable tax credits are capped at $5,000 per investor with a carry forward provision for three years after the year the credit is first claimed. The bill also modifies the definition of air quality facilities and makes ethanol plants eligible for Ohio Air Quality Development Authority (OAQDA) financing. Nationwide, some ethanol plants are corporations. Most of the farmer-owned ethanol plants are Limited Liability Partnerships (LLPs) or Limited Liability Corporations (LLCs). As such, they are pass-through entities that distribute net income from the ethanol plant to investors. This income would then be subject to either the individual income tax or the corporate franchise tax. Investors may participate in multiple LLCs or LLPs, each of which invests in several ethanol plants.

LSC assumes that the Ethanol Incentive Board would authorize several ethanol or biofuel plants to make Ohio self-sufficient in ethanol or biofuels,[1] although the timing of approvals and construction of plants cannot be determined. It is reasonable to expect that no ethanol plant approved by the Ethanol Board will be operating in Ohio in the current biennium. However, funds may be committed in calendar year 2002 and claimed in tax returns for that year, thus affecting FY 2003 revenues. Most farmer-owned ethanol plants are dry mill plants, which are less expensive to build than wet mill plants. LSC assumes that the initial ethanol plant would be a dry mill plant that processes corn. Capital costs for a dry mill plant vary from $1.20 to $1.50 per gallon of ethanol produced. Assuming a 40 million gallon per year (mgy) dry mill ethanol plant, capital investments would be about $52.0 million.[2] In existing farmers' cooperatives that own ethanol plants, members generally contribute 30 to 50 percent of the capital cost of the plants. Thus, total investment eligible for the tax credits on a $52 million investment would be approximately $26.0 million.[3] This assumes that each individual farmer-investor contributes a maximum of $5,000 for the plant.

The overall fiscal effect of S.B. 144 is dependent on the structure of the financing of any approved ethanol facility and the type and the size of the facility. It would also depend on the number of investors, their individual contributions, and the tax liabilities to which the $5,000 tax credit (or reduction in tax liability) would be applied.

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[1] To make Ohio self-sufficient at the current ethanol consumption level of 200 million gallons per year, Ohio may need about five 40-mgy (million gallons per year) plants.

[2] *Determining the Cost of Producing Ethanol from Corn Starch and Lignocellulosic Feedstocks*. A Joint Study Sponsored by the U.S. Department of Agriculture and the U.S. Department of Energy; National Renewable Energy Laboratory. October 2000.

[3] Farmer-investors will provide about half of the capital investment (Sponsor's testimony on S.B. 144 on October 16, 2001).

Table 1 illustrates the potential state revenue loss from S.B. 144 under various scenarios of contribution per investor, number of investors, total credits earned (at the maximum of $5,000 per investor) and total earned credits claimed. Credits earned and credits claimed are in millions of dollars. Table 1 shows that the credits earned by investors may range from $3.25 million to $13.0 million, depending on the number of investors. Because the tax credits are nonrefundable, the potential state revenue loss will be limited and would depend on actual credit claims and carryovers. At 50 percent credit claims, state revenue loss would be between $1.6 million and $6.5 million. At 25 percent credit claims, state revenue loss would be between $0.8 million and $3.3 million.

Table 1: Potential State Revenue Loss by Number of Investors and Earned Credits Claimed (in millions).

Investment	Number of investors	Credits Earned	Credits Claimed @ 50%	Credits Claimed @ 25%
$10,000	2,600	$13.0	$6.5	$3.3
$15,000	1,733	$8.7	$4.3	$2.2
$20,000	1,300	$6.5	$3.2	$1.6
$25,000	1,040	$5.2	$2.6	$1.3
$30,000	867	$4.3	$2.2	$1.1
$35,000	743	$3.7	$1.9	$0.9
$40,000	650	$3.3	$1.6	$0.8

Due to the structure of the tax credit, LSC believes that most investors may invest about $10,000 and a little more because the tax credit amount may yield a return on investment of up to 50 percent for investors with enough personal or corporate tax liabilities.

Table 2 provides General Revenue Fund (GRF) and various local government fund revenue losses for **one 40-mgy ethanol plant, qualifying investments of $26 million and 2,600 investors, a rate of 25 percent for credit claims, and a carry forward rate of 20 percent**. LSC assumes most tax credit claims will be against the state personal income tax (if most ethanol plants are LLCs or LLPs). The GRF receives 89.5 percent of state personal income taxes. The Library and Local Government Support Fund (LLGSF) receives 5.7 percent of state personal income taxes. The Local Government Fund (LGF) and the Local Government Revenue Assistance Fund (LGRAF) receive the remainder of the state personal income tax, or 4.8 percent.

Table 2: GRF and local government funds revenue losses, in millions.

Fiscal Year	State Revenue Loss	GRF Loss	LLGSF Loss	LGF/LGRAF Loss
FY 2003[4]	$2.6	$2.6	$0.0	$0.0
FY 2004	$2.1	$1.9	$0.1	$0.1
FY 2005	$1.7	$1.5	$0.1	$0.1

[4] The current biennium budget freezes contributions to local government funds. Therefore, FY 2003 state revenue loss is also GRF loss.

FY 2006	$1.3	$1.2	$0.1	$0.1

A higher rate of credit claims would generate higher revenue losses for the GRF and local government funds. For example, a rate of 50 percent for credit claims would decrease GRF revenues by $5.2 million in fiscal year 2003. In future years, with the potential of several eligible ethanol plants[5] authorized by the Ethanol Board, yearly GRF revenue loss would be higher depending on the total number of investors and tax credits claimed by the various investors.

Ethanol plant as a qualified "air quality facility"

S.B. 144 widens the definition of "air quality facility" under the existing Air Quality Development Authority (OAQDA) to include ethanol or biofuel plants. This makes ethanol and biofuel plants eligible to receive financing through OAQDA. OAQDA provides grants and loans, and issues revenue bonds. Thus, OAQDA may incur additional minimal expenditures due to S.B. 144. Any eligible ethanol plant would receive exemptions from the sales and use tax and exemptions from real and tangible personal property taxes.

Exemptions from the state sales and use tax will reduce GRF revenues. The GRF receives 95.2 percent of the state sales tax revenue. Exemptions from the sales and use tax available to projects financed through OAQDA may reduce sales tax revenue under the County Permissive Sales Tax, County Additional Sales Tax and Transit Authority Sales Tax. Also, 4.8 percent of state sales tax revenues are deposited into local government funds. Distributions from the state sales tax to the Local Government Fund (LGF) and the Local Government Revenue Assistance Fund (LGRAF) would be foregone.

Revenue from real and tangible personal property taxes are distributed to counties, municipalities, townships and school districts. The location of the ethanol or biofuel plants would determine local revenue loss from the tangible and real property tax exemptions. **Local revenue loss due to the real and property tax exemptions would be variable based on local tangible and real property tax rates**.

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[5] If the ethanol plants were mostly wet mill ethanol plants, GRF revenue loss may be even larger because of a higher initial investment per plant.