MADISON'S TIMBER PREVIEW

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In 2009 and through fiscal year 2010 US pulp and paper producers took advantage of a tiny clause in the 2009 Highway Bill meant to encourage the use of biofuel in transportation. Pulp mills were already using co-generated power fueled by black liquor, a byproduct of making pulp from wood, to offset their energy costs. Producers found if they added a small amount of carbon fuel into the black liquor, they became eligible for a tax credit by supposedly being green. After much careful consideration, the Canadian government eventually responded with the Green Transformation Funding program, providing similar financial resources to Canadian pulp and paper producers which had to be used for energy efficiency upgrades.

Companies with US pulp and paper operations reaped sizable refunds in 2010 under the Highway Bill, yet their abilities to claim these credits expired on December 31, 2009. US producers are now using a different biofuel tax credit to recalculate their tax bills for 2010 and beyond, to receive even greater refunds than they had previously. It turns out that the federal biofuels subsidy—a federal tax ruling on June 28, 2010 "allows black liquor to qualify for a different tax credit meant to encourage new cellulosic biofuels for transportation."

In 2010, the IRS said that the provision in the 2010 health-care legislation didn't prevent black liquor produced in 2009 from qualifying as a cellulosic biofuel, so the paper industry recalculated its credits. The cellulosic biofuel tax credit, part of the 2008 Food, Conservation, and Energy Act, also known as the Farm Bill, is worth US$1.01 a gallon. Some pulp and paper companies amended their 2009 earnings, giving back some of the alternative fuel credits in return for the more lucrative cellulosic credits. In addition, the cellulosic biofuel credit is not refundable, and it can be applied in future years, slashing tax bills perhaps as late as 2015, according to the Wall Street Journal.

If these credits are allowed to continue into 2015, US pulp and paper producers will have a distinct advantage over their Canadian counterparts. A further funding response will be necessary from the Canadian government or Canadian mills will simply not be able to compete.

In 2009, International Paper received US$1.7 billion in cash and cut its tax bill by another US$379 million due to the alternative fuel mixture credit, according to its annual report. The company said the cellulosic biofuel credit would cut the company's tax bill by US$40 million in 2010, and that there would be additional credits for later years. 64 million gallons of IP's black liquor not eligible for the alternative fuel mixture credit would qualify for the cellulosic credit. IP is still deciding whether to amend its 2009 tax return and convert the US$2.1 billion of alternative fuel credits it received into cellulosic biofuel credits.

PULP AND PAPER COMPANY US TAX REBATES

	2009 (US$,million)	2010 (US$,million)
International Paper	**1,700**	40
Weyerhaeuser		149
Packaging Corp. of America		47.7 + 102 kept aside for the future
Domtar's		209
Rock-Tenn		112
Temple Inland	228	83
MeadWestvaco	375	29

Canada's Green Transformation Program is capped at $1 billion to be distributed among 24 companies, with the program to complete in March 2012. Funding is calculated based on a $0.16 per litre credit for black liquor produced by its mills through 2009. By mid-April, more than $256.4 million had already been distributed to eligible companies across Canada, with several companies looking forward to receiving their funding before this fiscal year is over.

Unlike the Canadian funds, which must be used for energy efficiency upgrades or expansion into biomass fuel production, US companies are able to use their tax refund for anything they want. Most were able to decrease their debt load with the first round of tax credits.
Canada's cap on green transformation funds was based on the amount US competitors would get in credit according to the 2009 Highway Bill. If US producers are going to recalculate their refunds based on the 2008 Act and end up receiving more, Canadian companies will not be competitive on a level playing field without an increase in funding of their own.

Meanwhile, growing numbers of US analysts, government representatives, and watchdogs are disgusted with further hand-outs to pulp and paper producers. Especially when it is done in this seemingly sneaky way.

The credits have been "a boon to the industry," said a JP Morgan analysis of the pulp and paper industry. Even though Congress attempted in two separate pieces of legislation last year to limit the benefits for burning black liquor, the boon continues.

"It's outrageous that the IRS and Congress have let these companies get a tax windfall for something that serves no public policy purpose," said Martin Sullivan, a private tax economist who previously worked at the Treasury and on the staff of the Joint Committee on Taxation, to the Wall Street Journal. The IRS, he said, "definitely could have shut it down and, for reasons that are hard to understand, they caved to everything the industry asked for."

One does not need to probe for disingenuous motives to explain this policy, according to Neil Ward's April 27 piece on the Forest Industry Network. It is not a stretch to imagine a pulp mill directing its black liquor off-take to a transportation fuel refining unit and replacing the lost energy value with a fossil fuel component—for a net loss in energy efficiency and renewable energy deployment—in order to take advantage of the tax credit. As an argument against this tax policy, it should be enough to demonstrate that any biofuel subsidy directs biomass, or biomass-derived chemicals, away from integrated processes that currently consume them, creates waste and inefficiencies in supply, as those pulp mills attempt to replace them with less efficient alternatives, explains Ward.

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