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BEYOND EXTENDERS - WHAT MIGHT THE “BLUE WAVE” MEAN FOR RENEWABLES TAX LEGISLATION? (PART 3)

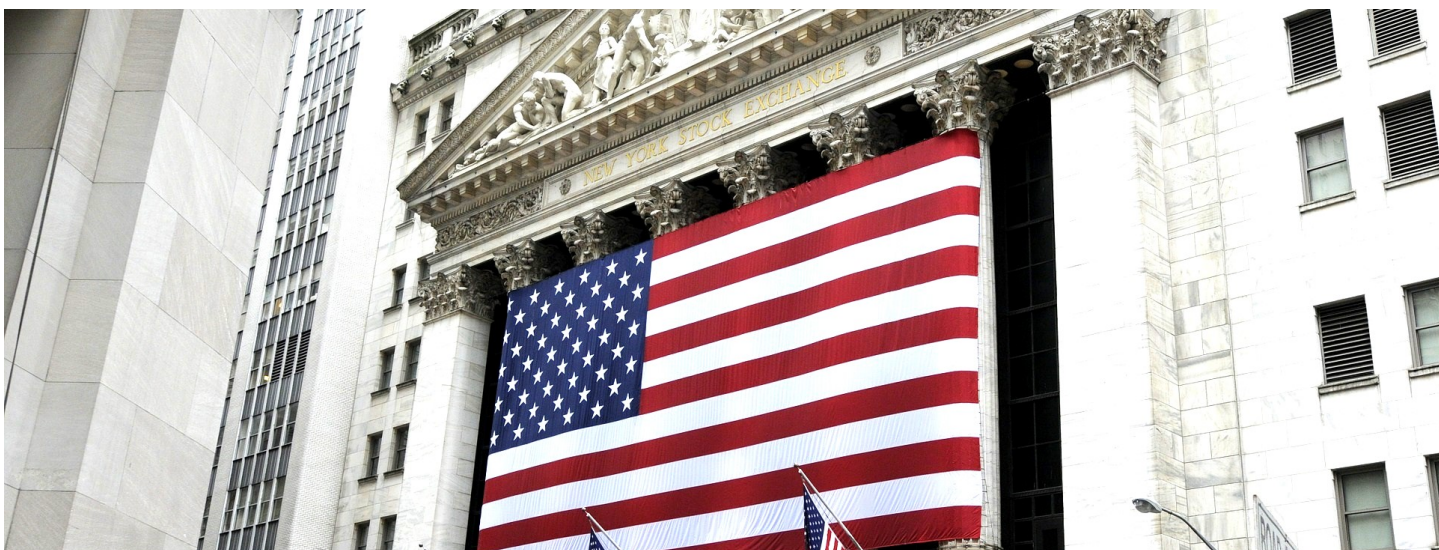
By Judy Kwok

The following is Part Three of a three part guest post by Judy Kwok, a Member at Mintz's Energy and Sustainability practice, specializing in tax-efficient strategies for renewable energy developers and investors. Prior to joining Mintz, she served as Vice President, Tax Planning and Tax Counsel for GE Energy Financial Services.

Maximizing Tax Credit Utilization

Not all potential changes to the renewables tax regime target the ITC, PTC and section 45Q carbon capture credit statutes. Some of the most powerful tax tools for encouraging renewables investment involve narrow changes to generally applicable provisions in the Code.

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Avoiding Publicly-Traded Partnership Status. One such possible change, proposed by the GREEN Act, involves expanding the publicly-traded partnership (“PTP”) carve-out in section 7704(d)(1)(E) to allow certain renewables-focused PTPs to avoid being taxed as corporations. Under the existing rule, if 90% of a PTP’s gross income falls into certain categories of qualifying income, the PTP is not taxed as a corporation. The proposed legislation would treat as qualifying income numerous renewables-based sources of income and gains, including from the generation of electricity exclusively using a “qualified energy resource” for purposes of the PTC, such as wind; the operation of energy property that qualifies for the ITC, including solar projects; and, in certain cases, from the generation or storage of electrical power at, or carbon dioxide capture by, a qualified facility under section 45Q. The Wyden Amendment contains a similar proposal.

Adding Credits Back to Base Erosion Minimum Tax. Section 59A imposes an additional base erosion and anti-abuse tax (“BEAT”), also described as the “base erosion minimum tax amount,” which is generally the excess of 10% (5% for taxable years beginning in 2018 and 12.5% for taxable years beginning after 2025) of “modified taxable income”—i.e., regular taxable income less (1) deductions arising from certain related party payments to foreign persons (including depreciation or amortization deductions with respect to the acquisition of property from such related foreign persons) and (2) a percentage of NOLs allowed in a given year, based on the proportion of deductions that are “base erosion tax benefits”—over “regular tax liability.” In calculating regular tax liability for BEAT purposes, specified credits are added back, including 80% of PTCs, ITCs and section 45Q carbon capture credits; however, for taxable years beginning after 2025, no such add-back of credits is permitted.



Including a 100% add-back to regular tax liability for these credits, for all taxable years, would be a welcome change to the BEAT regime. Indeed, the 45Q Carbon Capture, Utilization, and Storage Tax Credit Amendments Act of 2020, in addition to requesting a five-year extension of the credit, partially addresses this roadblock to credit utilization by proposing that section 59A be revised to include an add-back to regular tax liability equal to the amount of the section 45Q carbon capture credit, and that the post-2025 cessation of the add-back for tax credits not apply to the section 41 research credit or to 80% of section 38 credits (including PTCs, ITCs and section 45Q carbon capture credits). The bill's focus on section 45Q credits would be too narrow to please most of the renewables industry, but the concept of carving out renewables credits from the BEAT regime is sure to pique the interest of tax equity investors.



Rethinking the Passive Activity Loss Rules. Section 469, which applies *inter alia* to individuals, closely-held C corporations, personal service corporations and various other non-corporate persons, disallows aggregate net loss from all passive activities for a taxable year, as well as most tax credits (including ITCs, PTCs and section 45Q carbon capture credits) from passive activities in excess of the regular tax liability allocable to passive activities. For purposes of section 469, a passive activity includes any activity which involves the conduct of a trade or business, and in which the taxpayer does not materially participate. As credits from tax equity investments are generally considered to be passive activity credits, and most individuals lack passive activity income with which to offset such credits, section 469 is frequently cited as one of the key roadblocks preventing more widespread individual investment in renewables projects, either directly or via pass-through structures. Carving out renewable tax equity interests from the passive activity rules—even to a limited extent—could boost tax equity investment significantly among individuals.



Expanding the Tax Credit—and More?

In addition to the offshore wind ITC, the COVID-19 Economic Relief Bill provided a new ITC for “waste energy recovery property,” defined as property with capacity of 50MW or less that generates electricity solely from heat from buildings or equipment if the primary purpose of the building or equipment is not the generation of electricity. The waste energy recovery property ITC has a BOC deadline of January 1, 2024 and phase-out rules similar to those for other ITC-eligible property.

Beyond the recent additions discussed above lies a vast landscape of potential new and revived renewable tax credits, including the following proposals:

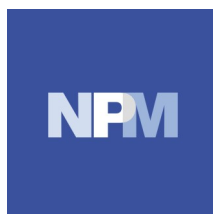
Extension of the expired biodiesel fuels credit under section 40A.

Separate production tax credit for certain “renewable chemicals” produced from biomass and composed of biobased content and an investment tax credit for facilities used to produce such chemicals.

ITCs for “qualified biogas property,” i.e. property using anaerobic digesters or certain other processes to convert biomass into a gas of at least 52% methane, and for “qualified manure resource recovery property,” i.e., certain property that recovers nitrogen and phosphorus from non-treated digestate or animal manure.

Extension of the expired alternative fuels credit under section 6426(d).

PTC for energy production by certain facilities that mainly use hydrogen fuel with “non-positive carbon intensity.”





ITC for electrochromic glass.

ITC for fuel cells using electromechanical processes.

ITC for open-loop biomass heating property.

Separate production tax credit for power produced by facilities using certain “emerging technologies,” which include renewable technologies meeting certain criteria but also nuclear reactor technologies, and an investment tax credit for such facilities.

Still more intriguing are the occasional proposals to replace the existing ITC and PTC entirely, like the Clean Energy for America Act, which contains the following proposals for a drastically different renewables tax regime:

Replace the current PTC with a ten-year “clean energy production credit,” not restricted to any specific type of facility, that increases with the facility’s level of carbon capture and decreases by the facility’s greenhouse gas emissions, as well as a ten-year “clean energy fuel credit” for transportation fuel that is adjusted for the level of emissions produced by such fuel.

Replace the current ITC with an investment credit, based on the eligible basis of electricity-generating and microgrid property, that fluctuates based on the anticipated greenhouse gas emissions rate on the property, as well as additional investment credits based on the eligible basis of qualified carbon capture and energy storage property; the investment credit could be recaptured if actual greenhouse gas emissions from the property are higher than anticipated, or if the carbon capture property fails to fulfil certain carbon capture or disposition standards.

Allocate an additional \$5 billion to the long-defunct “qualifying advanced energy project program” of section 48C, which provides (to the extent of the remaining allocation) an investment credit for investments in facilities that manufacture certain renewable energy property.

Establish a tax credit for “clean energy bonds,” i.e. certain bonds issued by governments or certain power providers that are used to fund various renewable energy projects, equal to a percentage of the interest received on such bonds. This concept also appears in the Agriculture Environmental Stewardship Act of 2019 with respect to biogas and manure-recovery property, but the credit is based on a specified rate multiplied by the face amount of the bond.



Given the seemingly unlimited tax benefit carrots that can be accorded to the renewables industry, it may come as a surprise that the uglier “stick” of a carbon tax has been proposed at least three times since the start of 2019. The America Wins Act generally imposes a tax on any “taxable carbon substance”—i.e. coal, petroleum, or natural gas—sold by the manufacturer, producer, or importer thereof, at a fixed rate (subject to cost of living adjustments), as well as on certain “carbon-intensive” imports. The American Opportunity Carbon Fee Act of 2019 contains a similar proposal for a carbon fee, but bases the carbon fee rate on the carbon dioxide emission level of the fuel in question and also includes an additional fee for certain fluorinated greenhouse gases and certain facilities that emit greenhouse gases above certain thresholds. The Climate Action Rebate Act imposes a carbon fee on the use, sale, or transfer of products derived from crude oil, natural gas, or coal “which shall be used so as to emit greenhouse gases to the atmosphere,” at a rate that fluctuates based on whether specified emissions targets for such covered fuels are met; fluorinated greenhouse gases, and imports of covered fuel and “carbon-intensive” products, are also subject to additional fees. The appetite for a carbon tax in a COVID-19 environment, however, is likely limited.



If there is any message that can be drawn from the labyrinth of legislative options outlined above, it is that human ingenuity has invented at least as many tax incentives to support renewable energy as methods to produce it. While renewables tax legislation has centered around extenders in recent years, industry watchers should be advised, particularly in the midst of a “Blue Wave,” that the true range of possible legislative outcomes—some more likely than others—is in fact much richer and more complex than would initially appear to be the case.

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