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Baucus Post-2016 Proposal: No Change to PTC & ITC Reduced to 20 Percent

Today, the chairman of the Senate Finance Committee, Max Baucus (D-MT), released his proposal for energy tax incentives as part of overall tax reform. The proposal is thoughtful and merits serious consideration by the renewable energy industry. Importantly, it eliminates the discrepancy in the tax benefits available to different types of energy technologies. Here are links to the official documents: a one page summary, an eight page summary, a 30 page legislative history and the statutory language.

What the Proposal Would Mean for Solar?

Solar projects placed in service prior to 2017 would remain eligible for a 30 percent investment tax credit. Solar projects placed in service in 2017 and later would be eligible for either (i) a 20 percent investment tax credit (ITC) or (ii) a 2.3 cents per KWh production tax credit (PTC) for ten years. The proposed PTC is the same as the PTC available to wind projects under current law and would continue to be adjusted for inflation.

What the Proposal Would Mean for Wind?

The current PTC would be extended for projects placed in service prior to 2017. Further, the option to elect ITC would also be extended for projects placed in service prior to 2017. Wind and other PTC eligible projects under current law that “started construction” prior to 2014 would have to be placed in service prior to 2017; effectively, the “start of construction” rules would have no bearing on any projects’ tax credits eligibility.

Wind projects placed in service in 2017 and later would be eligible for either (i) a 20 percent investment tax credit (ITC) or (ii) a 2.3 cents per KWh PTC for ten years with the inflation adjustment continuing. This is the same as solar.

Universal Technological Standard

The PTC and ITC are available to any electricity generation facility that emits, with respect to greenhouse gases, between one and 372 grams of equivalent carbon dioxide per kilowatt-hour (CO2e per KWh). As a project’s emissions approach 372 grams, the credit rate is reduced linearly. Technologies like wind and solar have zero emissions, so the linear reduction is moot for them. In addition, the Joint Committee’s report provides that nuclear power has zero emissions, so new nuclear power plants would also escape the linear reduction.

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This universally applicable standard for tax credits is a critical change because as technologies evolve it will not be necessary to try to shoehorn them into decades old statutory definitions. Rather, it will be merely a question of the emissions from the facilities using the technology. For instance, the staff of the Joint Committee on Taxation believes that a plant burning 100 percent wood waste would generate 48 grams of emissions and would be entitled to a 2 cent per KWh PTC or a 17 percent ITC. Even a bituminous coal project using 40 percent biomass that is projected to emit 308 grams would qualify for a 0.4 cent per KWh PTC or a 3 percent ITC.

If the actual emissions from a project that claimed the ITC were significantly worse than the anticipated emissions, then the investment tax credit would be subject to recapture. This would not be an issue for wind, solar or nuclear projects as those projects have zero emissions.

Proposed Phaseout Standard for all Technologies

Once the Treasury Department (after consultation with the Department of Energy and the Environmental Protection Agency) certifies that the annual average greenhouse gas emissions rate for electrical production facilities in the United States is equal to or less than 372 grams of CO_2e per KWh, the tax credits start to phase out for projects placed in service starting in the year following the certification.

The ITC is reduced 25 percent for projects placed in service the first year following Treasury's certification, 50 percent in the second year following the certification, and 75 percent in the third year following the certification. No investment credit is allowed thereafter.

PTC projects placed in service prior to the certification date are unaffected by the phaseout. PTC projects placed in service after the phaseout would have their PTCs reduced based on which year they are placed in service following the certification: 25 percent for facilities placed in service the first year, 50 percent the second year, and 75 percent the third year. Facilities placed in service thereafter would not be eligible for the PTC.

Why is the ITC Reduced to 20 percent?

The ITC would be reduced to 30 percent from 20 percent, while the PTC remains at its current levels with the inflation adjustments. There is no explanation for the disparate treatment of the two credits. On a conference call, congressional staff noted they had estimated that a 20 percent ITC was equivalent to a 2.3 cent PTC. It is not clear what the math was that resulted in that conclusion.

What about ITC Recapture?

The current recapture rules that apply to sales and transfers in the first five years of an ITC project's life would continue to apply. As noted above, the recapture rules would be expanded to also apply to ITC projects that have higher emissions than anticipated.

What about Depreciation?

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This proposal does not address depreciation. It is expected that depreciable basis will continue to be reduced by 50 percent of the ITC.

In addition, Chairman Baucus on November 21 released a separate proposal addressing cost recovery generally. The proposed legislative history for the cost recovery proposal is available [here]. Under that proposal, accelerated depreciation would be repealed. Therefore, the five-year double-declining depreciation (referred to as "MACRS") for renewable energy projects would be eliminated. Instead, renewables would be subject to depreciation of 5% a year on a declining balance. Therefore, if the asset pool has a balance of $1 million, the depreciation in the first year would be $50,000 (*i.e.*, 5% of $1 million). If no assets eligible for the pool are acquired or purchased in the next year, then depreciation for the second year would be $47,500 (*i.e.*, 5% of $950,000). Assets would be "pooled," which means that if an asset was sold the pool would go down while the purchase of an asset would increase the pool. To some extent, pooling is like a tax-free exchange without the hassle of the like-kind exchange rules.

The Chairman's depreciation proposals are not specific to renewables. All assets would be subject to similar rules. There will be four pools of asset; renewables were placed in the slowest depreciation pool. The renewables industry will rally to change that, if the cost depreciation proposal advances.

What about Expansion of the Master Limited Partnership (MLP) Rules to Include Renewables?

A MLP is able to raise equity in the public markets, while only being subject to a single layer of federal income tax. Senator Baucus's energy tax reform proposal is silent with respect to expansion of the MLP rules to include income from renewable projects as "qualifying income." The speculation regarding the omission is that the MLP rules are the topic of other potential tax reform discussions, so it would have confused matters to address MLP in the energy tax reform proposal.

Senator Baucus to China

It was reported today that President Obama will nominate Senator Baucus to be the next ambassador to China. It is not clear what Baucus's departure from the Senate will mean for the prospects for tax reform generally, or the energy proposals specifically.

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Contact Information

If you have any questions regarding this alert, please contact:

David K. Burton
dburton@akingump.com
212.872.1068
New York

Joshua R. Williams
jrwilliams@akingump.com
212.872.8014
New York

Adam Seth Umanoff
aumanoff@akingump.com
213.254.1300
Los Angeles

Jacob J. Worenklein
jworenklein@akingump.com
212.872.1027
New York

Elliot Hinds
ehinds@akingump.com
310.229.1035
Los Angeles

Jeffrey D. McMillen
jmcmillen@akingump.com
202.887.4270
Washington, D.C.

Anne S. Levin-Nussbaum
alevin-nussbaum@akingump.com
212.872.7476
New York

Edward W. Zaelke
ezaelke@akingump.com
213.254.1234
Los Angeles

Dino Elizardo Barajas
dbarajas@akingump.com
310.552.6613
Los Angeles

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