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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

A Snapshot Of Baucus's Vision For Energy Tax Incentives

Law360, New York (January 14, 2014, 12:02 AM ET) -- On Dec. 18, Senate Finance Committee Chairman Max Baucus, D-Mont., released a discussion draft of legislation that aims to reform U.S. energy tax incentives. The proposed energy tax incentives are a simpler set of incentives to promote cleaner energy that are designed to be technology-neutral and more predictable.

Currently, there are 42 different energy tax incentives, including 16 for clean energy, alternative vehicles and renewable fuels. Of these, over half are temporary and expire every year or two, creating considerable uncertainty for investors and developers seeking to utilize these incentives. Although taxpayers would welcome the greater predictability offered by the Baucus proposal, there are many aspects that may not be viewed favorably, including the elimination of many existing incentives.

The Baucus proposal may gain traction because it is projected to reduce overall government “tax expenditures” for energy, depending on the assumptions made for what those expenditures are projected to be under current law. The Senate Finance Committee predicts that the enactment of the proposal, along with proposed changes in depreciation that affect energy producers, would reduce the cost of the government incentives for energy, which would exceed $150 billion if extended for the next 10 years, by more than half.

New PTC and ITC

The proposal would replace all existing energy incentives with two new nonrefundable tax credits for clean energy and clean transportation fuels. Those credits, rather than requiring regular renewal, would be tied to national reductions in greenhouse gas intensity in U.S. electricity facilities and transportation fuels. Moreover, the credits would be available to facilities using all technologies as long as emissions standards are satisfied.

A tax credit for clean energy and clean transportation fuels would be available as either (1) a production tax credit (“PTC”) of up to 2.3 cents per kilowatt hour for energy or up to $1 per gallon for transportation fuel produced over a 10-year period or (2) an investment tax credit (“ITC”) of up to 20 percent of the cost of the facility producing energy or transportation fuels. Notably, the new ITC reduces the percentage of the cost of a facility that is eligible for the credit from 30 percent to 20 percent. Businesses could choose between claiming the credit as a PTC or an ITC.

It appears that many rules such as the recapture rules under Section[1] 50 that are currently applicable to Section 45 credit for renewable energy production and the Section 48 investment tax credit for renewable energy facilities will be applicable to the new PTC and ITC. The depreciable basis of property with respect to which the new ITC is claimed would continue to be reduced by 50 percent of the ITC.

The new PTC and ITC would be available for at least a 10-year period, but would not be permanent.

PTC and ITC for Clean Energy

Any facility producing electricity that is approximately 25 percent cleaner than the average for all electricity production facilities would be eligible to receive the new PTC or ITC. The principle that the proposal seeks to implement is: the "cleaner" the facility, the larger the credit. Cleanliness is defined by a simple ratio of the greenhouse gas emissions of a facility, as determined by the U.S. Environmental Protection Agency, divided by its electricity production. Electricity produced from wind, solar, hydroelectric and nuclear energy should be eligible for the maximum PTC or ITC because these technologies emit zero greenhouse gases. For the ITC, the credit percentage is based on the power facility's anticipated emissions. If a facility's actual emissions are significantly worse than the anticipated emissions at the time the facility was placed in service, the ITC is subject to recapture.

The new PTC and ITC for energy facilities would not be available to facilities that are placed in service before Jan. 1, 2017. However, after 2016, the ITC could be claimed for existing facilities that undertake a carbon capture and sequestration retrofit that captures at least 50 percent of carbon dioxide emissions.

To transition to the new incentives for clean electricity, the proposal would allow three expiring incentives to continue through 2016. Under the proposal, the Section 45 credit for renewable energy production, the Section 48 investment tax credit for renewable energy facilities and the Section 25D credit for residential renewable electricity investments would continue through 2016.

The clean energy credits would phase out over a period of four years after the greenhouse gas intensity of U.S. electricity generation has declined to the point that it is 25 percent cleaner than 2013 emissions.

PTC and ITC for Clean Transportation Fuels

The clean transportation fuels PTC and ITC would generally be available to fuels that are approximately 25 percent cleaner than conventional gasoline. The cleaner the fuel, the bigger the credit, up to a maximum of $1 per gallon for the PTC or 20 percent of the cost of the fuel production facility for the ITC. The cleanliness of the fuel would be determined based on how clean a given production process is on a lifecycle emissions basis, as determined by the EPA.

To transition to the new clean transportation incentives, the proposal would extend the Section 40, 40A and 6426 credits for transportation-grade, renewable and alternative fuels through 2016.

The clean transportation fuels PTC and ITC would be phased out over four years once the greenhouse gas intensity of all transportation fuels has declined to a level that is 25 percent cleaner than conventional gasoline.

Repeal of Other Energy Incentives

The plan would end, allow to expire, or set up for repeal a number of other energy-related tax incentives, including credits for enhanced oil recovery costs, marginal well production, electric plug-in vehicles, carbon dioxide sequestration and a residential energy efficiency.

Proposed Changes to Cost Recovery

Chairman Baucus on Nov. 21, 2013, released a separate proposal to change cost recovery generally. Under that proposal, accelerated depreciation would be repealed. Therefore, the five-year double-declining depreciation (referred to as "MACRS") currently available for renewable energy projects would be eliminated. Instead, renewable energy property would be subject to straight-line depreciation over a 20-year life (i.e., 5 percent a year). The depreciation proposals are not specific to renewables. However, if enacted, the proposal would take away a tax incentive that is crucial for renewable energy. Accordingly, the Baucus energy incentive proposals also must be considered in conjunction with the cost recovery proposal.

The Baucus proposal is one of several tax reform proposals that have been released by Rep. Dave Camp, R-Mich., chairman of the House Ways and Means Committee, and Sen. Baucus. On Dec. 15, Rep. Paul Ryan, R-Wis., told Meet the Press that the Ways and Means Committee in the first quarter of next year is going to be advancing tax reform legislation because "we think that's a key ingredient to getting people back to work, to increasing take-home pay, to grow this economy."

—By Michelle M. Jewett, Thomas A. Humphreys, Bernie J. Pistillo and Remmelt A. Reigersman, Morrison & Foerster LLP

Michelle Jewett is a partner in Morrison & Foerster's San Francisco office. Thomas Humphreys is a partner in the firm's New York office, head of the firm's federal tax practice group and co-chairman of the tax department. Bernie Pistillo and Remmelt Reigersman are partners in the firm's San Francisco and New York offices, respectively.

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[1] All references to "Section" in this discussion refer to sections of the Internal Revenue Code of 1986, as amended.

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