



Issue Brief: Tax Reform & Renewable Energy Finance

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Overview

The Trump administration and Congress have made comprehensive tax reform a priority and have broadly outlined approaches for reform.¹ While exact legislative language is reportedly being drafted at this writing, President Trump's initial proposal and the House Republican tax reform blueprint published in June 2016² seek to fundamentally reshape the U.S. tax system, with a major focus on reducing marginal corporate tax rates. This approach is reflected in the broad framework announced by the Administration and Congressional leaders in late September.

A reduction of tax rates from the current 35 percent level could have a positive impact on renewable energy finance and investment, just as lower taxes help promote investment in other major industrial sectors. As described below, however, a precipitous drop in rates could also create challenges, reducing the value of depreciation benefits, creating pressure for potentially problematic offsets, and perhaps impacting the availability of tax equity.

Beyond the discussion on rates, the American Council on Renewable Energy (ACORE) and its member companies are working to ensure that legislators also recognize the importance of current federal tax credits in promoting investment in renewable energy projects. Any revision of the tax code should avoid disruption of the renewable energy investment and deployment incentivized by the production and investment tax credits.

As lawmakers weigh the potential impacts of tax reform, our outreach efforts are intended to highlight the enormous changes taking place in what has become one of the nation's fastest growing economic sectors. Renewable energy generation has been the largest source of private sector infrastructure investment in the U.S. over the past six years.³ In 2016, more than \$46 billion was invested to support 21.5 gigawatts of new renewable power generation.⁴ This new investment in power generation is driving economic development, especially in rural areas, harnessing the nation's abundant domestic energy resources and helping achieve environmental objectives.

¹ The White House, Office of the Press Secretary. (2017). *Joint Statement on Tax Reform* [Press Release]. Retrieved from <https://www.whitehouse.gov/the-press-office/2017/07/27/joint-statement-tax-reform>.

² Speaker Paul Ryan. (2016). *A Better Way Tax Policy Paper*. Retrieved from <https://abetterway.speaker.gov/assets/pdf/ABetterWay-Tax-PolicyPaper.pdf>.

³ BlackRock, *The Mainstreaming of Renewable Power: Growth of an Infrastructure Sector*. (2015). Retrieved from <https://www.blackrock.com/au/intermediaries/literature/market-commentary/blackrock-the-mainstreaming-of-renewable-power-en-au.pdf>. (Data from Dealogic shows U.S. renewable investment through year-end 2016 was \$98.5 billion).

⁴ Business Council for Sustainable Energy and Bloomberg New Energy Finance. (2017). *Sustainable Energy in America Factbook*. Retrieved from <http://www.bcse.org/sustainableenergyfactbook/>.

In this paper, ACORE offers key perspectives on tax reform and renewable energy finance, drawn from members in the U.S. Partnership for Renewable Energy Finance (US PREF), a coalition of senior executives that finance, develop, manufacture and use renewable energy.

Recommendations to Promote Renewable Energy Investment

In the context of comprehensive tax reform, we have eight recommendations (covered in more detail in later sections) to promote greater market stability and encourage continued private sector investment in renewable energy infrastructure:

- 1. Maintain continuity of the existing production and investment tax credits included in the multi-year bipartisan tax agreement enacted in 2015;**
- 2. Provide biomass, geothermal, hydro, hydrokinetic and fuel cell technologies, which were excluded from the 2015 tax agreement, parity with the solar tax credits through their phase down;**
- 3. Allow for tax credit transferability, which could increase the efficiency and efficacy of existing tax policy, lower the cost of and expand the amount of available tax equity;**
- 4. Shift from multi-year depreciation to simple expensing, as proposed in the House tax plan, to accelerate depreciation benefits;**
- 5. Ensure smooth, workable transition rules as rates are lowered;**
- 6. Maintain the deductibility of interest expenses;**
- 7. Extend applicability of Master Limited Partnerships (MLPs) tax structures to renewable energy facilities; and,**
- 8. Support renewable energy generation and grid modernization investment as part of a new infrastructure investment initiative, and consider creative and innovative options to leverage private sector infrastructure investment.**

The prospect of changes in the tax code can create market uncertainty that affects finance and development decision-making both economy-wide and in the renewable energy sector. To address this uncertainty, we encourage carefully crafted transition rules for any major changes.

Energy Tax Provisions Remain Essential

Congress reached a bipartisan deal at the end of 2015 on a tax package that extended and ramped down renewable energy tax credits for wind and solar generation, and also lifted the oil export ban. Enactment of this package provided the renewable sector with predictability that has encouraged continuing capital investment.

ACORE's early discussions with key policymakers suggest it is highly unlikely that Congress will eliminate existing energy tax provisions, given the important role tax policy plays in driving private sector investment in energy infrastructure. In the renewable sector, tax credits have helped mobilize nearly \$100 billion⁵ in private sector investment over the past two years, and

⁵ Dealogic data. (2017).

continue to drive expansion of the sector. However, unlike tax provisions supporting conventional energy sources, renewable energy tax credits for wind and solar power are already on a transition schedule, ramping down or sun-setting over the next four to six years. And tax credits for other renewable generation technologies have been allowed to expire.

While tax credits that encourage wind and solar development enjoy strong support, there is still a possibility Congress could look to reduce or eliminate a large number of tax credits, including those for renewable energy, as part of the effort to raise revenue for tax reform.

We believe one of the most important objectives of tax reform should be to continue to incentivize private sector investment in energy infrastructure, where renewables haven't proven to be a top area of investment. Several key members of the tax committees in the House and Senate, both Republicans and Democrats, have expressed support for this perspective – and we continue to emphasize the significance of this objective as the House Ways and Means and Senate Finance committees consider and develop tax reform legislation.

Parity in the Renewable Energy Sector

As referenced above, the 2015 agreement provided critical policy stability for wind and solar power, but failed to include tax credits for other renewable energy technologies, such as geothermal, hydro, biomass and fuel cells. These technologies produce significant amounts of power and provide a number of important grid services with little to no emissions. Any tax reform bill should provide these technologies with the same long-term tax policy stability as was afforded to solar and wind power in the 2015 agreement, thus providing parity among renewable technologies. Given that these other technologies have now faced two years of expired credits, and that the wind credits have already begun to phase down, the additional technologies should be allowed parity with the solar credits through their phase down.

Tax Equity Financing

Tax equity financing plays a critical role in renewable energy finance. Tax equity investors provide capital to projects by monetizing tax credits acquired by renewable energy project developers who lack the tax appetite to use the credits directly, the case with most developers.

Tax and accounting rules for tax equity investments are complex and, along with the need to confidently project tax liability in future years, limit the number of tax equity investors in the market.

While tax equity investors have an ample amount of capital, especially for sizable projects with secure, credit-worthy off takers, it can be difficult or expensive for smaller projects or those with less credit-worthy off takers or unproven sponsors to qualify for needed tax equity. This is a particularly important concern in some underserved residential, commercial and industrial markets. The limited availability of tax equity, and higher cost of this important part of the capital stack, renders some projects uncompetitive, reducing investment and deployment.

Some experts have suggested innovative approaches, especially the transferability of tax credits, to expand the tax equity market and enable tax credits to be used more efficiently.

Modification of tax laws to allow for transferability of renewable energy tax credits would facilitate monetization and lower transaction costs. Ultimately, credit transferability would help

increase renewable energy investment and deployment, fostering a greater economic return for the public's tax dollars. Such a change would reduce the complexity of tax equity investment and attract additional capital providers.

Tax committees have historically been resistant to transferability, but recent discussions with key staff suggest a potential willingness to consider measures that would enhance tax incentive efficiency.

Capital Expense Depreciation and Modified Accelerated Cost Recovery System (MACRS)

Renewable energy developers, like other developers across the economy, use depreciation generated by their investments in projects to defer taxes and provide a greater return on capital investment. Reducing overall corporate tax rates would proportionally reduce the value of depreciation. The House Republican tax reform proposal recommends moving from MACRS to simple expensing, in which capital investments would be expensed in year one rather than depreciated over five years. The move to expensing would accelerate existing depreciation benefits and encourage renewable energy capital investment.

Tax Deductibility of Interest

The House plan would end the deductibility of interest on future loans, while the framework announced in September by the Administration and Congressional leaders suggests that some portion of interest expenses would no longer be deductible. Such an approach would adversely affect capital investment in the power sector, reducing renewable energy development and increasing the cost of renewable energy. Reducing the net interest expense deductions would raise the after-tax cost of debt, and increase the cost of capital for renewable energy projects and other power sector development. To promote continued investment in renewable energy infrastructure, the deductibility of interest should be maintained.

Master Limited Partnerships (MLPs)

Enabling renewable energy facilities to structure as MLPs would make greater amounts of more liquid and lower cost capital available to the sector. Fossil energy and other extraction industries currently qualify for MLP tax treatment while renewable energy power facilities do not. Members of Congress from both parties see MLP policy as successful in driving private sector investment in energy infrastructure, and bipartisan legislation was introduced in the last Congress in both houses to extend applicability to renewable power.

Authors of this legislation are expected to reintroduce the measure in this Congress, as soon as in the next few weeks. Congressional consideration of tax reform may present an opportunity to extend the applicability of MLP tax treatment to renewable power generation. However, renewable energy MLPs will not be able to share tax benefits, such as depreciation and tax credits, with their investors unless Congress also relaxes limitations in the at-risk and passive-loss investment rules, a step which most knowledgeable observers consider highly unlikely.

Infrastructure Investment

Lastly, there is the possibility of a new federal infrastructure initiative influencing a broader tax reform package. Measures to promote private sector investment in electricity and other areas of critical infrastructure are more important than ever to ensure required investment in the modernization and reliable operation of the nation's aging grid and power system. However, much depends on how the program is structured.

On July 19, 2017, the President signed an Executive Order establishing a Presidential Advisory Council on Infrastructure at the Commerce Department to make recommendations on funding, support, and delivery of infrastructure projects in several sectors, including renewable energy generation. However, this group was disbanded a month later along with other Presidential business advisory councils. While there is currently no formal structure devoted to securing industry insights and support on infrastructure issues, ACORE continues to engage with the Trump administration on energy infrastructure related issues.

Notably, an approach first proposed by the Trump campaign, but not necessarily embraced by the administration, creates a new tax credit to promote infrastructure investment. A new infrastructure credit would add an estimated \$180 billion in tax equity demand, potentially straining today's tax equity market. More specifically, the use of tax credits to finance infrastructure investment could exacerbate the tax equity supply-demand imbalance and thwart both infrastructure and renewable energy investment objectives, unless other changes are made to facilitate monetization of tax credits.

Additionally, private lenders are often unable to finance infrastructure projects because they do not directly yield sufficient financeable revenue streams. A further complication is that existing bank regulations limit the tenor of loans to seven to ten years, while longer term loans are typically needed to finance infrastructure projects.

As with other sectors of infrastructure development, public-private partnerships can be effective in driving investment and deployment of critical electricity and renewable energy infrastructure.

ACORE and US PREF members will continue to serve as an important resource for policymakers as they craft tax reform and infrastructure proposals in the days in months ahead.

About US PREF

The U.S. Partnership for Renewable Energy Finance (US PREF) is a coalition of senior-level executives with companies that finance, develop, manufacture and use renewable energy. US PREF members focus on increasing capital formation and investment in renewable energy and educating the public sector to ensure that policy impacts the market as efficiently and effectively as possible. US PREF is a program of the American Council on Renewable Energy (ACORE), a national non-profit organization dedicated to proving value to the renewable energy industry through market development, policy changes, and financial innovation. For more information, visit the [US PREF website](#).