Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

House Tax Reform Plan May Spook Clean Energy Investors

By **Keith Goldberg**

Law360, New York (February 27, 2014, 7:39 PM ET) -- While both the fossil fuel and renewable energy sectors are unhappy with the tax reform proposal unveiled Wednesday by U.S. House Ways and Means Chairman Dave Camp, R-Mich., renewables stand to the lose the most, and experts say even the suggestion of incentive changes will quickly unnerve clean energy investors and alter how project deals are structured.

Camp's sweeping proposal takes dead aim at the energy sector, calling for the scaling back and elimination of a broad swath of tax breaks. Major alterations to the sunset provisions of the renewable production and investment tax credits have the wind and solar industries up in arms, while the oil and gas industry is upset over the proposed elimination of the domestic manufacturing credit and the so-called last-in-first-out accounting principle, which companies use to lower their overall tax bills.

However, Camp's plan, which also eliminates energy efficiency tax credits and credits for electric vehicles, clearly inflicts more pain on renewables than on fossil fuels, experts say.

"It's more of a policy statement," said Phil Tingle, who leads McDermott Will & Emery LLP's energy tax team. "What this says is, We're not going to subsidize alternative power sources. It pushes it to a market environment where you go to the lower-cost fuel, no matter what."

Camp's bill would not revive the production tax credit, which had been a boon for the wind industry but expired at the end of 2013. It also would eliminate the inflation adjustment for projects that have already qualified for the credit — which now stands at 2.3 cents per kilowatt-hour of electricity produced — and restore the credit to a base amount of 1.5 cents per kilowatt-hour.

For wind projects that were just placed into service or began construction before the production tax credit expired, that's quite the retroactive haircut for tax equity investors, which offset their federal tax bills by investing in clean energy.

"A lot of these transactions were established based on PTC rates with the inflation adjuster," Tingle said. "To take away that inflation adjuster is going to put a lot of stress on these existing projects, particularly the lenders, because they're relying on that for repayment in the tax equity deals."

The proposal also changes the standard for beginning construction in order to qualify for the credit, and would overrule Internal Revenue Service guidance issued last year that said developers wouldn't have to show continuous efforts toward construction work to stay eligible for the credit as long as the projects were in service by Jan. 1, 2016.

That's a "huge potential land mine," says Jeff Davis, a Mayer Brown LLP tax partner and co-head of the firm's renewable energy group.

"Even if it isn't enacted, the mere fact that an influential member of Congress has suggested that the IRS safe harbor could be too generous or may be inconsistent with congressional intent could have a chilling effect in the industry," Davis said. "It raises questions about the PTC qualification of a bunch of projects that were started in 2013 but may have taken a break in construction, but still have an eye on being completed by the end of 2015."

The investment tax credit, which primarily benefits the solar industry and is set to expire in 2017, doesn't fare much better under Camp's plan.

Currently, the credit provides an incentive equivalent of up to 30 percent for solar projects that are placed into service by Dec. 31, 2016. The ceiling drops to 10 percent for projects placed into service after that date, but Camp's bill would remove the incentive entirely.

"I think this would effectively eliminate the development of utility-scale solar projects," Tingle said.

While these energy tax reforms won't make it into law anytime soon, if ever, the fact they're out there now is enough to spook potential tax equity investors in renewable projects, and they'll insist their deals contain protections against any potential tax law changes, experts say.

For example, the possible elimination of depreciation rules floated by former Senate Finance Committee Chairman Max Baucus, D-Mont., this fall is already creeping into deals, according to Greg Jenner, a former head of the U.S. Department of the Treasury's Office of Tax Policy who co-chairs Stoel Rives LLP's energy team. Risk-averse tax equity investors may even want deals written so they can walk away in the event of a major tax law change, he said.

"They are going to write in any possible protection they can from changes foreseen and unforeseen," Jenner said. "It makes deals difficult to structure. It also means sponsors are taking on more risk than they expected to."

Renewable developers and their investors will also be watching closely how Camp's plan jibes with the energy tax reform proposal Baucus put out in December, which observers say is somewhat friendlier to renewables. Baucus' plan would compress the existing patchwork of energy tax credits into two broad emissions-based credits for clean electricity and clean transportation fuel.

But Baucus is now U.S. ambassador to China, and Camp's term at the head of the Ways and Means Committee is up at year's end. There's no guarantee that their successors — in Baucus' case, Sen. Ron Wyden, D-Ore., and in Camp's case, unknown — will pick up where they left off.

Combine that with the fact that comprehensive tax reform likely remains several years away, and Jenner believes the renewable sector should focus on more pressing matters, such as a possible resuscitation of the production tax credit and championing a Senate bill introduced earlier this month that would allow solar projects to collect the investment tax credit as long as construction starts before the credit expires.

"It's not that you want to take your eye off tax reform, but given the timeline for reform actually happening, you've got more immediate things to worry about," Jenner said.

Still, Davis says Camp's bill is a warning.

"The industry has to not only worry about fighting for extensions of tax credits and other incentives, but it has to worry about protecting existing incentives and making sure they're not going to be taken away retroactively, or eliminated before the current sunset date," Davis said.

--Editing by Kat Laskowski and Edrienne Su.
