What Energy Sector Should Expect From Biden's Tax Policies

By **Gregory Matlock** (February 8, 2021)

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As the Biden administration takes shape, energy companies will be monitoring potential tax policy initiatives, especially those that could impact the energy sector.

Companies throughout the sector could be treated disparately, depending on how closely the underlying businesses and future aspirations tie to the new administration's focus areas.

Although the incoming administration has put forth bits and pieces on a variety of potential tax reforms and incentives, two focus areas have clearly emerged: a reduction or rollback of certain provisions of the 2017 Tax Cuts and Jobs Act and a focus on clean energy and reducing carbon emissions — while promoting U.S.-based manufacturing.

Policy initiatives, as aspirational concepts, and the ability to affect tax reform are distinct topics; however, taxpayers ought to have an understanding of what is potentially at stake.

General Provisions

Potential changes may vary between the sectors — i.e., oil and gas, mining and metals, power and utilities and renewables — but also may vary between subsectors — i.e., coal production versus precious metals, base metals or other metallic minerals, as discussed in more detail below.

However, many of the potential tax reform changes could have general applicability to companies in the energy sector, including, but not limited to, the following:

- Increase in the corporate tax rate — potentially to 28% from 21%;

- 15% corporate minimum tax on global book income of $100 million or more;

- Changes to the international tax regime, which could include, in part, an increase to the global intangible low-tax income rate to 21% — and potentially to 28% under one proposal, a potential change to a country-by-country analysis, tighter anti-inversion rules, an offshoring penalty and certain other changes; and

- Expiration of certain TCJA provisions. Under the Biden administration, we query whether certain, temporary TCJA provisions will be allowed to expire, including, but not limited to:

- The Internal Revenue Code Section 163(j) limitation on interest moving from an earnings before interest taxes depreciation and amortization, or EBITDA, based limitation to an earnings before interest and taxes-based limitation starting in 2022;[1]
- The current rules for 100% bonus depreciation on certain qualifying expenditures beginning to phase down after 2022;
- Certain research and development expenses being required to amortize over five years — instead of expensed currently — starting in 2022;
- Deductions related to global intangible low-tax income and foreign-derived intangible income being reduced starting in 2026; and
- The base-erosion and anti-abuse tax rate increasing slightly, as scheduled, starting in 2026.

The increase in tax rates — including the addition of a potential corporate minimum tax — coupled with the expiry of certain cost-recovery favorable provisions could lead to an increase in the cost of doing business, which could extend throughout the energy sector.

However, for companies engaged in clean energy-related businesses — or carbon-reducing efforts, such as carbon capture and sequestration — silver linings may exist.

Impacts on Natural Resource-Related Businesses

With a stated goal of moving away from fossil fuel-focused energy sources, the incoming administration has messaged that potential tax changes may be en route for certain natural resource-related businesses.

Specifically, ending fossil fuel incentives has been a stated priority of the incoming administration. Although not expressly defined, the term fossil fuels generally encompasses coal, crude oil and natural gas, among others.

The following provisions, among others, may be at risk, for fossil fuel-related activities:

- The Section 263(c) deduction for intangible drilling and development costs for oil and gas wells;
- The Section 613 allowance for percentage depletion — although query whether any potential change could be limited solely to fossil fuel-related production, as opposed to nonfossil-fuel-related production — that may apply to independent producers of oil or natural gas, royalty owners and nonoil and gas production; and
- The Section 617 — related to certain mining exploration expenditures — and Section 616 — related to certain mining-related development expenditures — deductions, at least with respect to coal-related activities.

Although the Biden administration has expressed a clear preference for cleaner energy, demand for fossil fuels is expected to continue, which will require ongoing investment to maintain market stability.

For nonfossil-fuel-related extractive industries, such as base metals and precious metals, as examples, it is not clear whether any tax reform changes would be specifically tailored to such activities.

Minerals such as steel, aluminum, copper, lithium, cobalt, nickel, rare earths and certain others are necessary for the production of and advancement of numerous clean energy technologies, including renewable energy, electric vehicles and battery technologies, and also play a significant role in increasing U.S. manufacturing capabilities.

Further, aggregates — such as sand, gravel, crushed stone and numerous other particulate materials — are interwoven and symbiotic with increased manufacturing and infrastructure improvements.

Additionally and as a general matter, a potential increase in tax rates, the phase-down of bonus depreciation and the move to an earnings before interest and taxes-based Section 163(j) limitation — from the current EBITDA-based limitation — may not be welcomed with any enthusiasm by natural resource-related companies.

Importantly, however, the phase-down of bonus depreciation and change to an earnings before interest and taxes-based interest deduction limitation will happen as a matter of course, based on existing law.

Although there will no doubt be a focus on innovation to reduce carbon emissions and footprints, minerals and natural resources — and the companies that develop and produce such minerals or resources — are essential to the continued growth of the country.

Companies ought to carefully analyze potential tax changes — along with potential licensing and permitting limitations, implementation of aggressive pollution limits and other nontax measures, or U.S. Environmental Protection Agency or U.S. Department of Energy initiatives — and the attendant impact on the cost of capital and return on investment.

Impacts on Power and Utilities

Both regulated and nonregulated power and utility companies may be impacted by potential tax changes under the Biden administration; however, the impacts of those changes may vary.

For example, an increase in tax rate could cause rate recovery issues for regulated power and utility companies.

When the corporate rate was lowered to 21% from 35% pursuant to the TCJA, benefits related to the lower rate were generally refunded by utilities to their customers.

The flipside, however — where the tax rate increases — may not be so customer-friendly. If an increase in the rate is effected, utilities may charge customers more — although the overall impact of a rate change would need to factor in all attendant tax reform changes.

An increase in the corporate tax rate to 28% — an increase of 7% — as well as the impact of a potential 15% corporate minimum tax, and certain other potential changes, ought to be carefully evaluated by regulated power and utility companies.

Impacts on Renewable Energy

Given the Biden administration's stated focus on a clean energy revolution, historic investment is expected to be sought in clean energy and innovation.

Clean energy efforts have continued to progress over the past couple of administrations, including a number of recent legislative and regulatory developments, such as (1) the recent extension of the solar and wind tax credits,[2] (2) the recent grant of beginning of construction relief for offshore renewable projects and renewable projects on federal land;[3] and (3) the recently released, taxpayer-friendly final regulations on carbon capture and sequestration activities.[4]

The clear, renewable energy focus expected to be supercharged under the Biden administration could be effected through additional tax incentives or provisions related to growth in new or existing clean energy technologies.

Takeaway

Potential tax reform changes require thorough evaluation and diagnosis in order to identify potential opportunities and areas for investment or to refocus holdings and operations. Tax and other policy changes ought to be evaluated in light of the convergence, evolution and transition of the energy industry.

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[1] All "Section" references contained herein are to the Internal Revenue Code of 1986, as amended.

[2] Available at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/12/solar-and-wind-tax-credits-extendedagain_1220_v1.pdf.

[3] Available at https://www.mayerbrown.com/en/perspectives-events/publications/2021/01/irs-grants-beginning-of-construction-relief-for-offshore-renewable-projects-and-renewable-projects-on-federal-land.

[4] Available at https://www.mayerbrown.com/en/perspectives-events/publications/2021/01/irs-issues-final-carbon-capture-regulations.