April 15, 2015

The Honorable John Thune
The Honorable Benjamin L. Cardin
Co-Chairs, Business Tax Reform Working Group
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Dean Heller
The Honorable Michael Bennet
Co-Chairs, Community Development and Infrastructure Tax Reform Working Group
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

Submitted via: Business@finance.senate.gov
CommunityDevelopment@finance.senate.gov

Dear Co-Chairs Thune, Cardin, Heller, and Bennet:

We are an ad hoc group of companies[1] that are involved in every aspect of the development of renewable energy projects throughout the United States. Individually, we design, develop, construct and operate renewable energy projects; and manufacture, in the United States, components for such projects. The tax incentives provided to renewable energy, particularly the renewable production tax credit (PTC) and the solar investment tax credit (ITC), have been the most significant policy drivers of renewable energy deployment in the United States. We understand that the tax reform process will entail an examination of these and other energy tax benefits.

We urge that your tax reform recommendations to the Senate Finance Committee include the continuation of tax incentives for renewable energy. Tax incentives have worked to spur innovation, increase efficiency, and develop a deep domestic manufacturing base for renewable energy. The United States is a leader in renewable energy development and we should work to maintain our leadership role in this crucial industry. The immediate cessation of renewable energy tax incentives will halt the current momentum that is leading renewable energy toward self-sufficiency and will reverse many of the benefits achieved to date, particularly in the research and manufacturing sectors of the renewable energy industry.

[1] Members of the ad hoc group include Apex Clean Energy Holdings, LLC; EDF Renewable Energy; EDP Renewables NA; E.ON North America; Iberdrola Renewables; Invenergy LLC; Pattern Energy Group LP; Terra-Gen Power; and Vestas-America Wind Technology, Inc.

Others, including the American Wind Energy Association and the Solar Energy Industries Association, will provide the working groups with a lengthier dissertation of why tax reform should include tax incentives for renewable energy production, and how those policies could be designed. We would like to associate ourselves generally with those remarks and bring to your attention a lesser-discussed issue related to tax incentives enacted by Congress—the opportunity for taxpayers to actually use the intended benefits in an efficient manner.

The Internal Revenue Code (Code) currently provides a somewhat conflicted approach to most tax incentives, including tax incentives for renewable energy. On the one hand, as noted above, the provisions do provide a useful impetus to motivate taxpayers to conduct research and invest in the deployment of renewable energy. On the other hand, the Code and underlying regulations provide several provisions that bar or limit the use of the tax benefits, significantly reducing the efficiency of the incentives.[2]

Many of these limiting provisions are intended to address "tax shelters," i.e., the perceived abuse of using or creating tax benefits in a manner unintended by Congress. Tax sheltering is not a concern with respect to the PTC because the credit applies to a specifically defined investment (a qualifying renewable energy facility), is only available if the facility produces electricity (which is regulated and easily metered), and must be sold to an unrelated third party (allowing for easy verification). These requirements eliminate the potential for abuse. Since its enactment in 1992, controversy between taxpayers and the IRS regarding tax sheltering allowed by the PTC has been nonexistent. Thus, the additional limitations detailed herein represent unnecessary burdens with respect to PTC utilization, creating inefficiencies that reduce the effectiveness of the incentives.

Moreover, the various limitations have a significant effect on the cost of and structuring for renewable energy projects. Renewable energy developers typically do not have sufficient tax liability to utilize all the PTCs generated by their various projects, and need to enter into tax benefit transfer transactions with partners who have tax appetites. Because of the various restrictions described above and the nature of renewable energy investments, the potential pool of such investors is quite small. Furthermore, because PTCs are spread over a ten-year period, the investor must make the judgment that it will not only have a tax appetite in the year of investment, but for the next decade as well. Investments in renewable energy projects are risky as it is. The investor must take into

[2] These limitations include (1) the taxpayer's need to have sufficient tax liability to use the benefit (so-called "tax appetite"), (2) the alternative minimum tax, (3) the passive loss rules, (4) the at-risk rules, (5) the limitations on carryovers of losses and tax credits, (6) the master limited partnership qualification requirements, (7) the PTC requirement that a renewable energy facility be both owned and operated by the same person, (8) the tax-exempt ownership rules, (9) the partnership allocation rules, and (10) the need to demonstrate the validity and substance underlying any partnership, lease or other transaction involving a tax benefit transfer.

account the strength of the technology, the validity of the wind studies, obligations to mitigate impacts on endangered and threatened species, and the future price and demand for electricity as well as whether the necessary permits are in order, whether the facility met the "start of construction" requirements to be eligible for the PTC, and whether the project will have access to the transmission grid. Adding a tax appetite risk creates further complications, decreases the number of interested investors, and can result in a significant discounting of the value of the credit. This discounting reduces the public benefits Congress intended in providing the tax incentives.

Currently, there are fewer than 20 firms that enter into tax equity transactions with renewable wind energy developers to any significant degree. Structurally, these firms must enter into complicated partnership arrangements with developers to invest in the PTC (see, e.g., Rev. Proc. 2007-65). Various partnership rules restrain the ability to effectively flow through the PTCs to the investor under these arrangements, and raise uncertainty that the investors will be guaranteed a return based on the PTCs. The partnership structures can also cause significant tax and financial accounting issues. A separate partnership generally is needed for each renewable energy project, further increasing transaction costs. In general, even though the partnership structure is the best (and generally only) way for investors to share in PTCs under current tax law, this structure is a costly and inefficient method to transfer tax benefits. The inefficiency of these structures and their high transaction costs mean that a certain amount of the value of the PTCs are "left on the table," and do not operate as Congress intended, i.e., to attract investment in renewable energy and reduce the levelized cost of renewable energy production for consumers.

There is a range of options Congress could adopt to make the tax benefits for renewable energy more efficient and effective. At one end of the spectrum, and perhaps the most efficient approach, is refundability. The original renewable energy tax incentive was refundable (the energy investment tax credit enacted in 1978). Similarly, section 1603 of the American Recovery and Reinvestment Act of 2009 allowed taxpayers, for a limited period, to claim direct payments in lieu of tax credits for renewable energy projects to address the scarcity of tax equity during the economic downturn. Under current law, certain alternative fuel tax credits are refundable. More recently, the Obama Administration has proposed to make the PTC refundable in its fiscal year 2015 and 2016 budget proposals.

Another approach would make the PTC more easily assignable or transferable. There are precedents for assignability. The PTC applicable to certain closed-loop biomass facilities may be claimed by the owner, lessee or operator of the facility. In 2003, the Senate Finance Committee favorably reported a bill (S.1149, the "Energy Tax Incentives Act of 2003") that would have allowed certain tax-exempt owners of renewable energy projects to assign any PTCs to any other person, or use the credits as prepayment to certain loans or obligations undertaken by such owner under the Rural Electrification Act of 1936. The railroad track maintenance credit of Code section 45G allows Class II or Class III railroads eligible for the credit to assign the credit to another Class II or Class III railroad, any person who uses the facilities of a Class II or Class III

railroad, or any person who furnishes railroad-related services to a Class II or Class III railroad. Various States allow tax benefits to be assigned, including renewable energy tax credits.

Finally, modifications could be made to current law to expand the pool of investors for renewable energy projects (e.g., by allowing a master limited partnership (MLP) to hold renewable energy projects and at the same time easing the passive-loss and at-risk rules applicable to renewable MLP and other partnership investors). More modest changes could modify the partnership rules that currently require developers and investors to enter into complicated partnership arrangements to share the benefits of the credit, allow the credit to more fully offset alternative minimum tax liability, expand the carryback and carryforward rules for unused credits, and allow renewable energy facilities to be leased.

We would appreciate the opportunity to discuss these concepts in greater detail with you and your staffs and explore the appropriate changes that could be made to make renewable energy tax incentives more efficient. Increased efficiency could increase the development of more renewable energy projects and could lead to potential cost savings for the government.

Thank you for your attention to this matter. If you have any questions, please contact Joseph Mikrut or Melissa Mueller of Capitol Tax Partners at 202-289-8700.