

# The Need for Direct Payment of Refundable Tax Credits for Public Power

## Summary

Since the 1970s, Congress has used federal tax incentives to encourage certain forms of energy investments in the United States. In more recent years, Congress has expanded and extended such incentives to promote non-emitting energy resources to address climate change. Arguably, tax expenditures are the single most powerful federal tool used to incentivize wind, solar, geothermal, and nuclear power development in the United States. However, most of these incentives do not work for public power utilities, which are, as units of state and local government, exempt from federal taxation. The American Public Power Association (APPA) believes that if Congress has market-wide policy objectives, such as addressing climate change, then tax-based energy incentives should be drafted to accommodate tax-exempt entities, including public power utilities. Congress is considering making such tax credits “refundable” beyond an owner’s tax liability and public power utilities should qualify for these credits. In addition, because this approach is novel, APPA strongly encourages Congress to enlist public power representatives in drafting such proposals to avoid unintended consequences.

## Background

Since the mid-1900s, Congress has incentivized certain types of energy investments and energy production. This has been done through direct federal grants, subsidized loans, and/or loan guarantees, but the most significant incentives have been—and continue to be—provided through the federal tax code. According to the most recent Joint Committee on Taxation estimate, energy-related tax expenditures are worth \$15.1 billion annually.<sup>1</sup> These tax policies began decades ago. Business energy investment tax credits (ITCs) were enacted in 1978 and 1980 to

stimulate the development of “alternative” energy sources and remain in effect today.<sup>2</sup> In 1992, Congress created a production tax credit (PTC) for the production of energy from renewable resources, which also remains in effect today.<sup>3</sup> Combined ITCs and PTCs account for 58 percent of the federal energy-related tax-expenditure budget.<sup>4</sup>

These tax credits are not intended to provide generalized relief from an owners’ tax liability, but to encourage investments in renewable energy by reducing the financial cost of the investment. However, tax-exempt entities, including public power utilities, cannot directly benefit from either the ITC or PTC for a facility that they own.<sup>5</sup> Some entities with little to no tax liability do jointly own qualifying facilities with a “tax equity” partner whose sole role is to monetize an ITC or PTC. However, a public power utility cannot feasibly enter this sort of “partnership flip” transaction.<sup>6</sup> Public power utilities can indirectly benefit from such credits by entering long-term power-purchase agreements with taxable entities that can claim these credits. However, the transactional costs of such agreements can be high. Additionally, only a portion of the value of the tax credit is generally considered to be passed on to the purchaser, thus muting the incentive effect.

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2 Energy Tax Act, Pub. L. 96-618, 92 Stat. 1374; Crude Oil Windfall Profits Tax Act Pub. L. 96-223, 94 Stat. 229 (codified as 26 U.S.C. 48).

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3 Energy Policy Act of 1992, Pub.L. 102-486 § 1914 (codified as 26 U.S.C. 45).

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4 Most of the remaining 42 percent is largely attributable to the electric vehicle tax credit, residential tax credits, and credits, depreciation provisions, and deductions related to fossil fuel extraction and transmission.

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5 Other energy-related tax expenditures generally do not directly apply to an electric power utility and so are not an issue here.

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6 Even the partnership flip has significant limitations, including substantial transaction costs, making it economically viable for only large projects (in the range of \$50–\$200 million); see, Nat’l Rural Elec. Coop. Ass’n, Cooperative Utility PV Field Manual: Volume I: Business Models and Financing Options for Utility-Scale Solar PV Installations (2015), at 51.

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1 Jt. Comm. on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2020–2024 (JCX-23-209) (Nov. 5, 2020).

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These costs and limitations are problematic in that tax-exempt entities serve a substantial percentage of the nation's retail electric customers (15 percent by public power and 12 percent by rural electric cooperatives). Additionally, omitting tax-exempt entities from energy-related tax incentives makes it more costly for public power utilities to make investments in renewable and other non-emitting resources and clean energy technologies that will be needed to reduce greenhouse gas emissions to address climate change. This is a significant shortcoming if Congress is seeking market-wide changes in energy-related investment and production decisions.

### Comparable Incentives

Over the last several decades, Congress has tried numerous methods of addressing these problems. In 1992, Congress authorized Renewable Energy Production Incentives (REPI) for public power and cooperative utilities, which sought to provide direct payments comparable to the PTC earned by taxable entities. However, during the 15 years in which REPI funds were appropriated, public power utilities and rural electric cooperatives qualified for \$329 million in REPI payments, but Congress only appropriated \$54 million. After 2009, Congress stopped appropriating funds for REPI entirely.

In the Energy Policy Act of 2005 (EPA05),<sup>7</sup> Congress sought to provide an investment incentive for certain tax-exempt entities akin to the ITC by creating the Clean Renewable Energy Bond (CREB). Qualified CREB issuers included public power utilities, states and localities, and rural electric cooperatives. Interest paid on a CREB is taxable, but the CREB holder receives a tax credit. However, tax credit bonds are quite complex, and issuers had a difficult time finding willing buyers. As a result, in 2010, Congress modified CREBs (now called New CREBs) to allow issuers the option of receiving a direct payment from Treasury in lieu of providing bond holders a tax credit.<sup>8</sup> CREBs and New CREBs were hamstrung by an overall volume limit, which was initially set at \$800 million, but eventually increased to \$2.4 billion.<sup>9</sup> This limit was problematic in that allocating volume was time consuming and burdensome both for issuers and the Internal Revenue Service (IRS). The limit was also substantially lower than needed to meet demand. For example, in 2009, the

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<sup>7</sup> Energy Policy Act of 2005, Pub. L. 109-58 § 1303 (codified as 26 U.S.C. 54).

<sup>8</sup> Hiring Incentives to Restore Employment Act of 2010, Pub. L. 111-147, 124 Stat. 71.

<sup>9</sup> American Recovery and Reinvestment Act of 2009, Pub. L. 111-5, 123 Stat. 115.

IRS received 38 applications from public power utilities requesting a total of \$1.45 billion in New CREB bond volume, but just \$800 million of bond volume was available for public power.<sup>10</sup> New CREBs issued as direct payment bonds were further handicapped by budget sequestration—across-the-board cuts applying to all mandatory spending, including payments to issuers of direct payments bonds. Finally, in 2017, Congress prohibited the issuance of any additional New CREBs as part of the Tax Cuts and Jobs Act.<sup>11</sup>

In some instances, Congress has allowed for the transfer of tax benefits from tax-exempt entities to taxable entities. For example, in EPA05, Congress expanded on existing tax preferences for clean-fuel motor vehicles by creating a tax credit for the purchase of an alternative fuel vehicle, including hybrid vehicles.<sup>12</sup> Under the statute, if the purchaser is a tax-exempt entity, the tax credit automatically transfers back to the vehicle's seller. Identical language was included in 2008, when Congress provided a tax credit for plug-in electric drive motor vehicles.<sup>13</sup>

In 2018, Congress modified two existing ITCs (one for carbon capture and sequestration, the other for advanced nuclear facilities) to allow for transferability.<sup>14</sup> Now the carbon capture and sequestration tax credit can be transferred from the purchaser of the carbon capture facility to the person that disposes of the carbon dioxide (CO<sub>2</sub>), uses the CO<sub>2</sub>, or uses the CO<sub>2</sub> as a tertiary injectant. Similarly, the advanced nuclear tax credit now can be transferred to another “eligible project partner.” These policy changes put public power utilities on a more level-playing field with other electricity providers and allow them to make investments in technologies and projects that will reduce CO<sub>2</sub> emissions.

### Congressional Action

House Ways & Means Committee Democrats—led by Subcommittee on Select Revenue Chairman Mike Thompson (D-CA)—have taken a different approach in trying to address the issue

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<sup>10</sup> Internal Revenue Service “IRS Announces New Clean Renewable Energy Bonds Allocations” (Oct. 27, 2009) (<https://www.irs.gov/tax-exempt-bonds/irs-announces-new-clean-renewable-energy-bonds-allocations-0>) (last visited Jan. 17, 2020).

<sup>11</sup> Pub. L. 115-97, 131 Stat. 2054.

<sup>12</sup> Energy Policy Act of 2005, *supra* note 3.

<sup>13</sup> Emergency Economic Stabilization Act of 2008, Pub. L. 110-343, 122 Stat. 3765.

<sup>14</sup> Bipartisan Budget Act of 2018, Pub. L. 115-123, 132 Stat. 63.

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of the lack of value of energy tax credits to entities with little or no income tax liability. In February 2021, they reintroduced H.R. 848, the Growing Renewable Energy and Efficiency Now (GREEN) Act. Originally introduced in the 116th Congress, this bill would revise various investment and production tax credits and make them available to for-profit companies with little to no tax liability and to tax-exempt entities, equally. The provision would work like the earned income tax credit in that these tax credits would be refundable beyond the amount of income taxes actually paid. (This approach is increasingly referred to as “direct pay,” although it has no relation to direct payment bonds discussed above.) In practice, this would mean that a qualified investor with little to no income taxes against which to offset a tax credit could elect to receive a direct payment equal to the value of the tax credit for which the project would otherwise qualify. Projects financed with tax-exempt bonds would receive 85 percent of the value of the credit. In May 2021, Ways & Means Committee member Earl Blumenauer (D-OR) introduced H.R. 3180, the Renewable Energy Investment Act, which is more narrowly focused on allowing for direct payment of the renewable electricity production tax credit and the energy investment tax credit.

The text of the GREEN Act was included in H.R. 5376, the Build Back Better Act, which passed the House in November 2021 on a party-line 217-205 vote. Additionally, in May 2021, the Senate Finance Committee approved a bill authored by Chairman Ron Wyden (D-OR), S. 1298, the Clean Energy for America Act. The legislation would replace existing ITCs and PTCs with a technology-neutral tax credit, allow for-profit companies to elect to receive tax credits as direct payments, and thanks to a successful amendment offered by Senator Michael Bennet (D-CO), give public power utilities, rural electric cooperatives, and Indian tribal governments the same access to direct payment of tax credits. The bill is now awaiting consideration by the full Senate. The House-passed Build Back Better Act incorporates elements of the CEA—generally expanding and modifying tax credits in the near-term as under the GREEN Act, then transitioning to the CEA’s “tech-neutral” approach in later years. Finally, in December 2021, Chairman Wyden released his committee’s version of the tax title to H.R. 5376 which largely tracks the House-passed bill, including the provision on refundable direct payment tax credits. The legislation remains pending in the Senate.

In March 2021, Senator Tina Smith introduced the “Carbon Capture, Utilization, and Storage Tax Credit Amendments Act of 2021.” The bill would amend the current law carbon capture tax credit, including by allowing the credit to not just be transferable, but also to be claimed as a refundable direct pay tax credit. The measure has 19 cosponsors, including 12 Democrats and seven Republicans.

In June 2021, House Ways & Means Committee member Tom Reed (R-NY) and Senate Finance Committee Ranking Republican Mike Crapo (R-ID) introduced the Energy Sector Innovation Credit Act (H.R. 4720/S. 2475). The bill also seeks to provide a technology neutral approach to incentivizing energy production and to provide better benefit of these credits to tax-exempt entities. However, rather than providing this new credit as a refundable direct payment tax credit, it would allow project owners—including tax-exempt entities—to transfer the value of the credit to other project partners.

### APPA Position

APPA believes that if Congress intends to create incentives in pursuit of national energy and climate goals, it should realize that tax-based incentives will not have the market-wide reach of direct grants and other incentives. As a result, the association believes that tax-based incentives should be drafted to accommodate tax-exempt entities, including public power utilities. New CREBs and tax credit transferability provide good examples of how comparable incentives can make targeted investments economically viable for public power utilities. However, they both come with significant drawbacks. As such, APPA strongly supports the refundable direct pay approach taken under the GREEN Act, the Clean Energy for America Act, the Build Back Better Act, and the Carbon Capture, Utilization, and Storage Tax Credit Amendments Act. This approach also benefits from being supported by stakeholders across the utility sector.

APPA also applauds Senator Crapo and Representative Reed for their efforts to provide better benefit of energy tax credits to tax-exempt entities through tax credit transferability. Finally, while examples of comparable incentives already exist in the income tax code, the tax code also includes a variety of provisions which can result in unintended consequences for the transfer or direct payment of tax credits. As a result, APPA strongly encourages lawmakers to enlist public power representatives when drafting such proposals to ensure that they work as intended.

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The American Public Power Association is the voice of not-for-profit, community-owned utilities that power 2,000 towns and cities nationwide. We represent public power before the federal government to protect the interests of the more than 49 million people that public power utilities serve, and the 96,000 people they employ. Our association advocates and advises on electricity policy, technology, trends, training, and operations. Our members strengthen their communities by providing superior service, engaging citizens, and instilling pride in community-owned power.