

The Need for Comparable Incentives 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 such 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. This could include amending current laws to allow the transfer of such tax benefits to others, to make tax credits “refundable” beyond the amount of taxes paid, or to allow the issuance of special purpose municipal bonds to finance qualifying facilities. While examples of such proposals already exist in the tax code, APPA strongly encourages Congress to enlist public power in drafting new proposals to avoid unintended consequences.

Background

Congress routinely seeks to incentivize certain types of energy investments and energy production. Sometimes this is done through direct federal grants, subsidized loans, and/or loan guarantees, but the most significant incentives are provided through the federal tax code. According to the most recent Joint Committee on Taxation estimate, energy-related tax expenditures were worth \$11 billion to project developers in 2019 alone.¹

1 Jt. Comm. on Taxation, “Estimates of Federal Tax Expenditures for Fiscal Years 2019-2023,” JCS-55-19 (Dec. 18, 2019).

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).

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

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.² In 1992, Congress created a production tax credit (PTC) for the production of energy from renewable resources, which also remains in effect today.³ Combined ITCs and PTCs account for 58 percent of the federal energy-related tax-expenditure budget.⁴

However, tax-exempt entities, including public power utilities, cannot directly benefit from either the ITC or PTC.⁵ Likewise, a public power utility cannot feasibly enter the sort of “partnership flip” transaction that electric cooperatives can use to indirectly access the ITC or PTC.⁶ Public power utilities can indirectly benefit from such credits by entering long-term power-purchase agreements with taxable entities that can benefit from the 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.

These costs and limitations are problematic in that tax-exempt entities serve a substantial percentage of the nation’s retail electric customers (14.4 percent by public power and 13.0 percent by rural electric cooperatives). Omitting tax-exempt entities from energy-related tax incentives makes it more costly for public power utilities to make investments in renewable resources 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.

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.

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

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.

Comparable Incentives

Over the last several decades, Congress has tried several 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 during which REPI funds were appropriated, public power utilities and rural electric cooperatives qualified for \$329 million in REPI payments, but Congress appropriated just \$54 million. After 2009, Congress stopped appropriating funds for REPI entirely.

In the Energy Policy Act of 2005 (EPAct05),⁷ 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.⁸ 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.⁹ 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 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.¹⁰ 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.¹¹

In some instances, Congress has allowed for the transfer of tax benefits from tax-exempt entities to taxable entities.

For example, in EPAct05, 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.¹² 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.¹³

In 2018, Congress modified two existing ITCs (one for carbon capture and sequestration, the other for advanced nuclear facilities) to allow for transferability.¹⁴ 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 (CO₂), uses the CO₂, or uses the CO₂ 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 level-playing field with other electricity providers and allow them to make investments in technologies and projects that will reduce CO₂ emissions.

There are many examples in the existing income tax code of how to accommodate tax-exempt entities when using the tax code to incentivize energy-related activities. However, the tax code also includes a variety of provisions which can make this conversion difficult or result in unintended consequences. For example, while a governmental entity can qualify for the PTC—it just has no tax liability against which to offset the credit—the tax code states specifically that no ITC will accrue to a government-owned project.¹⁵ As a result, it is not uncommon for legislation intended to accommodate public power to need further clarification or amendment to overcome these unseen hurdles.

Congressional Action

In recent years, lawmakers have looked to these past examples as inspiration for future legislation. For example, on May 14, 2019, Representatives Earl Blumenauer (D-OR) and Darin LaHood (R-IL) joined in introducing H.R. 2704, the Renewable Energy Transferability Act, which would have allowed for transfers of the renewable electricity production credit and the energy investment tax credit to project partners. Senator

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

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

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

10 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).

11 Pub. L. 115-97, 131 Stat. 2054.

12 Energy Policy Act of 2005, *supra* note 3.

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

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

15 26 U.S.C. 50(b)(4).

Michael Bennet (D-CO) introduced nearly identical language in the Senate on December 13, 2019. Senator Ron Wyden (D-OR) introduced S. 1288, the Clean Energy for America Act of 2019, which would have replaced existing ITCs and PTCs with a technology-neutral tax credit. The tax credit could not be transferred, but public power utilities could issue Clean Energy Bonds (CEBs) for comparable investments. Akin to New CREBs, CEBs could be issued as either tax credit or direct payment bonds. The credit to bondholders and credit payment to bond issuers would equal up to 70 percent of interest paid on the bond—roughly equivalent in economic benefit to the up-front 30-percent tax credit provided to taxable entities. Unlike New CREBs, there would be no limit on the volume of CEBs that could be issued.

Taking a different approach is a proposal by House Ways & Means Committee Democrats—led by Subcommittee on Select Revenue Chairman Mike Thompson (D-CA). The Growing Renewable Energy and Efficiency Now (GREEN) Act (H.R. 7330) would have revised various investment and production tax credits and made them available to tax-exempt entities. The provision would have worked 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 direct relation to direct payment bonds discussed above.) In practice, this would mean that a qualified investor who did not have income taxes against which to offset a tax credit could elect to receive a direct payment equal to 85 percent of the value of the tax credit for which the project would otherwise qualify. Tribal governments would receive the full value of the credit. The text of the GREEN Act was included, in full, in H.R. 2, the Moving Forward Act, which passed the House on July 1, 2020. Further action on these bills was not taken in the 116th Congress, but they could be reintroduced in the 117th Congress.

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 transferability both provide good examples of how comparable incentives can make targeted investments economically viable.

Tax credit refundability also has significant strengths, including simplicity and fairness. APPA strongly supports the approach taken under the GREEN Act and included in the Moving Forward Act. This approach also benefits from being supported by stakeholders across the utility sector. APPA strongly urges Congress to pass legislation providing tax credit refundability.

Finally, as discussed above, 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 new proposals. As a result, APPA strongly encourages lawmakers to enlist public power when drafting such proposals to ensure that these proposals 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 93,000 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.