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Senate Finance Committee Proposes Overhaul of Clean Energy Tax Provisions

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Today Senate Finance Committee Chairman Max Baucus (D-MT) released a staff discussion draft that proposes significant changes to the current tax regime for clean energy and energy efficiency technologies. This draft is one in a series of papers the Chairman has released in the last few weeks as he attempts to build momentum for comprehensive tax reform. Previous discussion drafts have proposed streamlining and lengthening depreciation schedules for various energy properties and eliminating the “last-in, first-out” accounting method for oil and gas.

This latest discussion draft contemplates eliminating and consolidating 42 energy tax expenditures into **two (2) tax credit programs** that cover 70% of the U.S. energy economy: (1) electricity generation, and (2) transportation fuels.

The Chairman aims to take the existing set of 42 energy tax expenditures–27 of which expire at the end of 2013 and would cost $150 billion over 10 years to extend–, eliminate provisions that he thinks do not work, consolidate ones that do not work so well, and tie the two remaining programs to a long-term goal emissions reduction goal to provide policy certainty.

The Chairman’s proposal provides incentives based on outcomes—the reduction of greenhouse gas (GHG) emissions in electricity generation and transportation fuel—rather than by technology. All clean energy technologies face the same phase-out trigger, when U.S. GHG emissions have fallen by 25 % compared with 2013 emissions, rather than an arbitrary date that varies by technology. Energy efficiency credits are a casualty under this proposal. If adopted, the plan would continue incentives for both onshore and offshore wind, but it also would allow new nuclear generation and certain investments in carbon capture and sequestration to qualify.

The following provides an overview of the proposal:

1. ELECTRICITY TAX CREDIT PROGRAM

a. Premise: Technology-neutral, performance-based tax credits based on existing investment tax credit (ITC) and production tax credit (PTC).

b. Impact on existing PTC / ITC: The Chairman proposes extending current ITCs and PTCs to 2016, giving two (2) years to transition to new program, AND eliminate “commence construction” language for PTC.

c. New Program: Beginning in 2017, taxpayers can either elect at 20% ITC or 10-Year, 2.23 c/kWh PTC (adjusted for inflation) for technologies that meet the credits’ definition of “clean”.

d. Eligibility:

1. Technologies that are 25% “cleaner” than the average emissions of the 2013 generating fleet will qualify.
2. Definition of “Clean”: Extent to which site (not source) emissions fall below the average CO_2 emissions of a natural gas facility, which is 372g CO_2e / kWh.

e. Credit amount: Sliding scale based on how much a technologies’ emission profile falls below the fleet average, as determined by EPA eGrid data. The cleaner the technology, the more of a credit it will obtain.

1. Non-biomass Renewables: Full PTC / ITC credit because they have no emissions.
2. Nuclear: Full PTC / ITC credit.
3. Storage: None. Only generating assets would qualify.
4. CCS: Retrofits & New Construction:

a. Retrofits: 20% ITC for retrofitting existing facilities so long as over 50% of CO_2 is captured. This is not a sliding scale. If you capture 50% or 90%, you still only get 20% tax credit.

b. New Facilities with CCS: Fall under new eligibility system, where credit is based on total emissions of the facility.

5. Other Technologies: Co-Firing / Biomass, etc.

a. Any technology that produces fewer emissions than the 2013 average fleet will be awarded credits in proportion to how much “cleaner” they are.

b. EPA will determine non-renewable technologies “net emissions” by January 2017 for technologies whose emissions data is unknown. Biomass will be case-by-case based on feedstock and technology.

c. For example, a co-fired coal / biomass power plant with CHP would qualify for the new PTC / ITC.

f. Phase-Out:

1. Once DOE has determined that aggregate U.S. GHG emissions have been reduced by 25% as compared to a 2013 baseline, the credit program begins a four (4) year phase out.
2. Year One (1) after determination: 75% of credit
3. Year Two (2): 50% of credit
4. Year Three (3): 25% of credit
5. Year Four (4): Zero.

2. TRANSPORTATION FUELS PROGRAM

a. Eligible Fuels: Includes both liquid biofuels and compressed natural gas or biogas.

b. Eligibility:

1. Threshold: To be eligible for the tax credit a fuel must be 25% “cleaner” than traditional gasoline based on EPA Renewable Fuels Standard life-cycle emissions analysis of fuels.
2. Baseline: Corn ethanol produced by plant using natural gas.
3. Determination: EPA must provide preliminary ruling one (1) year after a technology makes an application to EPA for the credit, and agency must make a final determination within two (2) years of the application for eligibility.

c. Credit:

1. Type: ITC of up to 20% or PTC of up to $1 per gallon for 10 years.
2. Calculation: [$1] * [Emissions Rate] * [BTU]
3. PTC Alignment: Unlike existing biofuel PTC in which eligibility is based solely as to whether fuels are produced in a year credit is available, new scheme envisions producers gets ten (10) years of credit no matter when they are placed in service.
4. Energy Content Adjustment: Different fuels will be adjusted based on emissions profile AND energy content on a BTU basis. For example, Cellulosic Diesel using Fischer-Tropsch: High energy content, lower emissions. Get 14% ITC or 67/c PTC.

d. Transition and Phase Out:

1. Certain current renewable fuel credits would be extended through 2016 so that new regime can commence Jan. 1, 2017.
2. Once DOE makes a determination that overall transportation supply is 25% cleaner than 2013 supply, policy starts to phase out over four (4) years just like the new electricity tax credit.

3. ERRATA:

a. Legislative Scoring:

1. Cost to extend all 42 existing tax credits through 2016: $150 billion
2. New energy tax credits post-2016 score less than $75 billion annually.

b. Master Limited Partnerships (MLPs): MLPs are not included in discussion draft because they deal with partnership tax law and are not specific to energy. The Chairman may issue a future discussion draft focusing on partnership treatment and MLPs.

c. Energy Efficiency:

1. The Chairman wants to eliminate various energy efficiency provisions based on concerns of fraud and the constant requirement to adjust as technologies become more and more efficient.
2. They are, however, requesting comments.

These documents released today constitute a draft, but they are not a final proposal. The committee will be soliciting comments as they continue to craft tax reform concepts. As the window for comprehensive tax reform shrinks heading into 2014, Congress may vote to extend a package of expiring tax provisions before it tackles a comprehensive reform like the Chairman's.

Furthermore, this energy tax reform proposal will not advance legislatively alone; its fate is tied to that of other tax reform proposals the committee is considering. While Chairman Baucus and House Ways and Means Chairman Dave Camp (R-MI) remain committed to enacting the first comprehensive tax reform in a generation, the upcoming election makes the outcome far from certain. Senators will be reluctant to take an important and difficult vote on taxes late in the year. Nevertheless, even if this clean energy proposal does not reach the Senate floor for a vote in 2014, it will influence the committee's thinking as it puts together tax reform legislation under either Chairman Baucus or the potential next Chair, Sen. Ron Wyden. When the Congress passed the last tax extender package in early January 2013, it adopted legislative language from a Senate markup held six months prior. The proposal is the result of deliberate consideration, and the lack of an immediate path to enactment does not preclude the proposal from becoming law in a similar form at a future date.

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