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The GOP's Tax Cuts and Jobs Act Includes Changes Impacting the Renewable Energy Industry

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On November 3rd, House Ways and Means Committee Chairman Kevin Brady (R. Tex.) released the "chairman's mark" to H.R. 1, the "Tax Cuts and Jobs Act" (TCJA). The TCJA represents the most extensive rewrite of the Internal Revenue Code in the last 30 years. The Ways and Means Committee is expected to begin reviewing the TCJA in the coming days with the intention of sending it to the House for a vote before the Thanksgiving recess. The Senate Finance Committee is expected to release its draft of tax reform legislation during the coming week.

While we believe it is unlikely that the TCJA will become law in its current form, the proposed legislation certainly creates both concerns and relief for the renewable energy industry. We note the following:

PTC

For wind developers and investors, proposed changes to the production tax credit (PTC) will understandably mobilize industry participants, as is reflected in AWEA's recent press release.

The TCJA would repeal the inflation adjustment for electricity produced at wind projects that begin construction after the bill is enacted. This would result in reducing the PTC by roughly one-third from the 2017 level of 2.4¢/kWh to the original 1.5¢ base amount of the credit for the 10-year PTC production period. This reduction may lead some developers to take the 30% ITC in lieu of the reduced PTC for projects going forward.

Based on the relatively light touch the TCJA made to the investment tax credit (ITC) as described below and the bi-partisan agreement to extend the PTC at the end of 2015 under the "Protecting Americans from Tax Hikes Act" (PATH Act), we are surprised with this change and view it as an attack on wind. We're hopeful this will be removed as the bill moves forward or perhaps modified to freeze the PTC at the current 2.4¢ level. That seems more consistent with other changes included in the proposed legislation. In any case, it is safe to assume that this will be the subject of many discussions with Rep. Brady and his staff and may be addressed differently when the Senate releases its proposed bill.

Another notable change included in the TCJA relates to PTC eligibility (and the amount of PTC available). Under current law, PTC eligibility depends on the date that construction of the project begins. For example, to qualify for 100% PTC, construction must have started on the project prior to 2017. Proposed changes in the TCJA would include an additional requirement that construction of any project would not be treated as beginning unless there is a "continuous program of construction which begins before such date and ends on the date such property is placed in service." This concept mirrors the language used by the IRS in Notice 2013-29, the first of many notices issued by the IRS to provide guidance to taxpayers regarding PTC eligibility following the Path Act.

We believe the proposed change made in the TCJA regarding PTC eligibility is intended to align the law with the IRS guidance; however, if it is not and is intended to override the guidance, it potentially raises significant issues for many projects currently under construction. Because of the historic sensitivity surrounding PTC start of construction requirements, we expect that clarification will be needed as to whether Notice 2013-29 and the tests set forth thereunder (including the safe harbor in Notice 2016-31, that if a project is placed in service within four years of the date construction begins it will be deemed to satisfy the continuous construction requirement) would remain effective under the TCJA. Such clarification could take the form of additional IRS guidance or could be included in the legislative history. Until this clarification is made, we expect the proposed changes included in the TCJA will create uncertainty in the wind market and chill wind development and investment. Another point of confusion is whether developers that commenced construction by incurring at least 5% of the project's cost must now engage in actual ongoing physical construction of the project up until the date that it is placed in service as opposed to just engaging in "continuous efforts" as provided in the IRS guidance which can be satisfied by entering into and paying contracts or obtaining permits. What is particularly troubling about the continuous program of construction requirement in the TCJA is that it applies retroactively to all projects that have not been placed in service as of the date of enactment and that it also applies to solar projects qualifying for the ITC.

ITC

As compared to the PTC, the proposed changes impacting the ITC seem relatively minor on their face. In fact, for developers of "orphaned technologies," the TCJA provides a welcome respite after being left in the cold in 2015 by the PATH Act.

Under the PATH Act, not all technologies eligible for ITC got the benefit of the extension enjoyed by the solar and geothermal industries. The TCJA would remedy this by extending the 30% ITC to these orphaned technologies (*e.g.*, fiber optic solar, fuel cell, small wind, micro turbine, CHP, and thermal energy) if construction begins before 2020, and phased out using the same schedule applicable for solar energy property (30% if construction begins prior to 2019, 26% if construction begins prior to 2020, and 22% if construction begins prior to 2021).

The PATH Act extended the 30% ITC for both solar energy property and geothermal property, with phase-downs over time to 10% for any project which begins construction after 2022 (or prior to 2022 but is not placed in service before 2024). Not wholly unexpected, the TCJA eliminates the ITC in its entirety if construction of such property starts after 2027.

Bonus Depreciation

The TCJA would increase bonus depreciation to 100%, effective for property acquired and placed in service after September 27, 2017 and before January 1, 2023.

The TCJA would eliminate the requirement that the property be “original use” (*i.e.*, new) property in the hands of the taxpayer to qualify for bonus depreciation.

Under a transition rule, the TCJA would provide a taxpayer the ability to elect to apply the prior law for its first taxable year ending after September 27, 2017, and thus avoid 100% expensing for that first taxable year.

As a carryover from current law, the TCJA would permit a taxpayer to elect out of bonus depreciation.

Corporate Tax Rates

The TCJA would lower the highest corporate tax rate from 35% to 20%. The reduction would begin for tax years commencing after 2017.

Conclusion

The TCJA contains sweeping proposals overhauling individual, business and international taxation to provide a $1.5 trillion dollar tax cut over ten years. It would reduce the highest marginal corporate tax rate to 20% and contains provisions that, if enacted as proposed, could have a negative effect on the wind industry. As currently drafted, it is primarily neutral as regards to solar and has a positive effect on other “orphaned” ITC property. However, it is unlikely to be enacted in its current form and the fact that it does not harm certain industries today does not mean that they are safe going forward as additional offsets may be needed to support the tax cuts. We will continue to monitor the legislation closely.

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