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# Tax Group Client Alert:

## Rep. Camp's Proposal Would Affect Tax Benefits for Renewable Energy Property

On February 26, 2014, a discussion draft of the Tax Reform Act of 2014 ("TRA") was released by House Ways and Means Committee Chairman Dave Camp. The TRA, if enacted, would make significant changes to the Internal Revenue Code affecting individuals and business, including reducing the maximum marginal rate of tax generally applicable to corporations to 25%. This client alert discusses the three provisions in the TRA that, in addition to the corporate rate reduction, will have the greatest impact on the financing of renewable energy projects: (1) the reduction commencing in 2015 in the amount of production tax credits ("PTCs") available in respect of all eligible property, regardless of when placed in service, (2) the repeal of the investment tax credit ("ITC") for energy property placed in service after December 31, 2016, and (3) the imposition of a new depreciation regime for all property placed in service after December 31, 2016. Although we believe these changes are unlikely to be enacted in this calendar year, and may never be enacted, they are an ominous precursor to the legislative efforts to renew the existing benefits available for renewable energy property, particularly the PTC, which has expired except in the case of property that satisfied the 2013 began construction requirement.

### PHASE-OUT OF THE PRODUCTION TAX CREDIT

The TRA would repeal the inflation adjustment and phase-out the PTC. Under section 45 of the Code,[1] a taxpayer may claim a PTC for the sale of electricity to an unrelated party if the electricity is produced at a qualified facility for a 10-year period, starting when the facility is placed in service.[2] The base amount of the credit is 1.5 cents per kilowatt-hour; however, the inflation adjustment factor has allowed this amount to increase to 2.3 cents per kilowatt-hour for energy generated by wind, geothermal and closed-loop biomass facilities. Under the TRA, electricity produced and sold by a

[1] All section references are to the Internal Revenue Code of 1986, as amended (the "Code" or "I.R.C.").

[2] I.R.C. §45(a).

qualified facility would only be eligible for a PTC equal to 1.5 cents per kilowatt-hour. The 1.5 cents per kilowatt-hour rate would apply to all PTCs after December 31, 2014.

In addition, under the TRA, PTCs would no longer be available after December 31, 2024. In other words, for those projects construction of which began in 2013 that are not completed this year, the period during which PTCs can be claimed would be less than 10 years.

Finally, the TRA would codify the requirement, expressed previously only in IRS guidance, that property not placed in service before January 1, 2014 will be eligible for PTCs only if construction commenced before January 1, 2014 and there is a continuous program of construction thereafter until the property is placed in service.

### REPEAL OF THE INVESTMENT TAX CREDIT

Under section 48(a), a taxpayer may claim an ITC for energy property placed in service during the tax year. For solar energy property, the ITC equals 30% of the basis of the energy property (this amount was scheduled to be reduced to 10% for property placed in service after December 31, 2016). For other types of energy property, the ITC equals 10% of the basis of the energy property. The TRA would repeal the ITC for all energy property placed in service after December 31, 2016.

### REFORM OF THE ACCELERATED COST RECOVERY SYSTEM

Under the modified accelerated cost recovery system ("MACRS"), most renewable energy property is eligible for five-year, two hundred percent declining balance depreciation deductions. The TRA would repeal the use of MACRS, and replace it with a system that is similar to the alternative depreciation system ("ADS"). Under the TRA, recovery periods would be determined by a new schedule developed to have class lives more closely aligned with the true economic life of the property in the various classes. The Treasury Department, in conjunction with the Bureau of Economic Analysis, would develop this new schedule of economic depreciation and submit a report to Congress detailing the new schedule by December 31, 2017. Under current law, in those circumstances when the ADS is applicable to renewable energy property (e.g., when the property is leased to a tax-exempt entity), the allowable depreciation is straight-line over twelve years. Although only speculation at this time, it is possible that twelve years would be the new class life for renewable energy property under the new schedules to be proposed by Treasury.

Under the TRA, only the straight–line method would be applied to determine the amount of depreciation. In addition, as an offset to the effects of inflation, taxpayers could elect to claim an additional depreciation deduction. The additional deduction would be based on the taxpayer's modified adjusted basis in the property at year-end multiplied by the cost of living adjustment as determined using the Consumer Price Index for the preceding calendar year.

The depreciation method proposed under the TRA would be effective for all property placed in service after December 31, 2016.

## CONCLUSION

The proposed changes under the TRA, besides the reduction in the PTC, would not apply prior to January 1, 2017. However, the proposals conflict with the energy agenda proposed by U.S. Senate Committee on Finance Chairman Max Baucus on December 18, 2013, and are unlikely to be acted upon in this calendar year. Even if enacted in the future, these provisions would likely be further revised and, regardless of the form they take, there will be concerted efforts by industry participants to grandfather property already placed in service or for which construction has begun or binding contracts have been entered into.

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