Adopt Key Tax Provisions in the Build Back Better Act – Support Comparable Incentives/Direct Payment Bonds and Restore Advance Refunding for Tax-Exempt Bonds

March 2022

Need

In order to ensure full-market incentives for investing in clean energy and renewable resources, Congress should: (1) adopt comparable incentives by which public power utilities can benefit in a similar manner as taxable entities; (2) permanently exempt expenditures related to clean and renewable energy from sequestration; and (3) reinstate advance refunding of tax-exempt bonds.

Background

Since at least the 1970s, Congress has routinely sought to incentivize investments in the production of clean energy and the use of renewable resources. The most successful incentives are usually provided through the federal tax code. Business Energy Investment Tax Credits (ITCs) were enacted in 1978 and 1980 to stimulate the development of "alternative" energy sources, and they remain in effect today. In 1992, Congress created a production tax credit (PTC) for the production of energy from renewable resources, which also remains in effect today.

Unfortunately, public power utilities cannot directly benefit from either an ITC or PTC. In fact, the tax code states specifically that no ITC will accrue to a government-owned project. Likewise, a public power utility cannot feasibly enter the sort of "Partnership Flip Transaction" that electric cooperatives can use to indirectly access an ITC or PTC. 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. The high transactional costs of such agreements, however, make them impractical. Additionally, only a portion of the value of the tax credit is generally eligible to be passed on to the purchaser, further reducing the benefit from the incentives.

In 1992, Congress authorized the Renewable Energy Production Incentive (REPI) for public power and cooperative utilities, which was intended to provide direct payments comparable to a PTC earned by other entities including investor-owned utilities. During the 15 years REPI funds were authorized, public power utilities and rural electric cooperatives qualified for $329 million in REPI payments; however, Congress appropriated just $54 million during that period. After 2009, Congress stopped appropriating funds for REPI entirely.

In the Energy Policy Act of 2005, Congress sought to provide an investment incentive for certain tax-exempt entities akin to an 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. Due to the complex nature of tax credit bonds, issuers had a difficult time finding willing buyers for CREBs. 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. 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. 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. 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 payment bonds. Finally, in 2017, Congress prohibited the issuance of any additional New CREBs as part of the Tax Cuts and Jobs Act.

The most recent effort to address comparable incentives is the Build Back Better Act. This legislation contains provisions allowing direct payment of energy tax credits for such things as production, investment, and carbon capture, to any entity owning the qualifying project, including public power utilities. Unfortunately, the Act also subjects investors to a possible 15% alternative minimum tax, a provision that should not be retained as it serves as a disincentive to needed investors. The Build Back Better Act, however, appears to have a doubtful future. The tax provisions, except those imposing the alternative minimum tax, need to be retained if the Build Back Better Act is revived or they need to be included in a new bill.

Sequestration, a process mandated under certain conditions specified in the 2011 Budget Control Act, serves as another significant disincentive when applied to efforts to encourage investment in clean energy and renewable sources. Responsible for over $2 billion in lost payments to issuers of Build America Bonds (BABs)—a means of financing infrastructure including power plants—the threat of sequestration makes BABs and similar finance tools less attractive.

Finally, advance refunding of municipal bonds—comparable to refinancing a mortgage—was repealed in the 2017 Tax Cuts and Jobs Act. This has cost local communities and public power utilities millions of dollars by blocking access to lower interest rates.

MMUA Position

The tax provisions in the energy section of the Build Back Better Act authorizing direct pay tax credits should be brought back in any new version of the bill (but without the alternative minimum tax provisions). These tax provisions could also be adopted as a standalone bill or as part of a broader tax package that can secure enough votes to pass both chambers of Congress. Sequestration should not apply to Build America Bonds, nor to any fund used to create comparable incentives for public utilities. And tax-exempt bonds should again be eligible for advance refunding, an important financial tool allowing communities everywhere to benefit from lower interest rates when they become available.