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U.S. House Ways and Means Committee Proposes Substantial Extension and Expansion of Clean Energy Tax Incentives

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On September 10, 2021, the Democratic majority of the United States House Committee on Ways and Means ("House Ways and Means Committee") released draft legislation of its contributions to the Build Back Better Act (the "Legislative Recommendations"), designed to be enacted through the budget reconciliation process. On September 15, 2021, following close to 40 hours of debate over the course of four days, the House Ways and Means Committee advanced the Legislative Recommendations. Ten days later, on September 25, 2021, the House Budget Committee advanced the Legislative Recommendations. If enacted into law, the Legislative Recommendations would substantially extend and expand available clean energy tax incentives, helping to bring President Biden's campaign promise to "reform and extend" these incentives to "unleash a clean energy revolution in America" closer to fruition.[1]

The Legislative Recommendations materially extend existing incentives, including the investment tax credit ("ITC"), the production tax credit ("PTC"), and the carbon capture and sequestration credit, including incentives that had begun (or were about to begin) to expire or phase down. These extensions will make the incentives available well into the next decade, while at the same time imposing new requirements designed to enhance the benefit to U.S. workers from spending on clean energy infrastructure (including prevailing wage and apprenticeship requirements). The Legislative Recommendations also expand the scope and availability of incentives, including making the ITC available for standalone energy storage and energy transmission assets and introducing new incentives for the production of clean hydrogen.

Perhaps most importantly, investors would have the option to elect to treat the applicable credit as a payment made against the tax imposed by subtitle A (the so-called "direct pay" option), and this option would be available for classes of investors (*i.e.*, tax-exempt entities, taxpayers with substantial losses, and certain governmental entities) that have historically not been able to benefit directly from tax credits. If enacted, the "direct pay" option may make it easier for taxpayers without substantial taxable income (and an attendant need for tax credits) to make equity investments in clean energy projects.

In addition, the Legislative Recommendations propose to make income generated by various types of renewable energy assets (as well as facilities that install sufficient carbon capture equipment) "qualifying income" for "publicly traded partnerships," opening up another source of capital for the development of clean energy projects.

Under budget reconciliation, Democrats only need 50 votes in the Senate to pass legislation through an equally divided Senate (the Vice President breaks the tie). But Democratic progressives and moderates disagree on the price tag and the scope of the Build Back Better Act. For the Legislative Recommendations to become law, they will need

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to pass muster with key Democratic moderates in both the House and Senate. If the Legislative Recommendations are enacted into law, we would expect that they will spur significant new investment in clean energy projects, providing increased certainty in an area of the law that has historically been subject to year-end stopgap extensions and a complicated patchwork of ever-changing and unpredictable qualification rules.

Direct Pay

The PTC, ITC, and section 45Q[2] carbon capture and sequestration credits (each of which is discussed in greater detail in a later subsection) have historically been non-refundable credits, meaning that substantial taxable income was generally a necessary prerequisite to benefit from the incentives.[3] The Legislative Recommendations would take steps to change that through a "direct pay" option, effective for projects whose placed in service date is after December 31, 2021. Under the "direct pay" option, an owner of a clean energy facility that would otherwise qualify for certain credits (including the ITC (including for transmission property), the PTC, the carbon capture and sequestration credit, and the advanced energy project credit) is authorized to make an irrevocable "direct pay" election. If the owner makes such an election, the owner will be treated as having paid tax in an amount equal to the credit amount (such that the investor is entitled to an overpayment or refund to the extent the deemed payment exceeds its tax liability).[4] In addition, partnerships and S corporations (*i.e.*, entities not subject to entity-level income tax) are eligible to receive "direct pay" payments. The Legislative Recommendations provide that such payments will be made directly to the partnership or S corporation (rather than to their partners or shareholders).

The irrevocable (it appears, solely for a particular taxpayer with respect to a particular year) "direct pay" election would be required to be made no later than the due date (including extensions) for the return of tax for the taxable year for which the applicable credit is determined. Under the Legislative Recommendations, it appears (but is not entirely clear) that direct pay elections will not be able to be made on a facility-by-facility basis. The Legislative Recommendations provide even less clarity as to whether taxpayers will be able to make elections on a credit-by-credit basis. Further legislative clarity on these points would be useful, although the Secretary of the Treasury is legislatively authorized to address the time and manner for making the direct pay election and so may have some flexibility to provide clarification through regulatory guidance.

In addition to making renewable energy incentives available to entities lacking sufficient taxable income, the "direct pay" option would make such incentives available to various classes of investors that have historically not benefited directly from them, including state and local governments, Native American tribal governments, and tax-exempt organizations.

The "direct pay" option would, however, be subject to various restrictions and limitations. Perhaps most notable is the "domestic content" requirement, which focuses on whether the facility is composed of iron, steel or manufactured products that were produced in the United States, where a "manufactured product" is deemed manufactured in the United States if not less than 55 percent of the total cost of the components are attributable to components mined, produced or manufactured in the United States (the "Domestic Content Requirement"). This requirement would phase in over time, first applying to facilities whose construction begins in 2024 (which would be subject to a ten percent haircut if the Domestic Content Requirement was not met), gradually ramping up in 2025 (projects starting construction in 2025 would be subject to a 15 percent haircut), and then becoming subject to a cliff in 2026 (when projects must meet the Domestic Content Requirement or face the complete loss of any "direct pay" benefit). While there is a long onramp to applicability of the Domestic Content Requirement and the Secretary of the Treasury is permitted to waive the "domestic manufacture" requirement for projects the construction of which starts later in the decade, these new requirements could become a material impediment to the utility of the "direct pay" option.

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In addition, the combination of the irrevocability of the "direct pay" election and the Domestic Content Requirement may deter taxpayers from the "direct pay" option. If a taxpayer elects into the "direct pay" option but fails to satisfy the Domestic Content Requirements, such taxpayer would not only be ineligible to receive the full amount of the "direct payment," but would also apparently lose its ability to claim any alternative tax credit (*e.g.*, the PTC, ITC, and section 45Q credits), at least for the taxable year for which the election was made.[5] Had the taxpayer not made the "direct pay" election, such credits would, at the very least, have been available to the taxpayer.

Moreover, the Legislative Recommendations clarify that direct payments elected with respect to ITCs will be subject to recapture and basis adjustment rules similar to the existing ITC rules.

In general, the "direct pay" option would be expected to reduce the need for tax-equity investors (*i.e.*, investors with significant taxable income that have the ability to utilize tax credits) to partner with developers to monetize clean energy tax credits. But tax-equity financing would still yield benefits because a tax-equity investor may be willing to monetize not just the federal clean energy tax incentives produced by a renewable energy project, but also the future cash flows, depreciation deductions, and other state-level incentives resulting from that project. Tax-equity financing could also provide timing benefits, as tax-equity investors generally fund before (in the case of the ITC) or shortly after (in the case of the PTC) a project is placed in service, whereas the "direct pay" payment would be a refund of a tax deemed paid, with the tax not being deemed paid until the later of the due date of the tax return for the taxable year to which the "direct pay" payment relates or the date on which the return is actually filed, resulting in a delay of cash payment to sponsors until such time. Moreover, tax-equity investors can also effectively offset tax credits received under the ITC and PTC regimes against estimated tax payments, so the "direct pay" option may result in the loss of an additional timing benefit available to some taxpayers.

In addition, the Legislative Recommendations provide that the Secretary of the Treasury may require such information or registration as the Secretary determines is necessary or appropriate for purposes of preventing duplication, fraud, improper payments, or excessive payments under these provisions. Drawing on regulatory authority to prevent any "direct payment" from exceeding the credit to which a taxpayer would otherwise be entitled, we would anticipate that the Secretary would clarify that other limitations imposed under the U.S. Internal Revenue Code, as amended (the "Code"), and any applicable Treasury Regulations (including, for example, the limitation in section 38(c) on the portion of a taxpayer's tax liability that can be reduced through the general business credit (which includes the energy credit)) to apply to direct payments. And, if the Secretary determines that there has been an excessive payment, a penalty is imposed (in an amount equal to the sum of the excessive payment plus 20 percent).

Furthermore, given the expected size of some of the refund claims contemplated by the "direct pay" arrangement, it is uncertain whether or not such claims may in the future be subjected to mandatory review by the Congressional Joint Committee on Taxation (the "JCT"). Treasury Regulations exclude refunds of overpayments (such as estimated tax payments and withholdings reported on original returns) from JCT review. The Internal Revenue Service has interpreted the applicable Treasury Regulations to exclude all refundable credits reported on original returns as well, but historically there have been few, if any, refundable business credits. The U.S. Treasury Inspector General for Tax Administration has prepared a report that criticizes the existing Treasury Regulations on this matter, which notes that the JCT should review more original returns. Making PTCs and ITCs refundable and adding the "direct pay" option could significantly increase the pressure to move that issue forward and require JCT review of original returns claiming PTC and ITC refund claims and claims under the "direct pay" option.

Expansion and Extension of Renewable Electricity Production Credit (PTC) under Section 45

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The PTC available to taxpayers under section 45 of the Code applies to “qualified facilities” (as currently defined in section 45 of the Code) at a specified percentage of certain credit amounts (as adjusted by the “inflation adjustment factor” in section 45(e)(2), the “PTC Credit Amounts”).

Under the current PTC regime, the full PTC is only available for projects the construction of which began by the end of 2016 (with the PTC phasing down for projects on which construction began in 2017 or later).

The Legislative Recommendations would extend the duration of the PTC for more than a decade, and expand the scope and amount of the credit in various respects, but would also impose new requirements that need to be satisfied in order to qualify for the credit.

In terms of the duration of the credit, for projects beginning construction between January 1, 2022 and December 31, 2031 (and for projects the construction of which began in 2020 or 2021, but only if those facilities are placed in service in 2022 or later), the credit would be available at 100 percent of the PTC Credit Amounts. This 100 percent credit would be a boon for taxpayers relative to the current regime, given that the PTC was going to be completely unavailable to projects beginning construction in 2022 or later, and (as noted) projects the construction of which began in 2017 or later were subject to phaseouts (*e.g.*, a 40 percent reduction for a 2021 start of construction project). Importantly, however, the Legislative Recommendations do not extend the full PTC to projects the construction of which began prior to 2020. While this may be a drafting glitch, if the Legislative Recommendations are enacted in their current form, we would expect that taxpayers who already began construction on a project (under the flexible regulatory “begun construction” guidance) would have incentives to try to take available steps to abandon or otherwise recommence the work that was done previously on such project, and in light of the placed in service rule for 2020 or 2021 start of construction projects, we would expect taxpayers to delay placing in service such projects until 2022 where feasible to benefit from being able to claim the credit at a 100 percent rate.

Under the Legislative Recommendations, the PTC would be subject to a gradual phaseout beginning more than a decade in the future, with a 20 percent phaseout for projects beginning construction during the year 2032, 40 percent for projects beginning construction during 2033, and a complete phaseout for projects beginning construction after December 31, 2033.

Beyond its temporal expansion, the Legislative Recommendations would also expand the scope of projects to which the PTC is available. The Legislative Recommendations permit credits for electricity generated by solar power for the first time in nearly two decades, at a PTC Credit Amount of 2.5 cents per kilowatt hour for facilities placed in service after December 31, 2021 and the construction of which begins before January 1, 2034. In addition, the Legislative Recommendations contain proposed section 45W, which creates a PTC for zero-emission nuclear power equal to the amount by which (1) the product of (a) 1.5 cents multiplied by (b) the kilowatt hours produced by the taxpayer at a qualified nuclear power facility and sold by the taxpayer to an unrelated person during the taxable year, exceeds (2) the “reduction amount” for such taxable year. The “reduction amount” is equal to the lesser of subparagraph (1) above, or 80 percent of the excess of (A) the gross receipts from any electricity produced by such qualified nuclear power facility and sold to an unrelated person during the taxable year, over (B) the product of (i) 2.5 cents and (ii) the figure calculated in subparagraph (b) above.

As part of an effort to incentivize domestic manufacturing, the Legislative Recommendations would create a bonus for certain projects, increasing the applicable PTC Credit Amount by ten percent for any qualified facility that satisfies the Domestic Content Requirement. This incentive approach deviates from the “direct pay” rules (which, as described previously, penalize taxpayers who place in service a facility that would otherwise be eligible for PTCs, make a “direct pay” election, but fail to satisfy the Domestic Content Requirement).

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As noted, however, in addition to expanding the PTC in various respects, the Legislative Recommendations would impose new requirements to qualify for the full PTC, subjecting projects that do not satisfy certain prevailing wage and apprenticeship requirements to a substantial 80 percent reduction to the otherwise available PTC Credit Amounts. Such requirements would apply broadly, to any project with a maximum net output of at least one megawatt, the construction of which begins on or after the date the Legislative Recommendations are signed into law.

The proposed wage requirements (the “Prevailing Wage Requirements”) in the Legislative Recommendations would require the taxpayer to provide written certification to the government that all laborers and mechanics employed in the construction (and, for the ten-year period beginning on the date of service, alteration or repair) of a qualified facility are paid wages at rates not less than the prevailing rates on projects of similar character in the locality, as determined by the Secretary of Labor. If a taxpayer underpays its employees and its available PTC is slashed (to 20 percent of the otherwise available credit amount) as a result, it could cure such violation by both (1) compensating each of its employees that worked on the project in an amount equal to the sum of (a) the difference between the actual wages paid during the applicable period and the amount of wages required to be paid under the Legislative Recommendations, and (b) applicable interest, and (2) paying a penalty to the U.S. government of $5,000 for each underpaid employee. The Legislative Recommendations leave unanswered practical questions about how or when the determination as to whether the Prevailing Wage Requirements has been satisfied would be made. Assuming such determination is to be made on audit, that audit would likely occur several years after the relevant credit had been claimed, requiring taxpayers (and contractors who work for them) to provide service providers with additional compensation at that time, even though certain service providers might no longer be affiliated in any way with the project (or the owner of the project that is claiming the credit).

The proposed apprenticeship requirement in the Legislative Recommendations (the “Apprenticeship Requirement,” and, together with the Prevailing Wage Requirements, the “Prevailing Wage and Apprenticeship Requirements”) would require the taxpayer to ensure that an “applicable percentage” of the total labor hours (which excludes hours worked by foremen, superintendents, owners, or executives) connected with the construction (and, for the ten-year period beginning on the date of service, alteration or repairs) on a project be performed by “qualified apprentices.” The term “qualified apprentice” means an individual who is (1) an employee of the project’s contractor or subcontractor, and (2) participating in an apprenticeship program registered under the National Apprenticeship Act. For projects beginning construction before January 1, 2023, five percent of the total labor hours must be performed by qualified apprentices. For projects beginning construction during calendar year 2023, ten percent of the total labor hours must be performed by qualified apprentices, and for projects beginning construction after December 31, 2023, 15 percent of the total labor hours must be performed by qualified apprentices. Each contractor or subcontractor who employs four or more individuals to perform construction, alteration, or repair work on a project must employ at least one qualified apprentice to assist in the work. The taxpayer may be excused for failing to satisfy these requirements if (1) the taxpayer can demonstrate that there is a dearth of qualified apprentices available for employment in the geographic area of the project, and (2) the taxpayer makes a good faith effort to comply with the Apprenticeship Requirement, including by requesting qualified apprentices from a registered apprenticeship program (even if such request is denied, the taxpayer will be excused as long as the denial is not the result of the refusal by contractors or subcontractors involved in the project to comply with the standards of a registered apprenticeship program).

Because projects whose construction begins prior to the enactment of the Legislative Recommendations would be exempted from the proposed Prevailing Wage and Apprenticeship Requirements, we can expect to see taxpayers seek to “grandfather” in projects by beginning construction before these requirements are enacted. For projects seeking to qualify for the full PTC, taxpayers will need timely and clear guidance from the government about how to meet the requirements (*e.g.*, clear guidance from the Secretary

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of Labor about how to determine the prevailing wages in a particular location). While the Prevailing Wage Requirement can generally be satisfied through the mere payment of additional wages (and so should be relatively easy to satisfy), the Apprenticeship Requirement will force taxpayers to closely monitor (and force their contractors and subcontractors to closely monitor) who performs construction, alterations, and repairs on projects, likely necessitating new certification processes, particularly because the Legislative Recommendations do not have a mechanism to "cure" failures to comply with the requirement through the payment of a penalty. In terms of tax-equity financings, we would expect that tax-equity investors will seek to push noncompliance risk onto project sponsors, particularly the risk that activities that occur following funding (such as repairs) might jeopardize PTC qualification.

Expansion and Extension of Energy Credit (ITC) under Section 48

The ITC available under section 48 of the Code would be significantly extended under the Legislative Recommendations. In particular, a solar facility on which construction began prior to 2032 (and which is placed in service after 2022 but before 2036) would be eligible for the ITC without phase-down if such solar facility meets the continuity of construction requirements issued by the IRS. Without the extension under the Legislative Recommendations, the ITC would continue to phase down through the end of 2023, and for projects beginning construction in 2024 would only be available at a modest ten percent rate.

It is worth noting that the Legislative Recommendations would not increase the ITC for solar projects for which construction began after 2019 if such projects are placed in service before the end of 2021. Beginning with projects placed in service in 2022, however, certain solar projects on which construction begins prior to 2032 would be eligible for the ITC at the rate of 30 percent—which is the highest amount of the ITC for which solar projects have been eligible in recent years. Thereafter, the credit would begin to step down, with the ITC being equal to 26 percent for projects beginning construction in 2032, and 22 percent for solar projects beginning construction in 2033. In addition, the Legislative Recommendations push out the statutory deadline (December 31, 2036) by which solar projects must be placed in service to qualify for an ITC greater than ten percent. The structure of the Legislative Recommendations, as it pertains to solar projects, would seem to incentivize sponsors that are developing solar projects that are nearly complete and operational to delay placing these projects into service until after the end of this year. All else being equal (and assuming enactment), an owner of a project eligible for the ITC could receive (at least) an additional four percentage points in ITCs if the owner (or sponsor) waited to place the solar project in service until after the end of this year.

The Legislative Recommendations also expand the list of renewable energy projects eligible for the ITC in various respects (including to "qualified biogas property" and "microgrid controllers"). Most notable, perhaps, is the expansion of the ITC to "energy storage technology" which is equipment, other than equipment primarily used in the transportation of goods or individuals and not for the production of electricity, that uses batteries or certain other technologies to store energy for conversion to electricity and that has capacity of at least five kilowatt hours. Equipment that would meet these requirements, but has a capacity of less than five kilowatt hours, can qualify for this credit if such equipment is modified or refitted such that it has at least five kilowatt hours of capacity. However, no portion of the tax basis that was part of such equipment before its modification can be taken into account in calculating the ITC after modification. The expansion of the ITC to standalone batteries could be of key importance to the renewable energy industry. Under current law, only certain storage technologies that are directly tied to facilities that *generate* electricity and that are otherwise eligible to claim the ITC (separate from such storage technologies) are ITC eligible. Not only would the expansion of the ITC to these standalone facilities spur development of such technologies and infrastructure, but it would also support the build-out of what many industry observers have described as a missing piece of the puzzle for the renewable energy space—sufficient

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battery storage to build reserves of renewably generated electricity for use during the periods of time when renewable facilities are not generating sufficient energy for public consumption (*e.g.*, storage of solar energy generated during the day for use during nights and evenings).

As with other portions of the Legislative Recommendations, for projects with a maximum net output of at least one megawatt, any credit claimed under section 48 would only be eligible for the full rate if the Prevailing Wage and Apprenticeship Requirements are satisfied. If such requirements are not satisfied, or otherwise cured, then any credit claimed under section 48 could be claimed at a rate equal to only 20 percent of the otherwise available credit amount. These requirements are similar to the requirements that apply to facilities seeking to claim PTCs, although the Prevailing Wage and Apprenticeship Requirements only apply for five years after a facility is placed in service (rather than for ten years). See the discussion of these requirements above under "*Expansion and Extension of Renewable Electricity Production Credit (PTC) under Section 45*." The exception from the Prevailing Wage and Apprenticeship Requirements for projects with a maximum net output of less than one megawatt would be particularly helpful to the residential rooftop solar industry.

With respect to an energy property that satisfies the Domestic Content Requirement, such energy property is eligible for a step-up—or bonus—in the amount of ITC that can be claimed in respect of that project. For a project that meets the Domestic Content Requirement but that (1) has a maximum net output of one megawatt or more, and (2) does not meet the Prevailing Wage and Apprenticeship Requirements, that project is eligible for a two percentage point increase in the amount of ITC that can be claimed. For projects that meet the Domestic Content Requirement and that either (1) have a maximum net output of less than one megawatt or (2) satisfy the Prevailing Wage and Apprenticeship Requirements, then such a project is eligible for a ten percentage point increase in the amount of ITC that can be claimed.

Certain solar facilities with a nameplate capacity of less than five megawatts are eligible for a ten percentage point step-up in the ITC if the facility is located in a "low-income community" (defined by cross-reference to the new markets tax credit rules in section 45D of the Code). If a solar facility with a nameplate capacity of less than five megawatts is part of a "qualified low-income residential building project or a qualified low-income economic benefit project," then it is eligible for a step-up in the ITC equal to 20 percentage points.[6] The property with respect to which this step-up in ITC can be claimed includes certain energy storage property installed in connection with such solar facility and the amount of expenditures incurred for "qualified interconnection property" (as defined in the Legislative Recommendations). In sum, under the Legislative Recommendations, certain small scale solar facilities that are installed as part of a "qualified low-income residential building project" and that meet the Domestic Content Requirements could be eligible for the ITC at an amount equal to 60 percent of the basis of the energy property placed in service in connection with that project.

Qualifying Electric Transmission Property (Section 48D)

In addition to expanding the ITC (as described above), the Legislative Recommendations provide for a new tax credit (similar to the ITC) claimable in respect of "qualifying electric transmission property" for an amount equal to 30 percent of the basis of the applicable property. "Qualifying electric transmission property" is generally defined to include an electric transmission line that is capable of transmitting electricity at a voltage of not less than 275 kilovolts that has a transmission capacity of not less than 500 megawatts and any property that, with respect to a credit-eligible electric transmission line, is necessary for the operation of such electric transmission line (or is otherwise listed as "transmission plant" in the Uniform System of Accounts for the Federal Energy Regulatory Commission).

A qualifying electric transmission line can be a replacement to, or upgrade to, an existing electric transmission line, but only if the transmission capacity of such electric transmission

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line, as upgraded, increases to an amount equal to the existing capacity of such transmission line plus 500 megawatts. The basis allocable to such existing transmission line also would not be eligible for any credit under section 48D. This new section 48D credit is not claimable with respect to property on which construction begins prior to January 1, 2022 or if a state or political subdivision thereof, any agency or instrumentality of the United States, a public service or public utility commission, or an electric cooperative has previously (before the date when the Legislative Recommendations are enacted) "selected for cost allocation such property for cost recovery."

As with other portions of the Legislative Recommendations, any credit claimed under section 48D would only be eligible for the full rate if the Prevailing Wage and Apprenticeship Requirements are satisfied, although these requirements will not apply to projects the construction of which begins before the Legislative Recommendations are enacted. Depending on when the Legislative Recommendations might be enacted, however, there may be little opportunity to plan around the Prevailing Wage and Apprenticeship Requirements, given that the credit does not apply to property the construction of which begins before January 1, 2022. If such requirements are not satisfied, or otherwise cured, then any credit claimed under section 48D could be claimed at a rate equal to only 20 percent of the full credit amount.

With respect to an energy project that is composed of "steel, iron, or manufactured products which were produced in the United States" (*i.e.*, that satisfies the Domestic Content Requirement), such energy property is eligible for a step-up—or bonus—in the amount of ITC that can be claimed in respect of that project. If a transmission project satisfies the Domestic Content Requirement but does not satisfy the Prevailing Wage and Apprenticeship Requirements, then that project is eligible for a two percentage point increase in the amount of ITC that can be claimed. Those projects that satisfy the Domestic Content Requirement and meet the Prevailing Wage and Apprenticeship Requirements are eligible for a ten percentage point increase in the amount of ITC that can be claimed.[7]

In general, any credit claimed under section 48D would have to be claimed in respect of property that is placed in service prior to January 1, 2032.

Expansion and Extension of Credit for Carbon Oxide Sequestration under Section 45Q

The Legislative Recommendations extend the date by which construction must have begun on a "qualified facility" for purposes of section 45Q from January 1, 2026 to January 1, 2032. The Legislative Recommendations leave many aspects of the tax credit rules for facilities that capture carbon oxide intact, but also makes some significant expansions and revisions to the rules.

The Legislative Recommendations would accelerate certain scheduled section 45Q rate increases (to be effective in 2022, rather than 2026 under current law): to $35 per metric ton, for qualified carbon oxide captured and used in an enhanced oil or natural gas recovery (or other allowable uses), and to $50 per metric ton for qualified carbon oxide captured and disposed of in secured geological storage.[8] For direct air capture facilities, each metric ton of qualified carbon oxide that is captured and disposed of in a geological storage would be eligible for a $180 credit, and each metric ton of carbon oxide that is captured and used in an enhanced oil or natural gas recovery (or another allowable use) would be eligible for a $130 credit.[9]

Under the Legislative Recommendations, the "qualified facilities" eligible for these expanded credits include:

1. "direct air capture facilities" that capture 1,000 metric tons or more of qualified carbon oxide during a taxable year (under current law, the applicable threshold is not less than 100,000 metric tons),[10]

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2. electricity generating facilities that capture 18,750 metric tons or more of qualified carbon oxide during the taxable year *and* at least 75 percent of the carbon dioxide from such facilities would otherwise be released into the atmosphere by such facility during such taxable year (under current law, the applicable threshold is not less than 500,000 metric tons, but there is no minimum percentage capture requirement under current law), and
3. any other facilities that capture 12,500 metric tons or more of qualified carbon oxide during the taxable year *and* at least 50 percent of the carbon oxide from such facilities would otherwise be released into the atmosphere during such taxable year (the facilities described in this paragraph, "Industrial Facilities") (under current law, the applicable threshold is not less than 25,000 metric tons, but there is no minimum percentage capture requirement under applicable law).

As with other portions of the Legislative Recommendations, any credit claimed under section 45Q would only be creditable in full if the Prevailing Wage and Apprenticeship Requirements are satisfied.[11] If such requirements are not satisfied, or otherwise cured, then any credit claimed under section 45Q could be claimed at a rate equal to 20 percent of the full credit amount.

Modification of Special Rules for Offshore Wind Projects

The Legislative Recommendations modify special rules that excepted certain offshore wind projects from ITC phase-outs under current law in light of such projects' significantly longer development timelines. Under the Legislative Recommendations, offshore wind projects are generally subjected to the same extended construction deadlines as onshore wind projects. The Legislative Recommendations make clear, however, that the 100 percent ITC remains available in respect of certain offshore wind projects placed in service before 2022.[12]

Going forward, the Legislative Recommendations would revert to prior law regarding the geographic boundaries for offshore wind projects eligible for the ITC. Under current law (which applies to projects that begin construction before 2022), for a project to be PTC eligible, it must be located within the United States or in a possession, which is defined for PTC purposes to include an exclusive economic zone (which generally extends as much as 200 nautical miles from a territorial sea baseline). For the ITC, on the other hand (which, under current law, is available for offshore wind projects that begin construction through 2025) the facility must be "located in the inland navigable waters of the United States or in the coastal waters of the United States." The narrower geographic ITC boundary for offshore wind projects would only apply to projects that were placed in service before 2022.

Publicly Traded Partnerships

In general, under existing law, a "publicity traded partnership" (which is any partnership if the interests in such partnership are traded on an established securities market or readily tradable on a secondary market (or the substantial equivalent thereof)) is taxed as a corporation (and therefore subject to entity-level U.S. federal income tax) unless an exception applies. The primary exception to these rules is for partnerships that earn 90 percent or more "qualifying income" (which includes a variety of types of passive income as well as income and gains from exploration, development, mining, production, processing, refining, transportation, and marketing of any mineral or natural resource). Historically, the income generated by a renewable energy facility would not have been "qualifying income." Under the Legislative Recommendations, however, the definition of "qualifying income" would be revised to include various types of income derived from clean energy projects (including PTC and ITC eligible property and income or gain from a "qualified facility" under section 45Q(d)).

This aspect of the Legislative Recommendations, if enacted, would open up a potential

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source of new capital for clean energy projects, making it possible for investors in the public markets to more easily participate (through a flow-through vehicle) in such projects. The impact of this proposal on traditional tax-equity investors is not entirely clear. On the one hand, "publicly traded partnerships" could compete against tax-equity investors, reducing returns as additional capital competes for the right to invest in projects. On the other hand, publicly traded partnerships would not be well situated to directly capture the key benefits generated by renewable energy projects—tax credits and depreciation deductions—because deductions and credits attributable to an investment in a renewable energy project would generally pass through to the holders of interests in the partnership, who may or may not be able to effectively monetize those items, although (with respect to the tax credits, but not depreciation deductions) publicly traded partnerships could seek to avail themselves of the "direct pay" election, subject to the limitations and restrictions on "direct pay" described previously in this alert, and subject to the limitations described in the next sentence. In addition, certain rules that can reduce or eliminate the availability of the ITC or accelerated depreciation (including the tax-exempt use property rules) based on tax characteristics of the owners of a partnership could make it challenging for publicly traded partnerships to partner with tax-equity investors in a way that would allow those investors to effectively monetize tax benefits from a clean energy project.

Clean Hydrogen Incentives

The Legislative Recommendations also propose to add section 45X, which would provide a tax credit for the production of clean hydrogen. This new credit would be available (subject to the Prevailing Wage and Apprenticeship Requirements[13]) for clean hydrogen projects the construction of which begins before January 1, 2029 that are placed in service after December 31, 2021, and, with respect to those projects, the credit would be claimable for the ten-year period beginning on the placed in service date of the clean hydrogen project. This credit is not available for clean hydrogen produced at a facility that includes property for which a section 45Q carbon oxide sequestration credit is allowed (*i.e.*, "blue" hydrogen facilities taking advantage of the section 45Q credit would not also be entitled to the section 45X credit).

The amount of the credit is equal to the product of (1) the number of kilograms of "qualified clean hydrogen" (hydrogen that is produced through a process that achieves a percentage reduction in lifecycle greenhouse gas emissions of at least 40 percent as compared to hydrogen produced by steam-methane reforming of non-renewable natural gas) produced during the applicable taxable year, and (2) the "applicable amount" of $3.00 (adjusted for inflation) multiplied by the "applicable percentage." The "applicable percentage" is a percentage available to taxpayers based on the percentage reduction in "lifecycle greenhouse gas emissions" (as defined in the Clean Air Act) as compared to hydrogen produced by steam-methane reforming. The "applicable percentage" can be: (a) 20 percent (for a less than 75 percent reduction), (b) 25 percent (for a reduction greater than or equal to 75 percent and less than 85 percent), (c) 34 percent (for a reduction greater than or equal to 85 percent and less than 95 percent), and (d) 100 percent (for a 95 percent or greater reduction). In other words, the higher the reduction, the higher the applicable percentage, and therefore, the larger the available tax credit eligible to be claimed under section 45X would be.

Tax Credits and BEAT

Tax credits are only useful to the extent they are able to actually reduce cash taxes payable. Under the Legislative Recommendations, the general business credit (which includes the PTC, the ITC, and section 45Q credits and would include the proposed section 48D and section 45X credits) would be fully creditable against BEAT liability. Under current law, only up to 80 percent of the otherwise-available section 48 ITC and the section 45 PTC (and none of the section 45Q credit) are able to reduce BEAT liability (and then only through 2025, after which the ITC and PTC would also effectively cease to reduce BEAT liability).

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This modification to the rules would be expected to make the credit more desirable to tax-equity investors with meaningful potential BEAT liability, particularly if BEAT liability is expanded as has been proposed.

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[1] Democratic National Committee, *The Biden Plan To Build A Modern, Sustainable Infrastructure And An Equitable Clean Energy Future*, JoeBiden.com (last visited Oct. 13, 2021), https://joebiden.com/clean-energy/.

[2] Unless otherwise noted, section references refer to sections of the Internal Revenue Code of 1986, as amended.

[3] Substantial taxable income was not, however, needed for developers/owners of certain renewable energy projects to benefit from the "cash grant" program under section 1603 of the American Recovery and Reinvestment Tax Act of 2009. Under this program, eligible developers/owners of certain renewable energy projects were able to forgo tax credits in lieu of a direct cash payment from the Treasury Department that would defray part of the cost of the project.

[4] Curiously, the payment is to be treated as a payment against "the tax imposed by subtitle A," which includes sections 1 through 1563. Thus, if enacted in its current form, the deemed payment would offset not only income tax liability (imposed under chapter 1 of subtitle A), but also liability for self-employment taxes, the net investment income tax, and various withholding taxes (including liability to remit taxes withheld on various payments to non-U.S. taxpayers). It is possible that the offset was intended be limited to income taxes.

[5] As noted, it appears that election is only irrevocable with respect to a particular taxable year. Thus, for credits that accrue over a period of time (*e.g.*, the PTC, which is available over ten years), it appears that taxpayers may be able to toggle between "direct pay" and PTCs from year to year. For facilities that would otherwise seek to claim the ITC, however, a "direct pay" election could completely foreclose the ability to claim that credit (which is a one-time credit, available in the year when a facility is placed in service).

[6] A solar facility is part of "qualified low-income residential building project" if (1) the facility is installed on a residential rental building that is part of one of various enumerated legislative programs (*e.g.*, a "covered housing program" defined in section 41411(a) of the Violence Against Women Act of 1994), and (2) the financial benefits of the electricity produced by the facility are equitably allocated among the building occupants. A facility is treated as part of a "qualified low-income economic benefit project" if at least 50 percent of the financial benefits of the electricity produced by the facility are provided to households that meet certain income requirements. For purposes of determining whether there has been a "financial benefit," the Legislative Recommendations specify that electricity acquired at below-market rates "shall not fail to be taken into account as a financial benefit."

[7] The Prevailing Wage and Apprenticeship Requirements also include an exception (similar to the ITC and PTC) for projects with a maximum net output of less than one megawatt, which in this instance appears to be a drafting glitch. First, it does not comport with the 500 megawatt requirement for "qualifying electric transmission property" described in the Legislative Recommendations. Second, this requirement is not noted in the JCT's report discussing the Legislative Recommendations, entitled "Description Of The Chairman's Modification To The Provisions Of The 'Clean Energy For America Act'." Similar issues arise with respect to the Prevailing Wage and Apprenticeship Requirements that would be made applicable to sections 45Q and 45X (discussed below). We would expect that these exceptions may be subsequently revised as the Legislative Recommendations make their way through the legislative process.

[8] Credit amounts are subject to inflation adjustments.

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[9] The Legislative Recommendations expanding section 45Q appear to contain several drafting oversights. The caption for new subparagraph (B) of section 45Q(b)(1), as provided for by section 136107(c) of the Legislative Recommendations, describes a "Special Rule for Direct Air Capture Facilities" but then, by its terms, would only apply to those facilities described in section 45Q(d)(2)(C), which (as amended by the Legislative Recommendations) only pertains to Industrial Facilities and not the "direct air capture facilities" that would be described in section 45Q(d)(2)(A). We note that section 136107(e)(1)(C) of the Legislative Recommendations would also revise section 45Q(b)(1)(B) without coordination with the changes proposed by section 136107(c). Also, the "direct pay" rules for a partnership or S corporation seeking direct payments for section 45Q credits would require the qualified facility be "held" by the partnership or S corporation.

[10] Note that a "direct air capture facility" is any facility that captures carbon dioxide, and the eligibility for such a "direct air capture facility" for the enhanced credit under section 45Q is calculated on the basis of the number of metric tons of "qualified carbon oxide" captured. However, with respect to a "direct air capture facility," "qualified carbon oxide" only includes, for purposes of section 45Q, carbon *dioxide* (1) that is captured directly from the ambient air, and (2) that is measured at the source of capture and verified at the point of disposal, injection, or utilization. As a result, and assuming that legislators clarify that a "direct air capture facility" is eligible for the expanded credit under section 45Q, any "direct air capture facility" can earn the expanded tax credits under the Legislative Recommendations only if such facility captures 1,000 metric tons or more of carbon *dioxide* during the taxable year, and meets certain other requirements.

[11] In the Legislative Recommendations, the Prevailing Wage and Apprenticeship Requirements for section 45Q contain an exception for a qualified facility with a maximum net output of less than one megawatt, which (similar to the issue in proposed sections 48D and 45X) may be a drafting glitch.

[12] To date, there are only two operating offshore wind projects in the United States, although a third project is reportedly slated for construction.

[13] In the Legislative Recommendations, the Prevailing Wage and Apprenticeship Requirements for section 45X contain an exception for a project with a maximum net output of less than one megawatt, which (similar to the issue in proposed sections 45Q and 48D) may be a drafting glitch.

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