

Tax Act and Its Consequences for Renewable Energy

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Web Conference Materials
CD enclosed on inside back cover



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The 2017 Tax Act and Its Consequences for Renewable Energy Projects



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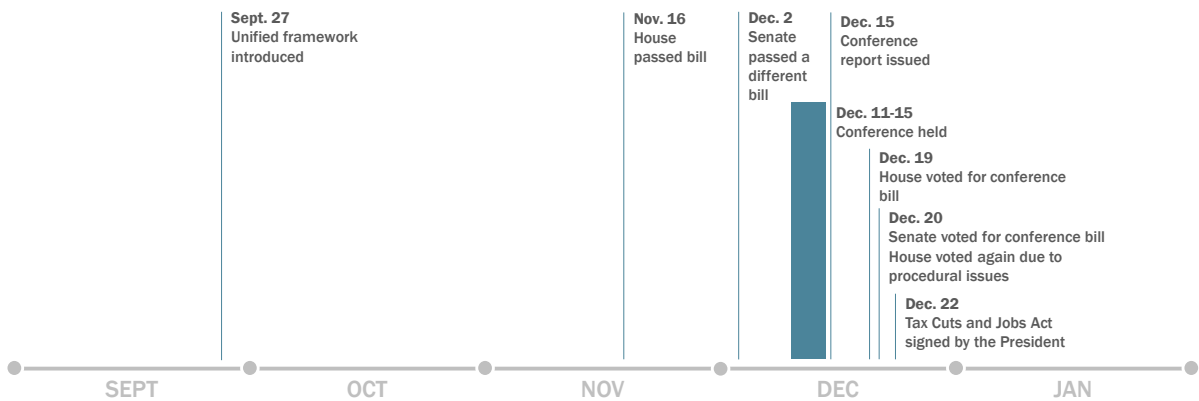
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History of Legislation





Renewable Energy Tax Credits

No specific changes to RETC –

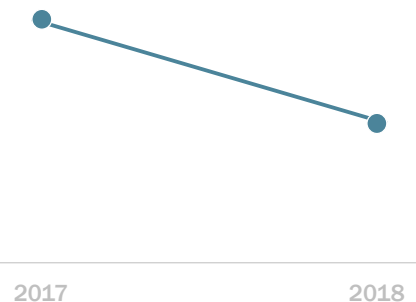
- 30 percent ITC **unchanged** (phased down after 2019)
- 10 percent **retained**
- ITC “Orphan” Renewable Energy Technologies **remain expired**
- PTC inflation adjustment and **phase down** unchanged from prior law: starting after 2016; PTC at 2.4 cents per kWh retained
- No change to **continuous construction requirement**

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Corporate Tax Rate

Lowering the top corporate rate



Effect on RETC equity pricing:

- Tax consequences of profits reduced
- Tax cost of exit reduced
- Depreciation less valuable
- Lower tax on 50(d) income (if lease pass-through is used)

Effective for tax years beginning after 12/31/17

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Tax Treatment of Service Providers

- Beginning in 2018, up to a 20% deduction for individuals' "qualified business income." Effective tax rate of 29.6%.
- Must be earned through pass-through entities, such as partnerships, LLCs, S corporations, disregarded entities and trusts.
- Qualified business income does not include guaranteed payments, amounts paid by S corporations that are treated as reasonable compensation, or, to the extent provided in regulations, amounts paid or incurred for services by a partnership to a partner who is acting other than in his or her capacity as a partner.
- May be reduced on account of losses from other businesses
- Limitation based on wages paid to others, but only if TP's income exceeds \$157K (or \$315K on a joint return)
- Will this change how developers and others conduct business?

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Bonus Depreciation -- 1

- Bonus depreciation increased from 50% to 100% for qualifying property

Placed in Service	Applicable Percentage
After Sep. 27, 2017; before Jan. 1, 2023	100 Percent
After Dec. 31, 2022; before Jan. 1, 2024	80 Percent
After Dec. 31, 2023; before Jan. 1, 2025	60 Percent
After Dec. 31, 2024; before Jan. 1, 2026	40 Percent
After Dec. 31, 2025; before Jan. 1, 2027	20 Percent

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Bonus Depreciation -- 2

- Certain qualifying property with a longer production period would gain an additional year from the dates shown on the previous chart
- Bonus available for RETC projects, unless they are caught by the government approved contract provision.
- There's also an under \$25M receipts exception, but must be on the cash method.

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Bonus Depreciation -- 3

- Used Property can be eligible. But it won't qualify for RETC, unless it is at least 80% new.
- As under previous law, to qualify for bonus depreciation, property must have a recovery period of 20 years or less
- Property depreciated using ADS not eligible for bonus depreciation (general rule)
- Elections available to elect out of bonus depreciation for each class of depreciable assets
- For those who want to slow things down, there's an election available to apply 50 percent instead of 100 percent for property placed in service during first taxable year ending after Sep. 27, 2017

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Energy Exception to bonus depreciation

- Bonus Depreciation is not available to taxpayers in the trade or business of furnishing or selling

- (1) electrical energy, water or sewage disposal services;
- (2) gas or steam through a local distribution system; or
- (3) transportation of gas or steam by pipeline,

if the rates for such furnishing or sale may be established or approved by a state or political subdivision, or any agency or instrumentality of the United States, or by a public service or public utility commission or other similar government body, or the governing or ratemaking body of an electric cooperative.

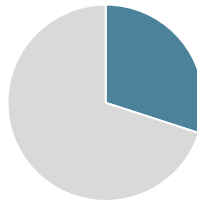
- Public Utilities? It could conceivably apply to a RETC project that derives its income from a power purchase agreement (or PPA) if it is subject to the approval of one of the listed agencies.
- There's an associated benefit with respect to interest expense; see below.

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Interest Expense Limitations

Interest expense limitations



Limited to 30 percent of business adjusted taxable income, certain small businesses and renewable energy with government approved contracts are exempt. Real property trades or businesses can elect out

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Interest Expense Limitations

- **Exemptions to limitations:**
 - See the description of certain energy businesses, discussed above:
 - business of furnishing or selling ... electrical energy ... if the rates ... may be established or approved by a [government entity], or by a public service or public utility commission or other similar government body, or ... an electric cooperative.
 - Businesses with average annual gross receipts under \$25m during three preceding years. Must be on accrual method; not available for partnerships where more than 35 percent of losses are allocable to limited partners
 - Real Property Trade or Business that makes an election. Don't expect this to apply to RETC transactions.

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Alternative Minimum Tax (AMT) and Regular Tax Limits

- **For corporations: AMT is repealed for tax years beginning after Dec. 31, 2017**
- **For individuals: AMT has an increased exemption and phase-out thresholds until Dec. 31, 2025**
- **LIHTC, HTC and ITC can be taken against AMT liability, but NMTC and years 5 through 10 of PTC cannot.**
- **Remember: TP's can't offset more than 75% of their REGULAR tax liability with credits**

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Base Erosion and Anti-Abuse Tax (BEAT)

- Goal is to tax multinational companies who shift profits overseas
- Only applies to certain taxpayers with over \$500m in revenues on average for last three years who also meet a certain threshold for deductions to foreign affiliates

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Base Erosion and Anti-Abuse Tax (BEAT)

- Who is **NOT** subject to BEAT?
 1. Regulated Investment Companies
 2. Real Estate Investment Trusts
 3. S-Corporations

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Base Erosion and Anti-Abuse Tax (BEAT)

- Who is subject to BEAT?

$$\frac{\text{BEAT deductions}}{\text{Total deductions}} = \text{BEAT \%}$$

Banks = 2% or more = subject to BEAT

All other corporations = 3% or more = subject to BEAT

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Base Erosion and Anti-Abuse Tax (BEAT)

- What are BEAT deductions?
- Payments to a foreign affiliate that results in:
 1. Current deduction
 2. Asset that results in future deductions (i.e. depreciation)
 3. Reduction in gross income

NOTE: Derivatives are specifically excluded

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Base Erosion and Anti-Abuse Tax (BEAT)

BEAT tax liability calculation:

Taxable Income
+ Base Erosion Tax Benefits
+ NOL Carryforwards and Carrybacks

Modified Taxable Income
x BEAT Rate

BEAT Tax

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Base Erosion and Anti-Abuse Tax (BEAT)

BEAT rate is generally lower than normal tax rate

Year	Corporations	Banks
2018	5%	6%
2019-2025	10%	11%
2026 and thereafter	12.5%	13.5%

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Base Erosion and Anti-Abuse Tax (BEAT) Sample Calculation

	<u>Regular Tax</u>	<u>BEAT</u>
Taxable Income	\$ 100,000	\$ 100,000
BEAT Adjustment		+ 125,000
Modified Taxable Income		<u>225,000</u>
Rate	x 21%	x 11%
Tax Before Credits	<u>\$ 21,000</u>	<u>\$ 24,750</u>
RETIC	<u>- 10,000</u>	<u>- 8,000 *</u>
Tax Liability	<u>\$ 11,000</u>	<u>\$ 16,750</u>

*up to 80% of your RETIC can offset up to 80% of your tentative BEAT through 2025.

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Base Erosion and Anti-Abuse Tax (BEAT)

- Investors paying BEAT:
 - Can lose up to **20%** of LIHTC, ITC and PTC for **2018-2025**;
 - Can lose up to **100% thereafter**
 - Can lose up to **100%** of NMTC and HTC in **2018 and beyond**
 - If credits reduce normal tax below BEAT in any given year, those credits are **lost FOREVER**
 - Investors can also lose about **50% of the benefits of tax losses**

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Base Erosion and Anti-Abuse Tax (BEAT) Implications

All tax credit investors will need to evaluate their exposure to BEAT

Those investors near or paying BEAT may pause investing and may even sell pieces of portfolio

Other investors not paying BEAT will carefully size future investments to avoid paying BEAT

Bottom line:

- Market will be in flux while investors assess BEAT exposure
- Demand may decline; negative impact on pricing

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Interest Expense Limitations

- Exemptions to limitations
 - **Real property trades or businesses** and **farming businesses** have option to make irrevocable election
 - Election requires real property and qualified improvement property be depreciated using ADS
 - Limits do not apply to **investment interest expense**
 - Particularly important for bond deals today!
 - Could also apply to NMTC structures at the investment fund

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Interest Expense Limitations Calculation

Adjusted taxable income: 2018-2021

Taxable income (loss)	\$ (100,000)	Business interest expense	\$ 90,000
Add back: Net interest expense	+ 90,000	Less: business interest income	- 0
Add back: Depreciation	+ 110,000	Net interest expense	\$ 90,000
Adjusted taxable income	\$ 100,000		
Multiply by 0.3	x 0.3		
Net interest expense limitation	\$ 30,000		
↓			
Net interest expense limitation	\$ 30,000		
Net interest expense	\$ 90,000		
Nondeductible interest expense	\$ 60,000 *		

*Disallowed business interest expense for any taxable year will be treated as paid or accrued in the following taxable year (i.e. indefinite/perpetual carryforward)

For partnerships, the nondeductible interest is allotted to its partners

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Interest Expense Limitations Calculation

Adjusted taxable income: 2022 and beyond

Taxable income (loss)	\$ (100,000)	Business interest expense	\$ 90,000
Add back: Net interest expense	+ 90,000	Less: business interest income	- 0
Add back: Depreciation	+ 110,000	Net interest expense	\$ 90,000
Adjusted taxable income	\$ (10,000)		
Multiply by 0.3	x 0.3		
Net interest expense limitation	\$ 0		
↓			
Net interest expense limitation	\$ 0		
Net interest expense	\$ 90,000		
Nondeductible interest expense	\$ 90,000 *		

*Disallowed business interest expense for any taxable year will be treated as paid or accrued in the following taxable year (i.e. indefinite/perpetual carryforward)

For partnerships, the nondeductible interest is allotted to its partners

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Impact of Depreciation and Interest Rules on Exits

- Effect on capital accounts
 - Slower depreciation will preserve capital accounts
 - Nondeductible interest reduces capital accounts
- Effect on gain on sale
 - Slower depreciation will reduce gain on sale
 - Nondeductible interest gets added back to outside basis when calculating gain on sale

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Other Notable Provisions

Repeal of “tech term” rules

- IRC Section 708(b)(1)(B) eliminated
- Effect on RETC partnerships
 - No longer have to re-start depreciation
 - DON'T FORGET: recapture rules for RETC still exist
 - States may create new ways to capture changes in ownership to transfer taxes and property tax assessments
 - Could result in delays for exiting partner receiving their final K-1

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Other Notable Provisions

Grants to corporations – new rules

- Basically prevents a for-profit corporation from receiving a grant tax free
 - For nonprofits, can still structure grant coming to nonprofit sponsor, then loaning to partnership
-
- Changes to Section 179 – Increased to \$1 million
-
- New Year of Inclusion Rules. Accrual basis TP's and financial reporting

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Other Notable Provisions

Investing in Opportunity Act

- Allows investors with capital gains from sale of assets to defer those gains
- Creates **new incentive to invest capital gains in low-income communities**
- Authorizes the designation of **“opportunity zones”**
- Governors responsible for designating these zones
- Encourages investors to **pool resources and risks** in “Opportunity Funds” (O Funds). Investors can temporarily defer capital gains recognition if they reinvest in these zones
- Incentivizes long-term investment
- Provides shallower subsidies than the NMTC, but can be used on a **greater scale**

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