KPMG

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KPMG report: Initial impressions of energy tax provisions in draft Senate reconciliation bill

As previously reported, Senator Joe Manchin (D-WV) on July 27, 2022, announced that he had reached an agreement with Senate Majority Leader Chuck Schumer (D-NY) on tax, climate change, energy, and health care provisions to be included in the *Inflation Reduction Act of 2022*.

This report provides high level preliminary observations regarding the energy and climate related tax provisions in draft legislative text for the proposed Senate bill also released on July 27, 2022. Keep in mind that legislative text could be modified during the legislative process.

Read ***TaxNewsFlash*** for more detail and a link to the draft legislative text.

KPMG observation

Basic overview

The climate provisions in the draft legislative text would make many of the same, or substantially similar, changes to the clean energy tax incentives as were proposed in the version of "Build Back Better" legislation (the "BBBA") that passed the House in November of 2021. Read the **KPMG report on the House-passed version of the BBBA** [PDF 2.4 MB]

These proposed changes that are identical or similar to those set forth in the BBBA include:

- Extensions of the expiration and phase-down dates for the investment tax credit for solar (ITC) and production tax credit for wind (PTC)
    - The amended ITC and PTC provisions would apply to any projects placed in service after 2021 (i.e., including projects that have been or will be placed in service in 2022) and on which construction begins prior to 2025.
    - A new technology neutral clean energy production tax credit would be available for projects placed in service after 2024.
- Imposition of a two-tiered credit system for energy tax credits, providing higher credits when certain prevailing wage and apprenticeship requirements are satisfied—the requirements would be deemed

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satisfied if construction begins on a project prior to 60 days after the date guidance is issued on these requirements

- Availability of bonus credit amounts for using domestic sourced components and domestically manufactured products in the construction of energy projects
- Availability of bonus credit amounts for certain projects located in certain specified communities and locations (e.g., low-income areas, coal communities, brownfield sites)
- Increased section 45Q carbon capture and sequestration credit rates, and lower minimum capture thresholds
- Significant additional funding for allocations of the section 48C advanced energy manufacturing credit
- Provision of tax credits for a variety of technologies and processes not previously incentivized under the Internal Revenue Code, including:
    - Stand-alone energy storage
    - Production of zero emissions nuclear power
    - Clean hydrogen production
    - Sustainable aviation fuel

Notably, the proposed bill does not include all of the new or updated incentives proposed in the House-passed version of the BBBA. In particular, it does not include the ability to treat renewable energy assets as “good” assets for publicly traded partnership testing purposes. It also does not include an ITC for transmission line buildout and upgrades, although interconnection property with capacity under 5 MW is included as ITC eligible and there are also provisions for loans and grant financing for transmission lines.

Direct pay and transferability

One of the more fundamental changes to the energy space proposed by the House-passed version of the BBBA was the “direct pay” election through which taxpayers could make most energy tax credits refundable. The BBBA’s direct pay provisions were viewed, at least in part, as a way to reduce reliance on tax-equity financing to monetize credits when taxpayers did not have sufficient tax liability on their own to absorb the relevant credits in a timely manner.

The proposed Senate bill also would provide for “direct pay” but in a scaled-back manner as compared to the House-passed version of the BBBA. In particular:

- Direct pay would be available to credit eligible projects owned by certain tax-exempt and government entities
- Direct pay would be available to the other taxpayers only for the following specific credits:
    - Section 45Q credit for carbon capture and sequestration
    - Section 45V credit for clean hydrogen production
    - Section 45X credit for the advanced manufacturing production tax credit

The draft Senate bill proposes to allow taxpayers ineligible for direct pay to sell their tax credits to third parties. This novel legislative proposal appears to be a trade-off for the more limited direct pay provisions, and likely is intended to reduce the necessity for tax-equity financing. Taxpayers would be permitted to transfer all or a portion of certain tax credits to unrelated parties in exchange for cash consideration that would be excluded from the selling taxpayer’s income.

Other provisions

The proposed Senate bill also would make various other changes to incentives in the energy space. These include enhancements and modifications to:

- Section 179D energy efficient commercial building deduction
- Credits for electric vehicles and charging stations

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- Individual credits for nonbusiness energy property, energy efficiency improvements, and new energy efficient homes

Additional developments and analysis regarding the proposed Senate bill will be provided in future reports via [KPMG's *TaxNewsFlash* Legislative Updates].

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