ML Strategies Legislative Update

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House Ways and Means Tax Reform Proposal Dramatically Changes Energy Tax Landscape

On February 26, House Ways and Means Committee Chairman Dave Camp (R-MI) released his long-awaited tax reform discussion draft, the Tax Reform Act of 2014. To achieve his goal of lower individual and corporate tax rates, Chairman Camp proposes eliminating a number of popular tax provisions, many of which are energy-related. Fossil fuel, nuclear, biofuel, and renewable energy sectors all lose key tax incentives. While the draft preserves the valuable intangible drilling costs deduction, which allows oil exploration and production companies to write off various expenses, Chairman Camp proposes eliminating both "last-in, first-out" accounting rules that lower the taxable value of stored inventory and the percentage depletion deduction for oil and gas wells. The proposal eliminates the Section 199 domestic manufacturing incentive, but it does so for all industries, not just the oil and gas industry.

The renewable energy sector is hit hard under the proposal, especially when compared with the tax reform draft then-Senate Finance Committee Chairman Baucus released a few months ago. Traditional energy companies with large revenues might benefit from lower corporate rates, even at the cost of various useful deductions or credits. Renewable energy companies with smaller tax appetites benefit less, relative to other industries, from lower corporate tax rates. The renewable industry currently depends on tax credits and accelerated depreciation to finance the commercialization of new technologies, so the elimination of these provisions would make renewable energy financing more difficult.

The draft declines to extend expired clean energy incentives such as the Section 45 production tax credit (PTC). Moreover, for companies still eligible for the PTC, which is paid out over ten years, the draft cuts the PTC by almost 40 percent, from 2.3 cents/kWh to 1.5 cents/kWh. Biofuel credits are also repealed. The 30 percent investment tax credit (ITC) for solar and geothermal energy under Section 48 would not be extended after it expires in 2016. The underlying ITC, which reverts to ten percent after 2016, also would be repealed. The summary does not detail whether other technologies eligible for ITC, including fuel cells and microturbines, would also have their ITCs repealed, but the general repeal of the energy credit suggests all Section 48 technologies would lose their ITCs after 2016 as well.

Chairman Camp's release of this draft is the culmination of many months of work. However, Republican leadership remains skeptical about the political prospects of pursing reform in an election year. Energy groups across the spectrum starting criticizing the discussion draft soon after it was released. Given the political realities, and the fact that Chairman Camp's greatest ally recently left the Senate to serve as the new ambassador to China, the bill is unlikely to gain traction on the House floor this year. Still, the discussion draft—like the Senate Finance one before it—provides an important marker for proposals likely to be assembled during the next Congress.

Below is a list and description of energy-related provisions impacted by the Tax Reform Act of 2014, taken from the official section-by-section summary, available here.

Sec. 3113. Repeal of deduction for energy efficient commercial buildings.
Under current law, a taxpayer could claim a deduction with respect to certain energy-efficient commercial building property expenditures incurred prior to 2014. Under the provision, the deduction would be repealed. The provision would be effective for property placed in service after 2013. The provision would have no revenue effect over 2014-2023.

Sec. 3122. Phaseout and repeal of deduction for income attributable to domestic production activities.
Under current law, taxpayers may claim a deduction equal to 9 percent (6 percent in the case of certain oil and gas activities) of the lesser of the taxpayer's qualified production activities income or the taxpayer's taxable income for the tax year. Under the provision, the deduction for domestic production activities would be phased out, with the deduction reduced to 6 percent for tax years beginning in 2015 and 3 percent for tax years beginning in 2016. The deduction would be repealed for tax years beginning after 2016. The provision would increase revenues by $115.8 billion over 2014-2023

Sec. 3130. Repeal of percentage depletion.
Under the percentage-depletion method, a percentage, varying from 5 percent to 22 percent (generally 15 percent for certain oil and gas properties), of the taxpayer's gross income from a producing property is allowed as a deduction in each tax year. Under the provision, the percentage-depletion method would be repealed. The provision would be effective for tax years beginning after 2014. According to the Joint Committee on Taxation (JCT), the provision would increase revenues by $5.3 billion over 2014-2023.

Sec. 3131. Repeal of passive activity exception for working interests in oil and gas property.
Under current law, the passive loss rules limit deductions and credits from passive trade or business activities. Pursuant to a special rule, a passive activity does not include a working interest in any oil or gas property that the taxpayer holds directly or through an entity that

does not limit the liability of the taxpayer with respect to the interest. Under the provision, the passive activity exception for working interests in oil and gas property would be repealed. The provision would be effective for tax years beginning after 2014. The provision would increase revenues by $0.1 billion over 2014-2023.

Sec. 3132. Repeal of special rules for gain or loss on timber, coal, or domestic iron ore.

Under the provision, gain from timber cut by an owner and used in its trade or business, and from the disposal of timber or coal or domestic iron ore held for more than one year before the disposal, would no longer be treated as capital gain. Thus, all gain in these circumstances would be treated as ordinary income. This provision generally would be effective for tax years beginning after 2014.

Sec. 3201. Repeal of credit for alcohol, etc., used as fuel.

Under current law, a taxpayer could claim per-gallon incentives relating to alcohol (including ethanol) and cellulosic biofuels. Under the provision, these fuel tax credits would be repealed. The provision would be effective for fuels sold or used after 2013. The provision would have no revenue effect over 2014-2023.

Sec. 3202. Repeal of credit for biodiesel and renewable diesel used as fuel.

Under current law, the biodiesel fuels credit was the sum of three credits: (1) the biodiesel fuel mixture credit, (2) the biodiesel credit, and (3) the small agri-biodiesel producer credit. Under the provision, these fuel tax credits would be repealed. The provision would be effective for fuels sold or used after 2013. The provision would have no revenue effect over 2014-2023.

Sec. 3205. Repeal of enhanced oil recovery credit.

Under current law, taxpayers may claim a credit equal to 15 percent of enhanced oil recovery (EOR) costs. Under the provision, the enhanced oil recovery credit would be repealed. The provision would be effective on the date of enactment. The provision would have no revenue effect over 2014-2023.

Sec. 3206. Phaseout and repeal of credit for electricity produced from certain renewable resources.

Under current law, a taxpayer may claim a credit (the production tax credit or PTC) for the production of electricity from qualified energy resources. Qualified energy resources are comprised of wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Under the provision, the inflation adjustment would be repealed, effective for electricity and refined coal produced or sold after 2014. The entire production tax credit would be repealed, effective for electricity and refined coal produced and sold after 2024. The provision would increase revenues by $9.6 billion over 2014-2023.

Sec. 3213. Repeal of credit for production of low sulfur diesel fuel.

Under current law, a small business refiner may claim, with respect to expenses paid or incurred before 2010, a credit of 5 cents per gallon for each gallon of low sulfur diesel fuel produced during the tax year. Under the provision, the credit would be repealed. The provision would be effective for expenses paid or incurred in tax years after 2014. The provision would have no revenue effect over 2014-2023.

Sec. 3214. Repeal of credit for producing oil and gas from marginal wells.
Under current law, producers may claim a $3-per-barrel credit (adjusted for inflation) for the production of crude oil and a 50-cents-per-1,000-cubic-feet credit (also adjusted for inflation) for the production of qualified natural gas. Under the provision, the credit would be repealed. The provision would be effective for tax years after 2014. The provision would have no revenue effect over 2014-2023.

Sec. 3215. Repeal of credit for production from advanced nuclear power facilities.
Under current law, a taxpayer producing electricity at a qualifying advanced nuclear power facility may claim a credit equal to 1.8 cents per kilowatt-hour of electricity produced for the eight-year period starting when the facility is placed in service. Under the provision, the credit would be repealed. The provision would be effective for electricity produced and sold after 2014. The provision would increase revenues by $0.6 billion over 2014-2023.

Sec. 3216. Repeal of credit for producing fuel from a nonconventional source.
Under current law, a taxpayer producing coke and coke gas in the United States at qualified facilities and sold to unrelated parties could claim a credit equal to $3 (generally adjusted for inflation) per Btu oil barrel equivalent. Under the provision, the credit would be repealed. The provision would be effective for fuel produced and sold after 2013. The provision would have no revenue effect over 2014-2023.

Sec. 3217. Repeal of new energy efficient home credit.
Under current law, an eligible contractor could claim the new energy-efficient home credit for the construction of a qualified new energy-efficient home prior to 2014. Under the provision, the credit would be repealed. The provision would be effective for homes acquired after 2013. The provision would have no revenue effect over 2014-2023.

Sec. 3218. Repeal of energy efficient appliance credit.
Under current law, a taxpayer could claim a credit for the production of certain energy-efficient dishwashers, clothes washers, and refrigerators prior to 2014. Under the provision, the credit would be repealed. The provision would be effective for appliances produced after 2013. The provision would have no revenue effect over 2014-2023.

Sec. 3221. Repeal of credit for carbon dioxide sequestration.
Under current law, a taxpayer may claim a credit of $20 per metric ton for qualified carbon dioxide captured by the taxpayer at a qualified facility and disposed of by such taxpayer in secure geological storage. Under the provision, the carbon dioxide sequestration credit would be repealed. The provision would be effective for credits determined for tax years beginning after 2014. The provision would increase revenues by $1.1 billion over 2014-2023.

Sec. 3224. Repeal of energy credit.
Under current law, taxpayers may claim up to a 30-percent nonrefundable, business energy credit for the cost of certain new equipment that either (1) uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat, or (2) is used to

produce, distribute, or use energy derived from a geothermal deposit. Under the provision, the credit would be repealed. The provision is effective for property placed in service after 2016. The provision would have no revenue effect over 2014-2023. While the discussion draft only mentions solar and geothermal as benefiting from the energy credit, other technologies, such as microturbines, qualify for a 10-percent investment tax credit. Presumably, the repeal of the energy credit would impact those technologies as well.

Sec. 3225. Repeal of qualifying advanced coal project credit.
Under current law, a taxpayer may claim an investment tax credit for power generation projects that use integrated gasification combined cycle (IGCC) or other advanced coal-based electricity generation technologies. Under the provision, the credit would be repealed. The provision would be effective for allocations and reallocations after 2014. The provision would increase revenues by $0.9 billion over 2014-2023.

Sec. 3226. Repeal of qualifying gasification project credit.
Under current law, a taxpayer may claim an investment credit for certain qualifying gasification projects. Under the provision, the credit would be repealed. The provision would be effective for allocations and reallocations after 2014. The provision would increase revenues by $0.3 billion over 2014-2023.

Sec. 3227. Repeal of qualifying advanced energy project credit.
Under current law, a 30-percent credit is available for investments in certain property used in a qualified advanced energy manufacturing project. A qualified advanced energy project is a project that re-equips, expands, or establishes a manufacturing facility for certain specified green energy uses. Under the provision, the credit would be repealed. The provision would be effective for allocations and reallocations after 2014. The provision would increase revenues by $0.3 billion over 2014-2023.

Sec. 3309. Nuclear decommissioning reserve funds.
Under current law, a taxpayer responsible for decommissioning a nuclear power plant may establish a nuclear decommissioning reserve fund to resolve certain tort liabilities. Under the provision, the special 20-percent tax rate for nuclear decommissioning reserve funds would be repealed, and the tax rate generally applicable to corporations would apply. The provision would be effective for tax years beginning after 2014. The provision would increase revenues by $1.2 billion over 2014-2023.

Sec. 3310. Repeal of last-in, first-out method of inventory.
Under current law, a taxpayer must account for inventories if the production, purchase, or sale of merchandise is a material income-producing factor in the taxpayer's trade or business. Under the last-in, first-out (LIFO) inventory accounting method, it is assumed that the last item entered into the inventory is the first item sold. Under the provision, the LIFO inventory accounting method would no longer be permitted. Thus, taxpayers could use first-in, first-out (FIFO) or any other method that conforms to the best accounting practice in a particular trade or business and clearly reflects income. According to JCT, the provision would increase revenues by $79.1 billion over 2014-2023.

Sec. 3317. Repeal of recurring item exception for spudding of oil or gas wells.

Under current law, an accrual-method taxpayer generally may deduct an expense only when all events have occurred that fix the fact of the liability, the amount of the liability is determinable with reasonable accuracy, and economic performance has occurred. An exception applies to certain expenses that are recurring in nature, which is commonly referred to as the "recurring item" exception. The recurring-item exception is not available for a tax shelter, unless the tax shelter involves drilling oil or gas wells and the drilling commences within 90 days of the close of the tax year to which the expense relate. Under the provision, the special exception for oil or gas well tax shelters would be repealed, and the recurring item exception would not apply to any associated drilling expenses. The provision would be effective for tax years beginning after 2014. The provision would increase revenues by $0.2 billion over 2014-2023.

Sec. 3620. Publicly traded partnership exception restricted to mining and natural resources partnerships.

Under current law, a publicly traded partnership is treated as a c corporation for Federal tax purposes, but an exception applies to a publicly traded partnership if 90 percent or more of the partnership's gross income comes from qualified income. Under the provision, the special exceptions for publicly traded partnerships would be repealed other than for partnerships with 90 percent of their income from activities relating to mining and natural resources (e.g., mining, production, refining, and transporting). Thus, publicly traded partnerships would generally be treated as C corporations. The provision would be effective for tax years beginning after 2016. The provision would increase revenues by $4.3 billion over 2014-2023.

Sec. 7002. Modifications relating to oil spill liability trust fund.

Under current law, an excise tax is imposed on crude oil (including crude oil condensates and natural gasoline) that is received at a U.S. refinery and on petroleum products that are imported into the United States, and revenues are deposited into the Oil Spill Liability Trust Fund. Under the provision, the excise tax would continue to be imposed at a rate of 9 cents per barrel for 2018 through 2023. In addition, the definitions of "crude oil" and "petroleum products" to which the excise tax applies would be modified to include crude oil condensates, natural gasoline, any bitumen or bituminous mixture, any oil derived from a bitumen or bituminous mixture, shale oil, and any oil derived from kerogen-bearing sources. The provision would be effective for oil and petroleum products received at U.S. refineries or imported into the United States during calendar quarters beginning more than 60 days after the date of enactment. The provision would increase revenues by $1.2 billion over 2014-2023.

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