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Green Energy Tax Plan May Come With Unwelcome Tradeoff

By **Keith Goldberg**

Law360, New York (April 24, 2013, 9:10 PM ET) -- U.S. lawmakers on Wednesday reintroduced a bipartisan bill that would allow for renewable energy projects to be structured as master limited partnerships, a favorable taxing structure often used by oil and gas developers that attorneys say could help level the playing field for renewables, but not if it comes at the expense of existing renewable tax credits.

Democrats and Republicans in both houses of Congress back the bill, dubbed the Master Limited Partnerships Parity Act. The bill would modify the tax code to let renewable projects be structured as master limited partnerships — which are taxed as partnerships rather than corporations, but have publicly traded ownership interests.

Currently, the attractive MLP option is limited to oil, gas and coal projects.

“The bipartisan Master Limited Partnerships Parity Act levels the playing field to help clean and renewable energy projects compete fairly with traditional energy projects," said a statement from Sen. Chris Coons, D-Del., one of the Senate bill's sponsors. "This market-driven solution supports the all-of-the-above energy strategy we need to power our country for generations to come. Our legislation will unleash private capital, create jobs and modernize our tax code."

Coons and co-sponsor Sen. Jerry Moran, R-Kan., introduced a similar bill last year, but it went nowhere.

Renewable energy MLPs would benefit from the lower cost of capital that comes with eliminating the corporate-level tax on profits. And they'd be able to raise funds publicly at better rates compared with private equity, which could make them more competitive with nonrenewable projects, attorneys say.

Now, renewable energy projects rely on incentives like tax equity financing, which allows investors to offset their federal tax bills by investing in clean energy, according to Day Pitney LLP of counsel Michael Stosser.

Traditional energy projects, on the other hand, don't need these types of incentives, said Stosser, who formerly worked as an investment banker specializing in energy.

But attorneys warn that MLP status should supplement the tax credits for renewable development that are already on the books, not replace them.

"There continues to be a significant question of whether raising capital in the public equity markets would provide a sufficient benefit to offset the lack of any subsidy," said Blake H. Winburne, the global head of McDermott Will & Emery LLP’s energy practice group.

Those subsidies include the production tax credit and the energy investment tax credit. These credits were set to expire Dec. 31, but Congress extended them by one year in its deal to avert the fiscal cliff. Some Republicans in Congress have sought to kill the credits, while President Barack Obama wants to make the production tax credit permanent.

"What the [renewable] industry fears is that members of Congress will view this [bill] as a trade — and that's not a trade that the industry wants to make, nor one that is a sensible trade to make," said Akin Gump Strauss Hauer & Feld LLP tax partner David Burton.

For one thing, even with the MLP option, securing tax equity financing for renewable projects is still difficult, attorneys say. And individual investors in MLP projects are largely unable to use tax credits and other benefits, due to 1986 tax reform rules that cracked down on the use of MLPs as tax shelters.

"If I wanted to invest in a wind farm and receive production tax credits, I would find that all of my tax benefits would be suspended because I can only use those tax credits against other passive income that I might have," Orrick Herrington & Sutcliffe LLP tax partner Greg Riddle told Law360. "Your typical individual investor isn't going to have a lot of passive income it can use."

Another issue is the relative immaturity of many renewable industries, at least compared to fossil fuels, attorneys say. MLP investors generally demand stable, consistent returns and may be reluctant to invest in renewable projects that aren't off the ground yet or that don't have long-term power purchase agreements to ensure a stable cash flow, attorneys say.

MLPs would be more effective for running projects or a portfolio of projects that have already utilized tax incentives, according to Morgan Lewis & Bockius LLP tax partner Paul Gordon.

"Where the MLP structure comes into play is once the project is developed," said Morgan Lewis business and finance partner Allan Reiss. "Once the MLP is up and running, it's a very flexible tool for financing future projects."

Still, MLPs would offer renewable project developers and their initial investors a way to cash out after any development tax credits have have been exhausted, attorneys say

"The initial investor might still be more willing to invest their funds in a renewable project if they thought they could get their money out of the project by going public as an MLP," said Mike Bresson, who heads Baker Botts LLP's MLP tax practice.

This year's version of the bill — which has the backing of the renewable industry — already has one powerful ally: Ron Wyden, D-Ore., who chairs the Senate Committee on Energy and Natural Resources.

“Sen. Coons is taking exactly the right approach by putting renewables on a level playing field with fossil fuels on master limited partnerships," Wyden said in a statement Wednesday. “My aim is for Congress to accomplish that as part of comprehensive tax reform."

While attorneys say the bill is a good first step, more can be done to even out the competition with fossil fuels.

"The next step would be to make sure the rules allow the MLP to take advantage of the tax credits," said McDermott energy tax team leader Phil Tingle. "If that's the next step, I could see it opening up a whole new avenue for equity for those projects."

But even that would be negated if the bill's price is the death of production tax credits, attorneys say.

"If you took away the tax incentives and allowed an MLP, I'm not sure the economics are going to be comparable," Tingle said.

--Editing by Kat Laskowski and Lindsay Naylor.