

Resurgent Renewables?

A quick look at current US and UK taxation initiatives in support of renewable energy

In advance of the upcoming UK Carbon Budget, and in light of President Obama signing the American Recovery and Reinvestment Act of 2009 (the Stimulus Act) into law in the US, it is interesting to compare the current approaches of the US and the UK towards encouraging renewable energy and how tax strategy has been, and will be, used to further these aims.

Energy production

Currently, US promotion of the production of energy from renewable sources at the national level involves the production tax credit (PTCs) and energy tax credit (ETCs) regimes. Essentially, PTCs are a per-unit tax credit (2.1 US cents per kWh for 2008, and adjusted annually for inflation) allowed to a qualifying energy facility which produces and sells energy to an unrelated person. Wind, geothermal and closed-loop biomass (organic matter planted for the exclusive purpose of producing energy) facilities qualify for full PTCs, whilst other production methods, including hydrokinetics, landfill gas, refuse and open-loop biomass (using certain waste nutrient and other by-products to generate energy) can qualify for half-rate PTCs. The credits are generally available over a ten-year period from the date on which the facility comes into service and are not subject to clawback on disposal. Accelerated taxable depreciation (over five years) is typically available in respect of the equipment used in qualifying for wind, biomass and geothermal facilities.

ETCs are available in respect of qualifying solar, gas microturbine, cogeneration and fuel cell equipment. The credit amounts to a one-time, non-refundable tax credit equal to 30% of the cost of the relevant property, claimed in the tax year in which the facility comes into service. The credit is subject to

Alex Cole and Julie Marion, associates at Latham & Watkins, review efforts on both sides of the Atlantic to encourage the use of renewable energy

clawback (on a declining basis) in the event of a disposal within five years of the into-service date, and owners claiming the ETC must reduce their depreciable basis in the qualifying property by 50% of the credit amount. Accelerated taxable depreciation (over five years) also is typically available for qualifying solar energy equipment.

The Stimulus Act extends and expands these regimes, giving US developers

(and 10% of certain other facility types). These grants generally are to be subject to the same clawback and basis reduction rules as under the ETC regime and are only available for qualifying facilities placed into service in 2009 or 2010 (or after 2010 in the case of certain long-term construction projects commenced in 2009 or 2010). Grant recipients may not claim either the PTC or ETC.

Interestingly, in terms of cross-border

The Stimulus Act gives US developers significantly greater opportunities to obtain and monetise environmental tax credits

greater opportunities to obtain and monetise these renewable energy tax credits. First, the Stimulus Act extends the deadline by which PTC-qualifying facilities must be placed in service. The deadline extensions vary according to the technology type, but average two to three years, which should give developers and investors comfort in planning and constructing new projects. The Stimulus Act does not extend the placed in service deadlines for ETC-qualifying property, as this date previously was extended long-term in October 2008.

Secondly, the Stimulus Act allows PTC-qualifying facilities in the US to elect for ETC treatment in lieu of the ability to claim PTCs. Thirdly, provisions allow the Secretary of the Treasury to make cash grants equal to 30% of the tax basis of certain renewables facilities

investment in environmental technologies, to the extent a qualifying facility is used or owned by a foreign person (or a pass-through entity with foreign ownership), the tax benefits of ETCs, cash grants and accelerated taxable depreciation generally are unavailable to the extent of such foreign use or ownership.

The UK approaches energy production tax incentives from the opposite direction. The climate change levy, charged on energy sources supplied by a utility on a per-kWh (or, in certain circumstances, per-kilo) basis, is not charged in relation to supplies made from renewable sources. In effect, the supplier contracts with its customers to supply them with renewable source electricity. The supplier is then obliged to ensure that, over an averaging period (implemented to allow for the unpredictable nature of some renewable

energy sources, such as wind power), it generates or receives enough of its energy from qualifying sources to meet its outgoing renewable energy supply commitments. Failure to satisfy this requirement over the averaging period results in a duty to account for the 'exempted' levy.

In some ways, the US PTC and ETC regimes (and the new cash grant initiative) are closer, economically, to the 'feed-in tariff' system used to promote environmental technologies in a number of countries (whereby fixed rates are paid for the production of energy from renewable sources). The UK climate change levy exemption, on the other hand, mimics a quota system (under which the state prescribes the proportion of energy which certain suppliers must source from renewables). Previously, both the UK and the US have traditionally espoused the quota system as the preferred method of allowing market economics to drive the uptake of renewables whilst, for instance, Germany (Europe's class leader in terms of renewable energy usage) has backed the 'feed-in tariff' approach. Interestingly, the US now seems to be moving towards the latter method, using a more 'carrot'



Alex Cole

water-saving and purifying equipment, and only s 45E expenditure (plant or machinery for gas refuelling station) directly promotes a renewable energy source. The extent to which the pro-renewables effect of the various categories mentioned above is offset by the s 45F first-year allowance for expenditure for



Julie Marion

this type and scale. Most of the current UK environmental tax initiatives (transport and fuel taxes, vehicle excise duties, landfill taxes, aggregate levies, congestion charges and the auctions of EU Emissions Trading Scheme permits) are punitive rather than incentive in their approach. In general these initiatives focus on discouraging, via excess duties, activities regarded as wasteful or carbon-generative, rather than directly encouraging investment in 'clean' or renewable technologies through tax incentives. It is unclear what appetite there is for further increases in such duties at a time when the Treasury is keen to be seen as assisting UK businesses through the current economic upheaval. Accordingly, it is unclear if and how the Treasury will be able to drive significant uptake of renewables in the UK whilst adhering to the current environmental tax strategy.

It will be interesting to see whether the publication of the inaugural Carbon Budget, which is to accompany the Chancellor's April Budget, will lead to a shift in Treasury policy towards a more proactive regime of tax-incentivisation for renewables and other 'clean' technologies. Such an approach would certainly follow the lead recently taken on these issues by the US under the Stimulus Act. Inevitably, it is likely that we will have to wait for the later publication of the detailed policies which are to implement the Carbon Budget's obligations before this becomes clear.

Alex Cole, Latham and Watkins, can be contacted at Alex.Cole@lw.com. Julie Marion, Latham and Watkins, can be contacted at Julie.Marion@lw.com.

The US now seems to be moving towards. . . a more 'carrot' and less 'stick' approach to renewables development

and less 'stick' approach to renewables development, possibly because it sees this as a more effective driver for growth in this area. The UK currently seems happy to keep faith with its prescriptive quota approach, highlighted by the recent removal of the duty differential between biofuels and other transport fuels (a tariff system), and the introduction of the Renewable Transport Fuel Obligation (a quota system) in its place.

Enhanced capital allowances/depreciation

Expenditure in the UK on certain designated energy-saving and other pro-environment technologies can qualify for 100% first-year capital allowances under Capital Allowances Act (CAA) 2001, s 52. However, whilst they may indirectly stimulate the renewables industry, the qualifying expenditure categories under the CAA do not actively promote renewables as such. For example, 'environmentally beneficial plant or machinery' under s 45H only really covers

use wholly in a 'ring-fence trade' (that is, oil-related activities) is of course open to debate.

The ETC regime in the US, described above, provides more direct and obvious promotion of renewable energy initiatives, as does the accelerated taxable depreciation regime available for certain renewable technologies. The Stimulus Act's extension of the 50% bonus depreciation regime (applicable to new property with a depreciable life of 20 years or less brought into service in 2008) to equipment brought into service in 2009 may further encourage investors looking to make investments in energy-efficient technologies in the immediate future.

Upcoming developments

In the US the Stimulus Act has materially extended the ability of US renewables investors to obtain and monetise tax credits in relation to their qualifying expenditure. The UK renewables industry has not yet benefited from tax-driven legislative encouragement of