Energy & Environmental Taxes Committee Meeting

ABA Tax Section Meeting
Washington, DC
May 10, 2019
Moderator:
  – Courtney Sandifer, Mazars USA

Presenters:
  – Jennifer Bernardini, Attorney, Branch 6, Passthroughs and Special Industries
  – Taylor Cortright, KPMG
  – Hannah Hawkins, Deputy Tax Legislative Counsel, Treasury- Office of Tax Policy
  – Brad Seltzer, Eversheds Sutherland

Note: Slides prepared by non-governmental panelists only
Agenda

- Regulatory Updates
- Judicial Updates
- Legislative Updates
Regulatory Updates
Utility related Highlights from the 163(j) Regulations Hearing:

- The definition of interest is too broad under the Proposed Regulations and should be restricted to what is generally treated as interest elsewhere in the Internal Revenue Code.
- Clarification should be provided as to whether certain rates charged by companies under the jurisdiction of FERC or other regulatory bodies qualify as a cost of service/rate of return basis to qualify a business as an excepted utility trade or business – specific example is excess power sales to RTO with proceeds credited to ratepayers.
- Speakers noted that the use of asset basis to determine the extent to which a trade or business is an excepted trade or business for purposes of section 163(j) is a reasonable method, and that the limited use of a tracing of debt approach provided in the Proposed Regulations should not be expanded.
- Simplification of the average asset basis determination was urged, especially for trades or businesses with relatively stable asset bases – less frequent testing.
Proposed Qualified Opportunity Zone Regulations

Hearing:

• Relaxing the proposed 50% gross income test – which requires that 50% of the gross income of an opportunity zone investor be derived from the respective zone – in order to allow consideration of income generated outside of the opportunity zone.

• Relaxing the timing of investments and reinvestments, both by investors into Qualified Opportunity Funds and by Qualified Opportunity Funds into Qualified Opportunity Zone businesses.

• Permitting the use of different valuation methods for the 90% asset test and the 70% substantially all test, including unadjusted cost basis.

• Treating cash as QOZ property for the first 12 months, conditioned on funds being invested within 12 months.

• Including long-term ground leases as Qualified Opportunity Zone property with a basis of zero.
Tax Reform Guidance—Opportunity Zones


• Acquisition of interest in Opportunity Funds
• Debt-financed distributions
• Section 1231 gain and 180-day rule
• Deferred gain inclusion
• Special rules for partnerships, S-Corporations, and REITs
• Original use requirement and substantial improvement
• Leases of TPP
• 90 percent asset test
• Active conduct of a trade or business/non-qualified financial property
• Consolidated returns
• Anti-abuse provisions
Opportunity Zones and Renewables

- Renewables industry had been concerned about depreciation recapture
- Guidance eases concerns regarding basis post-OF exit
- Renewed interest in using OZs for renewable projects
- Does a project that is legal under state law qualify if it is illegal under Federal law (indoor growing of cannabis)?
Section 48 Regulations Project

— Current Status
Excise Tax Guidance

  • Removals of taxable fuel from Milwaukee and Madison terminals
  • Extension until December 31, 2019

— Notice 2019-10, 2019-13 I.R.B. 913, Request for comments on Excise Tax Regulations regarding fuel used in a motor vehicle power takeoff or power transfer
  • Dual use of fuel issue
Normalization Guidance

— Normalization PLR 201842001
  • Taxpayer filed refund claims for additional bonus depreciation
  • Although refunds had not yet been received, taxpayer sought to reduce ratebase by the deferred taxes attributable to the additional bonus depreciation.
  • Consistent with the CNOL rulings, the IRS ruled that the rate base reduction prior to the time the benefits are realized (refunds received) violates normalization

— Notice 2019-33
  • Clarified ARAM requirement and Reverse South Georgia “exception”
  • Seeks comments on a variety of issues
  • Relationship to rumored “generic normalization guidance”?
Excess Deferred Taxes and Passthrough Entities

- On 2/21/2019, FERC issued “preliminary” order in Trailblazer paper hearing – assessing whether to grant tax allowance as non-MLP pass through entity – need to show no double recovery or reasonableness of rates – Can receive income tax allowance for corporate owners (55%), but not individual owners/PE funds (45%)

- On 4/18/19, FERC denied request for rehearing on its final rule on Federal income tax rates for jurisdictional natural gas pipelines (Order 849, Order 849-A) – required the filing of Form 501-G with proposed treatment of excess revenues, ADIT, and the tax allowance for pass through entities
Nuclear Decommissioning

- Decommissioning PLR 201907005 – transfer of a qualified nuclear decommissioning fund to a non-qualified fund in accordance with terms of a sale disqualified the fund in its entirety effective on date of transfer and the entire value, reduced by tax imposed, deemed distributed, and economic performance deemed satisfied. The distribution was not deemed to constitute self-dealing.

- Does amount realized include relief from decommissioning liabilities assumed by buyer?
Nuclear Decommissioning

- Loss Deduction PLR 201910001: An electric industry corporate subsidiary ("Taxpayer") is allowed a loss deduction under tax code Section 165 as a result of the abandonment of a nuclear plant. As costs and construction time exceeded projections, and Taxpayer was considering its options, "Joint Owner" unilaterally decided to suspend construction, prompting Taxpayer to likewise abandon the project and related property, and to pursue rate recovery of incurred costs, according to the representation. "Taxpayer demonstrated the requisite intent to abandon the Property and the Project, and effectuated that intent through numerous affirmative acts of abandonment," the IRS said.

- Possible generic rate recovery is not "insurance or otherwise." See Rev. Rul. 87-117
Nuclear Decommissioning

— Fund PLR 201909007: A nuclear plant plant’s owner ("Taxpayer") entered into a trust agreement establishing both a qualified and nonqualified nuclear decommissioning fund to hold money for decommissioning the plan under tax code Section 468A. Upon termination of the qualified fund, any remaining assets would be transferred into the nonqualified fund and such assets would remain in the trust. Pursuant to Treasury Regulations Section 1.468A-5(c)(3), Taxpayer’s qualified fund will be treated as disposing its assets via a deemed distribution to its nonqualified fund for purpose of Section 1001 as of the date of the termination with any gain or loss determined by a fair market value basis of the assets deemed distributed.
Judicial Updates

- On January 7, 2019, the Federal Court of Claims ordered developer to pay back $5.63m in 1603 grant
- Issue was whether developer fee overly inflated eligible ITC tax basis
- Developer fee was $50m or 12.3% of project cost, but developer made a capital contribution to the project company to pay itself the developer fee
- Opinion currently sealed, awaiting court order on redactions motions
- On 5/3/19, Taxpayer filed motion to stay execution of order, pending appeal – bond required

- Government filings indicate:
  - Plaintiffs could not provide evidence that any development services were actually provided
  - The development fee was determined by senior management based upon its assessment of what a third party would pay for a completed project
  - Many of the purported development services to be provided under the agreement were duplicative of other development costs that were already included in cost basis (presumably through other 3rd party agreements)
  - Because the Plaintiff could not state what development services were undertaken, it could not prove that the costs were for eligible activities
**Excise Tax Cases**

**Income tax treatment of section 6426 mixture credit**

  - Holding section 6426 mixture credit is a reduction of section 4081 fuel excise tax liability (and therefore a corresponding reduction to cost of goods sold)

  - Adopting *Sunoco* reasoning
  - Holding cost of goods sold must include only section 4081 fuel excise tax liability actually paid after subtracting section 6426 mixture credit

Definition of “alternative fuel” for purposes of the section 6426 alternative fuel mixture credit; butane

- Valero Marketing and Supply Co. v. United States, No. 5:19-cv-00328 (W.D. Tex. Apr. 1, 2019) (complaint filed)
Excise Tax Cases

Imposition of section 4611 oil spill tax on exported domestic crude; Export Clause of the U.S. Constitution

Pollution Control

Texas Commission on Environmental Quality v. Brazos Valley Energy LLC, Case 18-0128 (Tex. Spm Ct. May 3, 2019) – Texas Commission on environmental quality cannot deny property tax exemption for heat recovery steam generators – legislature expressly stated that such property is pollution control property – Commission can only determine the amount of property that qualified not whether any property qualified
Legislative Updates
Expired Provisions

- Expired provisions:
  - Alternative and renewable fuel credits and payments (IRC 40, 40A, 6426, 6427)
  - Oil spill tax (IRC 4611)
  - Energy efficient housing credit (IRC 45L)
  - Energy Efficient Commercial Building Deduction (IRC 179D)

- Higher rates expired:
  - Coal/Black lung excise tax (IRC 4121)
Extenders?

Ways and Means?


• Section 40 – Second generation biofuel producer credit (retroactive production through 2019)
• Section 40A/6426/6427 – Biodiesel and renewable diesel incentives (retroactive sales and uses through 2019)
• Section 6426 – Alternative fuel (retroactive sales and uses through 2019)
  • Section 6426(e) “clarification” of rules regarding alternative fuel mixture credit (excludes LPG, CNG, LNG, and certain compressed or liquefied gas derived from biomass) (effective for any fuel sold or used before date of enactment to extent a section 6426(e) credit has not been paid or allowed as of that date)
• Section 4611 – Oil spill tax (through 2019)
• Section 4121 – Coal/black lung (reduce tax rates through 2019)
• Section 45L – Energy efficient housing credit (through 2019)
• Section 179D – Energy efficient commercial building deduction (through 2019)
Questions?