

ENERGY! ENLIGHTENING & INVIGORATING THE PRACTICE OF INDIAN LAW

Plenary Panel: Pathways to Power: Energy Development in Indian Country - Tracey A. LeBeau

An Update Four Years Later....

“The Green Road Ahead: Renewable Energy Takes a Stumble but Is on the Right Track, Possibly Right through Indian Country”

(FBA Federal Lawyer Magazine, March/April 2009).

THE RENEWABLE MARKETPLACE & INCENTIVES

2009:

- Renewable energy marketplace contracted significantly in 2008-09 time period, creating more difficulty for already difficult investment environment in Indian Country.
- Recovery Act programs were seeking to incentivize renewable investments and supplant tax equity market contractions.
- Questioning and tinkering of federal and state tax credits and incentives for renewables were underway.

Updates:

The United States has nearly doubled renewable energy generation from wind, solar, and geothermal sources since 2008. In fact, last year, according to industry experts, the United States reclaimed the title as the world's leading investor in clean energy technologies, besting countries like China, India, and Germany. Even with record low natural gas pricing, which its renewables grid-parity proxy, renewable investments have steadily been decreasing. This year will be a new test, given the uncertainty around longer term incentive authorities.

Investments such as the Grant-In-Lieu-Of-Tax-Credits (GILTC) program and other strategic tax incentives and investment programs provided a financing bridge until tax equity markets rebounded. Strategic tax advantaged investors have come back into the marketplace since 2009. Although Tribes are technically eligible for these tax credits should they form taxable entities, the efficient use of them is more commonly taken by taxable entities with sufficient capacity and basis. The challenge remains on how best to incentivize non-taxable capital that Tribes could deploy in renewable energy so as to be competitive with projects which utilize incentives which can often account for up to 60% of the cost of a project (driving produced cost of energy down for taxable entities which then can be more competitive in the marketplace).

U.S. Oil and Gas Production

Domestic oil and natural gas production has increased every year since 2009. In 2011, American oil production reached the highest level in nearly a decade and natural gas production reached an all-time high. In 2010, the United States imported less than half of all oil consumed – a first in 13 years. In fact, net imports as a share of total consumption declined from 57 percent in 2008 to 45 percent in 2011 – the lowest level in 16 years. In the last year alone, we have cut net oil imports by 10 percent – a million barrels per day.

Questioning continues regarding federal tax and financial incentives for renewable energy. A one year extension for the federal Production Tax Credit (PTC), which largely affects wind investments, was passed the beginning of 2013. The GILTC program authority has expired and no proposals

appear imminent on reauthorization. States are beginning to re-engineer their tax incentive programs to attract energy investments now that federal incentives may be winding down and Recovery Act mechanisms have lapsed. The following are the most common federal incentives that are currently authorized:

Primary Federal Tax and Financial Incentives for Renewable Energy and Technologies

Modified Accelerated Cost-Recovery System (MACRS) + Bonus Depreciation

MACRS. Under the federal Modified Accelerated Cost-Recovery System (MACRS), corporate taxpayers recover investments in qualified property through depreciation deductions. Although MACRS establishes a set of class lives for various types of property usually ranging from three to 50 years, certain qualified renewable energy technologies are classified as five-year property (26 USC § 168(e)(3)(B)(vi)). Qualified property is referentially defined in 26 USC § 48(a)(3)(A).

BONUS DEPRECIATION. The January 2013 American Taxpayer Relief Act of 2012 (H.R. 8, Sec. 331) extended the placed in service deadline for qualified property for a 50% first-year bonus depreciation to December 31, 2013. Essentially, the property owner is entitled to deduct a significant portion of the adjusted basis of the property during the tax year the property is first placed in service and must be harmonized with any other tax credits which affect depreciation limits and adjusted basis.

To now qualify for bonus depreciation, a qualified property/project must:

- have a recovery period of 20 years or less under normal federal tax depreciation rules;
- the original use of the property must commence with the taxpayer claiming the deduction;
- have been acquired during the period from 2008 - 2013; and
- have been placed in service during the period from 2008 - 2013.

Business Energy Investment Tax Credit (ITC)

In January 2013 the American Taxpayer Relief Act of 2013 revised the language governing the ability of Production Tax Credit (PTC, see below) eligible facilities to claim the ITC to allow projects that begin construction by the end of 2013 to qualify for the ITC. [Note: Prior to H.R. 8, the law required PTC-eligible facilities to be placed in service by the end of 2013 (or 2012 in the case of wind) in order qualify for the ITC.]

In 2008, the federal business energy investment tax credit available under 26 USC § 48 was expanded significantly by the Energy Improvement and Extension Act (H.R. 1424), which extended the duration to December 31, 2016 of the existing credits for solar energy, fuel cells and microturbines; increased the credit amount for fuel cells; established new credits for small wind-energy systems, geothermal heat pumps, and combined heat and power (CHP) systems; allowed utilities to use the credits; and allowed taxpayers to take the credit against the alternative minimum tax (AMT), subject to certain limitations. The credit was further expanded by the American Recovery and Reinvestment Act of 2009, enacted in February 2009. In general, the taxpayer must own and/or construct at time property is placed into service. The American Recovery and Reinvestment Act of 2009 repealed a previous restriction on the use of the credit for eligible projects also supported by "subsidized energy financing." (e.g., New Market Tax Credits, etc)

In summary, the credits are as follows:

- Solar. The credit is equal to 30% of expenditures, with no maximum credit, on eligible property primarily used to generate electricity, heat or cool or provide solar process heat.
- Fuel Cells. The credit is equal to 30% of expenditures and credit is capped at \$1,500 per 0.5 kilowatt (kW) of capacity. Minimum capacity and efficiency requirements are specified.
- Small Wind Turbines. The credit is equal to 30% of expenditures for wind turbines up to 100 kW in capacity.
- Geothermal Systems. The credit is equal to 10% of expenditures, with no maximum, generally focused on geothermal energy property used to produce, distribute or use energy derived from a geothermal deposit. Other requirements are specified.
- Microturbines. The credit is equal to 10% of expenditures, with no maximum credit limit stated, capped at \$200 per kW of capacity. Minimum capacity and efficiency requirements are specified.
- Combined Heat and Power (CHP). The credit is equal to 10% of expenditures, with no maximum limit stated. Minimum capacity and efficiency requirements are specified and as well as other limitations.

Renewable Electricity Production Tax Credit (PTC)

A tax credit most commonly utilized for wind facility investments, the production tax credit is a per-kilowatt-hour credit for electricity generated and sold by the taxpayer to an unrelated person during the taxable year. Originally enacted in 1992, the PTC has had a long history of expirations and near-expirations which have caused a boom-and-bust cycle in wind investments throughout the years. To address and stimulate investment in 2009, the PTC was revised to extend the in-service deadline for most eligible technologies by three years and allow PTC qualifying facilities to opt to take the federal business energy investment credit (ITC) instead (or an equivalent cash grant from the U.S. Department of Treasury). Although the cash grant option has expired, Congress in January 2013 revised the credit by:

- removing "placed in service" deadlines with the "beginning of construction" as a basis for determining facility eligibility;
- extending the deadline for wind energy to December 31, 2013;
- extending the permission for PTC-eligible facilities to claim the ITC through "start of construction" date in 2013; and
- revising "municipal solid waste" to exclude "paper that is commonly recycled and which has been segregated from other solid waste."

TRANSMISSION, TRANSMISSION, TRANSMISSION

2009:

- Transmission policy and legislation was being considered to incentivize build-out and investment to connect renewable resources to markets.

Update:

Transmission legislation, nor clean energy standard legislation did not materialize which would significantly incentivize markets to commit to projects which would serve as financial anchors for new transmission build out on a regional or national basis. The Recovery Act did authorize new public-private partnerships between federal transmission administrations and private sector players, which has brought on line a number of planned and needed projects. In one case, a project which has been permitted has at least one commercial tribal solar project lining up to take

advantage of the new transmission capacity the project will bring to the marketplace. Additionally, the federal government has identified seven (7) interstate transmission projects for a pilot rapid response effort to speed the siting and permitting of transmission. The goal is speed bringing clean energy to ready markets - several of the rapid response projects have tribal land and territorial components.

NATION BUILDING/TRIBAL ENERGY SECURITY

2009:

- Indian tribes are ready for “nation building at home” by investing, developing, facilitating, and participating in building the infrastructure required to support green energy.

Update:

The proposition still rings true. As the nation’s interest in energy security has grown - ranging from seeking to become more energy independent from foreign oil to the Defense Department’s recent activity to reach their renewable energy procurement goals of 20% by 2025 - so has the articulated interest by Tribes gained traction in seeking out how to lower and stabilize energy costs on tribal lands. As a component, this Tribal interest and focus on energy infrastructure development has emerged as a strategy to serve growing populations as well as a need to attract economic investment. Steady specific requests from tribal leadership have resulted in increased levels of federal coordination to support clean energy and infrastructure projects in Indian country, not just for revenue generation but now also focused attention on leveraging resources to support infrastructure development for tribal consumption.

EMERGING CHALLENGES: COMPLEX MARKETS, COMPLEX REGULATION

2009:

Only one commercial scale renewable project was in operation on Indian lands. The concern regarding renewable energy leasing and permitting, as well as financing of these projects, were largely projections rather than actual experience to draw upon.

Update:

- Several commercial scale renewable energy projects are in operation or have been announced in Indian Country, as well as several community- and facility-scale energy projects.
- Tribal renewable energy leasing and permitting, and particularly pilot fast-tracked projects, are providing some lessons-learned.
- While some markets have expanded due to state-level regulatory goals or renewable compliance rules, others have contracted due to an uptick in renewable commitments in the 2008-2012 time period which has led to their reaching their renewable portfolio standard (RPS) requirements or goals. In absence of a national standard, the take away is that renewable markets are largely driven by state law and mandates.
- Updated, peer-reviewed renewable energy estimates were completed in late 2012 by the Department of Energy’s Office of Indian Energy, which found the following:
 - Indian land comprises approximately 2% of U.S. land but contains an estimated 5% of all renewable energy resources.
 - The total technical potential on tribal lands for electricity generation from utility-scale rural solar resource is about 14 billion MWh, or 5.1% of total U.S. generation potential.
 - The total technical potential on tribal lands for electricity generation from wind resources is about 1,100 million MWh, or about 3.4% of the total U.S. technical potential.
 - The total technical potential on tribal lands for electricity generation from hydropower resource is about 13 million MWh, or about 5.1% of the total U.S. technical potential.

- Natural gas production has increased in Indian Country in the last few years, and will likely continue to increase into the future, particularly shale oil and gas production.

Taxation and Regulatory Jurisdiction.

Taxation remains a vexing issue for Tribes, particularly for renewable energy projects which require owners to be taxpaying entities. In some cases, state and local taxation of renewable facilities or leasehold “improvements” is being assessed or threatening to be assessed to the extent that non-tribal entities are in positions of tax-paying ownership. Recent cases which have fueled new discussion around taxation on facilities, fixtures and improvements on tribal lands have included the *Confederated Tribes of the Chehalis Reservation v. Thurston County Board of Equalization*, No. Co8-5562BHS (W.D. Wash. Apr. 2, 2010) and *Calpine v. Arizona Department of Revenue*, 211 P.3d 1228 (Ariz.App. 2009), wherein a variety of taxes have been assessed on projects located on Indian reservations.

Some trends that are emerging include Tribes seeking and negotiating project ownership structures which efficiently deploy tax incentives during the period of the incentives, and provide options for ownership post-tax incentive periods. The most common tax assessments which have emerged in the renewable world have been contractors excise taxes, leasehold interest taxes, and sales and use taxes. Some states have proposed tax compacting for renewable energy project taxation of facilities on Indian lands; while others have refused to discuss tax compacting at all related to leasehold and other taxes on project assets located on Indian lands. In 2012, the Department of Interior promulgated new Indian leasing and permit regulations (Revisions to the Leasing Regulations, 25 CFR 162) in order to replace the “non-agricultural leases” subpart with subparts specific to residential leasing, business leasing, and wind and solar resource (WSR) leasing. In addition to eliminating BIA approval of permits for WSR uses of Indian land, the regulations also seek to clarify what laws and taxes apply to leases approved under 25 CFR 162 and speak to state taxation on improvements.

Jurisdictional coordination also remains an unresolved and emerging matter. This is particularly the case for commercial scale renewable and other generation projects which seek and require interconnection to transmission facilities, on or off tribal lands, which will transport generation to markets off-reservation. The inter- and intra-state nature of transmission regulation does make generation projects located on Indian lands more complex as state utility and line-siting commissions, as well as Tribes, do not have much experience or models to fall back on in wading through jurisdictional analysis and coordination on inter-jurisdictional energy and infrastructure projects.

Another emerging issue related to taxation and jurisdiction involves utilizing property and similar tax abatements as an incentive. Some states which were previously staking out strong energy taxation policies are now rolling back, or providing tax holidays, to renewable and transmission investments to incentivize capital. Tribes who might have previously looked to tribal taxation strategies are peering over their fences to see capital investment attracted to more potentially favorable tax regimes. Tax incentive planning can now run the gamut from tax credit optimization to tax abatement to tax avoidance. Given the nature of these new market drivers, tribal tax policy is riding those shifting sands.