EYE ON THE ELECTION: POTENTIAL IMPACT ON TAX INCENTIVES FOR POWER AND RELATED INDUSTRIES

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There is little doubt that the outcome of the 3 November federal election will be consequential for much of America, and that the consequences are likely to be very different depending on who sits in the Oval Office and the Senate after the inauguration. Of all the industries that employ Americans, the power and related industries such as oil and gas, carbon capture, and electric vehicles may experience the starkest consequences.

RENEWABLE ENERGY AND ENERGY STORAGE

Renewable energy, including wind, solar, biomass, and certain hydroelectric, facilities, currently qualify for significant U.S. federal income tax incentives that are slated to expire or be dramatically reduced in the next few years. While there is no income tax credit for standalone energy storage assets or storage that is paired with non-renewable generation, both energy storage and renewable energy facilities currently benefit from bonus depreciation deductions.

It is reasonable to assume that if either or both of the White House and Senate continue to be controlled by Republicans after the November election, then some of the federal income tax credits for renewable energy may be allowed to expire. Which and how many of those credits depends on a variety of factors, including whether any broader tax reform or infrastructure measures are taken up by lawmakers. It is also worth noting that the temporary tax provisions, including much of the production tax credit and investment tax credit provisions, are generally grouped together, so if any of them is extended, it is likely that most or all of them would be extended. On the other hand, while less useful for many investors, it is widely expected that bonus depreciation would be either extended or made permanent.

If the White House and Senate turn blue, the incentive structure for renewables may be very different. Former Vice President Joe Biden has released a clean energy plan to achieve net-zero emissions by 2050 and reduce the carbon footprint of U.S. buildings by 50 percent by 2035, in part by incentivizing "on-site clean power generation." Many of the topics addressed in Mr. Biden's clean energy plan were also addressed in H.R. 2, the Moving America Forward Act, which was passed by the House of Representatives earlier this year. In addition to renewal or extension of renewable energy credits and other incentives, it is possible that we would see another attempt—possibly successful—to enact a federal tax credit or other incentive specifically for standalone energy storage. If such an incentive is enacted, it is likely that it would be agnostic as to generation, which could help many utilities achieve the stabilization that is increasingly important on many grids. Nonetheless, the Congressional Budget Office recently projected that the 2020 budget deficit will be $3.3 trillion, which will presumably place additional stress on efforts to incent economic activity through the tax law without removing or reimagining other incentives, for example, those available to the oil and gas industry.

OIL AND GAS(SES)

The oil and gas industry currently may claim depletion deductions (somewhat similar to depreciation deductions) for some assets and bonus depreciation for others. Beyond that, there are several federal income tax credits for marginal oil or natural gas wells, low-sulfur diesel, enhanced oil recovery, and fuel manufactured from a nonconventional source. In addition, there are federal excise tax incentives for certain types of alternative fuels including hydrogen, which may be produced as a byproduct of petroleum-based processes, using certain emerging technologies that are petroleum-free, or through steam methane reforming (which currently is the predominant method in the United States). In addition, there is currently an income tax credit for investments in refueling property for hydrogen and other alternative fuel vehicles. In general, the alternative fuels incentives have recently expired or will very soon expire.

On the assumption that many state and local governments will continue their drive toward power and transportation that produces fewer emissions, it seems likely that the oil and gas industry as a whole will continue to support incentives for hydrogen and possibly other alternative fuels as well as the infrastructure needed to allow individual taxpayers to use such fuels. Given the public support for the industry by many Republican lawmakers, there appears to be a good chance that these incentives may be resuscitated or extended if Republicans retain the White House and Senate. In addition, making bonus depreciation permanent may help the industry recover from a very rough 2020.

On the other hand, if Mr. Biden is elected and at least 50 Democrats take seats in the Senate, the prognosis for hydrogen and other alternative fuels is somewhat murkier. Mr. Biden has indicated that he sees a continuing role for natural gas in the nation's electricity and fuels markets. Given that hydrogen can be produced through an emissions reducing process and burns clean when it is used, it is conceivable that hydrogen incentives could generally be extended in a Democrat-led tax reform program, though there is a chance that an incentive would be limited to so-called “green” hydrogen produced from petroleum-free processes. However, based on public statements by some Democratic candidates, it also seems that other tax incentives for the oil and gas industry may be considered for repeal, perhaps to help pay for expanded clean energy incentives or other Democratic policy priorities.

ELECTRIC VEHICLES

There are currently federal income tax credits for both electric vehicles and electric vehicle “refueling” stations. Both of these credits are set to expire this year. While it seems unlikely these credits would be revived if Republicans take the White House or the Senate, Mr. Biden has indicated he intends to work with state governments to dramatically increase the number of charging stations and work with Congress to revive the electric vehicle income tax credit. Presumably, an increase in charging stations would be supported by a revival of the electric vehicle refueling station credit.

CARBON CAPTURE

The federal income tax credit for carbon capture equipment was renewed and expanded in late 2018. Currently, the credit may be available in respect of carbon capture equipment in a variety of contexts, including carbon capture storage equipment used at natural gas processing facilities, direct air capture, and other industrial contexts that would otherwise result in carbon oxide emissions, e.g., concrete manufacturing. While the captured carbon must be sequestered, the credit provision allows for this to occur in a variety of ways, including utilization for bacterial or photosynthetic processes, mineralization, and use as a tertiary injectant, provided the carbon oxide is disposed of in secure geological storage. Recently released proposed regulations clarified many taxpayer questions and created additional paths toward qualification, but the credit is currently available only for industrial facilities and direct air capture facilities, the construction of which begins before 2024, and only then if carbon capture equipment was included in the original plan and the design of the facility or construction of the carbon capture equipment itself began before 2024.

The carbon capture industry is currently enjoying a day in the sun as more and more people in the United States recognize the need to not only reduce emissions of carbon, but to eliminate much of the carbon currently in the atmosphere. We have also seen a pronounced uptick in interest in carbon credits certified by various nongovernmental organizations and in California and New York. Given that commercialization efforts around captured carbon are still somewhat nascent, extending the time period for federal income tax credits could go a long way toward finding reasonably priced capital for carbon capture facilities. Given that the extension and expansion was passed by a Republican-controlled Senate and White House and the continuing popularity of carbon capture methods in the oil and gas industry, it is possible that the credit could be extended regardless of the party that controls the White House or Senate. Nonetheless, it seems somewhat more likely that additional government efforts to support carbon sequestration, for example, a national cap-and-trade system, would be more likely if Democrats control the White House and Senate.

INFRASTRUCTURE

While there are specific provisions of the tax law that concern rules unique to energy infrastructure and utilities, there are no significant provisions that seek to materially incent the revamping or extension of the U.S. power grid. However, grid infrastructure is widely recognized as needing significant investment for a variety of reasons including to prevent undue influence by foreign adversaries on the U.S. power grid and adapt to the changing generation profile in many parts of the country. Major infrastructure investment has been discussed for several years and included in some legislative efforts in the last couple of years, including a Democrat-led infrastructure bill in the Senate and H.R. 2 earlier this year. However, investment in the grid has not yet been made, and it is not clear that it would be made regardless of whether the federal government turns blue on 3 November. Nonetheless, if the federal government moves forward with a major infrastructure bill, it seems likely that tax or other monetary incentives related to essential infrastructure such as the electric grid would be included.

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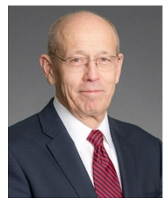

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