**Statement of Randy S. Howard**

**On behalf of the Northern California Power Agency and American Public Power Association**

**House Subcommittee on Select Revenue Hearing on**

**Tax Tools to Help Local Governments**

**March 11, 2021**

Chairman Thompson, Ranking Member Smith, and members of the subcommittee, thank you for this opportunity to discuss the operational and economic impacts to the Northern California Power Agency (NCPA) specifically and to publicly owned electric utilities in general related to tax tools to help local governments.

I am Randy Howard, General Manager of NCPA. NCPA consists of sixteen members representing approximately 700,000 utility customers—large and small, rural and urban, that have banded together to build and deliver a variety of generation resources. I also am testifying on behalf of the American Public Power Association (APPA). APPA is the voice of not-for-profit, community-owned utilities that power more than 2,000 towns and cities nationwide. Most public power utilities are owned by cities and towns, but many are owned by counties, public utility districts, and even states. Combined, public power utilities provide electric power to more than 49 million people and 2.6 million businesses and employ 93,000 people. Our business is to keep the lights on 24-hours a day, 365 days a year, and as you have read or experienced recently, it is becoming more challenging.

Nationwide on average, public power utility customers enjoy lower retail rates and higher reliability than customers served by other electric power utilities.[1] However, changes in the resource mix of electric power generation, a growing population, fuel transfer to electrification, more frequent extreme weather events, aging infrastructure, and a sprawling electric power grid pose challenges that must be addressed.[2] We believe that reforms to energy tax incentives to make them more broadly available and to the tax treatment of municipal bonds to make them more efficient could be critical to any "build back better" initiative.

[1] Am. Pub. Power Ass'n, 2017-2018 Public Power Directory & Statistical Report 48 (2017); Press Release, U.S. Energy Info. Admin., EIA Data Show Average Frequency and Duration of Electric Power Outages (Sept. 12, 2016), https://www.eia.gov/todayinenergy/detail.php?id=27892.

[2] The bulk power grid alone includes more than 240,000 miles of high-voltage power lines (230 kilovolts and greater). By comparison, the entire European Union has just 191,000 miles of such lines.

**Energy Tax Code Excludes State and Local Entities**

Congress routinely seeks to incentivize certain types of energy investments and energy production. Sometimes this is done through direct federal grants, subsidized loans, and/or loan guarantees, but the most significant and consistent incentives are provided through the federal tax code. According to the most recent Joint Committee on Taxation estimate, energy-related tax expenditures will be worth more than $14.6 billion to in 2021 alone.[3]

These tax policies began decades ago. Business energy investment tax credits (ITCs) were enacted in 1978 and 1980 to stimulate the development of "alternative" energy sources and remain in effect today.[4] In 1992, Congress created a production tax credit (PTC) for the production of energy from renewable resources, which also remains in effect today.[5] Combined ITCs and PTCs account for roughly 80 percent of the federal energy-related tax-expenditure budget.[6]

However, tax-exempt entities, including public power utilities, cannot directly benefit from either the ITC or PTC. Some entities with little to no tax liability enter into a "partnership flip" transaction with a tax-equity partner to monetize tax credits from projects in which they have an ownership interest. These transactions have significant limitations, including substantial transaction costs making it economically viable for only large projects in the range of $50 million to $200 million.[7] They also require the formation of a "taxable blocker" corporation which state and local entities are unable to create.

Public power utilities can indirectly benefit from energy-related tax credits by entering long-term power-purchase agreements with taxable entities that can benefit from the credits. However, the transactional costs and complexity of such agreements can be high. Additionally, only a portion of the value of the tax credit is generally passed on to the purchaser, thus muting the incentive benefits to the end-consumer.

As the resource mix transitions across public power utilities, managing grid reliability and resiliency becomes more difficult with a number of these power-purchase agreements. The current model is showing clear gaps as the electric grid is adapting and hardening for the extreme weather events. There is still a need and use for these agreements, but load serving entities are seeking more flexibility and control over the resources.

To meet some of the requirements and needs, many public power utilities have structured their power purchase agreements with developers using the ITC or PTC while including purchase and pre-paid options that provide them with better control over the operational activity, the quality of the equipment and underlying maintenance, and overall reliability of the projects.

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[3] Jt. Comm. on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2020-2024* (JCX-23-209) (Nov. 5, 2020).
[4] Energy Tax Act, Pub. L. 96-618, 92 Stat. 1374; Crude Oil Windfall Profits Tax Act Pub. L. 96-223, 94 Stat. 229 (codified as 26 U.S.C. 48).
[5] Energy Policy Act of 1992, Pub.L. 102-486 § 1914 (codified as 26 U.S.C. 45).
[6] Most of the remaining 42 percent is largely attributable to the electric vehicle tax credit, residential tax credits, and credits, depreciation provisions, and deductions related to fossil fuel extraction and transmission.
[7] Nat'l Rural Elec. Coop. Ass'n, Cooperative Utility PV Field Manual: Volume I: Business Models and Financing Options for Utility-Scale Solar PV Installations (2015), at 51.

These more complex structures add more development challenges and reduce ratepayer benefits of these tax incentives. Some public power utilities have moved forward and developed large renewable projects using their labor forces and tax-exempt financing without any ITC or PTC just to have the operational control and reliability to integrate these projects into the resource mix. In doing so, their ratepayers did not receive the intended tax benefits.

These costs and limitations are problematic in that tax-exempt entities serve a substantial percentage of the nation's retail electric customers. Roughly 14.4 percent of U.S. customers are served by public power utilities and another 13.0 percent are served by tax-exempt rural electric cooperatives. The remaining are served by investor-owned utilities (IOUs). Goals to reduce to net zero greenhouse gas emissions by electric utilities generally include all three types of retail utility providers, not just IOUs, but you cannot equitably nor efficiently get to 100 percent with just 70 percent of electric utilities.

**Comparable Incentives**

Over the last several decades, Congress has tried several methods of providing comparable federal energy incentives to tax-exempt entities. In 1992, Congress authorized Renewable Energy Production Incentives (REPI) for public power utilities and rural electric cooperatives. REPI sought to provide direct payments comparable to the PTC earned by taxable entities. However, during the 15 years during which REPI funds were appropriated, public power utilities and rural electric cooperatives qualified for $329 million in REPI payments, but Congress appropriated just $54 million for the program. After 2009, Congress stopped appropriating funds for REPI entirely.

In the Energy Policy Act of 2005 (EPAct05), Congress sought to provide an investment incentive for certain tax-exempt entities akin to the ITC by creating the Clean Renewable Energy Bond (CREB).[8] Qualified CREB issuers included public power utilities, states and localities, and rural electric cooperatives. Interest paid on a CREB is taxable, but the CREB holder receives a tax credit. However, tax credit bonds are quite complex, and issuers had a difficult time finding willing buyers. As a result, in 2010, Congress modified CREBs (now called New CREBs) to allow issuers the option of receiving a direct payment from Treasury in lieu of providing bond holders a tax credit.[9] However, CREBs and New CREBs still were hamstrung by an overall volume limit, which was initially set at $800 million, but eventually increased to $2.4 billion.[10] This limit was problematic in that allocating volume was time consuming and burdensome both for issuers and the Internal Revenue Service (IRS). The limit was also substantially lower than needed to meet demand. For example, in 2009, the IRS received 38 applications from public power utilities requesting a total of $1.45 billion in New CREB bond volume, but just $800 million of bond volume was available for public power.[11] New CREBs issued as direct payment bonds were further handicapped by budget sequestration—across-the-board cuts applying to all mandatory spending, including payments to issuers of direct payments bonds despite assurances from Treasury and Congress that new CREBs would not be subject to sequestration. Finally, in 2017, Congress prohibited

[8] Energy Policy Act of 2005, Pub. L. 109-58 § 1303 (codified as 26 U.S.C. 54).
[9] Hiring Incentives to Restore Employment Act of 2010, Pub. L. 111-147, 124 Stat. 71.
[10] American Recovery and Reinvestment Act of 2009, Pub. L. 111-5, 123 Stat. 115.
[11] Internal Revenue Service "IRS Announces New Clean Renewable Energy Bonds Allocations" (Oct. 27, 2009) (https://www.irs.gov/tax-exempt-bonds/irs-announces-new-clean-renewable-energy-bonds-allocations-0) (last visited Jan. 17, 2020).

the issuance of any additional New CREBs as part of the Tax Cuts and Jobs Act.[12]

In some instances, Congress has allowed for the transfer of tax benefits from tax-exempt entities to taxable entities. For example, in EPAct05, Congress expanded existing tax preferences for clean-fuel motor vehicles by creating a tax credit for the purchase of an alternative fuel vehicle, including hybrid vehicles.[13] Under the statute, if the purchaser is a tax-exempt entity, the tax credit automatically transfers back to the vehicle's seller. Identical language was included in 2008, when Congress provided a tax credit for plug-in electric drive motor vehicles.[14] In 2018, Congress modified two existing ITCs (one for carbon capture and sequestration, the other for advanced nuclear facilities) to allow for transferability.[15] As a result, the carbon capture and sequestration tax credit can be transferred from the purchaser of the carbon capture facility to the person that disposes of the carbon dioxide ($CO_2$), uses the $CO_2$, or uses the $CO_2$ as a tertiary injectant. Similarly, the advanced nuclear tax credit now can be transferred to another "eligible project partner." These policy changes put public power utilities on a more level-playing field with other electricity providers and allow them to make investments in technologies and projects that will reduce $CO_2$ emissions. Transferability seems the closest to comparability of incentives, but we understand that there are concerns about the potential for arbitrage and abuse should a greater volume of tax credits become transferable.

**The GREEN Act**

On February 5, 2021, House Ways and Means Committee Democrats introduced the Growing Renewable Energy and Efficiency Now (GREEN) Act of 2021, an updated version the bill introduced in June of 2020. The GREEN Act takes a different and superior tack to ensuring that all entities have access to energy investment incentives embedded in the tax code. Specifically, section 4 of the GREEN Act allows taxpayers to elect to be treated as having made a payment of tax equal to 85 percent of the value of the credit they would otherwise be eligible for under the ITC, PTC, or Tax Code section 45Q credit for carbon capture and sequestration. In the case of a public power utility or other tax-exempt entity, this deemed payment of tax would in turn be refunded to the entity by the Treasury Department.[16] This election is intended as an alternative for: a) taxable entities with little to no current taxes owed that would otherwise have to carry forward credits to years when they would have enough tax liability against which to offset the credits or b) tax-exempt entities, including public power utilities, that could not claim the credits at all.

APPA strongly supports this approach. It would ensure that public power utilities could make the best choices on behalf of the 49 million people they serve on how to move toward their energy goals most efficiently. Some will continue to make use of power purchase agreements with third party providers, but having the option to develop such projects on their own will be able to strike better deals for their customers. In many instances, the projects will look much the same – same designers and same

[12] Pub. L. 115-97, 131 Stat. 2054.
[13] Energy Policy Act of 2005, supra note 3.
[14] Emergency Economic Stabilization Act of 2008, Pub. L. 110-343, 122 Stat. 3765.
[15] Bipartisan Budget Act of 2018, Pub. L. 115-123, 132 Stat. 63.
[16] The exact mechanism for a tax-exempt entity seeking a refund of a deemed overpayment is not prescribed under the legislation, but we would hope that it would be a process akin to filing IRS Form 8849 seeking repayment of federal gasoline taxes paid on fuel used solely for governmental purposes.

contractors -- but the ownership will change. Again, these transactions will be simpler and less costly, with benefits flowing directly back to customers. In other instances, direct ownership with the benefit of tax credits could open opportunities for a host of smaller projects. These are projects too small to attract tax equity investors today (or on governmental sites where private ownership or long-term lease is not allowed), but are not economic today compared to other alternatives without the benefit of tax incentives.

We think these changes in energy-project development will produce three key benefits. First, insofar as these transactions are more efficient and more of the benefit of these tax incentives will flow through to customers in the form of lower prices, in turn reducing the cost hurdle and encouraging public power investments.

Second, encouraging cities and towns to build and own their own generation means local projects, under local control, with local jobs. Each of these communities' own land for the benefit of the community, such as civic building and airports, and may use these lands for energy consider projects.

Our member City of Healdsburg, California recently completed the largest floating solar project in the country at its water treatment facility. This project will serve approximately 8 percent of the community's power needs going forward and provides several additional benefits. The entire City of Healdsburg was recently evacuated due to wildfires surrounding community and has been the victim of multiple transmission public safety power shutoffs because of wildfire risks. Adding this important generating resource in the community increases the resiliency for emergency services and the opportunity for a microgrid that can operate when the transmission system shuts down. The other benefits are the floating solar covering the pond provides shade and reduces the water temperature and potential for algae that impacts the costs of processing and water quality for the community. Because of the project benefits, Healdsburg proceeded with a power purchase agreement where the developer applied for the ITC, but the city is challenged by allowing a third-party lease and operational access to such a critical part of its community infrastructure. With a comparable incentive, Healdsburg would have developed and owned this project directly.

NCPA on behalf of its members and non-members, including the State of California, owns and operates a large centralized natural gas power plant in the City of Lodi, California. The not-for-profit owners are leading an effort to transition this critical facility from natural gas to green hydrogen. This would be one of the largest and first green hydrogen gas projects in the country. The incentive benefits of the GREEN Act of 2021 will make this significant transition of an existing natural gas power plant more realistic.

In the western states, wildfires have become a year-round occurrence and have devastated entire communities resulting in deaths and loss of property. These wildfires emit dangerous and toxic emissions exceeding what many power plants emit in multiple years. Publicly owned utilities working with their communities on methods to mitigate wildfire risks and the devastation have identified removal and disposal of dead and infested forest wood waste as part of the mitigation requirements. Wood waste biomass generation is not part of the GREEN Act of 2021, but should be added. This would be a powerful tool for these communities and provide a dispatchable generating resource while restoring jobs to these impacted communities.

Third, a key challenge for tax-based energy incentives is spreading their benefit equitably. A refundable tax credit opens opportunities in communities, neighborhoods, and homes that might otherwise get left behind. Creating renewable jobs and investing directly within the community show the benefits of ownership and keep ratepayer funds within the community. Numerous public power utilities want to develop community solar parks to better serve their customers who do not own the rooftops or are unable to afford installing a rooftop system. These projects provide shade for parking lots, parks, zoos, schools, and civic buildings while addressing equity issues. Local communities can also connect and coordinate these projects with transportation electrification.

**Bond Modernization**

In the last decade, states and localities made approximately $2.3 trillion in tax-exempt-bond-financed new investments in public infrastructure and are on track to make another $3 trillion in such investments over the next 10 years. Tax-exempt municipal bonds finance construction, maintenance, and repair of schools, hospitals, roads, bridges, ports, airports, water systems, single- and multi-family housing, parks, fire stations, police stations, libraries, courthouses, jails, and other key infrastructure. Public power utilities alone are making $7 billion a year in tax-exempt-bond-financed investments in their generation, transmission, and distribution systems. As public power utilities respond to community demands for more clean energy and addressing environmental justice, and take steps to increase resiliency in the face of the growing frequency and severity of extreme weather events, the need for improving the efficiency and flexibility of tax-exempt financing is all the more important.

With interest rates near historic lows, the cost of financing these projects has been low. Nonetheless, we strongly believe that the volume of tax-exempt bond issuances is sufficient that even a modest change in the cost of borrowing would reap huge benefits. For example, just a 33 basis point reduction in the annual cost of borrowing would provide $10 billion a year in savings on the $3 trillion in municipal debt currently outstanding; a 66 basis point reduction would provide $20 billion a year in savings, and so on.

One way to achieve such savings would be to modernize the tax treatment of municipal bonds, which (but for the Tax Cuts and Jobs Act's prohibition of new issuances of tax-exempt advance refunding bonds and New CREBs) has not seen a substantive review since 1986. Such an agenda would:

- Reinstate tax-exempt advance refunding bonds;
- Prevent the sequestration of credit payments to issuers of Build America Bonds;
- Raise the small issuer exception from $10 million to $30 million; and
- Simplify private use rules.

This would make the public financing of public infrastructure simpler and more affordable. The Government Finance Officers Association (GFOA) outlined such an agenda,[17] which has been adopted by the Public Finance Network of which APPA is a member. A more detailed discussion of each of these proposals follows.

[17] Gov't Fin. Officers Ass'n, Issue Brief, "Tax Exempt Municipal Bonds and Infrastructure: Over 100 Years of Building Together" (Jan. 2019).

*Reinstate Advance Refunding* – Prior to enactment of the Tax Cuts and Jobs Act, issuers could refinance their tax-exempt municipal bonds with a tax-exempt advance refunding bond – although only once. The GFOA estimates that advance refunding from 2012-2017 saved state and local governments at least $11 billion through reduced interest expenses – savings passed onto state and local residents or reinvested. During the same period, 154 public power tax-exempt advance refundings of $20 billion of debt is estimated to have saved these utilities at least $600 million. Reinstating the ability to issue tax-exempt advance refunding would allow states and localities to refinance existing debt with the greatest flexibility, resulting in substantial reductions in borrowing costs.

*End Sequestration of Build America Bond Credit Payments* – In recent years, proposals to allow states and localities to issue taxable direct payment bonds have been considered as a way to expand the pool of investors for state and local infrastructure projects to include entities that are "indifferent" to tax, such as pension funds, insurance, and offshore investors. In turn, direct payments to issuers offset the added interest expense of issuing taxable debt, rather than tax-exempt debt. To ensure, however, that the federal government does not change the financials of these deals after the fact, these proposals generally (and appropriately) exempt credit payments from possible budget sequestration. This is also consistent with the current treatment of refundable tax credit payments to individuals and of refundable Alternative Minimum Tax (AMT) credit payments to corporations. However, prospective relief does not address the current inequity imposed by the sequestration that applies to direct payments bonds that have already been issued, including Build America Bonds and New CREBs. To date, payments to public power issuers of such bonds, including NCPA, have been cut by nearly $200 million under sequestration and will be cut by another $150 million by 2030. We strongly believe that credit payment to issuers of Build America Bonds and New CREBs should be treated the same as refundable credit payments to individuals and refundable AMT credit payments to corporations and be exempt from budget sequestration. Doing so would free up resources for future investments and increase the likelihood of uptake of any newly created taxable direct payment bond.

*Raise the Small Issuer Exception* – Under current law, a bank can deduct the carrying cost of purchasing debt from a "small issuer." An issue is considered "small" if the issuer will not issue more than $10 million in bonds during the year. However, that threshold has not been updated since 1986. Bipartisan proposals to permanently increase that threshold to $30 million and make other changes to "bank qualified debt" have been introduced in past Congresses and we support their enactment. Making small issuer debt more attractive to banks can provide access to capital that would not otherwise exist and/or reduce the cost of borrowing by increasing competition for these utilities' debt.

*Simplify Private Use Rules* – The tax code includes a simple, two-prong bright-line test for preventing municipalities from issuing tax-exempt municipal bonds for the private benefit of businesses:

- Prong 1: The Private Business Use Test – are more than 10 percent of the proceeds of a bond to be used by a private business; and

- Prong 2: The Private Business Payment Test – will more than 10 percent of the debt service on the bonds be derived from an interest in the property to be used by the private business.

A bond that exceeds both prongs of the 10-private-use test is considered a private activity bond, interest on which – unless being used to finance certain qualified facilities and activities – is taxable.

However, the tax code then muddies the 10-percent bright line test with a series of exceptions, including:

- A $15 million private-use limit for "output facilities" including electric utility equipment;
- A 5-percent limit for "unrelated or disproportionate" private business use of bond proceeds;
- A requirement that private activity bond volume cap be allocated for private use that exceeds $15 million;
- The automatic deeming as a private activity bond of a bond used to acquire an existing non-governmental output facility; and
- A 5-percent private loan test.

Many of these additional tests are needlessly complex, hinge on ill-defined concepts, and provide little additional public policy benefit.

Further complicating the issue is the nebulous definition of "private use" itself. For example, Internal Revenue Service regulations consider a customized contract between a public power utility and a commercial customer to be "private use" unless the contract is for three years or less, is an "all requirements" contract, or is a "small" contract, i.e., a contract in which annual revenues will be less than one percent of the tax-exempt bond debt service for the facilities related to the sale.

We recommend eliminating the $15 million private use limit for output facilities; the 5-percent limit for "unrelated or disproportionate" private business; and the requirement that private activity bond volume cap be allocated for private use that exceeds $15 million. APPA and NCPA would also like to work with stakeholders to consider reviewing the rules in relation to the acquisition of existing non-governmental facilities from a willing seller. This rule was crafted to prevent the use of tax-exempt debt to in a hostile acquisition, but is having unintended consequences for transactions involving willing sellers.

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## Private-Use Rules Flow Chart