10-1-2014

Renewable Energy: Where We Are Now and How Renewable Energy Investment and Development Can Be Expanded

Kevin M. Walsh

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The renewable energy field is currently stifled because many renewable energy developments require tax equity investors to provide additional funds to get the projects off the ground and running. The Tax Code provides credits to incentivize investors to invest. Currently, the Investment Tax Credit ("ITC") is the only available credit remaining for renewable projects. Tax credits are a step in the right direction to encourage renewable investment; however, the credits are limited in application, mostly to large financial institutions. Moreover, investing into one specific renewable energy project can be risky because there is no assurance that the development will yield a cash flow or be placed in service on time to receive the expected credit amount. Additionally, investing directly on-site into a renewable energy project is mostly accomplished for the purpose of receiving a credit to offset taxes from passive taxable income. This purpose may not meet the needs of many investors. Instead of a tax credit, other investors may want some type of rate of return, either through dividends, stock appreciation or some other method.

To remedy these issues, the legislature and the IRS should focus on alternative methods to expand renewable energy investment. First, the government should continue to put pressure on large companies (finance and other) to invest in renewable energy projects and to make renewable energy investment commitments. Second, these companies may not have an objective to receive a

[*] Experienced Associate, PricewaterhouseCoopers International Tax Services; LL.M. in Taxation, New York University School of Law, 2014; Law Clerk for the Superior Court of Connecticut, 2012-2013 term; J.D., Suffolk University Law School, 2012, *magna cum laude*; B.A., University of Michigan, 2008. Kevin wishes to thank his family, friends and professors for their support and encouragement.

tax credit for investing directly on-site to a renewable project. Therefore, there needs to be alternative methods for these companies to invest. Asset-backed securities, Real Estate Investment Trusts (REITs) and Master Limited Partnership's (MLPs) are alternative investment methods that would satisfy these companies' investment needs. Moreover, because on-site investment is mostly limited to large institutions, these alternative investment methods open the market for smaller investors to get a piece of the pie. The smaller investor pool is untested water: it could provide for a substantial amount of renewable energy investment.

These alternative methods should be used in conjunction with the ITC because companies have varying investment objectives. Large financial institutions will still want to invest on-site to receive the credits and deductions, whereas other companies that do not have enough taxes from passive taxable income (and otherwise would not be investing in the renewable project) can invest in the securities for a rate of return. This will have the effect of increasing renewable investment and development.

I. INTRODUCTION

Renewable energy has become an important economic sector in the United States over the past decade. Renewable energy has historically represented five to seven percent of power consumption in the United States.[1] In June 2013, the Energy Information Administration (EIA) issued a report that renewable energy sources provided 9.81 percent of U.S. energy consumption and 11.82 percent of U.S. energy production for the first half of year 2013.[2] Despite this progress, the United States remains far from its goal to have fifteen percent of electric energy consumption produced by renewable energy sources in 2016 and 2017, 17.5 percent in 2018 and 2019, and twenty percent in 2020 and each year thereafter.[3] To incentivize renewable energy growth, the United States government provides credits to tax equity investors. This Article will explore the available tax credits, identify the tax equity investors, describe those investors' roles in renewable energy development, explain why credits are limited to large financial institutions, and discuss four possible investment alternatives–(a) increased investment by large companies/institutions, (b) asset-backed securitization, (c) Real Estate Investment Trusts and (d) Master Limited Partnerships–that the government may use to incentivize renewable energy development and investment by broadening the investment pool to include large and small companies and smaller investors.

II. BACKGROUND

A. What is So Important About Renewable Energy?

There are two facets of renewable energy that are increasingly important. First, the United States heavily relies on coal, oil and natural

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1 Hobart King, *Trends in Renewable Energy Production & Consumption in the USA*, GEOLOGY.COM, http://geology.com/articles/renewable-energy-trends (last visited Sept. 27, 2014).

2 Kenneth Bossong, *Renewable Energy Mid-Year Report: 10% US Energy Consumption, 14% Net Electrical Generation*, RENEWABLEENERGYWORLD.COM (Sept. 30, 2013), http://www.renewableenergyworld.com/rea/news/article/2013/09/renewable-energy-mid-year-report-10-us-energy-consumption-14-net-electrical-generation.

3 Memorandum from President Barack Obama for the Heads of Executive Departments and Agencies about Federal Leadership on Energy Management (Dec. 5, 2013), *available at* http://www.whitehouse.gov/the-press-office/2013/12/05/presidential-memorandum-federal-leadership-energy-management [hereinafter Presidential Memorandum].

gas for energy consumption.[4] While the United States' net import share of total U.S. energy consumption was sixteen percent in 2012, the country imported forty percent of the petroleum it consumed that year.[5] The EIA predicts that the net import share of energy consumed will decrease to four percent by 2040.[6] This prediction demonstrates that the United States expects to domestically produce an increasing share of its energy consumption. This is a step in the right direction for our country.

There are currently about 950,000 people employed, directly or indirectly, through the renewable energy market.[7] At the very least, this Article contends that the United States needs to maintain the current level of production and utilization of renewable energy sources to keep these individuals employed. Fortunately, there is much room for growth here. For example, employment in the solar field has grown sixty percent since 2010, creating over 25,000 new jobs in that sector alone.[8] This Article also contends that if the renewable energy industry is to expand, the U.S. must rely less on exports from its foreign counterparts and boost domestic production, thereby augmenting GDP, by continuing to employ more workers. As renewable energy growth occurs, however, there is a likelihood that other, non-renewable energy sectors, such as coal mining, will lose market share and experience a possible compounding negative effect on employment therein.[9]

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[4] Kevin M. Walsh, *Renewable Energy Financial Incentives: Focusing on Federal Tax Credits and the Section 1603 Cash Grant: Barriers to Development*, 36 ENVIRONS ENVTL. L. & POL'Y J. 207, 208-09 (2012) (citing Gary C. Bryner, *Challenges In Developing A Diverse Domestic Energy Portfolio: Integrating Energy And Climate Policy In The Western United States*, 15 N.Y.U. ENVTL. L.J. 73, 73-74, 83 (2007); *How Dependent Are We On Foreign Oil?*, U.S. ENERGY INFO. ADMIN., http://www.eia.gov/energy_in_brief/foreign_oil_dependence.cfm (last updated July 13, 2012)).

[5] U.S. ENERGY INFO. ADMIN., DOE/EIA-0383ER(2014), ANNUAL ENERGY OUTLOOK 2014 EARLY RELEASE OVERVIEW 12 (Dec. 16, 2013).

[6] *Id.* at 2.

[7] Scott Sklar, *New Solar Job Statistics Released, But Other Renewables are Growing, Too*, RENEWABLEENERGYWORLD.COM (Jan. 28, 2014), http://www.renewableenergyworld.com/rea/news/article/2014/01/new-solar-job-statistics-released-but-other-renewables-are-growing-too; THE SOLAR FOUNDATION, THE ANNUAL REVIEW OF THE U.S. SOLAR WORKFORCE (2013), *available at* http://www.thesolarfoundation.org/sites/thesolarfoundation.org/files/TSF%20Solar%20Jobs%20Census%202013.pdf.

[8] *Id.*

[9] Christopher DeMorro, *The U.S. Has More Solar Workers Than Coal Miners*, CLEAN TECHNICA, http://cleantechnica.com/2014/07/22/u-s-solar-workers-coal-miners/ (last visited Oct. 28, 2014).

B. Tax Credit Overview[10]

Title 26 of the United States Code, section 45, governs the Production Tax Credit ("PTC"), a per-kilowatt-hour tax credit for electricity that is generated by "qualified energy resources" and sold to unrelated persons.[11] Section 45 provides that the taxpayer responsible for the renewable energy development will receive credits for ten years and that the annual credit is dependent on energy production.[12] The Section also provides that the credited project must have been placed in service by December 31, 2013, to be eligible to receive the credit.[13]

The inconsistency of the availability of tax credits is a major problem for investors as, for example, the tax credit expires and is not automatically renewed. Investors in renewable energy projects make their business decisions, in part, based on whether the tax credit will be available to use.[14] Tax equity investment is stifled without the kind of stability that is borne out of knowing whether the tax credit will be available.[15] A decrease in investment is seen especially when the credit expires because there is no assurance that the credits will be extended.[16] While understanding this issue is critical in context to grasp the issues in renewable energy investment, the focus of this Article discusses who can take advantage of these credits and how the current renewable investment sector can be expanded.

Title 26 of the U.S. Code, section 48, governs the Investment Tax Credit ("ITC"). Unlike the PTC, taxpayers utilize the ITC by taking a tax credit, equal to thirty percent or ten percent of their cost basis in the development—depending on the type of renewable energy development—in the year the development is placed in service.[17] The

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[10] Tax credits are amounts that reduce a taxpayer's total tax liability. The following example will illustrate this point: A person or company generates income. This income, following certain deductions, is considered a taxpayer's taxable income ("TI"). The applicable tax rates are applied against the TI and the taxpayer's resulting tax liability is borne. Credits are the amounts that reduce tax liability, dollar for dollar. If the taxpayer owes $4,000 in taxes but has $3,000 in tax credits, now the taxpayer only owes $1,000 in taxes.

[11] 26 U.S.C. § 45 (2006); DEP'T OF ENERGY, *Renewable Electricity Production Tax Credit (PTC)*, http://energy.gov/savings/renewable-electricity-production-tax-credit-ptc (last visited Oct. 6, 2014).

[12] 26 U.S.C. § 45 (2006).

[13] *Id.*

[14] *See* Walsh, *supra* note 4, at 235 (citing *Energy Tax Policy and Tax Reform: Hearing Before H. Comm. on Ways and Means*, 112th Cong. 14 (2011) (statement of Neil Z. Auerbach, Managing Partner of Hudson Clean EnergyPartners), *available at* http://waysandmeans.house.gov/uploadedfiles/auerbachtestimony922.pdf).

[15] *Id.*

[16] *Id.*

[17] 26 U.S.C. § 48 (2006).

ITC is also available for properties that are placed in service before January 1, 2017.[18]

From a policy perspective, the PTC seems like the more efficient credit because it is entirely based on the production of electricity. The ITC, however, has nothing to do with production of electricity, as the ITC development could be useless and the taxpayer would still receive the credit.[19] From a business perspective, this Article contends that the ITC is preferable to the PTC as an incentive to encourage renewable energy investment.

Although the ITC theoretically achieves the goal of attracting more investors to renewable energy projects[20], the ITC for solar energy used to generate electricity, heat and cool a building or provide solar process heat is legislated to decrease from thirty percent to ten percent after December 31, 2016.[21] Moreover, the ITC for geothermal heat pumps, hybrid solar lighting, small wind, fuel cells and micro-turbines will expire.[22] This Article contends that the reduction and expiration of the ITC is a mistake.

This Article believes that these forthcoming changes are bad policy. For example, consider that in the United States over the last decade, the amount of wind energy consumed has exponentially increased as compared to total renewable energy consumed.[23] In year 2000, wind energy consumption comprised less than one percent of total renewable energy consumed.[24] However, in 2007, wind energy represented 5.2 percent of total renewable energy consumed, and, in 2013, wind energy represented 17.2 percent of total renewable energy consumed.[25] This Article contends that reducing the percentage of the ITC against certain renewable energy, such as wind, will reduce the amount of renewable energy developments put in place.

Although there is not direct evidence that the credits are the reason that renewable energy production and consumption has increased over the past six years, there is a strong correlation between the availability of

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18 *Id.*

19 *See* generally 26 U.S.C. § 48 (2006).

20 *See* Walsh, *supra* note 4, at 235 (citing *Energy Tax Policy and Tax Reform*, *supra* note 14 (statement of Neil Z. Auerbach, Managing Partner of Hudson Clean Energy Partners)).

21 Dep't of Energy, *Business Energy Investment Tax Credit (ITC)*, ENERGY.GOV, http://energy.gov/savings/business-energy-investment-tax-credit-itc (last visited Oct. 6, 2014); *see also* 26 U.S.C. § 48 (2006).

22 Dep't of Energy, *supra* note 21.

23 U.S. ENERGY INFO. ADMIN., DOE/EIA-0035(2014/09), MONTHLY ENERGY REVIEW SEPTEMBER 2014 137 (Sept. 25, 2014).

24 *Id.*

25 *Id.*

the credit and the upticks in domestic production and consumption. The ITC was created and applied in 2006, and was expanded by the American Recovery and Reinvestment Act of 2009.[26] Since its adoption, total renewable energy production and consumption has increased from 6,500 trillion btu (British Thermal Unit) in 2007, to 8,100 in 2010 and 9,300 in 2013.[27] Further, since 2007, there has been an influx of renewable energy growth that this Article attributes to the availability and expansion of tax credits. Rather than reduce or eliminate the existing tax credits, this Article calls for the credit percentage for wind energy to increase if the United States intends to achieve its goal to have twenty percent of electric energy consumed through renewable energy sources in 2020.[28]

It has been previously documented that renewable energy investment and development sharply decreases as a result of tax credits lapsing.[29] Although renewable energy investment and development will not likely decline drastically as a result of the forthcoming ITC percentage decrease, the outcome could be similar. As a result, this Article issues a call to expand the investor base for renewable projects. Before describing the methods of expanding investment, this Article will first explain what are tax equity investments, why the investment is deemed to be passive, and what effect the passive limitation has on investors and their investment abilities and decisions.

C. What is a Tax Equity Investment?

Tax equity financing occurs when an investor makes an investment into a renewable energy development specifically for the cash flow and tax benefits associated with that investment.[30] These tax credits can only be used by clean energy developers who generate enough profits with which to offset the credit.[31] However, because renewable energy developments are typically start-ups, the developer most likely has not reached the point of profitability yet and, thus, will not be able to use the tax credits.[32] As a result, developers seek investment from institutions

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26 Dep't of Energy, *supra* note 21.

27 U.S. ENERGY INFO. ADMIN., *supra* note 23.

28 Presidential Memorandum, *supra* note 3.

29 Walsh, *supra* note 4, at 235 (citing *Energy Tax Policy and Tax Reform*, *supra* note 14 (statement of Neil Z. Auerbach, Managing Partner of Hudson Clean Energy Partners)).

30 U.S. PREF: U.S. P'SHIP FOR RENEWABLE ENERGY FIN., TAX CREDITS, TAX EQUITY AND ALTERNATIVES TO SPUR CLEAN ENERGY FINANCING 1 (Sept. 2011) [hereinafter U.S. PREF 1].

31 *Id.* (the mechanics of using credits to offset income will be described below).

32 *Id.*

that have enough taxes from passive taxable income with which to offset the tax credit.[33] These institutional investors are called tax equity investors, which are typically "large tax-paying financial entities such as banks, insurance companies and utility affiliates."[34] Fifteen to twenty of these financial institutions have dominated the renewable energy credit market.[35]

D. Why Are The Major Renewable Energy Credit Players Large Financial Entities?

Tax equity investors typically get involved in the management or development of the project when something goes wrong with the performance of the investment or project.[36] Such investments are commonly structured through limited liability companies ("LLC") or limited partnerships wherein the investor's activities are typically passive.[37] A passive activity means that the investor does not "materially participate" in the development and management of the renewable energy development.[38] The IRS designated what "material participation"[39] means in Publication 925.[40] Specifically, the IRS noted that "personal service activities" represent "material participation," stating that:

> The activity is a personal service activity in which you materially participated for any 3 (whether or not consecutive) preceding tax years. An activity is a personal service activity if it involves the performance of personal services in the fields of health (including veterinary services), law, engineering, architecture, accounting, actuarial science, performing arts,

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33 *Id.*

34 U.S. PREF: U.S. P'SHIP FOR RENEWABLE ENERGY FIN., U.S. RENEWABLE ENERGY TAX EQUITY INVESTMENT AND THE TREASURY CASH GRANT PROGRAM 1 (Apr. 2011) [hereinafter U.S. PREF 2].

35 Michael Meyers et al., *Bridging the Tax Equity Funding Gap*, PROJECT FINANCE INTERNATIONAL: RENEWABLES REPORT, May 2012, at 6.

36 U.S. PREF 2, *supra* note 34, at 1.

37 John A. Eliason, *Investing in Alternative Energy? Consider the Passive Activity Loss Rule*, RENEWABLEENERGYWORLD.COM (Dec. 19, 2012), http://www.renewableenergyworld.com/rea/news/article/2012/12/investing-in-alternative-energy-consider-the-passive-activity-loss-rule.

38 INTERNAL REVENUE SERV., PUB. 925, CAT. NO. 64265X, PASSIVE ACTIVITY AND AT-RISK RULES 3 (Jan. 23, 2014) [hereinafter IRS PUB. 925].

39 Black's Law Dictionary Online ("the taxpayer will be identified as materially participating in the business if the taxpayer participates in business activities on a regular basis").

40 IRS PUB. 925, *supra* note 38, at 5-6.

> consulting, or any other trade or business in which capital is not a material income-producing factor.[41]

Renewable energy investors are, for the most part, logically limited to large financial institutions for two reasons. First, the IRS provides an exception for large financial institutions by excluding them as a "personal service activity" in test six of the "material participation tests."[42] By definition, a financial institution is not a "material participator" unless it meets one of the other tests noted in the publication.[43] If the investor materially participates, the investment is no longer considered a passive activity.[44] The IRS further explains the exception for financial institutions by specifically noting that "[y]ou do not treat the work you do in your capacity as an investor in an activity as [material] participation unless you are directly involved in the day-to-day management or operations of the activity."[45] Although tax equity investors may get involved if something goes wrong with the investment or development, IRS Publication 925 designates in several "material participation tests" that an investor may not participate for more than a certain quantity of hours in the project, depending on the circumstances, in order to remain passive.[46]

Second, the tax credit is limited to passive taxable income because the credit relates to the investment, which is itself considered to be a passive activity as a result of the tax-planning structure that is set in place.[47] For this reason, the ITC is mostly limited to financial institutions, which have a lot of passive taxable income and, therefore, the capability to use the tax credit to offset passive taxes.[48] This Article will briefly discuss three structures to give a high-level idea about what

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41 *Id.* at 5.
42 *Id.*
43 *Id.*
44 *Id.*
45 *Id.*
46 IRS PUB. 925, *supra* note 38, at 5. The tests to which this refers are one, two, three, four and seven. Depending on which test is used, the hourly limit may be 100 or 500 hours.
47 ED FEO & STEPHEN TRACY, COMMERCIAL FINANCE: THE DARK ARTS OF LEVERAGE, TAX EQUITY, LEASES AND MORE 22 (2009), *available at* http://www.novoco.com/energy/resource_files/reports/sbt_finalpreso_102609.pdf (discussing financing structures, federal tax law, and sources of financial incentives); *see also* Eliason, *supra* note 37.
48 *See* U.S. PREF 2, *supra* note 34, at 1; U.S. PREF 1, *supra* note 30, at 1; Meyers, *supra* note 35.

is going on and why the tax credit relates to passive income: (1) Partnership Flip; (2) Sale Leaseback; and (3) Inverted Lease.[49]

1. The Partnership Flip Structure

In a partnership flip, a developer and tax equity investor form a partnership.[50] The taxpayer, who can be the partnership or the tax equity investor, must be the owner of the assets.[51] A taxpayer is considered the "owner" if there is substantial economic effect in the partnership's profit or loss allocations.[52] To have substantial economic effect, the partner to whom the allocation is made must receive the economic benefit or economic burden that corresponds to the allocation.[53] As the "owner," the taxpayer can take advantage of the allocations that the partnership agreement sets forth.[54]

The tax equity investor is allocated ninety-nine percent of partnership net income and losses for a five-year period.[55] Then, usually about ninety-five percent of the net income and losses are flipped back to the developer.[56] Therefore, the tax equity investor will retain about a five percent interest in the project.[57] Ultimately, the tax equity investor hopes to receive income and tax credits as a return on the investment (ROI), and the developer hopes to receive the partnership interest five years later at a discounted cost.[58] The tax equity investor retains a passive relationship in the partnership and the renewable energy development.

A typical partnership flip transaction may be shown as follows. First, a tax equity investor will contribute funds to a partnership for a ninety-nine percent partnership interest. The tax equity partner, therefore, will be entitled to ninety-nine percent of the tax credit.[59] The tax equity investor will be entitled to the ITC in the first year and the depreciation

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[49] Gary Hecimovich & Tom Stevens, *Introduction to Tax Equity Structures*, DELOITTE (2012), https://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Energy_us_er/us_er_AESem2012_1_1_2_1IntTaxEquity_101012.pdf.

[50] ANDREA S. KRAMER & PETER C. FUSARO, ENERGY AND ENVIRONMENTAL PROJECT FINANCE LAW AND TAXATION § 27.05 (2010).

[51] Hecimovich & Stevens, *supra* note 49, at 7.

[52] 26 U.S.C. § 704(b) (2006); *see also* Hecimovich & Stevens, *supra* note 49, at 7.

[53] Treas. Reg. § 1.704-1(b)(2)(ii)(a) (2013); *see* Treas. Reg. § 1.704-1(b)(2)(iii) (2013).

[54] 26 U.S.C. § 704(a)-(b) (2006).

[55] KRAMER & FUSARO, *supra* note 50; Brandon Conard, *Solar Tax Equity Investments 101*, GREENZU http://greenzu.com/solar-tax-equity-investor-returns (last visited Oct. 7, 2015); *see also* Rev. Proc. 2007-65, 2007-2 C.B. 967 (providing additional rules governing the structure of a solar project).

[56] KRAMER & FUSARO, *supra* note 50.

[57] Thomas W. Giegerich, *The Monetization of Business Tax Credits*, 12 FLA. TAX. REV. 709, 770 (2012).

[58] KRAMER & FUSARO, *supra* note 50.

[59] Giegerich, *supra* note 57, at 769-70.

deductions thereafter.[60] For example, if the project's cost was $334,000 (and ITC is based on cost basis) and the tax equity investor gets ninety-nine percent of the ITC—because in this example the investor has a ninety-nine percent partnership interest—the ITC is $100,000, or 30% of $334,000, and the tax equity investor gets a $99,999 ITC.[61] Then, the investor will be entitled to the allocable share of depreciation deductions in the following years.[62]

Even if the tax equity investor receives about $100,000 in tax credits and $100,000 in depreciation deductions over the five-year period, the tax benefit in and of itself is not enough to fully incentivize an investor to invest because the tax benefits are only worth the taxpayers' tax rate per dollar.[63] That is to say, if the taxpayers' tax rate is thirty-five percent, the benefit the taxpayer receives is thirty-five cents on each dollar. Thus, to make the investment worthwhile in any tax equity investment, there has to be some prospect of positive cash flow for the tax equity investor to receive a ROI. This cash flow is achieved, in part, by a constant rate of return each year and, at the end of the five-year period, through a buyout price that the developer pays to acquire the majority of the tax equity investor's interest in the partnership.[64] Otherwise, the tax equity investor only receives profit or loss, according to his ninety-nine percent interest in the partnership.[65] This alternative would prove to be an investment deterrent because, in the early years, many start-ups, such as those being discussed herein, lose money, which renders the tax equity investor as more likely to realize losses.

2. The Sale-Leaseback Structure

In a sale-leaseback scenario, the developer sells the renewable energy development to the tax equity investor, who subsequently leases the project back to the developer in an integrated transaction.[66] This is similar to car leases from dealerships where the dealership remains the "owner" for tax purposes–the tax equity investor is still the owner, and therefore, is entitled to receive the ITC the first year and depreciation deductions thereafter–and the lessee has a right to use the car–as the

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60 Conard, *supra* note 55.

61 *Id.*

62 *Id.*

63 *Tax Exemptions, Deductions, and Credits*, CENTER ON BUDGET & POL'Y PRIORITIES 2 (Apr. 16, 2013), http://www.cbpp.org/files/policybasics-exempt.pdf.

64 *Id.*

65 Giegerich, *supra* note 57, at 769.

66 BRUCE K. BENESH & M. KEVIN BRYANT, DEPRECIATION HANDBOOK § 8.03 (Matthew Bender & Co. ed., 2014).

developer has the right to operate the renewable energy development.[67] An advantage of the sale-leaseback model is that the tax equity investor receives one hundred percent of the tax benefits, in addition to the lease payments.[68] One disadvantage to this model is that the tax equity investor has to put up more financing—one hundred percent of the project's cost.[69] Still, parties are incentivized to enter into this type of transaction because once the tax equity investor has received the ROI and tax credits, the project is sold back to the developer.[70] Again, the nature of this structure is passive, and therefore, the credits offset taxes from passive taxable income.

3. The Inverted-Lease Structure

In the inverted-lease transaction, there are two partnership entities. The first partnership entity, the "master tenant," is created through funding by the tax equity investor, who furnishes ninety-nine percent of necessary funding, and the developer, who supplements the total with the remaining one percent.[71] The "master tenant" functions both as a flow-through (meaning the entity is not taxed, but rather the partners are) and as the lessee of the renewable energy development.[72] The other partnership entity, designated as a "property owner," installs the renewable energy project.[73] The "property owner" partnership then leases the renewable energy project to the "master tenant" partnership and elects to pass the credits to the "master tenant."[74] Because the "master tenant" is also a partnership, the credits will flow through to the partners–ninety-nine percent accredited to the tax equity investor and one percent to the developer.[75] The "master tenant" can then sublease the renewable energy development to a third-party entity, whereby the

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67 *See* Hecimovich & Stevens, *supra* note 49, at 10.

68 Stephan L. Hodge, *Sale-Leasebacks: A Search for Economic Substance*, 61 IND. L.J. 721, 726-27, 729 (1986).

69 BENESH & BRYANT, *supra* note 66.

70 *See* Hecimovich & Stevens, *supra* note 49, at 20-21.

71 *See id.*; Gary Hecimovich & Mark Hindes, *Structuring Lease Transactions – Tax Perspective*, DELOITTE 14-15 (Sept. 20, 2013), http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Energy_us_er/us_er_2013AESeminar_StruLeasTrans_Sep2013.pdf.

72 *See* Hecimovich & Stevens, *supra* note 49, at 25-27; Hecimovich & Hindes, *supra* note 71.

73 *See* Hecimovich & Stevens, *supra* note 49, at 26; Hecimovich & Hindes, *supra* note 71, at 15.

74 *See* Hecimovich & Stevens, *supra* note 49, at 26; Hecimovich & Hindes, *supra* note 71, at 15.

75 *See* Hecimovich & Stevens, *supra* note 49, at 26-27; Hecimovich & Hindes, *supra* note 71, at 14-15.

resultant income will be distributed to the partners according to the allocations set forth in the partnership agreement. These allocations must continue to operate within the IRS' standards for "substantial economic effect" to be sustained.

Given that the aforementioned nature of these structures is passive and, therefore, the credits offset taxes from passive taxable income, the structures and ITC are mostly limited in application to large financial institutions. These major financial institutions have the resources to understand and work through the above scenarios, but the inherent complications and technicalities often prove to be a strong barrier to entry for smaller "new entrant" investors, who might otherwise had been a viable investment candidate.[76] To remedy this barrier to entry issue, some scholars have proposed the issuance of a standardization of transaction documents and contracts to provide a comprehensive and understandable guide for investors who seek to use these tax structures.[77] These documents "could be drafted and peer-reviewed by key industry participants, energy finance lawyers and financial institutions, and then reviewed by various trade associations, including the American Wind Energy Association, the Solar Energy Industries Association, and the American Council on Renewable Energy."[78]

However, this Article submits that standardization of transaction documents is not nearly enough to broaden the investor base. Standardization in and of itself would not accomplish much because the investment remains passive as a result of the structure and investment objectives. Therefore, regardless of whether there is standardization, a direct, on-site, passive investment is still mostly limited to large financial institutions that invest to obtain credits to offset taxes from passive taxable income. Yet, standardization could prove to be effective if used in conjunction with other methods that expand the investor base. These other methods are: increasing investment amongst large companies; asset-backed securitization; "Real Estate Investment Trusts" (REITs); and "Master Limited Partnerships" (MLPs). The descriptions and analyses of these investment methods is where the Article will next turn.

III. BROADENING THE INVESTOR POOL

There are two major ways to broaden the investor pool: (a) generally encouraging investment from large companies in all industries, both (i)

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[76] *See* Meyers et al., *supra* note 35, at 6.

[77] Andrew C. Fink, *Securitize Me: Stimulating Renewable Energy Financing by Embracing the Capital Markets*, 12 U. N.H. L. REV. 109, 123-24 (2014).

[78] Meyers et al., *supra* note 35, at 9.

domestic and (ii) foreign,[79] and (b) expanding investment opportunities to companies and smaller investors through (i) asset-backed securitization, (ii) Real Estate Investment Trusts ("REITs") and (iii) Master Limited Partnerships ("MLPs").

A. Encouraging Investment from Large Companies

1. Domestic and Foreign Corporate Investment

In 2012, the Obama administration courted seventy-nine U.S. technological, industrial and retail companies, including Exxon Mobil and Walt Disney, to invest in renewable energy projects.[80] These companies have significant capacity to make renewable investments and take advantage of the ITC because, in 2011 alone, the 500 largest American companies paid over $137 Billion in taxes.[81] In fact, Ceres, a leading non-profit organization in the renewable field, has called for one trillion dollars of *global* renewable energy investment per year for thirty-six years.[82] In 2012, the total global renewable energy new investment was $250 billion.[83] In 2013, however, such new investment decreased to $214 billion.[84] Ceres notes that, to realistically attain the trillion-dollar goal, renewable energy investment needs to reach around $500 Billion per year by 2020.[85] This goal can be attained through increased investment from companies across all industries.

Applying political pressure to spur increased renewable investment by large corporations has had some success. Some Fortune 100 and Global 100 corporations, such as AT&T, Google, GM, HSBC and Wal-Mart, have set voluntary renewable energy investment commitments.[86] Currently, fourteen percent of the Fortune 100 and sixteen percent of the Global 100 have set renewable energy commitments.[87] These investment commitments are categorized as near-term (will invest through 2015), mid-term (investing through 2020) and long-term (investing through

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79 *Id.*

80 *Id.* at 8.

81 *Id.*

82 *Clean Trillion*, CERES, http://www.ceres.org/issues/clean-trillion (last visited Oct. 8, 2014).

83 FRANKFURT SCHOOL – UNEP COLLABORATING CENTRE FOR CLIMATE & SUSTAINABLE ENERGY FINANCE, GLOBAL TRENDS IN RENEWABLE ENERGY INVESTMENT 2014 KEY FINDINGS 15 (Angus McCrone et al. eds., 2014).

84 *Id.*

85 *Clean Trillion*, *supra* note 82.

86 DAVID GARDINER & ASSOCS., POWER FORWARD: WHY THE WORLD'S LARGEST COMPANIES ARE INVESTING IN RENEWABLE ENERGY 4 (Dec. 10, 2012).

87 *Id.* at 12-13.

2050).[88] Other companies, like Costco, buy into renewable energy without establishing commitment targets, but rather with a goal of offsetting their own electricity costs.[89] On the whole, however, companies with specific commitment targets have invested more into renewable projects.[90]

This Article advocates that the pressure for new companies to invest continue, but that the pressure also extends to existing corporate investors to harden their renewable energy investments by establishing investment commitments. Moreover, the political pressure might be most effective if concentrated on specific industries. For example, in 2012, the health care and industrial sectors had only one company that set renewable energy investment commitments.[91] These various pressures would hopefully help to achieve the United States' goal of having twenty percent of energy consumed by renewable energy sources in 2020 and each year thereafter.[92]

These renewable energy investment commitments are made domestically and globally. However, before foreign corporations invest in renewable energy projects in new markets (i.e., different countries), such as that of the United States, these corporations first identify favorable opportunities, such as the availability of renewable energy credits, before making any investment decisions. These opportunities should also include renewable-based asset-backed securities, REITs and MLPs.[93]

2. Foreign Corporation Issues with Global Renewable Investment

Companies will most likely invest in direct, on-site renewable projects only if the ITC will be available,[94] about which market uncertainty yields a couple of issues for foreign corporations. For one, foreign companies may be reticent to invest in U.S. renewable projects because foreign corporations need enough U.S.-source passive taxable income for the ITC to offset passive taxes, assuming that the investment is passive.[95] Without U.S.-source passive taxable income, the ITC cannot be applied.

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88 *Id.* at 13.
89 *Id.* at 14.
90 *Id.*
91 DAVID GARDINER & ASSOCS., *supra* note 86, at 16.
92 Presidential Memorandum, *supra* note 3.
93 *See infra* Parts III (c)-(e).
94 Walsh, *supra* note 4, at 235.
95 26 U.S.C. §§ 881-882 (2006).

Foreign entities operate under different rules than their domestic counterparts in determining U.S. active and passive income. A foreign entity has U.S.-source active income if the income is "effectively connected" to a U.S. trade or business ("ECI")[96]; a foreign entity has U.S.-source passive income if the income is interest, dividends, rents, salaries, wages and other fixed or determinable annual periodic income ("FDAP" income).[97]

For the purpose of foreign entities, passive income may be transformed into income that is effectively connected to a U.S. trade or business,[98] thereby triggering a reclassification of such passive income to active income and affecting the applicability of the ITC. In such situations, while the investment in the renewable project may be passive, the foreign corporation may not have passive taxable income where the FDAP is transformed into ECI, thereby rendering the ECI useless for the year at issue, if no other passive income exists for the ITC to offset.[99]

There are two tests that are used to determine whether FDAP income is reclassified as ECI: the asset-use test and the business-activities test.[100] The asset-use test examines "whether the income, gain, or loss is derived from assets used in, or held for use in, the conduct of the trade or business in the United States."[101] The business-activities test evaluates "whether the activities of the trade or business conducted in the United States were a material factor in the realization of the income, gain, or loss."[102]

This Article is skeptical that foreign companies would invest in renewable projects without ITC utilization and no other investment alternatives. This could occur if FDAP income were transformed into ECI due to the asset-use or business-activities test. This scenario assumes, however, that the multinational has no other U.S.-source passive taxable income to be offset by the ITC. If the multinational were to invest under this scenario, it would need to engage in foreign tax planning and generate passive income in the future to use the ITC, which can be carried forward twenty years thereafter.[103] It appears more probable that, without current use of the ITC, foreign multinationals will not invest. However, those foreign companies that are capable of investing in renewable projects are likely to be large, multinational

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96 26 U.S.C. § 882 (2006).
97 26 U.S.C. § 881 (2006).
98 Treas. Reg. § 1.864-4(c) (2005).
99 *Id.*
100 *Id.*
101 *Id.*
102 *Id.*
103 26 U.S.C. §§ 39, 48 (2006).

companies. As such, it is probable that these companies have sufficient U.S.-source passive income so as to render this a superfluous issue.

As a final wrinkle, recall that renewable energy credits are mostly limited to offset taxes from passive taxable income because the investment is considered to be a passive activity. Although large financial institutions satisfy Publication 925's "material participation" tests, foreign entities must also satisfy these tests as well.[104]

B. Encouraging Investment from Smaller Entities

The second major way to broaden the investor pool is to expand investment opportunities to smaller foreign and domestic corporations and investors by using renewable-based asset-backed securitization, REITs and MLPs.

1. Asset-Backed Securitization

Asset-backed securitization "refers to a process whereby receivables, loans or other predictable forms of cash flows are pooled and sold to investors through one or more special purpose vehicles ("SPV") in the form of debt instruments called asset-backed securities or . . . commercial paper."[105] This means that assets are pooled or bundled together into a SPV.[106] The SPV can be a trust, corporation or limited liability company (LLC), with the most efficient vehicles being the trust or LLC.[107] Then, the SPV markets securities, backed by the SPV assets, to investors.[108] The pooled assets produce a stream of income to investors through the securitized asset[109] to achieve a two-fold purpose: (1) reducing investor risk by pooling together multiple assets, as in a mutual fund; and (2) transforming illiquid assets into a liquidated security that can be sold to investors.[110]

As applied to renewable energy, a pool of renewable energy developments would back the offered security.[111] This means that asset-backed securities are less risky than direct on-site investments because the security pools various renewable developments into one security. Essentially, the security "hedges" the investor's risk because, instead of investing into one project that may fail, the security pools multiple—so

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104 *See* IRS PUB. 925, *supra* note 38, at 5-6.
105 JEROME F. FESTA, SECURITIZATIONS: LEGAL & REGULATORY ISSUES § 1 (2013).
106 *Id.* § 5.01.
107 *Id.* § 28.03.
108 *Id.* § 5.01.
109 *Id*.
110 Fink, *supra* note 77, at 120.
111 *Id.* at 124-25.

that one renewable project failure does not destroy the investment. Even still, companies will choose direct on-site investment for the ITC, asset-backed securitization, or both, depending on the company's financial needs. A company that needs deductions and tax credits would directly invest into the renewable energy project.[112] In contrast, companies that desire a steady, securitized rate of return, opt instead for the asset-backed security.[113] Thus, this Article contends that asset-backed securities would not replace the ITC, but rather would supplement the credit as such investments in asset-backed securities do not yield a tax credit.[114]

Moreover, this Article contends that renewable-based, asset-backed securities may provide an increase in investment to renewable energy projects because the securitization process allows companies to invest without having to carry the risk of direct on-site investment.[115] Direct on-site investment has been a historic deterrent to renewable energy developments for smaller corporations given the inherent risk of investing in only one particular project without a guarantee of success or income.[116] An additional risk of direct on-site investment is the lack of certainty that the project will be placed in service in time for the investor to take advantage of the ITC.[117] Finally, and again, the investor risks not having sufficient passive taxable income with which to offset the ITC.[118] By contrast, the asset-backed security absolves much of this risk because a pool of assets backs the security; the investor does not need to worry about offsetting taxes from passive taxable income.[119] Instead, the investor would receive a rate of return on the security and contribute to global investment goals for renewable energy projects.

The demographic of asset-backed security investors are typically institutional in nature.[120] Therefore, this Article contends that asset-backed securities accomplish the objective of increasing investment by foreign and domestic corporations. Moreover, foreign corporations do

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112 DAVID GARDINER & ASSOCS., *supra* note 86, at 24.

113 FESTA, *supra* note 105, at § 5.01; Fink, *supra* note 77, at 120.

114 FESTA, *supra* note 105, at § 5.01; Fink, *supra* note 77, at 120.

115 FESTA, *supra* note 105, at § 5.01; Fink, *supra* note 77, at 120.

116 *See* Fink, *supra* note 77, at 121.

117 *See* Walsh, *supra* note 4, at 235 (citing *Energy Tax Policy and Tax Reform*, *supra* note 14 (statement of Neil Z. Auerbach, Managing Partner of Hudson Clean Energy Partners)).

118 FEO & TRACY, *supra* note 47, at 22; *see also* Eliason, *supra* note 37.

119 FESTA, *supra* note 105, at § 5.01; Fink, *supra* note 77, at 120.

120 Travis Lowder, *New Report Navigates Solar Securitization*, RENEWABLEENERGYWORLD.COM (Feb. 13, 2014), http://www.renewableenergyworld.com/rea/news/article/2014/02/new-report-navigates-solar-securitization; *Introduction to Asset-Backed and Mortgage-Backed Securities*, FORBES.COM (Jan. 18, 2013, 1:08 PM), http://www.forbes.com/sites/investopedia/2013/01/18/introduction-to-asset-backed-and-mortgage-backed-securities/

not need to worry about FDAP and ECI distinctions because the investment is made purely for a rate of return, i.e., a passive investment.[121] These institutional investors use the securities to diversify their portfolio and receive a higher yield than on government bonds.[122] Additionally, the securities are available to smaller investors.[123] The asset-backed security, therefore, increases investment in renewable energy developments by: (1) allowing institutional investors and large corporations that want to avoid the risk of direct on-site renewable investment to get involved in the renewable energy field; and 2) providing smaller investors a chance to invest where they would be otherwise cut out from the field.

2. REITs

The U.S. Securities and Exchange Commission ("SEC") defines a REIT as a "company that owns – and typically operates – income-producing real estate or real estate-related assets . . . .REITs provide a way for individual investors to earn a share of the income produced through commercial real estate ownership – without actually having to go out and buy commercial real estate."[124] The SEC notes that to qualify as a REIT:

> [A] company must have the bulk of its assets and income connected to real estate investment and must distribute at least 90 percent of its taxable income to shareholders annually in the form of dividends. In addition to paying out at least 90 percent of its taxable income annually in the form of shareholder dividends, a REIT must: 1) Be an entity that would be taxable as a corporation but for its REIT status; 2) Be managed by a board of directors or trustees; 3) Have shares that are fully transferable; 4) Have a minimum of 100 shareholders after its first year as a REIT; 5) Have no more than 50 percent of its shares held by five or fewer individuals during the last half of the taxable year; 6) Invest at least 75 percent of its total assets in real estate assets and cash; 7) Derive at least 75 percent of its gross income from real estate related sources, including rents from real property and interest

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121 FESTA, *supra* note 105, at § 5.01; Fink, *supra* note 77, at 120.

122 *Introduction to Asset-Backed and Mortgage-Backed Securities*, *supra* note 120.

123 Fink, *supra* note 77, at 123.

124 *Real Estate Investment Trusts (REITs)*, SEC, http://www.sec.gov/answers/reits.htm (last visited Oct. 8, 2014); *see also* Treas. Reg. § 1.856-1 (2013).

> on mortgages financing real property; 8) Derive at least 95 percent of its gross income from such real estate sources and dividends or interest from any source; and 9) Have no more than 25 percent of its assets consist of non-qualifying securities or stock in taxable REIT subsidiaries.[125]

A REIT may be publicly or privately held.[126] Public REITs offer investors liquidity,[127] while private REITs may be difficult to exit because "new money has to come in before cash is available for a payout."[128] Public REITs, therefore, are a better option for large companies to balance a portfolio.[129] The REIT utilizes securitization because assets, such as real estate holdings, are pooled together in a trust, and dividend-yielding shares are issued to investors.[130] Securitization reduces the risk of the investment in a manner similar to that accomplished by a mutual fund.[131]

"An individual may invest in a publicly-traded REIT, which is listed on a major stock exchange, by purchasing shares through a securities dealer."[132] REIT investors may purchase common stock, preferred stock or debt securities,[133] and diversify their investment portfolio by buying shares in a REIT mutual fund or exchange-traded fund.[134] Institutional and small investors have an equal opportunity to buy securities because REIT shares average from $10 to $60 a share.[135] "This means the little guy can get a piece of the action."[136] Similar to the asset-backed security, a REIT comprised of renewable energy developments would allow domestic and foreign companies an option to invest in packages of renewable projects, without investing directly on-site for an ITC that may not be accessible to that specific company. In the absence of

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125 Treas. Reg. § 1.856-1 (2013).

126 Glenn R. Mueller, *Securitization of Real Estate and Global Growth*, GLOBAL EXECUTIVE FORUM REPORTS, Winter 2005-2006, at 4, *available at* http://www.ucdenver.edu/academics/InternationalPrograms/CIBER/GlobalForumReports/Documents/Global_Forum_Report_Winter_2005.pdf.

127 *Id.*

128 *Id.*

129 *Id.*

130 Fink, *supra* note 77, at 131.

131 Mueller, *supra* note 126.

132 Nat'l Ass'n of Real Estate Inv. Trusts, *Investing in REITs*, REIT.COM, http://www.reit.com/investing/reit-basics/reit-faqs/investing-reits (last visited Oct. 8, 2014).

133 *Id.*

134 *Id.*

135 Mueller, *supra* note 126.

136 *Id.*

alternative investment mechanisms, such as a REIT, an entity may not invest if the ITC, the only other investment incentive, is not obtainable given that entity's particular financial circumstances.

REITs invest in different property types–including those zoned for residential, industrial and health care uses–but there is a limit to the extent that the REIT can be comprised of a renewable energy project.[137] The IRS does not currently consider renewable energy projects "real estate"[138]; therefore, a REIT cannot consist of more than twenty-five percent of renewable energy projects.[139] Moreover, because ninety-five percent of income must be derived from "real estate," only five percent of income can be derived from the renewable energy project.[140]

In all, only twenty-five percent of the REIT can be comprised of renewable energy projects, only five percent of income can be derived from the renewable energy project and small and large investors alike can purchase publically traded REIT shares.[141] Like the asset-backed securities, this Article contends that REITs are not a replacement of, but rather a supplement to the ITC in terms of incentives for renewable energy investment. As aforementioned, the REIT and ITC perform different functions–and therefore, each attracts investors for different investment objectives.[142]

It is unclear what effect it would have if the IRS were to interpret renewable energy projects as "real estate" for REIT purposes. Some believe that the IRS will not take this type of "rifle-shot approach."[143] If the IRS did make such an interpretation, the REIT structure would become a very attractive method for small investors to get involved in the renewable energy investment world because the REIT shares are priced at reasonable levels and the investors receive most of the income in the form of a dividend.[144]

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137 *Id.*; Brad Thomas, *REITs Boom as More Industries Discover This Tax-Friendly Structure*, FORBES.COM (Nov. 26, 2012, 8:00 AM), http://www.forbes.com/sites/bradthomas/2012/11/26/reits-boom-as-more-industries-discover-this-tax-friendly-structure.

138 26 U.S.C. § 856(c)(5) (2006).

139 *Real Estate Investment Trusts (REITs)*, *supra* note 124; Fink, *supra* note 77, at 130.

140 *Real Estate Investment Trusts (REITs)*, *supra* note 124; Fink, *supra* note 77, at 130.

141 Mueller, *supra* note 126; Fink, *supra* note 77, at 130; *Real Estate Investment Trusts (REITs)*, *supra* note 124; Thomas, *supra* note 137.

142 Fink, *supra* note 77, at 131; 26 U.S.C. § 48 (2006).

143 Eric Kroh, *IRS Not Expected to Allow REITs To Invest in Renewable Energy*, TAX ANALYSTS 707 (2014).

144 Mueller, *supra* note 126.

3. MLPs

"A master limited partnership (MLP) is a type of business structure that is taxed as a partnership, but whose ownership interests are traded on financial markets like corporate stock."[145] Because the MLP is structured as a partnership there is only one level of tax—at the partner level.[146] The ownership interest in an MLP is not stock, but is called an "MLP unit."[147] Like corporate stock, the units are publically traded and pay dividends.[148] The MLP investors, i.e., partners, also receive their share of the "partnership's income, deductions, and credits, and pay tax on the net income according to ordinary income tax rate."[149] MLP units are attractive to investors because unlike the corporate double-level tax there is only one level of tax in a partnership–attached to the partners–and therefore, investors yield higher after-tax returns.[150]

In general, MLPs structurally own and operate business assets through a subsidiary or operating company.[151] The MLP is formed as a limited partnership, meaning there is a general partner and many limited partners.[152] The limited partners (LPs) provide most of the capital to the MLP in exchange for the MLP units.[153] This Article will briefly delve into partnership tax law so as to highlight the inter-workings of being a partner and distinguish limited partners from general partners.

The first step in forming an MLP is that a partner contributes property to a partnership (here, cash) and receives an interest in the partnership, the MLP unit. The partner and the partnership each receive a transfer basis in the partnership interest and asset, respectively.[154] The partner's capital contribution is placed as an asset on the partnership's balance sheet and also as the partner's equity amount (called the partner's capital account).[155] This capital contribution amount also constitutes a portion of the partner's outside basis in the partnership, and

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145 MOLLY F. SHERLOCK & MARK P. KEIGHTLEY, CONG. RESEARCH SERV., *Master Limited Partnerships: A Policy Option for the Renewable Energy Industry* 1 (2011) *available at* http://www.ieeeusa.org/policy/eyeonwashington/2011/documents/masterlmtdpartnerships.pdf.

146 *Id.*

147 *Id.* at 2.

148 *Id*.

149 *Id.* at 4.

150 *Id.* at 2.

151 Fink, *supra* note 77, at 132.

152 SHERLOCK & KEIGHTLEY, *supra* note 145, at 2.

153 *Id*.

154 26 U.S.C. §§ 722-723 (2006). As on any partnership balance sheet, *Assets = Liabilities + Equity*.

155 Wales Mack & John Marciano, *Modeling Investments in Tax Equity Partnerships: Solving the Puzzle in a Post-Treasury Grant World*, DAILY TAX REPORT 2-3 (2012).

will constitute the full amount of that outside basis if the partnership does not assume any liabilities or if there is not any debt relief.[156]

The advantage of being a LP is that the liability assumed by the LP is limited to either the LP's capital contribution or the capital contribution plus an additional amount, called the deficit restoration obligation ("DRO").[157] In the latter situation, if the LP's capital account is reduced below zero as a result of losses and deductions–that is, the partner "owes" the partnership money–and the allocations are sustained because they have substantial economic effect, then the LP does not owe any money beyond the DRO if the partnership terminates or is sold because the LP is only liable to the capital contribution amount plus the DRO.[158]

The general partner (GP), which can be a single person, parent company or group of individuals, manages the MLP in exchange for a percentage of the MLP's income–typically two percent[159]–called the "incentive distribution right"[160] to compensate the GP for taking on risks and to maximize return to investors.[161] The GP's risk is borne out of the possibility that the partnership could terminate or be sold, leaving no value in the partnership, while the partnership has a positive capital account balance. While, in such a case, the GP should conceivably receive at least nominal compensation, the GP may not get anything if the LPs do not have a DRO.[162]

The income, losses, deductions and credits generated from an MLP unit are deemed to be passive.[163] Given the partnership structure, the income, losses, etc. flow through to the partners, such as investors who own the MLP units in accordance with their distributive shares. Therefore, the investor can only use the credit to offset taxes from passive taxable income, which is similar to direct on-site investment that generates an ITC.[164] The MLP is unique in that the cash distributions are only taxed once, when the MLP unit is sold, typically at capital gain rates.[165]

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156 26 U.S.C. §§ 722, 752(a)-(b) (2006).

157 Treas. Reg. § 1.704-1(b)(2) (2013).

158 Treas. Reg. § 1.704-1(b)(2)(ii)(a) (Economic Effect); § 1.704-1(b)(3)(iii)(c) (PIP Orich Test); § 1.704-1(b)(2)(iii)(d) (2013) (Alternative Economic Effect Test).

159 SHERLOCK & KEIGHTLEY, *supra* note 145, at 2.

160 *Id.*

161 *Id.*

162 Treas. Reg. § 1.704-1(b)(2)(ii)(a); § 1.704-1(b)(2)(iii)(d); § 1.704-1(b)(3)(iii)(c) (2013).

163 SHERLOCK & KEIGHTLEY, *supra* note 145, at 4.

164 *Id.*

165 *Id.*

For renewable energy investments to enter the MLP field, income from renewable energy projects must be deemed "qualifying income."[166] Currently, the MLP structure requires

> at least 90% of a business's gross income must be considered 'qualifying income.' Qualifying income generally includes dividends, interest, rents, capital gains, and mining and natural resource income. Income related to the exploration, development, mining or production, processing, refining, transportation, storage, and marketing of any mineral or natural resource falls under the latter income category. Recently, the definition of qualifying income was expanded. The expanded definition includes income from the transportation and storage of certain renewable and alternative fuels, including ethanol and biodiesel, and activities involving industrial source carbon dioxide.[167]

On April 24, 2013, Senator Christopher A. Coons, Democrat-Delaware, proposed legislation, the Master Limited Partnerships Parity Act (S. 795), that would permit renewable energy investors to form MLPs.[168] This Article contends that expanding the definition of "qualified income" to include renewable energy would spur investment in renewable projects because MLP units, taxed only once because it is a partnership structure, yield a higher rate of return than corporate shares, which are subject to double taxation.[169] Both large institutions and small investors would be able to invest in the MLP, thus further expanding the renewable energy investor base.[170] This Article also contends that, similar to asset-backed securities and REITs, the MLP would not replace the ITC, but rather work in conjunction with the credit to target a different set of investors and investment purposes.

However, the MLP appears more limited in application than asset-backed securities or REITs. Although the MLP offers a security in the form of an MLP unit, the MLP features look very much like direct on-site investment as the investor receives an allocable share of income, loss, deductions and credits.[171] Moreover, because the investment in the

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166 *Id.* at 2.
167 SHERLOCK & KEIGHTLEY, *supra* note 145, at 2-3.
168 S. 795 "*Master Limited Partnerships Parity Act*", 113th Congress (2013-2014); *see also* Kroh, *supra* note 143, at 707.
169 SHERLOCK & KEIGHTLEY, *supra* note 145, at 1-2.
170 *Id.* at 9.
171 *Id.* at 2.

MLP unit is passive, like direct on-site investment to get an ITC, the allocable share of losses and credits are limited by passive rules.[172]

However, the MLP remains different than direct on-site investment in that: (1) the investor can buy "unit" shares instead of providing a substantial amount of capital directly into the project; and (2) the risk is reduced because the MLP unit is securitized through multiple renewable assets, as opposed to investing in merely one particular project. While the investor base for MLP units may be smaller than asset-based securities or REITs, the investment purpose is largely to receive losses, deductions and credits on a smaller scale than direct on-site investment.[173] The MLP unit does offer an allocable share of income, prospect for "unit" appreciation and reduces risk through securitization.[174]

IV. CONCLUSION

The ITC currently allows for a thirty percent or ten percent tax credit, the amount of which is dependent on what kind of renewable energy project is being placed in service, through 2017. At that time, the percentages will be reduced or eliminated for certain types of renewable projects. While this Article posits that this reduction is a mistake, there are other means by which the United States can facilitate renewable energy investment from foreign and domestic corporations and smaller investors. These alternative methods include encouraging investment from large corporations and pressuring them to make long-term investment commitments, and legislatively approving renewable-based asset-backed securities, REITs and MLPs. The asset-backed securities, REITs and MLPs could provide less risky investment alternatives to investors other than investing directly on-site.

Although these alternatives would not replace the ITC, they may compensate for the ITC in 2017, when the credit percentages are reduced or eliminated. The potential effect of these replacement possibilities is unknown. It is possible that the amount of investment by financial institutions will decline. More plausible, however, is the notion that financial institutions will instead invest in, for example, an MLP, if it were to be legislated into existence, instead of investing substantial funds into one isolated project, so as to give the investor an allocable share of income, losses, deductions and credits, along with diversified holdings.

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172 *Id.* at 4.
173 *Id.* at 2.
174 *Id.* at 2.

In the near future, the majority of renewable energy investments may come through securities, as opposed to direct on-site investments. The effect that this will have on the renewable energy field is a question for legislators to consider. If the effect is negative, legislators may want to reconsider extending the credits to work in conjunction with the alternative investment methods. This Article submits that a compilation of these investment strategies would satisfy all investor needs–institutional and individual, domestic and foreign–and offer the greatest potential for renewable investment growth.