Tilting at Windmills in the Cowboy State: Wyoming Proposes to Increase the Tax on Wind

Wyoming lawmakers are considering increasing the current state excise tax imposed on wind energy production.[1] Wyoming has more than 1,400 MW of installed wind capacity and is the only state to tax wind energy production. Wyoming is now considering becoming more of an outlier by increasing its tax on wind energy, while other states are providing incentives.

Currently, Wyoming imposes a tax of $1 per megawatt hour of electricity generated from wind on the producer of such electricity, the revenue of which is shared between the state and local governments where the wind development occurs. On May 11, lawmakers at a meeting of the Joint Interim Revenue Committee requested their staff to draft two alternative bills to increase the tax on wind energy production. One proposal would simply increase the current tax by an unspecified amount. The more interesting alternative would require wind companies to pay a percentage of their federal production tax credits ("PTCs") to the state.

Proponents of the tax increase argue that an increase in the wind tax is necessary to compensate for the recent decline in revenue from coal and natural gas and to create parity between the energy resources. The two primary state-level revenue raisers from the production of coal and natural gas are the severance tax and federal mineral royalties. The severance tax on coal and natural gas is currently imposed at rates of 6% and 7%, respectively, of their fair market value. Towards the end of 2015, Wyoming made a downward adjustment in its beginning-of-the-year severance tax projections by approximately $160 million. Wyoming's share of federal mineral royalties from mineral production on federal lands (which accounts for more than 80% and 70% of the statewide production of coal and natural gas, respectively) has likewise declined. Critics, however, question the appropriateness of equating wind energy with energy produced from fossil fuels such as coal and natural gas, considering that wind energy does not deplete Wyoming of its minerals and, unlike coal mines and natural gas fields, wind farms are often located on privately owned land.

Putting aside the merits of creating parity between renewable energy and conventional energy sources, the proposal that would require wind companies to pay a percentage of their PTCs to the state raises some interesting questions due to the nature of the PTC. The PTC is a non-refundable credit, not a cash payment from the IRS. In other words, the PTC reduces a taxpayer's federal tax liability by the amount of the PTC. Accordingly, a taxpayer must have a sufficient tax base (i.e., sufficient tax liability) to obtain the full value of the PTC. This raises the question of whether the proposal will impose the tax based on the assumption that the taxpayer has enough taxable income to fully absorb the value of the PTC or whether the proposed tax will be limited to the tax benefit that the taxpayer *actually* receives from the PTC.

The nature of the PTC as a non-refundable credit also raises a related tax policy question. Because developers often do not have sufficient tax base to maximize the value of the PTC, they will frequently bring in tax equity investors with sufficient tax credit appetite to take a disproportionate share of the PTCs. Thus, a state-level tax that is pegged to the PTCs would presumably have a disproportionate impact on tax equity investors. The tax might be more

[1] *See* State Tax Today, *Wyoming Lawmakers Eye Higher Tax on Wind Farms*, Paul Jones, May 18, 2016.

easily administered if it was imposed on the entity (e.g., a special purpose limited liability company) that owns the project.

Separate from the technical and policy questions implicated by the proposed tax on the PTCs, it will be interesting to see whether opponents consider challenging that the proposed law is preempted under the Supremacy Clause of the U.S. Constitution on the grounds that the taxation of the PTC is an obstacle to the accomplishment of Congress's goal of providing tax incentives to promote the proliferation of renewable energy.[2] While some states treat certain federal benefits as income and subject them to tax (thereby reducing the benefit of the federal subsidy), the proposed law would appear, at first blush, to go farther because the PTC merely reduces the amount of federal tax otherwise owed, and thus the PTC should generally not be treated as additional taxable income.[3] In other words, a tax on PTCs is arguably a tax that is imposed to compensate for a reduced federal tax liability (and not because of an increase in income). Accordingly, opponents may challenge that a state tax that is imposed on the production of wind energy based on the availability of the PTC would overstep constitutional bounds because it would directly interfere with Congress's objective of providing tax incentives (i.e., PTCs) for the production of wind energy.

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[2] *See Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 373 (2000) (holding that state law is preempted by federal law where the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress).

[3] *See Maines v. Comm'r*, 144 T.C. 123, 134 (2015) (holding that for federal income tax purposes the receipt of a state tax credit that "just reduces the amount of tax a taxpayer would otherwise owe is not itself a taxable event, 'for the investor has received no money or other 'income' within the meaning of the Internal Revenue Code'").