Barrier-Free Clean Capital Market Act (Straw Proposal)

Clean Asset Bonds Build Large, Barrier-Free Clean Capital Markets, to Fuel Pollution-Free Enterprise

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This is a draft federal "Clean Tax Cut" legislative policy proposal, for purposes of discussion, designed to solicit comments and suggestions. (For info on Clean Tax Cuts: http://cleantaxcuts.org/about)

Clean Tax Cuts (CTCs) are a new class of policy proposal that remove tax and other barriers to capital and participation for pollution-free enterprise, in order to drive broad-based prosperity and a cleaner world. Of all CTC mechanisms, Clean Asset Bonds (CABs) do that best – in fact better, with broader impact, and greater leverage, than any other incentive. CABs create a broad basis for very large, barrier-free clean capital markets. These can unlock large new capital flows from untapped investors, to fuel innovative pollution-free enterprise.

Clean Asset Bonds (CABs) – Definition & Advantages: As proposed, Clean Asset Bonds would be federally tax-exempt *corporate* green bonds financing manufacture and deployment of legislatively pre-qualified clean assets, historically known for high-impact pollution reduction (eg. any proven zero-emission power source). This unique design guarantees green impact and public benefit – without complicating easy, low-cost bond issuance.

Unique among incentives, CABs apply policy leverage to financial leverage (low cost ***private*** debt capital used to drive cheaper capital costs, faster growth, and higher return on equity in competitive enterprise). By magnifying that leverage, CABs create unusually democratic and cost effective incentives (plural) that appeal broadly to *ALL investors, large and small, in both debt and equity, taxable and tax-free*. CABs directly offer a new, tax-exempt investment opportunity that millions of retiring baby boomers will want in their portfolios. But cheaper capital from CABs also drives higher equity returns, attracting big corporate and institutional investors, and also millions of middle income investors, to the higher taxable returns on the rest of the capital stack. So CABs greatly broaden the universe of potential investors, which directly or indirectly, increases tax revenues. CABs also make clean energy and products cheaper, more available and desirable to everyone, driving demand. That also boosts profits for – and tax revenue from – every clean energy consuming enterprise… with impacts similar to a broad investment tax cut. CABs also can apply broadly, economy-wide, with neutrality, to all pollution reducing technologies, and can address a variety of environmental issues. These multiple broad-based advantages make CABs the ideal transactional building block for a very large, barrier-free clean capital market. Such multiple impacts can't be matched by other un-leveraged incentives, such as tax equity or municipal bonds. These advantages are the reason CABs form the essential core of this proposal.[1]

Six Year Pilot Program: We here propose a six year, metrics-based pilot program, authorizing the use of federally tax-exempt CABs (and similar, securitize-able, tax-exempt Clean Asset Loans (CALs)) to accelerate investment in a few key clean technologies and practices in the energy, transportation and real estate sectors, known to deliver well-defined, quantifiable pollution reduction impacts: *all low/no-emission electric generation and vehicles; all carbon capture; combined heat and power; zero energy*

[1] In addition, CABs increase GDP, and won't waste taxpayer dollars on failing business models. All CTCs employ targeted capital tax rate cuts, so remove "deadweight loss" and so increase GDP. Unlike other incentives, they only benefit profitable enterprise. CABs, by themselves, cannot prop up money losers.

buildings; and hydrocarbon capture for oil & gas. The pilot program starts there, because pollution metrics and control technologies are best understood for these sectors, and CABs can yield large impacts applied there.[2]

We propose CAB share of total financing steps down by 10 percentage points a year, from 80% of project funding in the first year, to 40% in years five and six. This will help kick start the use of CABs – and securitization in general, much needed for the maturing clean infrastructure sector. But the step down smoothly throttles back to encourage a steady increase in taxable investment, debt and equity, and federal tax revenue. This structure provides certainty for the market, and data to optimize CAB/capital structure going forward for environmental and economic impact.

International Reciprocity: Bigger barrier-free clean capital markets mean more capital flow, more participation, bigger opportunities, better prices, more jobs, faster clean infrastructure deployment, all resulting in a cleaner, more peaceful and prosperous planet.

Senators and Representatives can lead on the creation of an international barrier-free clean capital market, simply by inviting international reciprocity on CAB tax-emption. Reciprocal treatment of tax exempt organizations is a standard feature of most tax treaties. In this case, we propose the Act would provide that CABs issued by other nations would be interest tax exempt to US citizens and corporations, if those nations provide reciprocal tax exemption to their citizens and corporations for CABs issued in the US and other member nations. All nations would retain full discretion over equity side tax revenues. The Act would incent new foreign capital (debt and equity) to fund US clean infrastructure and *vice versa*. Nations would likely be eager to join, recognizing the vast benefits of openness to international capital flows.

Such a market would increase global prosperity, stability and peace via international clean infrastructure investment. Poverty breeds terrorism, war, environmental destruction, refugees and illegal immigration. Since most poor nations have abundant sun and other natural resources, clean capital markets could directly help resolve such crises, build free market structures, and unlock new wealth… *without new pollution*.

Zero Regrets for Tax-Free Clean Innovation: While CABs are generally more cost effective than other incentives, there is one equity side CTC mechanism that can be implemented with zero regrets. 100% tax exemption for clean innovation costs the taxpayer nothing. Since high risk pilot projects might never otherwise happen, and their uncertain profits cannot be forecast or foreseen, no measurable future tax revenue is lost looking forward. Even if we could look back from the future, the new technology pilot projects contemplated here simply will never be a major tax expense in their infancy, using CTC profit enhancement (as opposed to cost subsides, which are expensive, up front). Innovation offers the rare instance where a 0% tax rate has $0 cost, and so really offers a "Zero Regrets" solution.

To encourage innovation and round out the technological neutrality of the pilot program, we propose allowing 10 year of 100% tax exemption (on all income and gains taxes, debt and equity) for investments in pilot projects and the first five commercial scale plants, completed during the six year pilot program, for each innovative new technology seeking to prove commercial viability and zero or negative emission

2 In the future, Congress may consider CABs applied to other sectors and pollution issues, such as plastic waste, water pollution and scarcity, recycling, regenerative farming, etc., after studying the results of this pilot program.

impact in these categories: *power generation, fuels and products made from captured carbon, energy storage and control systems for renewable energy production*.[3]

This policy would directly reduce key barriers to investment in innovation. By maximizing potential rewards, we simultaneously reduce important risks. One chief risk faced by most innovative clean tech startups is the so-called "valley of death," the time between initial funding and the emergence of revenues and profits, when all can be lost if new rounds of investment can't be found. Many venture capitalists will not invest in any new kind of clean tech plant, even where the technology is proven, without 5 successful preexisting commercial scale plants of the same kind. They are usually concerned that the "valley of death" may be too long and risky.

Clean Tax Cuts for clean innovation can actually reduce the length of the valley of death, shrinking that risk barrier, shortening it, by making such investment more attractive, and such investors easier to find. That could significantly accelerate capitalization, making it much easier to scale-up faster, directly shortening the valley of death, and so reducing its risks.

Rough Draft Language for the Act:

We here offer a rough draft version of language that might be included in the Act, in order to lay out some specifics:

During a six year pilot program, interest on privately issued Clean Asset Bonds (CABs) and Clean Asset Loans (CALs) will not be subject to federal taxation. Proceeds from such bonds and loans must be used to finance a portion of the capital needed for projects that manufacture, purchase, deploy, or construct the following clean assets:

1. Electric generation sources that produce energy with zero direct emissions of mercury, SOx, NOx and greenhouse gases, including associated energy storage and control systems, and dedicated power lines needed to connect such power sources to the nearest substation; [Definitions from IRS Section 45 may be useful here.]
2. A home or building or industrial plant that is designed to achieve net zero energy performance, as defined by the Secretary of Energy, by rule, and certified by a licensed architect or engineer (need to be able to show design calculations, not actual performance).
3. Factories and other property, plants and equipment used for the production and sale of: (a) zero-emission vehicles as defined by the Environmental Protection Agency by rule; (b) battery systems and motors for zero emission vehicles; and (c) hybrid powertrains for medium- and heavy-duty trucks.
4. Electric vehicle charging systems that can be used by the public.
5. Best Available Technology for reducing emissions from oil and gas production and distribution, as determined by the Environmental Protection Agency.
6. A combined heat and power system as defined under the Energy Improvement and Extension Act of 2008.

[3] Projects would need to meet initial criteria established by the EPA to qualify, and would be required to measure and report impacts. The EPA would determine whether impact goals had been met, and perform a cost/benefit analysis for each project.

7. Power plants that capture at least 60% of their CO2 emissions, or facilities that capture CO2 from the atmosphere, and which either utilize the CO2 in durable products or store it for a century or more in accordance with criteria to be developed by the Secretary of Energy by rule.

Such tax-exempt CABs and CALs can be used to finance the following percentage of total project costs in each year of the pilot program: Year 1: 80%; Year 2: 70%; Year 3: 60%; Year 4: 50%; Year 5: 40%; Year 6: 40%. Use of tax-exempt CABs or CALs shall not prevent the use of additional similar taxable bonds and loans, or any other financing legally allowed.

The above mentioned Clean Asset Loans, paying tax-exempt interest may be combined with other similarly tax exempt CALs and re-sold as CAB debt securities, whose interest will also be tax exempt for holders of those securities.

The purpose of the above provisions is to create a large, barrier-free clean capital market to better finance the accelerated deployment of the above listed clean assets. Since these purposes are best served by making that market as large as possible, foreign nations are invited to join this market as Member Nations under this Act. Interest on privately issued Clean Asset Bonds (CABs) and Clean Asset Loans (CALs), issued by the taxpayers of the United State of America or any Member Nation, will not be subject to US federal taxation, or taxation by any Member Nation. Further, with respect to trade between the United States of America and all Member Nations, there will be no tariffs levied on the above listed clean assets, or any components thereof.

To become a Member Nation, any foreign nation must enact their own Clean Capital Market legislation with provisions identical to those here in this paragraph, and above, except applying to their own national tax laws and subject to oversight by their own governmental agencies, and specifically provide that interest on privately issued CABs and CALs, issued by US taxpayers and taxpayers of other Member Nations, will not be subject to their national taxation. Categories of clean assets, listed above, must be identical in such legislation. The percentage of tax-exempt CABs and CALs that can be used to finance total project costs must be harmonized with this Act so that the same percentages apply on the same calendar dates, regardless of when a Member Nation enacts its own Clean Capital Market legislation. Formation of companies and partnerships to deploy these clean assets and issue these CABs and CALs should be legal and at least as easily accomplished for any citizen or taxpayer of any Member Nation as it is for any citizen or taxpayer of the United States. Further, such legislation must specify that no tariff may be levied on any clean asset listed, or any component thereof.

On enactment of such Clean Capital Market legislation, each new Member Nation should notify the US Department of State and the US Department of the Treasury. The Secretary of the Treasury shall publicly announce whether such Clean Capital Market legislation satisfies the requirements of this Act, and if so, welcome the new Member Nation to the growing barrier-free clean capital market, in partnership with the United States and other Member Nations.

To avoid disadvantaging innovative pre-commercial clean technologies, all investments in debt and equity instruments financing pilot projects, including first five commercial scale plants (meaning plants intending to be operated at a profit), and all operating income from those projects, shall not be subject to federal taxation, if completed during the six year pilot program commencing on enactment of this Act, for each innovative new technology seeking to prove commercial viability and zero or negative emission impact in these categories: *power generation, fuels and products made from captured carbon, energy storage and control systems for renewable energy production.*

The Secretary of the Treasury, in consultation with the Administrator of the Environmental Protection Agency and the Secretary of Energy, after providing an opportunity for public comment, shall develop any needed criteria by which each of the above categories of clean assets or technologies shall be further defined, and where deemed necessary, certified by an independent third party; and they shall also consider simple procedures and criteria for proposing to Congress new categories and technologies that may arise in the future, that may be similarly qualified as clean assets, products, services and investments which reduce pollution.

The Secretary of the Treasury shall develop procedures for reporting use of proceeds, expenditures and income from such clean assets, projects and investments to the federal government in order to help with the evaluation of this pilot program.

Two years after the tax cuts begin, and every two years thereafter, the Secretary of the Treasury, in consultation with the Administrator of the Environmental Protection Agency and the Secretary of Energy, after providing an opportunity for public comment, shall report to Congress on the costs and benefits of the tax cuts and any recommendations for refinements of these provisions.

In carrying out all these duties, the Administrator of the Environmental Protection Agency and the Secretary of Energy shall focus on environmental and energy sector impacts and pollution costs avoided, and The Secretary of the Treasury and the Department of the Treasury shall focus on financial, fiscal, economic and market aspects of this program, including financial conclusions drawn by the Administrator of the Environmental Protection Agency and the Secretary of Energy. The Secretary of the Treasury and the Department of the Treasury shall not independently analyze or opine on environmental and energy sector impacts of this program, but rather reflect conclusions of the Administrator of the Environmental Protection Agency and the Secretary of Energy about such impacts, and incorporate them into financial analysis as required.

Issuers of CABs shall follow the Green Bond Principles, as published by the International Capital Markets Association in January, 2018, with respect to such bond issuance, at least to the extent consistent with compliance with this Act. If some CABs allowed under this act are not allowed under 2018 Green Bond Principles, the issuers of such CABs will nonetheless abide by 2018 Green Bond Principles to the extent they can, even though such CABs might not be labeled as Green Bonds.