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The Grace Richardson Fund
New Free Market Policy Solutions for 21st Century Challenges

Clean Tax Cuts for Green Bonds – Charrette Summary

Columbia University, New York, NY – March 6th, 2017

Clean Tax Cuts (CTCs) for qualified green bonds will be a new class of policy proposal designed to stimulate investment in and demand for clean technologies and solutions simultaneously by reducing taxes on - and ultimately the cost of capital and outputs for – initiatives that deploy them. It provides a framework to align conservative and progressive interests on energy, environmental protection, and economic growth by marrying two proven concepts: the green bond market and municipal bond tax abatement.

Green bonds have already proven to be an effective instrument for channeling investor funds into clean technologies. They represent a burgeoning market that has seen dramatic growth since their debut in 2007. The global value of green bonds issued last year rose to a record $93.4 billion, up over 3,500% from 2012's $2.6 billion. Moody's Investor Services suggests that green bond issues could more than double again in 2017, to $206 billion. Although the standards and definitions for green bonds are still being established, this designation helps reduce the costs of matching interested buyer and sellers. Green bonds are used for projects in a variety of sectors and are therefore an effective focal point for CTC. Applying CTC to green bonds promises accelerated, broad-scale impact with targeted simplicity.

The established market of municipal bonds represents a successful experiment in mobilizing large amounts of low-cost capital for public benefit. Adopting strategies similar to the municipal bond tax abatement model is the simplest, most impactful solution: by cutting taxes paid on interest earned from green bonds, CTC will lower the cost of capital for investors, thus making qualified projects more attractive. Because the target technologies and initiatives are typically capital intensive, lowering the cost of capital significantly lowers the levelized cost of production, be it electricity, lumber, water, or fish. Cheaper solutions will open up larger potential investor and consumer markets in tandem, and translate into accelerated deployment of clean technologies.

Thus, tax-free corporate green bonds create a new class of security, which simultaneously increase both supply and demand for clean solutions. Blending characteristics of tax free munis ($3.7 trillion market) and higher yield taxable corporate bonds ($35 trillion market) the potential appeal to investors and issuers - even those with no interest in sustainability - appears straightforward. These bonds offer lowest cost of debt for issuers, and potentially the highest tax-free return for investors. The market potential could be large.

There are many potential ways to design CTC mechanisms, but using them to accelerate the supply of capital holds significant potential impact across a broad swath of sectors. Green bonds are a similarly broad and flexible investment vehicles for the same purpose, and marrying the CTC tax benefits to the concept of green bonds represents a powerful tool for mobilizing cheaper capital where it is needed.

The proposals presented below were challenged to be simple, practical, and effective; generate bipartisan support and appeal to the broadest audience; and be hard to game but easy to administer.

1. Proposal 1: Emission Reduction Bonds (ERBs)

Similar to favorable tax treatment given to municipal bonds for large-scale assets deemed to be in the public interest, ERBs would eliminate federal taxes on interest income from bonds or loans invested in projects that meet the test of being an emissions-free energy generator, thus rewarding investments in clean energy infrastructure like wind, solar, nuclear and geothermal projects. Approved and verified technologies installed and put into service would qualify for the 100% tax cut exemption on all loan or bond debt interest.

The current ITC/ PTC could be eliminated or reduced to help fund this tax cut. At a minimum, projects should not be allowed to take advantage of both, which should assist in the scoring as projects migrate from one regime to another.

This approach sets a clear, understandable qualification threshold, avoiding contentious arguments about ambiguous impacts that might chill market participation. However, the initial proposal does limit participation to clean technology within the power market.

2. Proposal 2. Clean Asset Bonds (CABs)

ERBs could be expanded to include any desirable asset class, with definable known impact. CABs are privately issued green bonds, where the underlying assets deliver or support a known, quantifiable benefit, or are impact-certified by an external standard such as ENERGY STAR or CAFE. These qualify as "clean" without further external assessment, by virtue of proven ability to reduce waste, inefficiency and negative externalities. CABs could finance:

- Renewable and other low or zero emission energy infrastructure projects (ERBs)
- Electric or PEH private vehicles, service fleets, and public transportation
- Energy storage, batteries, and fuel cells; smart grids and transmission
- Green buildings and energy efficiency equipment (eg. ENERGY STAR loans and MBS)
- Oil & Gas, industrial, community waste reduction, monitoring and recycling systems
- CCUS, Air Capture, and downstream captured carbon product manufacture
- Factories, manufacture, construction and installation for all the above

This proposal builds on the municipal bond approach as a model, too. Projects financed by qualified bonds would voluntarily transition from the existing system of tax credits to clean tax cuts. Qualified bonds would be allowed to claim both credits and cuts for a three year transition period, after which they would be required to pick one or the other. Investors would follow tax-reporting procedures similar to those for existing tax-exempt bonds.

In cases where the known benefit is less that that of a zero emission power source (tax-free under the ERBs proposal) some charrette participants suggested the "clean" tax rate be half that of ordinary tax rates, but not zero… and in line with framework of the "Better Way" tax plan, where capital gains is taxed at half the rate of ordinary income because of the public benefit conferred by capital investment. They suggest "clean" capital investment confers a greater public benefit than ordinary capital investment, so clean capital returns should be taxed less. A non-zero tax rate would also have a better dynamic revenue effect.

__Note:__ This document compiles policy ideas from many sources for further discussion and consideration. Inclusion here does not imply that any CTC working group participant endorses any specific proposal as public policy.