KPMG

# The Wild West of Renewables

Audit Insights

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## Supply chain constraints, inflationary pressures and increased financing costs pose challenges for monetizing energy tax credits

*The Inflation Reduction Act promises renewable energy incentives and unprecedented innovation, but producers can't afford to turn on the lights. As new entrants and industry incumbents navigate an economic logjam, there are significant accounting and tax implications to consider.*

### New energy incentives are more plentiful, flexible and diverse

The passage of the Inflation Reduction Act (IRA) — a sweeping piece of budget reconciliation legislation signed into law on August 16, 2022 — brings a wealth of opportunity to the renewables sector.[1] The IRA includes long-anticipated tax incentives, credit enhancements and related requirements designed to bolster investment in and production of renewable energy:[2]

- **Transferable energy tax credits**, through which companies can choose to sell certain credits (or portions of credits) to third parties in exchange for cash
- **Provisions for existing investment tax credits (ITCs) and production tax credits (PTCs)**, including extensions, modifications and expansions for select credits
- **New energy tax credits**, applicable to standalone energy storage, clean hydrogen, zero-emissions nuclear power, sustainable aviation fuel and more
- **Direct pay features**, through which taxpayers can receive a refundable direct payment of tax rather than claim certain credits
- **Credit enhancements ("adders")**, potentially available for select project characteristics, such as the use of domestically sourced steel and iron, domestically manufactured components and production in specified energy communities
- **Prevailing wage and apprenticeship requirements** for projects to be eligible for the highest available credit rates

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[1] KPMG LLP, "Inflation Reduction Act of 2022," accessed March 29, 2023, https://tax.kpmg.us/insights/inflation-reduction-act-tax-insights.html.
[2] KPMG LLP, "Inflation Reduction Act: Implications for the Energy and Chemicals Industry," September 7, 2022, https://tax.kpmg.us/events/webcasts/2022/inflation-reduction-act.html.

The above examples only scratch the surface. There are several other manufacturing tax incentives now in play that could stimulate renewable energy production and investment even further.

If we zoom out, we're looking at a very different ecosystem for renewable energy today than we were just last year. Before the IRA, ITCs and PTCs in the renewables sector had been nonrefundable and nontransferable, and they largely focused on more traditional forms of renewable energy, such as solar and wind power. Today, there are a host of new credits available related to emerging green technology and more flexibility in acquiring and monetizing those credits. In short, the IRA is a tremendous boon to renewable energy innovation.

But there are a few key problems: supply chain disruption, inflationary cost pressures and the increasing cost to finance capital projects.

## Demand for renewable energy is outpacing global supply capabilities

Like companies in many sectors today, energy producers and suppliers continue to face rippling effects from global supply chain disruption and inflationary pressures. They lack the critical resources they need to bring new projects online quickly and effectively.

Let's look at, for example, offshore wind farms. Power production from offshore wind has the potential to help various stakeholders — federal and state governments, utilities and others — satisfy carbon reduction commitments. And interest in offshore wind has only increased given the recent and planned leases of coastal areas for offshore wind development. However, the steel that is required to construct wind towers, both onshore and offshore, is in short supply and being sold at an uncharacteristically high price point. Furthermore, there is a shortage of specialized vessels designed to construct these offshore wind towers.[3] These supply constraints are coupled with a mad rush of industry players all trying to competitively bid on offshore leases and bring new projects online quickly to meet state-imposed deadlines. The result: Demand far exceeds supply, while at the same time, the cost to finance projects is skyrocketing.

Similar scenarios are playing out across the industry. And it's not just wind energy. Lithium for battery storage plants, for example, has faced significant price volatility in recent months. And fluctuating solar panel prices are further complicated by high import tariffs. And then, of course, there are high interest rates increasing project costs even further, as well as high barriers to entry for new suppliers, such as the unique technology requirements and significant capital investment required. The IRA provisions incentivizing the domestic supply chain may alleviate some pressure, but the supply chain disruptions are only part of the story.

With all these factors at play, renewable energy companies are finding themselves at an impasse. On the one hand, they have an array of new energy incentives encouraging them to accelerate the development of renewable energy projects. But on the other, they are unsure how to take advantage of them in light of the abnormally high financing costs, lengthy project delays or, in some cases, project cancellations. As for their finance departments, there are significant accounting and tax implications to consider.

## Supply chain and financing risks muddle the financial statements

The interplay between new energy tax incentives and existing supply chain and financing constraints is forcing energy finance executives to think critically about the value of their portfolios. Some top-of-mind questions we're hearing across the industry include:

- What is the fair value of a project that has been delayed by supply chain disruption, inflationary pressures or increased financing costs?

[3] KPMG LLP, "Financial Reporting Amidst Economic Uncertainty," March 2023, https://info.kpmg.us/news-perspectives/advancing-the-profession/financial-reporting-economic-uncertainty-2023/financial-reporting-economic-uncertainty-renewables-2023.html.

- At what point do project setbacks indicate impairments? What evidence has been gathered to determine whether there is an impairment or not?
- What is the proper way to reconcile the fair value of a project that is eligible for the new tax incentives but incurring higher capital expenditures because of inflation and other external factors?
- With rising interest rates impacting the viability of offtake agreements, are certain projects becoming unfinanceable?
- For energy producers that have contracts with state governments to meet portfolio climate standards by specified target dates, at what point do project delays or cancellations become a compliance issue?
- Is there a point at which state governments or regulators will cease approving contracts on the grounds that heightened costs have made the resulting impact on ratepayers untenable?

## Uncertainties also remain in the monetization of IRA tax incentives

Even in a scenario where supply chain constraints are resolved and energy projects progress on schedule, there are still pending questions about the application, monetization and accounting for the IRA's energy tax credits.

- Who is verifying the validity of a credit that an entity wishes to transfer, and how is pricing determined? Is insurance over the amount of energy tax credits a viable option?
- When thinking about the application of tax credit adders, how is domestic content measured? Will projects be located in an energy community?
- Do all or parts of the long-standing definition of prevailing wage requirements apply to the new requirements for energy credits?
- Will the supply of credits ultimately outweigh the demand, diminishing returns for project sponsors?

Further guidance from standard setters is expected down the road. In the meantime, KPMG has compiled resources based on existing accounting principles and is working with clients to determine potential tax implications.[4] Until additional guidance is available, we anticipate that energy producers and investors will place a heavy emphasis on documentation, indemnification agreements and potentially insurance to make the most of the new incentives while minimizing risk exposure.

## Breaking the logjam for a greener future

The incentives in the IRA have the potential to drive the next wave of renewable energy innovation, encouraging new entrants to join the market while creating new mechanisms for industry incumbents to diversify and monetize their portfolio of renewable assets. However, inflation, supply shortages, geopolitics, high interest rates, the COVID-19 pandemic and other market- and industry-specific factors have played a role in delaying the full realization of the IRA's benefits.

That said, once the logjam begins to clear, we anticipate market participants will start monetizing energy tax credits to manage costs, diversify their energy portfolios and accelerate new projects. When they do, it will be critical for finance executives to closely monitor and mitigate associated risks. Obtaining credits under the IRA

[4] KPMG LLP, "IRA and CHIPS: Tax Considerations," February 2023, https://frv.kpmg.us/reference-library/2023/ira-and-chips-tax-considerations.html.

will entail additional work, particularly to fulfill the requirements needed to qualify. And while accounting for energy tax credits may look straightforward on paper, there are still gaps in the accounting guidance, and navigating complex transactions can get tricky.[5] Ensuring that the operations, accounting and tax functions stay closely aligned, and that all advisors are on board, will be essential to instilling confidence in investors and securing a competitive advantage.

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[5] KPMG LLP, “What do new entrants to the renewables market need to understand about energy tax credits?,” LinkedIn post, September 2022, https://www.linkedin.com/feed/update/urn:li:activity:6975166166864457729/.