

Office of the Secretary of State

Jeanne P. Atkins
Secretary of State

Robert Taylor
Deputy Secretary of State



Audits Division

Gary Blackmer
Director

255 Capitol St. NE, Suite 500
Salem, OR 97310

(503) 986-2255

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Michael Kaplan, Director
Oregon Department of Energy
625 Marion Street, NE
Salem, Oregon 97301-3737

Dear Mr. Kaplan:

We received a hotline call alleging that at least since 2013 the Department of Energy gave favorable treatment to Blue Tree Strategies in its pass-through transactions of some business energy tax credits by allowing Blue Tree to negotiate pass-through rates other than those authorized in statute.

Background

The 2007 Legislature expanded the original BETC (Business Energy Tax Credit) program to encourage investments in energy saving measures and green energy projects. Rather than budgeting for direct subsidies to businesses, the state forgoes tax revenues in the future to finance a portion of energy related projects. Due to ballooning lost revenues of nearly \$1 billion, the 2011 Legislature substantially revised and limited the program. The state continues to issue credits under the Energy Incentive Program (EIP) since the July 1, 2014 sunset of the BETC program.

Under the EIP and BETC programs businesses may propose a project to the department and, if approved, get reimbursed a percentage of a project's certified costs in tax credits. For example, a project with \$1 million in certified costs may receive a \$350,000 tax credit to be used over five years. (If certified costs are \$20,000 or less, the tax credit may be used in one year.) These tax credits can reduce dollar-for-dollar the tax liability of the business. Once completed, the energy project may undergo an examination by the department and an independent CPA to verify its completion and total costs before the department reimburses the business with a tax credit certificate, which may be used for a limited period of time.

In some cases, tax credits may not be an inducement to implement energy projects; the statutes allow the credits to be sold to a business that can write off taxes in the amount of the credits. For example, a business may not owe enough in taxes to make a tax credit worthwhile, or governments also qualify under the program, but do not have a tax liability. The department allows businesses or governments to sell the tax credits using either the pass-through process (before the final certificate has been issued) or the transfer process (after the final certificate has been issued).

Businesses offer discounts on tax credits to encourage sales, using formulas authorized in statutes which are also posted on the department website. The website's calculator is updated quarterly and takes into account current interest rates and other factors to set the discount, currently 18.46% for five year projects and 2.35% for one year projects.

Local financial firms such as Blue Tree Strategies may receive a commission for connecting a seller of tax credits with a buyer, and helping them through the transaction. The hotline caller alleged that Blue Tree was brokering transactions with a larger discount on pass-throughs than allowed in statute.

No larger discounts for pass-throughs involving Blue Tree, as alleged

We asked for a sample of Blue Tree pass-through transactions from June 2012 through December 2014 and learned the department does not distinguish pass-throughs from transfers in its tracking system. A manual search of the files produced 9 pass-through projects brokered by Blue Tree during this time period which we examined. We found that Blue Tree's pass through transactions complied with statute and appeared to be receiving no different treatment than other financial firms, as alleged by the caller.

Favorable treatment for negotiated transfers not so easily dismissed

Near the completion of our inquiry a newspaper reported that Blue Tree helped the Tri-Met transit district sell its tax credits at a negotiated 25% discount under the transfer provisions of the law. As reported, Tri-Met sold its \$1.8 million tax credit for \$1.35 million. The tax credit gave the buyer a dollar-for-dollar reduction in taxes at a cost of only 75 cents per dollar.

To examine the possibility that the hotline caller meant “transfers” rather than “pass-throughs,” we asked for a sample of transfer transactions from June 2012 through December 2014 brokered at a negotiated rate by a financial firm other than Blue Tree. The department provided documents for 9 transactions, but only two were negotiated transfers. The two examples were negotiated by brokers other than Blue Tree in 2013, although the dollar amounts were less than the Tri-Met example. While the discounts for the two transactions we reviewed were around 25%, the credits themselves were under \$26,000.

Equity concerns regarding transfers

The fact that discounts were being privately negotiated as early as 2012 was contrary to the department’s administrative rules requiring tax credits to be sold at the specified rate. Department management stated that they allowed privately negotiated discounts after seeking legal advice, due to ambiguities in the law. It was reported that some sellers of tax credits could not find a buyer within the allowable time period, and negotiated discounts was one way of obtaining some value from them. Department management acknowledged, however, it did not fully communicate, externally or internally, its 2012 decision to accept privately negotiated discounts. As a result, few finance firms were aware that discount restrictions had been lifted, and department staff gave conflicting advice when asked about transfer discounting.

It was not until March 2015 that the department initiated a temporary rule change to reflect what management said had been a business decision. Department management acknowledged they implemented temporary rules to address inconsistent rules pertaining to privately negotiated discounts for BETC transfers dating back to July 10, 2012, and EIP transfers dating back to December 22, 2014.

Fiscal implications

Higher discounts on energy credit transfers have no fiscal impact on future state revenues. A qualified energy-related project is completed, and the department grants tax credits to cover a limited amount of the organization’s costs. The organization selling a tax credit at a discount receives less revenue than the value allowed by the state, but presumably the buyer will file for the full tax credit amount.

A secondary implication of negotiated discounts also gained media attention. Specifically, the difference between the amount paid for a tax credit and the credit claimed on a tax return may result in a capital gain for the buyer. One news article reported Department of Revenue auditors discovered buyers were not paying taxes on those gains, and the Department of Revenue was not actively pursuing taxpayers claiming energy tax credits.

We met with Department of Revenue managers to ask them to explain Department of Revenue's position regarding energy tax credits. We were told that before 2012, it was not clear whether gains from purchases of tax credits were to be treated as capital gains. An IRS memorandum issued in late 2011 provided clarity that gains realized from the sale of transferable tax credits were federally taxable as capital gains. To obtain an understanding of the Legislature's position on capital gains from energy tax credits, the managers explained, they proposed a state tax exemption for the Legislature's consideration.

A bill was proposed in the 2013 Legislature but did not pass, and the capital gains remain taxable. Under its current auditing procedures, the Department of Revenue management stated that most businesses and individuals claiming energy tax credits have been reporting capital gains as required. When the department finds returns not reporting capital gains, those returns are amended and appropriate taxes are received. Management stated that the percentage not reporting capital gains has not risen to the level requiring alternative auditing procedures.

Recommendation

The concerns about transfer discounts, documentation, and inconsistent communications about allowable discounts, lead us to believe the program should be reassessed. We recommend the department work with the Legislature to clarify the intentions for the program, ensure its administrative rules and practices align with the intentions, consistently and clearly communicate its rules, and improve its tracking to better ensure transactions achieve program objectives.

We appreciate your staff's time and cooperation during this investigation. If you have any questions, please contact me at (503) 986-2351.

Sincerely,
OREGON AUDITS DIVISION

V. Dale Bond, CPA, CISA, CFE
Audit Manager

cc: Anthony Buckley, Chief Financial Officer
Rachel Wray, Communications Manager
Clyde Saiki, State Chief Operating Officer