INVESTOR'S Edge

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Earth Day: Renewable energy accomplishments and challenges

Renewable energy has come a long way. With prices depending on location, renewable energy only recently became cost-competitive with fossil fuels for generating electricity, according to BloombergNEF. The road to net zero increased the awareness of the energy sector and the transition to cleaner sources. Both traditional energy (oil and gas) and clean energy (like wind and solar) solutions are expected to play an important role in the transition. Many sub-sectors and forms of energy will contribute to an orderly transition as there is not a one size fits all solution.

Decarbonization strategies are an ever-growing area of growth, disruption and balance. As clean energy solutions are brought to market at scale and added to the energy mix, it will help reduce greenhouse gas (GHG) emissions. The path to net zero will take coordination and cooperation from many.

Specifically for oil and gas companies, it has become difficult to forecast the future mix of global energy in an era of increasing uncertainty and evolution to cleaner sources. Currently, one quarter of the GHG emissions in the U.S. comes from electricity production, according to the Environmental Protection Agency. The U.S. electrical sector is still dependent on fossil fuels, with 61% from burning fossil fuels (coal, natural gas or petroleum), 19% from nuclear and 20% coming from renewables (wind, hydropower and solar), according to the U.S. Energy Information Administration. There will be opportunities and challenges as adoption of renewables continues.

Challenges

Despite the current level of investment into clean energy projects and federal tax credits available, the pace of development and installations isn't keeping up as fast as anticipated, according to The Wall Street Journal. Supply-chain issues, long wait times to connect solar and wind farms to the grid and a challenging regulatory environment have contributed to a slower pace of wind and solar installations across the U.S.

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The U.S. Inflation Reduction Act may help propel demand and further incentivize investment and acceleration of renewable energy. However, it will depend on the speed and scale of the energy transition.

The costs and economics of power generation play a big part in the evolution of electricity generation. Transitioning costs are incurred when switching over from current power generation infrastructure to renewables. One of the barriers to a fully renewable grid is the location of wind and solar farms. Additional transmission lines and batteries to store excess power during times of low generation can help solve this. Efforts to create a domestic solar supply chain are expected to take time and continued investment, and there may be a few speed bumps.

Accomplishments

2022 was a double milestone for decarbonization efforts in the energy system with investment in the clean energy transition equal to global investment in fossil fuels at $1.1 trillion, according to BloombergNEF. This made 2022 the first year investment in decarbonizing energy surpassed the $1 trillion mark. The future is looking bright!

According to MSCI ESG research, the power sector is leaning into renewables as major utilities in the U.S. and Europe plan to spend nearly four times the amount budgeted for fossil fuels and nuclear to direct capital toward wind and solar as well as power lines and other grid components.

A spotlight on solar energy

RBC Wealth Management's Global Insight, Solar energy: here comes the sun, reports how cheap and emissions-free technology shines light on the potential of solar energy and how investors can look to tap into this growth opportunity. Highlights from the report include:

When did solar energy start?

The technology was created in the U.S. in 1954, but it didn't pick up momentum until Germany passed a law in 2000 to boost renewable energy development, creating a market for the solar industry in the process.

Global energy generation

A mere 3.6% of global energy generation is solar, though the percentages vary widely by country.

The growth potential of solar

Despite its low share of global electricity production, solar is one of the fastest-growing renewable energy technologies and appears to play a major role in the future global electricity generation mix. According to the International Energy Agency, the sun could be the largest source of electricity by 2050, accounting for more than a quarter of worldwide power generation.

The cost of solar versus fossil fuels

At the end of 2020, solar was the cheapest of all energy sources, according to calculations by Lazard, an advisory firm.

How investors can get involved with renewables

The U.S.'s Inflation Reduction Act and the current energy crisis in Europe have driven investment into the renewable energy sector. The act offers many incentives that should make the clean energy transition more affordable, including tax credits for electric vehicles, home electrification upgrades, heat pumps and solar systems. Additionally, investors can learn more about thematic investment themes (i.e. clean energy and renewables) for their portfolios.

Recognize Earth Day on April 22

Investors have an opportunity to participate in protecting the planet for future generations, specifically through the growing industry of renewable energy.

Contact your financial professional today to discuss the role renewable energy may play in your investment portfolio.

Get the most out of tax season: Know your loan interest deductibility options

Tax season is a busy time as you complete and file your income tax return(s). A common question that arises is when you can deduct interest on loans.

Factors affecting loan interest deductibility

The deductibility of loan interest depends on the purpose of the loan. Interest on loans for business expenses may be deductible, while interest on loans for personal expenses generally is not. Tracing the use of loan proceeds allocates the debt and interest, depending upon the type of expenditure to which the proceeds are used. The underlying property used to secure the loan being generally irrelevant. However, there are exceptions for personal residences and certain circumstances involving securities-based loans for investments such as business expenses or private capital calls.

Deductibility of business loan interest and capital expenditures

Interest paid on loans related to a trade or business may be deductible if the expenses meet certain criteria. These may include expenses incurred during the course of regular business such as employee compensation, rent or business-related insurance. The deduction begins only when borrowed funds are spent for business purposes.

Reducing your tax rate

If you paid $5,000 in deductible interest on a $100,000 loan (5% rate), and you are in the highest tax bracket (37% for married couples filing jointly earning greater than $647,850 in 2022), you saved $1,850 in taxes through the deduction.

Or, using the same example above, expressed differently, your after-tax interest rate is 3.15%.

Interest rate x (1 - your tax rate) = after tax rate

For illustration

In contrast to business expenses, capital expenditure is an investment in the business, such as buying new assets, which is not treated as an expense. Examples of capital expenditures include new buildings or upgrades to existing facilities. The loan collateral is irrelevant but tracing the use of proceeds is important. If a loan is used for both personal and business purposes, it is wise to have separate loans or segregate them for tax reporting. The tax rules around specific transactions can be complicated. As always, you should consult your own tax advisor about the application of these rules to your own particular circumstances as our firm does not provide tax advice.

Risks

When choosing a loan, it's essential to consider risk. Investment portfolios used as collateral are subject to margin calls and can be sold without notice. Home loans put your home at risk—affecting interest tax deductibility, and business loans may require personal guarantees, putting personal assets at risk. These risks should be carefully considered before choosing a loan.

Making loans part of your overall wealth plan

For every investor there may be times when loans play an important part in potentially growing wealth. But sometimes those loans could come with a large interest rate price tag. Knowing when loans qualify for tax deductions may help ease this pain point.

As you consider taking a loan, seek the help of your financial professional and tax professional to determine if the loan is eligible for these interest deductions and to help make well informed decisions during tax season.

Can your children manage a sudden financial windfall?

Receiving a windfall of money is a common dream. And a sudden increase in net worth is a reality many investors may experience at some point. However, even if it's expected, such a windfall can pose a challenge in determining what to do with the newfound wealth.

This is especially true for millennials, who in the coming years are set to be on the receiving end of one of the largest wealth transfers in history—approximately $80 trillion is expected to pass from baby boomers to the next generation, according to a report by Cerulli Associates. And with millennials in line to receive the majority of wealth and still being several decades from retirement, it's especially important for your children or grandchildren to be able to incorporate a windfall into their wealth plan in an effective way.

But 72 percent of millennials feel they don't have the knowledge, time or confidence to manage their wealth as it grows in complexity, according to a 2021 RBC Wealth Management survey.

If you have children or grandchildren who are expecting to receive an inheritance, equity compensation from a company or the sale of a family business, there are some wealth planning strategies that may help them successfully manage that money.

Inheritance

Your children or grandchildren may anticipate an inheritance, but often, they don't want to be financially dependent on it. Younger generations also tend to have a stewardship mindset and might feel they need to invest in a business or buy a vacation home for the family rather than just adding the inheritance to their portfolio.

If you are aware of your loved one anticipating an inheritance, it's important to discuss the money, what expectations are attached to it and how it may play a role in their long-term goals. Introducing them to your financial professional, who can help them develop a wealth plan with an inheritance strategy, can help prevent roadblocks when the inheritance happens.

If the inheritance isn't expected, when it happens, placing the investments in a holding account while a strategy is developed is a good option for the person you care about to figure out how to make it work in their wealth plan. Keep in mind, it can take several months for a strategy to come together. Have your loved one work closely with your financial professional to develop that plan.

Equity compensation

Many tech companies and start-up corporations are rewarding employees with equity compensation, and it's important for young professionals who may be helping these companies grow to fully understand how they're being compensated. Some examples of compensation include: stock grants, stock options, restricted stock or an employee stock purchase plan. Once the form of equity compensation is understood, have your loved one work with your financial professional to determine if their overall portfolio is well diversified, and—when wanted—to help determine if it's a good time to sell or keep stock.

Sale of a business

Business sales sometimes cause families difficulty, especially if the family was living with a limited budget for years while running the business, and then suddenly does not require budgeting restrictions because of a profitable sale.

Whether it's a family business or even a side hustle the person you care about started, a financial professional is key to helping find the valuation price, develop a succession plan, review tax implications and develop a wealth plan to smoothly incorporate the windfall into his or her lifestyle.

Overall considerations

No matter how the windfall happens—and no matter what age a person is when it happens—it is important for everyone to have a financial professional who can work with tax and legal professionals to help develop plans for successfully transitioning into a new financial life. These professionals can help your loved one develop financial, tax and long-term strategies to help meet today's needs, prepare for tomorrow's goals and perhaps even help a financial windfall last for generations to come.

How the SECURE 2.0 Act impacts retirement savings

Opportunities to save for retirement receive a boost from legislation passed into law in the U.S. in December 2022

The Setting Every Community Up for Retirement Enhancement (SECURE) 2.0 Act includes options for people at every stage of life. It expands upon the SECURE Act of 2019 and is designed to improve retirement savings, necessary because people are living longer. Through 92 new provisions, individuals have more flexibility to save for retirement. While some provisions took effect immediately, others begin in 2023, 2024, 2025 or later.

Here are some key points from the new act:

Automatic enrollment in retirement plans

Particularly a boost for young workers starting with retirement saving, companies will be required to automatically enroll eligible employees in new 401(k) and 403(b) plans. Initially, the employee automatic contribution must be at least 3% and each year will increase until it reaches at least 10% but not over 15%. Individuals may opt out during a specific timeframe and some employer plans are exempt.

Employer retirement plans for part-time employees

When an employee has two consecutive years or 500 hours of service, they may participate in that employer's 401(k) or 403(b) plan.

Higher catch-up limits for retirement investing

Starting in 2024, the annual limit allowed for people age 50+ to make in additional retirement savings account contributions will automatically adjust for inflation each year. In 2025, the catch-up for people age 60–63, with qualified plans, will be $10,000 or 150% of the standard catch-up amount permitted in 2024, whichever is greater. After 2023, catch-up contributions will be treated as Roth (after-tax) contributions for people earning more than $145,000 per year. While savers can't delay paying taxes on the extra catch-up contributions, the earnings on those savings will be tax-free when withdrawn in retirement.

Required minimum distributions

RMDs are increasing from age 72 to 73 effective January 1, 2023, and to 75 in 2033. This will benefit people who may not need their RMDs right away, so their investments can grow.

529 account rollovers

Beginning in 2024, there will be an option for 529 account rollovers to Roth IRAs. Allowing for tax- and penalty-free rollovers from 529 college savings accounts to Roth IRAs, this change will benefit individuals who have completed their education but may still have leftover funds in their 529 plans. However, there are limitations and restrictions for this provision.

Student loan payments

Starting December 31, 2023, employers can make matching contributions on behalf of employees who make qualified student loan payments. Previously, employees focused on repaying student loans may have missed out on matching contributions to their retirement account.

For more information on how the SECURE 2.0 Act can provide additional retirement saving opportunities, connect with your financial professional and accountant.

Our firm does not provide tax or legal advice. All decisions regarding the tax or legal implications of your investments should be made in connection with your independent tax or legal advisor.

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