



New IRS 45Q CCUS Tax Credit Regulations

26 CFR 1.45Q-1 et seq.

UTILIZATION / DISPLACEMENT PROJECTS

Background:

- “Old” 45Q passed 2009
- “New” 45Q passed February 9, 2018
- Omnibus 2021 Consolidated Appropriations Act extended construction date thru 2025
- IRS Rev. Proc. 2020-12 (partnerships)
- IRS Notice 2020-12 (construction)
- IRS final regulations 86 Fed. Reg. 4728 (Jan. 15, 2021)

Overview:

Utilization/Displacement

- Addition of utilization in 2018's "new" 45Q was a major expansion of 45Q opportunities.
- New 45Q credits utilization of captured carbon oxide in commercial uses that store CO₂ or displace fossil CO₂.
- Opportunities for existing facilities, as well as upgraded or new-build facilities.
- Qualifies some existing facilities until 75M cap reached (at least thru 2021).

45Q Regulations on Utilization/Displacement:

- IRS 45Q regulations are welcome, but they punted on critical issues.
- In other instances, regs impose unnecessary (and arguably illegal) bureaucratic burdens that increase the cost and risk profile of utilization projects.
- Notwithstanding, 45Q remains an attractive financing enhancement for CCUS projects.
- What is needed now is a platform to matchmake CO2 suppliers and offtake technologies for carbon utilization.

Effective Date:



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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

(TD9941)

RIN 1545-BP42

Credit for Carbon Oxide Sequestration

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance regarding the credit for carbon oxide sequestration under section 45Q of the Internal Revenue Code (Code). These final regulations affect persons who physically or contractually ensure the capture and disposal of qualified carbon oxide, use of qualified carbon oxide as a tertiary injectant in a qualified enhanced oil or natural gas recovery project, or utilization of qualified carbon oxide in a manner that qualifies for the credit.

DATES: *Effective date:* These regulations are effective on January 13, 2021.

Applicability dates: For dates of applicability, see §§ 1.45Q-1(i), 1.45Q-2(i), 1.45Q-3(f), 1.45Q-4(e), and 1.45Q-5(i).

FOR FURTHER INFORMATION CONTACT: Maggie Stehn of the Office of Associate Chief Counsel (Passthroughs & Special Industries) at (202) 317-6853 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 45Q of the Code.

Section 45Q was enacted on October 3, 2008, by section 115 of Division B of the Energy Improvement and Extension Act of 2008, Public Law 110-343, 122 Stat. 3785, 3829, to provide a credit for the sequestration of carbon oxide. On February 17, 2009, section 45Q was amended by section 1131 of Division B of the American Recovery and Reinvestment Tax Act of 2009, Public Law 111-5, 123 Stat. 115, 325. Section 45Q was further amended on December 19, 2014, by section 2096(j)(1) of Division A of the Tax Increase Prevention Act of 2014, Public Law 113-295, 128 Stat. 4010, 4030, and again on February 9, 2018, by section 4119 of Division D of the Bipartisan Budget Act of 2018 (BBA), Public Law 115-123, 132 Stat. 64, 162, to encourage the construction and use of carbon capture and sequestration projects. On December 27,

2020, section 45Q was amended by section 121 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, enacted as Division EE of the Consolidated Appropriations Act, 2021, Public Law 116-260, 134 Stat. 1182, 3051, to extend the beginning of construction deadline for qualified facilities and carbon capture equipment by two years.

On March 9, 2020, the Department of the Treasury (Treasury Department) and the IRS published Revenue Procedure 2020-12, 2020-11 I.R.B. 511, and Notice 2020-12, 2020-11 I.R.B. 495. Revenue Procedure 2020-12 provides a safe harbor under which the IRS will treat partnerships as properly allocating the section 45Q credit in accordance with section 704(b). Notice 2020-12 provides guidance on the determination of when construction has begun on a qualified facility or on carbon capture equipment that may be eligible for the section 45Q credit.

On June 2, 2020, the Treasury Department and the IRS published a notice of proposed rulemaking (REG -112339-19) in the *Federal Register* (85 FR 34050) containing proposed regulations under section 45Q (proposed regulations). The Treasury Department and the IRS received written and electronic comments responding to the proposed regulations. A public hearing on the proposed regulations was held on August 26, 2020. Copies of written comments and the list of speakers at the public hearing are available at <https://www.regulations.gov> or upon request.

After full consideration of the comments received on the proposed regulations and the testimony presented at the public hearing, this Treasury decision adopts the proposed regulations with clarifying changes and additional modifications in response to comments and testimony as described in the Summary of Comments and Explanation of Revisions section.

Summary of Comments and Explanation of Revisions

I. Overview

The final regulations retain the basic approach and structure of the proposed regulations, with certain revisions. This Summary of Comments and Explanation of Revisions section discusses the revisions as well as comments received.

II. General Credit Provisions

A. Credit Amount in General

Section 45Q(a)(1) allows a credit of \$20 per metric ton of qualified carbon oxide (i) captured by the taxpayer using carbon capture equipment which is

originally placed in service at a qualified facility before the date of the enactment of the BBA (February 9, 2018); (ii) disposed of by the taxpayer in secure geological storage; and (iii) neither used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project nor utilized in a manner described in section 45Q(f)(5).

Section 45Q(a)(2) allows a credit of \$10 per metric ton of qualified carbon oxide (i) captured by the taxpayer using carbon capture equipment which is originally placed in service at a qualified facility before February 9, 2018; and (ii) either (A) used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and disposed of by the taxpayer in secure geological storage; or (B) utilized by the taxpayer in a manner described in section 45Q(f)(5).

Section 45Q(a)(3) allows a credit of the applicable dollar amount (as determined under section 45Q(b)(1)) per metric ton of qualified carbon oxide (i) captured by the taxpayer using carbon capture equipment which is originally placed in service at a qualified facility on or after February 9, 2018, during the 12-year period beginning on the date the equipment was originally placed in service; (ii) disposed of by the taxpayer in secure geological storage; and (iii) neither used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project nor utilized in a manner described in section 45Q(f)(5) (referred to as "disposed" or "disposed of," respectively, throughout the final regulations).

Section 45Q(a)(4) allows a credit of the applicable dollar amount (as determined under section 45Q(b)(1)) per metric ton of qualified carbon oxide (i) captured by the taxpayer using carbon capture equipment which is originally placed in service at a qualified facility on or after February 9, 2018, during the 12-year period beginning on the date the equipment was originally placed in service; and (ii) either (A) used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and disposed of by the taxpayer in secure geological storage (referred to as "injection" or "injected," respectively, throughout the final regulations), or (B) utilized by the taxpayer in a manner described in section 45Q(f)(5) (referred to as "utilization" or "utilized," respectively, throughout the final regulations). Section 45Q(b)(1)(A)(i)(I) and (ii)(I) provides that the applicable dollar amount for activities under section 45Q(a)(3) for any tax year beginning in a calendar year (1) after 2016 and

- Rules effective next fiscal year beginning on or after Jan 15, 2021.
- Qualifies existing facilities until 75MM cap reached (at least thru 2021, maybe 2022).
- Applies to all new facilities.

Utilization/Displacement Projects:

- Displacement = ‘assumes existing product substituted with captured COx’ (pre-pub p. 81-82).
- Products must be comparable.
- IRS avoids addressing fact patterns (pre-pub p. 81).
- Declined to approve particular technologies or processes (pre-pub p. 89).
- References NETL 2019 LCA guidance.
- All activities must be in United States (1.45Q-1(a)) (pre-pub p. 138).

Commercial Markets 1.45Q-4(d):

- Statute qualifies any use for which commercial market exists, as determined by IRS.
- Market "broadly" defined as "sold or transacted on commercial terms" (pre-pub p. 86, 177).
- Not limited to particular products or markets (includes services).
- IRS declined to provide positive list.
- IRS alludes to forthcoming guidance or form instructions (pre-pub p. 86).
- Must include substantiation of commercial market with Form 8933 (arms-length contract suffice?) (1.45Q-4(d)) (pre-pub p. 177-78).

Lifecycle Analysis 1.45Q- 4(c)(1-6):

- Statute requires LCA per renewable fuels program.
- IRS requires written LCA report (pre-pub p. 176).
- IRS requires licensed (not accredited) third-party verifier (IRS dodged comments questioning legal authority to imply this non-statutory condition) (pre-pub p. 75, 177).
- Must include statement of verifier qualifications and independence thru sworn affidavit (pre-pub p. 177).
- Rejected safe harbor for using third-party verification.
- LCA must conform to ISO 14040/14044, but not ISO 14067 or EPA GHGRP (pre-pub p. 69, 176).
- Preamble states "must use" 2019 DOE/NETL CO2 Utilization Toolkit (consistent with statutory reference to EPA program?) (pre-pub p. 73).
- LCA measures CO2e but credits only COx not other GHGs.
- Alludes to future LCA guidance on common fact patterns (pre-pub p. 67).
- LCA boundary is "full product lifecycle" (pre-pub p. 176) on cradle-to-grave basis, but may disregard stages if same outcome (pre-pub p. 71).
- Must achieve net greenhouse gas reduction with comparison system (pre-pub p. 176).

LCA Submission 1.45Q- 4(c)(1-6)

- Must include substantiation of commercial market (1.45Q-4(d)) (pre-pub p. 177-78).
- LCA frequency not specified, alludes to forthcoming guidance (pre-pub p. 77) - plan on annual updates.
- Technical review of LCA by DOE (under what authority?) (pre-pub p. 177).
- Must submit LCA with Form 8933 (pre-pub p. 177).
- Must receive DOE/IRS approval prior to claiming credit - how does this work in practice? Anticipate delays and amended returns. (Maybe a reaction to EOR disqualifications) (pre-pub p. 177).
- Serious consequences for no approval, IRS warns no relief from 6662 penalties (pre-pub p. 79).
- Recapture never applies to utilization because LCA accounts for losses (pre-pub p. 87).
- IRS arguably lacks authority to require third-party verification; however, by and large because of the required DOE and IRS review of LCAs (which IRS more probably does have authority to require) it makes practical sense to work with a third-party verifier to increase the defensibility of the LCA.

Offtake Contracts 1.45Q-1(h)(2):

- “Contractually ensure” requires binding written COx offtake contract (pre-pub p. 148-51).
- Must bind offtaker and subcontractors.
- Must be enforceable (be cautious with LDs).
- Must have reasonable terms, but how is that judged?
- Must require compliance with 45Q.
- Taxpayer reports offtake contract on Form 8933 (and files with Form 8933 from offtaker) - hardwire filing in contract.
- Must amend/conform old contracts within 180 days (pre-pub p. 151).

Procedural Flaws:

- No full cost-benefit analysis.
- Unjustified assumption that regulations provide clarity (pre-pub p. 119-120).
- Unjustified assumption of decreased compliance costs despite 4-level review of LCA, timing mismatch complicates return filing, etc.
- Did not fix displacement glitch in amount utilized calculation (1.45Q-4)(b)) (pre-pub p. 175).