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CLIENT ALERT

IRS Releases Guidance Regarding Section 45Q Carbon Capture and Sequestration Tax Credit

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On July 1, 2021, the Internal Revenue Service released Revenue Ruling 2021-13 (the "Revenue Ruling") providing guidance regarding the tax credit for carbon oxide sequestration under Section 45Q. The Revenue Ruling provides guidance on what constitutes carbon capture equipment, who is eligible to claim the credit, and what is the relevant placed-in-service date for purposes of the Section 45Q credit.

The Revenue Ruling is premised on a factual scenario in which an existing industrial facility (the "Facility") produces methanol in a multi-step process. As part of the Facility's process, an acid gas removal ("AGR") unit purifies raw syngas and releases the separated CO2 into the atmosphere. This AGR unit was placed in service in 2017 (for purposes of depreciation under Sections 167 and 168) and no taxpayer had claimed a Section 45Q credit with respect to the Facility. Then, in 2021, an investor (the "Investor") purchased and installed new components of carbon capture equipment necessary to create a single process train capable of capturing, processing, and preparing for transport the CO2 that previously was being released into the atmosphere at the Facility. The Investor did not acquire an ownership interest in the AGR unit or the Facility.

What constitutes carbon capture equipment?

Section 45Q does not define the term "carbon capture equipment." The Treasury regulations provide a functionality-based approach to defining carbon capture equipment, and do not adopt a primary purpose test or allow taxpayers to elect to exclude "dual purpose" property from the definition of carbon capture equipment. Under the Treasury regulations all components that make up an independently functioning process train capable of capturing, processing, and preparing carbon oxide for transport will be treated as a single unit of carbon capture equipment, or a "single process train." The Revenue Ruling holds that the AGR unit described in the Revenue Ruling is carbon capture equipment for purposes of Section 45Q because one of its functions is to separate CO2 from a gas stream.

Who is eligible to claim the Section 45Q credit?

In the case of qualified carbon oxide captured using carbon capture equipment that is originally placed in service at a qualified facility on or after February 9, 2018, the Section 45Q credit is attributable to the person that owns the carbon capture equipment and physically or contractually ensures the capture and disposal, injection, or utilization of such qualified carbon oxide. The Treasury regulations provide that for each single process train of carbon capture equipment, the credit will be considered attributable to only one person. That person will be the one who either physically ensures the capture and disposal, injection, or utilization of such qualified carbon oxide or contracts with others to capture and dispose, inject, or utilize such qualified carbon oxide. The Revenue Ruling reasons that this requirement would be unnecessary if all components of carbon capture equipment within a single process train were required to be owned by the same taxpayer. Accordingly, the Revenue Ruling holds that the Investor is not required to own every component of carbon capture equipment within a single process

train, but must own at least one component of carbon capture equipment in that single process train to be the person to whom the Section 45Q credit is attributable.

What is the relevant placed-in-service date for purposes of the Section 45Q credit?

The credit period under Section 45Q is the 12-year period beginning on the date the carbon capture equipment is originally placed in service. The ruling explains that, for purposes of the Section 45Q credit, all components of a single process train shall be treated as a single unit of property and the relevant placed-in-service date is the original placed-in-service date of the single process train. That unit of carbon capture equipment will be considered originally placed in service for purposes of Section 45Q on the date that any person first places it in a condition or state of readiness and availability for the specifically designed function of capturing, processing, and preparing carbon oxide for transport for disposal, injection, or utilization. Under the facts of the Revenue Ruling, this cannot occur until the new components of carbon capture equipment are added to allow the Facility to capture, process, and prepare carbon oxide for transport for disposal, injection, or utilization, rather than release it into the atmosphere. Accordingly, the Revenue Ruling holds, for purposes of Section 45Q, the original placed-in-service date of a single process train of carbon capture equipment at the Facility that includes the existing AGR unit and new components of carbon capture equipment installed by Investor is in 2021.

For depreciation purposes, the result is different. The single process train as a unit of property and its original placed-in-service date for purposes of Section 45Q are not relevant for depreciation purposes under Sections 167 and 168. For depreciation purposes, the single process train at the Facility consists of two separate assets: the existing AGR unit that was placed in service in 2017, and the new carbon capture equipment components purchased and installed by Investor in 2021.

Takeaway

The Revenue Ruling helps to clarify several important aspects of the Section 45Q credit: dual purpose property can fall within the definition of carbon capture equipment, more than one owner is permitted for components in a single process train of carbon capture equipment, and the relevant placed-in-service date for purposes of the Section 45Q credit is the date a single process train of carbon capture equipment is placed in a condition or state of readiness and availability for the capture, processing, and preparation of carbon oxide for transport for disposal, injection, or utilization. The twelve-year period for claiming the Section 45Q credit begins on the date the single process train is originally placed in service. The Revenue Ruling, however, does not address how the ownership of "at least one component" of carbon capture equipment in that single process train will be measured to determine eligibility for the Section 45Q credit. For example, is the sufficiency of ownership based on the dollar value of the "component," so that prospective investors must consider at which point an investment will be considered de minimis? Or, is the standard based on the component's function within the single process train? Owners of different components in a single process train also will need to consider which party will claim the Section 45Q credit and ensure that party is otherwise eligible to do so.

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