

4 Takeaways From The Final IRS Carbon Capture Rules

By Joshua Rosenberg

Law360 (January 21, 2021, 6:46 PM EST) -- Final Internal Revenue Service rules released this month for the carbon capture and sequestration credit put to rest a number of lingering questions practitioners had regarding the credit.

Internal Revenue Code Section 45Q provides for a tax credit of up to \$50 per metric ton of carbon captured in qualified facilities. The credit was revised under the Bipartisan Budget Act of 2018, allowing companies to claim varying degrees of the credit if they engage in carbon capture and sequestration in association with enhanced oil recovery activities or in other contexts.

Under carbon capture and sequestration, carbon oxides are seized at the point of emission — at power plants, for example — and then permanently stored, or sequestered, deep underground in saline reservoirs or in oil and gas fields. The aim is to reduce atmospheric greenhouse gases that contribute to climate change.

The law establishing the credit requires that carbon oxides be securely stored deep underground, away from the atmosphere, in facilities such as salt deposits, oil reservoirs and unminable coal seams.

Here, Law360 looks at important aspects from the guidance and how industry actors may be affected.

Independent, Third-Party Analyses

Before the IRS released its **proposed** and **final guidance** on the changes, practitioners had to demonstrate compliance with the credit's secure geological storage requirements by adhering to the Environmental Protection Agency's greenhouse gas reporting standards known as the Greenhouse Gas Reporting Program's Subpart RR.

But under the IRS' proposed rules, those engaged in enhanced oil recovery projects could show that they meet the credit's secure storage requirements by adhering to the International Organization for Standardization's ISO 27916 — a "viable quantification methodology" for operators of certain oil and gas wells, the agency said at the time. Enhanced oil recovery is a process by which carbon dioxide is injected into the ground to help extract oil from wells.

Indeed, the agency's final guidance upheld the ISO avenue as a legitimate alternative, so long as a qualified third-party actor certifies the project, Carina Federico, an associate at [Crowell & Moring LLP](#)'s tax group, told Law360. That latter requirement provides greater clarity for the industry, she said.

"There were some people that said: 'Well, what if we have a qualified engineer on staff? Can they do it?' And the IRS said, 'No, it has to be an independent entity.'"

That's a helpful improvement, Nichole Saunders, senior attorney at the Environmental Defense Fund told Law360, but there's still a lack of parity between the ISO standard and Subpart RR regarding transparency.

"The 45Q rule shows improvement in requiring independent review of credit claims, but leaves a transparency gap for [enhanced oil recovery] operators claiming credits through the ISO standard, which — unlike the EPA RR alternative — does not require reports be made public," she said.

"In order to make ISO claims credible," Saunders said, "EPA needs to require appropriate reporting under the Greenhouse Gas Reporting rules."

Three-Year Recapture Period

Recapture periods refer to the time limit in which the IRS would have the capacity to rescind tax credits it has awarded. Because the carbon capture and sequestration tax credit requires secure and permanent geological storage, any leakage could jeopardize an organization's claim to the credit.

The IRS previously proposed a five-year recapture period for the credit, which would have largely aligned with the recapture periods for wind and solar tax credits. But after receiving comments from the public, the agency decided to shorten the period to three years.

That's a win for industry groups, David Blair, partner and chair of Crowell & Moring's tax group, told Law360, but it also reflects the unique technology used for carbon capture and sequestration projects.

"The time when it's most unstable and it's at the biggest risk of leakage is when you're injecting it, and then right after it's been injected, but it stabilizes relatively quickly," he said.

"I think the IRS did a nice job of listening to industry on points like that, where the technology is just different," he said, referring to the five-year recapture periods the IRS currently enforces for credits related to wind and solar energy.

But there's a danger in substantially shortening the recapture period, Scott Anderson, senior policy director at the Environmental Defense Fund, told Law360.

"The final recapture rule is the best that could be expected at this time, but EDF remains concerned that demonstrating secure storage as required by the statute is not something that can be done in just a handful of years," he said. "More needs to be done in order to assure that [enhanced oil recovery] operators who elect to use ISO continue to comply with ISO all the way through project termination."

Credit Transferability

The IRS' final regulations spelled out the circumstances under which owners of carbon capture and sequestration equipment may transfer the value of a tax credit to third parties.

Specifically, the IRS clarified that equipment owners may transfer the credit's value only to the final

disposers, injectors or users of carbon, with whom those owners have entered into contracts. That certainty should play a role in encouraging more investment in the program, Blair said.

Life-Cycle Analyses

The final regulations also affirm that those seeking to claim the credit must submit a life-cycle analysis to both the Department of Energy and the IRS for so-called utilized carbon that's used to create products. The DOE would provide a technical review of the analysis and the IRS would decide whether to approve or reject it, the agency said.

The question is whether the coordination envisioned in the regulation will run smoothly, Blair said.

"How quickly are you going to be able to get that kind of approval? Is it going to be in a timely way so that you can actually say: 'OK, I'm going to make an investment. I'm going to take the time to spend the money to build a plant,'" he said. He added that the IRS and EPA have traditionally worked well together when it comes to monitoring, reporting and verification plans.

The IRS said in its final regulations that it planned to release more industry-specific guidance regarding life-cycle analyses. But it's not altogether clear when that might happen, given that President Joe Biden has assumed office.

While it doesn't directly implicate the carbon capture and sequestration regulations, one of Biden's actions as president was to freeze new or pending regulations issued by the previous administration.

The IRS could not immediately be reached for comment.

--Editing by Leah Bennett and Robert Rudinger.