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45Q Regulations Will Spur Carbon Capture and Storage Investment

On January 6, the IRS issued much anticipated final regulations for carbon capture and storage (CCS) under Code Section 45Q. The regulations provide certainty and needed flexibility for project development, and we expect to see a ramp up in CCS projects as a result.

Generally, Section 45Q provides a tax credit for each metric ton of qualified carbon oxide captured at a qualified facility using carbon capture equipment and disposed of, used as a tertiary injectant in enhanced oil recovery (EOR), or otherwise used as described in Section 45Q(f)(5). The amount of such credit depends on whether the taxpayer captures qualified carbon oxide using carbon capture equipment originally placed in service at a qualified facility before February 9, 2018 or on or after February 9, 2018 and whether the carbon oxide is disposed of, injected, or utilized by the taxpayer. For disposal, the credit is $50 per ton of carbon oxide and for EOR the credit is $35 per ton of carbon oxide.

In February 2020, the IRS issued Rev. Proc. 2020-12, which provided a safe harbor framework for structuring tax equity partnerships formed to invest in projects that qualify for the Section 45Q tax credit, and Notice 2020-12, which provided guidance on determining when construction has begun on carbon capture equipment or qualified facilities. This initial guidance was followed by proposed regulations in May 2020 that offered guidance on, among other things, the documentation requirements of sequestration projects, events that trigger credit recapture, and the process of credit recapture in the year that the recapture event occurs.

Despite this initial guidance, questions remained about claiming and documenting the credit and credit recapture. This uncertainty caused reluctance in the energy industry to invest in tax-credit-motivated sequestration projects. However, the final regulations are largely taxpayer favorable and provide clarity in many of the areas that have remained murky since the release of the proposed regulations. Additionally, the final regulations modify previous guidance by extending certain deadlines and making the credit more generous. Below are some key takeaways from the final regulations:

- Following on the heels of the 2021 Consolidated Appropriations Act, extends the construction start date deadline for qualified facilities and carbon capture equipment through December 31, 2025, which allows an additional two years past the deadline provided in Notice 2020-12 for projects to ramp up.
- Provides clear rules on the standards for establishing "secure geologic storage," which for EOR allows reporting under either Subpart RR of the Environmental Protection Agency's (EPA) Greenhouse Gas Reporting Rule or the International Organization of Standardization (ISO) standard provided in CSA/ANSI ISO 27916:2019. Consistent with EPA regulations, reporting under Subpart RR is required for disposal wells. Taxpayers reporting under Subpart RR can self-certify the amount of carbon oxide stored, while those using the ISO standard must have its calculation verified annually by a qualified third-party engineer or geologist.
- Limits the recapture period to three years from the date of initial disposal or injection, which is shorter than the five-year lookback period provided for under the proposed regulations. Recapture takes place by reducing the credit allowable in the year of carbon oxide leakage or increases tax due to the extent that the leakage exceeds the credit received in such year. This shorter recapture period should generally reduce overall project risk.
- Provides further clarification of the "single project" rule under Notice 2020-12 that allows for aggregation by a taxpayer of several smaller carbon capture facilities into one project for purposes of claiming the credit when certain factors are present, such as common ownership and location. This opens the door for new industry players in CCS, such as landfills.
- Allows the owner of the carbon capture equipment to make a "transfer election," which allows the Section 45Q credit to be claimed by the party that disposes, injects, or utilizes the qualified carbon oxide.

The regulations are expected to spur private investment in CCS projects. Widespread support for CCS is expected from the incoming Biden Administration, including at the Department of Energy and EPA, because CCS will play a key role in meeting greenhouse gas reduction targets under Biden's climate plan and the Paris Agreement, which the President-elect says he will rejoin on day one of his presidency.

For more information, please contact Scott Harty at 404.881.7867, Elise Paeffgen at 202.239.3939, or April McLeod at 212.210.9487.

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If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Federal Tax Group

John F. Baron
Chair
704.444.1434
john.baron@alston.com

George B. Abney
404.881.7980
george.abney@alston.com

John F. Baron
704.444.1434
john.baron@alston.com

Henry J. Birnkrant
202.239.3319
henry.birnkrant@alston.com

Seth M. Buchwald
404.881.7836
seth.buchwald@alston.com

James E. Croker, Jr.
202.239.3309
jim.croker@alston.com

Jasper L. Cummings, Jr.
919.862.2302
jack.cummings@alston.com

Laura L. Gavioli
212.210.9432
214.922.3580
laura.gavioli@alston.com

Scott Harty
404.881.7867
scott.harty@alston.com

Brian D. Harvel
404.881.4491
brian.harvel@alston.com

Stefanie Kavanagh
202.239.3914
stefanie.kavanagh@alston.com

Sam K. Kaywood, Jr.
404.881.7481
sam.kaywood@alston.com

Clay A. Littlefield
704.444.144
clay.littlefield@alston.com

April McLeod
212.210.9487
april.mcleod@alston.com

Ashley B. Menser
919.862.2209
ashley.menser@alston.com

Daniel M. Reach
704.444.1272
danny.reach@alston.com

Heather Ripley
212.210.9549
heather.ripley@alston.com

Richard L. Slowinski
202.239.3231
richard.slowinski@alston.com

Edward Tanenbaum
212.210.9425
edward.tanenbaum@alston.com

Shawna Tunnell
202.239.3040
shawna.tunnell@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

ATLANTA: One Atlantic Center ▪ 1201 West Peachtree Street ▪ Atlanta, Georgia, USA, 30309-3424 ▪ 404.881.7000 ▪ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ▪ Suite 21B2 ▪ No. 7 Guanghua Road ▪ Chaoyang District ▪ Beijing, 100004 CN ▪ +86.10.85927500
BRUSSELS: Level 20 Bastion Tower ▪ Place du Champ de Mars ▪ B-1050 Brussels, BE ▪ +32 2 550 3700 ▪ Fax: +32 2 550 3719
CHARLOTTE: One South at The Plaza ▪ 101 South Tryon Street ▪ Suite 4000 ▪ Charlotte, North Carolina, USA, 28280-4000 ▪ 704.444.1000 ▪ Fax: 704.444.1111
DALLAS: Chase Tower ▪ 2200 Ross Avenue ▪ Suite 2300 ▪ Dallas, Texas, USA, 75201 ▪ 214.922.3400 ▪ Fax: 214.922.3899
FORT WORTH: 3700 Hulen Street ▪ Building 3 ▪ Suite 150 ▪ Fort Worth, Texas, USA, 76107 ▪ 214.922.3400 ▪ Fax: 214.922.3899
LONDON: 5th Floor ▪ Octagon Point, St. Paul's ▪ 5 Cheapside ▪ London, EC2V 6AA, UK ▪ +44.0.20.3823.2225
LOS ANGELES: 333 South Hope Street ▪ 16th Floor ▪ Los Angeles, California, USA, 90071-3004 ▪ 213.576.1000 ▪ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ▪ 15th Floor ▪ New York, New York, USA, 10016-1387 ▪ 212.210.9400 ▪ Fax: 212.210.9444
RALEIGH: 555 Fayetteville Street ▪ Suite 600 ▪ Raleigh, North Carolina, USA, 27601-3034 ▪ 919.862.2200 ▪ Fax: 919.862.2260
SAN FRANCISCO: 560 Mission Street ▪ Suite 2100 ▪ San Francisco, California, USA, 94105-0912 ▪ 415.243.1000 ▪ Fax: 415.243.1001
SILICON VALLEY: 1950 University Avenue ▪ Suite 430 ▪ East Palo Alto, California, USA 94303 ▪ 650.838.2000 ▪ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ▪ 950 F Street, NW ▪ Washington, DC, USA, 20004-1404 ▪ 202.239.3300 ▪ Fax: 202.239.3333