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Tax Equity and Carbon Sequestration

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Two broad questions:

What must be done to qualify for the tax credits?

Once qualification is assured, how can the tax credits be converted into current cash in the tax equity market to help pay for the project?

Three things must fall into place to qualify for tax credits.

- **You must have a qualified industrial facility that is a source of emissions.**
- **Add capture equipment.**
- **Dispose of the CO_2.**

There are deadlines to do certain things.

The tax credit amount and how long the tax credits run depend on when and how these items fall into place.

Three allowed uses of captured CO_2:

- Disposal in secure geological storage.
- Use as a tertiary injectant in a qualified enhanced oil or natural gas recovery project followed by disposal in secure geological storage.
- Use it another qualifying manner:
  - Conversion into an organic compound by growing algae or bacteria.
  - Chemical conversion to a material or compound in which the carbon oxide is securely stored.
  - Other purposes as designated by the IRS.

A qualified industrial facility =

- A facility that emits up to 500,000 metric tons of CO_2 a year and at least 25,000 tons are put to commercial use.
- A power plant that emits 500,000 metric tons or more of CO_2 a year.
- Any other facility that emits at least 100,000 metric tons of CO_2 a year.

The captured carbon emissions must be CO_2 that “would otherwise be released into the atmosphere as industrial emission of greenhouse gas or lead to such release.”

An industrial facility does not include a facility that produces CO_2 from CO_2 production wells at “natural carbon dioxide-bearing formations.”

A manufacturing process can be an industrial facility.

- **An industrial facility must produce CO2 from a fuel combustion source or fuel cell or a <u>manufacturing process</u>.**
- **A manufacturing process must involve the manufacture of a product, other than CO2, that is intended to be sold at a profit or used for a commercial purpose.**

The industrial facility must be under construction by the end of 2023. The capture equipment must be under construction by the same deadline or be part of the original planning and design for the industrial facility.

Section 45Q tax credits have been available since 2008, but they could only be claimed on the first 75 million metric tons in total CO_2 sequestered nationwide. In early 2018, Congress rewrote the statute to drop the cap, increase the credit amount, and allow tax credits to be claimed for 12 years after the capture equipment is first placed in service.

Amount – secure geological storage

2020	$31.77
2021	34.81
2022	37.85
2023	40.89
2024	43.92
2025	46.96
2026	50.00

Amount – other uses

2020	$20.22
2021	22.68
2022	25.15
2023	27.61
2024	30.07
2025	32.54
2026	35.00

An election can be made to treat equipment as originally put in service on February 9, 2018 to let tax credits be claimed under the new regime on older equipment. Tax credits cannot have been claimed by anyone before the election is made.

In addition, the IRS made it easier in proposed regulations on Thursday to treat capture equipment as new by spending at least four times on improvements the value of the used components retained from the old capture equipment. This is a way to get a later start date for the 12 years.

80-20 test

pipeline costs

“Carbon capture equipment”

The taxpayer must own all components of property used to capture or process CO_2 until the CO_2 is transported for disposal, injection or use.

Included components:

Property necessary to compress, treat, process, liquefy, pump or perform some other physical action to capture qualified carbon oxide.

- **Including absorbers, compressors, conditioners, cooling towers, dehydration equipment, dehydration systems, electrostatic filtration, engines, filters, fixtures, glycol contractors, heat exchangers, liquefaction equipment, lube oil systems, machinery, materials, membranes, meters, monitoring equipment, motors, mounting equipment, pipes, power generators and regenerators, pressure vessels and other vessels, processing equipment, processing plants, processing units, pumps, reboilers, recycling units, scrubbers, separation vessels, solvent pumps, sorbent vessels, specially designed flue gas ducts, support structures, tracking equipment, treating equipment, turbines, water wash equipment, and other carbon oxide related equipment.**

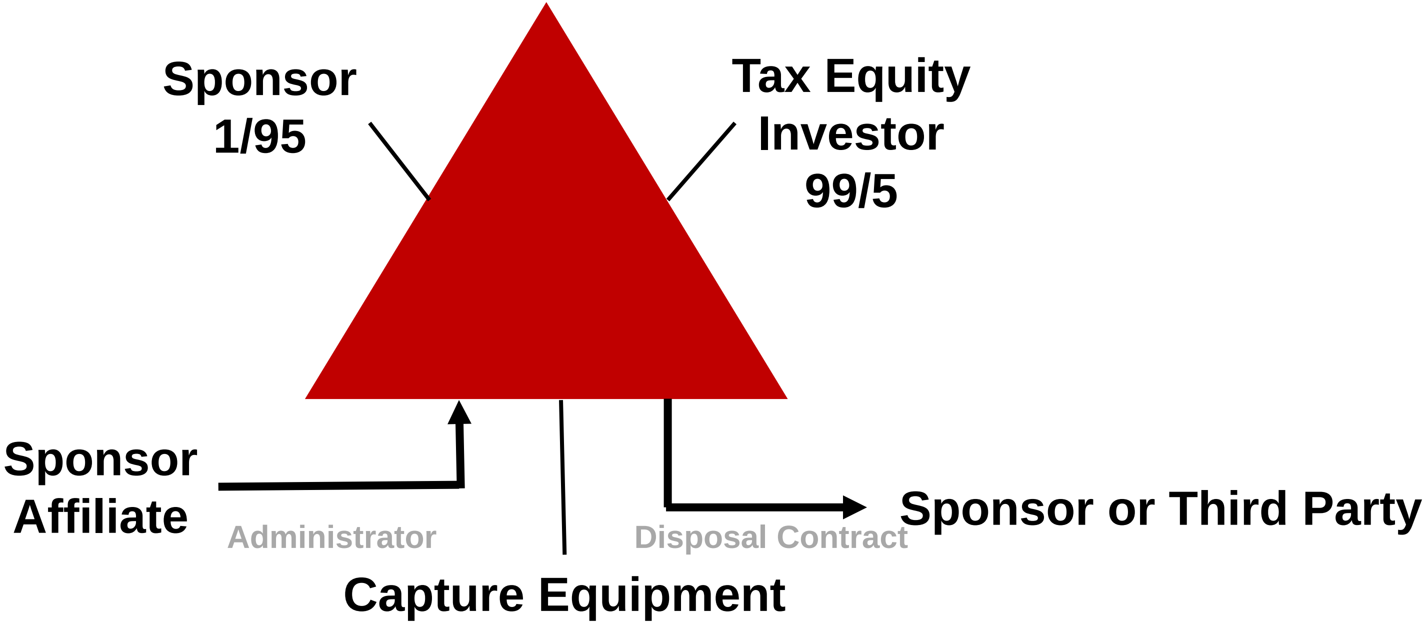
Excluded components:

The taxpayer does not have to own pipelines, branch lines, or land and marine transport vessels used for transporting captured qualified CO2 for disposal, injection or use.

The person claiming the tax credits must either capture and dispose of the CO_2 itself or else contract with someone else to do so. The capture equipment owner can elect to let the person disposing of the CO_2 claim the tax credits.

The election is made annually. The owner can choose whatever share of the tax credits that year to transfer. The owner transfers a percentage of the total credits rather than a dollar amount. It can transfer the credits to more than one other person if more than one person will use the CO_2.

Basic partnership flip



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Tax credits must be shared by partners in the same ratio they share in income or loss, depending on whether the partnership is expected to generate cash flow. Up to 50% of the tax equity investment can be made on a “pay-go” basis, meaning over time as tax credits are allocated. There cannot be a sponsor call or an investor put.

Historic Boardwalk language

The recapture period runs potentially for 17 years (i.e., the 12-year tax credit period plus five years after). Only the net leak in a year is recaptured (i.e., leak after offsetting the CO_2 injected into the ground that year). The IRS will look back as many as five years after the year the net leak occurs to recapture tax credits claimed during that period.

If multiple taxpayers are storing in the same underground reservoir, then they will have to come up with a method to allocate the leaked CO_2 among them. Leaks triggered by a volcano or earthquake do not lead to recapture.

Other issues:

New technology.

Potential environmental liabilities.

Timing: tax equity won’t take construction risk.

Risk that the minimum emissions levels will not be reached.

Risk that coal plants will shut down before the 12 years have run.

Audience questions

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