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The Inflation Reduction Act Includes Significant Benefits for the Carbon Capture Industry

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Carbon capture, utilization, and sequestration ("CCUS") projects around the United States received a significant boost from the Inflation Reduction Act of 2022 (the "IRA").[1] The IRA, which President Biden recently signed into law, includes approximately $369 billion in incentives for clean energy and climate-related program spending, including CCUS projects.[2]

Notably, the IRA (1) substantially increases the availability of the federal income tax credits available for domestic CCUS projects (often referred to as "45Q credits"),[3] (2) makes it easier for CCUS projects to qualify for 45Q credits, and (3) provides significant new avenues for monetizing 45Q credits.[4] The IRA also extends the deadline to begin construction on 45Q credit-eligible projects from 2026 to 2033.

Taken together, these changes are anticipated to significantly increase the number of CCUS projects that will enter service over the coming years.

Substantial Increases in Availability of 45Q Credits

The IRA substantially increases the availability of 45Q credits. Under current law, qualified CCUS facilities that captured qualified carbon oxides ("QCO") and either used the QCO in enhanced oil and gas recovery ("EOR") or utilized the QCO in certain industrial applications would have been entitled to receive 45Q credits of up to $35/metric ton ("MT"), and facilities that otherwise disposed of QCO in secure geological storage would have been entitled to receive 45Q credits of up to $50/MT (both rates computed before inflation adjustments).

The IRA effectively increases the above rates to $60/MT and $85/MT (before inflation adjustments) respectively; however the IRA conditions the availability of these credit amounts on satisfying new prevailing wage and apprenticeship requirements (otherwise, the new rates are reduced by 80 percent). At a high level, the prevailing wage and apprenticeship requirements are focused on making sure that projects provide well-paying jobs and training opportunities. The new requirements will apply only to projects the construction of which begins within 60 days on or after the date on which Treasury issues regulatory guidance regarding the new requirements.

The IRA makes similar changes to 45Q credits for QCO captured by direct air capture ("DAC") facilities, but the availability of 45Q credits for DAC facilities is even larger. Under current law, DAC facilities were eligible for 45Q credits at the same rates as industrial facilities. Under the IRA, DAC facilities are eligible for up to $130/MT for captured QCO used in EOR or utilized in certain industrial applications and $180/MT for other geologically sequestered QCO (subject to the same 80 percent haircut as other projects noted above if the DAC facility fails new prevailing wage and apprenticeship requirements).

The table below illustrates the extent to which the IRA is increasing the value of 45Q credits:

	2018 BBA 45Q Credit	2022 IRA 45Q Credit[5]
QCO Captured by Industrial Facility (Non-EOR/non-utilized)	$50/MT	$85/MT
QCO Captured by Industrial Facility (Used in EOR/utilized)	$35/MT	$60/MT
QCO Captured by DAC (Non-EOR/non-utilized)	$50/MT	$180/MT
QCO Captured by DAC (Used in EOR/utilized)	$35/MT	$130/MT

Expansion of Qualified Facilities

The IRA relaxes the annual thresholds that CCUS facilities must satisfy to be eligible for 45Q credits. For electric generating facilities, the IRA lowers the annual threshold from 500,000MT of captured QCO to 18,750MTs of captured QCO.[6] For DAC projects, the IRA lowers the annual threshold from 100,000MTs to just 1,000MTs. The IRA reduces the capture quantity requirements for all other industrial facilities to 12,500MTs. The high thresholds under prior law (combined with the cliff effect of failing to meet those thresholds) were major impediments to the financing of CCUS projects, so these reduced thresholds are a particularly welcome development for the industry.

Additional Options for Easier Monetization of 45Q Credits

The IRA also includes changes that could potentially result in significant adjustments to the manner in which 45Q credits are monetized, potentially diminishing the need for complicated tax equity structures to harvest the benefits of 45Q credits, which could expand the investor marketplace for CCUS projects. Most importantly, the IRA allows an owner of a qualified CCUS project to monetize 45Q Credits by selling any portion of its 45Q credits to third parties for cash or (in certain years) seeking direct payment for 45Q credits from the Treasury. In the case of a transfer, the cash payment received by the transferor will not be treated as taxable income, and the third party transferee may not deduct the cash payment. Once a 45Q credit is transferred to a third party under this rule, the third party may not transfer it again. Although expanded transferability of tax credits opens new potential monetization avenues, many practical questions (such as whether a purchaser that buys credits at a discount to face value would be required to recognize taxable income) remain unanswered and will likely require regulatory guidance. Moreover, the credit transfer regime contemplated by the IRA does not allow for depreciation deductions to be transferred, meaning that sponsors of projects who rely solely on the ability to transfer the 45Q credits will leave tax benefits on the table.

In addition to the new third-party transfer regime, direct payments from the Treasury in lieu of 45Q credits are available; however, with respect to claimants that are taxable entities, such direct payments are only available for the first five years of the twelve-year credit period, limiting the practical utility of the direct payment scheme.

It is important to note that additions to tax may apply to any “excessive credit transfer” (in the case of a credit transfer) or “excessive payments” (in the case of direct payments) in which the credit transferee or taxpayer, respectively, claims in excess of what the credit transferor or taxpayer could validly claim. The addition to tax is 120 percent of the excessive credit transfer or excessive payment. However, the 20 percent penalty component will not apply if the credit transferee or taxpayer can demonstrate reasonable cause for claiming the excessive credit transfer or excessive payment, respectively. Regulatory guidance will be needed to flesh out the details of this reasonable cause exception and other details of how the excessive credit transfer and excessive payment rules will operate in practice.

Conclusion

The IRA potentially fundamentally alters the CCUS landscape in the U.S. The substantially expanded availability of the 45Q credit, broadened scope of qualifying CCUS facilities, and simplified monetization of 45Q credits has the potential to incentivize current CCUS investors to increase the size of their investments, likely will encourage new investors to participate in CCUS projects, and should ensure that CCUS projects will be a significant feature of decarbonization efforts in the U.S.

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[1] As was the case with the so-called Tax Cuts and Jobs Act, the Senate's reconciliation rules prevented Senators from changing the Act's name and so the so-called Inflation Reduction Act is actually "An Act to provide for reconciliation pursuant to title II of S. Con. Res. 14."

[2] https://www.democrats.senate.gov/imo/media/doc/inflation_reduction_act_one_page_summary.pdf

[3] 45Q credits are authorized by section 45Q of the Internal Revenue Code of 1986 (the "Code").

[4] Inflation Reduction Act of 2022 (H.R. 5376), §§13104, 13801.

[5] These credit amounts are reduced by 80% unless new prevailing wage and apprenticeship requirements are satisfied (assuming those requirements apply to a project based on when it started construction).

[6] In addition to meeting this minimum requirement, the capture design capacity of the carbon capture equipment at the applicable electric generating unit at the CCUS project must be at least 75% of the baseline carbon oxide production of that unit.

Gibson, Dunn & Crutcher's lawyers are available to assist in addressing any questions you may have about these developments. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Oil and Gas or Tax practice groups, or the following authors:

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