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Office of Associate Chief Counsel (Passthroughs & Special Industries)
Attention: Maggie Stehn
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CC:PA:LPD:PR
(REG-112339-19)
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Internal Revenue Service
P.O. Box 7604
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Via Federal eRulemaking Portal

RE: Comments on REG-112339-19: Proposed Regulations Regarding the Credit for Carbon Oxide Sequestration Under Section 45Q of the Internal Revenue Code¹

Dear Sir or Madam:

The U.S. Chamber of Commerce appreciates the opportunity to provide feedback on REG-112339-19, guidance on the credit for carbon oxide sequestration under §45Q of the Internal Revenue Code, as published in the *Federal Register* on June 2, 2020.²

The Chamber has long supported the potential for carbon capture utilization and storage (CCUS) technologies to create innovative, scalable solutions to reduce emissions and preserve the

¹ Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

² This letter identifies issues arising under REG-112339-19 and provides suggested solutions as well as any additional explanation the Chamber believes would be helpful in addressing the issue. This feedback is the product of extensive conversations with impacted Chamber members. These comments may be considered as representing some of the most serious issues but are not all the issues concerning Chamber members on REG-112339-19.

affordability and diversity of our energy system. Implementation and expansion of the §45Q tax credit provides a critical foundation to realizing these goals, but clear and effective implementation guidance is essential to provide the certainty necessary to attract continued development of and capital investment in CCUS technologies by the private sector.

In general, the Chamber welcomes and supports the general direction of these proposed rules. We believe they provide much-needed standards that address many of the outstanding questions arising since the statute was enhanced by the Bipartisan Budget Act (BBA) in 2018. The discussion below highlights areas where Chamber members support the approach of the proposed rules as well as suggestions for improvements.

General Credit Provisions

Prop. Regs. §1.45Q-1 provides general credit provisions. While clarity on eligibility for the credit is appreciated, certain provisions do give rise to concern. For instance, Prop. Regs. §1.45Q-1(h)(2) could benefit from clarification in several areas. As an initial matter, the Chamber believes that pre-2018 BBA contracts generally should be grandfathered from the “contractually ensuring” provisions of -1(h)(2). The Chamber also believes that Prop. Regs. §1.45Q-1(h)(2)(i), which states that a written contract is binding only if it “does not limit damages to a specified amount,” should be revised. First, this language appears to be inconsistent with the language in Prop. Regs. §1.45Q-1(h)(2)(iii)(B), stating that a binding written contract “may include long-term liability provisions, indemnity provisions, penalties for breach of contract, or liquidated damages provisions.” Second, in large industrial projects such as carbon capture and sequestration, it would be unrealistic to entirely prohibit parties operating at arm’s length from using such provisions to allocate risk, so long as the contracts require the parties to properly dispose of the qualified CO in the manner required by §45Q and the proposed regulations. To the extent that the final regulations include a restriction on binding written contracts that cap damages, they should clarify that “a contractual provision that limits damages to an amount equal to at least five percent of the total contract price will not be treated as limiting damages to a specified amount.”³ Moreover, any such provision should apply solely to contractual provisions governing the disposal, injection, or utilization or recapture, and not limit damages for general contractual provision.

The Chamber is generally supportive of the approach adopted in Prop. Regs. §1.45Q-1(h)(2)(iii), which prescribes both required and permissible contract provisions for such contracts. The proposed language strikes a reasonable balance—on the one hand ensuring that contracts will be effective at ensuring disposal, injection, and utilization, and on the other hand recognizing that a valid contract governing a large-scale CO capture and storage project will typically include commercially reasonable terms governing long term liability, indemnities, liquidated damages, and quantities to be supplied and disposed of.

Additionally, Prop. Regs. §1.45Q-1(h)(2) creates confusion on whether the carbon capture equipment owner must directly contract with the party that stores, injects, or utilizes the carbon oxide or whether the third-party that takes the carbon oxide may subcontract activities. Treasury

³ Notice 2020-12, §8.02(1).

and the IRS should clarify that a direct contractual relationship to the ultimate individual that stores, injects, or utilizes the carbon oxide is not required.

Likewise, the Chamber believes that Prop. Regs. §1.45Q-1(g) provisions on additional carbon capture equipment should not exclude any operational changes that increase capacity of carbon oxide captured. Congress' intent in creating this provision is to incentivize sequestration of carbon oxides and all changes that increase capture capacity should be captured in the definition of additional carbon capture equipment. Further, Chamber believes that Treasury should provide that for purposes of §45Q(b)(2)(A) and Prop. Regs. §1.45Q-1(g), carbon dioxide capture capacity should incorporate certain factors such as turnarounds, maintenance, unscheduled and scheduled downtime, of both the industrial facility and the carbon capture equipment. Treasury should also provide that carbon dioxide capture capacity is measured on a per-year basis.

Definitions

Prop. Regs. §1.45Q-2 provides definitions for purposes of these proposed rules. Prop. Regs. §1.45Q-2(g)(5) adopts the 80/20 rule originally set forth in Rev. Rul. 94-31,⁴ which ruled that “for §45 purposes a facility that contains some used property would still qualify as originally placed in service, provided the fair market value of the used property is not more than 20 percent of the facility’s total value.” Rev. Rul. 94-31 also provided clear guidance on the determination of what constituted a facility,⁵ but the proposed rules discuss carbon capture equipment only in general terms without a clear framework for determining when carbon capture equipment is separate from other carbon capture equipment, while indicating that separate equipment can exist at the same facility by the examples provided under Prop. Regs. §1.45Q-1(g)(4).⁶ The Chamber believes these rules should provide more clarification on when to apply the 80/20 rule specifically to carbon capture equipment for determining the placed in-service date of §45Q(a) as it relates to separate pieces of carbon capture equipment, including defining separate unit of carbon capture equipment. The Chamber believes that a unit of carbon capture equipment should be an independently functioning process train capable of capturing, processing, and preparing carbon oxide for transport. Treasury also should provide that for purposes of the 80/20 test (1) the FMV of the used equipment should be determined via replacement cost new less physical depreciation and (2) the appropriate valuation date is the start of construction.

Also, of concern, Prop. Regs. §1.45Q-2(d) provides the definition of industrial facility, however Prop. Regs. §1.45Q-2(d)(1) excludes “natural carbon dioxide-bearing formations or naturally occurring subsurface springs” from the definition with a limited safe harbor for “a deposit of natural gas that contains less than 10 percent carbon dioxide.” All other formations are evaluated on facts or circumstances, however, the regulations do not provide insight into the facts and circumstances to be considered. To be consistent with legislative intent, the Chamber believes the safe harbor should be broadened to include, in the definition of industrial facility, any formation with used to produce least one commercial product that is intended to be sold at a profit or used for

⁴ 1994-1 C.B. 16.

⁵ Rev. Rul. 94-31 (“the term ‘facility’ under section §45(c)(3) means the wind turbine, together with the tower on which the wind turbine is mounted and the pad on which the tower is situated.”).

⁶ For instance, Prop. Regs. §1.45Q-1(g)(3) and (4), Ex. 3, illustrates application of the 80/20 rule to a single unit in a three-unit project. This example seems to contemplate separate process trains, as opposed to separate components within a process train, to be the relevant unit of carbon capture equipment. The regulations should be more explicit.

another commercial purpose, other than carbon dioxide.⁷

Secure Geological Storage

Prop. Regs. §1.45Q-3 provides rules for establishing secure geological storage of qualified carbon oxide (CO). Pursuant to Prop. Regs. §1.45Q-3, taxpayers must comply with the Environmental Protection Agency's (EPA) underground injection control (UIC) regulations, which determine the type of well permit required for injecting into the subsurface: Class II for most enhanced oil recovery (EOR) projects, and Class VI for disposal not in connection with qualified EOR. Taxpayers that use the qualified CO in a qualified EOR project and thereby store the qualified CO have two options: (1) compliance with Subpart RR and getting an EPA-approved monitoring and reporting verification (MRV) plan; or (2) compliance with Subpart UU (which does not require an EPA-approved MRV plan) and compliance with the International Organization for Standardization (ISO) standard (CAS/ANSI ISO 27916:19).

We appreciate Treasury's acknowledgement that, "commenters generally requested that the Treasury Department and the IRS provide alternatives to opting into subpart RR for demonstrating secure geological storage for EOR project." Prop. Regs. §1.45Q-3(b) provides an additional methodology for defining secure geologic storage for the purposes of §45Q and the Chamber supports this proposal. [6]

Credit Recapture

Prop. Regs. §1.45Q-5 provides for the recapture of credits in the event that qualified carbon oxide ceases to be captured, disposed of, or used as a tertiary injectant. Generally, the Chamber appreciates the additional clarity provided by the credit recapture provisions. However, while the proposed mechanics of recapture are based on the Carbon Utilization Research Council (CURC) recommendation, the agency did not adopt CURC's proposal to provide a safe harbor from recapture if the project is in compliance with the subpart RR or ISO standards for secure geologic storage. The proposed rules recommend a five year look back period, while the Chamber prefers the CURC recommended one year look back period.

Additionally, Prop. Regs. §1.45Q-5(g)(2) adopts last-in, first-out (LIFO) principles for calculating recapture amounts. This needs clarification for what happens in the use case (i.e., when a taxpayer intentionally removes carbon oxide for another qualified purpose). If the recaptured CO is permanently sequestered, disposed or used, there should be no recapture.

Election to Transfer Credit

Section 45Q(f)(3)(b) provides that the taxpayer to whom the credit is attributable may elect to transfer that credit to the person that disposes of the qualified CO, utilizes the qualified CO, or uses the qualified CO as a tertiary injectant. Prop. Regs. §1.45Q-1(h)(3)(iv) provides the rules for making this election and the Chamber appreciates this flexible approach to the mechanics of making this election.

⁶ Preamble to REG-112339-19 at 22

The Chamber appreciates the opportunity to provide this feedback on REG-112339-19. The Chamber strongly urges Treasury and the IRS to continue to work closely with the business community to on this vital issue. Thank you for your time and attention.

Sincerely,



Caroline L. Harris



Christopher Guith

Cc: Charles P. Rettig, Commissioner, Office of the Commissioner, Internal Revenue Service,
U.S. Department of the Treasury

David J. Kautter, Assistant Secretary, Office of Tax Policy, U.S. Department of the
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