

INSIGHTS

Certain CCUS Projects Now Eligible for Financing with Tax-Exempt Bonds

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Tax-exempt bonds can now be added to the list of ways in which carbon capture, utilization and storage (“CCUS”) projects can be financed. Specifically, the Infrastructure Investment and Jobs Act (the “Act”) amends section 142(a) of the Internal Revenue Code of 1986 (the “Code”) to add a new category of exempt facility bonds for the financing of “qualified carbon dioxide capture facilities” (“CCUS Bonds”). While tax-exempt bonds involve restrictions that aren’t applicable to other sources – including, among others, interactions with the governmental issuer, a public hearing requirement, mandatory straight-line depreciation, and limitations on the maximum maturity of the debt – the new legislation offers project sponsors the possibility of lowering their borrowing costs by adding tax-exempt bonds to the capital stack for a CCUS project.

General Summary of Key Provisions

Under new section 142(o) of the Code, the term “qualified carbon dioxide capture facility” means either:

- the “eligible components” of an “industrial carbon dioxide facility;” or
- a “direct air capture facility.”

Eligible Components

An eligible component means any equipment installed in an industrial carbon dioxide facility that satisfies the efficiency percentage described below and that is either:

- used for the purpose of capture, treatment and purification, compression, transportation, or on-site storage of carbon dioxide produced by the “industrial carbon dioxide facility,” or
- integral or functionally related and subordinate to a process that converts a solid or liquid product from coal, petroleum residue, biomass, or other materials, which are recovered for their energy or feedstock value into a synthesis gas composed primarily of carbon dioxide and hydrogen for direct use or subsequent chemical or physical conversion.

Importantly, the second prong includes equipment used in certain renewable energy processes, and not just in the capture and storage of carbon dioxide waste.

Industrial Carbon Dioxide Facility

An industrial carbon dioxide facility is a facility that emits carbon dioxide (including from any fugitive emissions source) that is created as a result of any of the following processes: fuel combustion; gasification; bioindustrial; fermentation; or any manufacturing industry relating to chemicals, fertilizers, glass, steel, petroleum residues, forest products, agriculture (including feedlots and dairy operations), and transportation grade liquid fuels.

An “industrial carbon dioxide facility” does not include any geological gas facility, or any air separation unit that: (i) does not qualify as gasification equipment; or (ii) is not a necessary component of an oxy-fuel combustion process.

Efficiency Percentage

If the “eligible components” are at least 65% efficient in capturing and storing carbon dioxide, 100% of the cost of the eligible components can be financed with CCUS Bonds. If the efficiency percentage of the eligible components is less than 65%, then those components can only be financed with CCUS Bonds in the same percentage as those as those components are efficient. In the case of eligible components designed to capture carbon dioxide solely from specific sources of emissions or portions of the emissions within an industrial carbon dioxide facility, the capture and storage percentage under these rules is determined based only on the specific sources of emissions or portions of the emissions.

Direct air capture facility

A “direct air capture facility” is defined in section 45Q(e)(1) of the Code as any facility using carbon capture equipment to capture carbon dioxide directly from the ambient air (as opposed to capturing it from an industrial process). Additional guidance from Treasury is needed to clarify whether any equipment related to a direct air capture facility that is used to transport the captured carbon dioxide for injection or further utilization would qualify for tax-exempt financing with CCUS Bonds.

Limitation on “Double Dipping” with the [Section 45Q Credit](#) for Carbon Oxide Sequestration

Despite lower borrowing costs typically associated with tax-exempt bonds, the new legislation limits a taxpayer’s ability to benefit from other federal subsidies. Specifically, the amount of the section 45Q carbon oxide sequestration credit for any project for any tax year generally is reduced by the lesser of: (i) 50%; or (ii) the amount of CCUS Bond proceeds related to the project divided by the aggregate amount of additions to the capital account for the project for the taxable year and all prior taxable years.

For example, if a \$400 million qualifying project were financed with \$100 million of CCUS Bonds and \$300 million of other sources, the section 45Q credit would be reduced by 25%. As a result, in evaluating the capital stack, project sponsors will need to consider the debt service savings compared to the reduced tax credit.

Reduced Need for Volume Cap

The federal government limits the amount of certain types of tax-exempt “private activity bonds” that can be issued each year by imposing upon each state a “volume cap.” Individual states set the rules for how that volume cap is allocated between different types of projects

and, in many states (such as Texas), the process for securing an allocation of volume cap can be incredibly competitive. For many large projects, it's simply not possible to finance the entire project with tax-exempt bonds because there is not enough volume cap to go around.

Fortunately, the Act provides that CCUS Bonds only require volume cap in an amount equal to 25% of the bond issue. In other words, a \$400 million CCUS Bond issue would only require a volume cap allocation of \$100 million. This is a significant benefit because, not only is more likely that a sufficient amount of volume cap might be allocated to cover the desired bond sizing, but states may be incentivized to allocate to a CCUS Bond application because it results in more "bang for the buck." For this reason, project sponsors may seek to maximize the use of CCUS Bonds, even if the project might otherwise qualify as a solid waste disposal facility (which requires 100% volume cap coverage).

Additional Guidance is Needed

Additional guidance from Treasury and the IRS is needed to fill gaps in the legislation, but given the Administration's focus on [ESG](#) and reducing carbon emissions, we are hopeful that clarifying guidance is released in the relatively near future. In the meantime, for any questions, please contact the authors or any member of Bracewell's [CCUS Team](#).

Bracewell is at the vanguard of policy, regulatory and legal developments related to CCUS projects and transactions. Our cross-disciplinary energy team has an in-depth understanding of the business issues facing CCUS developers, investors and off-takers, but unlike many energy firms, we also have deep expertise in tax-exempt bonds.