Articles + Publications | August 1, 2022

Locke Lord QuickStudy: Key Climate and Energy Provisions in ?the Proposed Inflation ??Reduction Act

WRITTEN BY

M. Benjamin Cowan | Michael P. Malfettone | Jordan A. Rodriguez

On July 27, 2022 Senators Joe Manchin (D-WV) and Majority Leader Chuck Schumer (D-NY) reached an agreement to add the Inflation Reduction Act of 2022 (the Act) to the FY 2022 Budget Reconciliation Bill. The Act resurrects many climate and energy-related provisions from the Build Back Better Act (BBBA) that failed to pass the Senate last year. The Act appropriates roughly $370 billion for energy and climate programs over the next 10 years, with the goal of reducing U.S. greenhouse gas (GHG) emissions by 40% from 2005 levels, the costs of which would be largely offset by revenue raised through the 15% corporate minimum tax and other tax reforms included in the Act, such as modifications to the taxation and treatment of carried interest. The legislative text has been submitted to the Senate parliamentarian for review, and the Act is expected to go to the Senate floor for a vote as soon as this week. Below, we provide a high-level summary of the bill's key provisions related to climate and energy.

Production and Investment Tax Credits for Renewable Energy

The Act extends the Production Tax Credit (PTC) and Investment Tax Credit (ITC) in Section 45D of the Internal Revenue Code (the Code) for renewable energy projects—including wind, solar, geothermal, biomass, and hydropower—for ten years, and also removes the phase-out of the wind energy PTC, although not retroactively (i.e. the current PTC phase-out would continue to apply for any project that was placed in service before January 1, 2022). The base value of the PTC and ITC have been reduced by 80%, but the original values can still be claimed for projects that meet prevailing wage and apprenticeship requirements. A facility is also be eligible for a bonus 10% PTC or ITC if it satisfies certain domestic product manufacturing requirements or is located in an "energy community," and an additional bonus ITC for certain solar and wind facilities located in low-income communities. Significantly, the Act allows solar projects to claim a PTC rather than an ITC for the first time since 2006, and allows hydrogen projects and existing nuclear projects to claim a PTC as well. It also provides a long-desired ITC for battery storage, thermal energy storage projects, qualified biogass, and microgrid controllers, but eliminates the BBBA's ITC for transmission lines and related property (other than for qualified projects less than 5 megawatts).

Notably, beginning January 1, 2025, under Sections 45Y and 48D of the Code, respectively, the PTC and ITC will transform into technology-neutral "clean electricity credits" that will remain in effect until at least 2032, or such later year (the "applicable year") as the annual GHG emissions from all U.S. electricity production is less than 25% of the GHG emissions for the 2022 calendar year. In the next three years after the applicable year, the value of the credit steps down to 100% (i.e., no reduction), 75%, and 50%, respectively, after which the tax credits will no longer be available. Qualified facilities would also be eligible for the bonus tax credits described above.

The Act creates a new “advanced manufacturing production credit” under Section 45X of the Code that would be available for the production of certain eligible components produced by the taxpayer in the United States and sold to an unrelated person after December 31, 2022 and would begin to phase out starting in 2030. Eligible components include photovoltaic cells and wafers, solar grade polysilicon, polymeric backsheets, solar modules, wind energy components, torque tubes, structural fasteners, electrode active materials, battery cells, battery modules, and certain critical minerals (as defined in section 45X(c)(6) of the Code). Also with respect to manufacturing, effective January 1, 2023, the Act expands ITC eligibility of certain projects that equip or expand manufacturing facilities that produce specified renewable energy equipment under Section 48C, which now include facilities that produce equipment or components for energy storage systems, electric and hybrid vehicles, grid modernization, energy conservation, and GHG emissions.

The Act also extends the 45Q carbon oxide sequestration credit for projects beginning construction before January 1, 2033, instead of January 1, 2026. Further, the legislation increases the amount of 45Q credit for facilities that capture their carbon emissions to $85 per metric ton for CO_2stored in geologic formations, $60 per ton for the beneficial use of captured carbon emissions, and $60 per ton for CO_2stored in oil and gas fields. Additionally, the Act establishes a new minimum capture threshold for carbon capture equipment for an “applicable electric generating unit”, requiring such equipment to have a capture design capacity of 75% of “baseline carbon oxide” that would otherwise be released by the facility, and includes detailed rules for calculating baseline carbon dioxide.

Direct Pay and Credit Transfer Alternative

The BBBA included a direct-pay option that would have allowed project developers to elect a cash refund from the IRS for the value of the applicable PTC or ITC. The Act does include a direct-pay option but limits it to tax-exempt organizations and governmental entities, except in the case of the credits for carbon sequestration, clean hydrogen, and advanced manufacturing of renewable energy equipment. The Act does, however, include a credit transfer provision that would allow the tax credits to be sold to third parties for cash. This unexpected alternative could significantly reduce or eliminate the need for the tax equity financing structures that have fueled the growth of the renewable energy industry over the past 20 years.

Methane Emissions Reduction Program

The Act would create a new “Methane Emissions and Waste Reduction Incentive Program for Petroleum and Natural Gas Systems” that would impose a fee on excess methane emissions from oil and gas facilities that report more than 25,000 metric tons of CO_2equivalent (CO_2e) of GHG emitted annually. According to the text of the bill, methane leaks from oil and gas wells, pipelines, and other infrastructure would lead to fees rising to as much as $1,500 per ton for some operators starting in 2026 and beyond. The legislation also includes up to $850 million in incentives for industry to monitor and mitigate methane leaks.

Permitting Reform for Oil and Natural Gas Projects

The inclusion of permitting reforms was apparently critical to securing Senator Machin’s support for the Act. The Act appropriates $70 million per year for FY 2022 through 2026 for the Federal Permitting Improvement Steering Council established by the Fixing America’s Surface Transportation (FAST) Act to coordinate federal environmental reviews among multiple federal agencies. In addition, for FY 2022, the Act appropriates $40 million to the Environmental Protection Agency, $125 million to the Department of Energy, $100 million to the Federal Energy Regulatory Commission, and $150 million to the Department of Interior, to promote “efficient, accurate, and timely” environmental reviews, permitting, and approval processes. The legislative text is light on details, however, stating that this money will be used to hire and train additional staff, develop programmatic documents, environmental data, and information systems, and purchase new equipment for environmental analysis, among other things. These commitments will be included in a separate stopgap funding bill that Congress will need to pass in September to sustain government operations. Possible projects that stand to benefits from these reform measures include offshore wind facilities, natural gas pipelines and other energy infrastructure.

Moreover, the Act would open up new oil and gas lease sales in the Gulf of Mexico and Alaska by reinstating lease sales on the Outer Continent Self. Specifically, the Act would require the Department of Interior to offer at least 2 million acres of public lands and 60 million acres of offshore waters for oil and gas leasing each year for a decade as a prerequisite to installing any new solar or wind energy projects on public lands. If the department fails to offer these minimum amounts for leasing, no rights-of-way could be granted for utility-scale renewable energy projects on public lands or waters. This quid pro quo provision ensuring continued oil and gas leasing has already proven quite controversial and drawn criticism for undermining the Administration’s climate goals.

Investments in Environmental Justice Communities

The Act includes over $60 billion to encourage investments in “disadvantaged communities.” Some of the highlights include: Environmental and Climate Justice Block Grants, funded at $3 billion, to address disproportionate environmental and public health impacts related to pollution and climate change; Grants to Reduce Air Pollution at Ports, also funded at $3 billion, to support the purchase and installation of zero-emission equipment and technology at ports; and $1 billion for clean heavy-duty vehicles, like school and transit buses and garbage trucks.

Conclusion

This QuickStudy is merely a high-level overview of some of the most significant climate and energy provisions of the Act. The Act is over 700 pages, with over 300 pages devoted to climate and energy; thus, we are continuing to scrutinize the Act to more fully comprehend and evaluate its many facets. It is clear, however, that the Act represents one of the most comprehensive legislative initiatives to address climate impacts in our nation’s history, and offers unprecedented support and flexibility for clean energy generation and manufacturing, while extending some of those benefits to oil and gas and other forms of energy as well.

Although Senator Manchin’s support for the Act is a major breakthrough, whether the Act will ultimately become law remains an open question. The legislation is currently under review by the Senate parliamentarian to ensure that its provisions (which address many topics besides climate and energy, such as prescription drug pricing, the carried interest tax exemption, and a corporate alternative minimum tax) can in fact be included in the Budget Reconciliation Bill, which would enable a united Democratic Senate to pass the bill without any Republican support. Assuming it does pass muster for the reconciliation process, Senator Kyrsten Sinema (D-AZ) has yet to reveal whether she will support the Act in its current form or in any form, while Senate Republicans have vowed to vigorously oppose its passage. Because Senator Schumer has expressed his hope to hold a vote on the bill as soon as the end of this week, before the August recess, it is possible, albeit unlikely, that we may receive answers to these questions in short order.

Locke Lord’s renewable energy attorneys will continue to follow this legislation and related developments closely. Please contact the authors with any questions or to discuss how provisions of the Act could affect your company.

RELATED INDUSTRIES + PRACTICES

- Energy
- Energy Tax
- Energy Transition
- Inflation Reduction Act of 2022 – Energy Industry Implications
- Maritime, Shipping + Logistics
- Renewable Energy
- Tax