

# Carbon Capture Legislation – Potential for a New Type of Exempt Facility Bond

On June 10, 2019, Senators Michael Bennet (D-CO) and Rob Portman (R-OH) introduced Senate Bill 1763<sup>1</sup> (the “Carbon Capture Bill”), which, if passed, would allow the issuance of exempt facility bonds for “qualified carbon dioxide capture facilities.” The Carbon Capture Bill has bipartisan support as this bill encourages continued use of carbon-generating natural resources by providing a new tax-exempt financing option for capital expenditures related to a green countermeasure – carbon capture and sequestration. If this sounds like Groundhog Day, that is because it is – this bill was also proposed in 2017<sup>2</sup> after an unsuccessful round of proposed tax-credit based carbon capture legislation in 2015.<sup>3</sup> During its last time at bat, the Carbon Capture Bill was up for consideration while tax-exempt private activity bonds were also on the chopping block – so it was highly unlikely that it was going to pass. Now, with infrastructure and climate change on Congress’ mind, the Carbon Capture Bill seems like it might be a viable candidate. For more on how this would work, read on.

## How would this work?

Under section 103 of the Internal Revenue Code of 1986, as amended (the “Code”), a state or local government can issue tax-exempt bonds to finance certain types of privately used “exempt facility” projects. The Carbon Capture Bill, if passed, would add “qualified carbon dioxide capture facilities” to the list of exempt facilities eligible for tax-exempt financing under section 142 of the Code. Such financings would include 100% of eligible capital expenditures, described below, for property that captures and sequesters carbon dioxide (“Carbon Capture Projects”) if 65%<sup>1</sup> or more of carbon dioxide generated at an “industrial carbon dioxide facility” is captured and stored. If less than 65% of the carbon dioxide generated at an industrial carbon dioxide facility is captured and stored, a proportional amount of the costs of any Carbon Capture Projects at the facility would still be eligible for financing with exempt facility bonds. Subject to certain exceptions,<sup>2</sup> an “industrial carbon dioxide facility” is broadly defined to include any facility that emits carbon dioxide that is created as a result of any of the following processes: (i) fuel combustion; (ii) gasification; (iii) bioindustrial; (iv) fermentation; or (v) any manufacturing industry described in section 48(b)(c)(7) of the Code.

Eligible capital expenditures for Carbon Capture Projects would include expenditures for equipment installed at an industrial carbon dioxide facility that is: (i) 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 (ii) integral or functionally related and subordinate a process described in section 48B(c)(2) of the Code, determined by substituting carbon dioxide for carbon monoxide.

Although we will have to expand our vocabulary to include some new industrial terms (and we only just learned what “biochemical oxygen demand” is), the tax-exempt bond community should have some comfort in the way the Carbon Capture Bill is structured. Tacking on qualified carbon dioxide capture facilities to the list of “exempt facility” projects listed in section 142 of the Code puts the issuance of these bonds into a familiar framework of Code provisions and regulations (warts and all). This means that the Code provisions and regulations that apply to other types of exempt facility bonds, such as the public approval requirement under section 147(f) of the Code and the 95/5 test under section 142 of the Code, would also apply to bonds for qualified carbon dioxide facilities. This is in contrast to other proposals, such as the recent “Move America Bonds” proposal,<sup>4</sup> which would create entirely new sections of the Code that incorporate some concepts from other sections but would cause uncertainty about the application of existing principles. Additionally, refundings of bonds issued for qualified carbon capture facilities would be subject to the same Code provisions and regulations (and open questions) as the refunding of other exempt facility bonds.

1 Guidance on how to calculate the percentage of carbon capture is provided in the Carbon Capture Bill.

2 An industrial carbon dioxide facility does not include (1) any geological gas facility that: (a) produces a raw product consisting of gas or mixed gas and liquid from a geological formation, (b) transports or removes impurities from such product, or (c) separates such product into its constituent parts; or (2) any air separation unit that does not qualify as gasification equipment or is not a necessary component of an oxy-fuel combustion process.

Similar to most other exempt facility bonds, bonds for Carbon Capture projects would require volume cap. However, unlike exempt facility bonds issued for solid waste disposal or sewage facilities (which are the current exempt facilities most analogous to qualified carbon dioxide capture facilities) where volume cap is required for 100% of the bonds, or exempt facility bonds issued for, say, airports, which are exempt from the volume cap requirement altogether, the Carbon Capture Bill unfortunately puts bonds for Carbon Capture Projects in the “75% exempt” category that currently applies only to high-speed intercity rail facilities.<sup>3</sup> In other words, an allocation of volume cap would be required for only 25% of the amount of the bonds issued to finance the Carbon Capture Project, per section 146(g)(4) of the Code. This would raise questions when it comes time to refund bonds for a Carbon Capture Project. A bond that refunds a bond that was subject to the volume cap requirement doesn’t need additional volume cap except to the extent that the amount of the refunding bond exceeds the outstanding amount of the refunded bond. It is unclear how the refunding exception would apply to a bond issue where 75% of every bond is exempt from the volume cap requirement in the first place. It is entirely possible that the issue price of the entire refunding issue would need to not exceed the outstanding stated principal amount of all of the refunded bonds of the refunded issue to avoid the need for additional volume cap for the refunding bonds.

The Carbon Capture Bill could spur innovation for carbon capture and sequestration, especially for carbon storage for pre-existing industrial carbon dioxide facilities with geographic and geologic carbon-storage limitations, by opening the door to tax-exempt financing for an entirely new realm of participants whose facilities do not otherwise currently qualify. This legislation would accomplish this by adding the financing of Carbon Capture Projects to an already familiar existing framework, rather than leaving the tax-exempt bond community attempting to suss out how to issue bonds for these projects under a new framework. The Carbon Capture Bill has bipartisan support and is on the table for an infrastructure-minded Congress.

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<sup>3</sup> Query how qualified carbon capture facilities and high-speed rail facilities are alike, or what other reason there was to lump them together in this way.

i [https://legiscan.com/US/text/SB1763/id/2039173/US\\_Congress-2019-SB1763-Introduced.pdf](https://legiscan.com/US/text/SB1763/id/2039173/US_Congress-2019-SB1763-Introduced.pdf)

ii <https://www.congress.gov/115/bills/s843/BILLS-115s843is.pdf>

iii <https://www.congress.gov/114/bills/s3179/BILLS-114s3179is.pdf>

iv <https://www.publicfinancetaxblog.com/2015/05/move-america-bonds-close-enough-for-government-work/>