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Carbon Mitigation Strategies Alert

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Private activity bonds: A new option for financing carbon capture projects

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The bipartisan Infrastructure Investment and Jobs Act ("IIJA") provides a new option for financing carbon capture projects through the use of tax-exempt private activity bonds.

What's the Impact?

- The IIJA's amendments to the tax-exempt bond sections of the Internal Revenue Code ("IRC") provide carbon capture and carbon capture transportation projects with another low-cost financing option
- The IRC imposes limitations on the availability of IRC Section 45Q carbon capture tax credits for projects which also benefit from tax-exempt bonds

A new option for financing carbon capture facilities in the US is now available following President Biden's signing into law the IIJA. The IIJA amends the Internal Revenue Code's tax-exempt bond provisions to include "qualified carbon dioxide capture facilities" in the list of project types that are eligible to be financed with such bonds. Under the amended provision—Internal Revenue Code Section 142(a)(17)—qualified, carbon dioxide capture facilities may now be financed through the issuance of tax-exempt bonds by authorized issuers.

The tax-exempt private activity bond provisions have long allowed governmental entities to use their authority to issue tax-exempt bonds to issue tax-exempt bonds for the type of private projects specifically enumerated in the IRC. The enumerated projects eligible for these private activity bonds have included private projects that are generally in the public interest such as airports, docks and wharves, and mass commuting facilities. Qualified carbon dioxide capture facilities are now included in the list of enumerated projects that are eligible for tax-exempt financing.

Under the IIJA's amendments, a qualified carbon dioxide capture facility includes both eligible components of industrial carbon dioxide capture facilities and direct air capture facilities. The eligible components of an industrial carbon dioxide capture facility are defined broadly to include those components that are not only used for the purpose of capturing, treating, purifying, and compressing the emitted carbon but also those components used to transport the captured carbon or store it on-site. The definition of eligible components further includes those components that are "integral or functionally related and subordinate to a process which 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."

Eligible carbon capture facilities generally must have a capture percentage that reduces the annual total metric tons of carbon dioxide, which would otherwise be released into the atmosphere by 65 percent. That being said, the IIJA provides an exception for industrial carbon dioxide facilities that are designed with a capture and storage percentage of less than 65 percent by allowing such facilities to be financed by private activity bonds up to the facilities' carbon capture rate. In other words, if a facility is designed to only capture 50 percent of carbon dioxide emissions, up to 50 percent of its financing can be derived from private activity bonds. It should be noted that computation of the carbon capture percentage allows for the captured carbon to be either geologically stored or used in an enhanced oil or gas recovery well. The carbon capture percentage also only takes into account the carbon emissions that the carbon capture equipment is designed to capture. An industrial carbon dioxide facility's carbon dioxide emissions would thus not necessarily be measured on a facility-wide basis.

The IIJA amendments provide that 75 percent of an issuer's issuance of private activity bonds for qualified carbon capture projects will not apply to that issuer's private activity bond volume cap under Internal Revenue Code Section 146.

A carbon capture facility utilizing private activity bonds would result in a reduction in the Section 45Q tax credits it would otherwise be eligible for of either 50 percent or the percentage of private activity bonds used for the project, whichever is less. The most recent version of the Build Back Better Act ("BBBA") passed by the House of Representatives would, however, revise this reduction to be the lesser of 15 percent or the percentage of private activity bonds used for the project, whichever is less.

Carbon capture, use, and sequestration projects—both point source and direct air—are increasingly being deployed in the US and abroad. With the passage of the IIJA, carbon capture projects now have additional avenues available to them to secure low-cost financing. Nixon Peabody's team of seasoned public finance lawyers and energy lawyers with carbon capture specific project finance experience are uniquely positioned to assist with carbon capture projects looking to take advantage of this new financing option.

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