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Nixon Peabody LLP regularly represents clients active in the energy, renewables and, more recently, carbon capture sectors, including advising tax credit investors, developers, lenders and cash equity investors with respect thereto. We commend Treasury, the Environmental Protection Agency and the Department of Energy (collectively, the "Agencies") in working collaboratively to craft the detailed proposed regulations set forth in 26 CFR Part 1 implementing IRC Section 45Q's general statutory framework, enabling the growth of this nascent industry. Below are several suggestions and clarifications, that we and our clients believe would further assist in helping to achieve this important objective:

a. Additional Adjustments to the Annual Tonnage Threshold. Section 45Q(d) mandates achievement by each of the "qualified facility" (i.e. the emitter) and the carbon capture facility of certain specified minimum annual metric ton emission and capture thresholds, respectively, each year during the 12-year credit period in order for credits to be generated with respect to such year. We assume that Congress intended, through establishment of these minimum thresholds, to promote development, construction and operation of carbon capture projects that support significant emitters providing for a quantitatively and meaningful environmental benefit. As such, Carbon Capture and Sequestration ("CCS") projects now under development and under consideration by prospective tax equity investors will be sized to comfortably satisfy these minimum thresholds. As recognized by the Agencies, as evidenced by proposed Section 1.45Q-2(g)(3) (providing for annualization of minimum thresholds in first year of operation), certain adjustments will be required in connection with the practical implementation of the statutory tonnage thresholds. Assuming that both a qualifying facility and the related CCS project have been initially engineered, designed, constructed

and operated consistent with these statutory tonnage thresholds, we suggest that further adjustments to the statutory tonnage thresholds should, for the reasons articulated below, be made in the following additional limited circumstances as follows:

(i) The recapture mechanism introduced by proposed Section 1.45Q-5 providing for credit offsets or reversals in the case of carbon oxide leakage, poses likely unintended, outsized risks to potential CCS investors if any such credit offset or reversal results in a CCS project's capture levels, in any given credit year, being pushed into to sub-threshold levels and thereby denying the CCS investor of any 45Q credits for such credit years. In the case of recapture, we therefor propose clarification that satisfaction of the minimum threshold capture levels be determined for each credit year without giving effect to any offsets or reversals required under proposed Section 1.45Q-5.

(ii) As is accomplished through the first year annualization of required minimum thresholds, we suggest the same concept also be provided for the last year of the credit period in order to provide for a full 12-year credit period.

(iii) Proposed Section 1.45Q-5(i) provides for a limited exception from recapture if leakage of sequestered carbon oxide results from the occurrence of an event not related to the selection, operation or maintenance of a storage facility such as volcanic activity or a terrorist attack. We suggest that the occurrence of similar force majeure events impacting a qualifying facility, carbon capture facility and/or supporting pipelines, should not be taken into account in determining whether a qualifying facility and/or carbon capture facility has satisfied its requisite minimum thresholds within any given year of the credit period. A similar annualization calculation should be adopted. We note that insurers that provide business interruption coverage during the pendency of a force majeure type event will typically look to the number of days of outage and will calculate damages based on $/day of outage and may find it difficult to underwrite the risk associated with a project falling off the minimum threshold "cliff" (i.e. going to zero credits) in any given year, especially given the dollar magnitude of the potentially lost credits. Tax equity investors, similarly, will find it difficult to accept this "cliff" risk in the case of a force majeure event if satisfactory mitigation is not otherwise available.

(iv) Our clients note that this minimum threshold requirement, unfortunately, is serving to discourage development of certain carbon capture facilities implementing newer technology. Ideally these types of projects are rolled out in an iterative, sequential manner with multiple "trains" being designed, engineered and constructed within a single capture facility over a period of time to permit issues identified in the first train to be addressed in the engineering of subsequent trains (or if insurmountable, not undertaking the second train). We note that in Section 8 of IRS Notice 2020-12 adopts "beginning construction" guidance with respect to the single projects consisting of multiple qualified facilities and/or separate carbon capture equipment. Given that in some instances, individual trains, each becoming operational over a period of years, and comprising a single project for purposes of the IRS beginning construction analysis, may, however,

fail to satisfy these minimum thresholds on a standalone basis. We encourage that, for purposes of satisfying the minimum threshold requirement, all proposed trains, whether or not yet operational, be considered as a single project to allow for a more conservative and measured approach to the roll out of newer technology.

b. "Contractual Assurance" Accomplished Through Daisy Chain. Proposed Section 1.45Q-1(h)(2) addresses the concept of "contractually ensuring the disposal, utilization or use. . . of qualified carbon oxide" used in Section 45Q(f)(3)(A) of the statute. The proposed regulation states that a taxpayer may claim the section 45Q credit if the taxpayer "contractually ensures in a binding written contract that the party that physically carries out the disposal, injection, or utilization of the qualified carbon oxide does so in the manner required under section 45Q and these regulations." The regulations set forth certain impermissible, mandatory (including the imposition of new reporting obligations on the disposing party) and permissible contract terms. It would be helpful for the Agencies to clarify that a taxpayer can satisfy this "contractual assurance" requirement through entry into a single offtake contract with a counterparty (the "Primary Offtaker") that itself will be "contractually assuring" the physical disposal of the qualified carbon oxide through one or more layers of subcontractors. Provided that the Primary Offtaker takes full responsibility for the performance of its direct and indirect subcontractors, the Agencies should recognize and affirmatively permit this "daisy chain" approach, given traditional segmentation in the oil and gas services sector, recent erosion of credit quality in the oil and gas sector, underwriting requirements for insurance providers in the sector and financial responsibility requirements for underground injection control (UIC) Class VI permits. Furthermore, the Agencies should expressly permit satisfaction of the annual reporting requirements set forth in 1.45Q-1(h)(2)(iv) through this "daisy chain" approach with the Primary Offtaker making the requisite reporting to the taxpayer based upon reporting provided by its subcontractors. The Agencies should also make it clear that specific fields can vary from year to year and do not need to be known at the time a contract is executed but can be updated through the annual reporting requirement.

c. Economic Substance. Some carbon capture operations may not naturally generate revenue. For example, carbon capture equipment added to an existing qualifying facility may be sustained on 45Q credits alone. Knowing this, the owners of the qualifying facility or the EOR operator may not necessarily have any economic incentive to pay the owner of the carbon capture equipment any fees in exchange for the capture and sequestration of the carbon. If using secure geological storage (non EOR), there may be no other potential source of revenue. The proposed regulations should provide a clear method to demonstrate that investments in anticipation of realizing Section 45Q credits as the primary or sole means generating investment returns have economic substance. Absent clear direction from Treasury, at best, these transactions will have increased uncertainty but almost certainly increased transaction costs and capital costs, and at worst, certain projects simply do not attract sufficient capital to move forward. Providing clarity on economic substance for Section 45Q can be accomplished without undermining the long-standing wealth of legal authority that

equips Treasury to combat abuses of the Code. Specifically, this can be accomplished by clarifying that Section 45Q credits may be taken into account in determining the pre-tax profit potential of a transaction for purposes of Section 7701(o). In the IRS Office of Chief Counsel Memorandum addressing the Refined Coal Tax Credit under IRC 45(e)(8)(A) and related partnerships (AM2018-002), the IRS recognized that in cases where a developer is subject to the risks and rewards of the refined coal production activity, it is, in form and substance, engaging in the activity the credit was intended to encourage and that in such a situation the economic substance doctrine should not be applied to disallow the credit." (p. 11). This analysis may provide a useful framework for IRS 45Q economic substance analysis. If there is a hesitation to bless tax equity investments in currently revenue-free projects, consider imposing minimum interest requirements in the long-term hypothetical profit potential of a project. For example, the IRS could require that the tax equity investor have at least a 5% stake in the value of any profits derived from a carbon tax or monetization thereon, should such a regime ever be implemented in the U.S. Or stated more accurately, the IRS could clarify that the Investor's minimum 5% interest need not be in a known and certain revenue stream at the time the partnership is formed and the asset placed into service.

We note that the ability to consider the value of the tax benefits in determining the profit potential from an investment would effectively bless one of the most widely-accepted methodologies the tax bar currently uses to ensure tax equity transactions have economic substance. This would allow a smooth transition for the solar and wind tax equity investors of today to participate in the CCS tax equity market of tomorrow. If this proposal is not acceptable, we recommend adopting a clear framework, with sufficient examples, for tax equity investments in projects that may not generate revenue.

Note that a failure to provide any type of guidance in this regard could stymie many otherwise desirable projects. Tax equity investors want to invest in the credit-qualifying activity and effectively forcing the tax equity investor to make additional investment into adjacent activities (e.g., electric generation or oil production) would introduce economic inefficiency. This means that tax equity will be most efficient if the carbon capture activity is a stand-alone entity and activity. Moreover, it may prove simply impractical to bring a tax equity investor into the ownership of the qualifying facility or the entity sequestering the carbon by contract. Even if tax equity was willing to make the investment, the existing owners of each business may not share the interest. Thus, without the ability to make an investment in the carbon capture activity in isolation, this type of project may never get built even if the Section 45Q credits would otherwise be sufficient to attract the required capital.

d. Pricing related to Section 45Q Credits. One potential aspect of Section 45Q has repeatedly been brought up by our clients in evaluating tax equity investment structures – can the value of Section 45Q tax credits be included in pricing? This question arises in a number of pricing contexts. For example, in determining the price to be paid by a tax equity investor to acquire a partnership interest from a developer. The

example structure in the Chief Counsel Memorandum addressing the Refined Coal Tax Credit (AM 2018-002) involved a tax equity investor purchasing its interest from the developer, with a portion of the purchase price structured as an earn-out. Blessing this tax equity payment structure would be beneficial for the industry. Another context that raises this question is offtake contracts – can a sequesterer buy captured carbon from a capturer and include the value of the credit in the purchase? For example, if a non-EOR sequestration operation seeks to purchase captured carbon that, absent the Section 45Q credit, would only be worth $10 / ton, can such purchase be effectuated at $45 / ton to account for the value of the credit that the capturer elects to pass-through to the sequesterer? A similar question arises in the context of emissions supply agreements and in various leasing structures that are currently under review by investors and sponsors. Providing definitive guidance that the value of Section 45Q credits can be a factor in determining cash pricing of various contracts could significantly simplify tax equity structures in this space, which translates to reduced transaction costs, increased economic efficiency, and, ultimately, more CCS projects being built.

e. Binding Written Offtake Contracts. Section 1.45Q-1(h)(2)(i) of the proposed regulations requires that offtake contracts not limit liability to a specified amount. Based upon client feedback, this presents a real commercial issue that may serve to discourage third parties from entering into the 45Q sequestration business. We note that while more traditional casualty insurance for environmental issues will likely be available, insurance for 45Q tax recapture is a very new concept and may not generally be available to a sequesterer.

Sincerely,

/s/ Ellen Friedman

/s/ Shariff Barakat