

45Q Implementation

December 2019 Update



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Background

- 26 U.S.C. §45Q was enacted Oct 3, 2008
 - IRS issued Guidance in 2009 (Notice 2009-83)
 - No regulations were ever proposed or adopted
- Section 45Q was amended effective Feb 9, 2018
- 45Q was the 2018 CO2 Conference “Seminar” topic
 - “45Q and CO2 EOR’s Vital Role in Carbon Management, and ROZ CO2 EOR”
 - Download full-day of slides for \$50 at <https://www.co2conference.net/product/2018-co2-and-ccs-seminar/>

2019 Activity

- IRS issued Notice 2019-32 on May 20, 2019, requesting comments
 - IRS identified 10 specific questions to be answered
 - IRS Solicited comments on all issues related to 45Q amendments
 - IRS mentioned that permanent rules or other sub-regulatory guidance would be developed
 - IRS had earlier predicted the Notice was to be issued in Feb/Mar 2019, but Notice wasn't issued until May 2019
- 105 comments were submitted by the public

Update: Anticipated IRS Actions

Most recent update from IRS was Nov 26, 2019

We are hearing that IRS currently intends to issue 3 different documents to provide interpretation/application of §45Q

1. Revenue Procedure: addressing structuring and partnership-related issues
2. IRS Notice: providing guidance on beginning of construction requirements
3. Notice of Proposed Rule Making (NPRM): regulations addressing all other matters

1. Revenue Procedure

- IRS may issue a “Revenue Procedure” to address structuring and partnership-related issues for §45Q
 - “Revenue Procedure” type of guidance was used by IRS on partnership issues on other tax credits (i.e. wind PTC; historic rehabilitation ITC)
- Timing
 - Initially was projected to be issued end of Nov 2019
 - Now projected to be issued end of Dec 2019 at the earliest

2. Guidance/Notice

- IRS may issue a Notice providing guidance addressing beginning of construction related issues for §45Q
 - IRS Notices were issued by IRS on beginning of construction requirements on other tax credits (i.e. wind/solar)
- Timing
 - Initially was projected to be issued end of Nov 2019
 - Now projected to be issued end of Dec 2019

3. Notice of Proposed Rule Making (NPRM)

- IRS may issue a “Notice of Proposed Rule Making” to adopt regulations for all other §45Q issues
- Timing
 - Initially was projected to be issued end of Dec 2019
 - Now projected to be issued in 1st quarter 2020
- Anticipated impact:
 - The notice would contain proposed regulations, and an opportunity for written comment (typically 60-90 days) followed by a public hearing
 - The proposed regulations would be temporary regulations that can be immediately relied upon until final regulations are issued
- Possibility of IRS Guidance prior to NPRM

Beginning of Construction – Expected Guidance

- Construction must begin before January 1, 2024
- Two alternative ways to show beginning of construction “BOC”:
 - Physical work of a significant nature has begun
 - 5% Safe Harbor
- Physical work test:
 - Physical work of a significant nature is a facts and circumstances test
 - Focuses on the nature of the work performed, not the amount or cost
- On-site and off-site work:
 - Any physical work on-site on the qualified facility
 - Physical work off-site for property included in the qualified facility
- Work done by the taxpayer and its contractors under a binding written contract
- Physical work must be “continuous” after BOC

Beginning of Construction – Expected Guidance

- The 5% Safe Harbor: Construction of a facility will be considered as having begun, if:
 - a taxpayer incurs five percent or more of the total cost of the project before January 1, 2024, and
 - thereafter, the taxpayer makes continuous efforts to advance towards completion of the facility
- “Continuous” Program of Construction or Physical Work
 - Generally determined on a facts and circumstances basis- however:
 - IRS has provided a “Continuity Safe Harbor” to wind and solar of 4 calendar years from the year in which construction starts
 - CCUS participants have asked for 6 years

Partnership Structure – Expected Rev Proc

IRS provided safe harbor guidance in Rev Proc 2007-65 to taxpayers on how to structure wind transactions using the partnership-flip structure. The IRS is expected to issue a similar Rev Proc for 45Q. Expected issues to be addressed:

- Definition of Investor and satisfaction of economic substance doctrine
- Minimum partnership interest. Investor may take up to 99% of tax items, but not less than 5%
- Minimum unconditional upfront investment of at least 20%
- Contingent consideration. CCUS industry has asked for 50% contingent
- Restrictions on sponsor purchase options
- Restrictions on Sale Rights. CCUS industry participants have asked for approval of a “put right”
- Guarantees. No party may guarantee the tax credit to the investor. CCUS industry participants have asked that guarantees of level of CO₂ production, environmental issues, and recapture risk, among others, be treated as permissible guarantees



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Perdure Petroleum – Executive Summary

Overview

Attractive Assets With Proven Production History and Storage Capability

- Producing ~8,000 bbl/d across 9 fields (95%+ oil, 98%+ operated)
- Significant land ownership in two fields
- Significant sequestration capacity - Over 1+ Bbbls of OOIP
- Approximately 250 miles of CO₂ pipelines
- Long-term asset history provides confidence in potential
 - First CO₂ floods on Burbank/Panhandle began in 2001;
 - Wellman tertiary production began in 1983; and George Allen CO₂ flood injections began in 2013

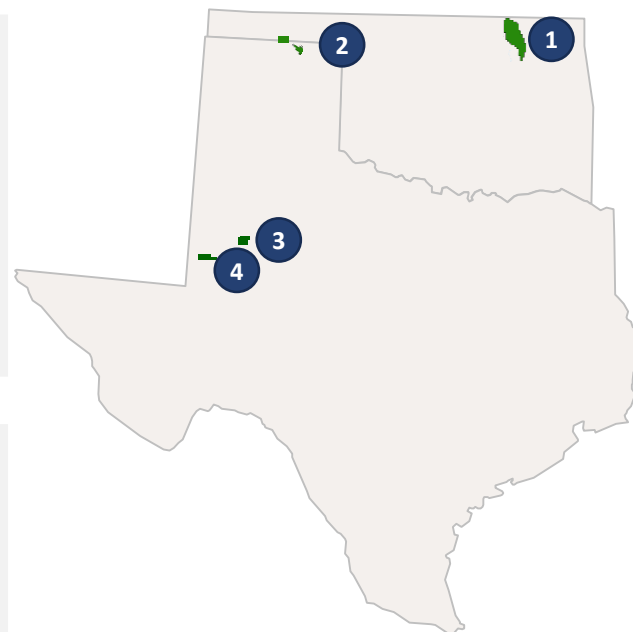
Steady CO₂ Supply

- Contracts provide CO₂ purchasing potential for ~90 MMcf/d
- ~75% of CO₂ supply is anthropogenic
- Burbank Supply: Nitrogen fertilizer plant in Coffeyville, KS
- Panhandle Supply: Ethanol plant in Arkalon, KS and nitrogen fertilizer plant in Borger, TX
- Trinity Supply: McElmo Dome and La Veta, CO

Flexible CapEx Program

- Capital investments can be turned on or off based on asset cash flows
 - Given the nature of the assets, Perdure has the ability to halt new capital investments and decrease capex spending to approximately zero, if necessary, while maintaining a similar production profile for 9-12 months

Asset Map



#	Field	Acquisition Date
1	Burbank	Nov-17
2	Panhandle	Nov-17
3	Wellman	Feb-19
4	George Allen	Feb-19

EOR Operator Perspective

- Fielding numerous calls from potential CO₂ providers
 - We have two projects internally, one which we are preparing for 45Q implementation and the other is less certain
- Potential Issues
 - Review of final regulations
 - Given our LLC structure, 45Q credits pass through to our equity investors
 - LLC maintains the cost of MRV, long term liability and compliance
 - Tax Equity partnership
 - Allocation of MRV, long term liability and compliance costs
 - Liability of failure to achieve minimum threshold
 - Many CO₂ Purchase contracts signed before 2018 allocated the 45Q credits inconsistent with the revised 45Q law/regulations
 - Contracts may need to be re-negotiated to align with updated regulations
 - Most have no monetary penalty in the event the CO₂ source fails to deliver
 - Minimum volume threshold concerns might require changes to EOR Operator's development plan(s)
 - EOR Field downtime
 - CO₂ Source downtime