

Investment Tax Credit Regs Could Limit Renewable Gas

By **Kat Lucero**

Law360 (December 21, 2023, 8:32 PM EST) -- The Inflation Reduction Act contained major tax breaks for the biogas industry, but recent proposed rules for the law's investment tax credit could leave producers of renewable natural gas, a refined form of biogas used as transportation fuel, out in the cold.

The potential setback is largely due to the U.S. Department of the Treasury not specifying in the proposed rules which major biogas components and equipment can qualify for the investment tax credit under Internal Revenue Code Section 48.

The rules, released in November, would implement several upgrades the Inflation Reduction Act made to Section 48, such as defining the various kinds of clean energy properties that can qualify for the tax credit. In the biogas section, the rules said cleaning and conditioning equipment in eligible facilities can qualify for the credit, but not upgrading equipment.

Even though the proposed rules requested public feedback on what components should be defined as "cleaning and conditioning property," Amish Shah of Holland & Knight LLP said it is not clear from the proposed rules what components count as cleaning and conditioning property and which count as upgrading property.

"The confusion of the proposed rules for the biogas industry largely lies in the proposal lacking specifics on the cleaning and conditioning equipment that can be part of a qualified biogas property," Shah told Law360.

The expectation in the industry was that there was no question that the upgrading equipment should be included in the investment tax credit, so it was extremely surprising that it wasn't in the proposed rules, he said.

Both upgrading equipment and cleaning equipment serve the same critical function — to refine raw biogas so it can become a renewable natural gas, or RNG, which has been a popular low-carbon energy source used in the transportation sector, according to Patrick Serfass of the American Biogas Council, which represents hundreds of companies in the biogas supply chain.

The proposal "was really poorly written" because upgrading equipment is excluded but conditioning and cleaning equipment is not, Serfass told Law360. "Well, those are the same things," he said.

The proposal does not treat key parts of an RNG property the same way it treats other clean energy

properties, such as wind energy farms, that can qualify for the investment tax credit, Serfass said.

"How can one incentivize the production of RNG if the equipment to make RNG isn't included?" he asked. "It would be like a wind ITC that only included constructing towers, but not the turbine blades."

Biogas comes from the natural breakdown of organic materials in a process called anaerobic digestion, in which microorganisms eat or digest organic matter in the absence of oxygen. The process naturally occurs in soil, swamps, lakes, landfills and animals' digestive systems.

Engineers have designed systems to optimize this process and mimic the natural decomposing process to transform larger volumes of waste on small footprints using heated tanks with mixers, called anaerobic digesters. These enclosed systems convert collected organic waste — such as livestock manure, food scraps and sewage sludge — into low- or negative-carbon heat, fuel and electricity for buildings, homes and vehicles. Biogas systems also recycle waste, turning it into digested materials such as fertilizers and animal bedding.

Many biogas projects are processing their gas into RNG, which is interchangeable with the more carbon-intensive natural gas from fossil fuels, according to Serfass. RNG is a popular end-product because it can be transported in already existing gas pipelines and used directly in natural gas vehicles to displace gasoline and diesel.

RNG use is growing in popularity in the transportation sector, potentially replacing fossil fuels, thanks in large part to transportation fuel initiatives such as the U.S. Environmental Protection Agency's renewable fuel standard program and California's low carbon fuel standard program. In 2022, RNG accounted for 69% of all fuel for on-road natural gas vehicles, including short- and long-haul trucks and transit buses, according to an April 2023 analysis by the Natural Gas Vehicles for America and the Coalition for Renewable Natural Gas.

To produce RNG from raw biogas, digesters are outfitted with upgrading and cleaning equipment to remove carbon dioxide, water vapor and other gases from the biogas, essentially leaving just methane. Doing so would meet industry standards for natural gas, making it almost indistinguishable from its fossil-based cousin, except it's renewable.

Policymakers and clean energy advocates recognized the benefits and popularity of biogas technology, which prompted Congress to broaden several clean energy incentives in the 2022 climate law for biogas and other technologies not previously covered.

Before 2022, the production tax credit under IRC Section 45 was one of the few tax breaks for biogas producers, but it was limited to facilities that produce renewable electricity. The incentive was also not always reliable, since the provision expired every few years and required congressional approval for renewal.

Thanks to the climate law, biogas and other clean energy technologies are now eligible for both production and investment tax credits. In the Section 48 investment tax credit, the statute provides an incentive to "qualified biogas property," which is defined as part of a system that converts biomass into a gas made of less than 52% methane by volume and uses the end-product for sale or productive use, as well as part of "a system that cleans or conditions such gas."

For a large-scale renewable energy project placed in service between 2022 and 2032, the credit is up to

30% of the project's eligible capital costs as long as it meets new prevailing wage and apprenticeship requirements. The percentage may also go up if the project meets the domestic content requirements for key building materials and location in an energy or low-income area.

In the proposed regulations, Treasury said it had reviewed several comments from biogas stakeholders that explained the similarities between upgrading and cleaning equipment. One comment said the equipment is necessary to condition the gas into the appropriate mixture for injection into natural gas transmission or distribution pipelines, according to the proposal.

The department, however, ended up with a different interpretation of the statute. "While this upgrading equipment makes the injection of biogas into a pipeline possible, such upgrading equipment is not necessary to satisfy the statutory requirements that the biogas converted from biomass contain not less than 52 percent methane, and that it be captured for sale or productive use," the proposed rules said.

Treasury said a qualified biogas property's components must also function independently, which means the placing in service of each component is "dependent upon the placing in service of each of the other components." The proposal listed anaerobic digesters and waste feedstock collection systems as examples of "functionally interdependent components."

Treasury reasoned that this approach offers "a technology-neutral way to determine" what can qualify as biogas property and "is broad enough to encompass technological changes," the proposed rules said.

The proposed rules stunned and confused the biogas industry, according to experts who viewed Treasury's interpretation as contradictory to the statute that included cleaning and conditioning equipment of gas in the incentive.

From an engineering perspective, "it may be hard to actually distinguish between what is eligible cleaning and conditioning equipment and distinguish that from what the IRS and Treasury are saying is ineligible upgrading equipment," Casey August of Morgan Lewis & Bockius LLP told Law360.

If the final regulations ultimately exclude upgrading equipment, Treasury would eliminate "the biggest opportunity to reduce carbon emissions" in the transportation sector, according to Serfass.

--Editing by Tim Ruel and Khalid Adad.