NW Natural®

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SUBMITTED ELECTRONICALLY VIA THE FEDERAL RULE MAKING PORTAL AT www.regulations.gov

Internal Revenue Service
CC:PA:LPD:PR (REG-132569-17)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: COMMENTS IN RESPONSE TO NOTICE OF PROPOSED RULEMAKING REG-132569-17 REGARDING ISSUES RELATED TO MULTIPLE OWNERSHIP AND SUBSEQUENT EXPANSIONS OF GEOTHERMAL HEAT PUMP ENERGY PROPERTY

NW Natural Gas Company (NW Natural) is a local distribution company serving more than 2.5 million people across the Pacific Northwest. Our mission is to provide safe, reliable and affordable energy in an environmentally responsible way to better the lives of the public we serve. We are committed to achieving carbon neutrality by 2050 and as such, are developing renewable natural gas supplies, piloting hydrogen blending onto our system and exploring the option for networked ground source heat applications. We respectfully submit our comments to the Treasury and the Internal Revenue Service ("IRS") regarding Notice of Proposed Rulemaking REG 132569-17 pertaining to the rules for investment tax credits ("ITC") under Section 48.

Geothermal heat pump ("GHP") systems are among the most efficient heating and cooling technologies in existence. They reduce energy costs to consumers and cut greenhouse gas emissions. They drive economic growth, require skilled, well-paid labor to install, and stabilize our nation's electrical grid. NW Natural believes that GHPs will be a central technology in America's clean energy transition and supports policies to advance their deployment.

On a utility scale, GHPs pave the way for natural gas utilities to transition from fossil fuels to renewable thermal energy delivery through deployment of community/networked geothermal systems. There are dozens of networked geothermal projects currently being planned or deployed across the country. The U.S. Department of Energy is funding 11 networked geothermal projects[1] and has recently released a report[2] that underscores the potential for GHPs to deliver significant societal benefits during the current nationwide movement toward building electrification.

The November 17th proposed regulations have the potential to impede this progress. The rules as written would prohibit GHP energy property systems from qualifying for the ITC if individual components of GHP

[1] *See* https://www.energy.gov/articles/doe-announces-13-million-support-community-geothermal-heating-and-cooling-solutions

[2] *See* U.S. Department of Energy Analysis of Highlights Geothermal Heat Pumps as a Pathway to a Dechorionized Energy Future (Dec. 6, 2023), available at https://www.energy.gov/eere/articles/us-department-energy-analysis-highlights-geothermal-heat-pumps-pathway-decarbonized.

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systems are owned by unrelated taxpayers. In addition, the rules impose significant restrictions on the ability of subsequent capital expenditures for expansions or improvements to qualify for the ITC.

Ownership Rule

Networked GHP systems almost always involve multiple owners by design. GHP networks can serve a diverse array of customer buildings while those customers own and maintain their own GHP equipment. The ground loop and the GHP units are functionally interdependent yet distinct components of the system. In many instances, utilities are prohibited from owning their customers' heating and cooling equipment. The viability of the networked geothermal business model rests on taxpayers' ability to share ownership of these separate components. Furthermore, a shared networked geothermal ownership model is very similar to gas utilities' existing business model. The utility owns the gas network and the utility's customers own the indoor heating equipment. Allowing a transition from networked gas to networked geothermal while maintaining customers' responsibilities for their heating and cooling equipment would allow for a smooth transition to utility-supported GHP deployment.

Section 48, either before or after the Inflation Reduction Act, does not include restrictions on ownership structures. Disallowing the ITC to taxpayers that own some but not all the components that comprise a single GHP unit of energy property would be inconsistent with treatment and guidance of similar property elsewhere. Section 1603 of the American Recovery and Reinvestment Act of 2009 provided for cash grants in lieu of investment tax credits for certain energy property. Treasury's Frequently Asked Questions document for this 1603 program,[3] in Q&A 35, indicates that when components of a facility are owned by different persons, a separate application must be submitted for each part of the facility with a different ownership structure.

It's unclear what policy objective would be met by allowing an ITC to two unrelated taxpayers that each own a 50 percent fractional interest each of the components that comprise a GHP unit of energy property but would disallow the ITC to those same two taxpayers if each owned 100 percent of one half the components that comprise a GHP unit of energy property. We urge the Treasury and the IRS to make changes in the final rule that would allow these types of partnerships to thrive. A rule which precludes such business models will have the unintended consequence of stifling innovation and progress in the clean energy sector.

80/20 Rule

The proposed 80/20 rule on replacement equipment requires revision to accommodate the future growth of networked geothermal systems. By their nature, geothermal networks will grow over time, adding additional customer buildings and ground loop capacity as needed. A penalty against this additive expansion will hinder the adoption of networked geothermal and limit the impacts of the technology. We ask that the Treasury and the IRS revise their approach on the 80/20 test to support the implementation of these grid-stabilizing, emissions-reducing systems.

Under the original ITC regulations, capital improvements are eligible for the ITC without regard to the 80/20 rule. Treasury Regulation § 1.48-2(b)(7) provides: "The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. Examples two and five from that regulation indicate additions or expansions to existing ITC property, if otherwise eligible, will be eligible for the ITC without imposition of the 80/20 test:

[3] Found at https://home.treasury.gov/system/files/216/A-FAQs0411-general.pdf.

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Example (2). In 1965, a taxpayer reconditions a machine, which he constructed and placed in service in 1962 and which has an adjusted basis in 1965 of $10,000. The cost of reconditioning amounts to an additional $20,000. The basis of the machine which shall be taken into account in computing qualified investment in new section 38 property for 1965 is $20,000, whether he contracts to have it reconditioned or reconditions it himself, and irrespective of whether the materials used for reconditioning are new in use.

Example (5). In 1962, a taxpayer buys from X for $20,000 an item of section 38 property which has been previously used by X. The taxpayer in 1962 makes an expenditure on the property of $5,000 of the type that must be capitalized. Regardless of whether the $5,000 is added to the basis of such property or is capitalized in a separate account, such amount shall be taken into account by the taxpayer in computing qualified investment in new section 38 property for 1962. No part of the $20,000 purchase price may be taken into account for such purpose. See, however, § 1.48-3 (relating to used section 38 property).

We appreciate the opportunity to comment on the proposed regulations and are available to answer any questions you may have.

Respectfully submitted,

Kathryn M. Williams
Vice President, Chief Public Affairs & Sustainability Officer
NW Natural