

January 22, 2024

**VIA ELECTRONIC FILING (<https://www.regulations.gov/commenton/IRS-2023-0054-0001>)
(REG-132569-17)**

Douglas W. O'Donnell
Deputy Commissioner for Service and Enforcement
CC:PA: LPD:PR (REG-132569-17)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Definition of Energy Property and Rules Applicable to the Energy Credit, Notice of Proposed Rulemaking, Public Hearing, and Partial Withdrawal of Notice of Proposed Rulemaking, 88 Fed. Reg. 82,188 (Nov. 22, 2023)

Dear Mr. O'Donnell:

NW Natural has been a leader in the development and procurement of renewable natural gas (RNG), which is derived from biogas that has been captured from organic waste streams. we write you regarding the implementation of the Inflation Reduction Act (IRA) amendments to the Energy Investment Tax Credit (ITC) under Section 48 of the Internal Revenue Code. The IRA presents a significant opportunity to reduce greenhouse gas (GHG) emissions, and deployment of biogas is and should be a key component of GHG reduction efforts. RNG derived from biogas is made from a wide variety of waste sources, including agricultural wastes, municipal wastewater, and municipal solid waste in landfills. It is cleaned and conditioned to achieve quality standards necessary to blend with or substitute for geologic natural gas. RNG projects utilize methane that might otherwise have been emitted into the atmosphere.

On November 22, the Department of Treasury and the Internal Revenue Service (IRS) issued a Notice of Proposed Rulemaking (NPRM) on implementation of the IRA amendments to the Energy ITC. In particular, the NPRM proposes a definition of qualified biogas property, which now qualifies for the ITC and is clearly intended to provide a tax benefit for RNG projects. **We write to express significant concern with the NPRM's apparent exclusion of "gas upgrading equipment" from eligibility to obtain the ITC.**

The NPRM excludes from ITC eligibility what the Treasury Dept. and IRS have termed, "gas upgrading equipment," which includes all the major equipment necessary to process biogas into RNG -- a refined, ~95% methane content biogas. **We believe this proposed exclusion is contrary to the plain language of statute, and the NPRM misunderstands the "cleaning and conditioning" process necessary to process biogas to standards that permit opportunities for**

its productive use or sale. Crucial to the production of RNG, “upgrading” equipment is essentially industry verbiage that describes equipment necessary to cause biogas to be saleable or usable. It often indistinguishable or interchangeable with those types of equipment which might be commonly referred to as “cleaning and conditioning” equipment. In other words, the most consequential components of “cleaning and conditioning,” as detailed in industry comments preceding the NPRM, are rendered ineligible to claim the credit as they fall under the proposal’s treatment of “gas upgrading equipment.” To interpret the statute to prohibit this cleaning and conditioning equipment from ITC eligibility also conflicts with the Congressional and policy intent of the modifications made to the Section 48 ITC in the IRA. For most RNG projects, “cleaning and conditioning” equipment IS the bulk of the project, both from a capital investment perspective and from a % of installed machinery perspective.

It is also critical to ensure that implementation of the tax credit is consistent with statute so the ITC for qualified biogas property fulfills Congressional and policy intent: To maximize the use and commercial deployment of biogas from landfills, U.S. farms, and other organic waste sites. An ITC unique to biogas that is conditioned to pipeline quality gas to displace fossil gas is necessary to align with existing incentives for biogas-based electricity production. Supporting the widest variety of utilization options for biogas will ensure the largest amount of biogas is captured and used productively, rather than emitted into the atmosphere. The IRA incorporated a new ITC from a pending bill, the intent of which was to establish an ITC for biogas use other than electricity, including broad use as a substitute for geologic natural gas.¹ The tax credit should be implemented in a manner that complements the U.S. government’s long-standing programs and policies that support not just the recovery of biogas (largely methane) from organic waste, but also the range of beneficial uses of biogas. The Environmental Protection Agency, the Dept. of Agriculture, and Dept. of Energy, including Argonne National Laboratory, recognize that the sustainable development, deployment and utilization of RNG not only advances methane abatement from organic waste, it also re-purposes methane that would have otherwise been emitted into fuels or feedstocks that displaces fossil fuel use.

The proposed regulations would dramatically reduce industry use of the ITC as they only extend tax credit eligibility to equipment that captures biogas. The capturing if the biogas is just the first step in utilizing it. Equipment to convert it into a usable product is also necessary. Biogas can be used to produce heat and/or electricity “on-site” at a landfill or dairy farm. Otherwise, its markets are inherently very limited since biogas cannot be stored or moved through the natural gas pipeline system in its raw state. As a functionally equivalent molecule to geologic natural gas, RNG offers the greatest commercial market for biogas sale or productive use. It can be deployed through natural gas pipelines and used for combined heat and power in “hard-to-abate” sectors; as a vehicle fuel, or as a feedstock for other energy carriers, such as low-GHG hydrogen and sustainable aviation fuel. As proposed, the regulations will render the ITC for qualified biogas property significantly less valuable because the tax credit will not be available for most capital

¹ See Agriculture Environmental Stewardship Act of 2021, S. 2461, 117th Congress (2021-2022) (July 22, 2021). Agriculture Environmental Stewardship Act of 2021 H.R. 3939, 117th Congress (2021-2022) **Note:** A biogas ITC has been introduced in every Congress since 2010 until it was incorporated into the IRA in 2022.

expenditure that is typically made on biogas production equipment. The project-level impacts would be more pronounced for smaller landfill gas and dairy RNG projects as the capital cost for cleaning and conditioning equipment doesn't scale as favorably as the capital cost for anaerobic digesters.

We kindly request your support for a revision of the NPRM such that property the proposed rule defines as "gas upgrading" equipment is appropriately categorized under the definition of "cleaning and conditioning" equipment in a final rulemaking, and thus eligible for the ITC. This revision would correctly align terms of art industry uses to describe biogas processing and would be consistent with the plain language of statute, with Congressional intent and with Treasury Dept. and IRS interpretations of functionally similar equipment in other energy systems.

Ownership Rule

Biogas production systems almost always involve multiple owners by design. It is common for the cleaning and conditioning equipment to be owned by a taxpayer other than the taxpayer that owns the system that collects the raw biogas. A *unit of energy property* is defined in the NPRM as all functionally interdependent components of property that can operate apart from other energy properties. The NPRM indicates that for biogas property, these interdependent components include the collection system and cleaning or conditioning equipment necessary to convert biomass into a gas with a sufficient percent methane. Proposed Regulation section 1.48-14(e)(2) provides:

Multiple owners. A taxpayer must directly own at least a fractional interest in the entire unit of energy property for a section 48 credit to be determined with respect to such taxpayer's interest. No section 48 credit may be determined with respect to a taxpayer's ownership of one or more separate components of an energy property if the components do not constitute a unit of energy property. However, the use of property owned by one taxpayer that is an integral part of an energy property owned by a second taxpayer will not prevent a section 48 credit from being determined with respect to the second taxpayer's energy property.

The viability of the biogas production business model rests on taxpayers' ability to share ownership of separate components. 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 biogas 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 biogas unit of energy property.

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 biogas 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,² 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.

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 subsequent capital improvements and additions requires revision to accommodate the future growth and improvements to biogas production systems. Most biogas production facilities will be constructed to clean and condition biogas from existing collection systems. In addition, biogas property will benefit over time from continuing improvements in technology which will result in prospective capital additions to these systems. Proposed Regulation section 1.48-9(f) provides that, “[e]nergy property also generally does not include equipment that is an addition or modification to an existing energy property” and therefore an addition or modification is not eligible for the section 48 ITC unless, pursuant to Prop. Reg. § 1.48-14(a), the addition or modification (Capital Improvement) otherwise meets the “80/20 rule,” which allows property to be treated as originally placed in service as energy property if it contains some items of used property, as long as the fair market value of the used property is not more than 20 percent of the total value of the total property.

The application of this 80/20 rule could result in otherwise ITC eligible construction costs of new cleaning and conditioning facilities becoming ineligible for the ITC if they are connecting to existing collection facilities. In addition, prospective costs incurred to adopt new and more efficient technologies could also be ineligible for the ITC.

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:

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

² Found at <https://home.treasury.gov/system/files/216/A-FAQs0411-general.pdf>.

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).

A penalty against constructing cleaning and conditioning facilities in connection with existing collection systems, or subsequently incorporating new technologies and expansions will hinder the adoption of biogas production systems 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 systems.

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

Sincerely,

Nels Johnson
Director of State & Federal Affairs
NW Natural
Nels.johnson@nwnatural.com