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Submitted via Federal Rulemaking Portal: https://www.regulations.gov

RE: Definition of Energy Property and Rules Applicable to the Energy Credit: Correction REG–132569–17

BP America Inc. ("bp") is pleased to submit supplementary comments to the Definition of Energy Property and Rules Applicable to the Energy Credit ("NOPR"), which was reopened with the issuance of a "Notice of proposed rulemaking; correction" ("technical correction" or "TC"), published in the Federal Register on February 22, 2024.

As detailed in bp's earlier comments on the NOPR[1], submitted on January 22, 2024, bp is investing in America as we transition to an integrated energy company. A key part of the transition for bp is investing in bioenergy. Through our 2022 purchase of leading biogas producer Archaea Energy, bp is now the largest Renewable Natural Gas ("RNG") producer in the US. In the past year, bp started up five biogas plants in the US, and expects to start-up between 15 to 20 new plants per year through 2025.

In our prior comment letter, bp raised concerns about the apparent exclusion of "cleaning and conditioning equipment" from Investment Tax Credit ("ITC") eligibility based on the NOPR's introduction of a non-statutory based term of "upgrading equipment." bp is pleased with the technical correction's recognition of this error. **However, as detailed in our prior comment letter, and as reemphasized here, "cleaning and conditioning" equipment should be classified as "functionally interdependent" property rather than "integral property."** Cleaning and conditioning equipment is a critical component of biogas property to ensure satisfaction of the statutorily mandated qualitative and productive use requirements under §48(a)(9). The characterization of cleaning and conditioning equipment as an "integral part" does not reflect this critical role.

Consequently, bp respectfully makes three requests:

[1] Available at: https://www.regulations.gov/comment/IRS-2023-0054-0150

Request 1: Revise the regulatory definition of qualified biogas property to ensure "cleaning and conditioning equipment" is characterized in the final regulations as a functionally interdependent component of the system collecting raw biogas.

Request 2: Revise the text of the NOPR's "multiple owners" rule to reflect the legal and commercial realities of qualified biogas property.

Request 3: Revise the NOPR's "Retrofitted Property" rules (or 80/20 Rule) to encourage the capture and productive use of methane from existing landfills and digesters.

In Appendix A, we provide suggested red-line edits to the proposed regulations to effectuate these changes.

Furthermore, bp emphasizes the importance of a timely resolution to the above stated requests. As of this filing, there are less than nine months remaining to begin construction on qualified biogas property to ensure qualification for the ITC, and even less time to make needed financial investment decisions. bp recommends that Treasury issue final regulations that correct the deficiencies highlighted in this comment letter as soon as possible.

Request 1: Characterize biogas "cleaning and conditioning" equipment (as defined by §48(c)(7)(B)) as a functionally interdependent ITC eligible component of qualified biogas property.

"Cleaning and conditioning" equipment is most properly characterized as a functionally interdependent component of the overall biogas system given its criticality in ensuring that the required methane content and productive use requirements contained in the statute are met. It is so critical in fact that Congress explicitly spells it out as ITC eligible in the statute.

> "Inclusion of cleaning and conditioning property: The term 'qualified biogas property' includes any property which is part of such system which cleans or conditions such gas."[2]

The inclusion of such equipment in §48(c)(7) is logical since absent the "cleaning and conditioning equipment", the existing landfill biogas collection property does not typically and consistently produce a product that meets the requirements of the statute—that of a gas with not less than 52% methane.

As bp stated in its January comment letter, biogas components constituting the landfill gas collection assets (the raw biogas that is collected prior to cleaning and conditioning) do not typically produce a gas containing at least 52% methane. For example, raw biogas originating from a landfill site has a highly variable methane content ranging from 45-65%[3] with such variability changing based on the season, weather conditions, and the ever-changing mix and decomposition of municipal waste. The only way to direct

[2] See Definition of Qualified Biogas Property. §48(c)(7)(B).

[3] U.S. Environmental Protection Agency (EPA), Renewable Natural Gas, https://www.epa.gov/lmop/renewable-natural-gas (last updated on Aug. 3, 2023).

that the 52% minimum methane content requirement is regularly and consistently satisfied is to install biogas cleaning and conditioning equipment.

Similarly, the landfill gas collection aspects of a biogas system alone allow for only a very limited productive use of such biogas. For example, gas collected at a landfill gas collection system has very limited productive use outside of on-or-near site combustion (i.e., combusted to generate electricity or heat at facilities located adjacent to and/or near the gas collection system). The "cleaning and conditioning equipment" is needed to broaden the productive use via its ability to create a product, RNG, that is the same as hydrocarbon based natural gas and thus acts as a substitute for the many uses that natural gas has in the US economy (for example, used as a less carbon intensive transportation fuel, or as a renewable energy source for utilities or corporations).

Put another way, the placing in service of both the landfill gas collection system and the cleaning and conditioning equipment is required to fulfil the intended function of qualified biogas property (converting biomass into a gas that is not less than 52% methane by volume).[4]

Also, in all previous instances where Congress has specifically articulated what constitutes ITC eligible property within §48 (as it has done in the case of "cleaning and conditioning equipment" under §48(c)(7)(B)), Treasury's interpretive guidance has echoed this clear intent by characterizing such property as "functionally interdependent." Stated differently, ITC eligibility in respect of "integral part" property has always been on a "derivative" basis and represents an appropriate and necessary extension of the statutory language to fully reflect Congressional intent. Here, no such regulatory extension is required as the plain language of §48(c)(7)(B) clearly provides for ITC eligibility in respect of the functionally interdependent cleaning and conditioning equipment. We believe Treasury's view of "cleaning and conditioning" equipment as "integral" does not reflect the critical role such components have in meeting the statutory requirements contained in §48(c)(7)(A) and (B); as critical in our opinion as a blade on a wind turbine has to the tower or gear box.

We therefore request that the regulatory definition of "qualified biogas property" in Prop. Reg. §1.48-9(e)(11)(i) be modified to characterize cleaning and conditioning equipment as a functionally interdependent part of a biogas property system.

Please see our suggested changes to Prop. Reg. §1.48-9(e)(11)(i) and (ii) in Appendix A.

Request 2: Modify the "multiple owners" rule to provide for ITC eligibility for functionally interdependent parts of energy property *regardless of any ownership stake (fractional or otherwise) in other components of the energy property*.

Currently, the proposed regulations require a taxpayer to directly own at least a fractional interest in the entire unit of energy property for the taxpayer to be eligible for the ITC, thus precluding multiple owners from owning different components of energy property.[5] Modest changes to this "multiple owners" rule are necessary to align with historic guidance on §48 and more fully actualize Congressional intent. The final regulations should provide for ITC eligibility for functionally interdependent components

[4] See Prop. Reg. §1.48-9(f)(2)(ii)(B).
[5] See Prop. Reg. §1.48-14(e)(2).

of biogas energy property regardless of any ownership stake (fractional or otherwise) in other components of the unit of energy property. While this particular request is not confined to the treatment of qualified biogas property under §48, certain aspects of the biogas industry serve to underscore the defects in the multiple owners rule, and we accordingly focus our commentary in this letter on the same.

For many years pre-dating the passage of the Inflation Reduction Act ("IRA"), the biogas industry has developed a tried and tested methodology for allowing landfill owners and biogas project developers to partner together to enable the development of biogas plants. This structure is often necessitated by contractual and legal restrictions on the owner of the cleaning and conditioning equipment owning the landfill (or digester). This structure relies on a contractual framework that is widely replicated across the industry and by design does not hinge on tax technical concepts related to tax ownership in each discrete part of the overall biogas property system. The framework is capital efficient and crucially ensures that the various benefits and burdens of each discrete component of a biogas system is placed with the appropriate party(s). Requiring developers of biogas "cleaning and conditioning equipment" to take a fractional ownership in the underlying gas collection system runs counter to how many of these projects are structured (or can be structured) under applicable law. To require most of the landfill biogas industry to move away from this longstanding practice for the sole purpose of accessing a tax benefit without any meaningful policy rationale for denying such benefit (that was designed specifically to further investment within that very industry) is unnecessary and counter to the objectives of the IRA.

There is also no sub-regulatory IRS guidance nor other common law precedent that unequivocally conditions taxpayer eligibility to claim the ITC on concepts such as "unit of energy property" or "fractional interest." Instead, the IRS, Treasury and the courts have adopted a pragmatic and flexible approach to this issue.[6] That longstanding and appropriate approach runs counter to the proposed multiple owners rule which serves no discernible tax policy goal.

We believe a "back to the basics" approach for assessing ITCs claimed by multiple taxpayers on separate components of energy property, leveraging decades of guidance and precedent, provides a readily administrable (and auditable) framework. This framework focuses on the following key factual questions that have always governed the ITC in respect of energy property under §48 (many of which are themselves appropriately echoed in the NOPR):

(1) Are the statutory requirements defining qualified energy property satisfied? Including, for avoidance of doubt the key sub-requirements that: (i) the energy property (whether under commonly owned or owned in discrete parts by taxpayers) meets its intended function[7]; (ii) is the energy property constructed, reconstructed or erected by the taxpayer (or if acquired by the taxpayer meets the "original use"

[6] See, e.g., Payments for Specified Energy Property in Lieu of Tax Credits Under the American Recovery and Reinvestment Act of 2009, "Frequently Asked Questions And Answers", FAQ 34, available at: https://home.treasury.gov/system/files/216/A-FAQs0411-general.pdf (stating in relevant part that functionally interdependent gas conversion equipment "may be [eligible for a § 1603 grant in lieu of the ITC] …, even if under different ownership or at a different site, if it is established that the conversion equipment is integrated into the facility.").

[7] See §48(a)(3)(A) and the detailed definitional rules of § 48(c).

requirement in the hands of the taxpayer)[8]; (iii) is the energy property subject to depreciation (or amortization in lieu of deprecation) for tax purposes[9]; and (iv) does the energy property meet performance and quality standard (if any) as prescribed via Treasury regulations[10];

(2) Does the taxpayer possess any recognized tax ownership interest (i.e., on a benefits and burdens basis) in the qualified energy property it seeks to claim an ITC in respect of?;
(3) Is the taxpayer's claimed ITC appropriately calculated by reference to such taxpayer's qualified investment in the energy property?[11]; and,
(4) Is the incentivized activity (or usage of the property) occurring in line with Congressional intent (reflected for these purposes in the relevant definition of ITC eligible energy property) and as primarily tested via application over time of the long-standing ITC recapture rules?

Considering the totality of prior guidance on §48 and the NOPR, we believe all these key considerations are addressed with a modified multiple owner's rule. Reliance on formalistic "unit of energy property" and "fractional interest" concepts inherent in the multiple owner's rule is not supported by the statutory language of §48, does nothing to further the ability of the IRS to audit taxpayer claims of ITC, and creates extra-statutory regulatory hurdles to claiming the ITC.

Please see our suggested changes to Prop. Reg. §1.48-9(e)(14)(e) and certain Examples contained in that subsection of the NOPR in Appendix A.

Request 3 – Clarify that the "Retrofitted Energy Property" rules provided for in the NOPR apply only to those portions of energy property owned by a taxpayer (and without regard to ownership (or fair market value) of other co-located energy property not owned by such taxpayer).

The NOPR provides that retrofitted energy property may be originally placed in service even though it contains some used components of the unit of energy property only if the fair market value of the used components of the unit of energy property is not more than 20 percent of the total value of the unit of energy property taking into account the cost of the new components of property plus the value of the used components of the unit of energy property (the "80/20 Rule"). As currently worded, the Retrofitted Energy Property provisions are not supported by the statutory language of §48 and are overly broad in application (if one assumes Treasury was merely intending to provide definitive regulatory guidance consistent with the long-standing 80/20 Rule as suggested by the Preamble to the NOPR). The final regulations should narrow this scope to ensure that it only applies in the scenario of a taxpayer that seeks to retrofit energy property they previously owned (in whole or in part) and benefit from the ITC in respect of this incremental capital investment.

[8] See §48(a)(3)(B).
[9] See §48(a)(3)(C).
[10] See §48(a)(4)(D).
[11] Cf. Prop. Reg. §1.48-14(e)(1) (providing in relevant part that a taxpayer that owns energy property is eligible for the ITC "to the extent of the taxpayer's eligible basis in the energy property."). Industry standard cost-segregation studies readily serve to validate a taxpayer's calculation of its respective eligible basis in energy property; bp would welcome the IRS requiring provision of such a third-party prepared cost segregation study if this would provide additional comfort to the IRS vis-à-vis auditing taxpayer ITC claims.

In particular, and as many comment letters highlight, the conflation of broad "unit of energy property" concepts along with the multiple owners rule (and treatment of integral property under the historic 80/20 Rule) may deny a taxpayer an ITC due to prior-in-time capital investments made by unrelated taxpayers.

As noted earlier in these comments, many landfill biogas projects take place at sites where gas collection property already exists—mostly due to non-tax federal or state regulations. That similarly may be the case with anaerobic digesters.

As proposed, a strict application of the multiple owners rule, combined with the Retrofitted Energy Property rule would still disallow the ITC for many in the industry. Most parties investing in landfill biogas plants do not have an ownership interest (fractional or otherwise) in the entire "unit of energy property" for legal and commercial reasons and would thus be unable to even entertain qualification for the ITC under the Retrofitted Energy Property rule.

The prior in time decision of a landfill owner to install a gas collection system should have no bearing on whether a biogas developer, who has separately built and installed "cleaning and conditioning" equipment, qualifies for the biogas ITC if that developer meets the statutory "beginning of construction" requirements for that functionally interdependent equipment and if the output of that biogas plant meets the statutory minimum methane content and productive use requirements—especially given that these new Treasury-introduced boundary conditions do not serve to advance any identifiable tax policy objective.

For all the foregoing reasons bp recommends that Treasury re-consider its approach to expanding on long-standing sub-regulatory guidance on the 80/20 rule prior to finalizing the §48 regulations.

Please see our suggested changes to Prop. Reg. §1.48-14(a) in Appendix A.

bp appreciates the opportunity to submit these supplemental comments and the recent engagement in the public hearing on February 20, 2024. We look forward to Treasury's consideration of these suggested changes and requested clarifications, as these are paramount to our interest in and desire to further invest in the build out of a premier, material biogas business in the US. We thank you for your time and consideration of this comment letter. Please contact us with any questions or clarifications.

Sincerely,

<u>/s/ Isabel Mogstad</u>

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Appendix A

Note: red text or ~~strikethroughs~~ reflect bp's suggested changes to the below provisions of the NOPR to align the text of the final regulation with bp's requests as discussed herein.

Request 1 – proposed changes to NOPR necessary to characterize biogas "cleaning and conditioning" equipment (as defined by §48(c)(7)(B)) as a functionally interdependent ITC eligible component of a broader biogas property system.

Prop. Reg. §1.48-9(e)(11)(***as corrected on Feb. 22***): Qualified biogas property—(i) In general. Qualified biogas property is property comprising a system that converts biomass (as defined in section 45K(c)(3) of the Code, as in effect on August 16, 2022) into a gas that consists of not less than 52 percent methane by volume (tested at the point described in paragraph (e)(11)(ii) of this section), or is concentrated by such system into a gas that consists of not less than 52 percent methane (tested at the point described in paragraph (e)(11)(ii) of this section), and captures such gas for sale or productive use and not for disposal via combustion. Qualified biogas property also includes any property that is part of such system that cleans or conditions such gas. For example, qualified biogas property includes, but is not limited to, a waste feedstock collection system, a landfill gas collection system, mixing or pumping equipment, and an anaerobic digester. ~~However, g~~ Gas upgrading equipment necessary to clean, condition and concentrate the gas into the appropriate mixture for ~~injection into a pipeline~~ its intended productive use through removal of other gases such as carbon dioxide, nitrogen, or oxygen is ~~not included in~~ a functionally interdependent component (as defined in paragraph (f)(2(ii)) of qualified biogas property.

Prop. Reg. §1.48-9(e)(11)(ii): Methane content requirement. The methane content requirement described in section 48(c)(7)(A)(i) of the Code and paragraph (e)(11)(i) of this section is measured at the point at which gas exits the biogas production system, which may include an anerobic digester, landfill gas collection system, ~~or~~ thermal gasification equipment or cleaning and conditioning equipment~~. This is the point at which a taxpayer generally must determine whether it will convert the biogas to fuel for sale or use it directly to generate heat or to fuel an electricity generation unit.~~

Request 2: proposed changes to NOPR necessary to modify the "multiple owners" rule to provide for ITC eligibility for functionally interdependent parts of energy property *regardless of any ownership stake (fractional or otherwise) in other components of the energy property*.

Prop. Reg. §1.48-14(e)(1): Special rules concerning ownership—(1) Eligible basis. For purposes of this section, a taxpayer that owns an energy property is eligible for the section 48 credit only to the extent of the taxpayer's eligible basis in the energy property. In the case of multiple taxpayers holding direct ownership in an energy property, each taxpayer determines its eligible basis based on its ~~fractional~~ ownership interest in the energy property.

Prop. Reg. §1.48-14(e)(2): 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.~~ A ~~No~~ section 48 credit may be

determined with respect to a taxpayer's ownership of one or more separate, functionally interdependent components of energy property.[~~which together constitute a qualifying unit of energy property~~]. No section 48 credit may be determined with respect to the ownership of integral energy property unless the same taxpayer owns an interest in one or more functionally interdependent components of the underlying ~~unit of~~ energy property for which the integral property connects to or completes]. 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.

Prop. Reg. §1.48-14(e)(4) (i) *New Example 1.*[12] *Separate ownership of property that is an integral part of a separate unit of energy property*. X owns ~~a wind energy property that is a unit of energy property and~~ property that is an integral part of a unit of ~~the~~ wind energy property owned by Y, specifically a transformer where the electricity is stepped up to electrical grid voltage before being transmitted to the electrical grid through an intertie. ~~Y owns the underlying unit of wind energy property is a unit of energy property that connects to X's transformer~~. Because ~~Y~~ X does not hold an ownership interest in the ~~transformer~~ wind energy property ~~Y~~ X may not compute its section 48 credit for its ~~solar~~ integral energy property. ~~but it will not include any costs relating to the transformer~~.

Prop. Reg. **§1.48-14(e)(4)**(iii) Example 3. Shared ownership of property that is an integral part of separate energy properties. X owns a wind energy property that is a unit of energy property and Y owns a solar energy property that is a unit of energy wind energy property and Y's solar energy property connect to a substation that houses a step-up transformer where the electricity is stepped up to electrical grid voltage before being transmitted to the electrical grid through an intertie. X and Y each own a 50% ~~fractional ownership~~ interest in the step-up transformer. The step-up transformer is an integral part of both the wind energy property and the solar energy property (as defined in §1.48–9(f)(3)(i). As a result, X and Y may both compute a section 48 credit for their respective energy properties by including 50% of the costs of the step-up transformer.

Request 3: Proposed changes to text of NOPR to clarify that the "Retrofitted Energy Property" rules are to apply only to those portions of energy property owned by a taxpayer (and without regard to ownership (or fair market value) of other co-located energy property not owned by such taxpayer).

Prop. Reg. §1.48-14(a) Retrofitted energy property—(1) In general. For purposes of section 48(a)(3)(B)(ii), (a)(5)(D)(iv), and (a)(8)(B)(iii) of the Internal Revenue Code (Code), a retrofitted energy property may be originally placed in service even though it contains some used components of the ~~unit of~~ energy property only if the fair market value of the used components of the ~~unit of~~ energy property is not more than 20 percent of the total value of the ~~unit of~~ energy property taking into account the cost of the new components of property plus the value of the used components of the ~~unit of~~ energy property (80/20 Rule). Only expenditures paid or incurred that relate to the new components of the ~~unit of~~ energy property are taken into account for purposes of computing the energy credit determined under section 48 (section 48 credit) with

[12] bp suggests that existing Example 1 and Example 2 in Prop. Reg. §1.48-14(e)(4) be replaced with the suggested new Example 1.

respect to the ~~unit of~~ energy property. The cost of new components of the ~~unit of~~ energy property includes all costs properly included in the depreciable basis of the new components. If the taxpayer satisfies the 80/20 Rule with regard to the ~~unit of~~ energy property and the taxpayer pays or incurs new costs for property that is an integral part of the energy property (as defined in §1.48-9(f)(3)(i)), the taxpayer may include the new costs paid or incurred for property that is an integral part of the energy property owned by the taxpayer (as defined in §1.48-9(f)(3)(i)) in the basis of the energy property for purpose of the section 48 energy credit. Further, in the case of an energy project (as defined in §1.48-13(d)), the 80/20 Rule is applied to each ~~unit of~~ energy property comprising an energy project.