Services

Public Finance

Congress Adds New Private Activity Bond Types for Broadband Internet and Carbon Capture Facilities and Expands Section 142(m) Issuance Cap

The Infrastructure Investment and Jobs Act, H.R. 3684 (the "Infrastructure Bill"), passed on November 5, 2021 by the House of Representatives after Senate passage on August 10, 2021, will add two new types of private activity bonds to the available tax-exempt financing tools already present in the Internal Revenue Code (the "Code") once it is signed into law by President Biden, as expected. Qualified Broadband Projects and Qualified Carbon Dioxide Capture Facilities may now be financed with private activity bonds starting January 1, 2022 subject to compliance with the new rules set forth in the Infrastructure Bill. In addition to adding new types of private activity bonds, the Infrastructure Bill increases the amount of available issuance cap for tax-exempt bonds to finance qualified highway and surface freight transportation facilities.

Qualified Broadband Projects

A "Qualified Broadband Project" means any project for the provision of internet service achieving certain speeds that is targeted to an underserved area and delivers a faster and theoretically more stable internet connection than previously existed. Under the new provisions, the Qualified Broadband Project must target specifically one or more census block groups in which more than 50% of households do not have access to fixed (non-mobile), terrestrial (non-satellite or radio) broadband service with a speed of at least 25 megabits per second ("Mbps") downstream and at least 3 Mbps upstream. The Qualified Broadband Project must, on completion, result in internet access to residential locations, commercial locations, or a combination thereof at speeds of at least 100 Mbps downstream and at least 20 Mbps upstream, but only if at least 90% of the locations provided with new service under the project are locations where, before the project, a broadband service provider (i) did not provide service at all, or (ii) did not provide service meeting the minimum speed requirements of 25 Mbps downstream and 3 Mbps upstream. In other words, the Qualified Broadband Project must deliver noticeably faster service to those who had slower connections before the project or to those who were not served at all. It is not clear how, when, and where the internet speeds achieved by the Qualified Broadband Project must be measured. We anticipate that the Internal Revenue Service (the "Service") will issue guidance to that effect.

The new provisions require that, at least 90 days before the issue date of any bonds used to fund the project, the issuer: (A) notify each broadband service provider in the area of the project and its intended scope; (B) request from each such provider information regarding the provider's ability to deploy, manage, and maintain a broadband network capable of providing gigabit capable (1000 Mbps) internet access to residential or commercial locations; and (C) allow each such provider at least 90 days

to respond to such notice and request. The Infrastructure Bill itself does not provide any guidance as to the manner of this notice and what remedy, if any, a provider may have if there is an objection to the project. We anticipate that the Service will provide further guidance as to the manner of this notice and any corresponding procedures for resolution of potential objections.

Bonds for Qualified Broadband Projects are classified as "exempt facility bonds," for which Section 146 of the Code requires an allocation of volume cap as a condition to issuance of the bonds. The new provision in the Infrastructure Bill includes a partial exception from this volume cap requirement. Only 25% of the issue price of bonds financing a Qualified Broadband Project must have an allocation of volume cap from a state's allocating authority. No volume cap is required for the remaining 75% of the issue price of the bonds. Furthermore, the bill provides for a complete exemption from the volume cap requirement if all of the property financed by the bonds will be owned by a governmental unit, with a safe harbor for certain circumstances where the property is subject to a lease.

Qualified Carbon Dioxide Capture Facilities

A "Qualified Carbon Dioxide Capture Facility" includes (i) the eligible components of an industrial carbon dioxide facility as well as (ii) a direct air capture facility. The carbon dioxide ("CO_2") captured by a qualifying facility must be stored, transported, and injected into facilities for geologic storage or enhanced oil and gas recovery wells followed by geologic storage in such wells. Eligible components of industrial carbon dioxide facilities are any equipment used to capture, treat and purify, compress, transport, or store on-site CO_2 and also any equipment that is used in a process that converts a solid or liquid coal, petroleum residue, biomass, or similar material into a synthesis gas that is primarily CO_2 and hydrogen either used directly or for subsequent chemical or physical conversion. Of note is that the eligible components that may be financed extend beyond equipment that captures CO_2 released as a waste product of an industrial process and includes equipment used in certain petroleum and biomass-based energy processes themselves, not just the exhaust.

Importantly, the efficiency of the eligible components determines the amount of the Eligible Components that may be financed. If the eligible components are more than 65% efficient in capturing and storing CO_2, then 100% of the cost of the eligible components can be financed. However, eligible components that are less than 65% efficient may only be financed in the same percentage as those components are efficient, so for example eligible components that are only 50% efficient can only be financed for 50% of their value.

The industrial CO_2 facility to which these eligible components must belong is any of a wide-variety of facilities that generate CO_2 as the result of fuel combustion, gasification, bioindustrial processes, fermentation, or the manufacturing of chemicals, fertilizers, glass, steel, petroleum residues, forest products, agriculture (including feedlots and dairies), and gasoline and diesel fuels. Natural gas production and transportation facilities are not included among these facilities though.

Separate from the eligible components of an industrial CO_2 facility are facilities that constitute a direct air capture facility as defined in Section 45Q(e)(1) of the Code, which relates to the tax credits available for the capturing of CO_2 and carbon monoxide. A direct air capture facility is any facility that uses carbon capture equipment to remove CO_2 directly from the ambient air, but not CO_2 that is deliberately released from naturally occurring subsurface springs or as a result of natural photosynthesis, in other words only CO_2 from human activities can be captured. While the carbon capture equipment that makes up a

Contacts

Adam R. Baird
Spokane
(509) 747-4040
adam.baird@kutakrock.com

Kevin L. Barney
Chicago
(312) 602 4100
kevin.barney@kutakrock.com

Mitchell J. Bragin
Washington D.C.
(202) 828 2400
mitchell.bragin@kutakrock.com

Larry L. Carlile
Denver
(303) 297 2400
larry.carlile@kutakrock.com

Matthias M. Edrich
Denver
(303) 292-7887
matthias.edrich@kutakrock.com

Robert B. Henderson
Omaha
(402) 231-8934
robert.henderson@kutakrock.com

David S. Lu
Washington D.C.
(202) 828-2468
david.lu@kutakrock.com

Jack McGill
Omaha
(402) 231-8974
johnk.mcgill@kutakrock.com

Shawn M. Willette
Denver
(303) 297 2400
shawn.willette@kutakrock.com

direct air capture facility is quite broad in scope and covers most equipment and property that is used to capture and process CO_2, it does not include equipment or property to transport CO_2 for disposal, injection, or further utilization. It is likely the case that not all processes that could be financed as parts of a direct air capture facility would be covered as eligible components of an industrial CO_2 facility for purposes of tax-exempt bond financing. We anticipate that the Service will provide guidance on the precise activities that constitute both an industrial CO_2 facility and a direct air capture facility.

With the new ability to finance Qualified Carbon Dioxide Capture Facilities with tax-exempt bonds, Congress has reduced the amount of the credit for carbon oxide sequestration under Section 45Q of the Code to minimize the double-dipping of tax benefits. For a direct air capture facility project that is financed with Qualified Carbon Dioxide Capture Facilities bonds, the amount of the credit will be reduced in the same proportion as the amount of tax-exempt bond proceeds related to the overall capital improvements made on the project, up to 50%. For example, if $20 million of bond proceeds were used to finance a carbon capture project that amounted to $60 million of total investments including equity and other sources of funds, the amount of the tax credits as computed under Section 45Q would be reduced by one-third.

Just as with Qualified Broadband Project bonds discussed above, bonds issued to finance Qualified Carbon Dioxide Capture Facilities must only have a volume cap allocation for 25% of the issue price of the bonds. Given the complexities of determining whether facilities qualify for financing with this new type of bond, we anticipate that industry experts will need to be involved early in transactions to help identify costs that qualify for tax-exempt financing.

Increased National Limitation for Qualified Highway or Surface Freight Transfer Facilities

Section 142(a)(15) of the Code, introduced in 2005, allows for the issuance of tax-exempt private activity bonds for the financing of privately developed and operated qualified highway or surface freight transfer facilities. A national limitation of $15 billion currently applies to these types of bonds, allocated by the Secretary of Transportation, with no requirement for separate state volume cap. According to the Department of Transportation, as of November 4, 2021, approximately $13.8 billion of the national limitation has been used up. The Infrastructure Bill increases the national limitation to $30 billion, effectively allowing for the issuance of an additional $15 billion in new bonds. We have been involved in several issuances of qualified highway or surface freight transfer facilities since 2005 and believe this increased national limitation will be a significant boost to encouraging further development of needed transportation infrastructure.

This client alert was prepared by the national public finance tax group of Kutak Rock LLP. If you have questions about the provisions described above or any other types of tax-exempt bonds, please contact any member of the tax group.