ONE BIG BEAUTIFUL BILL ACT: UPDATES TO SECTION 45Q TAX CREDITS FOR CCS AND PUBLICLY TRADED PARTNERSHIPS FOR CLEAN ENERGY

On July 4, 2025, President Trump signed into law *An Act to provide for reconciliation pursuant to title II of H. Con. Res. 14*, better known as the One Big Beautiful Bill Act (**OBBBA)**.

Among the many changes made by the OBBBA to federal tax credit regimes are key updates to the carbon oxide sequestration credit (Section 45Q Tax Credit) available under 26 U.S. Code § 45Q (Section 45Q). Specifically, the OBBBA adds credit value parity for certain types of carbon oxide utilization where facilities or equipment are placed into service after the date of the OBBBA, and introduces new limitations on the availability of Section 45Q Tax Credits for certain foreign or foreign-influenced entities.

Additionally, the OBBBA expands the definition of "qualifying income" under Section 7704 to include income derived from hydrogen storage, carbon capture, advanced nuclear, hydropower and geothermal energy. This change creates opportunities for new forms of investment in renewable energy projects, particularly those owned and developed by master limited partnerships that enjoy broad access to capital markets while retaining tax advantaged status.

I. Updates to the Section 45Q Tax Credits

BACKGROUND

The Section 45Q Tax Credits originated with the Energy Improvement and Extension Act of 2008 (**EIEA)**, which established the availability of tax credits under Section 45Q at (i) $10 per metric ton for qualified carbon dioxide disposed of in secure geological storage and utilized as a tertiary injectant for enhanced oil recovery (**EOR**) or (ii) $20 per metric ton if disposed of in secure geological storage and *not* utilized for EOR (**Sequestration**) (in each case, subject to annual inflation adjustments). Under the EIEA, Section 45Q Tax

Credits for carbon capture equipment placed in service prior to February 9, 2018, were only available until the end of the calendar year in which the Environmental Protection Agency (**EPA**) certified that 75,000,000 metric tons of qualified carbon dioxide had been captured and disposed of via Sequestration or used in EOR. [1] Subsequent amendments to Section 45Q discontinued the Section 45Q Tax Credit with respect to carbon capture equipment originally placed in service before February 9, 2018, effective as of the end of 2022.[2]

The Bipartisan Budget Act of 2018 (**BBA**) expanded the availability of Section 45Q Tax Credits to include utilization for purposes other than EOR and carbon oxides captured at direct air capture facilities. The BBA implemented a fixed 12-year term under which qualified facilities could claim Section 45Q Tax Credits measured from the date carbon capture equipment was placed in service. Additionally, the BBA increased the credit value for facilities or carbon capture equipment placed in service after February 9, 2018. In this regard, the BBA increased the dollar value of the Section 45Q Tax Credits to (i) between $22.66 and $50 per metric ton (following a linear interpolation over the taxable years after 2016 and before 2027) for Sequestration or (ii) between $12.83 and $35 per metric ton for qualifying utilization (including EOR). For each year after 2026, the value of the credit would be the maximum value in the applicable range as escalated pursuant to a yearly inflation adjustment. [3]

The final material change to the value and availability of Section 45Q Tax Credits prior to the OBBBA came in 2022 with the passage of the Inflation Reduction Act (**IRA**). For facilities or carbon capture equipment placed in service after December 31, 2022, the IRA altered the value of the Section 45Q Tax Credits to (i) $17 for Sequestration and (ii) $12 for EOR or other qualifying utilization. Such amounts were increased to $36 and $26, respectively, for carbon oxides captured at direct air capture facilities. Additionally, if the construction, alteration, and repair of the applicable qualified facility and carbon capture equipment complied with certain prevailing wage and apprenticeship (PWA) requirements, the baseline dollar values were eligible for a 5x multiplier.[4] The IRA also relaxed minimum carbon oxide capture requirements for carbon capture equipment that began construction after August 16, 2022; e.g., 12,500 MT/year for Sequestration in most cases versus 100,000 MT/year in effect under the BBA.

NEW DEVELOPMENTS

The final version of the OBBBA signed into law on July 4, 2025, adds credit value parity for certain types of carbon oxide utilization where facilities or equipment are placed into service after the date of the OBBBA. In this regard, the OBBBA left intact the credit values for Sequestration and the 5x multiplier available with PWA compliance, but it established parity for other uses of qualified carbon oxides. For any carbon capture equipment placed in service after July 4, 2025, qualified carbon oxides utilized in EOR or other qualifying utilization will be eligible for the same $17 base credit available for Sequestration. For direct air capture facilities, the base credit will be $36 regardless of whether the captured carbon oxides are sequestered or

[1] Energy Improvement and Extension Act of 2008, Pub. L. No. 110-343, div. B, §115, 122 Stat. 3765, 3829-3831 (2008).
[2] IRS Notice 2022-38, 2022-39 I.R.B. 239.
[3] Bipartisan Budget Act of 2018, Pub. L. No. 115-123, div. D, § 41119, 132 Stat. 64, 162-168 (2018).
[4] Inflation Reduction Act of 2022, Pub. L. No. 117-169, § 13104, 136 Stat. 1818, 1924–1929 (2022).

otherwise utilized.[5] Notably, however, for facilities placed in service before the OBBBA, unlocking the full value of the Section 45Q Tax Credits still requires Sequestration rather than EOR or other utilization.

This credit parity is likely to spur new interest in disposing of captured carbon oxides via EOR projects. There is a large market for EOR CO2 in the United States, much of which has historically been filled by naturally occurring CO2. The new higher credit value for carbon oxides utilized in EOR may help to displace the production and use of naturally occurring CO2 with emissions captured from industrial sources that would otherwise have been vented into the atmosphere.

Additionally, the ability to realize the full Section 45Q Tax Credit value through EOR utilization may help accelerate project timelines since EOR utilization does not require captured carbon oxides to be sequestered in Class VI underground injection control (**UIC**) Sequestration wells. Historically, Class VI UIC wells have required a lengthy permitting process that can take many years to finalize. While progress has been made in expediting this process (e.g., through the granting of primacy to certain states allowing them to directly oversee Class VI UIC well permit regulations[6]), these regulatory requirements can still create a barrier for carbon capture projects that rely on Class VI UIC permits.

Key takeaway: These increased incentives indicate the Section 45Q Tax Credit will remain an important tool in the federal government's efforts to decarbonize industrial facilities. This change may result in certain projects for carbon offtake generating greater credit values and could result in accelerated project schedules to capture these benefits.

Consistent with the approach taken with other renewable and clean energy tax credits, the OBBBA also introduced complex new "prohibited foreign entity" limitations that disallow the Section 45Q Tax Credits for certain foreign entities for taxable years beginning after the date of enactment.[7] Additionally, taxpayers can no longer transfer credits to any "specified foreign entity."[8] It is worth noting, however, that the enacted transferability limitation is less restrictive than the version originally proposed by the House of Representatives, which would have fully terminated transferability of Section 45Q Tax Credits for carbon capture facilities or equipment beginning construction after the date that is two years after enactment. In addition, unlike the tax credits under Sections 45X, 45Y and 48E, Section 45Q Tax Credits are exempt from the complex equipment procurement rules that disqualify projects from receiving tax credits if they receive "material assistance" from a "prohibited foreign entity."

[5] One Big Beautiful Bill Act, Pub. L. No. 119-21, § 70522 (2025).
[6] Please see more on Class VI regulation at the following link: https://www.cliffordchance.com/briefings/2025/05/progress-on-uic-class-vi-primacy--epa-and-texas-railroad-commiss.html
[7] One Big Beautiful Bill Act, Pub. L. No. 119-21, § 70522(a) (2025). Please see more on the new foreign entity limitations at: https://www.cliffordchance.com/briefings/2025/07/one-big-beautiful-bill-act---the-impact-on-the-clean-energy-prod.html
[8] *Id.* at § 70512(h).

II. Updates to § 7704 and Publicly Traded Partnerships

BACKGROUND

Congress originally amended the Internal Revenue Code (**Code**) to include Section 7704 as part of the Omnibus Budget Reconciliation Act of 1987. The new section significantly changed the taxation of partnerships listed on a securities or other secondary market by subjecting these "publicly traded partnerships" (**PTPs**) to corporate tax treatment. Although partnerships generally receive pass-through tax treatment and are subject to only a single layer of tax at the partner level, under Section 7704 PTPs taxed as corporations would now be subject to a layer of corporate taxation in addition to tax on distributions to shareholders. This addition to the Code was designed to prevent partnerships that functioned like publicly traded corporations from avoiding corporate tax treatment. [9] However, a limited carveout existed under Section 7704(d) allowing entities to retain pass-through treatment if at least 90% of the entity's income was deemed to be "qualifying income."

The definition of qualifying income includes income from passive sources such as dividends or interest.[10] Additionally, Section 7704(d)(1)(E) specifies that qualifying income also includes certain natural resource-related income, including income derived from particular industrial activities attributable to mining, oil or natural gas, geothermal energy and fuel transportation or storage.

Prior to the enactment of Section 7704, a market developed for financial arrangements known as master limited partnerships (**MLPs**). The first MLPs were formed in the early 1980s as a means for natural resources partnerships to capture the benefits of obtaining capital through public security markets while retaining partnership status. As well as only having one layer of tax, these arrangements allow certain distributions to partners to be tax-deferred. The qualifying income exception to Section 7704 arose in connection with a tax policy objective of encouraging the exploitation of oil, gas and other natural resources. Thus, many MLPs were able to retain their partnership tax status following the enactment of Section 7704, and the MLP market has since experienced several periods of growth.

Due to the limited scope of the qualifying income exception, the MLP structure primarily has been used to form PTPs for investment in the traditional energy sector, with many MLP businesses focusing on assets such as pipelines, natural gas processing facilities and fuel storage terminals. Notably, the original definition of qualifying income in Section 7704(d)(1)(E) does not reflect the mix of energy generation seen in the market today and proponents of renewable energy investment lobbied for legislation to create parity between traditional and renewable energy. In particular, the energy industry made efforts to expand Section 7704(d)(1)(E) through the introduction of the "Master Limited Partnerships Parity Act" in 2013. This bill attempted to add income

[9] Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10211(a), 101 Stat. 1330–403 (1987).
[10] 26 U.S.C. Section 7704(d).

from certain renewable energy projects, such as biofuels and carbon capture, to the qualifying income definition, but was ultimately unsuccessful. [11]

NEW DEVELOPMENTS

The final version of the OBBBA signed into law on July 4, 2025, amends the definition of qualifying income under Section 7704(d)(1)(E) to include income from hydrogen storage, carbon capture, advanced nuclear, hydropower and geothermal energy as qualifying income for PTPs. [12] This change allows PTPs to invest in certain renewable energy projects while still satisfying the qualifying income exception. The extension of the qualifying income exception to these markets creates the long-requested parity under Section 7704 between traditional and newer, transitional energy forms and may generate renewed investment in these areas.

Key takeaway: The broadening of the qualifying income exception demonstrates a continued effort by the U.S. Congress to create parity in the tax code between traditional and certain renewable energy markets. Following the OBBA's changes, MLPs which have historically been limited to investments in traditional energy markets may now invest in renewable energy while continuing to benefit from the tax advantages of the MLP structure. Further, existing partnerships operating in these industries may consider raising capital through IPOs, and the new legislation should enhance the attractiveness of these investments for investors previously deterred by higher tax costs associated with accessing public securities markets.

Clifford Chance is closely monitoring developments in these renewable energy markets. Please see our previous briefing: One Big Beautiful Bill Act: The impact on the clean energy production tax credit and investment tax credit. We will provide updates as further guidance becomes available. If you have any questions, please contact a member of Clifford Chance's Energy & Infrastructure team.

[11] Master Limited Partnerships Parity Act, H.R. 1696, 113th Cong. (2013).
[12] One Big Beautiful Bill Act, Pub. L. No. 119-21, § 70524 (2025).

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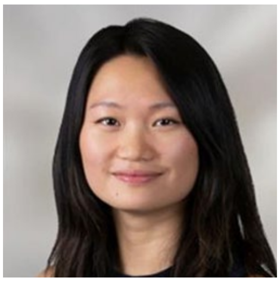

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