On August 16, 2022, President Joe Biden signed the $739 billion reconciliation budget bill, known as the Inflation Reduction Act of 2022 (IRA), into law after it was quickly adopted in the U.S. Senate and House of Representatives in a surprise move following months of stalled negotiations among Democrat lawmakers. The 730-page IRA, H.R. 5376, passed along strictly partisan lines with no Republicans voting in favor of the measure as they objected to many of the taxing, spending and climate-related provisions.

Senate Majority Leader Chuck Schumer (D-NY) and main holdout, Senate Energy and Natural Resources Committee Chairman Joe Manchin (D-WV), had negotiated for months on a large-scale climate change bill that failed to gather enough support, eventually landing on a suite of policies that congressional Democrats could get behind. The bill narrowly passed the 50-50 split Senate with Vice President Kamala Harris breaking the tie vote.

Described as the climate, health care and tax package, the IRA contains numerous provisions impacting traditional energy as well as renewables development. While some oil and gas industry stakeholders opposed the bill others tacitly supported it because it revives stalled federal onshore and offshore leasing, provides various tax breaks, carbon sequestration benefits and other incentives for oil and gas producers. The bill also provides a broad-based network of provisions to help fund the energy transition towards renewable and “clean” energy sources.

Overall, the IRA boasts $369 billion in climate investments, including long-term extensions of clean energy tax credits and a host of incentives for technologies like nuclear, hydrogen, carbon capture and battery storage. Independent analysts expect the bill to reduce emissions roughly 40 percent by 2030. As reported by Forbes, “After the concessions made to West Virginia Democrat Sen. Joe Manchin to secure his support, the IRA had enough protections for the industry to allow the legislation to move forward without hardline opposition from the oil sector. For much of the sector, the $369 billion in climate provisions in the IRA could serve as a boon, ensuring a manageable energy transition rather than an abrupt, expensive shift away from fossil fuels too fast.”

The legislation, however, increases federal oil and gas royalties, rents, minimum bids for operations on federal lands, and reimposes the long dormant Hazardous Substance Superfund financing rate tax on crude oil and oil product imports. Additionally, a first ever “waste emissions charge” for methane emissions from oil and gas production and onshore gas pipelines and gas storage will be imposed. Royalties will also be imposed on all extracted natural gas, including gas vented, flared, or leaked, with exceptions for safety.

In the end, the final legislation shed many costly fees and taxes initially proposed and includes beneficial provisions such as tying a requirement to hold federal offshore and onshore lease sales in order to green light wind and solar development. The bill also removes a proposed windfall profits tax many Democrats sought to impose on oil and gas companies. And the methane charge, although unfavorable, will rely upon a preexisting model of reporting rather than a burdensome regulatory regime found in earlier bill drafts.
As noted by Morgan Bazilian, Director of the Payne Institute and a professor of public policy at the Colorado School of Mines, the bill actually helps “quash some investor worries about long-term oil and gas infrastructure. That’s because, he said, this measure doesn’t directly legislate a reduction in greenhouse gas emissions. And that’s why you don’t see huge pushback from the oil and gas industry on this.” The IRA has also received support from energy majors such as ExxonMobil, ConocoPhillips, Occidental Petroleum, and BP Plc mainly due in part to the various tax incentives, mandatory federal leasing provisions, removal of initially proposed taxes and fees, and a more reasonable approach to methane emissions reduction policy.

“Most legislation of this type has carrots and sticks,” said Michael Webber, a professor of energy resources at the University of Texas at Austin. “This legislation mostly has carrots and not sticks.”

**Key Bill Provisions**

**Methane emissions charge**

The bill contains a new fee on the oil and gas industry for the “excess” emission of methane called the “Waste Emissions Charge” that applies to oil and gas production, transmission (including pipelines), storage, gathering and boosting. Oil and gas companies that emit above a certain level of methane across all operations trigger the fee that will escalate over time. And to enforce all this, there is additional Environmental Protection Agency funding for monitoring methane leaks.

The charge will only apply to facilities that emit more than 25,000 metric tons of carbon dioxide annually beginning in 2025. Although the American Petroleum Institute described the charge as a “new $6.3 billion natural gas tax,” the legislation allows companies that comply with future federal methane rules to avoid paying the fee as long as the same levels of emissions reduction are reached. This is part of the $850 million allocated in financial incentives through the Methane Emissions Reduction Program for industry to monitor and reduce methane.

The charge fees apply as follows: $900 per ton for emissions reported for 2024; $1,200 per ton for emissions reported for 2025; and $1,500 per ton for emissions reported for 2026.

The upside is the negotiations needed to garner Sen. Manchin’s support lowered the initially proposed fee structure which would have impacted nearly every producer emitting methane. Rather, according to an analysis by the Congressional Research Service, the fee is expected to apply only to roughly 40% of companies. The initially proposed 2021 version of the bill had lower emission thresholds triggering the charge and a much higher fee on emissions, starting at $1,800 per ton as early as 2023.

**Federal oil and gas leasing**

An additional concession gained by Sen. Manchin was tying wind and solar development to a reinstatement of federal onshore and offshore oil and gas leasing. The IRA requires the Interior Department to offer at least two million acres a year for federal onshore oil and gas lease sales or half of all the land nominated for leasing and hold a lease sale within 120 days of issuing any wind or solar rights-of-way. As to offshore leasing, the bill will not allow an offshore wind lease to be issued unless at least one offshore oil and gas lease sale had been held during the preceding one-year period, and unless the oil and gas leasing in that year covered not less than 60 million acres. According to federal data, on average the oil and gas industry has purchased for lease one million acres of land every year since 2009. By requiring two million acres per year to be offered for lease — an area the size of Yellowstone National Park — the legislation all but ensures that the traditional energy industry will maintain current oil and gas production levels without any change for the next decade.
The bill also amends the Outer Continental Shelf Lands Act to expand the definition of the Outer Continental Shelf to include lands within the control or the exclusive economic zone of the United States and adjacent to any territory of the United States. This expanded definition of the Outer Continental Shelf will open up additional federal lands for offshore leasing previously unavailable. The bill also requires that the Interior Department hold at least three more offshore oil and gas lease sales by October 2023. In particular, the bill would reinstate Lease Sale 257, a November 2021 auction of Gulf of Mexico drilling rights that had previously been invalidated by a federal judge because the Interior Department failed to address the climate harms from developing the leases. As reported by the California Independent Petroleum Association, “Under the legislation, the Secretary of Interior is required to accept within 30 days the highest valid bids lodged in that sale, which was set to bring in $191.7 million.” Additionally, offshore Lease Sales 258 and 259, canceled by the Biden administration, will now have to be held no later than December 31, 2022. And offshore Lease Sale 261 will have to be conducted by September 30, 2023. These additional Gulf of Mexico and Alaska lease sales mandated by the bill were originally part of a prior five-year leasing plan, but they never occurred. For the above, the IRA requires offering minimum lease terms of 10 years.

**Increases federal leasing royalty rate**

Under the IRA, federal onshore royalty rates rise from 12.5 percent to 16.67 percent, the first rate change since they were codified under President Woodrow Wilson in 1920. Federal offshore royalties rise from a 12.5 percent minimum to at least 16.67 percent, and no more than 18.75 percent. The lease reinstatement royalty rate rises from 16.67 percent to 20 percent.

The bill also provides that royalties be paid on extracted methane such that for all leases issued after the date of enactment, except as provided as follows, royalties paid for gas produced from federal land and on the Outer Continental Shelf “shall be assessed on all gas produced, including all gas that is consumed or lost by venting, flaring, or negligent releases through any equipment during upstream operations.” The exceptions to these royalty requirements are: (1) for gas vented or flared for not longer than 48 hours in an emergency situation that poses a danger to human health, safety, or the environment; (2) gas used or consumed within the area of the lease, unit, or communitized area for the benefit of the lease, unit, or communitized area; or (3) gas that is unavoidably lost.

**Federal parcel nomination, bid fees, noncompetitive leasing, and rental rates**

The IRA provides for an expression of interest fee in which nominating federal land for potential lease sales would now come at a price of $5 per acre, through a nonrefundable fee that would be adjusted for inflation every four years. Previously, there was no fee imposed for filing an expression of interest to nominate lands for competitive leasing.

The minimum price for bids at auction rises from $2 to $10 per acre for the first 10 years after enactment, with authority retained to raise it further by regulation thereafter. The bill also ends the practice of noncompetitive federal leasing, where previously a noncompetitive lease that failed to sell at a Bureau of Land Management auction would be available for $1.50 per acre.

The fossil fuel annual rental rate is amended from $1.50 per acre to $3 per acre per year during the 2-year period beginning on the date the lease begins for new leases, and after the end of that 2-year period, $5 per acre per year for the following 6-year period, and not less than $15 per acre per year thereafter, or, in the case of a lease issued during the 10-year period beginning on the date of enactment of the Act, $3 per acre per year during the 2-year period beginning on the date the lease begins, and after the end of that 2-year period, $5 per acre per year for the following 6-year period, and $15 per acre per year thereafter. In addition, rentals for reinstated leases rises from not less than $10 per acre to $20 per acre.
Offshore federal wind development

The IRA lifts the moratorium on offshore wind development in the southeastern United States and Gulf of Mexico put in place under the Trump administration. The bill also provides $100 million for offshore wind planning, transmission and development and staffing funding for the Bureau of Ocean Energy Management and the National Oceanic and Atmospheric Administration to expedite permitting and review processes.

Minimum 15% corporate “book tax” for $1 billion or more adjusted income

The IRA imposes a 15% minimum “book tax” on C corporations with annual profits in excess of $1 billion in pre-tax income (based on a three-year income average). This marks a reversal of the Tax Cuts and Jobs Act of 2017 that had previously eliminated the corporate alternative minimum tax. Under the Act, C corporations meeting the income threshold would be subject to the greater of: (1) the current 21% tax on a C corporation’s adjusted gross income, or (2) a 15% tax on a C corporation’s “adjusted financial statement income,” which generally consists of a C corporation’s “book income,” tracking generally accepted accounting principles or “GAAP” accounting with some adjustments. The tax will exempt companies taking advantage of accelerated depreciation used to pay for capital investments, such as expenses for new equipment. C corporations are the standard form of corporate entity, such as publicly traded companies. By contrast, S corporations – to which this provision does not apply – are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes and are more likely held by individual business owners.

According to the Joint Committee on Taxation this book tax will impact approximately 150 American companies and is effective in taxable years beginning after December 31, 2022.

Corporate stock buyback excise tax

The bill enacts a 1% excise tax on corporate stock buybacks and the bill sponsors expect the provision to raise $74 million over a decade. A U.S. corporation whose stock is traded on an established securities market that undertakes share repurchases of more than $1 million in the aggregate per tax year will be subject to the 1% share excise tax on the value of any share repurchase unless such share repurchase is taxed as a dividend. Covered corporations subject to this provision only include publicly traded domestic corporations.

As reported by The Hill, “Share repurchases by S&P 500 companies have soared in recent years and are on track to surpass $1 trillion this year. Companies buy back their stock to reward shareholders and boost their stock price by artificially limiting supply. Democrats have criticized the practice, arguing that companies should instead invest in workers and innovation.”

The excise tax generally does not apply to repurchases in connection with tax-free reorganizations, such as certain mergers, to the extent no gain or loss is recognized by the shareholder “by reason of” the reorganization (although it is unclear how or if this exclusion applies if stock and cash are issued to target shareholders as part of the tax-free reorganization); repurchases of stock, which are contributed to employee-sponsored retirement plans, employee stock ownership plans, or similar plans; repurchases by regulated investment companies or real estate investment trusts; annual repurchases that total less than $1 million in aggregate value (after allowable reduction); and certain repurchases by a dealer in the ordinary course of business.

Hazardous Substance Superfund financing rate excise tax

The IRA reinstates the Hazardous Substance Superfund financing rate, an excise tax on crude oil and certain imported petroleum products at a rate of 16.4 cents per barrel (indexed to inflation) beginning January 1, 2023. The excise tax funds the cleanup of industrial hazardous waste sites. The tax – which
previously stood at 9.7 cents – has not been in effect for 27 years after it lapsed in 1995. A congressional estimate projects that the tax could raise almost $12 billion.

**Increased Internal Revenue Service enforcement**

The IRA provides the Internal Revenue Service (IRS) with $80 billion to increase enforcement, which is expected to net an additional $204 billion in taxpayer money through the hiring of roughly 87,000 new agents over a 10-year period, although not all those new hires will be engaged in audits. According to the official bill summary, the funding includes allocations for operations support, business systems modernization, and the development of a free direct e-file tax return system. To allay fears of mass audits, the Treasury Department and IRS have assured the public that wealthy individuals and corporations – whose audit rates have decreased more sharply in recent years relative to regular Americans – are the intended targets rather than middle class or poorer American taxpayers.

**Renewable and alternative energy tax credits**

The IRA states that it “supports energy security and aims to reduce greenhouse gas emissions through new and modified renewable energy tax credits” which includes extending through 2024 tax credits for (1) producing electricity from renewable resources, specifically for wind, biomass, geothermal and solar, landfill gas, trash, qualified hydropower, and marine and hydrokinetic resources; (2) for investment in certain energy properties (e.g., solar, fuel cells, waste energy recovery, combined heat and power, small wind property, and microturbine property); and (3) for alternative fuels and fuel mixtures, and biodiesel and renewable diesel.

The legislation creates new tax credits for (1) qualifying zero-emission nuclear power produced and sold after 2023; (2) the sale or mixture of sustainable aviation fuel beginning in 2023; (3) the production of clean hydrogen; (4) the production of clean electricity and for investment in zero-emissions electricity generation facilities or energy storage technology; (5) domestic clean fuel production beginning in 2025; and (6) the domestic production and sale of qualifying solar and wind components.

**Carbon sequestration and additional energy tax credits**

The IRA extends and modifies the Internal Revenue Code (IRC) Section 45Q carbon sequestration tax credit for carbon capture use and sequestration (CCUS). Previously under the 45Q program industry that captures carbon from their operations could earn $50 per metric ton of CO₂ stored permanently or $35 if the CO₂ is put to use, such as for enhanced oil recovery. Under the bill, the 45Q credit for CCUS would be set at $17 per metric ton of qualified carbon oxide or, if certain wage and apprenticeship requirements are met, at $85. The 45Q credit is also expanded to include direct air capture and is set at $36 per metric ton of qualified carbon oxide or, if certain wage and apprenticeship requirements are met, at $180.

The IRA would also extend eligibility for the carbon capture tax credit under IRC Section 45Q for an additional seven years to 2033 and would substantially lower the minimum capture thresholds required for carbon capture projects placed in service after December 31, 2022.

The IRA also extends and expands other existing energy tax credits, such as the production tax credit (PTC) and the investment tax credit (ITC) and would restore the tax credit amounts to the previous levels before currently implemented phase downs. Property eligible for the ITC would generally qualify for a tax credit equal to the full 30% of eligible tax basis starting in 2022, while wind and geothermal would be eligible for the full inflation-adjusted PTC equal to the full inflation-adjusted $26 a MWh for 2022, and in each case is subject to the wage and hour requirements. The ITC would also be expanded to include stand-alone energy storage (previously only eligible if charged with solar energy), qualified biogas property and microgrid controllers. Additionally, owners of a solar project would gain the option of claiming PTCs instead of ITCs on projects placed in service in 2022 or later. A corollary 30% tax credit would be available for residential homeowners through 2034 and, like the ITC, would include eligibility for stand-alone energy storage for the first time.
The bill extends the PTC for production of electricity from many types of facilities, including wind, biomass, geothermal, and hydropower, the construction of which begins prior to January 1, 2025. The ITC extension for qualifying facilities, including wind, solar, fiber-optic, thermal, and others, is also extended to 2025 for construction beginning prior to that date.

The availability to sell tax credits is also included in the legislation. As highlighted by the energy law practice group at Pillsbury Winthrop Shaw Pittman LLP, “Historically, with few exceptions, to claim energy tax credits, taxpayers have been required to at least be an owner of the facility, if not both an owner and operator. Ultimately, the entire construct of tax equity is based on the need for a tax investor to hold an ownership interest in the facility. So, the ability for project owners to sell tax credits to unrelated third parties for a cash payment is a significant departure from the current tax credit regime and opens some new and interesting possibilities for developers to monetize tax credits.”

**EPA emissions reduction funding and enforcement**

The IRA provides funding to the Environmental Protection Agency (EPA) to establish a greenhouse gas reduction fund and to support several programs that provide financial incentives to reduce greenhouse gas emissions and other air pollution emissions. These incentive programs, once established, will provide for the monitoring of air pollution and greenhouse gases and reducing methane emissions from petroleum and natural gas systems.

Specifically, $1.55 billion in incentives are provided to reduce methane pollution by reporting, monitoring and mitigating methane. Over half of that will address methane from petroleum and natural gas systems with the remainder directed to marginal conventional wells.

Although the methane charge – noted above – is expected to generate as much as $1.9 billion a year from oil and gas companies, according to the Congressional Budget Office, companies self-report using EPA data sets and models which can lower their fees. In practice, regulators review companies’ emissions disclosures for potential inconsistencies and can ask them to resubmit, but the figures are ultimately the companies’ responsibility, said EPA spokeswoman Shayla Powell. Most of the numbers in oil and gas producers’ emissions reports aren’t based on field measurements. Instead, the companies tally up the equipment they use — like compressors, tanks, valves and flares — and apply EPA formulas to determine estimated emissions rates. Under the bill, the EPA may propose rulemaking to bolster inspections and/or base readings upon actual measurements rather than estimates.

**Pipeline and infrastructure side agreement**

Although not included in the IRA, a side agreement was reached between Sen. Manchin, Senate Majority Leader Chuck Schumer (D-NY), House Speaker Nancy Pelosi (D-CA) and President Biden to advance legislation that includes plans for sweeping changes to federal permitting practices that have slowed down, or blocked entirely, the construction of natural gas pipelines and electric transmission lines. This side deal will allow for the permitting required to finish the stalled Mountain Valley Pipeline – a 303-mile natural gas pipeline set to run from northwestern West Virginia to Virginia – as well as relaxing other environmental reviews for other energy infrastructure projects.

Specifically, the agreement will include plans to limit the ability of states to use “Section 401” water permits to block natural gas pipelines and other infrastructure. It would also set a two-year limit for federal reviews of major energy projects under the National Environmental Policy Act and designate a lead agency to manage those reviews. It also provides that the U.S. Court of Appeals for the DC Circuit would have sole jurisdiction over further lawsuits and would also require a random assignment of federal judges to hear permit challenges for all types of energy projects. Those policies are similar to permitting changes made under former president Trump that at the time won praise from the oil and gas sector.
Although the legislative text for the side agreement has yet to be released, Sen. Manchin has gained assurances that it will be advanced prior to the close of the federal government’s fiscal year ending September 30, 2022.

As always, AAPL members can find this and other legislative, as well as regulatory and judicial, information in our continuously updated Bill Tracking Summary spreadsheet available only to members on AAPL’s website at https://www.landman.org/resources/advocacy-and-legal as well as both current and an archive of past Governmental Affairs reports. And continue to keep an eye on the AAPLConnect Government Affairs Network for breaking information exclusively for AAPL members. The AAPLConnect Member Forum can be accessed here: https://www.landman.org/resources/member-resources/aapl-connect-member-forum.