Inflation Reduction Act: IPAA Analysis on Methane Tax Provisions

Congressional action to create a methane emissions charge as a part of the Inflation Reduction Act will result in numerous actions over the next several years with some potentially significant implications beyond the collection of the emissions charge. Before the methane tax becomes effective in 2025, the Environmental Protection Agency (EPA) will have to propose an array of regulations to implement it. Among the issues that will be addressed is a significant change in the importance of reporting under Subpart W. Subpart W reports will essentially become a taxable event subject to audit by EPA and potential enforcement actions because the methane tax is a part of the Clean Air Act (CAA). This memo reviews the methane tax and presents issues that need to be considered as EPA develops its implementing regulations.

Elements of the Methane Emissions Reduction Program

Following is a review of the key provisions in the methane tax legislation.

1. Two provisions provide for the appropriation of funds for various programs to mitigate and monitor methane emissions. The first provides $850 million. The second provides $700 million specifically directed to marginal conventional wells. However, the term "marginal conventional wells" is not defined.

2. The methane tax is cast as a waste emissions charge. Emissions calculations are based on reporting under Subpart W and utilize its structure.
   - The emissions charge will apply to the owner or operator of an applicable facility that reports more than 25,000 metric tons of carbon dioxide equivalent of greenhouse gases emitted per year pursuant to Subpart W.
   - An applicable facility is a facility within the following industry segments, as defined in Subpart W:
     (1) Offshore petroleum and natural gas production.
     (2) Onshore petroleum and natural gas production.
     (3) Onshore natural gas processing.
     (4) Onshore natural gas transmission compression.
     (5) Underground natural gas storage.
     (6) Liquefied natural gas storage.
     (7) Liquefied natural gas import and export equipment.
     (8) Onshore petroleum and natural gas gathering and boosting.
     (9) Onshore natural gas transmission pipeline.

3. The waste emissions threshold differs across the industry. The tax is imposed on the amount of emissions exceeding a specific threshold related to sales or throughput for different segments of the industry.
   - **Petroleum and Natural Gas Production**
     The threshold is 0.20 percent of the natural gas sent to sale from such facility or 10 metric tons of methane per million barrels of oil sent to sale from a facility, if the facility sent no natural gas to sale. This structure could create equity issues for oil wells with limited amounts of associated gas, but gas that is sold, compared to natural gas wells.
   - **Nonproduction Petroleum and Natural Gas Systems**
     For an applicable facility in an industry segment listed under (3), (6), (7), or (8), the threshold is 0.05 percent of the natural gas sent to sale from or through such facility.
   - **Natural Gas Transmission**
     For an applicable facility in an industry segment listed under (4), (5), or (9), the threshold is 0.11 percent of the natural gas sent to sale from or through such facility.

   Provisions in the tax allow for netting emissions across facilities under common ownership or control.

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4. Some exemptions are included to reduce or eliminate the tax.
   - One exemption relates to emissions resulting from unreasonable delays in environmental permitting of gathering and transmission infrastructure necessary for offtake of gas. However, there is no standard for determining unreasonable delay; it is left to the EPA to make a determination and will require regulations. It seems to apply only to emissions resulting from mitigation implementation, not expanded production. Most of these emissions would likely be flared and thereby become carbon dioxide emissions which are not taxed but they would count toward the 25,000 metric ton threshold.
   - A second exemption relates to compliance with regulations under CAA Section 111(b) and 111(d) regulations. Two conditions must be met. First, regulations under these sections – Subparts OOOO, OOOOa, OOOOb and OOOOc – would have to be approved and in effect in all states with affected facilities. Thus, if one state did not have regulations in place, no exemption would be available. It is unclear whether a federal implementation plan in a state would qualify. Second, those regulations would have to equal or be better than the regulations proposed in November 2021 – Subparts OOOOb and OOOOc – assuming that proposal had been finalized and implemented. Given that little of the November 2021 proposal had any regulatory text, it is difficult to assess how this section could be applied. Similarly, the Subparts OOOOb and OOOOc requirements do not apply to all of the industry segments subject to the methane tax.
   - Emissions charges would not apply to a well that has been permanently shut-in and plugged.
5. The tax will be imposed on emissions from calendar year 2024 and thereafter. The rates are $900/metric ton of methane in 2024, $1,200/metric ton in 2025 and $1,500/metric ton in 2026 and thereafter.
6. The legislation requires revisions to the Subpart W emissions factors and to allow for the use of empirical data no later than 2024. This could alter the current proposed revisions to Subpart W.

There is virtually no legislative history – committee reports, floor statements – describing how these provisions are supposed to be implemented. EPA will have to develop the details of implementation for all of the provisions, propose and finalize regulations prior to 2025 when the first taxes must be submitted.

Implementation Issues

This legislation represents a fundamental shift in raising federal revenues. While much of the attention has been directed toward these provisions as the first enactment of a carbon tax, a more significant aspect is the shift of revenue collection from the Internal Revenue Service to the EPA. EPA is not a tax collecting agency. It has no internal structure to establish taxable events, collect the revenues and audit the validity to the revenue submissions. EPA will have to develop these capabilities.

The role of Subpart W emissions factors will dramatically increase. The current emissions factors are imprecise; they were never developed for their current use much less their use for revenue collection. Even the changes that are being proposed in the current Subpart W revisions do not reach the level of accuracy that would be expected for use as a tax.

However, as a taxable event, all of the determinations in calculating emissions under Subpart W will be extensively scrutinized. Each calculation, each assumption related to the calculation will now be open to audit by EPA regarding its accuracy.

Moreover, any issues regarding accuracy will be subject to possible enforcement. While the current Greenhouse Gas Reporting Program is a standalone operation with limited authority for EPA to question results, this legislation amends the CAA. Consequently, it will bring in all of the enforcement authority of the CAA, including its penalties.

In addition to the revenue matters, EPA will also have to address revisions to the Subpart W emissions factors, the establishment of the grant/loan program, the assessment of the exemption provisions and the definition of terms not imported from Subpart W. All of these will require regulation development by EPA over the next two years. This is a tight time schedule for EPA particularly given its other pending regulatory actions, including completion of the Subpart OOOOb regulations and Subpart OOOOc emission guidelines.