The Guide to Solar Investment Tax Credits

Understand the latest tax credits, evaluate your opportunity, build a solar investing strategy.

Solar Investment Tax Credits 101

Why 2022 is the year to invest in solar.

A new kind of gold rush is upon us, as homeowners, businesses and utilities rush to install solar and energy storage systems using the expanded investment tax credit (ITC) included in the new Inflation Recovery Act (IRA).

How the ITC Works

Who qualifies?

Any homeowner or business with tax exposure is eligible to claim the credit. If you pay federal income tax, you're eligible. If your income tax is minimal, you may still be able to take advantage of the credit via transferability. In addition, recent changes to the ITC allow certain tax-exempt organizations to claim the credit via direct payment.

What if I don't qualify?

Although the Inflation Reduction Act significantly expands the availability of the credit with direct payment and transferability, there may still be a need for alternatives in some cases. One such alternative is called a power purchasing agreement (PPA). A solar project structured as a PPA can claim a credit if the project owner pays taxes, even if the electricity offtaker does not. Many educational and municipal solar projects are structured this way.

The ITC is a critical piece of the puzzle for the investors backing your PPA solar project. They will want to capture as much tax credit as possible to make their investment in your solar project pay back. Get in touch with our financial experts to discuss your institution's options.

How do direct payments work?

Direct payment is a cash payment from the federal government in an amount equal to the tax credit. Tax-exempt nonprofits, state and local governments, Indian tribal governments, Alaskan Native corporations, and rural electric cooperatives can choose this option. Homeowners and organizations with tax exposure cannot choose direct payment. We expect federal guidance on direct payment in the near future.

Key Points

ABOUT THE ITC

The ITC is a federal income tax incentive that allows you to deduct a percentage of the total cost of installing a solar or energy storage system from federal taxes with no cap. The credit includes equipment, wiring, labor, and even battery energy storage systems. It is a critical component in many customers' financial calculations.

ITC RESTORATION

The ITC has been restored in 2022 to 30% with options for "adders" on qualifying projects that increase the ITC amount by an additional 10% or more. A rush on solar is coming...act now to lock in equipment and pricing before demand drives prices up.

HOW DO BUSINESSES USE THEIR CREDIT?

Use your tax savings to grow your business, improve price competitiveness, and increase profits. However you choose to reinvest your tax credit, the savings and other advantages compound over time – giving your company an edge over your competition.

What if I don't have enough tax appetite?

If your business is eligible for the credit and pays taxes, but you don't have the tax appetite to benefit from the full credit in the first year, you still have several options.

As in the past, you can take advantage of **carrybacks and carryforwards**. The tax credit can be carried back one year and carried forward 20 years. If your business still hasn't claimed the full credit after 20 years, you are eligible for a refund equal to half the remaining credit. The rest is lost.

In a new development for 2022 and going forward, the Inflation Reduction Act allows tax credits to be sold to unrelated third parties. This **transferability** feature is meant to create a market for transferable tax credits that will allow homeowners and businesses with insufficient tax exposure to recoup most of the value of the ITC. The sale amount is limited to no more than the value of the credit. We expect additional guidance from the federal government in this area, so stay tuned.

Do energy storage systems qualify?

Yes. Battery energy storage systems qualified under the old ITC if they were installed at the same time as a qualifying solar installation. Now, however, even standalone battery energy storage systems can qualify for the ITC.

Residential battery energy storage systems over 3 kilowatt-hours (kWh) are eligible for a 30% credit through 2032. The credit begins stepping down in 2033.

Commercial systems over 5 kWh are eligible for a 30% credit through 2024. For projects started in 2025 or later, the credit will depend on whether or not the Department of Treasury determines greenhouse gas emission reduction goals have been met.

How do I make sure I get the credit this year?

In 2018 the IRS issued guidance on what exactly is meant by "starting construction" for the purposes of claiming the tax credit. The Solar Energy Industries Association (SEIA) summarized these methods as follows:

"(1) starting physical work of a significant nature (Physical Work Test), or (2) meeting the so-called Five Percent Safe Harbor test (i.e., paying or incurring five percent or more of the total cost of the facility in the year that construction begins)."

In either case, once a project begins, continuous progress has to be made towards completion. We can help with this. One of our specialties is walking our customers through every step of the solar process – including all permits, inspections, and applications needed to ensure you get your tax credit.

Does project size matter?

Yes. The Inflation Reduction Act creates a two-tiered system for commercial solar installations (and other clean energy projects) depending on project size.

Projects with a maximum net output of less than 1 megawatt (MW) AC do not need to meet prevailing wage & apprenticeship requirements to receive the full 30% credit.

Projects with a maximum net output of 1 MW or more must meet the labor requirements to receive 30% credit. All large installations will receive a base credit of 6% with an additional credit of 24% available if the requirements are met.

What are the prevailing wage & apprenticeship requirements?

New prevailing wage and apprenticeship requirements for large commercial projects (over 1 MW) are a significant feature of the Inflation Reduction Act.

Wages for construction and repair must be at least equal to prevailing wages for similar work in the region, as determined by the Secretary of Labor. Details have not yet been released.

Apprenticeship hours must be at least:

- 10% of total hours for projects begun before January 1st, 2023
- 12.5% for projects begun during 2023
- 15% for projects begun after January 1st, 2024

Projects placed in service in 2022, and projects that have already begun construction or will begin construction before the **Act Beginning Construction Deadline**, may qualify for the 30% credit even if they do not meet the prevailing wage and apprenticeship requirements. The **Act Beginning Construction Deadline** is 60 days after the IRS releases guidance regarding the prevailing wage and apprenticeship requirements. The IRS has not yet released such guidance.

What are adders?

The Inflation Reduction Act includes adders that can increase the value of the solar ITC on some clean energy projects. Adders are available for projects that meet certain criteria for project location or domestic content.

Examples of qualifying locations includes projects on brownfield sites or in communities near closed coal mines or retired coal power plants. Domestic content requirements vary depending on the type of clean energy project. Examples include 100% use of domestic steel or iron.

- Project location adders are worth 10% (or 2% if prevailing wage and apprenticeship requirements are not met).
- Domestic content adders are also worth 10% (or 2% if prevailing wage and apprenticeship requirements are not met).
- Up to 10% is available for projects under 5 MW in low-income communities or on tribal lands.
- Up to 20% is available for projects under 5 MW that qualify as low-income residential building or economic benefit systems.

When stacked, these adders could increase the ITC from 30% up to 50% for some projects. However, we caution against relying on adders in financial projections until after the federal government releases additional guidance on this topic.

What about the Production Tax Credit?

The Inflation Reduction Act allows solar projects to elect either the investment tax credit (ITC) or the production tax credit (PTC). This is a significant change – solar projects have not been eligible to receive the PTC since 2006.

The IRA sets the PTC to 2.6 cents per kWh for electricity produced and sold in 2022. This amount will adjust for inflation over time.

Many of the options and restrictions in the ITC are also present in the PTC, including adders, direct payment, transferability, and prevailing wage and apprenticeship requirements for projects over 1 MW. Our financial experts can help your organization decide which credit is best for you.

What about depreciation?

Under the federal tax code, renewable energy systems including solar can take advantage of one of two accelerated depreciation options. Either they can claim 100% bonus depreciation, or they

can use the 5-year Modified Accelerated Cost-Recovery System (MACRS) depreciation schedule. The total depreciation amount will depend on your businesses' tax rate.

Want to take advantage of solar tax credits in 2022?

Start with a FREE solar consultation with our energy experts.

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