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Solar ITC Provisions in the Inflation Reduction Act

The Inflation Reduction Act has passed the Senate and is expected to be voted on by the House on Friday August 12. The version of the bill that passed the Senate provides a long-term extension of the investment tax credit (ITC) for solar, as well as the opportunity for "bonus credits" in certain cases.

The full bill is lengthy and complicated and covers a lot of climate and other issues. The renewable energy tax provisions themselves are quite detailed and complex. This summary will address only the solar ITC provisions. Solar will also be eligible for the production tax credit (PTC) under the bill (as it was prior to 2006), but we will not address those rules here except to note that the basic eligibility requirements are the same for both the ITC and the PTC, but the ITC is earned in full at placement in service (subject to recapture for 5 years) and the PTC is earned as electricity is generated over 10 years.

We will provide additional updates and address other provisions after the bill becomes law.

2025 Will Be a Transition Year

The solar ITC world will change immediately under the new law and will change again in 2025. In short, projects that are placed in service before 2025 will receive a revamped "Traditional ITC," and projects placed in service in 2025 or later (through at least 2032) will be eligible for a new, technology neutral "Clean Electricity Investment Credit" (New ITC).

Extension and Expansion of Traditional ITC

The Traditional ITC is extended for solar projects that begin construction before January 1, 2025 (a 1-year extension). The rate will be 30% or higher for most projects, and the full rate will be based on a base rate, a multiplier, and bonus rates for qualifying projects.

The base rate is 6% for projects that begin construction before January 1, 2025 and 2% for projects that begin construction after December 31, 2024.

The base rate is multiplied by 5 (so 30% or 12% ITC) for projects that meet one or more of the following criteria ("Full ITC Projects"):

- Projects with a maximum net output of less than 1 MW(AC);
- Projects that begin construction within 60 days after Treasury publishes guidance on the prevailing wage and apprenticeship requirements; or

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- Projects that satisfy both (i) prevailing wage requirements during construction and the first 5 years of operation and (ii) apprenticeship requirements during construction.

CONTRACTING ADVICE: Developers should require in their project construction and operating agreements that all contractors will ensure that any applicable prevailing wage and apprenticeship requirements will be satisfied for the project.

The Traditional ITC rate may be increased for projects placed in service after 2022 that satisfy certain requirements:

- *Domestic Content* – For projects that meet specified "domestic content" standards, the increase is 10 percentage points (e.g., from 30% to 40%) for Full ITC Projects and 2 percentage points for other projects;
- *Energy Communities* – For projects located in an "energy community," the increase is 10 percentage points (e.g., from 30% to 40%) for Full ITC Projects and 2 percentage points for other projects, where an energy community is (i) a brownfield site, (ii) an area which has (or at any time since 1999, had) significant employment related to the extraction, processing, transport, or storage of coal, oil, or natural gas, or (iii) a census tract in which (or a census tract directly adjacent to a census tract in which) (A) a coal mine closed after 1999 or (B) a coal-fired electrical generating unit was retired after 2009; or
- *Low-Income Communities* – For projects with a maximum net output of less than 5 MW(AC) and that receive an allocation of the environmental justice solar and wind capacity limitation, the increase is up to 20 percentage points for projects that are part of a qualified low-income residential building project or a qualified low-income economic benefit project and up to 10 percentage points for projects that do not qualify for the 20 percentage point increase and are located in a low-income community or on Indian land.

For projects placed in service after 2022 that have a maximum net output of 5 MW (AC) or less, the Traditional ITC is also allowed for interconnection costs.

In addition, batteries and other energy storage systems with a capacity of 5 kWh or more that begin construction before 2025 and are placed in service after 2022 are eligible for the Traditional ITC whether placed in service as part of a solar project (without regard to how much of the input energy comes from solar) or on a stand-alone basis.

New ITC in 2025

The basic structure of the New ITC is the same as the extended and expanded Traditional ITC, including a base rate, multiplier, and bonus credits on substantially the same terms as the Traditional ITC. Interconnection costs and energy storage facilities are also eligible for the New ITC.

The bill also makes it clear that solar projects and battery or other energy storage systems (but not including, in either case, interconnection costs) placed in service in 2025 or later qualify for 5-year depreciation.

The primary differences between the New ITC and the Traditional ITC are as follows:

- The New ITC is only allowed for projects that have zero greenhouse gas emissions;
- The New ITC phases out beginning two years after the later of (i) the year that nationwide greenhouse gas emissions from the production of electricity are 25% or less of such emissions in 2022 or (ii) 2032 (the "Applicable Year"):
    - ➢ the New ITC is reduced by 25% for projects that begin construction in the second year following the Applicable Year;
    - ➢ the New ITC is reduced by 50% for projects that begin construction in the third year following the Applicable Year; and
    - ➢ the New ITC is no longer available for projects that begin construction after the end of the third year following the Applicable Year; and
- The environmental justice solar and wind capacity limitation is replaced by an environmental justice capacity limitation equal to 1.8 GW(DC) for each year 2025 through the Applicable Year.

Provisions Applicable to Both the Traditional ITC and the New ITC

For projects placed in service after 2022:

- Tax-exempt entities and state and local governments can receive a payment as a tax refund in the amount of the solar tax credits for projects they own; and
- Other taxpayers may directly sell solar tax credits to unrelated entities.

A solar project that begins construction after the date of enactment of the new law and that utilizes the proceeds of tax-exempt bond financing will have the credit amount reduced by the lesser of (i) 15% or (ii) a fraction equal to the amount of tax-exempt bond proceeds divided by the total capital cost of the project.

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We will be tracking the progress of the bill until it becomes law.