Tortoise QuickTake
Clean Energy and Infrastructure Podcast

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, senior members of Tortoise provide a timely update on trending topics in the market.

Hello, I'm Jerry Polacek, Managing Director and Group Lead for Tortoise's Clean Energy and Infrastructure business. Today, we're going to take a look at how a recent Internal Revenue Service notice is expected to boost growth in U.S. solar project development over the next several years.

Before we dive into the recent guidance from the IRS, let me set the stage by explaining the linkage between federal tax credits and the important role that they have played in spurring growth in the U.S. solar market.

The federal Investment Tax Credit for solar was created in 2005 and provides a credit for residential and commercial project owners equal to 30% of the amount invested to develop and construct solar energy projects. On large scale solar projects, the investment tax credit and other tax benefits are typically monetized by tax equity investors such as large corporations and banks. Tax equity investors typically provide over a third of the capital required to bring solar projects online. As a result, the Investment Tax Credit (ITC) is one of the most important federal policy mechanisms to support the deployment of U.S. solar power.

Since its multi-year extension in late 2015, the Investment Tax Credit has been a critical factor underpinning the rapid growth of U.S. solar power. The 2015 extension provided that at the start of 2020, the 30% Investment Tax Credit reduces to 26%, ramping down to 22% in 2021 and finally to a flat 10% for commercial projects in 2022 and beyond. Determining which percentage of credit applies for a solar project depends on when construction begins and when the project is placed in service. The only thing missing in the 2015 extension were clear rules for when solar projects in development begin to qualify for the credit. Tax equity investors were growing cautious about investing as the end of 2019 drew closer, potentially stifling future project development, if left unaddressed. Fortunately, after years of uncertainty, that clarity finally came on June 22nd when the IRS released 'commence construction' guidance (Notice 2018-59) establishing rules for solar Investment Tax Credit qualification.

The new IRS guidance clearly states that if a solar project meets one of two thresholds by an end-of-year deadline, it can still qualify for the credit current in that year. Most importantly, it allows qualifying projects funded with just 5% capital deployed in 2019 a pathway to come online before 2024 and still access the full 30% investment tax credit.

We believe this 'commence construction' IRS guidance is essential to the future development of U.S. solar projects and can help sustain the historical growth of the industry.

To qualify for the 30% investment tax credit under the start of construction guidance, project owners must invest at least 5% of the total expected cost or start significant physical work on the project before the end of 2019.

The Physical Work Test focuses on the nature of the work performed and there is no fixed minimum amount of work or monetary threshold required.

The second method for satisfying the start of construction requirement is referred to as the "5% Safe Harbor." It requires the project owner to incur 5% or more of the costs of the solar project. Developers can achieve the start of construction by purchasing solar modules, installing posts and racking, ordering custom made transformers, or starting construction of access roads.

We see this as positive news for U.S. solar developers, utilities, residential solar installers, and project investors who can now avoid recently imposed tariffs on imported solar equipment that run through 2021 and still access the full investment tax credit. The impact on upstream solar manufacturers is likely to be more mixed as developers are expected to secure partial equipment orders to achieve the 5% Safe Harbor in 2019 but may delay completing those projects until the 2020's. Overall, we believe this policy should help extend the runway for the solar industry to continue bringing down costs and achieve higher cumulative growth in U.S. solar through 2024.

We hope that this podcast shed some light on this important development in U.S. solar. On behalf of Tortoise, I would like to thank you for joining us.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseadvisors.com.

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