

Federal stimulus provides additional solar incentives

BUSINESSES WEIGH OPTIONS INCLUDING DIRECT OWNERSHIP, POWER PURCHASE AGREEMENT

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Business use of solar energy has grown significantly in recent years. A business that owns a building can update for solar by arranging to install on or near the building a rack or assembly of solar panels that are also connected to the local utility.

The building then receives electricity from both the solar panels and the local utility. Some businesses have already made the transition to solar, but most have not. There is a growing appreciation of the social and environmental value of solar energy, but many businesses are not fully aware of the financial incentives.

This article summarizes financial incentives for businesses that are not otherwise involved in renewable energy, including features of the federal stimulus legislation signed by the President earlier this year. This article also provides information on how to take advantage of the incentives.

Identifying the incentives

The long-term financial incentive for businesses to install solar facilities on their property is that the cost of electricity will be less than what the cost would have been without the solar facility. The short-term financial incentives include:

Federal tax credit now available as a grant. The owner of the solar panels and other solar equipment can claim a credit against its federal tax liability generally equal to 30 percent of the solar equipment cost. As a result of the recent stimulus legislation, the owner now has the option to receive, instead of the tax credit, a cash grant in the same amount.

The grant is not included in the owner's gross income for federal income tax purposes. The Treasury Department is to pay the cash grant within 60 days of the date on which the solar equipment is installed or the date the owner submits an application, whichever is later. Installation must occur prior to 2011. The grant is not available to government entities and nonprofit corporations, and it must be repaid to the federal government if the owner sells or transfers its interest in the solar equipment within 5 years of installation.

Depreciation. A portion of the solar equipment (approximately 85 percent) qualifies for depreciation deductions over a six-year period, with an additional 50 percent first-year bonus depreciation available for 2009.

Rebates. The State of California, through the California Solar Initiative, has required that regulated utility companies provide to their electricity customers either an up-front payment based on expected use (for smaller solar facilities) or periodic payments over a five-year period based on actual use (for larger solar facilities). In addition, municipal, county and local utility company rebates may be available.

Realizing the benefit of the incentives

The short-term financial incentives can offset most of the up-front cost of a solar facility.

However, government entities, nonprofit corporations and even some for-profit businesses cannot realize the full value of the tax credit and the depreciation deduction. This is due to certain tax limitations (known as the “at risk” and “passive loss” rules) and the fact that realizing the full benefit of credits and deductions requires sufficient taxable income.

In recent years, a market developed for institutional investors (who are not subject to the “at risk” and “passive loss” rules) to provide discounted electricity through solar facilities that are effectively owned by the investors.

A government entity, nonprofit or for-profit business that owns its building can enter into a power purchase agreement with a solar provider. The building owner agrees to purchase solar-produced electricity from the solar provider at pre-set rates, which are less than current market rates. Since the building owner does not own the solar panels, this arrangement often does not involve any up-front cost to the building owner.

The building owner provides access to the area where the solar panels are located, through a lease or license agreement, and the solar provider agrees to design, install and maintain the equipment. The solar provider contracts separately with institutional investors to allocate to them tax credits and depreciation deductions.

The power purchase agreement requires a long-term commitment, typically 15 to 20 years. For general information on the choice between direct ownership and power purchase agreements, go to <http://www.californiasolarcenter.org/sppa.html>.

Due to the current credit crisis and the overall downturn in the economy, the number of active institutional investors for solar tax incentives has decreased significantly. This has led to limited availability of power purchase agreements for certain businesses.

The recent stimulus legislation addresses this issue by providing an option to receive, instead of the tax credit, a cash grant in the same amount as the tax credit. More businesses can directly realize the benefit of a grant than a tax credit, so direct ownership will in some respects be more attractive.

However, a power purchase agreement with the building owner not owning the solar panels may still be necessary to realize the benefit of depreciation deductions.

There are still active solar providers that partner with institutional investors. “We are open for business,” said David Kunhardt, director of partnership finance at Solar Power Partners, a Mill Valley developer and power purchase agreement provider, www.solarpowerpartners.com.

“We are particularly interested in working with school districts, universities, hospitals, airports, water districts and businesses that have maintained a strong credit rating. We just finished 19 large projects worth \$70 million.”

The choice between direct ownership and power purchase agreements will be informed by circumstances that are specific to each business. Now is the time for businesses to review their options with advisers and consultants. During the coming months, the federal government and industry participants will work through the details of the grant program. Once program procedures are in place, businesses that have already started to evaluate their solar options will be well-positioned to take advantage of the financial incentives.

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