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RENEWABLE ENERGY ALERT

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New Solar Tax Property Guidelines

The State Board of Equalization today issued draft guidelines to local property tax assessors for application of the changes to the solar property tax exclusion under the recently enacted Assembly Bill X1 15 ("ABX1 15").

The Board's draft guidelines generally adopt taxpayer favorable positions, including clarification that the exclusion is not lost when a system is transferred during construction and that construction in progress qualifies for the exclusion. However, the guidelines leave certain major issues unresolved. We would be happy to work with our clients in developing comments and suggestions to resolve remaining open issues.

For more information, please contact us.

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Background

By way of background, as a general rule all California property is subject to property tax a rate in excess of 1% per year on its current value. Under proposition 13, passed in 1978, the California Constitution was amended to provide that for property that is real property, it may be assessed at current value only upon one of two events: a change in ownership or upon new construction. Under proposition 7, passed in November 1980, the State legislature was authorized to provide an exclusion for solar assets from the new construction trigger for property tax. (There was no explicit authorization to provide an exclusion on a change in ownership.) Section 73 of the Revenue and Taxation Code was enacted to give effect to this proposition.

The new construction exclusion under section 73 did not prevent property taxation if a tax monetization structure such as a sale/leaseback or partnership flip resulted in a change in ownership. (A change in ownership occurs on sale of the property or there is a direct or indirect transfer of more than 50% of the profits and capital interests in a legal entity owning the property.) Accordingly, a sale/leaseback of the project or a sale of more than 50% of the entity owning the project would cause the property to be subject to the annual property tax. This would not pose a problem if tax-oriented investors were willing to invest prior to commencement of construction, but these investors typically do not want to take construction risk and therefor want to invest only upon completion. If they invest at that time, there would be a change in ownership and the solar asset would become subject to property tax.

ABX1 15 was intended to change that result by providing that the legislature intends that a purchaser can rely on the solar exclusion. However, the language of the bill was flawed in many respects, principally because it provides that a purchaser can rely on the exclusion only in circumstances where "another taxpayer has not received an exclusion" for the same solar property. Under applicable property tax rules, newly constructed property is assessed on the earlier of the January 1 lien date or completion of construction of the property. This has led to three problems:

1. In situation where construction commences prior to January 1 and the tax monetization transaction occurs thereafter, the project company would technically have received the exclusion at the time of the sale to the investor. Accordingly, under a literal reading of ABX1 15, the solar exclusion would be lost at the time of the tax monetization transaction as the project company had previously received an exclusion.

2. For federal purposes, a sale/leaseback transaction can be completed within 3 months of the property's placed in service date and the purchaser/lessor will still be entitled to the investment tax credit or Treasury cash grant and bonus depreciation. However, upon completion, the project company would be entitled to the exclusion and thus the purchaser/lessor who buys after completion would not be entitled to the exclusion.

3. There is no definition of the appropriate unit of property for purposes of determining when the date of completion occurs. Typical utility scale PV solar projects consist of blocks or phases and it can be argued that the relevant completed property is each block or phase of PV panels.

Draft Guidelines

The draft guidelines resolve the first problem. They provide that the exclusion is not lost on transfer until a taxpayer receives the exclusion on a system on which construction has been completed and, moreover, construction in progress on the lien date would qualify for the exclusion.

The draft guidelines do not directly address the second problem, though the statement that the exclusion is lost on a transfer after the system is complete implies that a purchaser/lessor in a sale/leaseback will have the exclusion only if it buys before the property's placed in service date.

As to the third problem, the draft guidelines provide no definition of the relevant unit of property for purposes of determining when that unit of property is complete.

Where we go from here

The Board will review comments it receives from interested parties and post a matrix of those comments to the Board's website by January 6, 2012 and an interested parties meeting is scheduled for January 26, 2012 to discuss these comments.

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