

California Clarifies Property Tax Exclusion for Solar Projects in Partnership Flips

WRITTEN BY

[Adam C. Kobos](#) | [Roger S. Reigner Jr.](#) | [Mitchell T. Emmert](#) | [Anne C. Loomis](#) | [Judy Kwok](#)

On September 30, California Governor Gavin Newsom signed Senate Bill 267 (Bill) into law, preserving the property tax break (the solar exclusion) for partnership flips that own solar energy projects. Under the Bill, the solar exclusion will continue to apply after the investor's initial investment in the partnership and after subsequent changes in capital and profits interests that arise before or in connection with the flip.

Background: Partnership Flips

The Bill defines a "partnership flip transaction" as a financing arrangement that meets the following requirements:

- (A) A developer of an active solar energy system and one or more unrelated parties enter into the financing arrangement.
- (B) As part of the initial transfer, the unrelated party or parties agree to provide a capital contribution, or a series of contributions, to a partnership or LLC in exchange for, on a cumulative basis, an interest in a majority of the tax attributes, such as federal tax credits, depreciation, and a majority of either, or both, the capital and profits of the entity.
- (C) The unrelated party or parties receive the tax attributes until the party or parties achieve a preestablished yield or until after a preestablished period of time, at which time, the tax attributes are reduced, and the developer obtains a majority of both the capital and profit interests of the partnership or LLC.

This definition covers most transactions colloquially referred to as "partnership flips."

Background: Solar Exclusion

Solar projects are generally classified as real property for California property tax purposes. Under California's property tax limitation system known as "Proposition 13," the growth in the full cash value of property is limited to an inflation factor based on the California Consumer Price Index or 2%, whichever is less, except that real property generally is revalued when there is a change in ownership and when new construction is placed on the roll. For Proposition 13 purposes, changes in ownership include situations where a person obtains ownership of more than 50% of the total interests in capital and more than 50% of the total interests of profits of a partnership or LLC.

The property tax benefit for solar projects is an exclusion from the definition of “new construction.” Because there is no corresponding exclusion from the definition of “change in ownership,” the solar exclusion generally is lost when there is a subsequent change in ownership of the solar project, subject to certain exceptions described below.

In 2011, Assembly Bill AB X1 15 clarified that it was the legislature's intent that the solar exclusion remain available to the purchaser in a partnership flip or sale-leaseback, and the exclusion remains in effect only until there is a subsequent change in ownership.

In 2012, the California Board of Equalization (BOE) issued [Guidelines for Active Solar Energy Systems New Construction Exclusion](#), No. 2012/053 (2012) (Solar Guidelines), which provided additional guidance concerning the 2011 legislation. The Solar Guidelines stated that the investor's investment in a partnership flip structure would not cause a reassessment, but subsequent acquisitions of a majority interest by the sponsor or another party potentially could cause a reassessment.

Recently, some county assessors have determined that reassessments occur pursuant to partnership flip transactions. In its opposition to the Bill, Kern County stated that “... consensus among assessors is that the flip does constitute a change in ownership under California law ...” and that “[I]arge-scale commercial solar projects in California currently do not pay their fair share of property taxes due to the existing Solar Tax Exclusion.”

The Bill

The Bill preserves the solar exclusion in situations where a partnership flip could otherwise constitute a change in ownership for purposes of Proposition 13. The Bill adds new Section 64.1 to the California Revenue and Taxation Code, which states:

[I]n the case of a legal entity that owns an active solar energy system pursuant to a partnership flip transaction, neither an initial transfer of a capital and profits interest in the legal entity, nor any subsequent change in the allocation of the capital and profits of the legal entity among the members, shall be deemed to constitute a transfer of control of, or of a majority interest in, the legal entity.

Accordingly, the Bill ensures that the solar exclusion will remain available from the formation of the partnership through (and after) the flip date, notwithstanding that the sponsor's and investor's interests in profits and capital can change upon the formation of the partnership, during the pre-flip period, and upon the flip.

In addition, the solar exclusion should continue after the sponsor's exercise of a purchase option after the flip date. Section 64.1 does not explicitly address the impact of the exercise of the purchase option in connection with the flip, although Sections 64.1(c) and (d) clarify that the exclusion described above does not apply to sales or exchanges of ownership interests that are separate and apart from a partnership flip transaction. However, in most partnership flips, if the option is exercisable after the flip date, the sponsor already will have a greater than 50% interest in both profits and capital and therefore will not acquire a greater than 50% interest in profits and capital as a result of the purchase option.

Observations

The Bill is a welcome development for California solar projects. Sponsors and investors should now have additional certainty that the solar exclusion generally will remain available after the formation of the partnership and through the subsequent changes in allocations and capital and profits interests pursuant to the partnership flip.

Further, because typically the sponsor already will have a greater than 50% interest in both profits and capital upon the flip, the solar exclusion generally should remain available following the exercise of a purchase option after the flip date.

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