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California's Real Property Tax Exclusion for Solar Projects

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After receiving numerous inquiries, the California Board of Equalization (BOE) recently issued proposed guidelines for administering a statutory exclusion from real property tax assessment for active solar energy systems constructed on building rooftops or on land. The guidelines should settle months of industry uncertainty over the availability of the exclusion for new solar projects where the form of permanent financing is a sale-leaseback or a partnership flip.

Certain active solar energy systems are eligible for an exclusion from California property tax if they are "newly constructed" and have not undergone a "change in ownership." The BOE takes the position that a sale-leaseback of property constitutes a change in ownership of that property.

Amendments to the legislation in August 2011 were intended to clarify that a sale-leaseback of a newly constructed solar project that is installed as an addition to an existing structure qualifies for the exclusion where the existing structure is not also sold and leased back. In response to the solar community's call for confirmation of the legislative intent, the BOE on October 13, 2011, issued proposed guidelines on the application of the active solar energy system new construction exclusion.

The guidelines provide county assessors' staff, assessment appeals board members, and taxpayers with information about the exclusion. The text of the guidelines is available here and the August 2011 legislative amendment is here**.**

Background

All real and personal property is generally subject to *ad valorem* property taxation in California, unless a specific exemption applies. The tax is assessed annually, generally at 1% of assessed value. The valuation assessment rules vary depending on whether the property is classified as real or personal property.

In the case of "real property," increased assessments and the applicable rate are limited under Article XIII.A of the California state constitution. Real property generally cannot be reassessed above the year-of-acquisition valuation (plus an inflation factor) unless a "change in ownership" or "new construction" occurs with respect to the property. In the typical case of real estate, reassessment is triggered when the property changes hands (new owners) or when there is value added to existing property through new construction (e.g., an addition or renovation to an existing building or an improvement to land).

For California property tax purposes, "real property" includes not only land and buildings, but also "fixtures." "Personal property" generally means everything other than real property. In determining whether property is taxable as a fixture, courts generally look to its degree of "permanence" and the manner in which it is attached to the building.

It has been the BOE's informal policy to treat PV solar installations as "real property," and this position is formalized in the guidelines. As real property, PV systems generally were subject to assessment if they were "newly constructed" or a "change in ownership occurred." In order to encourage the installation of newly constructed solar systems, the California legislature adopted a specific exclusion from California real property tax for "active solar energy systems."[1]

However, the exclusion was worded so that while "newly constructed" PV systems were protected from reassessment, they were still subject to reassessment upon a "change in ownership." Questions immediately arose concerning whether a "change in ownership" occurs when a qualifying solar project is incorporated into a newly constructed building. Does the installation of qualified PV systems on newly constructed homes and buildings result in reassessment of the existing property when the builder sells the home to its first buyer? Similar questions arose in the context of newly constructed distributed generation projects that are financed upon completion with a sale-leaseback or partnership flip.

In 2008, the California legislature adopted A.B. 1451, amending the statutory exclusion for solar projects. What prompted the change was this: home builders delivering newly built homes equipped with built-in PV solar systems that otherwise qualified for the exclusion were concerned that the original sale of the home to the first buyer would constitute a "change in ownership" of the PV system, and preclude the exclusion from applying to the portion of the home's cost attributable to the PV system.

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The legislation provides that where an active solar energy system is incorporated by the owner-builder in the initial construction of a new building that the owner-builder does not intend to occupy or use, the sale of the building to the initial purchaser will not be treated as a "change in ownership" and the solar system qualifies for the exclusion from tax as new construction. The exclusion applies to the initial purchaser of the new building, so long as the owner-builder did not receive the exclusion for the same system. Similar rules were enacted for residential subdivisions.

As is demonstrated by A.B. 1451, the change in ownership rules were not intended to apply to brand new property, but rather to property that has had the opportunity to appreciate in value without reassessment over a period of years. Thus, a new PV installation should not be subject to reassessment until the project or the underlying property changes ownership after the initial sale-leaseback or transfer in connection with a partnership flip. However, A.B. 1451 did not address the question about sale-leasebacks and partnership flips.

Sale-Leasebacks and Partnership Flips

The industry sought clarification from the BOE that a new rooftop or ground-mounted PV system did not lose its eligibility for the new construction exclusion as a result of being financed with a sale-leaseback or a partnership flip. The industry also sought a clarifying amendment to the legislation. In August 2011, the California legislature adopted Assembly Bill ABX-1 15, the second amendment to the solar exclusion.

The bill provides that "…newly constructed active solar energy systems are often sold or transferred in sale leaseback arrangements, partnership flip structures, or other transactions to purchasers that may also be eligible for federal tax benefits" and "[a]s long as the active solar energy system is newly constructed or added and another taxpayer has not received an exclusion for the same active solar energy system, it is the intent of the Legislature that the purchaser of the active solar energy system in a transaction such as that described above receive an exclusion…." The new guidelines confirm, "this legislation ensures that newly constructed active solar energy systems transferred using sale-leaseback and similar arrangements that require the solar system itself, but not the real estate on which it is situated, to be sold or transferred to a third party, will continue to receive the property tax exclusion."

The bill clarifies that the exclusion remains in effect until there is a "subsequent" change in ownership. The guidelines identify several instances where a "change in ownership" will trigger a reassessment. In the context of equipment that is subject to a lease commencing at the time of installation, the system is excluded from the definition of new construction at the time of installation, and continues to be excluded from assessment until a change in ownership of the system occurs. At the end of the lease term, extension of the lease for an additional period will not trigger assessment. If the lessee purchases the system before or at the end of the lease term, such purchase terminates the new construction exclusion and makes the system assessable. If the lessee exercises no purchase option, the system is returned to the lessor at the end of the lease, and removed from the lessee's property. The guidelines confirm that the removal will not result in any change to the assessed value of the "host" property.

The guidelines do address partnership flips as specifically as they do sale-leasebacks. In a sale-leaseback, the transfer to which the exclusion applies is the sale to the lessor (immediately before the property is leased back). In the partnership flip context, the transfer that the exclusion prevents from triggering reassessment is the transfer of an interest in the solar project by the developer to the newly created partnership with the "tax equity" investors. Presumably, the property continues to be excluded from assessment until a change in ownership of the system occurs.

To qualify for the exemption where a system is sold in a sale-leaseback or a partnership flip, the lessee (or developer in the case of a partnership) must not have been entitled to or received an exclusion from property tax for the system, because in that case the owner-lessor (or partnership) would not be entitled to a second exclusion. In the context of a partnership flip, the partnership would be ineligible for the exclusion if the developer has claimed it before transferring an interest in the system to the partnership. The bill does not specify any procedure for demonstrating that there is no "double dipping" except in the case of a newly constructed building that incorporates a solar system. In this context, the bill provides for the filing of a certificate by a new building contractor, indicating that it does not intend to own or occupy the property.

However, the guidelines provide that a property owner who adds an active solar energy system to an existing structure is not required to file for the exclusion. The guidelines state that the exclusion should be automatically granted when the county assessor receives a copy of the building permit. Theoretically a notice may be appropriate in ground-mounted situations, including parking structures built on land, but, in all cases, a certificate from the lessee (or developer) to the effect that it has not and will not claim an exclusion should be sufficient to comply with the bill.

Leasehold Interests in Government Property

The guidelines clarify that systems installed on leased land or leased building rooftops are also eligible for the solar exclusion. However, when a lease involves a government-owned land or building, a taxable possessory interest in the real property is created and will be valued and assessed. In the context of a sale-leaseback, there may be government-owned land or building rooftop space leased to the solar project owner-lessor. If there is a corresponding lease of the land back to the solar project lessee, for a term and for rents that match those of the ground lease, there may be little or no value attributable to the possessory interest granted in the ground lease.

Retroactive Effect and Sunset

The solar system exclusion applies retroactively to all eligible projects completed on or after January 1, 2008. It is estimated that between 2008 and 2010, approximately $1.5 billion in value of new active solar systems were installed in California, and may be eligible for the exclusion. All solar systems eligible for exclusion on January 1, 2017, will continue to be excluded after that date until a change of ownership occurs. The bill's provisions sunset prospectively on January 1, 2017.

County or State Assessment

Only solar systems assessed at the county level can qualify for the solar exclusion. State-assessed property is not subject to the solar exclusion and is assessed at fair market value annually on the lien date. By law, state assessment is required if the facility has a generating capacity of 50 megawatts or more; and is owned by a company which is an "electrical corporation." An electrical corporation does not include production of solar power for one's own use, or the use of one's tenants, or the sale to not more than two corporations or persons for use on the real property on which the power is generated, or, in some instances, the land immediately adjacent. Most distributed generation PV solar projects are such "behind the meter" projects, providing power to one "host" customer under a lease or a power purchase agreement, solely for the use by the host on the real property on which the power is generated (i.e., on a building rooftop or on land located on or near the building site.) Owners of these projects are not "electrical corporations" as defined in the statute and therefore are county assessed and may qualify for the solar exclusion.

Request for Comments

The guidelines are issued in proposed form and the BOE has invited public comments. Suggested revisions or comments on the guidelines should be submitted to the BOE by November 23, 2011, to Mr. Michael McDade at

PO Box 942879, Sacramento, CA 94279 or Michael.mcdade@boe.ca.gov. Comments received from interested parties will be posted to the BOE Web site on January 6, 2012. Final guidelines are expected shortly thereafter. All documents regarding the guidelines are available here.

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[1] Cal. Rev. & Tax Code § 73; Cal. Const., Art. XIIIA, § 2(a). An "active solar energy system" is a system that uses solar devices, which are thermally isolated from living space or any other area where the energy is used, to provide for the collection, storage, or distribution of solar energy. The statute clarifies the definition to mean a system that, upon completion of the construction of the system as part of a new property or the addition of a system to an existing property, uses solar devices to provide for the collection, storage, or distribution of solar energy. Eligible systems do not include solar furnaces, hot water heaters, swimming pool heaters, hot tub heaters, passive energy systems, or wind energy systems. Only equipment used up to, but not including, the transmission stage is eligible for the exclusion.

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