CleanReit partners llc

November 23, 2011

Mr. Michael McDade

State Board of Equalization

Property Tax and Special Taxes Department

450 N. Post Street

Sacramento, CA 94279-0064

Dear Mr. McDade:

The Board of Equalization has asked for suggested alternate text to the document titled "GUIDELINES FOR ACTIVE SOLAR ENERGY SYSTEMS NEW CONSTRUCTION EXCLUSION" DATED OCTOBER 2011" (http://www.boe.ca.gov/proptaxes/pdf/lta11039.pdf).

The first section of this note discusses problems with the language in this document so there is a context on the suggested alternate text. The second section of this note suggests specific language changes. Since we are not experienced writers of legislation, we are interested in any language that addresses the problems. Our suggested alternate text is just one such alternative.

1. Background

Partnership flips, sale-leasebacks, and other tax-driven financing transactions are structured to take advantage of safe-harbors within the federal tax law. These safe harbors involve multiple-step transactions that bring a tax investor into a financing, and enable him to exit the financing after monetizing federal tax benefits[1].

The legislature specifically passed a new law in 2011 (ABx1 15) to preserve the new construction exclusion in the case of these tax-driven financings. Therefore, the draft should indicate that the exemption applies during all steps of the tax-driven (flip/leaseback/etc.) transaction.

[1] For background information on these structures, see "Ownership Structures" at http://www.novoco.com/events/retc/san_francisco/2011/manual/presentations/precon/SF%202011%20-%20Ownership%20Structures%20Rev1%20%282%29.pdf.

As written now, the BOE interprets ABx1 15 to create an explicit tax obligation on solar financing firms during the middle of each tax-driven transaction (e.g., at the time of the flip or during an interim transfer between financial/tax investors in a transaction). This implementation of the law is exactly opposite the legislative intent. No law was needed last July for such an interpretation. The BOE's proposed implementation draft would be analogous to offering "free admission" to attendees of a baseball game, but then requiring payments to watch the intermediate innings after receiving "free admission" for the first inning only.

There are two problems with the draft:

(a) Partnership Flip: The BOE draft would institute a property tax obligation on solar investors as of the date when any partnership flipped ownership from 99/1% to 5%/95% in keeping with the Federal Rev. Proc. 2007-65 safe harbor.

(b) Securitization of Flip or Sale-Leaseback Equity: The same problem would apply to sale-leaseback or partnership flip transactions that are transferred into a securitization structure consistent with the safe harbor in Section VII of the U.S. Treasury Guidance for the 1603 energy grant[2] (See: http://www.treasury.gov/initiatives/recovery/Documents/B%20Guidance%203-29-11%20revised%20(2)%20clean.pdf). Even though this transaction is purely part of a multi-step financial transaction, where the New Construction Exclusion was intended to be preserved, the draft as written would eliminate the exclusion mid-transaction as well. This creates a financial burden for partnership flip or sale-leaseback investors who entered transactions with intent to securitize their equity into a publicly traded entity.

Under the current interpretation of ABx1 15, it would be impossible to follow the applicable federal tax safe-harbors and maintain the new construction exclusion that legislators intended without burdening the project with a reassessment due only to financing structure.

[2] Section VII states: "Selling or otherwise disposing of the property to an entity other than a disqualified person does not result in recapture provided the property continues to qualify as a specified energy property and provided the purchaser of the property agrees to be jointly liable with the applicant for any recapture." It was drafted to support securitization of these assets so that public stock investors could provide project finance to solar and other renewable energy projects.

We believe that the recent ABx1 15 legislation was intended to maintain the New Construction Exclusion through the full life cycle of a Solar System's Partnership Flip, Sale-leaseback, securitization, or other steps in the financing—not just during the first step within that transaction. This life cycle should include the various ownership changes that happen in keeping with safe harbors needed to monetize tax equity unless or until:

(a) Solar System ownership transfers, in whole or in part, to the Real Property Owner upon whose property the solar was constructed (whether that transfer occurs explicitly or implicitly pursuant to Civ. Code, § 1013); or

(b) the system reaches the end of its useful life; or

(c) the underlying Real Property upon whose property the solar was constructed is sold; or

(d) the Solar System is upgraded, replaced or removed from the Real Property by its financial investor/owners.

2. Specific Alternate Text Recommendations.

(a) Page 3, Lines 16-19 should be changed to read:

"California Civ. Code, § 1013 states that: 'When a person affixes his property to the land of another, without an agreement permitting him to remove it, the thing affixed, except as otherwise provided in this chapter, belongs to the owner of the land, unless he chooses to require the former to remove it or the former elects to exercise the right of removal provided for in Section 1013.5 of this chapter.'

Thus, when a typical solar energy system is owned by a third-party required to remove said system at the end of a financing transaction, or upon demand, then the intent of the parties is such that solar is personal property, not subject to the exclusion. Otherwise, a typical active solar energy system is considered a fixture, and thus real property, if it meets the tests outlined above.

Additionally, the exclusion is not applicable to portable active solar energy systems since they are items of personal property.

(b) Page 9, Line 17

"Systems that are installed on leased land or leased building rooftops are also subject to the new 16 construction exclusion, and are not assessable until:

a. Solar System ownership transfers, in whole or in part, to the Real Property Owner upon whose property the solar was constructed (whether that transfer occurs explicitly or implicitly pursuant to Civ. Code, § 1013); or

b. the system reaches the end of its useful life; or

c. the underlying Real Property upon whose property the solar was constructed is sold; or

d. the Solar System is upgraded, replaced or removed from the Real Property by its financial investor/owners.

(c) Page 10, lines 23-28

"A change in ownership between a legal entity that received Federal Tax Credits and/or 5-year MACRS accelerated depreciation (e.g., federal tax incentives that are more favorable than normal federal tax treatment for non-solar assets) and any other third party (not eligible for any such federal tax incentives), would terminate the new construction exclusion for the active solar energy system.

Also transfer between such a legal entity and the underlying land or building owner would also terminate the new construction exclusion."

(d) Page 11, line 13:

"Except in the case of any financing transaction (defined as those transactions where the active solar system acquirer receives federal tax incentives subject to a federal safe-harbor[3]), there are two exceptions to this general rule…."

Sincerely,

Bill Hilliard

[3] Examples of such safe-harbors might include (a) Section VII of the Treasury Guidance for Section 1603 of the American Recovery and Reinvestment Act of 2009 and (b) Revenue Procedure 2007-65, among others.