

August 17, 2012

Sherrie Kinkle
California State Board of Equalization
Property and Special Taxes Department
450 N Street
Sacramento, CA 94279
Via E-mail: slkinkle@boe.ca.gov

RE: Second Draft of the Guidelines for Active Solar Energy Systems New Construction Exclusion

Dear Ms. Kinkle:

With great respect, we are providing comments to the second draft of the *Guidelines for Active Solar Energy Systems New Construction Exclusion*.

The proposed revisions are intended to clarify that a "flip" in a partnership flip does not cause a change in ownership.

IN-LINE TEXT REVISIONS

"A partnership flip transaction is a financing arrangement between a renewable energy developer and a single or multiple tax investors whereby the parties form a partnership or limited liability company to develop own a solar energy system. This structure involves the tax investor making an investment in the partnership or limited liability company in exchange for the majority of the tax items~~economic benefits in the form of (1) (federal tax credits, 2) depreciation and net income (including depreciation)) until (3) sale of electricity. When the investor achieves its pre-established yield. The manner in which partners share net cash flow will vary from one transaction to another. The investor's share of tax items and net cash flow is reduced when it reaches a target return. This reduction is~~the economic ownership will known as the "flip." to the developer.

~~If the initial investment made by the tax investor causes it to own more than 50 percent of the capital and profits interests of the partnership or limited liability company, the change in control is~~The exclusion for new active solar energy system is not extinguished by (1) the formation of a partnership with an investor that will be paid back, in part, with tax benefits, (2) the flip in such a partnership or (3) any buyout of an investor in such a partnership excluded by the new construction exclusion and no reassessment of the active solar energy system will occur. There is no assessment of the active solar energy system in any of these cases because a partnership flip transaction merely is a financing where the investor is repaid in part with cash and in part with tax benefits.

~~However, when the ownership "flips" to the developer, a change in control is caused if the developer obtains more than 50 percent of the capital and profits interests of the partnership or limited liability company. If the flip transaction does not result in one party obtaining more than a 50 percent interest in the capital and profits, it will not cause a change in control and~~

~~no reassessment of the active solar energy system will occur.~~ However, if any third party ~~subsequently~~ obtains more than a 50 percent interest in the capital and profits, a change in control and reassessment of the solar energy system will occur."

RATIONALE

The Legislature acknowledged that partnership flip transactions are financing arrangements. This legislative intent is not implemented in full if the formation of a partnership flip transaction is treated as a financing, but the unwinding of that transaction is not. In addition, the "flip" is not a "transfer," which is required to cause a reassessment under the current regulations. The flip occurs pursuant to the terms of the partnership agreement the investor signs when it becomes a member.

That is, a change in ownership does not occur on the way out, if it did not occur on the way in.

However, if the Board determines instead that a "flip" is a transfer, it is unclear how to determine whether a person "obtains" more than 50% of the capital and profits due to the transfer.

As a threshold matter, the rules do not define either "capital" or "profits" interests. A good way to determine a person's capital interest in a partnership would be to look to what the partner would receive based on a hypothetical liquidation in accordance with the partnership's capital accounts at the time of the transfer at issue. Profits are a little harder to gauge. They can be judged as a snapshot on a particular day or as an average over the life of the project (typically 35 years). Given the transitory nature of a partnership flip, it seems appropriate to look at the average.

Secondarily, it is unclear what it means for someone to "obtain" something due to the transfer. If the developer has more than 50% of the capital immediately before and after the transfer, but its share of profits changes with the flip, is that a transfer, especially if it started out with 100% of the profits and never intended to relinquish more than a minimal profits share (except for the short period before the flip occurs).

In a typical partnership flip, the developer has more than 50% of the partnership's capital immediately before it forms the partnership with the investor and more than 50% immediately before or after the flip. That suggests that no change in control would occur due to the flip.

Thank you for the opportunity to further comment on the draft Guidelines. We would be happy to discuss our suggested revisions with you and other staff at your convenience.

Sincerely,

Stephen Cinoski

NRG Energy, Inc. – Tax Department