August 17, 2012

Via E-mail: slkinkle@boe.ca.gov

Sherrie Kinkle
California State Board of Equalization
Property and Special Taxes Department
450 N Street
Sacramento, CA 94279

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

Dear Ms. Kinkle:

We have reviewed the second draft of the *Guidelines for Active Solar Energy Systems New Construction Exclusion*. SolarCity submits these comments to propose revisions to the Board's rewrite of the Guidelines prompted by the discussions at the January 2012 meeting and comments received on the initial draft.

Our suggested revisions would clarify that a "flip" in a partnership flip does not cause a change in ownership. The revisions are shown in "track changes" format below.

A. SOLARCITY'S PROPOSED REVISIONS TO THE SECOND DRAFT OF THE GUIDELINES

"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 and/or 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 attributes~~economic benefits in the form of (1)~~ (i.e., federal tax credits,~~2)~~ depreciation and net income) until ~~(3) sale of electricity. When~~ the investor achieves its pre-established yield. Depending on the deal the investor may receive the majority of net cash flow from electricity sales or lease revenues during that period, but this is not universal. The investor's share of these items is reduced when it reaches its target yield. This reduction is~~the economic ownership will~~ known as the "flip." ~~to the developer.~~

Since a partnership flip, in essence, is a financing where the investor is repaid in part with cash and in part with tax benefits, none of (1) the formation of a partnership flip partnership, (2) the flip in such a partnership or (3) any buyout of a tax investor in such a partnership is a change in ownership. Thus, ~~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 value of a new active solar energy system owned by such a partnership is excluded by the new construction exclusion and no reassessment of the active solar energy system will occur due to any of the events described in the preceding sentence.

~~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 ~~re~~assessment of the solar energy system will occur."

B. ANALYSIS

Partnership Flip Transactions Are Financing Arrangements.

As noted in the Guidelines, the Legislature acknowledged that partnership flip transactions are financing arrangements. This legislative intent should be applied consistently to all parts of the transaction. If entering into a flip partnership transaction is a financing and not a change in control that would cause a loss of the exclusion, then neither the "flip" occurring nor the investor exiting the transaction through a purchase option should be treated as a change in control.

In other words, if there is not a transfer on the way in, there should not be a transfer on the way out.

To the Extent the Partnership Flip Transaction Is Considered a Transfer, the Flip Point is not the Appropriate Point in Time.

There are potentially three points in time where a change in ownership could be deemed to occur in a flip partnership: (1) the formation of a partnership, (2) the flip in such a partnership, or (3) any buyout of a tax investor in such a partnership. Of those three points in time where a transfer could be deemed to occur, the flip is the least logical place for there to be a change in ownership, as no transfer actually occurs on such date. Additionally, considering the "flip" to be a transfer would seem contrary to the transfer provisions of Revenue & Taxation Code section 64, which triggers a reassessment of property based on a sale or transfer, not a shift in allocations resulting from the operation of a partnership agreement.

If a partnership flip transaction does indeed create a deemed transfer for property tax purposes, presumably the logical and obvious place for such a transfer to be deemed to occur would be the time that the tax investor enters into the partnership. At such time, it could be determined whether, taking into account the future shift in allocations, if such transfer is a sale of over 50% of the profits and capital of the partnership. The flip itself is not a change or amendment to the partnership agreement, but an adjustment of the partnership allocations over time. Therefore, such an anticipated allocation shift should be taken into account upfront when the tax investor enters the partnership to determine if, on a blended basis, over the term of the partnership the tax investor receives over 50% of the capital and profits of the partnership. Certainly, if the granting of the interest in the partnership to the tax investor is not a transfer because it is considered a financing, then a mere shift in allocations of the same partnership, between the same Members, also cannot be considered a transfer.

Additionally, analyzing the transfer at the time the tax equity investor enters the transaction is far more consistent with the provisions of Revenue & Taxation Code section 64, which governs partnership transfers for reassessment purposes. Section 64 triggers a reassessment of property based on a sale or transfer of such property, not a shift in allocations resulting from the operation of a partnership agreement. Thus, for the Board to consider the "flip" to be a separate transaction for the original tax equity purchase that triggers a transfer back to the developer when no change or amendment occurs to the partnership agreement, would seem contrary to Section 64, as well as federal income tax law that does not consider a flip to be a change in ownership or to trigger a IRC section 708 technical termination of the partnership.

Otherwise, the buyout of the tax investor's interest in the partnership would be a more appropriate point than the flip point to determine if a transfer has occurred, as a sale actually occurs at such time. Assuming the entire transaction is not considered to be a financing, the buyout clearly would be a transfer pursuant to Revenue & Taxation Code section 64 and would be a separate transaction for the initial purchase transaction.

Further Guidance Required on How To Calculate Percentage of Capital and Profits

If the Board believes instead that the "flip" is a transfer that can cause a change in control if the developer obtains more than 50% of the capital and profits interests in the partnership, then clear guidance is needed on how to calculate whether such a shift has occurred.

We suggest that the determination of one's capital interest in a partnership be determined by what the partner would receive based on a hypothetical liquidation in accordance with the partnership's capital accounts at the time of the flip. Thus, if the developer has more than 50% of the partnership's capital when it forms the partnership with the investor and more than 50% immediately before or after the flip, then no change in control has occurred.

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

Sincerely,

/s/

Jorge Medina
Senior Tax Counsel

cc: Michael McDade, BOE