SEIA Solar Energy Industries Association®

Sale Lease-Back Transactions

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Monetizing Tax Benefits

Why do it?

- Developers often cannot effectively utilize benefits tax credits provide
- Allows developers to transfer tax incentives to "tax equity" investors, enabling developers to share in economic benefits

Requires Structuring

- Tax credits cannot be sold
- Structuring goal: Have tax equity investor treated as an owner of the project for federal income tax purposes

Sale-Leaseback (Step 1: Sale)

Developer/ lessor

Cash for project

Tax Equity Investor/lessee

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Power and REC sales

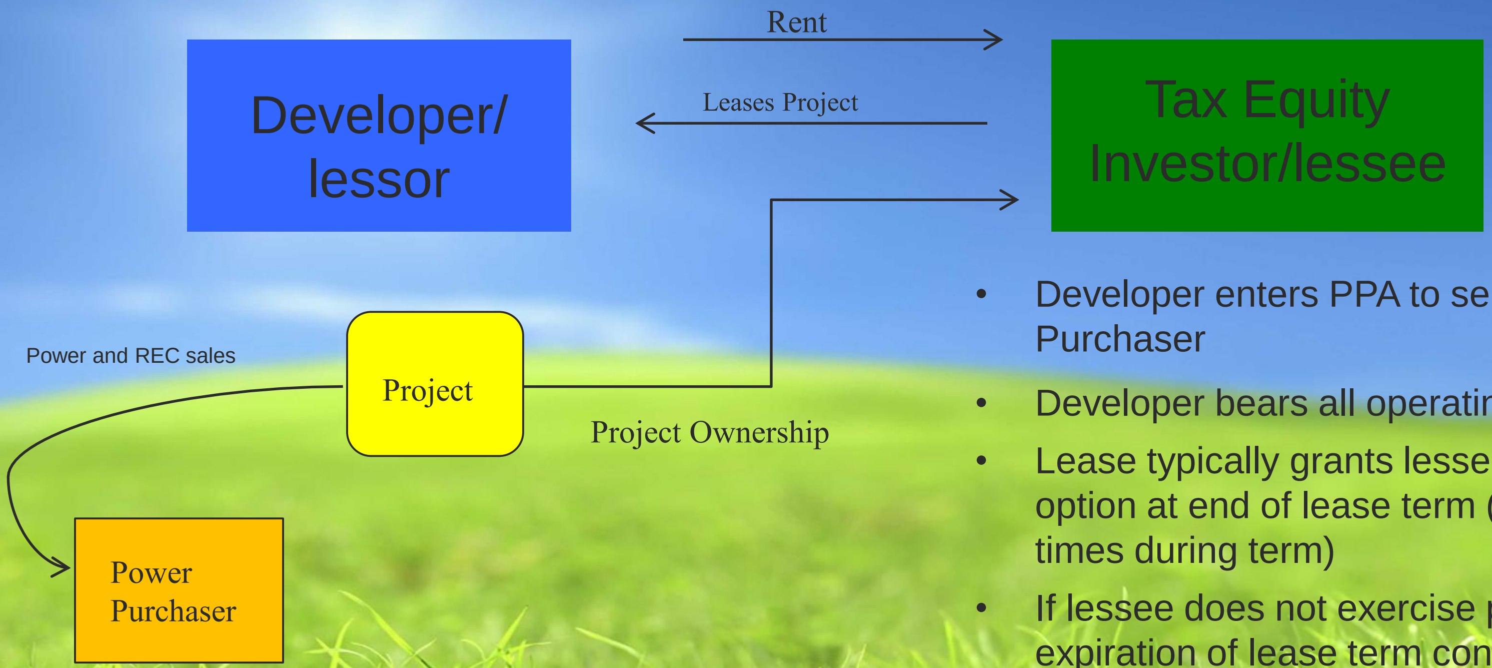
Project

100% of tax benefits from Project (as owner)

Power Purchaser

- Developer sells project to Tax Equity Investor
- Tax Equity Investor is owner of the property for federal tax purposes and entitled to ITC and tax depreciation (reduced by 50% of ITC)

Sale-Leaseback (Step 2: Leaseback)



- Developer enters PPA to sell power to Power Purchaser
- Developer bears all operating costs
- Lease typically grants lessee FMV purchase option at end of lease term (and often at fixed times during term)
- If lessee does not exercise purchase option at expiration of lease term control of system reverts back to Tax Equity Investor
- Developer receives 100% of cash flows (after rent service)

Common Structuring Concerns

- Will Tax Equity Investor be respected as an owner?

- Will allocation of credits and other tax benefits be respected?

Tax Ownership and True Lease Analysis

- IRS scrutinizes lease structures to determine whether it is a “true lease” or if there has been a disguised sale.

- Economic substance and benefits and burdens tests. Frank Lyon Co. v. United States, 435 U.S. 561 (1978)

- Some courts have enumerated lists of “tax ownership” characteristics. Grodt & Mckay Realty, Inc. v. Commissioner, 77 T.C. 1221, (1981)

- Facts and circumstances. Larsen v. Commissioner, 89 T.C. 1229 (1987); Estate of Thomas v. Commissioner, 84 T.C. 412 (1985)

Tax Ownership and True Lease Analysis (cont'd)

Rev. Proc. 2001-28

- No Limited Use Property
- No lessee loans or guarantees
- Purchases and sale rights
- Minimum investment "at risk"
- Pre-tax profit

Pros and Cons of Sale-Leaseback

Developer's Perspective

- \+ No upfront equity contribution required from developer
- \+ Developer receives upfront cash flows in form of asset sale and can grow business with current cash flow
- \+ Ideal structure for underperforming projects
- \+ Developer receives 100% of financing to construct project

- \- More costly than partnership flip to buy back project because Tax Equity Investor owns entre project at end of lease and residual value is over 20%
- \- Compared to partnership flip, developer may need to offer broader indemnities against loss of tax benefits

Pros and Cons of Sale-Leaseback

Tax Equity Investor's Perspective

- \+ Familiar structure for banks - Banks historically engaged in leasing arrangements to capture tax benefits which operator cannot fully utilize
- \+ Passive role for Tax Equity Investor
- \+ Tax benefits are fully transferable
- \+ Reduced construction risk
- \+ Flexibility: structure can be put in place 3 months after PIS, minimizes PIS/construction risk
- \+ Tax Equity Investor receives 100% of tax benefits (unlike partnership flip where Class B Member receives 1%)
- \+ Basis for tax purposes = to price paid for system (which may be higher than costs to build system)
- \- Most significant equity contribution required from Tax Equity Investor (compared to other structures)
- \- Early buyout option limits Tax Equity Investor upside
- \- Structure must satisfy strict IRS rules regarding lease characteristics

Thank You!

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