

## Project Finance Alert

### California Solar Project Real Property Tax Exclusion Clarified

June 30, 2011

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On June 28, 2011 California Gov. Jerry Brown signed into law Assembly Bill X1 15 (ABX1 15), which clarifies the availability of a property tax exclusion for newly constructed solar energy systems under Section 73 of the California Revenue and Tax Code. Under Article XIII A of the California Constitution, tax reassessment of real property may only occur when it is purchased, newly constructed or subject to a change in ownership.

Section 73 of the California Revenue and Tax Code excludes newly constructed “active solar energy systems” from any “new construction” real property reassessment. There were two problems with the pre-ABX1 15 version of Section 73. First, the exclusion would not (except in limited circumstances) apply following a sale or change in ownership of the system. Second, the statute was unclear as to when an owner had to acquire its interest in the facility to avoid a “sale” or “change in ownership” reassessment that included the value of the completed system. These two issues are crucial to the financing of solar energy systems, which are often financed through equity transactions that occur at or near completion of construction. In such financings, under the former language of Section 73, it could be argued that the reassessment trigger from a transfer of project ownership at any time during or after construction would eviscerate the “new construction” exclusion. ABX1 15 purports to solve these problems by defining “active solar energy system” as a completed system.<sup>1</sup> Thus a party acquiring a newly constructed solar energy system before it is completed will avoid an ownership transfer reassessment that includes the value of the completed system. This certainty should provide some comfort to developers and investors financing solar projects through partnership flip and other pre-completion equity transactions.<sup>2</sup>

ABX1 15 is silent on whether an active solar energy system acquired after completion qualifies for the reassessment exclusion. This could call into question whether solar systems that are equity financed shortly after completion (such as sale-leaseback financings that close in the three months following commercial operation) are subject to reassessment. The legislative findings for ABX1 15 reflect intent to include sale-leaseback transactions within the scope of Section 73, but do not state whether a sale leaseback consummated after commercial operation would be treated differently than a sale leaseback

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<sup>1</sup> The legislative findings for AB X1 15 indicate the revisions to Section 73 “do not constitute a change in, but are declaratory of, existing law.” Clearly AB X1 15 is intended to have retroactive effect.

<sup>2</sup> Section 73 is, regardless of its express language, subject to the constitutional requirements of Article XIII A on reassessment. To the extent there is conflict between Section 73 and Article XIII A, the constitutional requirements should trump the statutory provisions.



consummated prior to commercial operation.<sup>3</sup> The California Board of Equalization will likely address lingering questions about the solar property tax reassessment exclusion in Section 73 in the coming months.

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<sup>3</sup> While the legislative findings express intent to include sale-leaseback transactions within the scope of Section 73, the revisions to Section 73 remain silent on this limited point.