

**Ken Birrell**

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**From:** Ken Birrell  
**Sent:** Wednesday, October 31, 2012 9:50 AM  
**To:** 'jason@orangeinsure.com'  
**Subject:** RE: Generlized Documents  
**Attachments:** Tax Issues Relating to Purchase of Solar Lenses Memo.pdf

Jason,

Please see the attached memo, which contains a generalized analysis of the tax consequences relating to purchasing the solar lenses. Please note that this analysis is limited to C corporations – there would be different issues for an individual, partnership or S corporation purchaser.

Thanks,  
*Ken*

**Kenneth W. Birrell**  
KIRTON | McCONKIE  
P: 801-321-4826  
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[kbirrell@kmclaw.com](mailto:kbirrell@kmclaw.com)

**From:** [jason@orangeinsure.com](mailto:jason@orangeinsure.com) [mailto:[jason@orangeinsure.com](mailto:jason@orangeinsure.com)]  
**Sent:** Tuesday, October 30, 2012 3:52 PM  
**To:** Ken Birrell  
**Subject:** RE: Generlized Documents

Great. I look forward to it.

Could you also include the opinion letter executive summary?

The end of the letter has a pretty good summary that could be edited for that purpose if you wanted.

The front of a page document that sums up the basics points of the letter would be great.

Thanks,

Jason

----- Original Message -----

**Subject:** Re: Generlized Documents  
**From:** Ken Birrell <[kbirrell@kmclaw.com](mailto:kbirrell@kmclaw.com)>  
**Date:** Tue, October 30, 2012 11:04 am  
**To:** "[jason@orangeinsure.com](mailto:jason@orangeinsure.com)" <[jason@orangeinsure.com](mailto:jason@orangeinsure.com)>

Yes, I will have it to you first thing tomorrow morning

On Oct 30, 2012, at 11:31 AM, "[jason@orangeinsure.com](mailto:jason@orangeinsure.com)" <[jason@orangeinsure.com](mailto:jason@orangeinsure.com)> wrote:

Ken,

EXHIBIT 362  
WIT: Birrell  
DATE: 2-14-17  
CitiCourt, LLC

KM00148

KM00148

PLEX00362

Are you close on the opinion letter/reasoned analysis?

Thanks,

Jason

----- Original Message -----

Subject: Generalized Documents

From: Ken Birrell <[kbirrell@kmclaw.com](mailto:kbirrell@kmclaw.com)>

Date: Tue, October 30, 2012 9:28 am

To: "'[jason@orangeinsure.com](mailto:jason@orangeinsure.com)'" <[jason@orangeinsure.com](mailto:jason@orangeinsure.com)>

Jason,

Attached are generalized versions of the Purchase Agreement (including a Promissory Note for the Installment Payments – it will be the Promissory Note rather than the Purchase Agreement that varies as the applicable federal rate fluctuates) and the Operation and Maintenance Agreement. As before the Operation and Maintenance Agreement basically states that the Operator is required to provide the services detailed in the Operation and Maintenance Guidelines. If we don't actually have such Guidelines to attach, then we will need to instead explain the services to be provided in the Operation and Maintenance Agreement itself.

Thanks,

*Ken*

**Kenneth W. Birrell**

<[image003.jpg](#)>

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KIRTON | McCONKIE

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MEMORANDUM

DATE: October 31, 2012  
TO: SOLCO I, LLC  
Attn: Neldon Johnson  
FROM: Kenneth W. Birrell  
SUBJECT: Tax Issues Relating to Purchase of Solar Lenses

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INTRODUCTION

This memorandum is in response to your request for our analysis of certain tax consequences for the buyers (the "Buyers") of solar lenses from SOLCO, I, LLC (the "Seller") based on factual circumstances that are substantially similar in all material respects to the Facts (as such term is defined below). Please note that the analysis in this memorandum is based upon the existing provisions of the Internal Revenue Code of 1986, as amended (the "Code") and regulations thereunder (including final, temporary and proposed) and upon current Internal Revenue Service ("Service") published rulings and existing court decisions, any of which could be changed at any time. Any such changes may be retroactive and could significantly modify the analysis set forth herein. Similarly, any change in the Facts or the assumptions stated below, upon which our analysis is based, could modify our conclusions.

EXECUTIVE SUMMARY

The solar lenses that Buyers purchase from Seller (the "Solar Lenses") will qualify as "energy property" that is eligible for the energy tax credit under Code Section 48. For purposes of calculating the energy credit, the basis of each Solar Lens will be Three Thousand Five Hundred Dollars (\$3,500) and the energy percentage will be thirty percent (30%) so long as the energy credit is claimed prior to January 1, 2017 (and will be ten percent (10%) if claimed after that date). Buyers will be able to claim the energy credit in the year that the Solar Lenses are placed into service.

The Solar Lenses will be eligible for depreciation under Code Section 168(a) as 5-year property. In addition, Solar Lenses acquired by a Buyer and placed in service before January 1, 2013, will also be eligible for additional first-year depreciation under Code Section 168(k).

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## FACTUAL BACKGROUND

The Solar Lenses will be purchased by Buyers that are (i) corporations or limited liability companies organized in the United States, (ii) neither tax-exempt nor governmental entities and (iii) taxed as subchapter C corporations for federal income tax purposes. The Solar Lenses will be purchased pursuant to a Solar Lenses Purchase Agreement that is substantially similar to the agreement set forth in Exhibit A hereto (the "Purchase Agreement"). The Solar Lenses were manufactured by International Automated Systems or one of its affiliates and consist of thin-film solar lenses that focus the sun's energy, which energy is collected and transmitted to produce heated steam for power generation and other uses. The Treasury Department has made a grant under Section 1603 of the American Recovery & Reinvestment Act of 2009 with respect to the same model of solar lenses as the Solar Lenses and related equipment, which grant required a finding by the Treasury Department that such solar lenses and related equipment constituted property described in Code Section 48(a)(3)(A)(i) or (ii).

According to the Purchase Agreement, the purchase price ("Purchase Price") for each Solar Lens shall be Three Thousand Five Hundred Dollars (\$3,500). Buyer shall pay thirty percent (30%) of the Purchase Price upon execution of the Purchase Agreement and provide Seller with a Promissory Note that is substantially similar to the promissory note set forth in Exhibit B hereto (the "Promissory Note") for the remaining balance of the Purchase Price. The Promissory Note provides for payment of the remaining balance of the Purchase Price in substantially equal annual installment payments over a period of thirty (30) years (the "Installment Payments") with interest at a rate equal to the long-term applicable federal rate determined in accordance with Code Section 1274 as such rate is in effect for the month in which the Solar Lenses are acquired.

All of the Solar Lenses will be new at the time of their purchase by the Buyer. No person will have put the Solar Lenses to any type of use prior to the Buyer's purchase of the Solar Lenses. No person will have claimed any credits under Code Section 45 or 48 or received a Section 1603 grant with respect to the Solar Lenses prior to the Buyer's purchase of the Solar Lenses. All of the Solar Lenses will be installed at projects located within the United States.

The Buyer will enter into an Operation and Maintenance Agreement that is substantially similar to the agreement attached hereto as Exhibit C (the "O&M Agreement") with LTB, LLC, a Nevada limited liability company (the "Operator") to oversee the operation and maintenance of the Solar Lenses. The Operator is a for-profit commercial enterprise that is not related to either Buyer or Seller through common ownership. The Operator will also lease from Seller or an affiliate of Seller the towers in which the Solar Lenses will be installed, receivers to collect the energy from the Solar Lenses and certain other equipment relating thereto. The Operator shall be responsible for performing the services described in the O&M Agreement, including the collection of all income generated from the operation of the Solar Lenses, including any revenue generated from the use or sale of thermal energy or electric power generated using the Solar Lenses (the "Gross Revenue"). As compensation for its services, the Operator shall be entitled to retain an amount equal to the Gross Revenue minus an annual rental payment as set forth in the O&M Agreement (the "Rental Payment"). The Rental Payment shall be a fixed amount and shall not be a function of the net profits generated by the Solar Lenses.

The Purchase Agreement, Promissory Note and O&M Agreement are referred to herein as the "Transaction Documents." The factual matters set forth above along with the Transaction Documents shall be referred to collectively herein as the "Facts."

#### EXPLANATION OF THE LAW AND APPLICATION OF THE FACTS TO THE LAW

##### I. Sale vs. Lease

The Buyer's tax treatment with respect to the Solar Lenses depends in part upon whether the overall transaction constitutes a sales transaction in which the Buyer becomes and remains the owner of the Solar Lenses for tax purposes and therefore is the party entitled to claim the energy tax credits and depreciation deductions relating to the Solar Lenses. Although there is no bright-line test for determining whether a transaction constitutes a sale or a lease for tax purposes, the Service and the courts have developed various factors that they use to guide this determination. For example, in Rev. Rul 55-540 the Service stated that the determination of whether a transaction constitutes a sale or a lease "depends upon the intent of the parties as evidenced by the provisions of the agreement, read in light of the facts and circumstances existing at the time the agreement was executed." The Service noted that although "no single test, or any special combination of tests, is absolutely determinative," it provided a list of several conditions that, if present, "in the absence of compelling persuasive factors of contrary implication [evidence] an intent warranting treatment of a transaction for tax purposes as a purchase and sale rather than as a lease or rental agreement."

One of the conditions indicating a sale is that "[p]ortions of the periodic payments are made specifically applicable to an equity to be acquired by the lessee." Rev. Rul. 55-540, citing *Truman Bowen v. Commissioner*, 12 T.C. 446, acquiescence, C.B. 1951-2. The Purchase Agreement specifies that the Promissory Note represents payment of the Purchase Price that remains due after receipt of the Down Payment. Conversely, no part of the Rental Payment due under the O&M Agreement is specifically applicable to the Operator acquiring an equity interest in the Solar Lenses since the parties do not anticipate the Operator ever acquiring such an equity interest.

Another and related condition indicating a sale is that "[s]ome portion of the periodic payments is specifically designated as interest or is otherwise readily recognizable as the equivalent of interest." Rev. Rul 55-540, citing *Judson Mills v. Commissioner*, 11 T.C. 25, acquiescence, C.B. 1949-1. As noted above, the Purchase Agreement and Promissory Note specifically designate a portion of the Installment Payments as interest, but there is no corresponding specific designation of interest within the O&M Agreement. Moreover, no portion of the Rental Payments appear to be readily recognizable as the equivalent of interest.

A third condition indicating a sale is that "[t]he lessee will acquire title upon the payment of a stated amount of 'rentals' which under the contract he is required to make." Rev. Rul. 55-540, citing *Hervey v. Rhode Island Locomotive Works*, 93 U.S. 664 (1876); *Taft v. Commissioner*, 27 B.T.A. 808; *Truman Bowen v. Commissioner*, 12 T.C. 446, acquiescence, C.B. 1951-2. Under the terms of the Purchase Agreement and the O&M Agreement, the Buyer will receive title to the Solar Lenses from Seller and not pass that title to the Operator under any conditions. Therefore, the Buyer will hold title to the Solar Lenses throughout the term of both agreements.

In general, courts look to whether the benefits and burdens of ownership have passed to the purported buyer/lessor when determining how to classify sale-leaseback transactions for tax purposes. One important factor has been whether the buyer/lessor truly had an economic investment that would be meaningful if it abandoned the property. For example, in *Frank Lyon Co v. United States*, 435 U.S. 561 (1978), a key factor in the Supreme Court's decision to uphold a sale-leaseback transaction was the substantial economic investment made by the buyer/lessor. The buyer/lessor purchased a building for \$7.64 million with a \$500,000 down payment (representing 6.5% of the purchase price) and took out a mortgage for the remaining purchase price. The buyer/lessor then leased the building back to the seller/lessee with the annual rent exactly equal to the buyer/lessor's annual mortgage payments. The seller/lessee had options to purchase the building at various times at a price equal to the sum of the unpaid mortgage plus the buyer/lessor's \$500,000 plus 6% interest. The Supreme Court's decision to uphold the sale-leaseback transaction was based in large measure the significance of the buyer/lessor's economic investment, with the court finding that the buyer/lessor's financial position was substantially affected due to the \$500,000 investment and long-term debt and the buyer/lessor was exposed to real and substantial risk. Conversely, sale-leaseback transactions that have not been upheld by the courts typically involve minor down payments, nonrecourse financing and inflated sales prices. See e.g., *Franklin Estate v. Commissioner*, 64 T.C. 752 (1975), *aff'd*, 544 F.2d 1045 (9th Cir. 1976). Here, the Buyer will make a substantial economic investment in the Solar Lenses. For example, the Buyer's down payment is thirty percent (30%) of the Purchase Price, nearly five times as large as the down payment in *Frank Lyon*, and the financing on the remainder of the Purchase Price is fully recourse.

Another important factor for the courts is the existence of repurchase options at favorable prices, which indicate that the seller/lessee has not truly relinquished its interest in the property. See e.g., *Sowerby v. Commissioner*, 47 T.C.M. 897 (1984). Here, neither the Seller nor the Operator will have an option to purchase the Solar Lenses at any price, let alone a favorable price.

Another important factor for the courts has been the relative cash flows, such as situations where the rental income stream is tailored to match the debt payments without any significant positive cash flow for the buyer/lessor. See e.g., *Larsen v. Commissioner*, 89 T.C. 1229 (1987). Here, it is anticipated that the annual revenue stream (from the Rental Payments) will be substantially greater than the annual debt payments (the Installment Payments), which means that the Buyer should have substantial positive cash flows.

Finally, the Purchase Agreement provides that all parties shall, for tax purposes, report the transactions provided for in the Purchase Agreement and O&M Agreement as a sale of the Solar Lenses to the Buyer followed by a thirty (30) year operating lease of the Solar Lenses to the Operator. Thus, the parties clearly intend for the transactions to constitute a sale of the lenses to Buyer with the Buyer bearing the economic benefits and burdens of ownership of the Solar Lenses. Given the substantial economic investment being made by the Buyer, the specific designation of principal and interest payments by the Buyer to Seller and no such designation of with respect to payments by the Operator to the Buyer, the fact that the Buyer will have title to the Solar Lenses, the fact that neither the Seller nor the Operator will have an option to acquire the Solar Lenses from the Buyer and the fact that the Buyer will recognize substantial positive cash flow from the Solar Lenses, we believe that the transactions should be treated as a sale of the Solar Lenses to Buyer for tax purposes. Accordingly, the Buyer should be the person entitled to claim the energy credit and depreciation deductions relating to the Solar Lenses.

## II. Energy Tax Credit

Code Section 38 provides as a credit against a taxpayer's federal income taxes an amount equal to various credits, including "the investment credit determined under section 46." Code Section 46 defines the investment credit as the sum of various credits, including "the energy credit." Code Section 48(a) provides that, subject to certain exceptions not applicable to the Solar Lenses, that "the energy credit for any taxable year is the energy percentage of the basis of each energy property placed in service during such taxable year."

### A. Energy Property

Code Sections 48(a)(3) and 50(b) contain six (6) requirements that property must satisfy in order to qualify as "energy property." As summarized below, the Solar Lenses satisfy each of these requirements.

#### 1. Solar Energy Property

First, the property must consist of property described in Code Section 48(a)(3)(A). Among the types of property described therein is "equipment which uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat, excepting property used to generate energy for the purposes of heating a swimming pool" Code Section 48(a)(3)(A)(i). Such solar energy property includes equipment and materials, as well as parts related to the function of that equipment, that use solar energy directly to perform these functions, generally through the use of equipment such as collectors (to absorb sunlight and create hot liquids or air), storage tanks (to store hot liquids), rockbeds (to store hot air), thermostats (to activate pumps or fans that circulate the hot liquids or air) and heat exchangers (to utilize hot liquids or air to create hot air or water). See Treas. Reg. Section 1.48-9(d)(1). Solar energy property includes equipment that uses solar energy to generate electricity, and includes storage devices, power conditioning equipment, transfer equipment, and parts related to the functions of those items, which are part of the process involving the transformation of sunlight into electricity through the use of such devices as solar cells or other collectors so long as such equipment is used up to (but not including) the state that transmits or uses electricity. See Treas. Reg. Section 1.48-9(d)(3). Equipment that uses solar energy beyond the distribution stage is eligible only if specially adapted to use solar energy. See Treas. Reg. Section 1.48-9(d)(5).

It is not necessary for solar energy property to comprise a completely functional solar system in order to qualify for the energy credit. In *Cooper v. Commissioner*, 88 T.C. 84 (1987), the Tax Court held that property within the meaning of Code Section 48(a)(3)(A)(i) is any equipment that uses solar energy to generate electricity, to heat, cool, or provide hot water for use in a structure, or to provide solar process heat, and includes parts solely related to the functioning of such equipment; the court found that an incomplete system made up of qualifying parts, such as collectors, storage tanks, thermostats, heat exchangers, etc. can qualify for the credit.

The Solar Lenses will be capable of using solar energy to generate electricity and/or solar process heat once they have been properly installed in a tower and otherwise incorporated into a larger solar energy system. As explained by the Tax Court in *Cooper v. Commissioner*, 88 T.C. 84 (1987), the fact that the Solar Lenses must be installed and incorporated into a larger solar

energy system does not prevent them from qualifying as energy property. Finally, it is our understanding that the Solar Lenses will not be used for the purposes of heating a swimming pool except to the extent that electricity generated by the Solar Lenses is sold to an end-user who uses such electricity to heat a swimming pool. Therefore, the Solar Lenses are described in Code Section 48(a)(3)(A)(i) and thereby satisfy this first requirement to being classified as energy property.

## 2. Acquisition and Original Use

Second, the Property must either be (i) constructed, reconstructed or erected by the taxpayer or (ii) acquired by the taxpayer if the original use of such property commences with the taxpayer. Code Section 48(a)(3)(B). Treas. Reg. Section 1.48-2(b)(6) provides that property is deemed to be acquired when reduced to physical possession or control. Treas. Reg. Section 1.48-2(b)(7) provides that original use means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer.

The Buyer will not construct, reconstruct or erect any of the Solar Lenses itself. However, the Buyer will acquire control of the Solar Lenses pursuant to the terms of the Purchase Agreement. Therefore, the Buyer will have acquired all of the Solar Lenses within the meaning of Code Section 48(a)(3)(B) and Treas. Reg. 1.49-2(b)(6). As noted in the Facts, none of the Solar Lenses will have been put to any use by any other person prior to their acquisition by the Buyer. Therefore, the original use of the Solar Lenses will commence with the Buyer within the meaning of Code Section 48(a)(3)(B) and Treas. Reg. 1.49-2(b)(6). Accordingly, the Solar Lenses satisfy this second requirement to being classified as energy property.

## 3. Qualify for Depreciation

Third, the property must qualify for depreciation (or amortization in lieu of depreciation). Code Section 48(a)(3)(C). Treas. Reg. Section 1.48-1(b)(1) provides that property qualifies for depreciation within the meaning of Code Section 48(a)(3) "if the property is of a character subject to the allowance for depreciation under section 167 and the basis (or cost) of the property is recovered through a method of depreciation, including, for example, . . . methods of depreciation which measure the life of the property in terms of years."

As summarized in greater detail in Section III.A below, the Solar Lenses are of a character subject to allowance for depreciation under Code Section 167 and the Buyer's basis in the Solar Lenses will be recovered through a method of depreciation. Therefore, the Solar Lenses satisfy this third requirement to being classified as energy property.

## 4. Satisfy Performance Standards

Fourth, the property must satisfy the performance standards, if any, which the Service has prescribed by regulation and are in effect at the time of the acquisition of the property. Code Section 48(a)(3)(D). However, taxpayers need not wait for issuance of performance standards before proceeding with the acquisition of the property or the claiming of the energy credit. *See* Information Release 2134, 1979-28 I.R.B. 36.

To date the Service has not published any performance standards that would apply to the Solar Lenses. Because a Buyer need to wait until performance standards are issued, until such



time as the Service publishes performance standards, the Solar Lenses will satisfy this fourth requirement to being classified as energy property.

#### 5. No Claiming of Code Section 45 Credit

Fifth, taxpayer cannot have claimed a renewable electricity production credit under Code Section 45 for the taxable year or any prior taxable year with respect to the property. Code Section 48(a)(3). Code Section 45 provides a credit to certain facilities that use renewable resources, such as solar energy, to produce electricity. However, Code Section 45(d)(4) provides that such a facility "shall not include any property described in section 48(a)(3) the basis of which is taken into account by the taxpayer for purposes of determining the energy credit under section 48." In essence, the taxpayer has to choose between claiming a tax credit under Code Section 48 (which is based upon the basis of the property) or Code Section 45 (which is based upon the amount of electricity sold).

No person has claimed a credit under Code Section 45 with respect to the Solar Lenses. So long as the Buyer does not attempt to claim such a credit in the future, the Solar Lenses will satisfy this fifth requirement to being classified as energy property.

#### 6. No Disqualifying Use

Property does not qualify as energy property if it is used (i) predominantly outside of the United States, (ii) predominantly to furnish lodging or in connection with the furnishing of lodging, (iii) by certain tax-exempt organizations, (iv) a governmental entity or (v) a foreign person or entity. Code Section 50(b).

The Solar Lenses will all be installed in projects located within the United States; therefore the Solar Lenses will not be predominantly outside of the United States. Given the nature of the Solar Lenses, they are not capable of furnishing lodging within the meaning of Code Section 50(b), therefore their use will not be predominantly to furnish lodging or in connection with the furnishing of lodging. Neither the Buyer nor the Operator is a tax-exempt organization, governmental entity or foreign person. Moreover, under the terms of the O&M Agreement the Operator is not permitted to sublet any of the Solar Lenses or assign any of its rights or obligations under such agreement without the prior written consent of the Buyer, so the Operator cannot cause the Solar Lenses to be used by a tax-exempt organization, governmental entity or foreign person or entity without the Buyer's consent. Therefore, so long as the Solar Lenses are subject to the O&M Agreement, they will not be used by a tax-exempt organization, governmental entity or foreign person or entity without the Buyer's prior consent. Accordingly, the Solar Lenses satisfy this sixth and final requirement to being classified as energy property.

#### B. Energy Percentage

Code Section 48(a)(2)(A)(i)(II) provides that the energy percentage is thirty percent (30%) for various types of properties, including energy properties described in Code Section 48(a)(3)(A)(i) for periods ending before January 1, 2017 and ten percent (10%) for periods beginning on January 1, 2017. As summarized in Section II.A.1 above, the Solar Lenses are described in Code Section 48(a)(3)(A)(i). Therefore, so long as the energy credit is claimed before January 1, 2017, the energy percentage for the Solar Lenses will be thirty percent (30%).

If the energy credit is claimed on or after January 1, 2017, then the energy percentage will be ten percent (10%).

## C. Basis

### 1. In General

The basis of the Solar Lenses for purposes of the energy credit will initially be determined in accordance with Code Section 1012(a), which provides that basis of the Solar Lenses is their cost. Because the Purchase Price for each Solar Lens will be Three Thousand Five Hundred Dollars (\$3,500), such amount will be the cost basis of each Solar Lens for purposes of Code Section 1012(a).

### 2. At-Risk Limitation

For purposes of calculating the amount of the energy tax credit under Code Section 48(a), the cost basis amount determined in accordance with Code Section 1012 must be reduced to the extent required by the at-risk rules of Code Section 49. Code Section 49(a)(1)(A) provides that in computing the investment credit amount, the basis of property placed in service by a taxpayer described in Code Section 465(a)(1) and used in an activity with respect to which any loss is subject to limitation under Code Section 465 must be reduced by the amount of nonqualified nonrecourse financing relating to such property as of the close of the tax year in which the property is placed in service.

Taxpayers described in Code Section 465(a)(1) include individuals and subchapter C corporations with respect to which the stock ownership requirement of Code Section 542(a)(2) are met. The stock ownership requirement of Code Section 542(a)(2) is met if more than fifty percent (50%) of the corporation's stock is owned, directly or indirectly, by not more than five (5) individuals. Code Section 544 includes various attribution rules for determining stock ownership for purposes of Code Section 542(a)(2) which, among other things, deem an individual to hold all of the stock held by various members of the individual's family (including brothers, sisters, spouse, ancestors and lineal descendants) and various corporations, partnerships, estates and trusts. In terms of the type of activity requirement, if a corporation satisfies the ownership requirements of Code Section 542(a)(2), then essentially all of its activities are activities with respect to which losses are subject to limitation under Code Section 465. Thus, whether a Buyer will be described in Code Section 465(a)(1) will depend upon the Buyer's ownership structure. If a Buyer's stock is widely held, then it will not be subject to the at-risk limitations of Code Section 49; if a Buyer's stock is closely held (as defined in Code Section 542(a)(2)), then the Buyer will be subject to Code Section 49.

However, even if a Buyer is described in Code Section 542(a)(2) and therefore subject to Code Section 49, the amount of its basis in the Solar Lenses will not be reduced. Code Section 49(a)(1)(F) provides that the at-risk rules of Code Section 49 do not apply to qualified energy property as such term was defined for purposes of Code Section 46(c)(8) as such was in effect prior to the enactment of the Revenue Reconciliation Act of 1990 ("RRA-1990") on November

5, 1990. Qualified energy property is any property that satisfies each of the four (4) conditions summarized in the following sections.<sup>1</sup>

**a. At-Risk Limitations Would Otherwise Apply**

First, the property must be energy property to which the at-risk limitation on the investment credit would otherwise apply. Pre-1990 RRA Code Section 46(c)(8)(F). As described above, the at-risk limitation rules generally apply to property that is placed in service by a taxpayer that is described in Code Section 465(a)(1) and is used in connection with an activity with respect to which losses are subject to limitation under Code Section 465. Whether the Solar Lenses are qualified energy property is only an issue if they would otherwise be subject to the at-risk limitation, so the Solar Lenses will satisfy this first requirement for being qualified energy property.

**b. Energy Percentage Greater than Zero**

Second, the energy percentage for the property must be more than zero at the time it is placed in service. Pre-1990 RRA Code Section 46(c)(8)(F)(ii). As noted in Section II.B. above, the energy percentage for the Solar Lenses will be either thirty percent (30%) or ten percent (10%). Therefore, the Solar Lenses satisfy this second requirement for being qualified energy property.

**c. No More Than 75% Qualified Nonrecourse Financing**

Third, as of the close of the tax year in which the property is placed in service, no more than seventy-five percent (75%) of the basis of the property may be attributable to nonqualified nonrecourse financing. Pre-1990 RRA Code Section 46(c)(8)(F)(ii). To be nonqualified nonrecourse financing, the financing must, among other things, be nonrecourse financing. Code Section 49(a)(1)(D)(i). Financing is "nonrecourse financing" if (i) the borrower/taxpayer is protected against loss through guarantees, stop-loss agreements or other similar arrangements or (ii) any amount borrowed from a person who has an interest (other than as a creditor) in the activity in which the property is used or from a person related to such a person. Code Section 49(a)(1)(D)(iii). A person has an interest other than as a creditor only if the person has either a capital interest in the activity or an interest in the net profits of the activity. Treas. Reg. Section 1.465-8(b)(1). For this purpose, a capital interest means an interest in the assets of the activity that is distributable to the owner of the capital interest upon liquidation of the activity. Treas. Reg. Section 1.465-8(b)(2).

The Buyer is not protected against loss through guarantees, stop-loss agreements or other similar arrangements – the Buyer is the only person that is liable with respect to the Installment Payments. Thus, the Buyer is not protected against loss through guarantees, stop-loss agreements or other similar arrangements within the meaning of such terms for purposes of Treas. Reg. Section 1.465-8(b)(2).

<sup>1</sup> Note: The rules set forth in pre-1990 RRA Code Section 46(c)(8)(F) included a fifth condition that precluded exclusion from applying to all energy property. Pre-1990 RRA Code Section 46(c)(8)(F)(ii)(1). However, the repeal of pre-1990 RRA Code Section 46(c)(8)(F) was accompanied by a narrowing of eligible energy property, with the result that property that qualifies for the energy credit necessarily satisfies the fifth condition in all events. Pre-1990 RRA Code Section 46(c)(8)(F)(iii).

Likewise, Seller, the person providing the financing for the Solar Lenses, will not have an interest other than as a creditor in the activity in which the Solar Lenses will be used. Seller will not have a capital interest in such activity since it will not be entitled to receive any portion of the Solar Lenses in the event the Buyer decides to liquidate the activity. For example, if the Buyer decides to sell the Solar Lenses and liquidate, the Seller would not be entitled to a portion of the sale or liquidation proceeds except that Seller would be entitled to payment of the remaining balance of the Purchase Price, which right is consistent with the interests of a creditor. Similarly, Seller will not have an interest in the net profits of the activity since the amounts that it receives, both from Buyer in the form of Installment Payments and from Operator in the form of rental payments for the solar towers, receivers and other equipment, is not a function of the net profits, as opposed to the gross receipts, from the activity. Therefore, the Installment Payments do not constitute either nonrecourse financing or nonqualified nonrecourse financing and the Solar Lenses satisfy this third requirement for being qualified energy property.

#### d. Level Payment Loan

Fourth, any nonqualified nonrecourse financing in connection with the property must consist of a loan in which each installment is substantially equal, a portion of each installment must be attributable to the repayment of principal, and that portion must be increased commensurately with decreases in the portion of the payment attributable to interest. Pre-1990 RRA Code Section 46(c)(8)(F)(ii)(II). Because the Installment Payments do not constitute nonqualified nonrecourse financing, there is no nonqualified nonrecourse financing with respect to the Solar Lenses. Therefore, the Solar Lenses satisfy this fourth requirement for being qualified energy property. Accordingly, Code Section 49 does not require any reduction in the basis of the Solar Lenses as determined in accordance with Code Section 1012 irrespective of whether the Buyer is described in Code Section 465(a)(1).

#### D. Placed in Service

Property is placed in service when it is "placed in a condition or state of readiness and availability for a specifically assigned function," Treas. Reg. Section 1.46-3(d)(1)(ii). However, the Tax Court has held that for property purchased for lease to others to be placed in service, "it is not necessary that the property actually be used during the taxable year in the taxpayer's profit-motivated venture. It is sufficient that the property be available for use." *Waddell v. Commissioner*, 86 T.C. 848 (1986), citing *Sears Oil Co. v. Commissioner*, 359 F.3d 191, 198 (2d Cir. 1966) and *Grow v. Commissioner*, 80 T.C. 314, 326-327 (1983). An important factor in the court's decision in *Waddell* was the fact that the taxpayers executed distribution agreements simultaneously with the purchase, thereby showing that the equipment was actually available for lease at the time of purchase even though it was not actually leased until more than a year later.

The Buyer will enter into the O&M Agreement, which effectively leases the Solar Lenses to the Operator, simultaneously with the execution of the Purchase Agreement. Thus, the Solar Lenses will be available for use in the Buyer's leasing operations as soon as they are manufactured and Buyer acquires them. Therefore, given the holdings in *Waddell* and the cases cited therein, the Solar Lenses will be considered to have been placed in service as soon as they are acquired by the Buyer even though they will not be installed and actually used by the Operator to generate electricity or solar process heat until some later date.

### III. Depreciation

#### A. In General

Code Section 167(a) permits taxpayers to claim a depreciation deduction with respect to certain types of property used in a trade or business or held for the production of income. Code Section 168(a) provides that the depreciation deduction authorized by Code Section 167(a) for any tangible personal property is determined by using (i) the applicable depreciation method, (ii) the applicable recovery period and (iii) the applicable convention.

Code Section 168(b)(1) provides that the applicable depreciation method for property generally is the double declining balance method. There are exceptions to this general rule for various types of properties listed in Code Section 168(b)(2) and (3), but the Solar Lenses would not fall into any of the listed property types. Therefore, unless the Buyer elects otherwise, the applicable depreciation method for the Solar Lenses will be the double declining balance method.

Code Section 168(c) provides that the applicable recovery period for a property is determined by the recovery class of the property. Code Section 168(e)(B)(vi) provides that the 5-year recovery class includes property that is described in Code Section 48(a)(3)(A). Code Section 168(c) provides that the applicable recovery period for 5-year property is five (5) years. Therefore, the applicable recovery period for the Solar Lenses will be five (5).

Code Section 168(d) provides that the applicable convention for tangible personal property such as the Solar Lenses is generally the half-year convention. However, the applicable convention becomes the mid-quarter convention if the aggregate bases of depreciable property placed in service during the final three (3) months of the taxable year exceed forty percent (40%) of the aggregate bases of all depreciable property placed in service during such taxable year. Therefore, the applicable convention for the Solar Lenses will be either the half-year or the mid-quarter convention.

Code Section 167(c) provides that the basis for depreciation purposes is the property's adjusted basis determined in accordance with Code Section 1011 for purposes of determining the gain on the sale or other disposition of the property. Code Section 1011 provides that such basis is the basis as determined under Code Section 1012 and adjusted as provided in Section 1016 (and certain other provisions not applicable to the Solar Lenses). As noted above, Code Section 1012 provides that the basis of property is the cost of such property. Code Section 1016 provides that the cost basis must be adjusted by certain amounts, including the adjustment required by Code Section 50(c) for investment credit property. Code Section 50(c) provides that if an investment credit (including the energy credit) is claimed with respect to a property, that the basis of such property shall be reduced by an amount equal to fifty percent (50%) of the credit.

As noted above, the Buyer's cost basis in each Solar Lens will be the Purchase Price of Three Thousand Five Hundred Dollars (\$3,500). Assuming the Buyer claims the energy tax credit prior to January 1, 2017, such that the energy credit would be equal to thirty (30%) of such basis amount, the reduction to basis required by Code Section 50(c) would be an amount equal to fifteen percent (15%). Therefore, the basis of each Solar Lens would be reduced Two Thousand Nine Hundred Seventy-Five Dollars (\$2,975) for purposes of calculating its depreciation deductions under Code Section 168(a).

## B. Additional First-Year Depreciation

Code Section 168(k) permits taxpayers to deduct, rather than capitalize and recover through depreciation deductions, fifty percent (50%) of the adjusted basis of "qualified property" during the first year in which the property is placed in service. In order to constitute qualified property for this purpose, the property must satisfy each of the four (4) conditions summarized below.

First, the property must have an applicable recovery period of twenty (20) years or less or certain other types of property. Code Section 168(k)(2)(A)(i)(I). Because the Solar Lenses will have an applicable recovery period of five (5) years, they will satisfy this first requirement for being qualified property.

Second, the property's original use must begin with the taxpayer after December 31, 2007. Code Section 168(k)(2)(A)(ii). Because the Buyer will acquire all of the Solar Lenses after December 31, 2007, they will satisfy this second requirement for being qualified property.

Third, the property must be acquired by the taxpayer either (i) after December 31, 2007 and before January 1, 2013 or (ii) pursuant to a binding written contract entered into after December 31, 2007 and before January 1, 2013. Code Section 168(k)(2)(A)(iii). A contract is binding only if it is enforceable under state law against the taxpayer and does not limit damages to a specified amount. Treas. Reg. 1.168(k)-1(b)(4)(ii)(A). The Purchase Agreement will be enforceable against the Buyer under state law and does not limit damages to a specified amount. Therefore, any Purchase Agreement that is entered into before January 1, 2013, will satisfy this third requirement for being qualified property.

Fourth, the property must be placed in service by the taxpayer before January 1, 2013. Code Section 168(k)(2)(A)(iv). As summarized in Section II.D. above, Solar Lenses that have been acquired by a Buyer will be considered placed in service upon the simultaneous execution of the Purchase Agreement and O&M Agreement. Therefore, Solar Lenses will satisfy this fourth requirement for being qualified property if they are acquired by a Buyer prior to January 1, 2013.

## IV. Limitations upon Use of Credits and Depreciation Deductions

### A. At-Risk Limitations

Code Section 465(a) provides that the losses (in this case, depreciation deductions in excess of the Rental Payments) of certain taxpayers from certain activities are only allowed to the extent of the aggregate amount with respect to which the taxpayer is at risk with respect to such activity. The taxpayers subject to Code Section 465(a) include a subchapter C corporation that meets the ownership requirements of Code Section 542(a)(2), which are summarized above.

For purposes of Section 465(a), a taxpayer is considered to be at risk for an activity in amount equal to the sum of the amount of money or property contributed to the activity and certain amounts borrowed with respect to the activity. Code Section 465(b)(1). Taxpayers are considered to be at risk for borrowed amounts only if the taxpayer is personally liable for the repayment of such amounts or has pledged property (other than property used in such activity) as security for such borrowed amounts; provided that a taxpayer will not be considered to be at risk

with respect to borrowed amounts to the extent such amounts are borrowed from a person who has an interest in the activity (other than as a creditor) or from a person who is related to such a person. Code Section 465(b)(2) and (b).

Whether an obligation constitutes debt for tax purposes ultimately depends upon whether there was “a genuine intention to create a debt, with a reasonable expectation of repayment, and did that intention comport with the economic reality of creating a debtor-creditor relationship.” *Jensen v. Commissioner*, 208 F.2d 226 (10th Cir. 2000) (citing *Dixie Dairies Corp. v. Commissioner*, 74 T.C. 476, 494 (1980)). Courts consider a variety of factors in making this determination, including (i) whether the promise to repay was evidenced by a written agreement, (ii) interest was charged, (iii) a fixed maturity date and/or a fixed schedule for repayments was set forth in the instrument or by agreement, (iv) security or other collateral was given to ensure repayment, (v) repayments were made, (vi) the borrower was not insolvent at the time of the advance and (vii) the parties otherwise acted consistently with such transfer being a loan. See e.g., *Fisher v. United States*, 54 T.C. 905 (1970) and *Miller v. Commissioner*, T.C. Memo 1982-629. Of course, not every factor is relevant in every situation, and the weight assigned to each factor varies from situation to situation. As noted by the Supreme Court, “[t]here is no one characteristic . . . which can be said to be decisive in the determination of whether the obligations are . . . debts” for tax purposes.” *John Kelley Co. v. Commissioner*, 326 U.S. 521, 530 (1946).

It is our understanding that the parties genuinely intend to create a debt in the form of the Promissory Note and Buyer’s obligation to make the Installment Payments and that the parties intend for the Installment Payments to be made. Similarly, the economic relationship between the Buyer and Seller appears to comport with the economic reality of creating a debtor-creditor relationship. For example, the Buyer and Seller have evidenced their intent for the Buyer to make the Installment Payments in both the Purchase Agreement and the Promissory Note; they have agreed that the Installment Payments will bear interest at the long-term applicable federal rate; they have agreed upon a fixed schedule for repayments; the Buyer’s obligation to make the Installment Payments is secured by the Solar Lenses, which the Seller may repossess in the event the Buyer fails to make the Installment Payments when due; the Buyer will not be insolvent when it enters into the Purchase Agreement and is expected to have sufficient cash flow to make the Installment Payments; and the parties have acted consistently with treating the Installment Payments as a loan. Therefore, the Installment Payments appear to be a bona fide debt for tax purposes.

As discussed in Section II.C.2.c above, the Buyer is personally liable for the Installment Payments and such amounts are not borrowed from a person who has an interest in the activity (other than as a creditor) in which the Solar Lenses will be used or from a person who is related to such a person. Therefore, the Buyer’s amount at risk with respect to the Solar Lenses for purposes of Code Section 465 shall be an amount equal to the aggregate Purchase Price for the Solar Lenses.

#### **B. Passive Activity Limitations**

Code Section 469(a) provides that certain losses (in this case, depreciation deductions in excess of the Rental Payments) and credits associated with passive activities of certain taxpayers are only allowed to the extent of the taxpayer’s income from passive activities. The taxpayers subject to Code Section 469 include closely-held subchapter C corporations. Code Section 469(a)(2). However, Code Section 469(e)(2) provides that a closely held subchapter C

corporation that is not a personal service corporation can offset active income with passive activity losses and credits. Code Section 269A(b)(1) defines a personal service corporation as a corporation the principal activity of which is the performance of personal services and such services are substantially performed by employee-owners. Code Section 269A(b)(3) provides that all related persons, within the meaning of Code Section 144(a)(3), are treated as a single entity. Code Section 144(a)(3) defines a related person as anyone described in Code Sections 267, 707(b) or 1563(a) (except that 80% is substituted for 50% everywhere it appears in Code Section 1563(a)).

So long as a Buyer's principal activity is something other than the performance of personal services, the Buyer will be able to use the credits and losses attributable to the Solar Lenses to offset active income from other sources.

**CIRCULAR 230 DISCLOSURE**

The analysis set forth in this memorandum was not intended or written to be used, and it cannot be used, by any taxpayer for the purpose of avoiding United States federal tax penalties that may be imposed on the taxpayer. The analysis was written to support the promotion or marketing of the transactions or matters addressed in this memorandum. Each taxpayer should seek advice based upon the taxpayer's particular circumstances from an independent tax advisor. The foregoing language is intended to satisfy the requirements under the regulations in Section 10.35 of Circular 230.