Office of Chief Counsel
Internal Revenue Service

Memorandum

Number: **201524024**
Release Date: 6/12/2015

CC:PSI:B03:JRWorst
POSTU-129615-14

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 48.00-00

date: November 24, 2014

to: John A. Guarnieri
Associate Area Counsel (Philadelphia, Group 1)
(Large Business & International)

from: Richard T. Probst
Senior Technician Reviewer, Branch 3
(Passthroughs & Special Industries)

---

subject: Applicability of Rev. Proc. 2007-65 to Section 48 Energy Credit Partnership

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

LLC =

DRE =

S1 =

S2 =

S3 =

A =

B =

C =

D =

E =

A% =

B% =

C% =

D% =

E% =

F% =

G% =

H% =

I% =

$A =

$B =

$C =

$D =

$E =

$F =

$G =

$H =

$I =

$J =

a =

b =

c

State 1 =

State 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Year =

ISSUE

Whether LLC may rely on the safe harbor in Rev. Proc. 2007-65, 2007-2 C.B. 967, with respect to § 48 energy credits.

CONCLUSION

Rev. Proc. 2007-65 does not apply to partners or partnerships with § 48 energy credits. Further, LLC does not satisfy all of the safe harbor requirements of Rev. Proc. 2007-65.

FACTS

Transactions Relating to Solar Generators

LLC, a State 1 limited liability company, was formed on Date 1. On Date 2, LLC entered into three agreements. First, LLC entered into a purchase agreement with S1, a State 1 corporation that is classified as an S corporation, to acquire a solar generators at a purchase price of $A. Individuals A and B own A% and B% of S1, respectively. The purchase was financed by a $B loan from S1, as discussed in the next paragraph. DRE's capital contributions to LLC, as discussed below, financed the balance of the purchase price. Under the purchase agreement, S1 agrees to indemnify and hold LLC harmless from and against any loss, lawsuit, liability, damage, cost and expense

(including reasonable attorneys' fees) which arise out of or result from (i) claims by third parties against LLC that the solar generators has caused damage to property or bodily injury; (ii) claims by third parties against LLC that has now or ever infringed, violated, or misappropriated the intellectual property of any other person; (iii) any defects in the solar generators; and (iv) the inaccuracy or breach of any representation, warranty or covenant of S1 contained in or made pursuant to the agreement. S1 also represents that all of the solar generators constitute "energy property" as defined in section 48(a)(3) of the Internal Revenue Code and that no portion of the solar generators must be excluded from basis in determining the amount of energy credit available with respect to the solar generators under section 48(a).

Second, LLC gave S1 a promissory note to pay for the solar generators on Date 2. Under the note, LLC is to pay S1 $C per month for b months. As security, LLC gave S1 a security interest in the solar generators and any proceeds of the rents received by LLC under the lease agreement discussed in the next paragraph. The note provides that LLC's members, officers, directors, or managers do not have any personal liability for any of the obligations under the note. S1 agrees that upon a default that it will look solely to LLC and collateral pledged by LLC in support of LLC's obligations.

Third, LLC entered into a lease agreement with S2, a State 1 corporation that is classified as an S corporation, to lease all of LLC's solar generators. Related individuals, A and C respectively own C% and D% of S2. The lease term begins on Date 3. Pursuant to the lease, S2 was responsible for the maintenance and repair of the solar generators. S2 also ensures that the solar generators are operational and capable of producing solar energy at all times throughout the lease's rental term, which was for c months. The amount of rent was $D per month. Under the lease agreement, S2 agrees to indemnify LLC for all liability, obligations, losses, damages, penalties, claims, suits, costs and expenses, including attorneys' fees, arising out of or related to the possession, leasing, renting, operation, maintenance, repair, control, or use of the solar generators.

Structure of LLC

On Date 2, DRE and S3 entered into a written agreement regarding LLC's operation. DRE, a State 2 limited liability company, owns E% of LLC. DRE is wholly-owned by D, an individual. S3, a State 1 corporation that is classified as an S corporation, owns the remaining F%. Individuals A and E own A% and B% of S3, respectively. The purpose of LLC is to acquire and lease solar generators.

DRE is obligated to make capital contributions to LLC projected to equal $E in three installments. The first installment in the amount of $F is payable on Date 2. The second installment in the amount of $G is payable on the date the solar generators are placed in service. The third installment in the amount of $H is payable upon DRE's receipt of the Schedule K-1 for Year. As a condition precedent to DRE's obligation to contribute the second and third installments, S3 must certify that (1) the use and

operation of the solar generators in all material respects complies with section 48 and that the solar generators have been placed in service for purposes of claiming the tax credit and have been delivered to S2 under the lease agreement (described above); (2) no default has occurred; (3) no bankruptcy has occurred; (4) S3 is not in breach of any provision under the LLC agreement; (5) that DRE will have sufficient basis in LLC and capital account balance and share of minimum gain to claim its full proportionate share of the tax credits and 100% bonus depreciation in the year the solar generators are placed in service; and (6) LLC continues to own the solar generators. DRE will defer its capital contributions if these requirements are not met.

The amount of DRE's capital contribution to LLC was designed to equal for each dollar of Federal energy credits LLC expected to receive. If the energy credits were less than anticipated, then S3 would contribute E% of the tax credit shortfall (the adjustment payment) and an amount equal to interest on such amount at the "short term applicable federal rate" plus basis points, but not more than per annum from Date 4 until the date of the adjustment payment. LLC would subsequently distribute this total to DRE. If the energy credits were greater than anticipated, then DRE would contribute an amount equal to G% of E% of the tax credit excess.

In the event the amount of the energy credits varies because of an IRS audit, the LLC agreement treats the variation as a tax credit shortfall or tax credit excess under the agreement. If the energy credits allocated to DRE are recaptured, S3 would contribute to LLC an amount equal to the recapture. LLC would subsequently distribute this amount to DRE. If the solar generators were placed in service prior to DRE's admission into LLC, S3 would purchase DRE's interest for an amount equal to DRE's total capital contributions plus interest.

From Date 2 through Date 5, items of income, loss, and credit are allocated E% and F% to DRE and S3, respectively. After Date 5, the allocations are H% and I% to DRE and S3, respectively.

Through Date 5, DRE is entitled to a $I preferred annual distribution. An irrevocable and automatically renewable letter of credit issued by a bank reasonably acceptable to DRE guarantees the preferred distribution. S3 does not receive a preferred distribution. In addition, for each year DRE is a member of LLC, DRE is entitled to an annual asset management fee of $H per annum to cover costs associated with visits to the solar generators and for other asset management tasks.

The LLC agreement allocates net income and loss and credits in accordance with the members' ownership interest. Through Date 5, LLC will distribute cash as follows:

- Payment of DRE's preferred annual distribution;
- Payment to DRE for any amounts distributable and/or due and payable to DRE because DRE indemnified S3 or there is a tax credit shortfall;

- Payment to DRE for any portion of the asset management fee for any prior year and the current year which has not been paid in full;
- Payment to S3 for any operating deficit loans; and
- The balance is distributed E% to DRE and F% to S3.

From and after Date 5, LLC distributes cash the same as above, except there is no preferred annual distribution to DRE, and the balance is distributed H% to DRE and I% to S3.

Put and Call Options

S3 has a call option to purchase DRE's interest in LLC. S3 may exercise the call option on Date 6, which is 90 days after Date 5. The price of the call option is equal to the fair market value of DRE's interest.

DRE has a put option to have its interest redeemed by LLC. DRE may exercise its option on Date 7, one year after Date 6. If DRE exercises its option, LLC will distribute to DRE E% of distributable cash until DRE has been distributed, on a cumulative basis, cash equal to the lesser of the fair market value of DRE's interest or the positive amount of DRE's capital account.

Risks and Responsibilities of the Members

S3 is the managing member of LLC, while DRE is the investor member. The LLC agreement vests in S3 all authority, rights and powers conferred by law, and those required or appropriate to the management of LLC's business. S3 is also obligated to adequately insure the assets of LLC, as well as obtaining insurance for the value of the energy credits. S3 will take any action required to insure the solar generators will initially qualify and continue to qualify for energy credits and to avoid recapture or reduction of the energy credits or the imposition of penalties or interest on LLC or its members for failure to comply with section 48.

If at any time before Date 5, an operating deficit exists or there is insufficient cash to make the annual preferred distribution to DRE, then S3 will make a loan to LLC equal to the operating deficit. The loan would be non-interest bearing and is only repayable from LLC's distributable cash.

All liabilities are nonrecourse to DRE. DRE's liability is limited to its capital contributions. It has no other liability to contribute money to LLC. It is not obligated to make loans to LLC.

LAW AND ANALYSIS

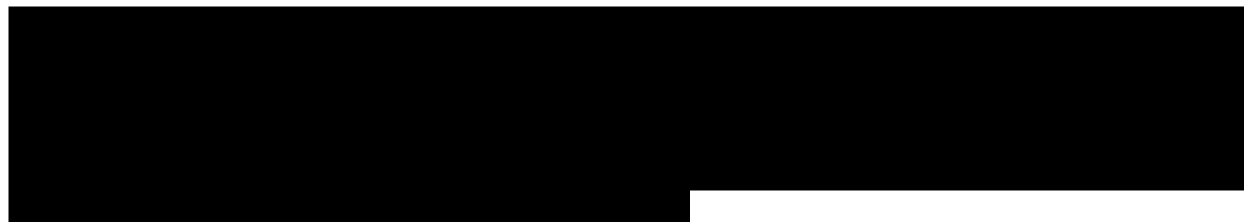
Section 48(a) provides for an energy credit equal to 30 percent of the cost basis of qualifying solar energy property placed in service before January 1, 2017.

In 2007, the IRS issued Rev. Proc. 2007-65, 2007-45 I.R.B. 967, to set forth a safe harbor under which the IRS will respect the allocation of § 45 wind energy production tax credits by partnerships in accordance with § 704(b). The revenue procedure applies only to partners or partnerships with § 45 production tax credits from renewable sources from wind. Thus, the revenue procedure does not apply to any other tax credits. Among the safe harbor requirements are: (1) at least 75 percent of the fixed capital contributions plus reasonably anticipated contingent capital contributions to be contributed by the investor with respect to an interest in the partnership must be fixed and determinable obligations that are not contingent in amount or certainty of payment; (2) the investor may not have a contractual right to cause any party to purchase its partnership interest in the partnership; and (3) the investor may not be the beneficiary of a guarantee of a tax credit allocation, but rather must bear the risk that the partnership's activities do not give rise to an anticipated amount of credit.

Rev. Proc. 2007-65 does not apply to partners or partnerships with § 48 energy credits. Rev. Proc. 2007-65 clearly provides that the safe harbor only applies to partners or partnerships with § 45 wind energy production tax credits. In addition, Rev. Proc. 2007-65 applies to a production tax credit, the amount of which varies over time based on how much wind energy the partnership produces. The requirements of such a credit are different than an investment tax credit, such as the § 48 energy credit, which is an upfront credit. That permits the investor to recover its initial investment much more quickly than an investor receiving a production tax credit. Thus, LLC cannot use the safe harbor provided by Rev. Proc. 2007-65 for support that the IRS should respect its allocation of § 48 energy credits to DRE.

Although Rev. Proc. 2007-65 is not applicable, LLC does not meet all of the requirements of the safe harbor. First, of DRE's capital contributions that it makes in three installments, only DRE's first installment is fixed and determinable. The amount of the first installment, $F is less than 75% of its total expected contribution, $E. Second, DRE has a contractual right to have LLC to redeem its interest. Third, DRE does not bear the risk that LLC's activities do not give rise to an anticipated credit amount. In the event LLC generates credits less than expected, then S3 contributes the shortfall, which LLC will subsequently distribute to DRE. Further, S3 is obligated to purchase insurance in the amount of the total anticipated energy credits.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 317-5279 if you have any further questions.