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# TAX LAW CONFERENCE

March 7-8, 2019

Ronald Reagan Building and International Trade Center  
Washington, D.C.

## Partnership & Passthrough Updates (Part II)

Moderator:

Thomas Moffitt, IRS



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## Agenda

- Tax equity financing
- Recent legislation, administrative guidance, and case law impacting S corporations and their owners.



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## Panelists

- Sarah Haradon, Holland & Hart
- Laura Howell-Smith, Deloitte
- Keith Martin, Norton Rose
- Amish Shah, Eversheds Sutherland
- Michael Gould, IRS



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## Tax Equity Financing



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## Why Tax Equity Financing is Necessary for the Renewable Sector

- Monetization of tax incentives allows matching of investors availability of capital with their ITC appetite.
  - When solar developers are not profitable (and thus not able to use the tax credits), financial institutions and other profitable investors may invest in renewable energy projects as tax equity partners
- This matching simultaneously provides the upfront capital developers needed to construct and own renewable energy systems on a widespread basis.
- Consumers benefit because the capital injected by investors allowed the renewable market to be scaled, thus lowering costs.



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## Three Common Tax Equity Structures

- Partnership Flip
- Sale Leaseback
- Inverted Lease



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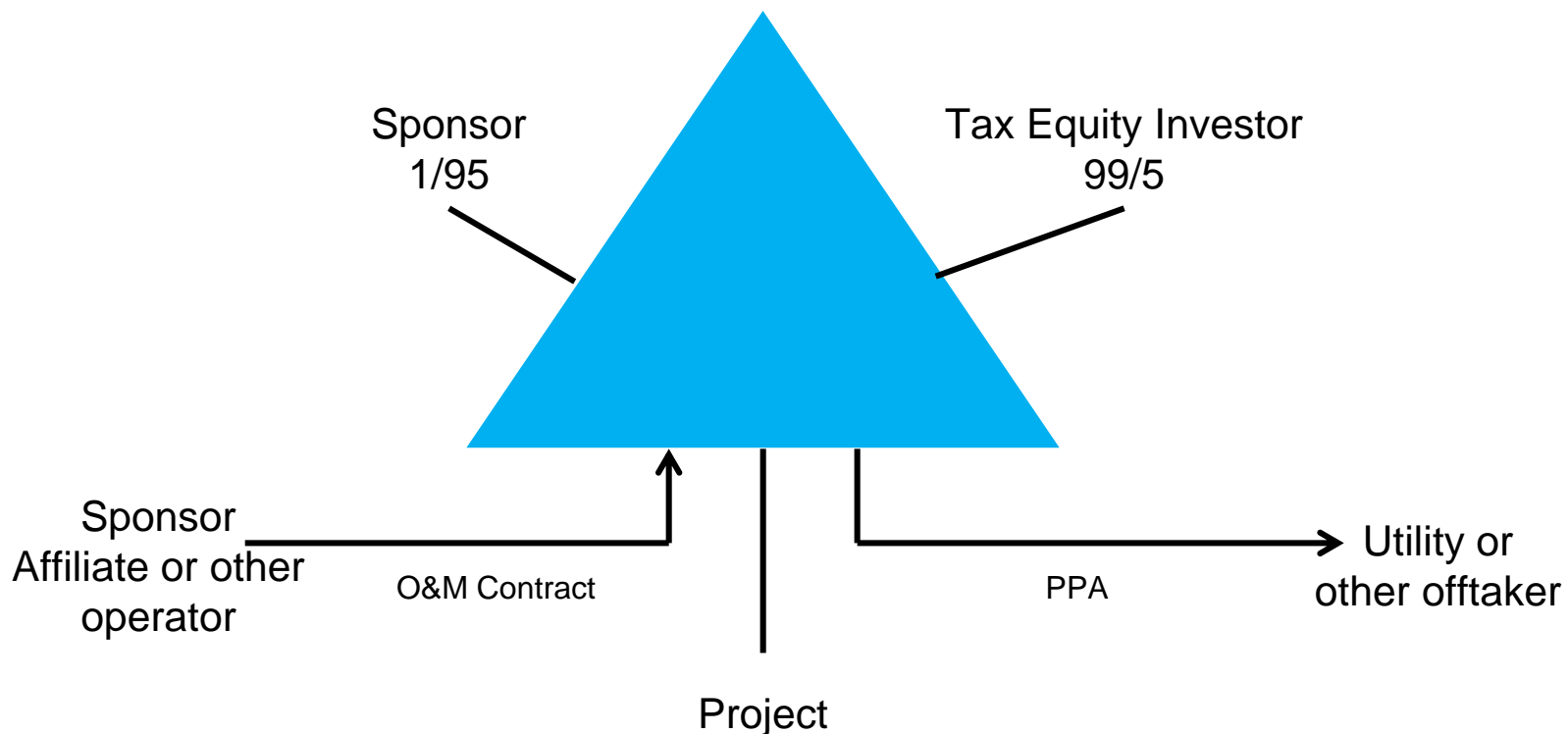
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## Partnership Flip



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## Partnership Flip Basics

- Both the Sponsor/Developer and Tax Equity Investor own the project through a partnership
  - Partnership receives revenue from PPA
- Tax Equity Investor
  - Receives majority of the ITC (99%)
  - Receives the majority of taxable income and loss for a predefined period (99%) – until the “flip”
  - After the flip, income and loss share drops to 5%
- Sponsor/Developer
  - After the flip, income and loss share increases to 95% and Developer has an option to buy the Tax Equity Investor’s interest



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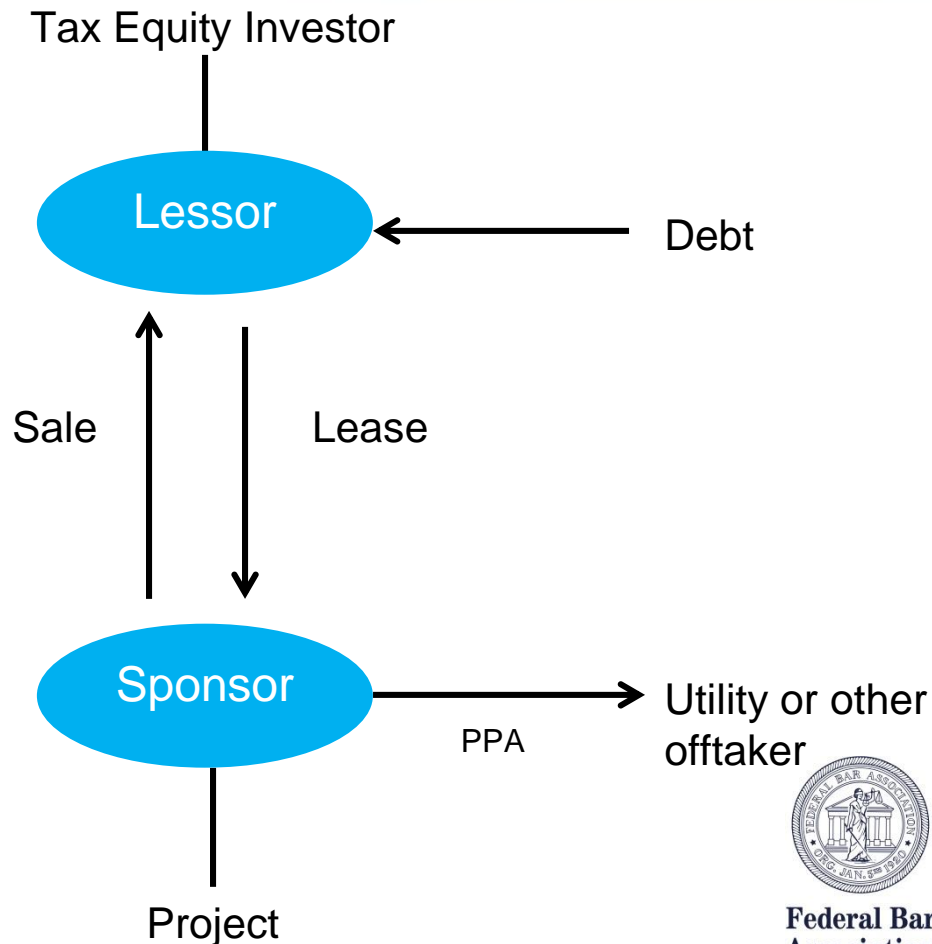
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## Sale-Leaseback





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## Sale-Leaseback Basics

- Lessee (Sponsor/Developer)
  - Develops and constructs the project (self or third-party construction)
  - Sells equipment to tax equity investor, then leases the equipment back
  - Operates the project (covers operating expenses; makes lease payments to the lessor; receives revenue from electricity sales through PPA)
- Lessor (Tax Equity Investor)
  - Retains 100% of the project's tax benefits
  - Receives ongoing lease payments from the Sponsor sized to produce the Tax Equity Investor's target rate of return



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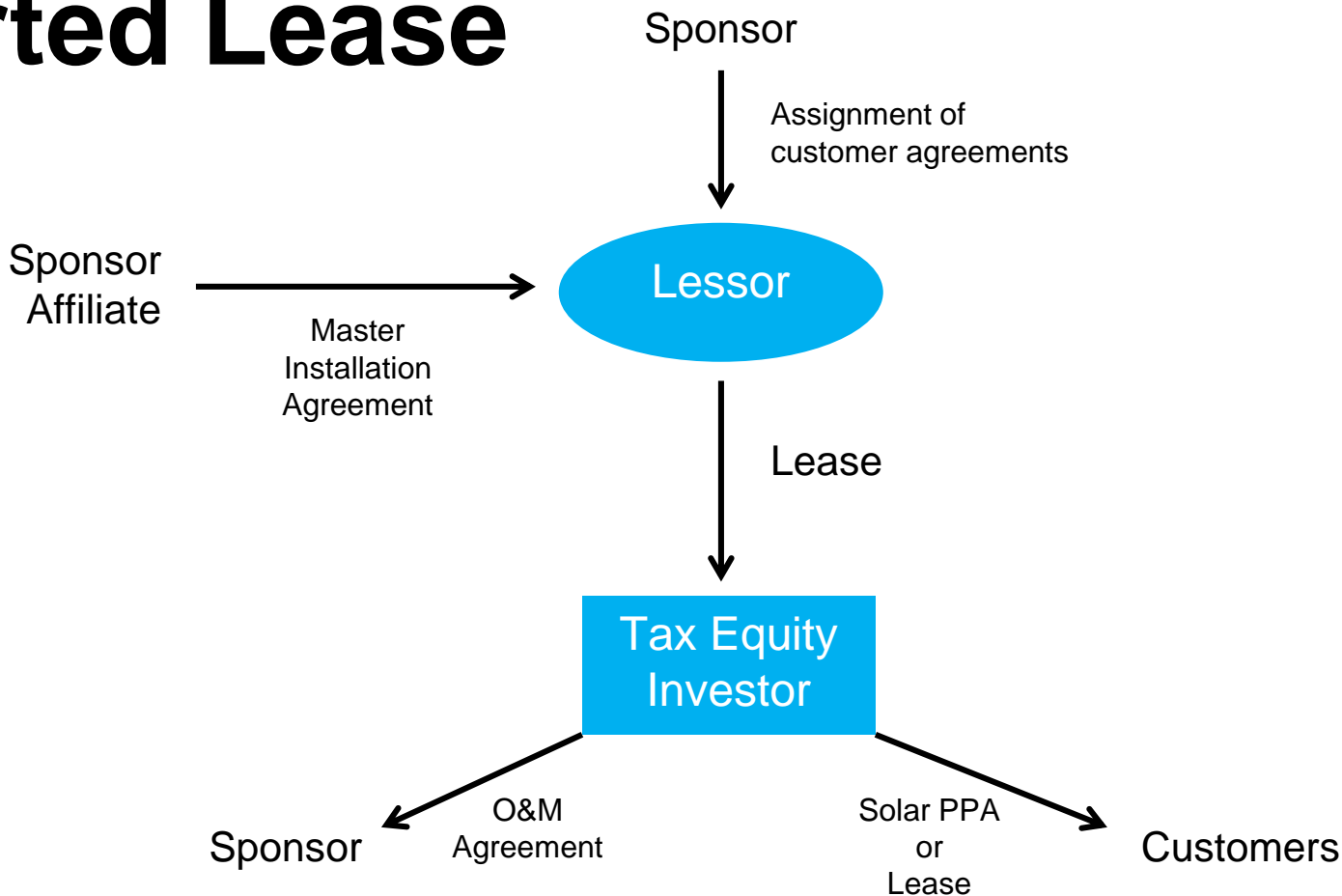
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## Inverted Lease



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## Inverted Lease Basics

- Lessee (Tax Equity Investor)
  - Sponsor operates the project through agreement
  - Lessee receives revenue from customers
- Lessor (Sponsor/Developer)
  - Develops and constructs the project (self or third-party construction), and retains ownership
  - Elects to pass through the ITC to the Tax Equity Investor
  - Receives ongoing lease payments from the Tax Equity Investor



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## Challenges to the Industry: Uncertainty

- This is a financing-dependent industry, and uncertainty creates financing risk
  - Inability to receive IRS guidance with the open reg. project under IRC Section 48
  - Inconsistent IRS audit positions
- Uncertainties created by government victories in two recent court cases:
  - *Alta Wind* (Fed. Cir. July 27, 2018)
  - *Bishop Hill* (Fed. Cl., opinion publication pending)



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## Recent Case: Alta Wind

- Dispute over section 1603 grant eligible costs for wind farms (total purchase price vs. actual construction and development costs)
- Federal Circuit sided with the IRS position that section 1060 allocation principles applied; portion of the purchase price should be classified as goodwill



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## Recent Case: Bishop Hill

- Dispute over whether a developer fee can be added to the basis of the property eligible for section 1603 grants
- Government arguments centered on belief that the developer fee was an effort to boost section 1603 payments, and without substance



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## Issues

### *Alta Wind: Section 1060 Allocation*

- What intangible value can there be in an aggregation of PV systems and their affiliated contracts.
- Goodwill or Going-Concern Value: driven by perceived value in the PPAs in an operation that has yet to start, and that isn't generating a branded, consumer-based product

### *Bishop Hill: Developer Margin*

- How to view the amount of the purchase price under IRC Section 1012 above the actual construction and development costs?
- Turn-key Value: driven by the significant amount of developer activity to get the wind farms ready to operate (permitting, studies, testing, performed in the course of developing, constructing, and financing the wind farms)



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## Some Legislative Background of the ITC

- Congress has adopted numerous laws and policies over the past 50+ years that pushed capital investment into alternative and renewable energy technologies
- Recent laws that were particularly important to the residential solar industry:
  - 2005 - ITC was increased from 10% to 30% for solar energy property
  - 2009 - ARRA was enacted which extended the ITC and added the section 1603 Grant program
  - 2015 - Consolidated Appropriations Act, 2016 (H.R. 2029) extended the ITC for solar energy property



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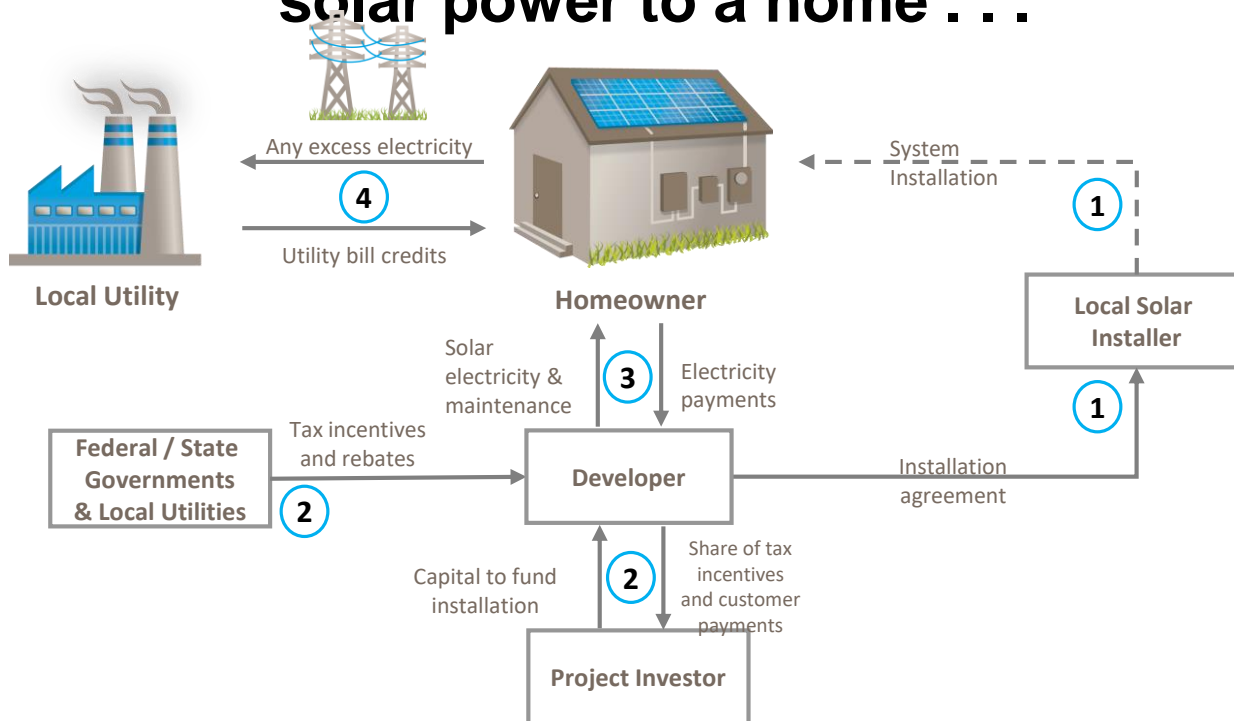
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## Many parties are involved to bring affordable and reliable solar power to a home . . .



- ① Developer contracts to have a solar facility installed on a customer's home
- ② Developer partners with a Project Investor to monetize some/most tax incentives and/or cash flows
- ③ Developer sells electricity to Homeowner under a 20-year initial term contract, maximizing energy production
- ④ Homeowner remains grid-connected, benefiting from both power sources simultaneously



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## S CORPORATIONS

Recent Developments



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## Agenda

- Recent S Corporation Guidance
- 2018-2019 Priority Guidance Plan
- LB&I Campaign - S Corporation Losses
- S Corporation Relevant Cases



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## Recent S Corporation Guidance

- Proposed and Final Regulations – § 199A
  - Notice 2019-07
  - Rev. Proc. 2019-11
- Proposed Regulations – § 163(j)



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## Recent S Corporation Guidance

### Rev. Proc. 2018-44 (§ 481(d))

- Automatic consent procedure to spread § 481(a) adjustment resulting from a change from cash to accrual method of accounting due to conversion of S corporation to C corporation
- Applies to both elective and nonelective changes to accrual method of accounting



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## Recent S Corporation Guidance

### Final Regulations – § 965(i)

- S corporation shareholders can elect to defer repatriation tax liability until a “triggering event” occurs
- Grantor trust owners, QSST beneficiaries and ESBT trustees are eligible to make § 965(i) election and sign transfer agreements
- Transfer of S corporation stock is a triggering event if it results in a change in ownership for U.S. federal income tax purposes, i.e., a transfer by reason of death and conversion of trust to non-grantor status is a triggering event



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## Recent S Corporation Guidance

### PLR 201840004 – Inadvertent Termination of S Election

- Operating agreement liquidated in accordance with capital accounts
- Filed tax returns consistent with being an S corporation
- IRS concluded that provisions in operating agreement created a second class of stock



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## 2018-2019 Priority Guidance Plan

- Guidance under §1361 regarding electing small business trusts



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## 2018-2019 Priority Guidance Plan

- Revenue ruling under §1371(e) on the treatment of a redemption characterized as a § 301 distribution received in the post-termination transition period



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## 2018-2019 Priority Guidance Plan

- Guidance under §1371(f) on the treatment of earnings and profits in the after post-termination transition period when an entity converts from an S corporation



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## 2018-2019 Priority Guidance Plan

- Guidance under § 1362(f) regarding the validity or continuation of an S corporation election in certain situations involving disproportionate distributions, inconsistent tax return filings, or omissions on Form 2553
- IRS Informal No-Rule Position?



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## Large Business and International Division's S Corporation Losses Claimed in Excess of Basis Campaign

- Overview
- Soft Letters
- Practice Unit and Update to Schedule E



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## S Corporation Relevant Cases

- ***Machacek v. Commissioner***, No. 12701-11 (6th Cir. Oct. 12, 2018): Economic benefits resulting from S corporation's payment of premium on shareholder-employee's life insurance policy under compensatory split-dollar arrangement can be treated as a shareholder distribution instead of compensation



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## S Corporation Relevant Cases

- ***Ronnie J. Smith, et ux. v. Commissioner***, T.C. Memo 2018-170 (Oct. 15, 2018): Married personal services S corporation owners required to include in their individual income total amount income reported by S corporation; not employees of S corporation
- ***Estate of Lydia Ramirez v. Commissioner***, T.C. Memo 2018-196 (Nov. 28, 2018): Decedent did not qualify as § 469(c)(7) “real estate professional”



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