STATE OF CALIFORNIA

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September 17, 2008

Re: *Section 73 Exemption from New Construction for Active Solar Energy Systems*
Assignment No. 08-091

Dear Mr. :

This is in response to your April 21, 2008, letter to Ms. Kristine Cazadd, Chief Counsel, in which you asked us to opine on a number of questions related to whether a proposed solar energy system to be installed on a variety of different properties would be subject to property tax. In particular, you explicitly or implicitly raised several questions which are answered below.

Factual Background

In the April 21, 2008, letter, you stated that your client wished to install solar energy systems throughout California. The systems are to be installed on property belonging to various government and private property owners (the host). Under the agreements, your client will lease space on which to install the solar energy systems from the host for a nominal fee. In turn, the host will sign a solar power purchase agreement to purchase the entire output of the solar energy system for a fee determined according to a kilowatt hour schedule that increases yearly. The lease and purchase agreements are for terms of 10 to 25 years. The solar energy systems may be attached either to improvements or may be installed directly on the land, depending on the specific installation site. You provided us with a generic sample lease and power purchase agreement.

Law and Analysis

1. **Are the proposed solar energy systems subject to assessment by the State Board of Equalization (the Board) or by assessors in the counties in which the property is located?**

   The proposed solar energy systems are subject to assessment by the assessors in the counties in which the solar energy systems are located rather than by the Board.

Pursuant to article XIII, section 19 of the California Constitution, the Board is authorized to annually assess companies that transmit or sell electricity. Revenue and Taxation Code[1] section 721.5, subdivision (a)(1) provides that:

> Notwithstanding Section 721 or any other provision of law to the contrary, commencing with the lien date for the 2003-04 fiscal year, the board shall annually assess every electric generation facility with a generating capacity of 50 megawatts or more that is owned or operated by an electrical corporation, as defined in subdivisions (a) and (b) of Section 218 of the Public Utilities Code.

Likewise, Property Tax Rule[2] 905, subdivision (a), as amended by the Board on November 28, 2001, with an effective date of June 13, 2002, states, in relevant part, that:

> Commencing with the assessment for the lien date for the 2003 assessment year, an electric generation facility shall be state assessed property for purposes of article XIII, section 19 of the California Constitution if: (1) the facility has a generating capacity of 50 megawatts or more; and (2) is owned or used by a company which is an electrical corporation as defined in subdivisions (a) and (b) of section 218 of the Public Utilities Code . . . .

Both section 721.5 and Property Tax Rule 905 require the Board to assess any "electric generation facility" owned and operated by an "electrical corporation." Public Utilities Code section 218, subdivision (a) provides that:

> 'Electrical corporation' includes every corporation or person owning, controlling, operating, or managing any electric plant for compensation within this state, except where electricity is generated on or distributed by the producer through private property solely for its own use or the use of its tenants and not for sale or transmission to others.

Public Utilities Code section 218, subdivisions (b), (c) and (d) provide for a number of exceptions to the definition of "electrical corporation." Specifically, Public Utilities Code section 218, subdivision (b)(2) excludes an entity from the definition of public utility when

[1] All further statutory references are to the Revenue and Taxation Code unless otherwise specified.
[2] All Property Tax Rule or Rule references are to title 18 of the California Code of Regulations.

". . . [t]he use of or sale [of the electricity is] to not more than two other corporations or persons solely for use on the real property on which the electricity is generated . . . ."[3] Additionally, Public Utilities Code section 218, subdivision (b)(3) provides that:

> 'Electrical corporation' does not include a corporation or person employing cogeneration technology or producing power from other than a conventional power source for the generation of electricity solely for any one or more of the following purposes . . . .
>
> > (3) Sale or transmission to an electrical corporation or state or local public agency, but not for sale or transmission to others, unless the corporation or person is otherwise an electrical corporation.

"Conventional power source" as defined in Public Utilities Code section 2805 means:

> . . . power derived from nuclear energy or the operation of a hydropower facility greater than 30 megawatts or the combustion of fossil fuels, unless cogeneration technology, as defined in Section 25134 of the Public Resources Code, is employed in the production of such power.

Because solar power is not listed as a conventional power source, it is therefore excluded from this definition and, thus, falls within the category of "other than a conventional power source" under Public Utilities Code section 218, subdivision (b).

In the present case, you have stated that all of the power produced by the solar energy systems will be sold by your client only to private parties and government agencies on whose property the solar energy systems are to be erected (the host). Solar Power Purchase Agreement Section 3(a)(1) states that:

> Beginning on the Commercial Operation Date, and continuing for the term specified in Section 3(b) below, *Purchaser* shall purchase and accept delivery from *Power Provider* at the purchase price set forth in Section 3(a)(2) below, and *Power Provider* shall sell and deliver to *Purchaser*, the entire Energy Output (in such amount of output as the Generating Facility produces from time to time). *Purchaser* shall not resell any of the Energy Output. (Emphasis added.)

Because it would appear under the terms of the Solar Power Purchase Agreement that the entirety of the power produced by the solar energy systems is to be consumed on-site, it follows that your client would likely satisfy the requirements of Public Utilities Code section 218, subdivision (b)(2), which would exempt it from classification as an electrical corporation pursuant to Public Utilities Code section 218, subdivision (a). Moreover, even if some power purchase agreements permit the host to sell power off-site, your client would not be an "electrical

[3] Public Utilities Code section 218, subdivision (b)(2) also exempts from the definition of electrical corporation power used on both the property on which the electricity is generated and an adjoining parcel under certain specified conditions. Because we do not have any specific information concerning your client's particular parcels and whether they are located next to parcels under common ownership, we cannot say definitively whether this provision may apply as well.

corporation" if it met the exception in Public Utilities Code section 218, subdivision (b)(3). Thus, your client, as a solar-power producer, should be assessed by the counties in which the solar energy systems are located rather than by the Board pursuant to section 721.5.

2. In the event that the present solar energy systems are subject to county assessment, do they qualify for the exclusion from new construction pursuant to Revenue and Taxation Code section 73?

The proposed solar energy systems qualify for the exclusion from new construction pursuant to section 73 if they are fixtures for property tax purposes.

California Constitution article XIII A, section 2, subdivision (a) provides in relevant part that full cash value means the appraised value of real property as shown on the 1975-76 tax bill or "the appraised value of real property when purchased, newly constructed or a change in ownership has occurred after the 1975 assessment." Section 70, subdivision (a)(1) of the Revenue and Taxation Code defines "new construction," in part, as "[a]ny addition to real property, whether land or improvements (including fixtures), since the last lien date . . . ." Section 73, subdivision (a)(1) provides that:

> . . . the term 'newly constructed,' as used in subdivision (a) of Section 2 of Article XIII A of the California Constitution, does not include the construction or addition of any active solar energy system, as defined in subdivision (b).[4]

Section 73, subdivision (b)(1) defines "active solar energy system" as ". . . a system that uses solar devices, which are thermally isolated from living space or any other area where the energy is used, to provide for the collection, storage, or distribution of solar energy."

Property Tax Rule 122.5, subdivision (a)(1) defines the term "fixture" as:

> . . . an item of tangible property, the nature of which was originally personalty, but which is classified as realty for property tax purposes because it is physically or constructively annexed to realty with the intent that it remain annexed indefinitely.

Property Tax Rule 122.5 provides several tests for determining whether a piece of personal property becomes a fixture upon its attachment to land or an improvement. In the present case, the first relevant test is the physical annexation test.

> Property is physically annexed if it is attached to, imbedded in, or permanently resting upon land or improvements in accordance with section 660 of the Civil Code, or by other means that are normally used for permanent installation. If the property being classified cannot be removed without substantially damaging it or the real property with which it is being used, it is

[4] It should be noted that section 73 is scheduled to sunset on January 1, 2010. A bill to reenact section 73 with some amendments, AB 1451, passed the Senate on August 14, 2008 and the Assembly on August 18, 2008. The bill has been sent to enrollment.

> to be considered physically annexed. If the property can be removed without material damage but is actually attached, it is to be classified as a fixture unless there is an intent, as manifested by outward appearance or historic usage, that the item is to be moved and used at other locations.[5]

The second relevant test is the intent test.

> Intent is the primary test of classification. Intent is measured with—not separately from—the method of attachment or annexation. If the appearance of the item indicates that it is intended to remain annexed indefinitely, the item is a fixture for property tax purposes. Intent must be inferred from what is reasonably manifested by outward appearance. An oral or written agreement between parties, such as a contract between lessor and lessee, is not binding for purposes of determining intent.[6]

As the rule states, the intent of the parties is the primary measure of whether the solar energy systems should be regarded as fixtures or as personal property.[7]

In the present case, you have provided us with few specifics regarding the solar energy systems and the locations at which your client intends to install them. For this reason, we must state certain assumptions regarding the installation of these solar energy systems, and in the event that these installations differ materially from those described, our analysis could be subject to change.

First, while we have little information concerning the solar energy systems that your client intends to install, we assume they are of substantial size and weight.

In your correspondence of April 21, 2008, you stated that "[s]ystems may be either roof-mounted or ground-mounted." If the systems are ". . . affixed to Host facility roofs, the Systems become the ballast for the roof structures." In other cases, when the solar energy systems are connected directly to the ground, "[e]arth-constructed Systems require footings and connections necessary to construct and affix the Solar Energy System in such a manner to secure it to the earth, protecting it from elements and wind events up to 120 mph."

You also stated that the solar energy systems will be placed on property leased from the host for periods of between 10 and 25 years. Under a separate power purchase agreement, the host will agree to purchase power according to a schedule of payments per kilowatt hour that will increase each year that the agreement is in effect.

Based on the information you have provided, it appears to us that the solar energy systems in question would qualify as "active solar energy systems" as defined by section 73, subdivision (b)(1). Thus, your client's solar energy systems will qualify for the exclusion if they qualify as fixtures pursuant to Property Tax Rule 122.5.

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[5] Prop. Tax Rule 122.5, subd. (b)(1).
[6] Prop. Tax Rule 122.5, subd. (d)(1).
[7] See also *Crocker Nat'l Bk. v. City and County of San Francisco* (1989) 49 Cal.3d 881, 886-887.

The solar energy systems in question appear to be physically-annexed to the structures or land in that they do not appear to be readily moveable or mobile. Rather, they appear to be anchored in place both with regard to improvements or to land in order to protect them against the elements and likely could not be removed without causing damage or disturbance to the land and/or improvements. This satisfies the physical annexation test.

With regard to the intent test, it appears to us that the solar energy systems in question are to be indefinitely attached to either improvements or to the land itself. While the contracts state that the solar energy systems are to be placed for periods of 10 to 25 years, Property Tax Rule 122.5, subdivision (d)(1) explicitly states that a lease ". . . is not binding for purposes of determining intent." Rather, the physical attachment of the solar energy systems to the improvement and/or the land, the power purchase agreements and the structural damage that would result to the improvements and/or land upon removal suggest that the parties to these transactions intend to annex the solar energy systems to the real property indefinitely.

For the above-stated reasons, assuming there are no additional, material facts of which we are unaware, your client's solar energy systems may be classified by the county assessor as fixtures pursuant to Property Tax Rule 122.5. Therefore, active solar energy systems subject to leaseholds and power purchase agreements such as (but not limited to) those executed by your client will qualify for the exclusion from new construction pursuant to section 73.

3. Because you have stated that some of the proposed solar energy systems would be installed on state or local government-owned property in California, would these solar energy systems be subject to taxation as taxable possessory interests?

We lack sufficient specific information concerning the installation of your client's solar energy systems on government land to render a decision on this issue.

You ask whether your client may be responsible for property taxes on a taxable possessory interest in the event that its solar energy systems are erected on land and/or improvements belonging to government agencies. However, you have not provided us with any specific facts related to the installation of a solar energy system on a particular government-owned property, such as an executed power purchase agreement or a lease. For this reason, we cannot provide an analysis of whether a taxable possessory interest would arise in your client's situation. Generally, however, a taxable possessory interest exists when a taxpayer possesses an interest in government real property that is durable, independent, exclusive of the rights held by others in the real property and the interest provides a private benefit to the possessor.[8]

[8] See Rev. & Tax. Code, § 107, subd. (a); Property Tax Rule 20, subd. (a)(1). See also Annotations 660.0100, 660.0142 and 660.0172 among others.

The opinions expressed in this letter are only advisory and represent the analysis of the Legal Department based on current law and the facts set forth herein. These opinions are not binding on any person, office, or entity.

Sincerely,

/s/ Andrew Jacobson

Andrew Jacobson
Tax Counsel

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cc: Honorable Kenneth Stieger, President
California Assessors' Association

Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70