North Carolina Department of Revenue

Pat McCrory
Governor

Lyons Gray
Secretary

April 16, 2014

[redacted]

Re: The Application of the Business and Energy Tax Credits to a Solar Photovoltaic Facility in [redacted]

Dear [redacted]:

This letter is in response to your letter dated [redacted], wherein you requested that the North Carolina Department of Revenue ("Department") issue an expedited private letter ruling on behalf of your client, [redacted] ("Taxpayer/Lessee"), regarding the application of the tax credit for investing in renewable energy property (the "NC Tax Credit"), N.C. Gen. Stat. § 105-129.15 et seq., to a solar photovoltaic electricity generating project to be located in [redacted] (the "PV Facility").

The statement of facts submitted for the Department's consideration is summarized as follows:

[redacted], a North Carolina limited liability company ("Owner/Lessor") is pursuing the development of the PV Facility. The PV Facility will be comprised of several installations of solar photovoltaic electricity generation equipment (each an "Installation"). Each Installation will function independently to produce electricity per the rated output of each such Installation and will consist of a number of solar PV modules and inverters and wiring and balance of system components, transformers, metering and monitoring equipment, and other ancillary equipment. Each Installation, standing alone or in combination with other machinery, equipment or real property, will be able to produce usable energy on its own.

The PV Facility will generate electricity to be delivered to a transformer(s) and distribution line owned and operated by a regulated public utility before being exported to the electric grid. Owner/Lessor has entered or will enter into (i) an interconnection agreement with the Utility to govern the terms of the interconnection of the PV Facility and (ii) a power purchase agreement with the Utility (the "PPA"), pursuant to which the electricity generated by the PV Facility will be sold to the Utility. Accordingly, each Installation will be used for a business purpose. Owner/Lessor will assign certain of its rights under the PPA to Taxpayer/Lessee.

All of the issued and outstanding membership interests of Owner/Lessor and Taxpayer/Lessee are currently owned by [redacted]. Prior to the date the first Installation comprising the PV Facility is placed in service, it is expected that a federal tax equity investor will be admitted as a direct or indirect member of Owner/Lessor, and a state tax equity investor will be admitted as a direct or indirect member of Taxpayer/Lessee. The members of Owner/Lessor, including the expected federal tax equity investor, will receive an allocation of the Federal Energy Credit proportionate to its interest in the income and loss of Owner/Lessor. Similarly, the members of Taxpayer/Lessee, including the expected state tax equity investor, will receive an allocation of the NC Tax Credit proportionate to its interest in the income and loss of Taxpayer/Lessee. The NC Tax Credit will be allocated in its entirety to the members of Taxpayer/Lessee in accordance with the requirements of N.C. Gen. Stat. § 105-269.15. Neither Owner/Lessor nor Taxpayer/Lessee has elected to be taxed as an association taxable as a corporation.

[redacted] ("[redacted] Contractor") will construct and install each Installation and the balance of the assets comprising the PV Facility under an [redacted] Agreement (the "[redacted] Agreement") with Owner/Lessor. The [redacted] Contractor will transfer possession and control of each such Installation to Owner/Lessor when the construction is substantially complete, and the parties will conduct critical testing and synchronization into the power grid. After successful testing and the completion of the Installations, Owner/Lessor will transfer possession and control of each Installation to Taxpayer/Lessee, and the term of the Equipment Lease will commence. Taxpayer/Lessee will then commence regular operation of each such Installation. The date the PV Facility is placed in service (the "Placed-in-Service Date") will be certified by an independent engineer.

Prior to the Placed-in-Service Date, Owner/Lessor and Taxpayer/Lessee will enter into an equipment lease (the "Equipment Lease"), pursuant to which Owner/Lessor will lease each of the Installations to Taxpayer/Lessee. The Equipment Lease will be structured as an operating lease for federal income tax and financial accounting purposes. During the term of the Equipment Lease, Lessee will use, operate and maintain each Installation and the site upon which it is located to generate and sell renewable energy. Taxpayer/Lessee will be prohibited under the Equipment Lease from subleasing the Installations.

Pursuant to the Equipment Lease, rent will be established and paid based on a fixed-rent schedule set forth in the Equipment Lease (whereby tax rents will equal cash rents) (the "Rental Accrual"). The Equipment Lease will provide that the amount of rent payable during the tax year in which the Placed-in-Service Date occurs is equivalent to approximately [redacted] of the costs incurred by Owner/Lessor to develop, construct and install each of the Installations. These costs are eligible for the NC Tax Credit. The Rental Accrual will establish lower payments in subsequent annual periods which are expected to remain constant in amount for the balance of the term of the Equipment Lease.

Owner/Lessor will certify in writing to Taxpayer/Lessee that it will not make a claim to the NC Tax Credit; however, Owner/Lessor will not pass-through the federal energy credit under Section 48 of the Code. A federal grant in lieu of the Federal Energy Credit is not applicable or otherwise available for the PV Facility. Since Taxpayer/Lessee will claim the NC Tax Credit, and Owner/Lessor will not make a lease pass-through election under the Code, Taxpayer/Lessee proposes to calculate the NC Tax Credit based on the sum of the values of each Installation pursuant to N.C. Gen. Stat. § 105-129.15(2). In other

words, the basis for the NC Tax Credit to Taxpayer/Lessee will be [redacted] times the net annual rental rate paid by Taxpayer/Lessee for each Installation.

REQUESTED RULING:

In determining the net annual rental rate for purposes of calculating the amount of the NC Tax Credit under the second sentence of N.C. Gen. Stat. § 105-129.15(2), will North Carolina recognize Taxpayer/Lessee's rent expense, as determined for federal income tax purposes under Section 467 of the Code, for the year in which each of the Installations is placed into service?

Department's Response:

Based on our review of the information provided, together with our understanding of the relevant legal authority, we agree with your analysis and conclusion as presented in your letter. For purposes of determining the net annual rental rate for purposes of calculating the amount of the NC Tax Credit under the second sentence of N.C. Gen. Stat. § 105-129.15(2), the Department will recognize Taxpayer/Lessee's rent expense, as determined for federal income tax purposes under Section 467 of the Code, for the year in which each of the Installations is placed into service.

Since Owner/Lessor will provide the necessary certification to Taxpayer/Lessee that it will not claim the NC Tax Credit and will not elect to pass-through the Federal Energy Credit or a federal grant in lieu thereof, Taxpayer/Lessee is entitled to claim the NC Tax Credit. Pursuant to N.C. Gen. Stat. § 105-129.16A, the credit amount allowed is equal to thirty-five percent (35%) of the cost of the renewable energy property. For purposes of determining the basis on which the NC Tax Credit is computed, N.C. Gen. Stat. § 105-129.15(2) refers a taxpayer leasing renewable energy property under the circumstances described therein to N.C. Gen. Stat. § 105-130.4(j)(2).

Importantly, N.C. Gen. Stat. § 105-130.4 addresses the calculation of the North Carolina apportionment factor for purposes of calculating a multi-state business taxpayer's state tax liability. To determine the property factor with respect to leased property, subsection (j)(2) of the statute instructs Taxpayer/Lessee to multiply the "net annual rental rate" of its leased property by eight (8). As a result, the basis of Taxpayer/Lessee's NC Tax Credit will be calculated as a multiple of eight (8) times Taxpayer/Lessee's net annual rent paid under the Equipment Lease.

Although N.C. Gen. Stat. §§ 105-129.15(2) and 105-130.4(j)(2) are clear that the "cost" of renewable energy property that is leased by a taxpayer is measured and calculated based on the net annual rent for the year the property is placed in service, the North Carolina Revenue Law does not address the precise method for determining the "net annual rental rate." In this case, according to the Statement of Facts, Taxpayer/Lessee and Owner/Lessor will follow Section 467 and the related federal regulations in accounting for the rent under the Equipment Lease. The Rental Accrual agreed to by Taxpayer/Lessee and Owner/Lessor will treat rent consistently between them and will establish rental income/expense for the initial year of the Equipment Lease in the amount of receivable/payable pursuant to the agreement. Importantly, the initial year's rent payment under the agreement will be established at approximately one-eighth (l/8th) of Owner/Lessor's costs to develop, construct and install each Installation. As a result, the basis computed under N.C. Gen. Stat. § 105-130.4(j)(2) will approximate the NC Tax Credit as if Taxpayer/Lessee was entitled to use the I.R.C. § 1012 cost of each Installation, as otherwise permitted

by the first sentence of N.C. Gen. Stat. § 105-129.15(2). Since our statutes and regulations are silent with respect to a methodology for determining the net annual rent in these circumstances, the Department will follow the federal code, including IRC § 467, and allow Taxpayer/Lessee to conform their determination of net annual rent for North Carolina apportionment property factor purposes to the same treatment accorded for federal income tax purposes.

This ruling is based solely on the facts submitted to the Department of Revenue for consideration of the transactions described. If the facts and circumstances given are not accurate, or if there are other facts that were not disclosed that might cause the Department to reach a different conclusion, then the taxpayer requesting this ruling may not rely on it. A letter ruling is not equivalent to a Technical Advice Directive that generally affects a large number of taxpayers. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that this document is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

Sincerely,

