Is It Safe? – A Solar Safe Harbor

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In this article, Moran, Gambino, and Chase suggest that the IRS issue a safe harbor for solar energy assets regarding the investment tax credit similar to safe harbors for wind energy assets and the rehabilitation tax credit. They argue that an investment tax credit safe harbor would provide criteria for an investment structure, improve transaction efficiency, and reduce transaction expenses.

By all accounts, the growth of the renewable energy industry has been unprecedented and is expected to continue for years to come.[1] A huge contributing factor for that growth is solar energy, which has been one of the fastest growing renewable energy sources.[2] In 2016 alone, the United States installed nearly 14.8 gigawatts of solar photovoltaic systems,[3] and forecasters expect total installed U.S. solar photovoltaic capacity to nearly triple over the next five years.[4]

Despite these expected milestones, solar energy is a relatively new source of power, and its parity with fossil fuels is still lacking regarding cost and intermittence (that is, time-of-day usage). Recognizing this, in 2015 Congress extended the section 48 investment tax credit.[5] This extension provides the solar energy industry additional time to improve technologies and induce further participation of investors and lenders, thereby feeding a cycle of development and investment that will sustain capital needs of solar developers. It also gives Treasury and the IRS the time and incentive to provide much-needed guidance to the

[1]U.S. Energy Information Administration, "Annual Energy Outlook 2017" (Jan. 5, 2017); Bloomberg New Energy Finance and the Business Council for Sustainable Energy, "2017 Sustainable Energy in America Factbook" (2017) (Sustainable Energy in America Factbook).

[2]Solar Energy Industries Association, "Solar Market Insight Report 2016 Year in Review" (2017) (SEIA 2016 report).

[3]SEIA 2016 report; Sustainable Energy in America Factbook.

[4]SEIA 2016 report.

[5]The Consolidated Appropriations Act of 2016, P.L. 114-113. Under current law, the amount of ITC is 30 percent of eligible basis if construction of energy property begins before January 1, 2020; 26 percent if construction begins after December 31, 2019, and before January 1, 2021; and 22 percent if construction begins after December 31, 2020, and before January 1, 2022. Otherwise, the ITC is 10 percent if construction begins after January 1, 2022 — or before January 1, 2022, if the subject property is not placed in service before January 1, 2024. Section 48(a)(6).

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solar energy space. As previously discussed in the Power & Taxes column,[6] what is and isn't solar energy equipment for purposes of section 48 has been given a fair bit of attention in prior IRS rulings and Treasury regulations under former section 48.[7] What is lacking, however, is guidance on structures to own, lease, and partner with developers to hold solar energy assets. Our suggestion is that the IRS issue a safe harbor for solar energy assets, as it has done for wind energy assets and the rehabilitation tax credit (RTC).

Like the wind energy and RTC safe harbors, solar safe harbor guidance (an ITC safe harbor) would provide clear criteria for solar energy investment structures, thus significantly improving transaction efficiency and reducing transaction expenses. The wind energy and RTC spaces have enjoyed these benefits by virtue of Rev. Proc. 2007-65[8] (the production tax credit (PTC) safe harbor) and Rev. Proc. 2014-12[9] (the RTC safe harbor), respectively. In our experience, there has been little, if any, deviation from the criteria set forth in the PTC and RTC safe harbors in the wind energy and RTC-related industries. This strongly suggests that clear guidance by the government leads to greater adherence and compliance by taxpayers.

Although the ITC is certainly different from the PTC or RTC, many of the concepts set forth in the PTC and RTC safe harbors should be equally applicable to solar investments. While there are some important features regarding the nature of solar projects and the ITC that differ materially from wind projects and rehabilitated buildings and the PTC and RTC, these differences can be easily dealt with accordingly and should not preclude the IRS from issuing guidance that is logical, commercially reasonable, and consistent with sound tax principles.

[6]*See* Sean Moran, Nicole Gambino, and Lauren Chase, "Back to the Beginning: Energy Property Revisited," *Tax Notes*, Dec. 19, 2016, p. 1493.

[7]Reg. section 1.48-9; LTR 201444025 (ruling that energy property includes storage); LTR 201308005 (same); LTR 201208035 (same); LTR 201142005 (same).

[8]2007-2 C.B. 967, as revised by Announcement 2007-112, 2007-2 C.B. 1175, and Announcement 2009-69, 2009-1 C.B. 1023 (applicable to transactions occurring on or after Nov. 5, 2007).

[9]2014-1 C.B. 408 (applicable to transactions occurring on or after Dec. 30, 2013).

I. Existing Tax Credit Safe Harbors

A. The PTC Safe Harbor

Section 45 provides PTCs for taxpayers that own (directly or through a partnership or other passthrough entity) specific renewable energy resources — for example, wind, biomass, and geothermal deposits[10] — in the amount of 1.5 cents, adjusted for inflation,[11] per kilowatt-hour of energy produced and sold by the renewable energy facility for the 10-year period beginning on the date the facility is placed in service.[12] Because wind projects experience intermittent periods of production attributable to the variability of the wind resource, providing a production-based tax credit puts wind on more equal economic footing with other sources of power and attracts purchasers of wind power (that is, offtakers), sponsors/developers, investors, and lenders to the wind industry.

The PTC safe harbor applies to partnerships claiming PTCs for "qualified wind facilities" and provides that the IRS will respect the allocation of PTCs by partnerships in accordance with section 704(b) if they satisfy the PTC safe harbor's requirements for qualified wind facilities.[13] The safe harbor applies to any partnership (the "project company") between a project developer and one or more investors — defined as partners in the project company whose investment return is reasonably anticipated to be derived from both PTCs and participation in operating cash flow[14] — with the project company owning and operating the qualified energy facility.[15]

The major requirements set forth under the PTC safe harbor are generally as follows:

[10]Taxpayers who construct or own specific facilities eligible for PTCs can elect instead to claim the ITC. Section 48(a)(5).

[11]The PTC is currently 2.4 cents per kilowatt-hour. Notice 2017-33, 2017-22 IRB 1256.

[12]Section 45(a).

[13]*See* PTC safe harbor, section 1. It's not clear why the PTC safe harbor was narrowly drafted to cover only section 704(b) allocations; presumably, if a transaction satisfies the requirements of the PTC safe harbor, it should be respected for other U.S. federal income tax purposes.

[14]*Id.* at section 4.01.

[15]*Id.* at section 3. Note that unlike section 48, which permits an ITC in certain lease structures, section 45 requires direct ownership (or indirect ownership through a passthrough entity) of a wind facility. Section 45(d)(1).

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- the developer must have a minimum 1 percent interest in each material item of partnership income, gain, loss, deduction, and credit, and each investor must have a minimum interest in each material item of partnership income and gain equal to 5 percent of the investor's largest percentage interest in partnership income and gain;
- the investor must make an initial investment equal to at least 20 percent of the sum of fixed capital contributions and reasonably anticipated contingent capital contributions;
- at least 75 percent of the investor's fixed capital contributions plus reasonably anticipated contingent capital contributions must be fixed and determinable;
- any option to purchase the wind farm by the developer, the investor, or any related party must be for at least the fair market value of the property (determined at the time of exercise) or, if the purchase price is determined before exercise, must be at a price that the parties reasonably believe will not be less than the FMV of the property when the right may be exercised;
- if the developer has a call option, it may not be exercisable earlier than five years after the wind farm is first placed in service;
- the investor may not have a "put right"; and
- no person may guarantee or otherwise assure the investor of the right to any allocation of PTCs, and the project company must bear the risk that the available wind resource is not as great as anticipated or projected.[16]

B. The Rehabilitation Tax Credit Safe Harbor

Similar to the PTC and ITC, which seek to attract investment in renewable energy assets, the RTC seeks to attract investment for the restoration of historical buildings because generally, on their own, historical buildings do not generate enough revenue to cover the significant costs of rehabilitation.[17] Therefore, Congress enacted the RTC in 1978 to spur revitalization of some historical buildings.[18] The RTC is available to taxpayers that make qualified rehabilitation expenditures and is equal to 10 percent of qualified rehabilitation expenditures for any "qualified rehabilitated building"[19] and 20 percent of qualified rehabilitation expenditures for "certified historic structures."[20]

The RTC safe harbor was enacted, in part, in response to *Historic Boardwalk Hall*,[21] in which the Third Circuit held that an investor did not have a valid equity interest in a partnership claiming RTCs because the investor was not required to make a capital contribution to the partnership until it had been verified that the subject project would generate tax credits that were at least equal to the sum of the investor's capital contributions to date. If a transaction satisfies the requirements set forth in the RTC safe harbor, the IRS will respect the allocation of RTCs by a partnership to an investor.[22]

Along the lines of the PTC safe harbor, the major requirements set forth under the RTC safe harbor are generally as follows:

- the developer must have a minimum 1 percent interest and the investor must have a 5 percent interest in each material item of partnership income, gain, loss, deduction, and credit;
- the investor must make a minimum upfront investment equal to at least 20 percent of the investor's total expected capital contributions;
- at least 75 percent of the sum of the investor's capital contributions must be fixed; and

[16]PTC safe harbor, section 4.

[17]IRS Market Segment Specialization Program, "Rehabilitation Tax Credit" (2002) (explaining that the RTC was enacted to promote urban and rural revitalization and to encourage private investment in rehabilitating historical buildings).

[18]Revenue Act of 1978, P.L. 95-600. *See also id.*

[19]As defined in section 47(c)(1)(A). Section 47(a)(1).

[20]As defined in section 47(c)(3)(A). Section 47(a)(2).

[21]*Historic Boardwalk Hall LLC v. Commissioner*, 694 F.3d 425 (3d Cir. 2012), *rev'g* 136 T.C. 1 (2011).

[22]Partnerships subject to the scope of the RTC safe harbor include partnerships that own and restore a qualified rehabilitated building or a certified historic structure, and partnerships that lease a qualified rehabilitated building or a certified historic structure and for which an election is made in accordance with reg. section 1.48-4(a)(1) to treat the lessee as having acquired the qualified rehabilitated building or a certified historic structure for purposes of the RTC. RTC safe harbor, section 3.

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- any guarantees provided to the investor must not be impermissible guarantees.[23]

The RTC safe harbor requires that the investor's interest in a partnership "constitute a bona fide equity investment with a reasonably anticipated value commensurate with the Investor's overall percentage interest in the Partnership, separate from any federal, state, and local tax deductions, allowances, credits, and other tax attributes to be allocated by the Partnership to the Investor."[24] The RTC safe harbor further provides that a partnership agreement cannot provide for a call option to purchase or redeem the investor's interest, but may include a put right as long as the price to exercise it is no more than the FMV of the purchased interest at the time of exercise.[25]

II. Section 48 and the Investment Tax Credit

The ITC is designed to address the major impediment historically found in the solar industry — that of cost. Unlike wind and some other renewable assets, solar development (big or small) is relatively expensive. While generally subject to fairly accurate forecasting, solar energy is an intermittent resource and produces power most often during the time of day when usage is at its lowest (that is, solar energy reaches its peak generation midday, whereas there is the most need for energy in the evening). Given these facts, and to spur investment, Congress took a different approach from that of the PTC and provided an upfront credit (as opposed to a credit based on production) on the basis of eligible property[26] when that property is placed in service by the taxpayer.[27] The ITC has undeniably accomplished many of Congress's stated goals and helped create the potential for solar energy to be a reliable and long-term source of power.[28]

III. A Solar Safe Harbor

An ITC safe harbor, akin to the PTC and RTC safe harbors, would create additional certainty in the solar energy industry. An ITC safe harbor would assure taxpayers that as long as specific requirements are followed, the IRS will respect the allocation of ITCs by partnerships in accordance with section 704(b). The government would obviously benefit because it would be

[23] RTC safe harbor, section 4.

[24] *Id.* at section 4.02(2)(b). We are unaware of any guidance from the IRS or elsewhere regarding the meaning of "a reasonably anticipated value commensurate with the investor's overall percentage interest in the partnership." The vagueness of this requirement is especially odd in the context of a safe harbor.

[25] *Id.* at section 4.02(6). This is obviously inconsistent with the PTC safe harbor and case law. *See, e.g.*, *Transamerica Corp. v. United States*, 15 Cl. Ct. 420 (1988), *aff'd*, 902 F.2d 1540 (Fed. Cir. 1990) (holding that "the fact that the parties expected the option to be exercised is not inconsistent with the intent to enter into a leasing transaction"); *Lockhart Leasing Co. v. United States*, 446 F.2d 269, 272 (10th Cir. 1971) (finding a true lease when the amount of a fixed purchase option negotiated at the commencement of a lease was based on the expected FMV at the end of the lease term); *Belz Investment Co. Inc. v. Commissioner*, 72 T.C. 1209, 1228-1229 (1979), *aff'd on other grounds*, 661 F.2d 76 (6th Cir. 1981) (finding a true lease when there was no reason to believe that the fixed purchase option did not reflect FMV); and *LTV Corp. v. Commissioner*, 63 T.C. 39, 50 (1974) (finding a true lease in a transaction that included a fixed purchase option at expected FMV). Therefore, we believe this requirement should be viewed as unique to the RTC space.

While there is case law that has recharacterized a transaction, in part, because there was an FMV call option, each of these cases involved other facts indicating that there was a likelihood that the purchase option would be exercised, regardless of whether it was at FMV. *Consolidated Edison Co. of New York Inc. v. United States*, 703 F.3d 1367, 1381 (Fed. Cir. 2013) (recharacterizing a lease agreement on the grounds that there was a reasonable likelihood that an FMV purchase option would be exercised); *John Hancock Life Insurance Co. v. Commissioner*, 141 T.C. 1 (2013) (holding that the transaction at issue should be recharacterized as a loan because there was a reasonable likelihood that a lease purchase option would be exercised); *AWG Leasing Trust v. United States*, 592 F. Supp.2d 953 (N.D. Ohio 2008) (holding that a sale-leaseback transaction should be recharacterized as a lending transaction when there was a high likelihood that the purchase option would be exercised). Absent factors indicating that there is compulsion or it is likely that a purchase option will be exercised, there is no reason not to permit an FMV call option.

[26] Technologies eligible for the ITC include solar energy property, geothermal energy property, and specific PTC-eligible property for which the ITC can be claimed. Section 48(a)(3); section 48(a)(5).

[27] Section 48(a)(1).

[28] *See* discussion, *supra* notes 1-4.

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setting forth sound guidance that is consistent with tax policy and would reduce the need for audits.[29]

Since the solar industry uses many of the same investment structures as used in PTC and RTC transactions, we believe that the IRS should use many of the same principles found in the PTC and RTC safe harbors in an ITC safe harbor.

A. Defining Investor

There is no reason to think that an investor in a partnership that intends to generate ITCs should not be required to anticipate producing a return from its investment in the partnership.[30] That said, the government has indicated that when tax benefits are designed to encourage investment (such as the ITC), they should be treated as an item of cash in calculating an investor's return.[31] Accordingly, an ITC safe harbor should clarify that in determining whether an investor has a good equity investment in the company (or that its investment has economic substance), the anticipated ITC may be treated as a pretax item.

B. Minimum Interest

The minimum interest requirement found in the PTC and RTC safe harbors ensures that the developer and the investor retain the benefits and burdens of the tax consequences of the partnership during the term of their investment in the partnership. Based on our experience, this constraint has been complied with in most, if not all, partnership transactions in the solar market. This requirement is consistent with general tax ownership principles (that is, it requires more than a *de minimis* interest in the partnership) and the common law principle that an investor must have a meaningful stake in the success or failure of the partnership.[32]

C. Initial Investment in the Partnership

Of course, it is reasonable for an investor to be required to make a meaningful upfront investment in a partnership in order to obtain an equity interest in the partnership and to be required to maintain it.[33] The more material question to us is the timing of the investment given that section 48 requires that the taxpayer claiming the ITC place the asset in service — in other words, the investor is already statutorily required to be a partner before the asset is placed in service. As we have previously addressed in this Power and Taxes column, requiring an investor to make its investment before the date an asset is placed in service creates significant commercial and practical issues.[34]

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[29] A major caveat is a potential for IRS challenge on the tax basis of solar energy property. While there are undoubtedly abuses on occasion, in our experience, the concluded fair market basis is grounded in arm's-length negotiations and closely reviewed and challenged appraisals.

This is not to suggest that we do not believe that investors and developers should continue to seek comprehensive and well-reasoned appraisals. Instead, we believe that appraisal methods should be standardized and the IRS should provide clear guidelines on the appropriate manner for valuing renewable energy systems. We hope that the recent *Alta* decision will serve to reduce difficulty and uncertainty regarding value-based challenges. *Alta Wind I Owner-Lessor C v. United States*, 118 A.F.T.R. 2d 6344 (2016) (holding that the taxpayer's basis for determining the amount of American Recovery and Reinvestment Act of 2009 section 1603 grant-eligible property is the purchase price paid for the subject wind farm). This topic deserves much more attention than a footnote, but we will save further commentary for a future column.

[30] This would be consistent with general tax principles, which define a partner in a partnership as a member that has joined other members to carry on a trade, profession, or business, when there is a community of interest in the profits and losses. Section 761(b); section 7701(a)(2); reg. section 1.761-1(b); *Commissioner v. Tower*, 327 U.S. 280, 286 (1946).

[31] *See* Joint Committee on Taxation, "Present Law and Background Relating to Tax Credits for Electricity Production From Renewable Sources," JCX-36-05 (May 19, 2005) (advising taxpayers that when making an investment decision, a taxpayer should view PTCs as a subsidy that is part of the taxpayer's stream of revenue). As stated in Rev. Rul. 86-100, 1986-2 C.B. 3, section 48 reflects the same congressional intent as section 29 in that it encourages domestic energy conservation and production. *See also* S. Rep. No. 108-192 (2003); *Sacks v. Commissioner*, 69 F.3d 982 (9th Cir. 1995); *Friendship Dairies Inc. v. Commissioner*, 90 T.C. 1054 (1988); *Fox v. Commissioner*, 82 T.C. 1001, 1021 (1984); reg. section 1.269-2.

[32] *See TIFD III-E Inc. v. United States*, 459 F.3d 220, 232 (2d Cir. 2006), *rev'g* 342 F. Supp.2d 94 (D. Conn. 2004) (holding that the issue of whether a partner held an equity interest in a partnership or was a lender ultimately turned on whether the purported partner had a meaningful stake in the success or failure of the business, *i.e.*, "whether the 'funds were advanced with reasonable expectations of repayment regardless of the success of the venture or were placed at the risk of the business'"); and *Coleman v. Commissioner*, 87 T.C. 178, 204 (1986), *aff'd*, 833 F.2d 303 (3d Cir. 1987) (determining whether a taxpayer is the owner of an asset, for tax purposes, requires examining whether the taxpayer has the benefits and burdens of ownership; if the taxpayer does not have the benefits and burdens, he will likely not be considered the owner of the asset).

[33] *See, e.g., Hartman v. Commissioner*, T.C. Memo. 1958-206 (relying in part on a contribution of substantial capital as an indicia of equity ownership); *Hunt v. Commissioner*, T.C. Memo. 1990-248 (same); *cf. Historic Boardwalk*, 694 F.3d 425.

[34] *See* Moran, Gambino, Chase, and Lysondra Ludwig, "Renewable Power Facilities: Placed-in-Service Issues," *Tax Notes*, May 23, 2016, p. 1109; Moran, Gambino, Chase, and Ludwig, "The Unwind: 'I Don't Want It,'" *Tax Notes*, Sept. 12, 2016, p. 1567.

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Further, while an upfront investment is not controversial in the ITC space (particularly given the placed-in-service requirement in section 48), in the PTC safe harbor, presumably, the IRS believed that the parties would set the initial investment amount on a negotiated arm's-length basis and establish the appropriate ratio of initial capital contribution based on future projected PTCs and other returns on the project. An upfront tax credit such as the ITC, however, creates additional complexity as to the amount of an investment, given that investors recognize a large portion of their return shortly after making their upfront investment (that is, the investor will receive its share of the 30 percent ITC soon after making its initial investment).

Accordingly, it may be appropriate for an ITC safe harbor to require the investor's initial investment in an ITC partnership to exceed 20 percent — the more appropriate size of the initial investment would be some material amount (for example, 15 or 20 percent of the investor's total expected capital contributions) after reduction for the anticipated ITC.[35] In other words, rather than merely requiring a 20 percent upfront investment, an ITC safe harbor may require that the amount initially invested be at least equal to the value of the ITC that the investor expects to receive plus a material percentage of its remaining investment.

D. Put and Call Options

The requirement that a purchase option be for no less than FMV is implicitly reasonable. Certainly, it would create perverse incentives and undermine the equity nature of the investor's interest if the developer were entitled to call the investor's interest for less than FMV or, alternatively, if the investor could force a sale for an amount in excess of FMV (thereby guaranteeing its return). Similarly, an unrestricted investor put option gives the investor the ability to walk away from its investment and eliminate downside risk and may result in the investor's interest in the company being more akin to debt (especially if the anticipated FMV of the interest is determined at the time of investment, as opposed to determining the anticipated FMV at the time of exercise).[36]

Accordingly, we believe that similar to the PTC safe harbor, the ITC safe harbor should permit a developer call option, if the purchase price is no less than the FMV determined at the time of exercise or if the purchase price is determined before exercise, at a price that the parties reasonably believe will not be less than the FMV of the property when the right may be exercised.

E. Guarantees

The general consensus is that the prohibition on guarantees in the PTC and RTC safe harbors is meant to disallow structural indemnifications of the right to claim the applicable credit. It is also generally agreed that a standard indemnification obligation for unrelated representations (for example, regarding title or absence of liens on the property), which if breached can cause a reduction or loss of the applicable credit as a collateral consequence, is not a prohibited guarantee under either the PTC or RTC safe harbor.

We believe that a restriction on guaranteeing the allocation of the credit should be included in an ITC safe harbor, as in the RTC and PTC safe harbors, because a guarantee of the credit tends to rise to the level of a structural protection that may call into question the equity nature of an investment. Consistent with general tax ownership principles and the market generally, however, we suggest that an ITC safe harbor unequivocally permit factual representations from developers. This is especially true for representations regarding value or basis because (1) the underlying information and data are possessed and will be determined by the developers; (2) the industry is still at an early

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[35] As indicated above, an owner of solar energy property may lease the property without sacrificing the ability to claim the ITC, or alternatively, a lessee of solar energy assets may be eligible for the ITC. Section 48(d)(6) (before repeal in 1990), as incorporated into post-1989 law by section 50(d)(5).

Rev. Proc. 2001-28, 2001-1 C.B. 1156 (known generally as the leasing guidelines), provides a safe harbor for leases of property generally. *See also* Rev. Proc. 2001-29, 2001-1 C.B. 1160. That raises the question of whether the leasing guidelines should be updated to require a greater than 20 percent investment for property that qualifies for a 30 percent ITC.

[36] That said, a put option should be permissible in limited circumstances outside the control of the parties (*e.g.*, if there are regulatory or other nontax requirements that make it illegal or otherwise problematic for the investor to maintain its investment).

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stage and comparable, reliable values are not readily available; and (3) the government has provided limited, and often illogical, direction for appraisal methods. Moreover, investors and developers lack the motivation to arbitrarily inflate value or basis since the parties bear the risk of the administrative time and delay of an audit and, eventually, investors bear the risk and delay of the collectability of an indemnification payment and developers bear the cost of that payment.

F. Allocation of the Credit

The PTC and RTC safe harbors require allocating applicable credits in accordance with reg. section 1.704-1(b)(4)(ii), which generally provides that because allocations of tax credits and tax credit recapture are not reflected by adjustments to the partners' capital accounts[37] and thus cannot have economic effect, tax credits and tax credit recapture must be allocated in accordance with the partners' interests in the partnership.[38] This is somewhat of a statement of the obvious and we have no reason to suggest that this requirement should not be applicable to an ITC safe harbor; however, it raises an issue that desperately needs clarity in the solar space — that is, the interaction of section 704 and the recapture rules. The IRS should clarify that regulatory reallocations under section 704 do not cause a recapture of the ITC under reg. section 1.46-3(f)(2).[39]

IV. Conclusion

We have not discussed the requirements in the PTC safe harbor that (1) the project company bear the risk that the available wind resource is not as great as anticipated or projected or (2) the developer (or any party related to the developer) not lend any investor the funds to acquire any part of the investor's interest in the project company or guarantee any debt incurred or created in connection with the acquisition of that investor's interest in the project company. To the extent applicable to ITC projects, these are reasonable requirements that ensure an investor's equity ownership in the partnership, and therefore, we see no reason they should not be included in an ITC safe harbor.

We have also not addressed the requirement in the RTC safe harbor that the value of the investor's partnership interest not be reduced through fees, lease terms, or other arrangements that are unreasonable as compared with those for a real estate development project that does not qualify for RTCs, and not be reduced by disproportionate rights to distributions or by issuances of partnership interests or rights to acquire partnership interests for less than FMV consideration. While this requirement would undoubtedly need to be revised to apply to an ITC partnership, requiring arm's-length terms generally is not offensive and it would not be unreasonable to include a similar requirement in an ITC safe harbor.

Subject to the considerations discussed herein, given the similarities of investment structures in wind, building rehabilitation, and solar energy, the PTC and RTC safe harbors provide a roadmap for how to implement a practical safe harbor for solar investments. An ITC safe harbor would provide clear criteria for an investment structure, significantly improve transaction efficiency, and reduce transaction expenses. ■

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[37] Reg. section 1.704-1(b)(2)(iv)(j) requires adjustment to capital accounts to take into account adjustments to the tax basis of ITC property.

[38] PTC safe harbor, section 4.08; RTC safe harbor, section 4.07.

[39] The IRS provided limited guidance in the form of a private letter ruling in which the IRS found that a reallocation of income and gain to a general partner, in conformity with the 704(b) regulations, would not result in ITC recapture. LTR 8651050. This issue is well beyond the scope of this article and is the subject of disagreement among practitioners.

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