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IRS Modifies Guidance on Wind Energy Partnerships

On September 21, 2009, the Internal Revenue Service (the Service) released Announcement 2009-69 (the Announcement). The Announcement modifies Revenue Procedure 2007-65 (the Rev. Proc.), which sets forth the safe harbor for wind energy partnerships using the flip partnership structure. Although the Rev. Proc. is limited by its terms to wind farms claiming the benefit of the production tax credit, it is widely relied upon for structuring other types of renewable energy projects such as solar or biomass.

The Announcement makes three material changes to the Rev. Proc. Each of these changes is taxpayer favorable. Because these changes replace portions of the Rev. Proc., they appear to be retroactive.

First, the Announcement removes the warning that the Service will “closely scrutinize” transactions where the structure did not fully satisfy all of the safe harbor’s requirements. The Announcement clarifies that the Rev. Proc. is not to be used as an audit guideline and is not intended to provide substantive guidance. Any returns claiming wind credits and not satisfying the safe harbor are now merely “subject to examination by the Service.” This is an important improvement over the Service’s previous position.

Second, the Announcement softens the Rev. Proc.’s restrictions on fixed price purchase options. The Announcement now allows a fixed price purchase option so long as (i) the option is negotiated for valid non-tax business reasons at arm’s length by parties with material adverse interests and (ii) the exercise price is either not less than fair market value at the time the option is exercised or reasonably determined not to be less than fair market value at the time the option may be exercised. Prior to this Announcement, the Rev. Proc. only permitted options with an exercise price that was at least equal to the fair market value determined at the time of exercise. This change more closely aligns the Rev. Proc. with the tax common law relating to purchase options. A developer’s purchase option still may not be exercised within five years of the placed-in-service date.

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Third, the Announcement clarifies the application of the passive activity loss rules to production tax credits generated by wind investments. In the case of individuals, S corporations, and closely held C corporations, credits may be used to the extent of their tax liability from passive activities, rather than the tax liability from only passive wind investments, which the Rev. Proc. previously implied. This clarification will be of most benefit to private equity funds with individual investors.

The Announcement is scheduled to be published in Internal Revenue Bulletin 2009-40 on October 5, 2009.

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