Client Alert

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Solar Energy Systems on California Tax-Exempt Property

by Ofer Lion

California's Board of Equalization has provided guidance regarding the effect on a nonprofit's property tax exemption when solar energy systems are installed and are owned or operated by for-profit entities.[1] The concern is whether the property is still considered "used exclusively" for exempt purposes, as required to maintain the property tax exemption.

The guidance provides that a nonprofit organization may install a solar energy system that it does not own or operate (to produce electricity for the nonprofit organization), without disqualifying any portion of the property's exemption, including the system's location. However, if the for-profit owner/operator of the system can benefit from all or some of the power generated, the portion of the property on which the system is installed may have its tax exemption revoked.

In addition to the property taxes that could be incurred, the loss of even a portion of a nonprofit's property tax exemption could lead to the loss of the tax-exempt status of bonds issued for the benefit of the organization or the violation of bond covenants.

As a result, nonprofits considering the installation of solar power systems may wish to consider carefully their agreements with solar power providers, particularly as to whether the provider has the right to utilize or sell any excess power generated by the system.

Background

Under what is commonly known as the "Welfare Exemption," property used exclusively for religious, hospital, scientific or charitable purposes, and owned and operated by nonprofits organized and operated for such purposes, generally is exempt from California property tax. Separate nonprofit exemptions are provided under the "Church Exemption" and the "Religious Exemption."

With California's plentiful sunshine, solar energy systems are often installed on rooftops, on steep hillsides, as parking lot canopies and elsewhere on the grounds of nonprofit organizations.

The Board has indicated that nonprofits may continue to qualify for the property tax exemption if they enter into an agreement with a for-profit entity to install and operate a solar energy system on their property, so long as the solar energy system is used to produce electricity for the nonprofit's own use.

While "used exclusively" is not statutorily defined, the California Supreme Court in *Cedars of Lebanon Hospital v. Los Angeles County* did not define it literally, indicating that "the phrase 'property used exclusively for ... hospital ... purposes' should be held to include any property which is used exclusively

[1] *See* Letter to Assessors 2013/063, Solar Energy Systems on Nonprofit Properties (Dec. 16, 2013). Note that, unrelated to nonprofit status, California law provides that the installation of a qualifying solar energy system will not result in either an increase or a decrease in the assessment of the existing property.

for any facility which is incidental to and reasonably necessary for the accomplishment of hospital purposes; or, in other words, for any facility which is reasonably necessary for the fulfillment of a generally recognized function of a complete modern hospital."[2]

Effect of the Solar System on Property Tax Exemption

The county assessor will be responsible for determining, on a case-by-case basis, if the solar system is incidental to and reasonably necessary to the accomplishment of exempt purposes. If so, the installation should not disqualify any portion of the property's tax exemption. The assessor may need to review the nonprofit's contract with the solar provider to make the determination. As a result, California nonprofits should consider carefully the nature of any such agreement.

The Letter to the Assessors provides three examples of solar energy systems installations, whereby either the nonprofit or the for-profit entity, or both, are able to use the power generated from the solar energy system.

In the first example, a nonprofit leases a portion of its property to a for-profit entity, where a solar power system is installed and the for-profit utilizes the power generated. The resulting disqualification of the exemption for that portion of the property will not alone jeopardize the exemption on the remaining portion of the property.

In the second example, the nonprofit leases a portion of its property to a for-profit for the installation of a solar power system and the nonprofit uses the power generated. In this situation, the solar system does not serve to disqualify any portion of the property's tax exemption, including the portion specifically used for the placement of the system.

In the third example, the nonprofit leases a portion of its property to a for-profit for the installation of a solar power system and the power is used by both the nonprofit and the for-profit entity. Presumably, this could be the case where the capacity of the solar energy system at times exceeds the nonprofit's usage, and the excess energy can then be utilized or sold by the for-profit. The portion of the property leased to the solar power system owner/operator would be disqualified, but the exempt status of the remaining portion of the property would not be revoked for that reason.

Effect on Tax-Exempt Bond Financing

The disqualification of even a portion of a nonprofit's property, resulting from a for-profit's ability to utilize or sell the excess capacity of a solar power system, may violate bond covenants relating to tax compliance and may be material information required to be disclosed in any new bond offering.

Conclusion

California's Board of Equalization has indicated that a nonprofit organization may install a solar system that it does not own or operate to produce electricity, for use by the nonprofit, without disqualifying any portion of the property's tax exemption. If the for-profit owner/operator of the system can benefit from all or some of the power generated, however, the portion of the property on which the system is installed may lose its tax exemption.

Nonprofits considering the installation of solar power systems may wish to consider their property's tax exemption when deciding whether the owner/operator of the system will be permitted to utilize or sell any excess power generated by the system.

[2] *Cedars of Lebanon Hospital v. Los Angeles County*, 35 Cal. 2d 729 (1950) (emphasis added).

If you have any questions about this alert or property tax exemptions for nonprofits generally, please contact any of the Hunton & Williams LLP lawyers listed below.

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