Tax Court Reduces Taxpayer's Basis in Solar Panel Venture, but Finds in Taxpayer's Favor on Bonus Depreciation and Other Issues

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The Tax Court held that a taxpayer who purchased solar panels installed on host properties, and who acquired rights under agreements with the host property owners to provide electricity contingent on receiving tax credits and other incentives, had a basis in the solar equipment equal to the amount of a promissory note that partially financed the purchase but could not include in his basis a down payment that was never made, nor a credit for rebates that the host property owners assigned to the previous solar panel owner before the sale. The Tax Court also found that the taxpayer's investment qualified for the bonus depreciation deduction and that the taxpayer (1) was at risk with respect to the promissory note, (2) materially participated in the venture for purposes of the passive loss rules, and (3) was not liable for penalties assessed by the IRS because he had reasonable cause and acted in good faith. Golan v. Comm'r, T.C. Memo. 2018-76 (2018).

Donald Golan is an account representative for a dealer of precious metals. Golan sought an investment to generate extra income, and in 2010 was introduced to Ken Salveson, owner of Solar Energy Equities LLC. Through the LLC, Salveson offered property owners discounted electricity in exchange for permission to install solar panels on their properties. The LLC would retain ownership of the panels in order to take advantage of tax credits and rebates. The LLC would then sell the solar equipment, along with all related rights and obligations, to a buyer. One such buyer was Golan, who bought solar equipment on three host properties.

The host properties included a warehouse, a rental property, and a residential property in California. For each property, Salveson assisted the owners with applying to connect the solar panels to the electric grid. Salveson and the owners then entered into a power purchase agreement (PPA) under which Salveson's LLC would sell discounted electricity to the owners for a five-year term, and the LLC would retain ownership of the panels and the rights to any tax or other benefits. In each case, the property owners became entitled to utility rebates of between $16,000 and $20,000 as of the time they installed bidirectional meters to monitor the flow of electricity. Each owner assigned the rebate to Salveson's LLC as required under the PPAs.

Golan purchased the solar equipment for the three host properties in January 2011. The sale was effected by an asset purchase agreement, a promissory note, a guaranty by Golan, and a bill of sale. Golan agreed to buy the solar equipment on the host properties, in addition to the rights and obligations under the PPAs. The purchase agreement specified that the original use of the solar equipment began on or after the closing date.

The purchase price was $300,000, which equaled the sum (1) a $90,000 down payment, (2) a $57,750 credit for the rebates the host property owners had assigned to Salveson, and (3) Golan's promissory note in the principal amount of $152,250. The note provided for 2 percent interest and matured in 2041, but did not have a fixed payment amount. It was secured by the solar equipment and, in the event of default, Salveson agreed to seek recourse against the equipment before exercising any rights against Golan. Golan also provided a guaranty ensuring his personal liability for the amount borrowed. To further evidence the transfer of the equipment, Golan signed copies of the PPAs. Although the PPAs were all dated July or August 2010, Golan signed them in January 2011.

Sometime after the sale, the utility company connected the solar equipment on the host properties to the electric grid. The equipment began generating electricity and the property owners began making monthly payments under the PPAs. Golan was unable to pay the $90,000 down payment in 2011. Although Golan was in default, Salveson continued to honor the contract, and Golan directed the property owners to pay their electric bills directly to Salveson. Salveson credited these payments to toward the note, which was never amended to account for the unpaid down payment. Golan made partial payments toward the down payment in 2012 and 2013. Golan remained in default for $10,000, but Salveson did not cancel the contract or assert any claims for breach.

On his 2011 tax return, Golan reported no income and claimed various deductions, including depreciation of $255,000, which he claimed was a special depreciation allowance for qualified property. Golan also attached a Form 3468, Investment Credit, on which he claimed an energy credit of $90,000 (30 percent of $300,000).

The IRS issued a notice of deficiency stating that Golan's Code Sec. 179 allowance was disallowed because the property did not qualify as Code Sec. 179 property. Golan's energy credit was also disallowed; the notice stated that Golan's expenses did not qualify for the rehabilitation credit shown on Form 3468. In addition, the IRS determined that Golan was liable for an accuracy related penalty under Code Sec. 6662. Golan challenged the notice in the Tax Court.

The IRS subsequently acknowledged that the references in the notice to a Code Sec. 179 deduction and a credit under Code Sec. 47 were in error because Golan did not claim a deduction or credit under those Code sections. Nevertheless, it maintained that Golan could not claim the special depreciation allowance (i.e., bonus depreciation under Code Sec. 168(k)(5)) or the energy credit because it said that Golan had no basis in the solar equipment in 2011. The IRS claimed that Golan was not entitled to expense 100 percent of the solar equipment because he did not acquire the property after September 8, 2010 and January 1, 2012 and place it in service before January 1, 2012, as required under Code Sec. 168(k)(5). In the IRS's view, Salveson must have earlier acquired the solar panels because he installed and placed the panels in service on two of the host properties in the summer of 2010. The IRS argued that Golan was not at risk with respect to the investment because Salveson had a prohibited continuing interest in the solar equipment activity under Code Sec. 465(b)(3). The IRS also contended that the venture was a passive activity under Code Sec. 469. Because none of these theories were mentioned in the notice, the Tax Court concluded that the burden of proof shifted to the IRS on these new matters.

The Tax Court held that Golan's basis in the property at issue was limited to the amount of his promissory note ($152,250) and that he could not include in his basis the downpayment of $90,000 or the $57,750 credit for the rebates the host property owners had assigned to Salveson; however, the court rejected all of the IRS's other arguments. Golan's basis was limited to the amount of the note because he failed to make the $90,000 down payment in 2011 and the host property owners had assigned the utility company rebates to Salveson prior to the sale of the solar equipment. The Tax Court viewed the $57,750 credit as a price reduction to account for Salveson's receipt of the rebates before the sale closed. The note, however, was includible because it was issued in exchange for the solar equipment and the court saw no evidence that Golan would not be expected to repay the note or that the equipment was overvalued.

The Tax Court found that Golan qualified for the bonus depreciation allowance under Code Sec. 168(k)(5) since that provision applies to property acquired by the taxpayer after September 8, 2010, and there was no authority for the IRS's position that the special allowance applied only to the original purchasers of manufactured property.

The Tax Court found that Salveson did not have a prohibited continuing interest in the solar equipment activity under Code Sec. 465(b)(3). To have such an interest, Salveson would have had to be entitled to the assets of Golan's venture upon its liquidation or have an interest in his net profits. But the court found that Salveson's interest was a permitted gross receipts interest because he was entitled under the note to all monthly revenue generated by the equipment. The Tax Court also found that Golan materially participated in the venture for purposes of the passive activity loss limitation in Code Sec. 469 because he spent at least 100 hours on it and his participation was not less than that of any other individual.

Finally, the Tax Court held that Golan was not liable for a penalty under Code Sec. 6662(a) because he relied in good faith on his accountant and provided all the information needed to prepare the return.

For a discussion of the basis in property acquired by purchase, see Parker Tax ¶110,505. For a discussion of bonus depreciation, see Parker Tax ¶94,201. For a discussion of determining amounts at risk under Code Sec. 465, see Parker Tax ¶247,520. For a discussion of the material participation tests under the Code Sec. 469 passive activity rules, see Parker Tax ¶247,115.10.

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