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As of August 19, 2025

Opinion Letter

Energy LLC
9075 S Lisa Ave
West Jordan, UT 84088

Dear Dan,

We are furnishing this opinion letter (the "**Opinion**") to you, at your request, in connection with a number of separate transactions that we have reviewed together which are listed below:

1. Independent third party (**"Business Owner"**) purchases a solar system (the "**Solar System**") brokered by Energy LLC ("**Energy**") for 43-52% of the purchase price of the Solar System, with the remainder of the price being a seller take-back note held by Energy.

2. One or more homeowners (jointly "**Homeowner**") agree(s) to have the Solar System installed on their property.

3. Business Owner negotiates with an energy purchasing entity ("**Energy Purchasing Company**") to purchase all the energy produced by the Solar System for a fixed price, provided the Solar System meets certain production requirements. Energy Purchasing Company is not related to nor owned by Energy nor the owners/shareholders of Energy.

4. Energy Purchasing Company has its own purchasers of the energy produced by the Solar System.

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5. Business Owner receives payments from the sale of the energy from the Solar System going forward. Business Owner manages the relationship with the Energy Purchasing Company, including collecting all payments and ensuring that the Solar System continues to produce energy.

6. Business Owner claims the state and federal solar tax credit for the full value of the Solar System that it has purchased.

7. Business Owner takes the depreciation for the Solar System it has purchased.

Our analysis and Opinion will deal with the following questions as they relate to the series of transactions listed above:

1. Does the structure of the transactions allow a Business Owner to claim depreciation for the Solar System?

2. Does the structure of the transactions allow a Business Owner to claim the federal solar tax credit for the Solar System?

3. What basis amount should be used to determine the federal tax credit?

4. Does the structure of the transactions make any losses/depreciation/income from the Solar System active or passive losses/income?

5. Will the transactions be invalid under a Sham Transaction/Economic Substance argument?

Based upon the documents and statements that we have reviewed (listed in this Opinion) we are rendering this Opinion regarding certain tax aspects of the entities and transactions listed above as they relate to Federal income tax under the Internal Revenue Code of 1986, as amended (the "**Code**") and the treasury regulations promulgated thereunder (the "**Regulations**").

Each defined term in this Opinion shall have that meaning throughout the Opinion.

I. INTRODUCTION

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Energy LLC ("**Energy**") is our sole client with regards to this Opinion. Our review of the transactions and our subsequent findings are only as they relate to Energy. No other party to these transactions nor any other individual or entity can use or rely on these findings as we have not reviewed the transactions on behalf of anyone other than Energy.

Our findings and legal opinions contained in this Opinion are given in accordance with the American Bar Association Opinion No. 85-352, dated July 7, 1985 (the "**ABA Opinion**"). That ABA Opinion allows attorneys to prepare legal opinions for their clients as to federal tax matters provided, however, that there is at least a "reasonable basis" for taking the stated position. We believe that there is a greater than "reasonable basis" for the legal positions we outline in this Opinion. The level of certainty for each position is outlined in that legal opinion.

As this Opinion contains written findings about federal tax matters, it is also issued in accordance with the United States Treasury Department Circular 230, dated November 1984, as amended ("**Circular 230**"). This Opinion is intended to be "Written Advice" as it is defined in Circular 230 and is to be used only by Energy for its sole use.

II. DISCLOSURE & CIRCULAR 230

This Opinion has been prepared for the exclusive use of Energy and the findings and legal opinions rendered herein may not be relied on by any individual or party other than Energy. Olson & Partners Law hereby disclaims any responsibility or liability to any individual or entity other than Energy.

This Opinion in no way imposes a duty of confidentiality on Energy or any other person as to the underlying transactions reviewed in this Opinion. As such, nothing in this Opinion shall be construed to create a condition of confidentiality (within the meaning of Treas. Reg. §1.6011-4(b)(3)) for the underlying transaction or any advice rendered by any professional or advisor with regards to those transactions.

The recipient of this Opinion does not have a right to a full or partial refund of the fees paid in connection with this Opinion if certain tax consequences addressed in this Opinion are not met. Nothing about the payment arrangement of this Opinion creates or otherwise makes the underlying transactions or any advice given in connection with those transactions "Transactions with Contractual Protection" (within the meaning of Treas. Reg. §1.6011-4(b)(3)).

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Given the foregoing, nothing in this Opinion or the preparation or payment of this Opinion makes any of the transactions which are reviewed in this Opinion a "Reportable Transaction" as defined in Treas. Reg. §1.6011-4. This Opinion does not address whether the transactions themselves or advice rendered in connection to those transactions has made those transactions "Reportable Transactions," that require disclosure.

This Opinion is limited to those issues that are germane to the legal opinions rendered herein. Nothing in this Opinion should be read to support or promote the marketing by others of the transactions or issues addressed herein. Nothing in this Opinion should be read to support or market a tax shelter.

We believe this Opinion and the findings and legal opinions contained herein are given in full compliance with Circular 230, Section 10.37 governing "Written Advice," including that this Opinion is based on reasonable factual and legal assumptions; reasonably considers all relevant facts and circumstances that the writer of this Opinion knows or reasonably should know; the writer of this Opinion used reasonable efforts to identify and ascertain the facts relevant to written advice on each Federal tax matter; and relies only on appropriate representations, statements, findings and agreements or any person or entity; relates applicable law and authorities to facts; and does not take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit, as it relates to evaluating any Federal tax matter.

III. DILIGENCE UNDERTAKEN FOR THE OPINION

In preparation for this Opinion and the opinions rendered herein, we have reviewed the following documents and representations:

1. Review of Utah state website for Energy LLC;

2. Review of blank System Purchase and Install Agreement between Energy and Business Owner;

3. Discussion with Daniel Lake and other Energy personnel about the structure of the agreements between Solar System and Energy Purchasing Company;

4. Representations by Daniel Lake that the Energy Purchasing Company is not owned by the same owners as Energy LLC nor are they otherwise related in any way.

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5. Verbal representations by Daniel Lake and other Energy personnel about the set up, purchase and operations of the Solar System.

We have also reviewed the cases, law and regulation cited in this Opinion as well as treatises and other analysis.

IV. ASSUMPTIONS

The following are assumptions relied on in preparing this Opinion and the findings and opinions rendered herein.

1. We have assumed the authenticity of all documents to submitted to us as originals;
2. The conformity to the originals of all documents submitted to us as copies;
3. Each party to the transactions has the legal capacity to enter and perform the various transactions listed in this Opinion.
4. Energy LLC is a validly existing entity;
5. Energy performs less than 100 hours of work during the initial year, including directing the installation of the Solar System;
6. No person or entity performs more than 100 hours of work during the first year of the Solar System installation other than potentially the Business Owner;
7. Each document reviewed in due diligence for this Opinion that was blank, will be completed and finalized as part of the transactions;
8. There are no modifications (verbal, written, or otherwise), and no amendments to any of the documents reviewed in this Opinion or any other documents as they relate to any of the transactions listed in this Opinion.
9. Energy and the Business Owner are true arm's length parties, within the meaning of Code Sec. 267;

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10. The Business Owner is the true owner of the Solar System, including taking the risks of destruction of the Solar System as well as the risks of Energy Purchasing Company ceasing to pay for the energy;

11. The Business Owner performs substantially all of the work of the Solar System after he/she purchases it;

12. Business Owner purchased the Solar System for its fair market value in an arm's length transaction with unrelated parties;

13. Business Owner has a legitimate business purpose for purchasing the Solar System aside from any intended tax benefits;

14. Business Owner will be operating a profitable business or a business that it intends to be profitable;

15. Energy Purchasing Company is unrelated to Energy or the Business Owner;

16. Energy has no interest in the Solar System other than as a creditor once the Business Owner purchases the Solar System.

17. The Solar System qualifies as "Energy Property" under Code Section 48.

V. NO RELIANCE ON OTHER LEGAL OPINIONS

We have relied on no other legal opinions in the preparation of this Opinion and the findings and legal opinions rendered herein.

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VI. LEGAL OPINIONS

The following are the legal opinions that we reach in this Opinion:

1. **The structure of the series of transactions should allow a Business Owner to claim depreciation for the Solar System.**

In order for a taxpayer to claim depreciation on property the taxpayer must own the property and it must be used in a trade or business or for the production of income.[1] The calculation for the depreciation is the basis in the property.[2] For purposes of the Solar System property, Code section 50 reduces the basis of the property by 15%.[3] Each of these points will be dealt with below.

Ownership

The first question is whether the structure allows the Business Owner to be treated as the owner of the property. Simple legal title is not sufficient to be considered ownership for depreciation purposes.[4] The determination of whether a taxpayer is the owner of property subject to depreciation is whether the taxpayer suffers an economic loss through the depreciation and erosion in value of the property.[5]

Property in a lease situation can be depreciated by the lessor provided the lessor has the economic interest in the property.[6] The factors used to determine whether the lessor has the economic interest in the property includes (1) whether legal title passes; (2) how the parties treat the transaction; (3) whether an equity interest was acquired in the property; (4) whether the contract creates a present obligation on the seller to execute and deliver a deed and a present obligation on the purchaser to make payments; (5) whether the right of possession is vested in the purchaser; (6) which party pays the property taxes; (7) which party bears the risk of loss or damage to the property; and (8) which party receives the profits from the operation and sale of the property.[7]

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[1] 26 U.S.C. 167. See e.g. *Olson v. Commissioner,* 52 F.4th 889 (10th Cir. 2022).
[2] 26 U.S.C. 167(c)(1); 26 U.S.C. 1011; 26 U.S.C. 1012
[3] 26 U.S.C. 50(c)(1); 26 U.S.C. 50(c)(3).
[4] *Gladding Dry Goods Co. v. Commissioner,* 2 B.T.A. 336 (1925).
[5] *Weiss v. Weiner,* 279 U.S. 333 (1929).
[6] Rev. Rul. 55-540.
[7] *Coleman v. Commissioner,* T.C. Memo 1987-195 *aff'd* 16 F.3d 821 (7th Cir. 1994).

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The US Supreme Court in *Frank Lyon co. United States*[8] addressed a different but similar issue regarding true ownership in a leaseback situation.

The Court in Frank Lyon stated the following:

> This Court, almost 50 years ago, observed that 'taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid.' *Corliss v. Bowers*, 281 U.S. 376, 378 (1930). In a number of cases, the Court has refused to permit the transfer of formal legal title to shift the incidence of taxation attributable to ownership of property where the transferor continues to retain significant control over the property transferred. (572-573)

The Court concluded by saying: "[S]o long as the lessor retains significant and genuine attributes of the traditional lessor status, the form of the transaction adopted by the parties governs for tax purposes."

In this instance we review the situation vis-à-vis the Business Owner: (1) legal title passes to the Business Owner and the Business Owner retains legal title throughout the term of the business operations; (2) all parties treat the initial purchase of the Solar System and the subsequent sale of the electricity from the Solar System treat the Business Owner as the owner of the Solar System; (3) The Business Owner holds the only equity interest in the Solar System; (4) No contract that we have reviewed requires any present obligation for the Business Owner to transfer deed to any third party; (5) N/A; (6) The Business Owner pays all obligations on the Solar System; (7) The Business Owner bears the risk of loss or damage to the Solar System such that if the Solar System produced electricity below the threshold in the energy purchase agreement the Business Owner would not be paid for the electricity; (8) Business Owner receives the profits from the operation and sale of electricity from the Solar System.

We next review the situation vis-à-vis the Energy Purchasing Company. In that instance, (1) legal title remains with the Business Owner; (2) the parties will be treating the transaction as the sale of energy with the Business Owner retaining the legal title to the energy producing assets; (3) The Energy Purchasing Company will not have any equity interest in the Solar System; (4) The Business Owner has no present obligation to deliver a deed to the Energy Purchasing Company; (5) N/A; (6) The Business Owner pays the taxes and other obligations for the Solar System; (7) The Business Owner bears the risk of loss or damage to the Solar System; and (8) the Business Owner receives the profits from the sale of energy from the Solar System.

[8] 435 U.S. 561 (1978).

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Provided the IRS does not conclude that the transaction as a whole can be recharacterized as a Sham under the IRS Sham doctrine, it appears the structure of the transaction will allow the Business Owner to be treated as the owner of the Solar System for depreciation purposes. The discussion of the IRS Sham Doctrine is discussed later in this Opinion.

For Profit

In order to take depreciation for the Solar System, the taxpayer must have entered into the business arrangement for profit. Courts appear to have interpreted the language of 167(a) to mean that there must be a profit motive for the venture, or no depreciation will be allowed.[9]

The 9th Circuit Court of Appeals has reviewed the profit motive issue as it applies to the purchase and leasing of solar equipment.[10] The Court found that the taxpayer did have a profit motive. It stated the following:

> Mr. Sacks' investment did not become a sham just because its profitability was based on after-tax instead of pre-tax projections. It is undisputed that he stood to make money on an after-tax basis. "The fact that favorable tax consequences were taken into account ... is no reason for disallowing those consequences." Frank Lyon, 435 U.S. at 580, 98 S.Ct. at 1302. Where a transaction has economic substance, it does not become a sham merely because it is likely to be unprofitable on a pre-tax basis. If in a sale-leaseback, the purchaser retains significant risks and benefits of ownership and is "the one whose capital was committed" based on cash or negotiable full recourse promissory notes, then the possible imprudence of his investment does not disqualify him from taking the depreciation deductions and tax credits. Id. at 572, 581, 98 S.Ct. at 1298, 1302. This is true even though the investor paid more "because [the investor] anticipated the benefit of the depreciation deductions." Id. at 580, 98 S.Ct. at 1302.
>
> ...
>
> Absence of pre-tax profitability does not show "whether the transaction had economic substance beyond the creation of tax benefits," Casebeer, 909 F.2d at 1365, where Congress has purposely used tax incentives to change investors' conduct. Congress and the Arizona legislature purposely skewed the neutrality of the tax system, even more than

[9] *See e.g. Olsen v. Commissioner*, 52 F.4th 889 (10th Cir. 2022).
[10] *Sacks v. Commissioner*, 94-70756 (9th Cir. 1995).

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> the usual tax credits and accelerated depreciation designed to encourage more investment in capital goods than would otherwise be made, because they sought to induce people to invest in solar energy."[11]

Conversely, the 10th Circuit found that a taxpayer did not have a profit motive where the taxpayer attempted to claim an energy credit. In that case, the Court applied a test called the *Nickeson* test. That test looks at five common characteristics suggesting the absence of a profit motive: (1) the marketing materials focus on expected tax benefits; (2) the taxpayer buys the item for a grossly inflated price without negotiating; (3) the taxpayer does not ask the seller about potential profitability; (4) the taxpayer lacks control over activities; and (5) the taxpayer uses nonrecourse debt.[12]

In this instance, we cannot comment on the marketing materials used by Energy. However, we understand that the purchase price of the Solar System is within the bounds of a normal price for similar solar systems and can be negotiated by the Business Owner. We cannot comment on whether the Business Owner asks about profitability of the Solar System. Here the Business Owner has full control over the activities of the Solar System either as between the Business Owner and the Energy Purchasing Company. Lastly, here the Business Owner uses recourse debt rather than nonrecourse debt.

Treasury Regulation 1.183-2 lists nine factors that the IRS will look at in determining whether an activity was engaged in for profit. Although it does not have to do with the structure of the series of transactions, Business Owner would be wise to ensure that they meet the test for profitability in the Treasury Regulations 1.183-2. That test lays out the following factors that show profitability.

It states,

> "all facts and circumstances with respect to the activity are to be taken into account. No one factor is determinative in making this determination. In addition, it is not intended that only the factors described in this paragraph are to be taken into account in making the determination, or that a determination is to be made on the basis that the number of factors (whether or not listed in this paragraph) indicating a lack of profit objective exceeds the number of factors indicating a profit objective, or visa versa. Among the factors which should normally be taken into account are the following:

[11] *Id.*
[12] *Olsen v. Commissioner*, 52 F.4th 889 (10th Cir. 2022).

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(1) Manner in which the taxpayer carries on the activity.—The fact that the taxpayer carries on the activity in a businesslike manner and maintains complete and accurate books and records may indicate that the activity is engaged in for profit. Similarly, where an activity is carried on in a manner substantially similar to other activities of the same nature which are profitable, a profit motive may be indicated. A change of operating methods, adoption of new techniques or abandonment of unprofitable methods in a manner consistent with an intent to improve profitability may also indicate a profit motive.
(2) The expertise of the taxpayer or his/her advisors.—Preparation for the activity by extensive study of its accepted business, economic, and scientific practices, or consultation with those who are expert therein, may indicate that the taxpayer has a profit motive where the taxpayer carries on the activity in accordance with such practices. Where a taxpayer has such preparation or procures such expect advice, but does not carry on the activity in accordance with such practices, a lack of intent to derive a profit may be indicated unless it appears that the taxpayer is attempting to develop new or superior techniques which may result in profits from the activity.
(3) The time and effort expended by the taxpayer in carrying on the activity.—The fact that the taxpayer devotes much of his personal time and effort to carrying on an activity, particularly if the activity does not have substantial personal or recreational aspects, may indicate an intention to derive a profit. A taxpayer's withdrawal from another occupation to devote most of his energies to the activity may also be evidence that the activity is engaged in for profit. The fact that the taxpayer devotes a limited amount of time to an activity does not necessarily indicate a lack of profit motive where the taxpayer employs competent and qualified persons to carry on such activity.
(4) Expectation that assets used in activity may appreciate in value.—The term *profit* encompasses appreciation in the value of assets, such as land, used in the activity. Thus, the taxpayer may intend to derive a profit from the operation of the activity, and may also intend that, even if no profit from current operations is derived, an overall profit will result when appreciation in the value of land used in the activity is realized since income the activity together with the appreciation of land will exceed expenses of operations. …
(5) The success of the taxpayer in carrying on other similar or dissimilar activities.—The fact that the taxpayer has engaged in similar activities in the past and converted them from unprofitable to profitable enterprises may

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indicate that he/she is engaged in the present activity for profit, even though the activity is presently unprofitable.

(6) The taxpayer's history of income or losses with respect to the activity. — A series of losses during the initial or start-up stage of an activity may not necessarily be an indication that the activity is not engaged in for profit. However, where losses continue to be sustained beyond the period which customarily is necessary to bring the operation to profitable status such continued losses, if not explainable, as due to customary business risks or reverses, may be indicative that the activity is not being engaged in for profit. If losses are sustained because of unforeseen or fortuitous circumstances which are beyond the control of the taxpayer, such as drought, disease, fire, theft, weather damages, other involuntary conversions, or depressed market conditions, such losses would not be an indication that the activity is not engaged in for profit. A series of years in which net income was realized would of course be strong evidence that the activity is engaged in for profit.

(7) The amount of occasional profits, if any, which are earned. — The amount of profits in relation to the amount of losses incurred, and in relation to the amount of the taxpayer's investment and the value of the assets used in the activity, may provide useful criteria in determining the taxpayer's intent. An occasional small profit from an activity generating large losses, or from an activity in which the taxpayer has made a large investment, would not generally be determinative that the activity is engaged in for profit. However, substantial profit, though only occasional, would generally be indicative that an activity is engaged in for profit, where the investment or losses are comparatively small. Moreover, an opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate that the activity is engaged in for profit even though losses or only occasional small profits are actually generated.

(8) The financial status of the taxpayer. — The fact that the taxpayer does not have substantial income or capital from sources other than the activity may indicate that an activity is engaged in for profit. Substantial income from sources other than the activity (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit especially if there are personal or recreational elements involved.

(9) Elements of personal pleasure or recreation. — The presence of personal motives in carrying on of an activity may indicate that the activity is not engaged in for profit, especially where there are recreational or personal elements involved. On the other hand, a profit motivation may be indicated

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> where an activity lacks any appeal other than profit. It is not, however, necessary that an activity be engaged in with the exclusive intention of deriving a profit or with the intention of maximizing profits. For example, the availability of other investments which would yield a higher return, or which would be more likely to be profitable, is not evidence that an activity is not engaged in for profit. An activity will not be treated as not engaged in for profit merely because the taxpayer has purposes or motivations other than solely to make a profit. Also, the fact that the taxpayer derives personal pleasure from engaging in the activity is not sufficient to cause the activity to be classified as not engaged in for profit if the activity is in fact engaged in for profit as evidenced by other factors whether or not listed in this paragraph.

The regulations go on to provide several examples which are not quoted here.

If a taxpayer can show a sufficient profit motive that should not disqualify them from taking depreciation in the Solar System.

Basis in the Solar System

Code section 1012 states "the basis of property shall be the cost of such property..."[13] Treas. Reg. 1.1012-1 goes on to state, "The cost is the amount paid for such property in cash or other property."

The Tax Court in *Golan v. Commissioner*, 1425 T.C. Memo 2018-76 stated the following regarding costs and basis: "Although cost basis generally equals the price paid for property, irrespective of its actual value, this rule might not apply 'where a transaction is based upon peculiar circumstances which influence the purchaser to agree to a price in excess of the property's fair market value."

Important to answer the question about the Business Owner's potential basis in the Solar is whether the purchase price of the Solar System, including the down payment and the seller take back note, is the fair market value of the property. As a general rule, parties transacting at arm's length are a good estimate of fair market value.[14] However, in this instance the IRS could claim that there are outside influences on the arm's length relationship. We understand and our

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[13] 26 U.S.C. 1012
[14] *See e.g.* IRS Publication 561 "Determining FMV" and "Problems in Determining FMV"

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assumption is that the Solar System is priced within the range of normal fair market value for such solar systems and, therefore, the basis should be the price of the Solar System.

The next question is whether the value of the seller take back note is an amount "paid" for the property.

The Tax Court has stated the following regarding cost "Cost generally includes promissory notes issued in exchange for property … However, when a transaction is structured so that, taking economic realities into account, there is no realistic expectation that the taxpayer will repay the entire nominal debt, the amount recognized as actual debt should be limited accordingly."[15]
In *Golan* the Court found that the taxpayer did have basis equal to the amount of the note given in exchange for the solar property because there was no claim that the property was overvalued or sold above its fair market value.

In another tax court case discussing this position the Court stated that the taxpayer had agreed in separate litigation that there was no expectation that he should pay out of his own funds any portion of the note. In such an instance the Court found that the basis of the taxpayer was not increased by the value of the promissory note.[16]

Here, we understand that the note and the communications between Energy and its Business Owner do not include anything about a non-payment of the seller note. In that instance, the structure of the transactions should allow the Business Owner to have a basis equal to the price of the Solar System, including the amount of the recourse note (however, see the paragraph below outlining a reduction of the basis)

Code section 50 reduces the basis of the Solar System by 15%.[17] This amount appears to be reduced for all relevant purposes of the Code. This means that any amount of depreciation allowed under Code section 167 will be reduced by 15%.

Depreciation Amount

Code section 167 regulates depreciation of property outlines the following rules for taking depreciation: "There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) (1) of property

[15] *Golan v. Commissioner*, 1425 T.C. Memo 2018-76.
[16] *Moore v. Commissioner*, T.C. Memo. 2013-249.
[17] 26 U.S.C. 50(c)(1) and (c)(3).

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used in the trade or business, or (2) of property held for the production of income." We have dealt with the "trade or business" or "production of income" portion earlier in this Opinion.

Code section 168 allows accelerated depreciation in certain instances.[18] In order to qualify, the property must be "qualified property."[19] Code Section 168(k)(2) defines "qualified property"[20]

The applicable percentages for the accelerated depreciation for property placed in service after December 31, 2022 and before January 1, 2024 is 80 percent.[21]

The Tax Court in *Golan v. Commissioner*, found that a taxpayer in that case did meet the requirements of Code section 168(k) to receive the accelerated depreciation for a solar system placed in service on other homeowners' homes. [22]

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[18] Section 168(k)(1) states,

"In the case of any qualified property

(A) The depreciation deduction provided by section 167(a) for the tax year in which such property is placed in service shall include an allowance equal to the applicable percentage of the adjusted basis of the qualified property; and

(B) The adjusted basis of the qualified property shall be reduced by the amount of such deduction before computing the amount otherwise allowable as a depreciation deduction under this chapter for such taxable year and any subsequent taxable year.

[19] *Id.*

[20] 168(k)(2) defines "qualified property" as "property (i) (I) to which this section applies which has a recovery period of 20 years or less, ... (ii) the original use of which begins with the taxpayer or the acquisition of which by the taxpayer meets the requirements of clause (ii) of subparagraph (e), and (iii) which is placed in service by the taxpayer before January 1, 2027."

[21] 26 U.S.C. 168(k)6).

[22] T.C. Memo 2018-76.

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2. **The series of transactions should allow a Business Owner to claim the Federal Investment Energy Credit for the Solar System.**

The Federal Investment Energy Credit (the **"Credit"**) is governed by Code Sections 38, 46, and 48[23]. There are several requirements for claiming the Credit.

The first of those requirements is that the property qualifies as "energy property"[24]. We have assumed, and we believe that assumption is correct based on the information that has been provided, that the Solar System qualifies as "energy property" as it is defined in Code Section 48.

The second requirement is that the taxpayer claiming the Credit must have "acquired" the energy property[25]. This prong has been analyzed in the previous Opinion and is referenced here. We come to the same conclusion as above.

The combination of Code sections 48, 38, and 46 determines the amount of the credit.[26]
The amount of the credit for energy property the construction of which begins before January 1, 2025 is 30% of the basis of the energy property.

Nonqualified Nonrecourse Financing

A taxpayer's ability to claim the Federal Investment Energy Credit is reduced by any amount of nonqualified nonrecourse financing.[27]

Nonqualified nonrecourse financing is defined as "any nonrecourse financing which is not qualified commercial financing."[28]

"Nonrecourse Financing" is further defined as "any amount with respect to which the taxpayer is protected against loss through guarantees, stop-loss agreements, or other similar arrangements, and, except to the extent provided in regulations, any amount borrowed from a person who has an

[23] 26 U.S.C. 38, 46, and 48
[24] 26 U.S.C 48(a)(3) states "For purposes of this subpart, the term 'energy property' means any property (A) which is (i) equipment which uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat, excepting property used to generate energy for the purposes of heating a swimming pool…"
[25] 26 U.S.C. 48(a)(3)(B)
[26] 26 U.S.C. 38, 46, and 48(a)(9)(A)
[27] 26 U.S.C. 49(a)(1)(A)
[28] 26 U.S.C. 49(a)(1)(D)(i)

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interest (other than as a creditor) in the activity in which the property is used or from a related person to a person (other than the taxpayer) having such an interest."[29]

The first question is whether anything in the structure of the transactions protects the Business Owner from loss. The 9th Circuit Court has opined on this issue and found the following:

> [T]he purpose of subsection 465(b)(4) is to suspend at risk treatment where a transaction is structured—by whatever method—to remove any realistic possibility that the taxpayer will suffer an economic loss if the transaction turns out to be unprofitable *See Melvin v. Commissioner*, 88T.C. 63 (1987) *affirmed* 894 F.2d, at 1074. A theoretical possibility that the taxpayer will suffer economic loss is insufficient to avoid the applicability of this subsection. We must be guided by economic reality.[30]

From our review of the documents of the series of transactions there is no guarantee, contractual or otherwise, that would remove the Business Owner from the chance of loss if the Energy Purchasing Company or the Homeowner stopped paying or if the Solar System were somehow damaged or destroyed. In our view, those risks are more than theoretical. Our understanding is that the promissory note from Energy is a recourse note, which would bolster the position that there is a risk of loss to the Business Owner.

The next question is whether Energy has any interest in the activity other than as that of a creditor. The 9th Circuit Court has reviewed a similar issue as it relates to identical language to Code section 465. The Court found the following: "The legislative history suggests that 'any type of financial interest in the activity (other than as a creditor) would constitute a prohibited 'other interest' under section 465'"[31]

From our review of the documents, it appears that Energy does not share any of the profits of the Solar System, nor does it have any capital interest in the Solar System other than that of a creditor.[32]

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[29] 26 U.S.C. 49(a)(1)(D)(iii)
[30] *Am. Principals Leasing Corp. v. United States*, 904 F.2d 477 (9th Cir. 1990).
[31] *Pritchett v. Commissioner*, 827 F.2d 644 (9th Cir. 1987) *Citing Bennion v. Commissioner*, 88 T.C. 684 (1987).
[32] The Tax Court in *Golan v. Commissioner*, T.C. Memo 2018-76 found that a promissory note from a taxpayer to the seller of a solar system was not restricted by the at-risk provisions because the sale agreement of the solar system did not give the seller a right to the assets of the solar system, other than as a creditor in liquidation. We believe the documents give Energy only the same right.

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An additional requirement for claiming the Credit is that the taxpayer can claim depreciation on the property. We have analyzed depreciation for the property earlier in the Opinion.

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3. What basis amount should be used to determine the federal tax credit?

The amount of basis allowed for the Tax Credit is not necessarily the same as the amount allowed for depreciation. In an earlier Opinion we laid out how to calculate the depreciable amount. This, however, is not the same calculation for the tax credit basis.

The basis for the Tax Credit is the price paid for energy property.[33] For the purposes of this Opinion, the qualifying energy property will be the "equipment which uses solar energy to generate electricity…"[34] buildings and their structural components do not qualify as property qualifying for the tax credits.[35]

Similarly, the tax court has taken the position, that power purchase agreements, goodwill, going concern, and renewable energy certificates are not considered energy property. This point is still being worked out by the courts.[36] The IRS has issued proposed regulations that would clarify that the list above do not count as energy property.[37]

This is important in the transaction listed in this Opinion. If the Business Owner is purchasing the power purchase agreement, goodwill, going concern, or renewable energy certificates as part of the Solar System purchase, the amounts allocable to that power purchase agreement, goodwill, going concern, or renewable energy certificates would not count as basis for the tax credit.

[33] 26 U.S.C. 48(a)(3)
[34] 26 U.S.C. 48(a)(3)(A)(i)
[35] Reg. 1.48-1(e)(1).
[36] Desert Sunlight 250, LLC v. United States, 157 Fed. Cl. 209 (Fed. Cl. 2021).
[37] Prop. Reg. 1.48-9(d)(2).

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4. The structure of the transactions should not preclude losses, depreciation or income from the Solar System being considered active losses and income.

If the depreciation and credits from the Solar System business are treated as a passive activity, that depreciation and those credits can only be used to offset passive income.[38]

The rules surrounding passive vs active business activity are extensive and cannot be covered comprehensively in this Opinion. However, we have attempted to include relevant tests.

Code section 469(c)(1) states, "The term 'passive activity' means any activity (A) which involves the conduct of any trade or business, and (B) in which the taxpayer does not materially participate."

The Treasury Regulations outline a 7-part test to help determine whether a taxpayer has "materially participated" in the business.[39] It states, in relevant part:

(a) In general. Except as provided in paragraphs (e) and (h)(2) of this section, an individual shall be treated, for purposes of section 469 and the regulations thereunder, as materially participating in an activity for the taxable year if and only if

1. The individual participates in the activity for more than 500 hours during such year;
2. The individual's participation in the activity for the taxable year constitutes substantially all of the participation in such activity of all individuals (including individuals who are not owners of interests in the activity) for such year;
3. The individual participates in the activity for more than 100 hours during the taxable year, and such individual's participation in the activity for the taxable year is not less than the participation in the activity of any other individual (including individuals who are not owners of interests in the activity) for such year;
4. The activity is a significant participation activity (within the meaning of paragraph (c) of this section) for the taxable year, and the individual's aggregate participation in all significant participation activities during such year exceeds 500 hours;

[38] 26 U.S.C. 469.
[39] 26 C.F.R. 1.469-5T

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5. The individual materially participated in the activity (determined without regard to this paragraph (a)(5) for any five taxable years (whether or not consecutive) during the ten taxable years that immediately preceded the taxable year;
6. …
7. Based on all the facts and circumstances (taking into account the rules in paragraph (b) of this section), the individual participates in the activity on a regular, continuous, and substantial basis during such year.

Although we do not know what other businesses the Business Owner may have, the two tests that would most likely apply to an Business Owner would be test 2 or 3. Those tests (tests 2 and 3) were included "because the Service recognizes that the operation of some activities may not require more than 500 hours of participation, or may not require more than 500 hours of participation by any one individual during a tax year."[40] This is likely one of those types of activities.

Several of the tests have additional restrictions and clarifications. Those are not included in this Opinion.

Some of the important clarifications that apply to tests 2 and 3 are the following:

> Work done in connection with an activity shall not be treated as participation in the activity for purposes of this section if
>
> (A) Such work is not of a type that is customarily done by an owner of such an activity; and
>
> (B) One of the principal purposes for the performance of such work is to avoid the disallowance, under section 469 and the regulations thereunder, of any loss or credit from such activity.[41]

Additionally,

> (A) Work done by an individual in the individual's capacity as an investor in an activity shall not be treated as participation in the activity for purposes of this section unless the individual is directly involved in the day-to-day management or operations of the activity.

[40] T.D. 8175 (Preamble to Temporary Regulations), 53 Fed. Reg. 5686, 5698 (Feb 25, 1988).
[41] 26 C.F.R. 1.469-5T(f)(2)(i)

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(B) For purposes of this paragraph (f)(2)(ii), work done by an individual in the individual's capacity as an investor in an activity includes
   1. Studying and reviewing financial statements or reports on operations of the activity;
   2. Preparing or compiling summaries or analyses of the finances or operations of the activity for the individual's own use; and
   3. Monitoring the finances or operations of the activity in a non-managerial capacity.[42]

Another important clarification that applies to tests 2 and 3 "In the case of any person who is a married individual … for the taxable year, any participation by such person's spouse in the activity during the taxable year … shall be treated, for purposes of applying section 469 and the regulations thereunder to such person, as participation by such person in the activity during the taxable year.[43]

Our understanding is that the Business Owner purchases the Solar System when it is complete but prior to it being placed in service. If this is the case, the Business Owner may be able to qualify under test 2 ("Substantially all") provided that he/she does, in fact, do substantially all of the work in the business. If the Business Owner is selling all the electricity from the Solar System to the Energy Purchasing Company, there may be an argument that the Business Owner could potentially meet test 2 (the "substantially all" test) if the Business Owner worked with professionals to determine whether the Solar System business was a good business for them, negotiated the purchase of the Solar System, negotiated the purchase power agreement with Energy Purchasing Company, collected energy sale payments from the Energy Purchasing Company, and otherwise took care of the management of the relationship with the Energy Purchasing Company. It would likely be wise if the Business Owner ensured that they did in fact perform all the services for the business and that those services are meaningful.

If the Business Owner cannot do substantially all the work in the initial year, the Business Owner (combined with their spouse, if they have one) could potentially perform services exceeding 100 hours for the Solar System business in that year. Those services would need to be more hours than any other person spent in the year on the Solar System business.

[42] 26 C.F.R. 1.469-5T(f)(2)(ii).
[43] 26 C.F.R. 1.469-5T(f)(3)

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The tests are applied on a yearly basis, meaning that different tests can apply in different years. Additionally, in future years, once the depreciation and credits had been fully claimed, a taxpayer may want to have the income from the business be considered passive income.

If the client is trying to qualify under Test 2 ("substantially all" test), there cannot be any other person who participates in any significant way.[44] Under that test that taxpayer could potentially still use the occasional contractors for technical tasks and still qualify.[45] In that instance, the Business Owner would want to run every aspect of the Solar System business, including collecting the payments and otherwise managing the business day to day.

In addition to meeting the material participation test, the taxpayer will want to contemporaneously record their participation. One Tax Court case reviewing this issue ruled against the taxpayer, finding that the taxpayer did not meet his burden to show that he met one of the material participation tests. The tax court stated the following: "While the regulations permit some flexibility with respect to the evidence required to prove material participation, we are not required to accept postevent 'ballpark guesstimates', nor are we bound to accept the unverified, undocumented testimony of taxpayers."[46]

Similarly, the Tax Court in *Bartlett v. Commissioner*, T.C. Memo. 2013-182, the Court found that the taxpayer did not meet their burden to show that they had materially participated in the business of bull raising mostly because the taxpayer did not have any contemporaneous records which showed his involvement. If the taxpayer could have shown through contemporaneous records his involvement in the business the court suggested he would have met the material participation threshold.[47]

The structure of the series of transactions for the Solar System should not preclude a Business Owner from meeting the material participation test and qualifying as an active business.

[44] *See e.g. Wilson v. Commissioner,* T.C. Memo 2012-101 (taxpayer could not qualify under the substantially all participation test for his solar panels leased to his father-in-law, because the solar company promoter installed the panels, collected payments, maintained records regarding the income, and made the loan and excise tax payments); *Conner v. Commissioner,* T.C. Memo 2018-6, *aff'd per curiam,* 123 AFTR 2d 2019-2015 (11th Cir. 2019) (taxpayer could not qualify under the substantially all participation test for a real property development activity when the business hired a land surveyor and has an employee who handles accounting and bookkeeping responsibilities).
[45] *Fitch v. Commissioner,* T.C. Memo 2012-358.
[46] *Lum v. Commissioner,* 1557, T.C. Memo. 2012-103.
[47] T.C. Memo. 2013-182.

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5. The IRS should not look through the transaction using a Sham Transaction/Economic Substance argument.

Under US federal tax law a transaction must meet the test that looks beyond the form of the transaction in search of its economic reality.[48] The Economic Substance doctrine was a common law doctrine that was codified in Code Sec. 7701(o). That section states, in relevant part:

> The Term 'economic substance doctrine' means the common law doctrine under which tax benefits under Subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purposes."

The Section then defines how economic substance is to be understood: "In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—

> (A) The transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and
>
> (B) The taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction."

Evidence about how the Sham Transaction Doctrine may not be meant to apply to the series of transactions listed in this Opinion come from the Joint Committee Technical Explanation where they give interesting insight into where this doctrine was meant to apply and where it was not meant to apply.

> The doctrine of economic substance becomes *applicable* (relevant) where a taxpayer seeks to claim tax benefits, *unintended by Congress*, by means of transactions that serve no economic purpose other than tax savings.[49]

Again, there is an argument that as to this series of transactions, Congress specifically intended taxpayers to take the tax credits and the depreciation.

[48] *See e.g. Dow Chem. Co. v. United States*, 250 F.Supp. 2d 748 (E.D. Mich. 2003).
[49] Staff of the Joint Committee on Taxation, Technical Explanation of the Revenue Provisions of the 'Reconciliation Act of 2010,' as amended, at 143.

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The IRS has clarified that the test for economic substance is simply the test outlined in the Code sec. 7701(o). They have stated, "[S]ection 7701(o) mandates the use of the conjunctive two-prong test to determine whether a transaction shall be treated as having economic substance. The first prong … requires that the transaction change in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position. The second prong … requires that the taxpayer have a substantial purpose (apart from Federal income tax effects) for entering into the transaction."[50]

The Courts have, in many instances, reviewed these two prongs through the lens of whether there existed an objective reasonable possibility of profit from the transaction. For example, in *Rice's Toyota World, Inc. Commissioner*[51] the Court found that "The economic substance inquiry … requires an objective determination of whether a reasonable possibility of profit from the transaction existed apart from tax benefits." Similarly, in *IES Indus., Inc. Commissioner*[52] the Court stated "the application of the objective economic substance test involves determining whether there was a 'reasonable possibility of profit … apart from tax benefits'." Although the cited case predate the codification of the Economic Substance doctrine in statute, the IRS has made clear that the codification of the doctrine is in no way meant to change the law as it has been developed by the Courts. Thus, pre-codification cases are still valid and applicable.[53]

Code Sec. 7701(o)(2) limits the use of a transaction's "profit potential" to instances where the present value of the reasonably expected pre-tax profit is substantial in relation to the present value of the expected net tax benefits if the transaction were respected.

One case that gives an analysis for a solar system is *Sacks v. Comm'r.*[54] In that case the Court found that the taxpayer could look at the profit motive after taking into considerations the tax benefits that Congress intended. The Court in that instance found that there was a profit motive. The Court in that instances found that the transactions at issue were not Shams.

Here, we understand that the series of transactions change in a meaningful way the economic position of the Business Owner, as the property changes hands, and the Business Owner pays for the property and takes on the operations and income from the Solar System.

[50] IRS Notice 2010-62.
[51] 752 F.2d 89 (4th Cir. 1985).
[52] 752 F.2d 89, 94 (4th Cir. 1985).
[53] See example IRS Chief Counsel Advice Memo 202240019 – Section 7701 – 7701(o) Question.
[54] 69 F.3d 982 (9th Cir. 1995).

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Similarly, we understand that the Business Owner does have an ability to earn a profit after the tax incentives. Provided this is true, the series of transactions should not be disregarded using a Sham Transaction/Economic Substance argument.

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VII. QUALIFICATIONS AND LIMITATIONS TO LEGAL OPINIONS

The legal opinions in this Opinion are expressions of professional judgment and not and guarantees of a particular result.

This Opinion is to be interpreted in accordance with customary practice, which means, among other things, that words and phrases in this Opinion are not always meant to be interpreted in accordance with their literal meaning but with the meaning that customary practice has given them.

The opinions expressed in this Opinion are limited to the matters stated in this Opinion, and, without limiting the foregoing, no other opinion is to be inferred.

This Opinion and the legal opinions listed herein are rendered as of the date of this Opinion, and we are under no obligation, and do not undertake, to advise Energy or any other person or entity of any change of law or fact that occurs, even though such change or such fact may affect the legal analysis or a legal conclusion in this Opinion.

This Opinion and the legal opinions expressed herein may not be relied on by or furnished to any other person or entity without our prior written consent, and without limiting the foregoing, may not be quoted, published, or otherwise disseminated, without in each instance our prior written consent.

No opinion is given, nor should one be implied as to the amount or timing of any federal income benefits.

VIII. PARTIES PERMITTED TO RELY ON THIS OPINION

The legal opinions rendered in this Opinion are prepared for the exclusive use of Energy for its sole use and cannot be used by any other individual or entity or for any other purpose.

IX. LAWS AND JURISDICTIONS COVERED AND EXCEPTED

The legal opinions in this Opinion are limited in all respects to the federal law of the United States.

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No opinion is given, nor should one be implied as to any tax benefits or other tax consequences under state, local, or foreign tax law.

Yours very truly,

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