

July 1, 2014

CONTACT

Leah Karlov
Partner
+213-892-4522
lkarlov@milbank.com

Henry T. Scott
Associate
+213-892-4378
hscott@milbank.com

Project Finance Group Client Alert: Proposed Amendment to California's Proposition 13: The Impact of AB-2372 on the Active Solar Energy Exclusion

The California State Assembly recently approved legislation amending a Proposition 13 provision that has historically allowed some commercial real estate owners, including owners and purchasers of solar energy systems, to avoid property reassessments when property or businesses that own property are sold or transferred, and therefore avoid higher property taxes. AB-2372 (the "Bill") was brokered in a rare bipartisan deal supported by lawmakers as well as California business and anti-tax groups. It passed the Assembly on May 29, 2014 by a vote of 56-8, and was sent to the Senate for consideration. If approved by two-thirds of the Senate and the Governor, the Bill would be the first change to Proposition 13 since its enactment in 1978.

The Bill eliminates a loophole commercial property owners often use to avoid reassessment when property is sold or transferred. While it is aimed at older California commercial institutions that have, over time, avoided reassessment through carefully structuring ownership changes, the Bill could have a particularly negative impact on buyers of solar energy systems currently shielded from reassessment by the Active Solar Energy Exclusion. This client alert addresses provisions of the Bill that, if signed into law, will likely affect current and future projects in California's solar energy project marketplace.

AB-2372: THE PROPOSED CHANGE TO PROPOSITION 13

Proposition 13, which rolled back property taxes and capped how much they could increase each year, has not changed since 1978. The Bill, co-authored by Assembly members Tom Ammiano (D-San Francisco) and Raul Bocanegra (D-Pacoima), is expected to break this streak.

Under current law, commercial property is generally not subject to reassessments unless over 50% of the ownership interests are transferred to one new party. Thus,

carving up ownership so that no single party has a majority stake perpetually averts reassessment. Under the proposed law, however, a transfer of 90% of cumulative ownership in a single transaction would trigger a reassessment, regardless of whether any one party received majority interest. Under both the current law and proposed amendment, a “change of ownership” triggers reassessment. The proposed law, however, broadens the meaning of “change of ownership” to include any sale or transfer of 90% or more of the ownership interests in a legal entity in a single transaction. A “sale or transfer” includes any change of ownership interests other than those in the regular course of trading activity on an established securities market. This means that prospective commercial property buyers and parties considering a merger or acquisition will no longer be able to avoid a post-transaction commercial property tax reassessment by splitting up shares into minority portions if over 90% of the ownership in a company changes hands.

The second notable change the Bill proposes is a 50% increase in the penalty for failure to give notice of a change in ownership to the State Board of Equalization office in Sacramento. The penalty, which is based on the amount of property taxes, will be increased from 10% to 15% of the applicable property taxes. While this change may not meaningfully increase revenue for the government, it does provide a further disincentive for some of the accounting maneuvers to avoid reassessment that have become common practice for California companies in the decades since the enactment of Proposition 13.

The Bill is currently under consideration by the Committee on Appropriations, having been approved by the Committee on Governance and Finance with a 5-2 vote. In the committee stage, several staff recommendations were presented that, if incorporated into the Bill, would make reassessments even more likely by, for example, eliminating the three-year cut-off (instead providing that reassessment occurs whenever the 90% threshold is reached) or giving the Bill a retroactive effect by directing assessors to enroll new values for property that would have been reassessed under the Bill’s terms.

LOOKING AHEAD: PRACTICAL CONSEQUENCES FOR CURRENT BENEFICIARIES OF THE ACTIVE SOLAR ENERGY EXCLUSION

If approved by two-thirds of the Senate, the Bill will result in less flexibility for commercial real estate owners in California to make changes in ownership without triggering a property tax reassessment. Today, in California, the original beneficiaries of the Active Solar Energy System Exclusion for a given property are able to avoid reassessment unless one party acquires over 50% of the ownership interests in a qualifying solar project. This has historically left many options open for a buyer or group of buyers interested in purchasing over 90% of that property without forfeiting the Active Solar Energy Exclusion; essentially, they are free to structure the transfer

however they please without reassessment as long as no single legal entity or person acquires more than 50%. The Bill would limit this freedom, because under the new law, no arrangement of ownership structure would exempt the owners from reassessment if 90% or more of the ownership interests are being transferred.

While the Bill is not yet law, in light of its bipartisan support, backing from California business groups like the California Chamber of Commerce, and the notable absence of opposition from anti-tax groups like the Howard Jarvis Taxpayers Association, the Bill is likely to garner the requisite two-thirds support in the Senate and be passed to the Governor. With no signal of aversion from the Senate or Governor's office, all signs indicate that the Bill will be law in the near future. Consequently, commercial property buyers going forward will need to factor in the cost of increased property taxes into their economic evaluation of a potential land purchase, merger, or acquisition in situations where they could currently avoid reassessment and continue to pay the transferor's lower grandfathered rate. The Senate leaders have expressed that they intend for the Senate to vote on the Bill by the end of the fiscal year.

We will continue to monitor the Bill as it progress through the legislative process and intend to provide an updated analysis if and when enacted.

PROJECT FINANCE GROUP

Please feel free to discuss any aspects of this Client Alert with your regular Milbank contacts or any of the members of our Project Finance Group.

If you would like copies of our other Client Alerts, please visit our website at www.milbank.com and choose "Client Alerts" under "News."

This Client Alert is a source of general information for clients and friends of Milbank, Tweed, Hadley & McCloy LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this Client Alert without consulting counsel.

©2014 Milbank, Tweed, Hadley & McCloy LLP.

All rights reserved.
Attorney Advertising.
Prior results do not guarantee a similar outcome.

NEW YORK

One Chase Manhattan Plaza, New York, NY 10005

Daniel D. Bartfeld	dbartfeld@milbank.com	+1-212-530-5185
William B. Bice	wbice@milbank.com	+1-212-530-5622
Roland Estevez	restevez@milbank.com	+1-212-530-5324
Jonathan J. Green	jgreen@milbank.com	+1-212-530-5056
Daniel J. Michalchuck	dmichalchuk@milbank.com	+1-212-530-5079
Eric F. Silverman	esilverman@milbank.com	+1-212-530-5648
Caroline Walther-Meade	cwalther-meade@milbank.com	+1-212-530-5238

LONDON

10 Gresham Street London EC2V 7JD England

John Dewar	jdewar@milbank.com	+44-20-7615-3004
Phillip D. Fletcher	pletcher@milbank.com	+44-20-7615-3002
Clive Ransome	cransome@milbank.com	+44-20-7615-3144

SINGAPORE

12 Marina Boulevard, Marina Bay Financial Centre #36-03 Tower 3, 018982 Singapore

Jaqueline Chan	jchan@milbank.com	+65-6428-2433
James J. Murray	jmurray@milbank.com	+65-6428-2422
David H. Zemans	dzemans@milbank.com	+65-6428-2555

LOS ANGELES

601 South Figueroa Street, 30th Floor Los Angeles, CA 90017

Allan T. Marks	amarks@milbank.com	+1-213-892-4376
Karen B. Wong	kwong@milbank.com	+1-213-892-4419

TOKYO

21F Midtown Tower, 9-7-1 Akasaka, Minato-ku, Tokyo 107-6221 Japan

Alexander K. Borisoff	aborisoff@milbank.com	+813-5410-2841
Aled Davies	adavies@milbank.com	+813-5410-2851

HONG KONG

30/F Alexandra House, 18 Chater Road, Central Hong Kong

Young Joon Kim	yjkim@milbank.com	+852-2971-4802
----------------	-------------------	----------------

WASHINGTON DC

1850 K Street, NW, Suite 1100, Washington, DC 20006

Jonathan A. Maizel	jmaizel@milbank.com	+1-202-835-7565
--------------------	---------------------	-----------------
