

2007

## Client Alert- IRS Issues Safe Harbor Guidance for Partnership Flip Structures in Wind Deals

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### Repository Citation

"Client Alert- IRS Issues Safe Harbor Guidance for Partnership Flip Structures in Wind Deals" (2007). *William & Mary Annual Tax Conference*. 63.

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October 2007

**Contacts****Richmond Office**

Riverfront Plaza, East Tower  
951 East Byrd Street  
Richmond, Virginia 23219

**David S. Lowman, Jr.**

(804) 788-8789  
dlowman@hunton.com

**Laura Ellen Jones**

(804) 788-8746  
ljones@hunton.com

**Timothy L. Jacobs**

(804) 788-8362  
tjacobs@hunton.com

**IRS Issues Safe Harbor Guidance for Partnership Flip Structures in Wind Deals**

On October 19, 2007, the Internal Revenue Service (the "IRS") issued Revenue Procedure 2007-65 (the "Revenue Procedure"), establishing a "safe harbor" for so-called "flip" structures for partners and partnerships that own and produce electricity from qualified wind energy facilities for purposes of section 45 of the Internal Revenue Code (the "Code"). If the partners and partnerships satisfy the requirements set forth in the Revenue Procedure, the IRS will not challenge the allocation of section 45 wind energy production tax credits by the partnership that is otherwise in accordance with the partnership allocation rules.

The Revenue Procedure indicates that the safe harbor applies to any partnership (the "Project Company") between a project developer (the "Developer") and one or more investors (the "Investors"), with the Project Company owning and operating the project containing the wind facilities (the "Wind Farm"). In order to qualify for the safe harbor, the partners and the partnership must satisfy the following 12 requirements:

(1) The Investor's investment return must be reasonably anticipated to be derived from both section 45 credits and participation in operating cash flow.

(2) The Developer must have a minimum 1% interest in all partnerships items, including section 45 credits.

(3) The Investor must have a minimum interest in partnership income and gain equal to 5% of its largest share of such items during its ownership of an interest in the partnership.

(4) The Investor must make and maintain at least a 20% minimum investment (not protected against loss) in the Project Company, but reduced for distributions of cash flow.

(5) At least 75% of the Investor's capital contributions must be fixed and determinable and not contingent in amount or certainty of payment.

(6) Neither the Developer, the Investors nor any related parties may have a purchase option at a price less than fair market value (determined at the time of exercise).

(7) The Developer (or party related to the Developer) may not have a purchase option exercisable earlier than five years after the wind facility is first placed into service.

(8) Neither the Project Company nor the Investors may have a put option with respect to the Wind Farm, property included in the Wind Farm, or interest in the Project Company.

(9) No person may guarantee or otherwise insure the Investor the right to any allocation of the section 45 credit.

(10) The Project Company must bear the risk of wind availability (no guarantees except from third parties if the Project Company or an Investor directly pays the cost of or premium for such guarantee).

(11) The Developer (or a party related to the Developer) may not lend any Investor the funds or guarantee any indebtedness with respect to acquisition of its interest.

(12) Section 45 credits must be allocated in accordance with the partnership rules (e.g., in the same manner as receipts from the sale of electricity produced at the Wind Farm are allocated).

The Revenue Procedure provides two illustrations of the safe harbor rules. One of those examples involves a partnership in which the Investor is initially allocated 99.5% of the Project Company's gross income or loss and section 45 credits. The Revenue Procedure indicates that this partnership will not satisfy the safe harbor requirements (which requires the Developer to have at least a 1% interest in such items) and states that the Project Company's classification as a valid partnership would be closely scrutinized by the IRS. Thus, it appears that in certain circumstances the IRS may use the Revenue Procedure to challenge transactions that fail to meet its requirements.

The Revenue Procedure states that it applies only to partners or partnerships with section 45 production tax credits from renewable resources from wind

and does not apply to any other tax credits. Based on this statement, it is not clear that the IRS will apply the safe harbor in the context of other section 45 production tax credits or other tax credit investments. The IRS also indicates that the Revenue Procedure is intended to provide guidance to taxpayers in lieu of taxpayers requesting a letter ruling, and the IRS will not rule on any issues under the Code's partnership rules for partnerships claiming the credit under section 45. The Revenue Procedure is effective for transactions entered on or after the date of its publication in the Internal Revenue Bulletin. Nevertheless, the IRS will not challenge a transaction entered into prior to the effective date that satisfies all of the requirements of the Revenue Procedure.

A copy of the Revenue Procedure can be obtained by [clicking here](#).

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