

Purpose & Context

This summary outlines the primary exit strategies available to tax equity investors after the five-year recapture period for solar investments. Each option varies in ease of execution, tax impact, and level of IRS scrutiny.

These strategies are evaluated through the lens of both compliance and investor return optimization, and should be reviewed alongside project-specific tax, legal, and financial documentation.

Exit Option	Ease of Execution	Audit Risk	Notes
1. Sale to Lessee (Sponsor Buyout)			Most common and straightforward; FMV sale well established; only risk is improper pre-arrangement.
2. Sale to Third Party			More complex process and diligence; FMV validation strong; moderate risk from allocation/depreciation reviews.
3. Long-Term Hold			Minimal legal steps; IRS risk extremely low since no disposition occurs.
4. Donation to 501(c)(3)			Requires qualified appraisal and AGI limitation analysis; low IRS risk if valuation is well supported.
5. Assignment to Nonprofit			Structurally complex; may raise partnership basis and valuation questions.
6. Assignment to Company			Straightforward within same ownership group; limited risk if FMV and basis maintained.
7. Contribution to New Entity for Equity			Requires partnership formation and IRC §721/§752 compliance; potential disguised-sale scrutiny (Treas. Reg. §1.707-3).

Key Takeaways for Solar Facility Owners

- Sale to Lessee remains the most straightforward and commonly executed option, though it can trigger substantial taxable gain.
- Sale to Third Party offers independent Fair Market Value (FMV) validation and may yield higher exit pricing.
- Long-Term Hold provides tax deferral benefits but minimal remaining depreciation shelter.
- Donation to 501(c)(3) appeals to investors seeking charitable deductions and ESG-aligned outcomes.
- Assignment to Nonprofit allows charitable integration without full asset transfer.
- Assignment to Company provides operational flexibility within a controlled group.
- Contribution to New Entity for Equity supports roll-ups, restructures, or continued equity participation with potential deferral under partnership rules.

Structuring & Legal Reference

Code Section	Description
IRC §721(a)	Nonrecognition of gain or loss on contribution of property to a partnership.
IRC §752	Basis adjustments and treatment of partnership liabilities.
Treas. Reg. §1.707-3	Rules governing disguised sales to partnerships.
IRC §170	Deduction rules and AGI limits for charitable contributions.
IRC §1001	Recognition of gain or loss upon sale or disposition of property.
IRC §751	Treatment of unrealized receivables and inventory items (“hot assets”).


Market Exit & Monetization Event: Convert equity into cash through a sale.

Exit Strategy	Tax Implications	IRS Audit Risk Notes	PROS +	CONS X
Sale to Lessee (Sponsor Buyout)	Treated as sale at fair market value (FMV). Recognize capital gain to the extent the sale price exceeds adjusted basis (often lower after depreciation).	Low risk if priced at FMV; elevated risk if a pre-arranged option appears to be a disguised sale or if the price is not FMV, which could jeopardize ITC validity.	Clean, straightforward exit; predictable counterparty (sponsor already involved); option can be pre-structured if FMV is respected.	Taxable gain can be significant if basis is low; sponsor must have sufficient liquidity or financing to complete the buyout.
Sale to Third Party	Same capital-gain rules: gain recognized over adjusted basis. Competitive bidding may increase price; an installment sale can spread tax liability.	Low-Medium risk: IRS is less likely to challenge FMV but may review depreciation allocations and ITC recapture compliance.	Potentially higher exit value; market-driven FMV validation (generally IRS-friendly).	Higher transaction costs and deal complexity; buyer diligence can slow closing; may be harder to align with existing debt covenants.


Retention & Reinvestment: Maintain ownership or restructure for future value.

Exit Strategy	Tax Implications	IRS Audit Risk Notes	PROS +	CONS X
Long-Term Hold	Investor continues to report share of income/loss. Depreciation benefits are largely exhausted after five years; distributions taxed as ordinary income or capital gains depending on source.	Low risk: little to contest since no exit occurs; primary risk is substantiating prior ITC and depreciation positions.	Defers recognition of taxable gain; continued cash flow from PPA/lease; flexibility to exit later in a stronger market.	Depreciation benefits are gone; investor capital remains tied up longer; opportunity cost versus redeploying capital elsewhere.
Contribution of Asset & Debt to New Entity for Equity	Generally a nonrecognition event under IRC §721(a) when contributing to a partnership/LLC in exchange for an ownership interest; carryover basis in the contributed asset; no gain unless liabilities assumed exceed basis (per IRC §752 rules).	Low-Medium risk: IRS may review for disguised-sale concerns under Treas. Reg. §1.707-3; maintain contemporaneous valuations and clear partnership-intent documentation.	Allows continued upside without triggering current tax; can consolidate multiple projects into a joint venture or roll-up; useful for restructuring prior to sale or refinancing; preserves basis and capital-account continuity.	Requires careful structuring to satisfy partnership nonrecognition standards; future sale of the new-entity interest will trigger deferred gain; potential governance and control complexities with new partners.
Assignment of Lease & Debt to For-Profit Company	Generally treated as a transfer of contract rights. If consideration is received, recognize gain to the extent proceeds exceed adjusted basis in the leasehold interest (often minimal). May shift ongoing income/expenses and relieve investor of debt.	Moderate risk: IRS may recharacterize as a sale of the underlying property if substance suggests it; strong contracts and valuation support reduce risk.	Enables exit without disposing of the physical asset; preserves the tax-credit history on the original asset; buyer assumes operational risk and debt service.	May trigger gain if the lease has built-in value; potential exposure to IRC §751 "hot assets" if a partnership is involved; lender consent may be required.


Charitable Transfers: Exit with social impact and a charitable mission alignment.

Exit Strategy	Tax Implications	IRS Audit Risk Notes	PROS +	CONS X
Donation to 501(c)(3)	Charitable deduction generally equals FMV (subject to AGI limits) with carryforward if unused; no capital gain recognized.	Medium risk: IRS scrutinizes valuation; deduction may be limited if asset is treated as ordinary-income property (unlikely after >5 years).	Potentially strong tax outcome if FMV deduction exceeds after-tax sale proceeds; positive ESG/PR optics; simplifies exit.	Deduction limited to a percentage of AGI (typically 30% or 50% depending on charity and property); no cash proceeds; confirm the donee can accept and manage the facility.
Assignment of Lease & Debt to Nonprofit (501(c)(3))	If properly structured, may avoid gain recognition because no asset sale occurs—only transfer of lease rights and associated debt; may be treated as a partial gift if FMV exceeds liabilities assumed; debt relief may trigger income if liabilities exceed basis; can avoid depreciation recapture if the underlying asset remains with the original owner.	Medium-High risk if viewed as a disguised sale (i.e., transfer of economic ownership); mitigate with robust valuation, clear debt-assumption documentation, and a charitable-intent memorandum.	Creates charitable-use alignment and potential indirect deduction if any equity component is donated; simplifies operations by having the nonprofit assume the energy use/lease stream.	Complex to document and value; must ensure assignment is permitted under lease and financing documents; nonprofit must be qualified to assume obligations.