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FORTIFIED SOLAR LLC

Re: Fortified Solar – U.S. Federal Income Tax Treatment of Material Participation by Individual Solar Facility Owners Under IRC § 469

Dear Mr. Draplin:

Fortified Solar LLC ("**Fortified Solar**") has asked for our advice and analysis (this "**Memorandum**") regarding the application of Section 469 of the Internal Revenue Code of 1986, as amended (the "**Code**"), to individuals acquiring and operating photovoltaic solar facilities through the structure described below. Specifically, Fortified Solar has asked whether an individual who owns a solar facility through a single-purpose limited liability company and participates in the development, construction, commissioning and operation of that facility in the manner described herein should be treated as materially participating in the solar facility activity under Treasury Regulation § 1.469-5T(a)(3), and, as a result, whether an energy investment tax credit determined under Section 48 or a clean electricity investment credit determined under Section 48E, as applicable (each, a "**Credit**"), attributable to such activity should not constitute a passive activity credit under Section 469.

As described more fully below, this Memorandum does not conclude that every individual acquiring a solar facility from or through Fortified Solar will materially participate in the applicable activity. Material participation under Section 469 is determined annually and depends in significant part upon the actual activities and hours of the individual taxpayer and of each other individual participating in the activity. Rather, this Memorandum addresses the federal income tax consequences for an individual who satisfies the factual conditions and documentation requirements described herein (each such, a "**Qualifying SFO Member**").

For the reasons described below, and subject to the representations, assumptions, qualifications and limitations set forth herein, a Qualifying SFO Member who (i) performs more than 100 hours of qualifying participation in the applicable solar facility activity during the taxable year, (ii) participates in such activity for not less time than any other individual participating in that activity during such year, and (iii) otherwise satisfies the conditions described herein, should be treated as materially participating in the solar facility activity pursuant to Treasury Regulation § 1.469-5T(a)(3).[1] Accordingly, assuming the applicable solar facility activity is not otherwise treated as a passive activity, including as a rental activity within the meaning of Section 469(c)(2) and Treasury Regulation § 1.469-1T(e)(3), the activity should not constitute a passive activity of the Qualifying SFO Member under Section 469(c)(1), and a Credit attributable to such activity should not constitute a passive activity credit solely by reason of Section 469.[2]

[1] Temp. Treas. Reg. § 1.469-5T(a)(3).

[2] § 469(c)(1), (2), (4), (d)(2); Temp. Treas. Reg. § 1.469-1T(e)(3).

I. Background

A. *Fortified Solar and the Solar Facility Structure*

Fortified Solar develops and constructs photovoltaic solar generation facilities for individual business owners. As we understand the contemplated structure, each solar facility is ultimately owned through a separate single-purpose limited liability company (each, an "**SFO**"), and each SFO is wholly owned by one individual (the "**SFO Member**"). For purposes of this Memorandum, we assume that each SFO is treated as an entity disregarded as separate from its SFO Member for U.S. federal income tax purposes and has not elected to be classified as an association taxable as a corporation.

Each SFO is intended to own a discrete photovoltaic solar facility and the contractual and other rights associated with that facility (each, a "**Project**"). The Project will generate electricity following completion and commissioning, and the SFO will enter into an applicable power purchase, offtake or similar customer arrangement pursuant to which the Project derives revenue from its operations (the "**Customer Agreement**").

The Project also may generate a Credit. Depending upon the applicable statutory regime and the facts relating to the Project, the Credit may be determined under Section 48 or Section 48E. Section 46 includes the energy credit and clean electricity investment credit within the investment credit, and Section 38 includes the investment credit determined under Section 46 as a component of the general business credit.[3]

This Memorandum does not address whether a particular Project or expenditure qualifies for a Credit, the amount of any Credit, the basis of property taken into account in determining any Credit, compliance with prevailing wage, apprenticeship, domestic content, energy community or other requirements or bonus provisions, or any other requirement imposed by Sections 38, 46, 48, 48E, 49 or 50. For purposes of this Memorandum, we assume that the applicable Credit has otherwise been validly determined and focus solely upon the treatment of such Credit under Section 469.

B. *Acquisition and Construction of the Project*

Fortified Solar coordinates the development and construction of the Projects. As we understand the arrangement, Fortified Solar is responsible for managing significant aspects of the construction process and is compensated for its role through the purchase price payable in connection with the Project. The cost of installation and construction management is included within the contractual purchase price rather than being separately stated to the SFO as an independent construction-management fee.

The SFO, or in certain circumstances a predecessor that subsequently assigns its rights to the SFO, engages Hero Solar LLC ("**Hero Solar**") in connection with the installation process. Hero Solar does not itself physically install the Project. Rather, Hero Solar's function is to identify and engage an installation subcontractor capable of completing the applicable installation work. Hero Solar is compensated by Fortified Solar, with such compensation being economically included within the

[3] See §§ 38(b)(1), 46(2), (7), 48, 48E.

overall arrangement between Fortified Solar and the SFO rather than being separately charged to the SFO.

The SFO has the right to select an installation contractor from among contractors approved for the applicable Project. The SFO Member is expected to exercise that right and to participate meaningfully in the selection and oversight process. Depending upon the applicable Project, such participation may include reviewing prospective installers, considering qualifications and proposed terms, approving or rejecting the installer proposed for the Project, discussing schedule and pricing issues, reviewing engineering and site information, approving design or construction changes, addressing interconnection issues, reviewing and approving milestones, monitoring construction progress, participating in commissioning, and taking other actions in the management and operation of the Project.

Our conclusion assumes that these rights are substantive and are actually exercised by the applicable SFO Member. A contractual right that exists on paper but is not exercised does not, standing alone, constitute participation within the meaning of Treasury Regulation § 1.469-5T.[4] Accordingly, the material participation analysis depends upon what the SFO Member actually does in connection with the Project and not merely upon authority nominally reserved to the SFO under the Project documents.

Fortified Solar, Hero Solar, installation contractors and other service providers may employ multiple individuals in connection with a Project. As discussed below, this fact is significant under Treasury Regulation § 1.469-5T(a)(3), because that regulation compares the participation of the SFO Member with the participation of each other individual in the activity rather than with the aggregate participation of all contractors or service providers.[5]

C. *The SFO Member's Participation in the Project*

The contemplated structure requires the SFO Member to be an actual participant in the management and operations of the Project and not merely a passive recipient of information regarding an investment.

The SFO Member may participate during development and construction by, among other activities, considering and selecting contractors, participating in meetings regarding Project development, reviewing matters requiring owner approval, providing direction concerning construction issues, approving material changes, reviewing and acting upon interconnection matters, coordinating inspections where owner participation is required, reviewing completion and commissioning matters, and making other decisions with respect to the Project.

Following commissioning, the SFO Member is expected to continue operating and managing the Project. No third party is expected to be granted general authority to operate or manage the Project on behalf of the SFO during the operating period. The SFO may retain contractors to provide discrete maintenance or technical services, including panel cleaning, equipment replacement or repair and other

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[4] *See* Treas. Reg. § 1.469-5(f)(1) (providing that work done by an individual in connection with an activity in which the individual owns an interest generally constitutes participation); Temp. Treas. Reg. § 1.469-5T(f)(2) (excluding specified categories of work from participation).

[5] Temp. Treas. Reg. § 1.469-5T(a)(3).

maintenance functions, but such contractors are expected to perform such services at the direction of the SFO Member rather than exercise general operational decision-making authority over the Project.

In determining whether an SFO Member has performed more than 100 hours of qualifying participation, not all activities relating to the SFO Member's ownership of the Project necessarily constitute participation for purposes of Section 469. In particular, hours devoted to genuine operational and managerial activities concerning the Project generally present a substantially stronger basis for treatment as participation than time devoted to general investment review, personal financial analysis, tax planning or generalized education concerning solar investments. Accordingly, each Qualifying SFO Member must have more than 100 hours of qualifying participation after excluding hours that constitute investor-capacity activity, pre-property acquistion activity or other work that is not treated as participation under the Section 469 regulations.[6]

D. *Records of the SFO Member's Participation*

Each SFO Member is expected to maintain records identifying the services performed in connection with the Project, the dates on which those services were performed and the approximate amount of time devoted to those services (the "**Participation Records**").

The Participation Records are expected to be maintained on a current basis and supported, where applicable, by source materials such as emails, calendar entries, meeting invitations, Project portal records, written approvals, change orders, engineering documents, contractor communications, utility correspondence, commissioning materials and similar records.

Although Treasury Regulation § 1.469-5T(f)(4) does not require contemporaneous daily time reports or logs where participation can be established by other reasonable means, the Participation Records are intended to provide substantially stronger evidentiary support than a reconstruction of hours prepared only after an examination has commenced.[7]

For purposes of this Memorandum, each Qualifying SFO Member is represented to have more than 100 hours of participation that qualifies under the principles described in Part IV below, without reliance upon hours that we conclude should be excluded from participation.

E. *Records of Participation by Other Individuals*

Test 3 of the material participation regulations also requires a comparison between the SFO Member and every other individual participating in the activity.[8] The SFO Member ordinarily will not have independent access to the time records of Fortified Solar employees, Hero Solar personnel, installation subcontractors, engineers, technicians, maintenance contractors and other individuals who may provide services to a Project.

Accordingly, Fortified Solar has established a process intended to substantiate the participation of such other individuals. Under that process, Fortified Solar will obtain Project-specific certifications or affidavits from the persons and entities supplying labor or services to the Project, and Fortified Solar

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[6] *See* Treas. Reg. § 1.469-5(f)(1); Temp. Treas. Reg. § 1.469-5T(f)(2)(i)-(ii).
[7] Temp. Treas. Reg. § 1.469-5T(f)(4).
[8] Temp. Treas. Reg. § 1.469-5T(a)(3).

will provide a comparable certification with respect to its own personnel (collectively, the **"Participation Certifications**").

For purposes of this Memorandum, we assume that the Participation Certifications will:

1. address the hours of each individual providing services with respect to the Project rather than merely aggregate entity-level hours;
2. cover employees, independent contractors, agents and other individuals performing services on behalf of the applicable service provider, rather than being limited only to persons formally classified as employees;
3. identify or permit identification of individuals who perform work through more than one entity or in more than one capacity so that such individual's Project-specific hours can be considered in the aggregate;
4. be prepared following completion of the relevant work or at the conclusion of the relevant taxable year and state the actual Project-specific hours reflected in the applicable books, payroll records, time records or other business records;
5. identify the records upon which the certification is based and provide for retention of those records for an appropriate period;
6. allocate the hours of individuals working on multiple Projects using a reasonable and consistently applied methodology that reflects the actual time attributable to the particular Project; and
7. establish that no individual participated in the applicable Project for more hours during the relevant taxable year than the Qualifying SFO Member.

The Participation Certifications are not intended to create hours that did not occur or to allocate labor artificially for purposes of satisfying Section 469. They are intended to document the actual participation of each other individual in the Project.

F. *Master Purchase Agreement and Individual Project Assignments*

We further understand that Fortified Solar may use a master solar purchase agreement or similar master contractual arrangement covering more than one solar facility (the "**Master Purchase Agreement**"). Individual facilities or contractual rights relating to individual facilities may thereafter be separated from the Master Purchase Agreement and assigned to individual SFOs pursuant to Project-specific assignments or other conveyance documents (each, an "**Assignment**").

Each SFO is intended to acquire only the Project identified in its Assignment. Each Project is separately owned and is expected to have Project-specific records, contractual rights and operational information. The fact that Fortified Solar may initially document multiple Projects under a common Master Purchase Agreement does not, by itself, cause the individual SFO Members to constitute one taxpayer or to own interests in one common Section 469 activity.

The timing of an Assignment is relevant for a different reason. As discussed below, work performed by an individual generally constitutes participation only if the individual owns an interest in the relevant activity, directly or indirectly, at the time the work is performed.[9] Accordingly, for purposes of this Memorandum, no Qualifying SFO Member relies upon hours performed before the date on which the SFO Member first owns a direct or indirect interest in the applicable Project.

This Memorandum therefore does not depend upon a conclusion that a contractual right held before a Project Assignment or closing necessarily constitutes an indirect ownership interest or engagement in a specific trade or business for purposes of Treasury Regulation § 1.469-5(f)(1). Any hours for which the existence of an business interest is uncertain are excluded from the more-than-100-hour threshold for purposes of the conclusion expressed herein.

G. *Customer Arrangements and Rental Activity Assumption*

Section 469 contains a separate rule for rental activities. In general, an activity that constitutes a rental activity within the meaning of Section 469(c)(2) is treated as passive without regard to whether the taxpayer materially participates in the activity.[10]

Accordingly, the conclusion in this Memorandum requires the additional assumption that the applicable Project is not a rental activity for purposes of Section 469.

For purposes of each Project covered by this Memorandum, we assume that the Customer Agreement is an electricity purchase, offtake or comparable arrangement pursuant to which the Project's gross income is principally attributable to the production and sale of electricity or other output of the Project and is not principally attributable to amounts paid for the customer's use of the Project's tangible property.[11]

This Memorandum does not address a Project operated pursuant to an equipment lease, facility lease or other arrangement under which payments may be principally for the customer's use of tangible property unless such arrangement is separately reviewed and determined not to constitute a rental activity under Treasury Regulation § 1.469-1T(e)(3).

II. <u>Representations and Assumptions</u>

In addition to relying upon the facts set forth above, in rendering this Memorandum we have reviewed and relied, to the extent material to this Memorandum, upon such facts, circumstances and documents as we have deemed necessary to render this Memorandum.

We have examined the form of Master Solar Purchase Agreement, the form of Assignment, the applicable construction and installation documentation, and the form of Participation Certification. We also have reviewed the form of SFO operating agreement, the form of SFO Member material participation certification, the form Lease substantially in the form contemplated to be used where

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[9] Treas. Reg. § 1.469-5(f)(1).

[10] § 469(c)(2), (4). *See also* § 469(j)(8) (defining "rental activity" as an activity in which payments are principally for the use of tangible property).

[11] *See* Temp. Treas. Reg. § 1.469-1T(e)(3)(i) (providing generally that an activity is a rental activity where tangible property is used or held for use by customers and gross income represents amounts paid principally for use of such property, regardless of whether the arrangement is denominated a lease, service contract or otherwise); *id*. § 1.469-1T(e)(3)(ii) (providing specified exceptions).

applicable to a Project, the form Revenue Sharing Agreement (collectively with the other documents described in this paragraph, the "**Reliance Documents**").

We have not made an independent investigation of the facts or representations contained in the Reliance Documents except to the extent we have deemed necessary in our professional judgment or as specifically requested. We have therefore assumed that (i) the Reliance Documents have not been and will not be amended in any respect material to this Memorandum, (ii) other than as disclosed to us, there are no agreements, arrangements or understandings that supplement or are inconsistent with the Reliance Documents, and (iii) the information contained in the Reliance Documents and otherwise furnished to us accurately and completely describes, in all material respects, the facts relevant to this Memorandum. We have no actual knowledge that any such material fact, representation or statement is untrue.

Additionally, for purposes of this Memorandum, we understand and assume the following:

(i) each SFO is a validly existing single-purpose limited liability company that owns only its applicable Project and related assets and contractual rights;

(ii) each SFO has one individual SFO Member and is treated as an entity disregarded as separate from that individual for U.S. federal income tax purposes during the taxable year at issue;

(iii) each applicable Project constitutes or is conducted as a trade or business activity within the meaning of the Section 469 regulations, including, during the development and construction period, an activity conducted in anticipation of the commencement of a trade or business;

(iv) the applicable Project does not constitute a rental activity within the meaning of Section 469(c)(2) and Treasury Regulation § 1.469-1T(e)(3);

(v) the SFO Member does not treat the applicable Project as grouped with another activity in a manner that would alter the participation comparison addressed by this Memorandum, and the Project is properly treated as a separate activity of the SFO Member for purposes of Section 469;

(vi) each SFO Member for whom the conclusion in this Memorandum is applicable owns a direct or indirect interest in the Project at all times during which the hours relied upon by such SFO Member are performed;

(vii) each such SFO Member performs more than 100 hours of qualifying participation in the applicable Project during the relevant taxable year after excluding investor-capacity activities other activities excluded under Treasury Regulation § 1.469-5T(f);

(viii) such hours represent services actually performed by the SFO Member in connection with the management or operations of the Project and are not fabricated, nominal, duplicative or assigned to the SFO Member for the principal purpose of avoiding Section 469;

(ix) the Participation Records accurately describe the nature and approximate duration of the SFO Member's activities and are supported, where reasonably available, by contemporaneous business records;

(x) Fortified Solar manages aspects of Project construction and is compensated for doing so as part of the consideration payable under the applicable Project documents;

(xi) Hero Solar performs the functions described in Part I.B and does not itself perform the physical installation of the Project;

(xii) the SFO or its applicable predecessor has the contractual authority described herein with respect to the selection or approval of the installation contractor, and the SFO Member actually exercises the rights and responsibilities attributed to the SFO Member in the Participation Records;

(xiii) during the operating period, the SFO Member retains ultimate responsibility for operational decisions concerning the Project, and no compensated third party is granted general authority to manage the Project in place of the SFO Member;

(xiv) any maintenance, engineering or technical service provider retained during the operating period performs services within the scope of its engagement and does not exercise general managerial authority over the Project except as specifically disclosed to us;

(xv) the Participation Certifications accurately identify the actual Project-specific participation of all individuals providing services through Fortified Solar, Hero Solar, the installation contractor and other material service providers during the relevant taxable year;

(xvi) for each Qualifying SFO Member, no other individual participates in the applicable Project for more hours during the relevant taxable year than such Qualifying SFO Member;

(xvii) where an individual performs services through more than one entity or in multiple capacities in connection with the Project, the Participation Certifications account for the individual's total Project-specific hours rather than treating such individual's work as separate persons or separate participation solely because the services were performed through different entities;

(xviii) where Fortified Solar personnel or other individuals work on more than one Project, the hours reflected in the Participation Certifications are allocated among Projects using a reasonable and consistently applied method that reflects the actual services performed with respect to each Project;

(xix) the staffing and service arrangements reflected in the Participation Certifications arise from the actual performance of the Project and are not fictitious or implemented in a manner inconsistent with the underlying services solely to create a material-participation result;

(xx) each SFO Member and Fortified Solar will retain the Participation Records, Participation Certifications and underlying supporting documentation for the applicable period of limitations and will make such records available if reasonably required to substantiate the tax treatment addressed by this Memorandum; and

(xxi) the SFO Member will report the applicable Project consistently with the factual and legal positions upon which this Memorandum is based.

The Memorandum expressed below is based upon the Code, Treasury Regulations, judicial decisions, administrative authorities and such other authorities as we have considered relevant, all as in effect as of the date hereof and all of which are subject to change, potentially with retroactive effect. There can be no assurance that the Internal Revenue Service (the "**Service**") will not challenge the position described herein or that a court would not sustain such a challenge. We express no Memorandum as to the laws of any jurisdiction other than the federal laws of the United States of America.

III. Summary of Overall Conclusions

For the reasons described below, and based upon and subject to the facts, representations, assumptions, qualifications and limitations set forth herein, we conclude that an SFO Member satisfying the conditions described in this Memorandum should be treated as materially participating in the applicable Project pursuant to Treasury Regulation § 1.469-5T(a)(3) for a taxable year in which: [12]

1. the SFO Member performs more than 100 hours of participation that is properly taken into account under Treasury Regulation § 1.469-5T(f);
2. the SFO Member's participation is not less than the participation of any other individual in the Project for such year;
3. the Project is properly treated as the relevant activity for purposes of applying Section 469 to the SFO Member; and
4. the Project is not otherwise treated as a passive activity, including as a rental activity under Section 469(c)(2).

The determination under Test 3 is objective in the respects most relevant here. A Qualifying SFO Member must satisfy both the more-than-100-hour requirement and the comparative-participation requirement. Neither the aggregate participation of all third parties nor the mere fact that Fortified

[12] Temp. Treas. Reg. § 1.469-5T(a)(3).

Solar receives compensation for construction-management services substitutes for those requirements. Likewise, the SFO Member must actually perform qualifying services during the applicable taxable year, and the factual comparison with every other individual participating in the Project must be satisfied.

Under those circumstances, the Project should not constitute a passive activity of the SFO Member under Section 469(c)(1). Accordingly, a Credit properly attributable to such Project should not constitute a passive activity credit solely by application of Section 469 and should instead remain subject to the otherwise applicable rules governing the general business credit.

IV. <u>TAX ANALYSIS</u>

A. *General Principles Applicable to Section 469*

Section 469(a) generally disallows the passive activity loss and passive activity credit of an individual taxpayer for the taxable year.[13] Amounts disallowed under Section 469 generally are carried forward and treated as allocable to the activity in the succeeding taxable year, subject to the rules of Section 469.[14]

For this purpose, Section 469(c)(1) defines a "passive activity" generally as an activity involving the conduct of a trade or business in which the taxpayer does not materially participate. Section 469(h)(1) provides the statutory standard for material participation and states that a taxpayer is treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a basis that is regular, continuous and substantial.[15]

The Treasury Regulations implement that standard through seven specific material-participation tests. An individual satisfying any one of those tests is treated as materially participating for the taxable year, subject to the rules governing what constitutes participation.[16]

The credit consequence follows from the characterization of the underlying activity. Section 469(d)(2) defines the passive activity credit by reference to credits attributable to passive activities. The investment credit determined under Section 46 is included in the current-year general business credit under Section 38(b)(1), and Section 46 in turn includes the energy credit and clean electricity investment credit.[17] Accordingly, where a Credit is attributable to a trade or business activity that is not passive with respect to the taxpayer, the Credit is not included in the taxpayer's passive activity credit merely by reason of Section 469.

Section 469(d)(2) defines the "passive activity credit" as the excess, if any, of specified credits from passive activities over the regular tax liability allocable to all passive activities.[18] Thus, Section 469 does not create a separate classification of the Section 48 or Section 48E credit in the abstract. The relevant inquiry is whether the activity to which the Credit is attributable is a passive activity of the particular taxpayer.

[13] § 469(a)(1), (2)(A).
[14] § 469(b).
[15] § 469(c)(1), (h)(1).
[16] Temp. Treas. Reg. § 1.469-5T(a).
[17] *See* §§ 38(b)(1), 46(2), (7), 48, 48E.
[18] § 469(d)(2).

This conclusion does not eliminate other limitations applicable to the Credit. The general business credit remains subject to Sections 38 and 39 and any limitations or special rules otherwise applicable to the relevant investment credit.

1. *Rental activities require separate treatment.*

The distinction between a non-rental trade or business activity and a rental activity is essential to this Memorandum.

Section 469(c)(2) generally includes any rental activity within the definition of passive activity without regard to material participation. Section 469(c)(4) makes that point express by providing that the rental-activity rule is applied without regard to whether or not the taxpayer materially participates in the activity.[19]

Treasury Regulation § 1.469-1T(e)(3) generally treats an activity as a rental activity where tangible property is used or held for use by customers and the gross income from the activity represents amounts paid principally for the use of such tangible property.[20] The temporary regulation also contains specified exceptions to rental-activity treatment, the availability of which depends upon the particular facts of the arrangement.[21]

Accordingly, merely satisfying Test 3 does not convert a true rental activity into a non-passive activity.

For that reason, the Memorandum expressed herein assumes that the applicable Customer Agreement produces gross income principally from the production and sale of electricity or other Project output and not principally from permitting a customer to use the solar equipment. Any Project subject to a certain lease agreements or economically similar arrangement must be analyzed separately before relying upon this Memorandum.

2. *Development and construction may be part of the trade or business activity.*

Treasury Regulation § 1.469-4(b) provides that a trade or business activity includes not only an activity currently involving the conduct of a trade or business within the meaning of Section 162 but also an activity conducted in anticipation of the commencement of a trade or business.[22]

Accordingly, the fact that a Project has not yet achieved commercial operation does not, by itself, mean that qualifying work performed during development and construction necessarily falls outside the Section 469 activity. Where the SFO already engages in a trade or business interest associated with a Project that is being developed and constructed in anticipation of electricity-generation operations, bona fide management and operational work performed by the SFO Member with respect to that Project, including (but not limited to) promotional work associated with raising revenue and attracting customers may constitute participation, subject to the separate limitations discussed below.

[19] § 469(c)(2), (4).
[20] Temp. Treas. Reg. § 1.469-1T(e)(3)(i); *see also* § 469(j)(8).
[21] Temp. Treas. Reg. § 1.469-1T(e)(3)(ii).
[22] Treas. Reg. § 1.469-4(b)(1)(i)-(ii).

This conclusion should be distinguished from the separate ownership requirement contained in Treasury Regulation § 1.469-5(f)(1). The fact that development of a Project may constitute activity conducted in anticipation of a trade or business does not cause work performed before the SFO Member owns an interest in that activity to become the SFO Member's participation. Both requirements must be satisfied: the work must be performed in connection with the relevant activity, and the taxpayer must own an interest in the activity at the time the work is performed.[23]

The distinction is material to the Fortified Solar structure because development and construction may provide the largest opportunity for substantive owner involvement. The timing of the Assignment therefore may materially affect the number of qualifying hours available to an SFO Member in the year the Project is placed in service.

B. *The Seven Regulatory Material Participation Tests*

Treasury Regulation § 1.469-5T(a) provides seven alternative tests for material participation.[24] Satisfaction of any one test is sufficient, although the rules in Treasury Regulation § 1.469-5T(f) governing what constitutes participation apply in determining the hours or participation relevant to the applicable test.

(i) First, an individual materially participates if the individual participates in the activity for more than 500 hours during the taxable year. This test provides the most straightforward objective standard, but the contemplated Project structure does not assume that an SFO Member will devote more than 500 hours to a single Project in the year the Credit arises. We therefore do not rely upon Test 1. Its potential availability to a particular SFO Member, however, would provide an independent basis for material participation and would eliminate the need to establish the comparative-hours element applicable to Test 3.[25]

(ii) Second, an individual materially participates if the individual's participation constitutes substantially all of the participation in the activity by all individuals, including persons who are not owners. Because Fortified Solar, Hero Solar, installation contractors and other service providers participate in development and construction, we do not rely upon this test. The relevant comparison under Test 2 is materially different from Test 3. Test 2 looks to whether the taxpayer's participation constitutes substantially all participation in the activity by all individuals. The Fortified Solar structure necessarily contemplates meaningful participation by numerous other individuals during construction, and the present facts therefore do not provide a basis for the Memorandum to depend upon Test 2.[26]

(iii) Third, an individual materially participates if the individual participates in the activity for more than 100 hours during the taxable year and the individual's participation is not less than the participation of any other individual, including an individual who does not own an interest in the activity. This is the principal test addressed by this Memorandum.

[23] Treas. Reg. § 1.469-5(f)(1).
[24] Temp. Treas. Reg. § 1.469-5T(a)(1)-(7).
[25] Temp. Treas. Reg. § 1.469-5T(a)(1).
[26] *Id.* § 1.469-5T(a)(2).

Two features of Test 3 are central. First, the regulation requires “more than 100 hours”; exactly 100 hours is insufficient. Second, the regulation compares the taxpayer separately with “any other individual.” It does not compare the taxpayer with the aggregate hours of all employees, contractors or service providers. At the same time, the express inclusion of individuals who do not own an interest in the operating business entity means that third-party personnel cannot be disregarded simply because they have no economic ownership in the Project.[27]

(iv) Fourth, an individual may materially participate where the activity is a “significant participation activity” and the individual's aggregate participation in all significant participation activities exceeds 500 hours. A significant participation activity generally is a trade or business activity in which the taxpayer participates for more than 100 hours but does not otherwise materially participate. The availability of this test depends upon the taxpayer's participation in other activities and therefore cannot be established solely from the facts of one Project. We do not rely upon Test 4 for the conclusion expressed herein.[28]

(v) Fifth, a taxpayer materially participates if the taxpayer materially participated in the activity for any five of the ten immediately preceding taxable years. This test generally cannot apply to a newly acquired and newly placed-in-service Project in the initial credit year, although it may become relevant to a long-held Project in later years. Importantly, Test 5 requires material participation in the prior years; prior ownership or some lesser degree of participation is not sufficient. For the newly developed Projects principally addressed by this Memorandum, the required five-year history will not exist in the year in which the initial Credit arises.[29]

(vi) Sixth, special rules apply to personal service activities where the individual materially participated for any three preceding taxable years. A solar generation activity is capital intensive and does not constitute the type of personal service activity contemplated by that provision. We therefore do not rely upon Test 6. Treasury Regulation § 1.469-5T(d) defines a personal service activity to include specified fields such as health, law, engineering, architecture, accounting, actuarial science, performing arts and consulting, as well as other trades or businesses in which capital is not a material income-producing factor. A business consisting of ownership and operation of photovoltaic generation equipment necessarily depends upon significant capital assets. On the facts assumed herein, the Project therefore does not fall within Test 6.[30]

(vii) Seventh, an individual materially participates if, based upon all the facts and circumstances and subject to the limitations in Treasury Regulation § 1.469-5T(b), the individual participates in the activity on a regular, continuous and substantial basis. As discussed below, the compensated-management limitation applicable specifically to Test 7 creates a material obstacle to use of that test in the Fortified Solar construction structure. Test 7 is subject to limitations not applicable in the same manner to Test 3. Among other things, an individual who participates in an activity for 100 hours or less

[27] *Id.* § 1.469-5T(a)(3).
[28] *Id.* § 1.469-5T(a)(4), (c).
[29] Id. § 1.469-5T(a)(5).
[30] Id. § 1.469-5T(a)(6), (d).

during the taxable year cannot satisfy Test 7, and management services performed by the taxpayer are not taken into account under Test 7 unless specified conditions concerning compensated management by others are satisfied.[31]

Accordingly, although another material participation test may apply to a particular taxpayer on different facts, this Memorandum principally relies upon Test 3.

C. *Application of Test 3 to the Fortified Solar Structure*

As described above, Treasury Regulation § 1.469-5T(a)(3) provides that an individual materially participates in an activity for a taxable year if (i) the individual participates in the activity for more than 100 hours during such year and (ii) the individual's participation is not less than the participation in the activity of any other individual, including individuals who are not owners of interests in the activity.[32]

The regulation therefore establishes two distinct requirements. First, the SFO Member must perform more than 100 hours of participation that is properly taken into account for purposes of Section 469. Second, the SFO Member's participation must equal or exceed the participation of every other individual participating in the Project during the taxable year.

Both requirements must be satisfied. An SFO Member who performs 150 hours of qualifying services will not satisfy Test 3 if another individual participates in the Project for 160 hours. Conversely, an SFO Member who participates more than every other individual but performs only 100 hours will not satisfy Test 3 because the regulation requires participation for more than 100 hours.

1. *The SFO Member Must Perform More Than 100 Hours of Qualifying Participation*

Treasury Regulation § 1.469-5(f)(1) generally provides that work performed by an individual in connection with an activity in which the individual owns an interest at the time the work is performed is treated as participation in the activity, without regard to the capacity in which the individual performs such work.[33]

This rule is broad. For example, Example 2 of Treasury Regulation § 1.469-5T(k) treats services performed by an individual pursuant to an employment arrangement as participation in an activity in which the individual owns an interest, even though the services were formally performed in the individual's capacity as an employee of another entity.[34] Thus, for purposes of the general participation rule, the legal capacity in which an SFO Member performs bona fide Project work ordinarily is not determinative.

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[31] Id. § 1.469-5T(a)(7), (b)(2).
[32] Temp. Treas. Reg. § 1.469-5T(a)(3).
[33] Treas. Reg. § 1.469-5(f)(1).
[34] Temp. Treas. Reg. § 1.469-5T(k), Example 2.

The rule nevertheless applies only to actual work performed in connection with the activity and is subject to the specific exclusions contained in Treasury Regulation § 1.469-5T(f)(2). Accordingly, the more-than-100-hour requirement cannot be satisfied merely by identifying time that has some relationship to the taxpayer's investment. The hours relied upon must constitute participation within the meaning of the regulations.

(a) *Genuine Project Management and Operational Activities*

Based upon the facts and representations described herein, an SFO Member may perform a range of activities that constitute actual management or operational work in connection with a Project.

During the development and construction period, such activities may include:

(i) evaluating proposed installation contractors and exercising the SFO's right to approve or reject an installer;

(ii) reviewing and responding to substantive Project design, engineering or site-development matters;

(iii) participating in meetings with Fortified Solar, Hero Solar, installation contractors, utilities and other service providers in which Project decisions are made or operational issues are resolved;

(iv) reviewing proposed construction changes and approving, rejecting or directing modifications;

(v) monitoring construction schedules for purposes of addressing delays, coordinating required owner action and directing responses to Project issues;

(vi) reviewing and acting upon utility interconnection requirements;

(vii) coordinating inspections and responding to matters requiring action by the Project owner;

(viii) reviewing commissioning results, identifying deficiencies and requiring corrective action;

(ix) making decisions regarding Project operations and the Customer Agreement; and

(x) taking other actions ordinarily associated with the owner-management of a Project.

Following commencement of commercial operation, qualifying activities may include directing maintenance and repairs, monitoring Project production for operational purposes, responding to equipment failures or production shortfalls, managing relationships with utilities or customers, administering material contractual matters and making other decisions concerning continued operation of the Project.

These activities differ from passive observation because they require the SFO Member to take action, exercise judgment or provide direction concerning the Project's management or operations.

The regulation does not require that the taxpayer personally perform physical installation, electrical work or maintenance labor. Work performed in a managerial capacity generally constitutes participation, subject to the limitations applicable to the facts-and-circumstances test discussed separately below.[35] Test 3 itself does not exclude management activity merely because other persons also perform management or because another person is compensated.

Accordingly, where the SFO Member actually performs the activities described above after acquiring the requisite business interest, such services generally should constitute participation for purposes of Test 3.

(b) *Investor Capacity Activities*

Treasury Regulation § 1.469-5T(f)(2)(ii) excludes work performed by an individual in the individual's capacity as an investor unless the individual is directly involved in the day-to-day management or operations of the activity.[36]

The regulation provides examples of investor-capacity work, including studying and reviewing financial statements or reports on operations, preparing or compiling financial or operational summaries for the individual's own use, and monitoring finances or operations in a non-managerial capacity.[37]

The distinction is functional rather than formal. For example, an SFO Member's review of a weekly construction report solely to remain informed about the value or status of the investment ordinarily is investor monitoring. In contrast, reviewing the report to identify a construction delay, communicating with the contractor concerning corrective measures and approving a revised construction sequence constitutes management activity.

Similarly, reviewing Project financial information solely to evaluate the personal return on the investment ordinarily is investor-capacity activity. Reviewing the same information to make a decision concerning Project operations, vendor payment, contractual performance or another day-to-day business matter may constitute participation.

The Tax Court has applied this distinction by examining the actual nature of the taxpayer's involvement rather than relying exclusively upon the description attached to the activity.[38] The material question is whether the taxpayer is directly involved in management or operations or instead is merely monitoring the investment.

Accordingly, for purposes of the Memorandum expressed herein, the more-than-100-hour requirement is assumed to be satisfied without reliance upon time principally attributable to:

(i) reviewing the SFO Member's personal investment return;

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[35] *See* Treas. Reg. § 1.469-5(f)(1); Temp. Treas. Reg. § 1.469-5T(f)(2); see also Scheiner v. Commissioner, T.C. Memo. 1996-554.
[36] Temp. Treas. Reg. § 1.469-5T(f)(2)(ii)(A).
[37] *Id.* § 1.469-5T(f)(2)(ii)(B).
[38] *See Scheiner v. Commissioner*, T.C. Memo. 1996-554; Mordkin v. Commissioner, T.C. Memo. 1996-187.

(ii) studying the general federal income tax benefits of solar investments;

(iii) reviewing tax-credit rules solely to understand the SFO Member's personal tax position;

(iv) reviewing financing solely in the capacity of a capital investor;

(v) monitoring Project reports without taking a managerial or operational action; or

(vi) other activities performed principally in the SFO Member's capacity as an investor.

This limitation does not imply that every financial, tax-related or informational activity is excluded. An activity must be evaluated in context. The same underlying information may be relevant to an operational decision. The Memorandum nevertheless does not depend upon borderline investor-capacity hours in reaching the more-than-100-hour threshold.

(c) *Work Performed Principally to Avoid Section 469*

Treasury Regulation § 1.469-5T(f)(2)(i) provides a separate exclusion where (i) the work performed by the individual is not of a type customarily performed by an owner of the activity and (ii) one of the individual's principal purposes for performing such work is to avoid the disallowance of losses or credits under Section 469.[39]

Example 7 of Treasury Regulation § 1.469-5T(k) illustrates this anti-avoidance rule. In that example, a taxpayer caused the taxpayer's spouse to perform receptionist services in connection with a professional football activity in anticipation of passive activity losses. Because receptionist work was not of a type customarily performed by an owner of that activity and a principal purpose of the arrangement was to avoid Section 469, the services were not treated as participation.[40]

The rule is relevant where a taxpayer performs artificial, unnecessary or atypical tasks principally to accumulate participation hours.

The Project activities on which this Memorandum relies are materially different. Contractor selection, design approval, construction oversight, resolution of Project issues, commissioning decisions, utility coordination and ongoing Project management are bona fide functions of an owner responsible for managing a solar facility. Subject to the factual representations herein, such services have independent operational purposes and are not assumed to have been created merely to generate participation hours.

Accordingly, the existence of a structured process through which an SFO Member is expected to perform and document Project responsibilities does not, standing alone, cause those responsibilities to be disregarded. The relevant question is whether the services actually were performed, whether they served a genuine Project function, and whether the anti-avoidance conditions in Treasury Regulation § 1.469-5T(f)(2)(i) are satisfied.

For purposes of this Memorandum, we assume that the SFO Member performs bona fide owner-management services and does not rely upon artificial or nominal tasks principally undertaken to avoid Section 469.

(d) *Merely Being Available to Perform Services is Insufficient*

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[39] Temp. Treas. Reg. § 1.469-5T(f)(2)(i).
[40] *Id.* § 1.469-5T(k), Example 7.

Section 469 and the applicable regulations look to services actually performed by the taxpayer. Accordingly, time during which an SFO Member merely remains available to respond to Project issues, but performs no services, should not be included in the participation calculation.

The Tax Court has rejected attempts to count "on call" time toward analogous personal-service hour requirements where the taxpayer did not actually perform services during that period.[41] Although those cases do not arise specifically under Test 3, they are consistent with the regulatory requirement that participation represent work actually performed in connection with the activity.

For purposes of this Memorandum, the SFO Member's qualifying hours therefore include only periods during which the SFO Member actually performs identifiable Project services.

2. *The SFO Member's Participation Must Equal or Exceed the Participation of Every Other Individual*

The second element of Test 3 requires that the SFO Member's participation not be less than the participation of "any other individual," including individuals who do not own interests in the activity.[42] The text of the regulation is significant in two respects.

First, the comparison is made to individuals rather than entities. Accordingly, Fortified Solar, Hero Solar and an installation contractor are not each treated as one person whose aggregate entity-level hours are compared with the SFO Member. Instead, the relevant comparison is between the SFO Member and each natural person who performs services in the Project.

Second, the regulation expressly includes individuals who do not own an interest in the activity. Thus, employees, independent contractors, installation workers, engineers, consultants, technicians and other third-party personnel are included in the comparison to the extent they participate in the Project.

Example 3 of Treasury Regulation § 1.469-5T(k) illustrates Test 3 directly. Two individuals were the only participants in an activity and each worked the same number of hours, exceeding 100 hours. The regulation concludes that the taxpayer materially participated because the taxpayer's participation was not less than the participation of any other individual. The example confirms that the taxpayer need not perform strictly more hours than every other participant. Equal participation is sufficient because Test 3 requires that the taxpayer's participation be "not less than" the participation of another individual.[43]

The same principle applies to the Projects. For example, if a Qualifying SFO Member performs 135 qualifying hours during the taxable year, an installer performs 120 Project-specific hours, a Fortified Solar employee performs 95 hours, and all other individuals perform fewer hours, the comparative requirement is satisfied even if the aggregate third-party hours materially exceed 135. Conversely, if a single installation worker or other individual performs 140 hours, the SFO Member with 135 hours does not satisfy Test 3, regardless of the number of other participants with fewer hours.

Accordingly, the Test 3 conclusion depends upon reliable Project-specific information concerning the participation of each material third-party individual.

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[41] *See Moss v. Commissioner*, 135 T.C. 365, 369-70 (2010).
[42] Temp. Treas. Reg. § 1.469-5T(a)(3).
[43] *Id.* § 1.469-5T(k), Example 3.

3. *Golan v. Commissioner*

The Tax Court's decision in *Golan v. Commissioner*, T.C. Memo. 2018-76, provides particularly relevant authority because it addressed application of Section 469 to an individual's solar energy activity.[44] In *Golan*, the taxpayers acquired solar energy equipment that was installed at host properties. Among several issues, the Service contended that the taxpayers' deductions and credits were limited by Section 469.

The court identified Treasury Regulation § 1.469-5T(a)(3) as the material participation test asserted by the taxpayers and quoted its requirements: more than 100 hours of participation and participation that is not less than that of any other individual, including nonowners.[45]

The procedural posture of *Golan* is important. The Section 469 argument had not been raised in the notice of deficiency and constituted a new matter. As a result, the Service bore the burden of proof with respect to the issue.[46]

The Tax Court ultimately concluded that the Service had not carried that burden.[47] The court credited the taxpayer's assertion regarding his participation and found that the record did not establish that another individual had participated more than the taxpayer.

Golan illustrates the application of Test 3 to an individual taxpayer's solar energy activity and confirms that the regulatory inquiry includes a comparison between the taxpayer's participation and the participation of other individuals. Because the Service bore the burden of proof on the Section 469 issue in Golan, however, the decision does not establish that a taxpayer who bears the ordinary burden of proof may satisfy Test 3 without affirmatively substantiating both the taxpayer's qualifying hours and the comparative-participation requirement.

We do not, however, interpret *Golan* as relieving an SFO Member of the ordinary obligation to substantiate material participation. Its result was materially affected by the Service's burden of proof on the newly raised issue.

In the ordinary case, the taxpayer generally bears the burden of establishing entitlement to the tax treatment claimed on the return. Accordingly, the Projects should be administered on the assumption that the SFO Member must affirmatively substantiate both components of Test 3.

For that reason, the Participation Records and Participation Certifications described in this Memorandum are an important component of the factual foundation for our conclusion.

4. *Third-Party Participation Must Be Determined From Actual Project-Specific Services*

[44] *Golan v. Commissioner, T.C. Memo. 2018-76.*
[45] *Id.*
[46] *Id.*; see Tax Ct. R. 142(a).
[47] *Golan*, *T.C. Memo.* 2018-76.

Test 3 focuses upon actual participation in the relevant activity during the taxable year.[48] Accordingly, a general representation that no contractor employee is expected to exceed a specified number of hours does not establish the hours actually performed.

For purposes of this Memorandum, the Participation Certifications are assumed to be based upon the actual services provided during the relevant period and upon records reasonably capable of substantiating those services.

The Certifications should address all individuals performing services relevant to the Project, including:

(i) Fortified Solar personnel;

(ii) Hero Solar personnel;

(iii) installation subcontractor personnel;

(iv) sub-subcontractor personnel whose work is separately identifiable;

(v) engineers and consultants;

(vi) commissioning personnel;

(vii) utility or interconnection consultants to the extent they perform services on behalf of the Project;

(viii) maintenance contractors; and

(ix) any other individual materially participating in the Project on behalf of a service provider.

An entity-level certification that the entity collectively performed 500 hours is not sufficient to determine whether the SFO Member satisfies Test 3. Likewise, a certification that merely states that "no employee exceeded 100 hours" may be insufficient where the SFO Member relies upon a greater number of hours and where nonemployees also performed Project services.

The preferred factual record identifies each individual and the individual's actual Project-specific hours or otherwise provides information sufficient to establish that no individual exceeded the SFO Member.

Where an individual performs services through more than one entity or in more than one capacity, we believe the Project-specific hours of that natural person should be considered together for purposes of Test 3. The regulation compares the SFO Member's participation with the participation of each other individual, rather than with each separate entity, employment relationship or contractual capacity through which such individual performs services.

5. *The Fortified Solar and Hero Solar Arrangements Do Not Aggregate Entity-Level Hours Under Test 3*

[48] Temp. Treas. Reg. § 1.469-5T(a)(3), (f).

Fortified Solar performs substantial services in connection with Project development and construction. Hero Solar also performs services in the construction chain. Neither fact causes the aggregate hours of Fortified Solar or Hero Solar to be compared with the SFO Member under Test 3.

The regulation expressly compares the taxpayer's participation with the participation of "any other individual."[49] Accordingly, an entity that deploys several personnel does not itself constitute an individual participant.

This distinction is not merely semantic. It reflects the regulatory design of Test 3. If five Fortified Solar employees each perform 50 Project-specific hours, Fortified Solar has supplied 250 employee-hours, but no one Fortified Solar individual has participated for more than 50 hours for purposes of the Test 3 comparison.

The same analysis applies to Hero Solar and the installation contractor.

The conclusion is subject to two qualifications. First, the hours must reflect the actual allocation of work. Project work performed principally by one individual cannot be divided artificially among multiple persons in the records. Second, hours of one natural person cannot be fragmented merely because that person performs services through multiple entities or roles.

Subject to those qualifications, the plain language of Test 3 requires an individual-by-individual analysis and does not aggregate service-provider entities.

D. *Effect of Compensated Management Services*

The involvement of compensated management requires separate analysis because Treasury Regulation § 1.469-5T(b)(2)(ii) imposes a specific restriction on the facts-and-circumstances test under Treasury Regulation § 1.469-5T(a)(7). The regulation provides that an individual's management services are not taken into account in determining material participation under Test 7 unless, for the taxable year: (i) no other person performing services in connection with management of the activity receives compensation described in Section 911(d)(2)(A) for those services; and (ii) no other individual performs more management services, measured in hours, than the taxpayer.[50]

1. *Example 8*

Example 8 of Treasury Regulation § 1.469-5T(k) illustrates the application of this rule. In that example, an individual owned an interest in a cattle-feeding partnership. The general partner periodically submitted operational decisions to the individual owner, including decisions regarding feed purchases, feeding practices and the sale of cattle. The individual had discretion to approve or reject the proposed actions.

The general partner, however, received compensation constituting earned income for managing the cattle-feeding operation. The example concludes that the individual's managerial decisions were

[49] Temp. Treas. Reg. § 1.469-5T(a)(3).
[50] Temp. Treas. Reg. § 1.469-5T(b)(2)(ii)(A)-(B).

not taken into account under Test 7 because another person performed compensated management services.[51]

The example is relevant to the Fortified Solar structure because it demonstrates that a taxpayer cannot preserve Test 7 simply by retaining formal decision-making authority while another person is compensated for management.

2. *Application to Fortified Solar's Construction Management*

Fortified Solar is represented to perform construction-management functions and to receive compensation in connection with those functions. For purposes of the Test 7 analysis, we do not believe the result changes merely because compensation for those services is embedded within the Project purchase price instead of appearing as a separately stated management fee.

For purposes of this Memorandum, we assume, as provided above, that a portion of the consideration received by Fortified Solar constitutes compensation for its construction-management services. Accordingly, we treat Fortified Solar as receiving compensation for management services for purposes of Treasury Regulation § 1.469-5T(b)(2)(ii)(A), notwithstanding that such compensation is not separately stated as a management fee.

Accordingly, Fortified Solar's compensated construction-management role materially impairs reliance upon Test 7 in the construction and placed-in-service year.

For that reason, this Memorandum does not rely upon Test 7.

3. *The Test 7 Management Restriction Does Not Apply to Test 3*

The conclusion regarding Test 7 does not prevent an SFO Member from satisfying Test 3. Treasury Regulation § 1.469-5T(b)(2)(ii) expressly states that its management-services limitation applies in determining whether an individual materially participates "under paragraph (a)(7)."[52] It does not modify the objective tests contained in paragraphs (a)(1) through (a)(6).

The Tax Court recognized this distinction in Scheiner v. Commissioner, T.C. Memo. 1996-554. There, the taxpayer attempted to establish material participation in a condominium hotel activity. Compensated onsite personnel performed management functions. The court applied the Test 7 management-services restriction but separately considered whether the taxpayer could satisfy other tests, including Test 3.

The existence of compensated management therefore did not itself prevent application of Test 3. The taxpayer nevertheless failed because the evidence did not establish that her participation satisfied the comparative-hours requirement.[53]

The relevant distinction is thus:

[51] *Id.* § 1.469-5T(k), Example 8.
[52] Temp. Treas. Reg. § 1.469-5T(b)(2)(ii).
[53] *Scheiner v. Commissioner*, *T.C. Memo.* 1996-554.

- under Test 7, compensated management by another person may cause the taxpayer's own management services to be disregarded; but

- under Test 3, the taxpayer's bona fide management work may constitute participation, while the actual participation of the compensated manager and other individuals is included in the comparative-hours analysis.

Accordingly, the fact that Fortified Solar receives compensation does not itself prevent a Qualifying SFO Member from materially participating under Test 3. It does, however, make the Fortified Solar personnel's actual Project-specific hours important to the Test 3 analysis.

4. *Hero Solar*

The same general principles apply to Hero Solar. Hero Solar's compensation does not create an independent disqualification under Test 3. Nor does the fact that Hero Solar is retained in the Project chain cause its entity-level hours to be compared with the SFO Member.

The relevant Test 3 inquiry is the participation of the natural persons acting for Hero Solar. Accordingly, if Hero Solar's role is limited as represented and no individual associated with Hero Solar exceeds the SFO Member's participation, Hero Solar's involvement does not prevent satisfaction of Test 3.

If the actual facts differ—for example, if one Hero Solar individual exercises substantial Project management and performs more hours than the SFO Member—the Test 3 conclusion may change. The Participation Certification with respect to Hero Solar therefore must reflect the services actually provided rather than rely solely upon the contractual characterization of Hero Solar's role.

E. *Ownership Requirement and Timing of Participation*

Treasury Regulation § 1.469-5(f)(1) provides that work performed by an individual in connection with an activity is treated as participation where the individual owns an interest in the activity at the time the work is performed.[54] The ownership requirement is significant to construction-period participation.

1. *Work Performed Before Ownership Generally Does Not Count*

Example 6 of Treasury Regulation § 1.469-5T(k) illustrates the rule. In that example, an individual worked in an activity before acquiring stock in the entity conducting the activity. The regulation provides that the individual is not treated as participating during the taxable years before acquiring the stock.[55]

[54] Treas. Reg. § 1.469-5(f)(1).
[55] Temp. Treas. Reg. § 1.469-5T(k), Example 6.

Accordingly, work performed by an SFO Member before the SFO Member acquires a direct or indirect interest in the applicable Project generally may not be included in the SFO Member's participation hours.

This is true even if the work ultimately benefits the Project. For example, preliminary diligence, review of prospective Projects, general solar-industry research and negotiations undertaken before the SFO Member owns the requisite interest do not become participation merely because the SFO later acquires the Project. Rather, these must be considered under the totality of the circumstances.

2. *Construction-Period Work Following Ownership May Count*

The ownership rule does not require the Project already to be operational. Treasury Regulation § 1.469-4(b)(1) provides that a trade or business activity includes an activity conducted in anticipation of the commencement of a trade or business.[56]

Accordingly, once the SFO Member engages in a trade or business directly tied to a Project being developed for future electricity-generation operations, bona fide Project management and operational work performed during construction may constitute participation even though the Project has not yet been placed in service.

Thus, qualifying construction-period participation may include contractor selection, design approvals, construction decisions, interconnection work, commissioning oversight and similar owner-management functions occurring after ownership begins.

3. *Assignment Timing*

Because the Project may initially arise under a Master Purchase Agreement and later be transferred through an Assignment, the date upon which the SFO Member obtains an ownership interest in the operating entity should be clearly established: the Assignment, SFO ownership records and Participation Records should be consistent concerning that date.

For purposes of this Memorandum, we do not rely solely upon work performed before the date on which the SFO Member clearly owns a direct or indirect interest in the Project. This approach avoids requiring a conclusion regarding whether a particular preliminary contractual right under a master arrangement constitutes a sufficient interest within the meaning of Treasury Regulation § 1.469-5(f)(1) based on the facts and circumstances.

Where the SFO Member exceeds 100 qualifying hours after the ownership date, resolution of that issue is unnecessary to the Test 3 conclusion.

4. *The Ownership Limitation Applies to the Taxpayer's Hours, Not by Its Terms to the Comparison With Other Individuals*

The ownership requirement governs when the taxpayer's own work is treated as participation. Test 3, however, separately compares the taxpayer's participation during the taxable year with the participation of any other individual in the activity during such year.

[56] Treas. Reg. § 1.469-4(b)(1)(ii).

Nothing in Treasury Regulation § 1.469-5T(a)(3) limits the other individual's participation to periods after the taxpayer acquired an ownership interest.[57] Accordingly, where third-party individuals perform Project services earlier in the same taxable year, those hours may remain relevant to the Test 3 comparison even if the SFO Member does not count the SFO Member's own pre-ownership work.

This asymmetry can be significant where substantial construction work occurs before the SFO Member acquires the relevant interest.

For purposes of this Memorandum, the Participation Certifications therefore should account for all relevant participation in the Project during the taxable year and should not automatically exclude third-party hours merely because those hours preceded the date on which the operating entity is formed and interests in it acquired by the SFO Member.

F. *Substantiation of Material Participation*

Treasury Regulation § 1.469-5T(f)(4) provides that the extent of an individual's participation in an activity may be established by any reasonable means.[58] Contemporaneous daily time reports, logs or similar documents are not required if the taxpayer's participation may otherwise be established through reasonable means, including appointment books, calendars or narrative summaries.[59]

The regulation's flexible evidentiary standard does not eliminate the taxpayer's obligation to establish the factual requirements of the applicable material participation test.[60] For purposes of Test 3, the taxpayer must be able to establish both the amount of the taxpayer's own qualifying participation and that such participation was not less than the participation of any other individual in the activity.

Accordingly, our conclusion depends upon the accuracy and reliability of the Participation Records and Participation Certifications described above. Those records must be reasonably sufficient to substantiate the nature and duration of the SFO Member's qualifying services and the Project-specific participation of other individuals during the applicable taxable year.

G. *Relevant Activity and Single- and Multi-Project Structure*

Treasury Regulation § 1.469-4 governs the determination and grouping of activities for purposes of Section 469.[61] For purposes of this Memorandum, we assume that each Qualifying SFO Member owns a single Project through a separate SFO and that such Project is properly treated as the relevant activity of that SFO Member.

The fact that multiple Projects may be developed by Fortified Solar or documented under a common Master Purchase Agreement does not, by itself, cause those Projects to constitute a single activity for Section 469 purposes.[62] Each SFO Member is a separate taxpayer, and the participation analysis is applied separately to the activity of that taxpayer.

[57] Compare Treas. Reg. § 1.469-5(f)(1), *with* Temp. Treas. Reg. § 1.469-5T(a)(3).
[58] Temp. Treas. Reg. § 1.469-5T(f)(4).
[59] *Id.*
[60] *See Moss v. Commissioner*, 135 T.C. 365, 369 (2010).
[61] Treas. Reg. § 1.469-4(a)-(c).
[62] *See* Treas. Reg. § 1.469-4(c)(1)-(2).

Accordingly, individuals performing services solely with respect to another Project are not included in the Test 3 comparison for the applicable SFO Member. Individuals who perform services with respect to the applicable Project are included to the extent of their Project-specific participation.

H. *Application to a Qualifying SFO Member*

Based upon the foregoing authorities and the representations and assumptions described herein, a Qualifying SFO Member should satisfy Test 3 if the SFO Member performs more than 100 hours of qualifying participation in the applicable Project during the taxable year and such participation is not less than the participation of any other individual in the Project.

The activities described above, including contractor selection, Project decision-making, construction oversight, utility coordination, commissioning activities and ongoing operational management, may constitute qualifying participation to the extent actually performed by the SFO Member after acquiring the requisite interest and not otherwise excluded under Treasury Regulation § 1.469-5T(f).

Fortified Solar's compensated construction-management role, and the involvement of Hero Solar and other contractors, do not independently prevent satisfaction of Test 3. Rather, the Project-specific participation of the individuals performing services through those entities must be included in the comparative-hours analysis.

Accordingly, subject to the representations and assumptions herein, an SFO Member who satisfies those requirements should be treated as materially participating in the Project under Treasury Regulation § 1.469-5T(a)(3).[63]

V. Overall Conclusion

For the foregoing reasons, and based upon and subject to the facts, representations, assumptions, qualifications and limitations set forth herein, an individual SFO Member who meets the below criteria should be treated as materially participating in the applicable:

(i) owns an interest in the applicable Project during the period in which the relied-upon services are performed;

(ii) performs more than 100 hours of qualifying participation in the Project during the applicable taxable year after excluding investor-capacity activity, artificial or nominal activity and other services not treated as participation under the applicable Treasury Regulations;

(iii) participates in the Project for not less time than any other individual participating in such Project during that taxable year;

[63] Temp. Treas. Reg. § 1.469-5T(a)(3).

(iv) substantiates the nature and extent of such participation and the participation of other individuals through records reasonably sufficient to support the requirements of Treasury Regulation § 1.469-5T(a)(3);

(v) properly treats the Project as the relevant activity for purposes of Section 469; and

(vi) operates a Project that is not otherwise treated as a passive activity, including as a rental activity under Section 469(c)(2).

Accordingly, under those circumstances, the Project should not constitute a passive activity of the SFO Member under Section 469(c)(1).

As a result, a Credit properly determined under Section 48 or Section 48E and properly attributable to the Project should not constitute a passive activity credit with respect to such SFO Member solely by application of Section 469.

The foregoing conclusion is dependent upon the actual activities of the SFO Member and other individuals during each applicable taxable year. The establishment by Fortified Solar of contractual rights, recordkeeping processes or participation procedures does not independently establish material participation for an SFO Member who does not satisfy the factual requirements described herein.

With best regards,

Nelson Mullins Riley + Scarborough, LLP
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