

## BP works through solar tax problems

01 February 2011

**BP Solar's sale of a number of PV plants in Italy to a leading insurance company gave rise to a complex tax structuring case, which was also affected by a new interpretation by Italy's tax authorities, explains Federico Trutalli of NCTM, who advised the seller during the transaction.**

The solar division of BP Group sold eight photovoltaic (PV) plants in the south of Italy together with the related operation and maintenance agreements (O&M) to one of the largest financial services providers in 2009. The deal was one of the most interesting transactions in the renewable energy industry and allowed BP Solar to develop a unique business model envied by the renewable energy market.

BP Solar Italia is the local subsidiary of BP Group engaged in the solar PV industry, with particular focus on the implementation, management and maintenance of solar PV plants. BP Solar acquires the PV project directly from the local developers – or even develops projects internally – and then takes care of the completion of all the authorisation processes, plant construction and connection, as well as providing buyers for the subsequent operation and maintenance services necessary over years. This impressive turnkey offer that covers all the start-up phase.

In this innovative deal the purchaser was one of the leading companies in the financial and insurance industry, which is now engaged in the Italian renewable energy industry after the acquisition of a number of special purpose vehicles (SPV) from BP. The SPV were incorporated and/or previously acquired by BP Solar with the scope to build and then manage single PV plants located in different areas.

The deal required a few months of negotiation and tax structuring work. It was an intense transaction that, working with the purchaser's tax advisers, had to be structured accurately to take into account an impressive number of pre and post-closing details. Some well known uncertainties of Italian tax legislation and the complexities of a transaction that was negotiated in the very middle of the plants' construction meant it took four to six months to reach a tax structure satisfactory to both parties.

At the end of 2008, arrangements took place for the first part of the deal, that is, the acquisition of 45 megawatts projects from local developers in Puglia, some of them subsequently sold to the same financial services provider. The main tax issue affecting that initial acquisition was how to recognise, for tax purposes, the projects and goodwill paid by BP Solar in the books of the SPV created by the local developers. The tax issue was solved only in part and some unavoidable inefficiencies had an impact on the final negotiations.

Gianni Chianetta, chairman of Assolare (the Italian Association of companies working in the PV industry) and a member of the BP Solar Italia board, who led the negotiations, was really sensitive in understanding the relevance of the transaction's tax aspect. BP finally asked for a relevant discount and taxes significantly affected the final acquisition



**Transactions involving photovoltaic plants are leading to increasingly complex and innovative tax structures**

**Source:**

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price. A lot was learned from that negotiation about how taxes can substantially affect relevant elements of a transaction and how it can be used as a negotiation tool.

Afterwards BP Solar entered into further negotiations with the purchaser.

## Quota sale

Two specific issues affected this deal. Firstly, there was the sale of the SPV quotas jointly with the transfer of the credit of BP Solar towards each SPV for the EPC supply. BP was indeed the owner of the SPV quotas during the construction that took a few months before closing. That phase was regulated by a complex EPC agreement (engineering, design supply and turnkey construction agreement) stipulated by BP Solar with each SPV and under the direction and control of the purchaser.

The debt of each SPV for the EPC supply was a sort of potential inheritance for the purchaser entering as new quota holder and that credit inherited was potentially affecting the future financial structure of the SPV and the leverage plans of the new investor. The sale of quotas jointly with the transfer of the EPC credit to plant purchasers is now part of the business model of BP Solar and that arrangement was often adopted in other deals signed by BP in 2009 and 2010.

This arrangement forms in part the turnkey project and allows the final investor to buy an *ad hoc* vehicle only when the authorisation process and construction are completed and the plant is connected, with an adequate quotaholder loan inherited from BP Solar acting as seller and EPC contractor.

## VAT management

The other critical point that was heavily discussed during the tax structuring phase was how to manage the input VAT credit reported in the SPV books as a consequence of the EPC invoicing. The 10% VAT rate applicable to this kind of supply and charged to the SPV was initially seen by the purchaser as an element of potential inefficiency for its envisaged financial structure. BP Solar and the purchaser's tax teams researched and analysed to implement a plan to recover the VAT credit in the quickest way to mitigate the financial impact.

One possibility that was heavily analysed from a technical point of view was a sale of the VAT credit back from the SPV to BP Solar immediately after the SPV to the financial investor. That arrangement was finally deemed feasible though sophisticated. In the end, some potential inefficiencies regarding VAT finally had an impact on the selling price, confirming once more just how important the tax implications are in this kind of transaction.

In addition to specific issues having an impact on the deal, during the negotiation the seller and purchaser faced another – and at that time completely new – tax issue that would have significantly affected the financial models and budgets of the PV industry in Italy. All investors know now about ICI, a property tax levied by the municipalities (the equivalent of local council in the UK or US) and based on the cadastral value of the property, but at the beginning of 2009 that was an area of uncertainty.

## Reclassification

In the first months of 2009, ICI became the greatest concern among investors in PV plants in Italy after the decision taken by the cadastral authorities (*Agenzia del Territorio*) to consider PV plants as regular industrial sites (*opificio*) and not as mere equipment (that is, panels with minor links to ground).

Under the new (and technically debatable) cadastral classification proposed by the authorities – by the way disputed by the same Internal Revenue Service (the different body called *Agenzia delle Entrate*) – ground-based PV plants are



**Federico Trutalli:**  
**Quota and VAT issues complicated the transaction**

due to pay ICI 100 time higher than if PV plants sites were to be classified as farmland sites, as they were before. The economic impact is actually severe, enough to turn down the best IRR-project and to reduce the appeal of investment in ground-based PV plants.

Assolare, the Italian Solar Association, immediately wrote to the Revenue Authority and called a meeting to discuss the issue with the government. Gianni Chianetta acting as chairman of Assolare led the Assolare team, supported by advisers. The initial meeting with the authorities was held in February 2009 when BP Solar had entered into the most critical phase of the negotiation with the purchaser. In the subsequent months of 2009, the authorities did not change their position on ICI but at the beginning of the year, during the negotiation with the purchaser, that was still an outstanding critical point potentially affecting the transaction in an unpredictable way. Along with other investors, the purchaser finally changed their financial models to take into account the new tax burden.

With the deal in place and the complex tax solutions implemented, BP Solar and the buyer closed the deal for the sale of six plants in March 2009 and entered into a maintenance agreement for the next 20 years. The remaining two plants will finally be sold over the next few months.

## Knowledge gain

In 2010 BP Solar entered into a number of similar transactions with other investment funds and enterprises active in the PV industry. BP Solar is now one of the major players in Italy and the experience accumulated by the BP team and their tax advisers in completing this transaction is now part of the know-how available to investors interested in turnkey projects. A number of alternative tax structures for acquiring the projects were analysed, complete the construction and then sale the plants to final investors. This knowledge for managing and solve the main tax issues affecting complex transactions in the PV sector is now available to others.

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