

Depreciation; "first placed in service"; electric generating unit.

Advice has been requested as to when a coal-fired electric generating unit was first placed in service for depreciation and investment credit purposes, under the circumstances described below.

The taxpayer, a regulated electric utility company that files its Federal income tax return on a calendar year basis and uses the accrual method of accounting, owns a coal-fired electric generating unit, construction of which commenced in September 1971.

The major components that are necessary to the operation of the generating unit include: main steam/hot and cold reheat steam system; main <Page 47> boiler water/steam system; condensate/feedwater system; condensate make-up system; main boiler fuel system; auxiliary boiler and steam system; air quality control system; waste disposal system; main turbine system; and coal handling system.

On December 11, 1975, necessary permits and licenses to operate the coal-fired electric generating facility had been approved.

December 11, 1975, was also the date of synchronization of the generating unit into the power grid of the company and the date when the critical testing had been completed on the component systems of the coal-fired electric generating facility to assure that the generating unit could operate in its intended manner.

In addition, the generating unit was placed in the control of the taxpayer by the contractor on December 11, 1975, and daily operation of the unit began. However, subsequent testing was performed to determine and eliminate latent defects, if any.

A substantial portion of the projected cost of the waste disposal system was attributable to a 400-foot high dam that was not completed on December 11, 1975. However, on this date the dam was of sufficient height to take care of the current waste disposal though it would have to be increased as waste disposal requirements increased. The height of the dam did not interfere with the generating unit's intended purpose on December 11, 1975.

The coal-fired electric generating unit is depreciable property and has a useful life of more than 3 years.

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in section 38 property. The determination of what property qualifies as section 38 property is made in accordance with the rules provided in section 48.

Section 48(a)(1) of the Code provides, in pertinent part, that in order to qualify as section 38 property, the property must be depreciable and have a useful life of 3 years or more.

Section 167(a) of the Code provides, in part, that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business.

Section 1.167(a)-11(e)(1)(i) of the regulations provides, in part, that property is first placed in service when it is in a condition or state of readiness and is available for a specifically assigned function. In general, the provisions of section 1.46-3(d)(1)(ii) and (d)(2) apply for the purpose of determining the date on which property is placed in service.

Section 1.46-3(d)(1) of the regulations provides, in part, that for purposes of the investment credit allowed by section 38 of the Internal Revenue Code of 1954, property shall be considered placed in service in the earlier of the following taxable years: (i) the taxable year in which, under the taxpayer's depreciation practice, the period for depreciation with respect to such property begins; or (ii) the taxable year in which the property is placed in a condition or state of readiness and availability for a specifically assigned function.

Section 1.46-3(d)(2) of the regulations provides, in part, that equipment acquired by a taxpayer for a specifically assigned function in his trade or business that is operational but is undergoing testing to eliminate any defects is considered in a condition or state of readiness and availability for a specifically assigned function.

Under the circumstances described above, the generating unit in the instant case was in a condition or state of readiness and availability for a specifically assigned function on December 11, 1975, in that the necessary permits and licenses had been approved, the critical tests for the various components were complete, the generating unit was placed in the control of the taxpayer by the contractor, the generating unit was synchronized into the taxpayer's power grid for its function in the business of generating electric energy for the production of income, and daily operation of the generating unit began, notwithstanding the fact that the generating unit would undergo further testing to eliminate any defects and the height of the dam would have to be increased for future requirements.

Accordingly, in the instant case, the coal-fired electric generating facility was "first placed in service" on December 11, 1975, for depreciation and investment credit purposes.