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Person To Contact:
, ID No.
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Date:
October 24, 2005

LEGEND

Taxpayer =

Holdco =

LLC =

Project Company =

Project =

Company 2 =

Company 3 =

Utility =

Operator =

State A =
Investor =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

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m =

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Dear :

This letter responds to your letter dated e, requesting private letter rulings regarding Holdco's qualification for tax credits under § 45 of the Internal Revenue Code for the production and sale of electricity from its wind-based generation project (the Project).

The relevant facts as represented in your submission are set forth below.

Taxpayer is a State A limited partnership that owns all of the interests of LLC. LLC is a State A limited liability company that is disregarded for federal tax purposes. LLC and a United States domestic investor (the "Investor") will form Holdco, which will be treated as a partnership for federal tax purposes. Holdco, LLC and Investor will enter into a limited liability company agreement (Operating Agreement). Project Company, a State A limited liability company, is owned by an affiliate of Taxpayer, and is a disregarded entity for federal tax purposes. The proceeds of the issuance of membership interests in Holdco will be used by Holdco to purchase all of the interests in Project Company.

Project Company entered into a wind lease agreement (the "Wind Lease Agreement") with Company 2, effective as of b. Under the Wind Lease Agreement, Project Company leased the Project site on Company 2's land for a period of c years with one d-year renewal option. The Wind Lease Agreement permits Project Company to construct the Project on the site and to construct a transmission line across the Project site to a substation located on Company 2's land. The Project consists of c separate 2 MW wind turbine generators.

Project Company paid $h on the effective date of the lease and will pay a quarterly royalty fee equal to i percent of the gross receipts from electricity sold and the proceeds from the sale of certain credits such as state renewable energy credits (but not § 45 credits). The quarterly royalty fee minimum is $j per wind turbine generator and is adjusted every d years based on average electricity sales during the prior d-year period.

Project Company entered into a power purchase agreement (the "PPA") with Utility, dated f. Project Company will sell to the Utility electricity produced from the Project that is not for the operation of the Project itself during the k-year delivery period of the PPA, which production is projected to be l MWHs per year. The Utility will pay Project Company $m per MWH during contract year 1, $n per MWH during contract year 2, $o per MWH during contract year 3, $p per MWH during contract year 4 and $q per MWH during contract years 5-20. Project Company guarantees energy production of r MWHs per contract year and will credit the Utility $k per MWH for any shortfall in actual annual output.

Project Company has also entered into several other agreements for the interconnection facilities and interconnection with Utility, a turbine supply agreement with Operator, the balance of a plant engineering, procurement and construction agreement with Company 3, and an operation and maintenance agreement with Operator (O&M Agreement) dated z.

Taxpayer expects to form Holdco on or before g, prior to the end of the Project construction period. Pursuant to the membership interest agreement and equity capital agreement, Holdco, will issue membership interests designated as Class A Units to the Investor and Class B Units to LLC in exchange for capital contributions. The Class A Units and Class B Units will have different economic and management rights. Class A Units will constitute s percent of the acquisition price of Project Company, and Class B Units will constitute the balance.

Based upon expected distributions of cash to the members of Holdco, LLC, as the holder of the Class B Units, expects to receive a positive cash-on-cash return, and the Investor, as the holder of the Class A Units, does not expect to receive a positive cash-on-cash return on its investment, although the Investor expects to achieve a positive return taking into account its allocation of § 45 credits.

The Operating Agreement contains certain restrictions on the transfer of the Class A Units and the Class B Units. Moreover, upon the occurrences of certain events (including the y year anniversary of the Investor's investment), LLC, as holder of the Class B Units, will have the option to purchase the Class A Units from the Investor for the then-appraised fair market value.

Taxpayer makes the following representations:

1. The Utility will not be a related person to Holdco under § 45(e)(4).

2. The electricity generated by the wind turbines within the Project is not being sold to a utility pursuant to a contract originally entered into before January 1, 1987 (whether or not amended or restated after that date) for purposes of § 45(e)(7).

3. Holdco currently projects that, at the end of the term (including the renewal term) of the Wind Lease Agreement, it will be economically feasible for the Project Company to remove the Project wind turbines from the land.

4. The terms of the agreements described above have been, or will be, negotiated at arm's length, and the fees or other amounts paid or to be paid under such agreements are believed to represent fair market value consideration.

Law and Analysis

Under § 45, the renewable electricity production credit for any taxable year is an amount equal to the product of 1.5 cents, multiplied by the kilowatt hours of electricity produced by the taxpayer from qualified energy resources, and at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service, and sold by the taxpayer to an unrelated person during the taxable year.

Under § 45(b)(3), the amount of the credit determined under § 45(a) with respect to any project for any taxable year (determined after the application of § 45(a)(1) and (2)) is reduced by the amount which is equal to the product of the amount so determined for such year and the lesser of one-half or a fraction A) the numerator of which is the sum, for the taxable year and all prior years of i) grants provided by the United States, a State, or a political subdivision of a State for use in connection with the project, ii) proceeds of an issue of State or local government obligations used to provide financing for the project the interest on which is exempt from tax under § 103, iii) the aggregate amount of subsidized energy financing provided (directly or indirectly) under a Federal, State, or local program in connection with the project, and iv) the amount of any other credit allowable with respect to any property which is part of the project, and B) the denominator of which is the aggregate amount of additions to the capital account for the project for the taxable year and all prior taxable years.

The amounts under the preceding sentence for any taxable year shall be determined as of the close of the taxable year. Section 45(b)(3) does not apply to any facility described in § 45(d)(2)(a)(ii).

Section 45(c)(1) defines “qualified energy resources” to include wind. Section 45(d)(1) defines a “qualified facility” in the case of a facility using wind to produce electricity as any facility owned by the taxpayer that is originally placed in service after December 31, 1993, and before January 1, 2008.

Under Rev. Rul. 94-31, 1994-1 C.B. 16, with respect to electricity produced from wind energy, the term "facility" under § 45(c)(3) means each separate wind turbine, together on the tower on which the turbine is mounted and the supporting pad on which the tower is situated. Although § 45 does not define "placed in service," the term has been defined for purposes of the deduction for depreciation and the investment tax credit. For these purposes, property is considered to be placed in service in the taxable year that the property is placed in a condition or state of readiness and availability or a specifically assigned function. See §§1.46-3(d)(1)(ii) and 1.167(a)-11(e)(1)(i) of the Income Tax Regulations.

Section 702(a)(7) provides that each partner determines the partner’s income tax by taking into account separately the partner’s distributive share of the partnership’s other items of income, gain, loss, deductions, or credit to the extent provided by

regulations prescribed by the Secretary. Under § 1.702-1(a), the distributive share is determined under § 704 and § 1.704-1.

Section 704(a) provides that a partner's distributive share of income, gain, loss, deduction, or credit is, except as otherwise provided in chapter 1 of subtitle A of Title 26, determined by the partnership agreement. Under § 704(b), a partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) is determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if (i) the partnership agreement does not provide for the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or (ii) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) lacks substantial economic effect.

Section 1.704-1(b)(4)(ii) provides that allocations of tax credits and tax credit recapture (except for section 38 property) are not reflected by adjustments to the partners' capital accounts. Thus, these allocations cannot have economic effect under § 1.704-1(b)(2)(ii)(b)(1), and the tax credit and tax recapture must be allocated in accordance with the partners' interest in the partnership as of the time the credit or recapture arises. If a partnership expenditure (whether or not deductible) that gives rise to a tax credit in a partnership taxable year also gives rise to valid allocations of partnership loss or deduction (or other downward capital account adjustment) for the year, the partners' interests in the partnership regarding the credit (or the cost giving rise to it) are in the same proportion as the partners' respective distributive shares of the loss or deduction (and adjustments). See § 1.704-1(b)(5), Example 11.

Identical principles apply in determining the partners' interests in the partnership regarding tax credits that arise from income of the partnership (whether or not taxable). If a partnership receipt gives rise to a tax credit, such as the credit under § 45, and that receipt also gives rise to a valid allocation of partnership income, the partners' interests in the partnership with respect to the item of credit will be in the same proportion as the partners' respective distributive shares of such income. See § 1.704-(b)(4)(ii).

Section 708(b)(1)(B) provides that a partnership will be considered as terminated if, within a 12 month period, there is a sale or exchange of 50 percent or more of the total interests in partnership capital and profits.

Under § 1.708-1(b)(4), if a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur. The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership. Immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated

partnership, either for the continuation of the business by the new partnership, or for its dissolution and winding up.

Section 301.7701-3(b) of the Procedure and Administration Regulations provides that unless it elects otherwise, a domestic eligible entity is disregarded as an entity separate from its owner if it has a single owner.

Section 7701(a)(14) provides that the term "taxpayer" means any person subject to any internal revenue tax. Section 7701(a)(1) provides that when used in Title 26, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, the term "person" will be construed to mean and include an individual, trust, estate, partnership, association, company, or corporation.

Conclusions

Based solely on the facts and representations provided and the relevant law and regulations set forth above, we conclude as follows:

1. The Project wind turbines will be deemed to have been originally placed in service for purposes of § 45(d)(1) on the date the turbines are placed in a condition or state of readiness and availability to produce electricity within the meaning of § 1.46-3(d)(1)(ii) and 1.167(a)-11(e)(1)(i) of the Income Tax Regulations.

2. The electricity generated from the Project wind turbines that is sold to the Utility will qualify for the production tax credit under § 45 provided the project is placed in service before January 1, 2008.

3. The production of electricity from the Project wind turbines will be attributable to the Project Company, and as a result, Holdco will be entitled to the § 45 credits for electricity that is sold to the Utility.

4. The § 45 credits attributable to Holdco will be passed through to and allocated among the members of Holdco, to consist of LLC and the Investor, under the principles in § 702(a)(7), in accordance with each member's interest in Holdco at the time the § 45 credit arises. For purposes of allocating the § 45 credit, a partner's interest in the partnership is determined under § 1.704-1(b)(4)(ii) and is proportionate to valid allocations of gross income arising from the Project Company's receipts from the sale of electricity from the Project wind turbines that is sold to unrelated persons during the taxable year.

5. Any termination of Holdco under § 708(b)(1)(B) arising from sales or exchanges of interests in Holdco will not preclude Holdco as reconstituted from taking the § 45 credit for the Project Company's production and sale of electricity from the Project wind turbines to unrelated persons during the taxable year.

Except as specifically set forth above, no opinion is expressed concerning the federal income tax consequences of the above described facts under any other provision of the Code or regulations. Specifically, we express no opinion regarding the validity of the allocations under § 704(b) or any other partnership provision. Further, we express no opinion as to whether § 45(b), regarding credit reductions for grants, tax-exempt bonds, subsidized energy financing, and other credits, is applicable in this case.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Susan J. Reaman
Branch Chief, Branch 5
Office of Associate Chief Counsel
(Passthroughs and Special Industries)