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November 03, 2011

LEGEND

Taxpayer =

State =

Location =

Acreage =

Company =

Line =

Transmitter =

Purchaser =

Switching Station =

City =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

A =

B =

C =

D =

E =

F =

G =

Dear :

This letter responds to a letter dated September 26, 2011, submitted by, requesting a private letter ruling that certain circumstances will not prevent each wind turbine generator (WTG) in its Project from being “placed in service” for purposes of the allowance for depreciation under §§ 167 and 168 of the Internal Revenue Code and the renewable energy production credit under § 45.

FACTS

Taxpayer represents that the facts relating to its request are as follows:

Taxpayer, a State limited liability company, is developing a wind power generating facility (the Project) that will be located in Location. Taxpayer has executed long-term real property leases with the landowners in the area of Location on which the Project will be constructed, representing approximately Acreage. The main components of the Project, which will be owned by Taxpayer, include (i) the wind turbine generators and their attendant parts, and (ii) the electrical gathering and transmission facilities, including electrical substations.

The wind turbine generators and their respective towers and tower foundations (the WTGs) for the Project will be constructed, erected, synchronized to the power grid, and tested before Date 1. Taxpayer intends to enter into a construction contract with Company for the design, procurement, and construction of the Project. Taxpayer expects the construction contract to be for a fixed contract value. The construction

contract will provide for the construction, installation and testing of the WTGs. The construction contract also will provide for the construction, installation and testing of the electrical gathering and transmission facilities, including the electrical substation. Taxpayer will enter into agreements to maintain, service, and repair the WTGs, and manage, operate, maintain, and administer the Project.

The construction contract will provide that the Project must achieve substantial completion by Date 1, including each WTG successfully passing all critical performance testing by such date. Taxpayer anticipates that each WTG will reach Commercial Operation as of such date, meaning a WTG is ready for daily operation, has been connected to the power grid, and is capable of producing and delivering electrical energy to the power grid.

The specific number of WTGs, and the average capacity of each WTG, will be determined when a supplier is selected, which selection will be based principally on a supplier's ability to provide WTGs by Date 2. Any WTG selected will transmit the electricity produced by the WTG to the initial step-up transformer at A. It is anticipated that each WTG will have a nameplate capacity between B and C.

Each WTG is a self contained unit capable of operating independently of all other WTGs. Each WTG can be started up, tested, commissioned, and synchronized to a power grid separately and independently of all other WTGs. Upon mechanical completion of each WTG, each will be tested and. Each WTG will be connected to the Project's electrical gathering and transmission facilities. Once energized, all of the components that make up each WTG will be tested to insure that each component has been installed properly and is working correctly and that the WTG as a whole is fully functional. Upon completion of the initial tests, a performance test of each WTG, which includes the generation of electrical power and the synchronization to the power grid, will be performed. Successful completion of the performance tests will demonstrate that the WTG is capable of consistently performing its intended function on a routine basis.

The output of each WTG will be metered and transmitted from its step-up transformer, along a Taxpayer-owned buried electrical collection system, to a Taxpayer-owned substation. This substation will have a dual-tap transformer to step-up the output from the individual WTGs to either D or E for a direct connection to the grid via a switching station along the Line owned by Transmitter. The interconnection point is adjacent to the Taxpayer-owned project substation and no significant Taxpayer-owned transmission lines are required for grid interconnection. Transmitter must complete certain upgrades to the transmission system. In the event the transmission upgrades provided by Transmitter are not completed prior to Date 1, the Taxpayer-owned substation will connect to the grid at D and switch to E upon completion by Transmitter of the required upgrades. As of Date 1, Taxpayer expects to be capable of producing electricity at the full capacity of each of its WTGs (subject to wind conditions, which are expected to allow for, on an annual average, a E capacity factor). Because Taxpayer's WTGs are

expected to be operational as of Date 1, Taxpayer expects to be operating substantially all of its WTGs within the Project on a daily basis, producing power as of Date 1 and transmitting it to Purchaser, for purchase at the then Purchaser market price.

It is anticipated that the WTGs will be delivered in Date 2, mechanical completion will occur in Date 3, commissioning of WTGs will take place during the period beginning Date 3 and ending Date 1, and the Project as a whole will be substantially complete before Date 1. Commissioning and testing of each WTG will take place as each WTG becomes ready. The construction contract will require that, by Date 1: (1) all necessary permits and licenses with respect to the WTGs will have been obtained; (2) the WTGs will have become synchronized to the power grid for its function of generating electricity for production of income; (3) the critical tests for the various components of the WTGs will have been completed; (4) the WTGs will have been placed in control of the Taxpayer by the contractor; and (5) all site communications systems, including the WTG control systems, will have been installed and commissioned. Further, Taxpayer expects to have sold a non-de minimis amount of electricity by Date 1.

The proposed Switching Station along the Line serves as the point of interconnection between the Project and the Purchaser transmission system. The current operating voltage of the Line is D. Taxpayer will enter into an Interconnection Agreement with Transmitter, which will require Transmitter to complete an additional circuit on the Line in order to accommodate the new interconnection and will have an increased operating voltage of E. It is expected that the Interconnection Agreement will require Transmitter to use reasonable efforts to construct the Switching Station and the upgrade to the Line (together, the Transmission Upgrades) by the earliest feasible date, but not later than Date 4. Accordingly, Taxpayer expects to be able to deliver its Project output as required under the Power Purchase Agreement as of Date 1. Transmitter is currently undertaking to determine if the Transmission Upgrades can be completed by Date 1, so that the Project can transmit the power that it generates along the Line at E. The Facilities Study Report prepared by Transmitter on Date 5 indicated that the Transmission Upgrades are not expected to be completed until Date 4. In the event that the Transmission Upgrades cannot be completed by Date 1, the Project will connect to the Line at D and the Projects production will be limited until the Transmission Upgrades are completed. Thus, notwithstanding that the Transmission Upgrades to E may not be completed by Date 1, Taxpayer expects to be delivering its Project output as of Date 1.

In the event of a delay in the Transmission Upgrades beyond Date 1, Taxpayer can nevertheless deliver Project output by making minor and temporary modifications to its Taxpayer-owned project substation. No modifications to the WTGs will be necessary. In the event of such delay, Taxpayer intends to utilize the D tap on the Line to deliver and sell output. Once the Transmission Upgrades are completed, the Taxpayer-owned transmission lines will be switched from the D tap of the transformers and to the E tap of

the transformers. Taxpayer expects that utilization of the D taps will allow for delivery and sale of at least G of the Project's maximum expected output.

In the event of a delay in the completion of the Transmission Upgrades, the D tap of the transformers would be used to facilitate testing, commissioning, and synchronization of each WTG. Thereafter, each of the WTGs would be able to produce at its full rated capacity but, due to the limitations of the D system prior to the completion of the Transmission Upgrades, if the WTGs are operated simultaneously, may be limited in the amount of energy it may transmit. During any such delay, Taxpayer expects to operate a fluctuating number of WTGs in a manner that maximizes operating efficiency given the part load characteristics of the WTGs and the then current site specific wind conditions. In some instances, fewer WTGs will be operated at or close to full capacity; in other instances, a larger number of WTGs will be operated at less than full load. In either case, Taxpayer expects to be able to operate the Project at least at G of the Project's full-rated capacity; i.e. in excess of H per month assuming modeled wind speeds. Taxpayer expects to rotate the operation of WTGs during the time prior to completion of the Transmission Upgrades, so that a reasonably consistent number of operating hours is logged among all of the WTGs for warranty purposes. Once the Transmission Upgrades are completed, the interconnection capacity will be sufficient to transmit the maximum output capacity (measured in megawatts) of all of Taxpayer's WTGs at the desired voltage.

Purchaser could limit the output delivery from time to time, known as curtailment, of any or all wind farms linked to the Purchaser market, including the Project. Curtailment could result at any time that the Purchaser system is unable to handle all of the available output from wind farms linked to the system. Examples of situations that could result in curtailment include system upgrades or periods of high winds that result in transmission congestion. Taxpayer does not presently expect the Project to be curtailed in this manner due to its location, which is close to the load in City.

RULINGS REQUESTED

Taxpayer requests a ruling that the following will not preclude Taxpayer from treating each WTG in its Project as "placed in service" for purposes of the allowance for depreciation deductions under §§ 167 and 168 and the renewable energy production credit under § 45:

1. Any temporary limited capacity of Transmitter's Line if Transmitter does not complete the Transmission Upgrades by Date 1;
2. The temporary operation of Taxpayer's substation and transmission system at D to accommodate any such limitations of the Line until Transmitter completes the Transmission Upgrades; and,

3. Any curtailment by Purchaser due to transmission congestion.

LAW AND ANALYSIS

Section 45 provides a renewable electricity production credit for any taxable year for each kilowatt hour of electricity which is (i) produced by the taxpayer from qualified energy resources at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service and (ii) sold by the taxpayer to an unrelated person during such year. Section 45(c)(1) provides that qualified energy resources include wind. Section 45(c)(3) provides that a qualified facility is one that is placed in service after December 31, 1993 and before January 1, 2012.

Section 167(a) provides a depreciation deduction for the exhaustion, wear and tear of property used in a trade or business or held for the production of income. Section 168(a) provides the rules of the general depreciation system with respect to the depreciation deduction under § 167(a) for tangible property placed in service after 1986. The depreciation deduction is computed by using a prescribed depreciation method, recovery period, and convention. Section 168(e)(3)(B)(vi) provides that 5-year property includes any property (modifying the language of § 48(a)(3)(A)(i)) which is equipment which uses solar or wind energy to generate electricity.

Treasury Regulation § 1.167(a)-11(e)(1)(i) provides, in part, that property is first placed in service when first placed in a condition or state of readiness and availability for a specifically designed function. It further provides that the provisions of § 1.46-3(d)(1)(ii) and (d)(2) generally apply for purposes of determining the date on which property is placed in service.

Revenue Ruling 94-31, 1994-1 C.B. 16, provides the Service's published position on what constitutes a qualified facility for purposes of § 45(c)(3). While noting the array of equipment used to generate electricity from wind energy and deliver the final product, the revenue ruling concludes, in part, that the term "facility" under § 45(c)(3) means the wind turbine (which includes blades, gear box, generator and a control and a communication mechanism), together with the tower on which the wind turbine is mounted and the pad on which the tower is situated. The revenue ruling further concludes that each wind turbine together with its tower and supporting pad is a separate facility. This definition is quite narrow, excluding from the term facility support and delivery assets such as transformers, on-site power collection systems, monitoring and meteorological equipment, and site improvements such as roadways and fencing.

In general, property is placed in service in the taxable year the property is placed in a condition or state of readiness and availability for a specifically designed function. See, §§ 1.46-3(d)(1)(ii) and 1.167(a)-11(e)(1)(i) of the Federal income tax regulations. Placed in service is construed as having the same meaning for purposes of the investment tax credit under section 46 and depreciation under section 167. Section

1.46-3(d)(2) provides examples of when property is in a condition of readiness and availability. One of those examples is equipment that is acquired for a specifically assigned function and is operational but undergoing tests to eliminate any defects. See also Rev. Proc. 79-40, 1979-1 C.B. 13, where machinery and equipment were placed in service in the year critical tests (with appropriate materials) and operational tests were completed. Another example in § 1.46-3(d)(2) involved operational farm equipment acquired and placed in service in a taxable year even though it was not practical to use such equipment for its specifically designed function in the taxpayer's business of farming until the following year.

Several Tax Court cases have addressed placed in service questions in the context of electric power plants. In Olgethorpe Power Corp. v. Commissioner, T.C. Memo. 1990-505 and Consumers Power Co. v. Commissioner, 89 T.C. 710 (1987) facilities can be deemed placed in service upon sustained power generation near rated capacity. However, if the facility operates on a regular basis but does not produce the projected output, it may still be considered placed in service. Sealy Power, Ltd v. Commissioner, 46 F.3d 382 (5th Cir. 1995), nonacq. 1995-2 C.B. 2. In the Action on Decision for Sealy Power, the Service stated that at a minimum, the property would have to have been in a state of readiness sufficient to produce electricity on a sustained and reliable basis in commercial quantities. AOD 1995-010. Finally, in Rev. Rul. 84-85, 1984-1 C.B. 10, a solid waste facility that was experiencing operational problems such that it was unable to operate at its rated capacity was nonetheless considered to have been placed in service since it was being operated on a regular basis and saleable steam was being produced. However, if a facility is merely operating on a test basis, it is not placed in service until it is available for service on a regular basis. Consumers Power v. Commissioner, 89 T.C. at 724.

The above-referenced cases and rulings, provide that the following are common factors to be considered in determining placed in service dates for power plants:

- (1) approval of required licenses and permits;
- (2) passage of control of the facility to taxpayer;
- (3) completion of critical tests;
- (4) commencement of daily or regular operations; and,
- (5) synchronization into a power grid for generating electricity to produce income.

See generally, Rev. Rul. 76-256, 1976-2 C.B. 46, and Rev. Rul. 76-428, 1976-2 C.B. 47.

The focus in determining a placed in service date is on ascertaining from the relevant facts and circumstances the date the unit begins supplying product in such a manner that it is routinely available and is consistent with the unit's design. It is necessary to examine relevant factors occurring both before and after the claimed placed in service date so that the date can be verified. However, a facility does not have to achieve full

design output to be placed in service as long as it is in the process of ramping up its production levels. Subject to exceptions that are beyond the taxpayer's control, the Service has generally required actual operational use as a prerequisite for an asset to be deemed placed in service. See, e.g., SMC Corp. v. United States, 675 F.2d 113 (6th Cir. 1982).

To be a qualified facility for wind credit purposes, the facility (each WTG) must be placed in service before January 1, 2013. In addition, the wind energy credit is available for a ten-year period which starts on the date the qualified facility is originally placed in service. Similarly, the period for tax depreciation of five-year property such as the WTG begins when the depreciable wind equipment is placed in service. For purposes of the wind energy credit, a facility is deemed to be placed in service when it would be deemed placed in service for depreciation purposes. Thus, each WTG is deemed placed in service when it is placed in a condition or state of readiness and availability for a specifically assigned function, i.e., to produce and deliver electricity generated from wind energy.

Based on the facts provided and applying those facts to the factors delineated in Rev. Rul. 76-256, the Taxpayer represents that, as of Date 1:

- (1) all necessary permits and licenses with respect to the WTGs will have been obtained;
- (2) the WTGs will have been synchronized to the power grid for its function of generating electricity for production of income;
- (3) the critical tests for the various components of the WTGs will have been completed;
- (4) the WTGs will have been placed in the control of Taxpayer by the contractor; and,
- (5) Taxpayer expects to have sold a non-de minimis of electricity by that date.

Taxpayer further represents that in the event of a delay in the completion of the Transmission Upgrades by Date 1, the Taxpayer expects to operate a fluctuating number of WTGs in a manner that maximizes operating efficiency given the part load performance characteristics of the WTG and the then current site specific wind conditions. Taxpayer also expects to rotate the operation of WTGs during the time prior to the completion of the M substation upgrade so that a reasonably consistent number of operating hours is logged among all of the WTGs for warranty purposes. This would result in an operating level of approximately G of the Project full rated capacity.

Daily operation at full rated capacity is not necessary to establish that the WTGs are placed in service. Even without the temporary delivery limitations or curtailments, the site specific wind conditions could dramatically reduce daily WTG or Project output. As long as the WTGs are ready and available for use and producing commercial output on a regular basis, operating at full rated capacity is not necessary to establish that the

WTGs are placed in service. See Sealy Power, supra. Any additional curtailment of Project output due to transmission congestion does not affect adversely the regular use of, the availability for use and the production of commercial output by the WTGs.

CONCLUSIONS

Accordingly, based solely on the representations submitted by the taxpayer and the applicable law discussion above, the Taxpayer will not be precluded from treating each WTG in its Project as placed in service for purposes of the allowance for depreciation deductions under §§ 167 and 168 and the renewable energy production credit under §45, by reason of (1) any temporarily limited capacity of Transmitter's Line if Transmitter does not complete the Transmission Upgrades by Date 1; (2) the temporary operation of Taxpayer's substation and transmission system at D to accommodate any such limitations of the Line until Transmitter completes the Transmission; or, (3) any curtailment by Purchaser due to transmission congestion.

The above ruling is expressly conditioned upon Taxpayer otherwise meeting the placed in service factors of Rev. Rul. 76-256 for each of the WTGs before January 1, 2013, and upon the operation of the WTGs in accordance with Taxpayer's representations.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives. We are also sending a copy of the letter ruling to the appropriate operating division director.

Sincerely,

Patrick M. Clinton

Patrick M. Clinton
Assistant to the Branch Chief, Branch 7
(Income Tax & Accounting)