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March 21, 2013

Re: Request for Private Letter Ruling Under Sections 48 167, and 168

LEGEND

Taxpayer =

Holdco =

Member1 =

Member2 =

State1 =

State2 =

Project =

County1 =

County2 =

Product =

Segment =

A =

B =

C =

Number1 =

Number2 =

Number3 =

Number4 =

Year1 =

Year2 =

Date1 =

Date2 =

Dear :

This letter responds to a letter dated October 5, 2012, and supplemental correspondence, submitted by Taxpayer requesting a private letter ruling that certain circumstances will not prevent the Project from being placed in service in Year1 for purposes of sections 48, 167, and 168 of the Internal Revenue Code.

FACTS

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

Taxpayer, a State1 limited liability company, is a developer of renewable energy projects. Taxpayer uses the accrual method of accounting.

Taxpayer is developing a Number1 megawatt solar photovoltaic (PV) power generation facility in State2 that is referred to as the Project. Taxpayer has two members, Member1 and Member2, both of which are disregarded entities for Federal tax purposes. The first regarded entity in the ownership chain of both Member1 and Member2 is Holdco.

Taxpayer is building the Project in County1 and County2 of State2. The main components of the Project include (i) Product, each of which is a Number2 megawatt alternating current PV block, (consisting of solar panel modules mounted on a single-axis tracking system), a Number2 megawatt alternating current inverter station, and a medium voltage step-up pad mount transformer; and (ii) the electrical gathering and transmission facilities, including electrical substations. The Project will have Number3 Products, totaling Number4 solar panel modules and Number3 inverters.

By Date2, physical construction will have been completed on all components of the Project, all of the components will have been commissioned and accepted, a final commissioning certificate will have been issued for the Project as a whole, the Taxpayer will have all the permits and licenses needed to operate, the Project will be synchronized to the power grid, legal title and control over the Project will have been conveyed to the Taxpayer, and the Project will be transmitting energy on a regular and routine basis.

The electricity generated by the Project will be connect to the grid and transmit power through A, owned and operated by B. The grid is controlled by C. The electricity generated will be sold to B under a power purchase agreement. Under the power purchase agreement, the point of interconnection to the grid and delivery of the

electricity is A. Under the power purchase agreement, the Project must achieve full capacity deliverability status, which is measured not only by the quantity and quality of the electricity produced by the Project but also by the completion of various deliverability and reliability network upgrades (the network upgrades) to the network by B. All of the network upgrades are expected to be completed by Date2. However, the upgrade to Segment is the subject of litigation by local residents and such litigation may delay the installation of the upgrade beyond Date1. C, the controller of the grid, has determined that the Project will achieve full capacity deliverability status even if the upgrade to Segment is not installed. However, production of electricity by the Project may be curtailed by B during the installation of the upgrade to Segment under instructions from C to protect transmission system reliability.

RULING REQUESTED

Taxpayer requests the following ruling:

The Project will not be precluded from being in placed service in Year1 for purposes of sections 48, 167, and 168 if more frequent than anticipated curtailment of the Project occurs due to unanticipated delays in completing Segment.

LAW AND ANALYSIS

Section 48(a) of the Code provides for an energy credit equal to 30 percent of the cost basis of qualifying energy property placed in service before January 1, 2017.

Section 48(a)(3)(A)(i) of the Code provides that energy property includes equipment which uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat, excepting property used to generate energy for the purposes of heating a swimming pool.

Section 1.48-9(a)(2) of the Income Tax Regulations provides that in order to qualify as “energy property” under § 48 of the Code, property must be depreciable property with an estimated useful life when placed in service of at least three years and constructed after certain dates.

Section 1.48-9(d)(1) of the regulations provides as follows:

(d) Solar energy property—(1) In general. Energy property includes solar energy property. The term “solar energy property” includes equipment and materials (and parts related to the functioning of such equipment) that use solar energy directly to (i) generate electricity, (ii) heat or cool a building or structure, or (iii) provide hot water for use within a building or structure. Generally, those functions are accomplished through the use of equipment such as collectors (to absorb sunlight and create hot liquids or air), storage tanks (to store hot liquids), rockbeds (to store hot air),

thermostats (to activate pumps or fans which circulate the hot liquids or air), and heat exchangers (to utilize hot liquids or air to create hot air or water). Property that uses, as an energy source, fuel or energy derived indirectly from solar energy, such as ocean thermal energy, fossil fuel, or wood, is not considered solar energy property.

Section 1.48-9(d)(3) of the regulations provides, in part, that solar energy property includes equipment that uses solar energy to generate electricity, and includes storage devices, power conditioning equipment, transfer equipment, and parts related to the functioning of those items. Such property, however, does not include any equipment that transmits or uses the electricity generated.

Section 167(a) provides a depreciation deduction for the exhaustion, wear and tear, and obsolescence of property used in a trade or business or held for the production of income. The depreciation deduction provided by section 167 for tangible property placed in service after 1986 generally is determined under section 168. This section prescribes two methods for determining depreciation allowances. One method is the general depreciation system in section 168(a) and the other method is the alternative depreciation system in section 168(g). Under either depreciation system, the depreciation deduction is computed by using a prescribed depreciation method, recovery period, and convention.

For purposes of the general depreciation system, the depreciation method, recovery period, and convention are determined by the property's classification under section 168(e). Section 168(e)(3)(B)(vi) provides that 5-year property includes any property (modifying the language of section 48(a)(3)(A)(i)) which is equipment which uses solar or wind energy to generate electricity.

Section 1.167(a)-11(e)(1)(i) of the Income Tax Regulations 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 section 1.46-3(d)(1)(ii) and (d)(2) generally apply for purposes of determining the date on which property is placed in service.

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 sections 1.46-3(d)(1)(ii) and 1.167(a)-11(e)(1)(i). 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. Rul. 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 section 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 revenue 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. These factors are not exclusive – they are used as guideposts to determine whether, looking at the totality of the facts and circumstances, a facility has been placed in service.

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 qualified energy property for purposes of the § 48 energy credit the facility must be placed in service before January 1, 2017. Similarly, the period for tax depreciation of 5-year property begins when the depreciable solar equipment is placed in service. For purposes of the § 48 energy credit, a facility is placed in service when it would be placed in service for depreciation purposes. Thus, the project is placed in service when it is placed in a condition or state of readiness and availability for a specifically assigned function, that is, to produce and deliver electricity generated from solar 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 Project will have been obtained;
- (2) the Project 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 Project will have been completed;
- (4) the Project will have been placed in the control of the Taxpayer; and,
- (5) Taxpayer expects to have produced and sold more than a de minimis amount of electricity generated by the Project.

Taxpayer further represents that it is expected that all network upgrades will be completed before Date1. Further, if the upgrade to Segment is not completed by Date1, the Project will nevertheless have full capacity deliverability status under the power purchase agreements and the rules governing the grid. Thus, the Project will be considered placed in service prior to Date1.

If the upgrade to Segment is not completed by Date1, power produced by the Project may be curtailed during certain periods while that upgrade is being installed. However, the Project is ready and available for use and capable of producing commercial quantities of electric power. Temporary curtailment for reasons beyond the control of Taxpayer does not affect the status of the Project as being placed in service. See, Yellow Cab Co. of Pittsburgh v. Driscoll, 24 F.Supp. 993 (W.D. Pa 1938).

CONCLUSIONS

Accordingly, based solely on the representations submitted by Taxpayer and the applicable law discussion above, we conclude that the Project will not be precluded from being in placed service in Year1 for purposes of sections 48, 167, and 168 if the

upgrade to Segment is not completed by Date1 and that results in curtailment of the power produced by the Project for certain periods while the upgrade is being installed.

The above ruling is expressly conditioned upon Taxpayer otherwise meeting the placed in service factors of Rev. Rul. 76-256 for the Project before January 1, 2017, and upon the operation of the Project in accordance with Taxpayer's representations.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provisions of the Code. Specifically, no opinion is expressed or implied as to the entity classification of Taxpayer, Holdco, Member1 or Member2, or on when the Project is actually placed in service by Taxpayer.

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

In accordance with the power of attorney, we are sending a copy of this letter to Taxpayer's authorized representative. We are also sending a copy of the letter ruling to the appropriate operating division director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):
copy of this letter
copy for section 6110 purposes

cc: