Internal Revenue Service

Department of the Treasury

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May 19, 2003

TY:

Legend

Taxpayer:

General Partner:

Location A:

Acreage B:

C:

D:

Date 1:

Date 2:

Date 3:

Date 4:

Date 5:

F:

G:

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N:

P:

R:

Dear :

This letter responds to a letter dated August 13, 2002, submitted on behalf of Taxpayer by General Partner, requesting as to when each wind turbine generator (WTG) in its Project is “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. Additional material was submitted on December 6, 2002.

FACTS

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

Taxpayer will develop a wind power generating facility (the Project) that will be located primarily in Location A. Taxpayer has executed long-term real property leases with the respective landowners in the area of Location A, representing approximately Acreage B for the project. 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 substations.

Taxpayer has entered into a construction contract for the design, manufacture and construction of the Project on a turn-key basis for an aggregate fixed purchase price. The construction contract provides for the construction, installation and testing of approximately C wind turbine generators, with an average capacity of approximately D each, and their respective steel towers and tower foundations (WTG). The construction contract also provides for the construction, installation and testing of the electrical gathering and transmission facilities, including the electrical substation. The construction contract provides the Project must achieve substantial completion by Date

1, including each WTG successfully passing an initial performance test by such date. Taxpayer anticipates each WTG to 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. Taxpayer has or will entered into agreements with two entities to maintain, service and repair the WTGs, and management, operation, maintenance and administration of the Project.

Each WTG is a self contained unit capable of operating independently of all other WTGs. Each WTG can be commissioned, started up, tested, and synchronized to a power grid separately and independently of all other WTGs. A step-up transformer will increase the voltage at which the wind turbine generates electricity to F Kv. Upon mechanical completion of each WTG, each will be tested and synchronized using N's system. 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 at M substation, 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 Taxpayer-owned transmission lines to one of two Taxpayer-owned substations. These two substations will have multiple-tap transformers to step-up the output from the WTGs to either G Kv or H Kv (depending on whether the M Substation upgrade, discussed below, has been completed). The two substations will be connected to each other and connected to M substation by Taxpayer-owned transmission lines. The M substation is owned by N, a subsidiary of P, a state authority. As of Date 1, Taxpayer expects to be capable of producing electricity at the full capacity of its WTG (subject to wind conditions). 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 J, an energy trading company unrelated to Taxpayer. Under a power purchase agreement, J will purchase K percent of the electrical output of Taxpayer's Project for L, commencing on the earlier of the date the Project achieves commercial operations, or Date 2.

The M substation serves as the point of interconnection between the Project and the R transmission system. The current operating voltage of the M substation is G Kv. Under the Interconnection Agreement between Taxpayer and N, N will complete an upgrade to the M substation in order to accommodate the new interconnection and increase the operating voltage to H Kv. The Interconnection Agreement requires N to use reasonable efforts to construct the M substation upgrade by Date 3. Accordingly, Taxpayer expects to be able to deliver its Project output as required under the Power Purchase Agreement as of Date 1.

In the event of a delay in the M substation upgrade beyond Date 2, Taxpayer can nevertheless deliver Project output by making minor and temporary modifications to its

electrical gathering and transmission facilities. In the event of such delay, Taxpayer intends to utilize the G Kv tap on the multiple-tap transformers at its two substations, to deliver and sell output during any delay in the completion of the M substation upgrade. Once the M substation upgrade is completed, the Taxpayer-owned transmission lines will be disconnected from the G Kv tap of the transformers and reconnected to the H Kv tap of the transformers. Taxpayer expects that utilization of the G Kv taps will allow for delivery and sale of Mw of electricity, or about % of the Projects maximum capacity.

In the event of a delay in the completion of the M substation upgrade, the G Kv tap of the transformers would be used to facilitate testing and synchronization of each WTG. Thereafter, each of the C WTGs would be able to produce at its full rated capacity subject only to the limitations of the M substation prior to the completion of the M substation upgrade, such capacity limitation estimated to be approximately MW. 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 (D per WTG); in other instances, a larger number of WTGs will be operated at less than full load. Taxpayer expects to rotate the operation of WTGs during the time prior to 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.

Once the M substation is upgraded, the capacity of the M substation will be sufficient to transmit the maximum output capacity of all of Taxpayer's WTG at the desired voltage. Because N receives output from various wind farms in the local area of the Project, overloading of the N transmission infrastructure during periods of high winds can occur. Although N is upgrading its transmission system to relieve such congestion, N could from time to time limit the output delivery, known as curtailment, of any or all wind farms linked to N's system, including the Project, until such time as the transmission system upgrades are complete. Thus, during periods of high winds, Taxpayer may temporarily be prevented from delivering all of its output as a result of N's transmission congestion. This curtailment will be at the direction of R. With respect to the project, during the period between the completion of the M substation upgrade and the upgrade of N's transmission system, there will be days when there will be no curtailment of Taxpayer's output to N and thus 100% of its output maybe delivered to N; while on other days during such period, Taxpayer's output may be limited due to curtailment to an estimated % of its peak output. In addition, until the upgrade of N's transmission system is completed, R may intermittently interrupt, for periods of expected to be less than 48 hours at a time, deliveries of Project output to the M substation as a result of work related the upgrade of N's transmission system. Notwithstanding the effect of R's curtailment and the intermittent delivery interruptions due to the upgrade of N's transmission system on delivery of Taxpayer's Project output, each WTG will remain capable of operations at its full capacity. In revenue terms, curtailment is expected to result in an estimated energy reduction of approximately % in Date 4 and

approximately % in Date 5 for the Project. Once the upgrade to N's transmission system is completed, it is estimated that by the second quarter of Date 5, N will be able to receive at all times the Project's full peak output.

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 N's M substation due to delay by N in upgrading that substation;

2. The temporary operation of Taxpayer's substation and transmission system at G Kv to accommodate any such limitations of the M substation until N completes such upgrade; and,

3. Curtailment by R until N has upgraded its transmission system and any temporarily limited capacity of N's transmission system during such upgrade.

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, 2004.

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, Treas. Reg. 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. 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 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. 1996-1 C.B. 6. 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 710.

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.

To be a qualified facility for wind credit purposes, the facility (each WTG) must be placed in service before January 1, 2004. 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. The Service position is that for purposes of the wind energy credit, a facility will be 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 2:

(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 electricity by that date.

Taxpayer further represents that in the event of a delay in the completion of the M substation upgrade, 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 % of full rated Project capacity.

Daily operation at full rated capacity is not necessary to establish that the WTGs are placed in service. And 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. The additional curtailment of Project output, by as much as % due to temporary capacity limitations of N's transmission system does not affect adversely the regular use of, the availability for use and the production of commercial output by the WTGs.

CONCLUSIONS

Accordingly, based soley on the representations submitted by the taxpayer and the applicable law discussion above, we rule that 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 N's M substation due to any delay by N in upgrading that substation; (2) the change in voltage taps (from G Kv to H Kv) at the transformers in Taxpayer's substations for energy transmission to M substation upon completion of the M substation upgrade; or, (3) Any temporary curtailment of Project output by R until N has upgraded its transmission system.

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, 2004, the operation of the WTGs is in accordance with Taxpayer's representations, and that the upgrades of N's M substation and transmission system is completed in a timely manner.

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 representative. We are also sending a copy of the letter ruling to the appropriate Industry Director, LMSB.

Sincerely,

PETER C. FRIEDMAN
Senior Technician Reviewer, Branch 6
Office of the Associate Chief Counsel
(Passthroughts and Special Industries)

cc: