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Department of the Treasury

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LEGEND:

Taxpayer	=	
GP	=	
LP	=	
Corp 1	=	
Corp 2	=	
Corp 3	=	.
State 1	=	
Project	=	
State 2	=	
City 1	=	
Utility	=	
Admin Code	=	
Agreement	=	
Contract	=	
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Dear

This letter responds to Taxpayer's letter dated March 27, 2001, requesting private letter rulings concerning the renewable electricity production credit under § 45 of the Internal Revenue Code.

The facts as represented in Taxpayer's submission are set forth below.

Taxpayer, a limited partnership, was organized under the laws of State 1 on b, to construct, own, operate, and maintain an h MW wind energy project (Project) located near City 2 in State 2, and to engage in activities incidental to the Project. The initial partners of Taxpayer are GP and LP. The Project will consist of e g MW turbines that will provide h MW of electricity to customers of Utility, the gas and electric utility of City

1, pursuant to a Power Sales Agreement (PSA) between Taxpayer and Utility dated c.

LP has acquired a wind easement and other property rights from the landowners of the land where the Project will exist in exchange for an annual rental payment of at least $m. LP is in the process of assigning a portion of the wind easement and other property rights to Taxpayer. Under the terms of these property rights, Taxpayer will have the right to construct, operate, maintain, and otherwise use the turbines, roadways, access points, and power collection system on the land for k years.

Taxpayer has contracted with Corp 2, an indirect wholly-owned subsidiary of Corp 1, to provide and install the turbines and related equipment for the Project pursuant to the terms and conditions of the Contract. The Contract is on a fixed-price basis, with price, performance, and timely completion guaranteed by Corp 1. Corp 2 will also provide certain warranties in connection with the Project. Each turbine will be manufactured, installed, completed, and tested separately. Risk of loss for a turbine will not be transferred to Taxpayer until the Corp 2 signs the certificate of completion relating to the turbine and delivers it to Taxpayer.

Corp 2, as the supplier of the turbines, will warrant to Taxpayer that the turbines will perform at r percent of their rated power curve, and that s days after commissioning, will sustain an r percent annual average availability for the n years of operation. The rated power curve expresses the relationship between the wind speed and power output. During the first year of operation, Taxpayer will test selected turbines to measure their actual power curve versus their rated power curve. If the turbines fail to perform at r percent of their rated power curve, Corp 2 will be liable for a warranty payment for imputed electricity revenue shortfall resulting from the deficient power curve of the turbines for the n-year warranty term.

Availability measures the proportion of time that the turbine is capable of generating electricity if there is sufficient wind. Under the availability warranty, to the extent that the annual availability of the turbines is less than r percent in any year, Corp 2 will be liable for warranty payments related to the electricity revenue shortfall for that year resulting from the deficient availability of the turbines. Under certain circumstances, Corp 2 may offset its payment obligations under one warranty obligation with surplus revenues from the other.

Corp 3, an indirect wholly-owned subsidiary of Corp 1, will provide the daily management operations plus scheduled and unscheduled maintenance for the Project. Corp 3 will provide a comprehensive operations and maintenance program for the Project and will operate the turbines in accordance with the Agreement. Corp 3 will be responsible for 1) performing routine and non-routine maintenance on the turbines throughout the n-year warranty period; 2) monitoring the operations of the Project via the computer monitoring system; 3) performing all duties to the standard mandated by the PSA; 4) complying with all regulatory obligations; 5) developing operating and safety plans; and 6) maintaining all Project information and plant data, including reports to the Project owners. For these services, Corp 3 will be paid an annual fee equal to its costs increased by t percent.

The ownership interests in Taxpayer will be p percent for GP and x percent for LP. The partners will make all capital contributions in accordance with their ownership interests. All current distributions will be made to the partners and all items of income, gain, loss, deduction, and credit of Taxpayer will be allocated to the partners in accordance with their respective ownership interests. LP intends to sell all or a portion of its partnership interest in Taxpayer to an equity investor. Taxpayer represents that upon the sale, Taxpayer will become a partnership for federal income tax purposes. It is anticipated that partnership will have a total of $u million of indebtedness, comprised of $v million in senior indebtedness and $w million in junior indebtedness. The partners will make capital contributions to the partnership measured by a percentage of the § 45 tax credits generated by the partnership from the sale of electricity to Utility to enable the partnership to retire the junior indebtedness.

Under the Admin Code, beginning in d, each retail electric provider in State 2 will be required to obtain a certain number of State 2 Renewable Energy Credits (REC) and submit the RECs to the administrator of the REC program. Under the REC program, an aggregate REC requirement for all retail electric providers is established by multiplying the product of the renewable energy capacity target and y hours by the capacity conversion factor. For d and f, the aggregate REC requirement will equal z RECs. This aggregate REC requirement generally is allocated among the various retail electric providers based on their relative contribution to the total retail energy sales in State 2. After the end of each compliance year, its each retail electric provider must submit its allocated number of RECs to the program administrator. Retail electric providers failing to submit the required number of RECs are subject to substantial administrative penalties for each deficient REC.

Certain electricity generators that rely on renewable technology, including wind power generators like Taxpayer, will be awarded a REC for each megawatt hour of electricity produced from renewable resources. Renewable energy generators may sell their RECs to retail electric providers through a REC trading program. Alternatively, they may bundle their RECs with energy they sell to retail electric providers under power purchase agreements.

Taxpayer represents that no proceeds of any issue of state or local government obligation has or will be used to finance any Taxpayer project within the meaning of § 45(b)(3)(A)(ii) (including any turbine). Taxpayer further represents that any fees paid to affiliates of Taxpayer or its partners will be reasonable in relation to the services performed or rights transferred and will be negotiated on arm’s length terms.

Taxpayer requests the following rulings:

1. The wind turbines will be deemed to have been placed in service for purposes of §45(c)(3) on the date the turbines are placed in a condition or state of readiness and availability to produce electricity.

2. Production of electricity from the turbines will be attributable solely to Taxpayer, and as a result, Taxpayer, and therefore its partners, will be entitled to the § 45 credit for electricity sold to unrelated persons.

3. The amount of the § 45 credits attributable to Taxpayer and therefore its partners, are entitled to claim will not be reduced because of the RECs attributable to Taxpayer's electricity production.

4. The § 45 credits attributable to Taxpayer may be passed through to and allocated among GP and LP under the principles of § 702(a)(7) in accordance with the partner's interest in Taxpayer at the time the § 45 credit arises.

5. A future termination of Taxpayer under § 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the § 45 credit for the sale of electricity to unrelated persons that is generated from the turbines.

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 1) 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 2) sold by the taxpayer to an unrelated person during the taxable year.

Under § 45(b)(3), the amount of the credit with respect to any project for any taxable year is reduced by an amount equal to the product of 1) the amount of the credit otherwise allowable for such year and 2) a fraction, the numerator of which is the sum 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 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.

A similar reduction exists under § 29(b)(3) relating to governmental grants or subsidized energy financing provided in connection with a nonconventional source fuel project. Section 29 was added to the Code as a part of the Crude Oil Windfall Profit Tax of 1980, section 231, 1980-3 C.B. 1, 40. The Conference Report, in explaining the reduction mechanism found in § 29(b)(3), provides that the § 29 credit is reduced in proportion to federal grants provided in connection with the construction or acquisition of the facility. H.R. Rep. No. 96-817 (Conf. Rep.), 96th Cong., 2d Sess. (1980), 1980-3 C.B. 245, 300. In Rev. Rul. 85-77, 1985-1 C.B. 15, price support payments paid by the United States were not considered to be grants that reduce the credit allowed by §29. The rationale was that the grants described in § 29(b)(3) are grants for capital costs of the nonconventional source fuel project, and the price-support payments were based on the sale price of the fuel.

Section 45(c)(1) defines “qualified energy resources” to include wind. Section 45(c)(3) defines a “qualified facility” as any facility owned by the taxpayer that is originally placed in service after December 31, 1993, and before January 1, 2002. The placed in service deadline under § 45(c)(3) focuses on when the facility is first placed in service without respect to whether the facility was originally placed in service by the taxpayer. Compare H.R. 776, 102d Cong. § 1914 (Senate version of § 45(c)(3)) with H.R. 776, 102d Cong. § 1914 (House version of § 45(c)(3)). The House version defined a qualified facility as any facility originally placed in service by the taxpayer after December 31, 1993, and before July 1, 1999. See page 546 of the House version. The phrase “by the taxpayer” was deleted in the Senate Version and does not appear in § 45(c)(3).

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.

In Rev. Rul. 76-256, 1976-2 C.B. 46, the Service described five factors to consider in determining whether a coal-fired electric generating unit will be deemed to have been placed in service on a particular date. The five factors are: 1) whether the necessary permits and licenses to ate the generating unit have been approved; 2) whether the generating unit has been synchronized into the taxpayer’s power grid for its function in the business of generating electric energy for the production of income; 3) whether the critical tests for the various components of the generating unit have been completed; 4) whether the generating unit has been placed in the control of the taxpayer by the contractor; and 5) whether the daily operation of the generating unit had begun, notwithstanding the fact that the generating unit will undergo further testing to eliminate further defects.

Under § 7701(a)(14), 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.

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, deduction, 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.

Under § 704(a), 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 fact 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.

Under § 1.704-1(b)(4)(ii), 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 partner’s interests 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 principals apply in determining the partners’ interest 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’ interest 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 § 1.704-1(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)(1)(iv), 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.

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

1. The wind turbines will be deemed to have been placed in service for purposes of § 45(c)(2(3) on the date the turbines are placed in a condition or state of readiness and availability to produce electricity.

2. Production of electricity from the turbines will be attributable solely to Taxpayer, and as a result, Taxpayer and Taxpayer's partners, will be entitled to the § 45 credit for electricity sold to unrelated persons.

3. The amount of the § 45 credits attributable to Taxpayer and its partners are entitled to claim will not be reduced because of the RECs attributable to Taxpayer's electricity production.

4. The § 45 credits attributable to Taxpayer may be passed through to and allocated among GP and LP under the principles of § 702(a)(7) in accordance with the partner's interest in Taxpayer at the time the § 45 credit arises.

5. A future termination of Taxpayer under § 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the § 45 credit for the sale of electricity to unrelated persons that is generated from the turbines.

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. 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 yours,
Walter H. Woo
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Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures:
Copy for 6110(k)(3) purposes
Copy for filing purposes