



electric power combustion turbine generator sets (the "Project Sets") with the proceeds of the Bonds will not constitute acquisition of "nongovernmental output property" under § 141(d) of the Internal Revenue Code (the "Code").

Facts and Representations:

The Authority is a \_\_\_\_\_ established by the District and another \_\_\_\_\_ pursuant to the laws of the State. The Authority issued the Bonds, on behalf of the District, to finance a natural gas-fired, combustion turbine-based combined cycle facility (the "Project"), including the costs of the Project Sets.

Company A is a business unit of a for-profit independent power producer. Company B is a manufacturer of power generation equipment. Company A, through a wholly-owned subsidiary, entered into an agreement, effective on Date 1, with Company B to purchase four electric power combustion turbine generator sets (the "Generator Sets") to be manufactured by Company B (the "Company A Purchase Agreement").

Company B's Generator Sets are non-customized, mass-produced items that are generally available for sale to both public and private electric power companies. Company B begins to manufacture a generator set once an order is placed according to the following process: (1) Company B manufactures or purchases several hundred of the component parts that comprise the generator set; (2) each component part is then allocated to one of several generator sets that Company B may have in progress; (3) the allocated components are crated and segregated in storage; (4) at a time specified by the purchaser, the component parts are delivered to purchaser's designated site; (5) the component parts are assembled and installed at the purchaser's site over a period of 6 to 9 months; and (6) the generator set is made ready for commercial operation after 6 to 18 weeks of testing. The entire process from placement of the order to final operation takes approximately 20 to 26 months.

Approximately eight months after entering into the Company A Purchase Agreement, Company A concluded that it did not require the Generator Sets. At this time, Company B was approximately halfway through steps 1 and 2 of the manufacturing process. Company A could not terminate the Company A Purchase Agreement without great cost and, instead, decided to sell the right to the sets. Company B continued to manufacture the Generator Sets, and Company A arranged to have the component parts stored until sold.

The District solicited bids for two generator sets and received six responses, including offers from Company A and Company B. All bids were for the same type of generator set, with one bidder offering used property. Company B's offer provided that it would only commence manufacturing the generator sets after it was awarded the contract. Company A was the lowest bidder. The District and Company A entered into a purchase agreement effective Date 3 (the "District Purchase Agreement"). Company B

acknowledged Company A's sale of the right to the Project Sets to the District in a revised purchase contract dated Date 4 (the "Assignment Agreement").

The component parts will be delivered and the Project Sets will be assembled and constructed at the Project in Year 1 and early Year 2. The Project is expected to be operational by the end of Year 2.

#### Law and Analysis:

Section 103(a) of the Code provides in general, that gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141).

Section 141(d)(1) provides, in general, that the term "private activity bond" includes any bond issued as part of an issue if the amount of the proceeds of the issue which are to be used (directly or indirectly) for the acquisition by a governmental unit of nongovernmental output property exceeds the lesser of five percent of such proceeds or \$5,000,000.

Section 141(d)(2) provides that the term "nongovernmental output property" means any property (or interest therein) which before such acquisition was used (or held for use) by a person other than a governmental unit in connection with an output facility (within the meaning of § 141(b)(4)) (other than a facility for the furnishing of water).

Section 141(b)(4) sets forth lower private activity bond limits for certain output facilities, but does not define the term "output facility". Section 10631(c) of the Omnibus Reconciliation Act of 1987 (the "1987 Act"), 1987-3 C.B. 102, 173, added § 141(d) to the Code. The Conference Committee Report accompanying the 1987 Act (the "1987 Conference Report"), H.R. Conf. Rep. No. 100-495, at 1007 (1987), 1987-3 C.B. 287, states that "as under present law, output property includes, e.g., facilities such as electric and gas generation, transmission distribution, and other related facilities."

According to the House Report, H.R. Rep. No. 100-391, at 1138 (1987), the term "nongovernmental output property" also includes property which was constructed by or for an investor-owned utility with the expectation that it would be placed in service by an investor-owned utility but that is not actually placed in service before its acquisition by a governmental unit. The 1987 Conference Report at 1011, 1987-3 C.B. 291, states "if property is constructed for an investor-owned utility, that property is treated as nongovernmental output property. This determination is made without regard to whether the investor-owned utility actually placed the property in service."

Company A originally intended to install the Project Sets in an output facility within the meaning of § 141(b)(4) and the 1987 Conference Report. Therefore, we must

determine whether the Project Sets were used or held for use by Company A before District entered into the District Purchase Agreement with Company A.

Based on the facts and circumstances of this case, we conclude that the Project Sets were not used (or held for use) by Company A. The Project Sets are mass-produced items that were not customized for Company A's use. Other generator sets of the same type were available for sale by Company B and four other companies. The District, had it not purchased the Project Sets from Company A, could have purchased generator sets from one of the other four companies. At the time of the sale to the District, Company B had not yet manufactured all of the component parts. The Project Sets will be assembled and installed for the first time at the Project. It follows that the Project Sets will first be constructed for and used by the District, a governmental unit.

Conclusion:

Accordingly, because we conclude that the Project Sets were not used (or held for use) by Company A, the acquisition of the Project Sets with proceeds of the Bonds will not constitute acquisition of nongovernmental output property under § 141(d).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Assistant Chief Counsel  
(Exempt Organizations/Employment  
Tax/Government Entities)

By: \_\_\_\_\_  
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