Internal Revenue Service

Number: **201142005**
Release Date: 10/21/2011

Index Number: 48.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B06
PLR-105086-11

Date:
July 11, 2011

LEGEND:
Taxpayer

Parent

Company A
Company B
State A
State B
State C
Location
County 1
County 2
Town
Area
Region
RTO
Date 1
Date 2
Date 3
a
b
c
d
e
f

g
h
i
j
k
l
m
n
o
p
q
r
s
t

Dear :

This is in response to your request for rulings, submitted by your authorized representative, concerning the federal income tax consequences of the transaction described below. The facts as represented by the Taxpayer are as follows.

The wind farm (including a storage device) is owned by Taxpayer, a State A limited liability company that is a disregarded entity (the Project Company). It is a third-tier subsidiary of Parent. The two intermediate entities are also disregarded State A limited liability companies.

Parent is a large power company headquartered in the United States that owns a electric utilities and operated as of Date 1, b megawatts of generating capacity in c countries and has d employees.

Parent expects to construct the new wind farm entirely with equity and possibly debt, but is exploring different permanent financing structures that would make sense after the project is completed. Parent may bring in a tax equity investor as a part owner of the wind farm shortly before the project is placed in service. If Parent were to do that, then any such tax equity investor would invest in the Project Company directly or in another limited liability company one tier up from the Project Company, causing the project to be owned for tax purposes by a partnership of Parent and another entity by the time it is placed into service.

Parent is building a e-megawatt wind farm called Location in County 1 and County 2 in State B. Construction started in Date 2. The project substation was energized in Date 3 and selected turbines have already begun to be put into service. Parent expects that all of the turbines will be put into service in the near future. The Project is bisected by an existing Company A f-kv overhead transmission line that

crosses Location at about the midpoint in the string of wind turbines. An interconnection substation that will belong partly to the Project Company and partly to Company A is being constructed at the point where the Company A transmission line crosses the project to permit the energy generated by the project to enter the transmission grid. The Project Company has a long-term interconnection agreement with a regional transmission organization (RTO), the independent system operator of the utility grid in Region of the United States, allowing it to connect to the grid.

In the near term, electricity will be sold on a merchant basis into the RTO power pool. RTO takes bids from all the power plants in the region for each hour of the following day showing the prices at which the plants are prepared to sell their power into the day-ahead market. RTO then schedules plants each hour based on economic merit order from least costly to most expensive until the amount generated matches the forecasted demand for electricity within the RTO system. In addition to scheduling electricity to meet forecasted demand, RTO also selects bids from generators to reserve additional capacity that can ramp up and down depending on the actual real-time needs of the system

The storage device will enable the project to provide regulation service to the RTO. For example, most power plants provide various ancillary services to the grid in addition to capacity and electricity. Regulation service is one type of service that ensures a balance between the supply and consumption of electricity over different time periods ranging from seconds to several hours. The Location project will provide "regulation service," meaning that it has agreed, with the aid of the storage device, to ramp up or down the output from the wind farm on very short notice to help the grid manage imbalances in a manner similar to that of power plants that do not use renewable energy.

The project will consist of g h-megawatt Company B turbines that are expected to stretch about l miles along the top of the ridge of Location. The project is near Town in the Area part of State B near the State C border. The turbines are i to j feet apart. In addition to the turbines, gearboxes, pads and towers, the other main items of equipment that make up the project are step-up transformers, medium-voltage cables, a collector system, meteorological towers, a control house, a k-kV bus bar and supports, disconnect switches, circuit breakers, meters, the SCADA system (computer software and related lines and controls that monitor the turbines and allow the operator to adjust the pitch of the wind turbine blades), a relay system, communication devices such as servers, switches and fiber, and a storage device.

The project will connect via a f-kV line to a switchyard operated by Company A. Following the power line backwards into the project's half of the substation, there is a step-up transformer that increases the voltage from the k kV at which it exits the wind farm to f kV. Between the turbines and the step-up transformer are switchgear, breakers and meters and the plant bus bar that aggregates the electricity before feeding it into the step-up transformer. The step-up transformer, switchgear, breakers, meters

and bus bar are physically situated in the section of the substation that belongs to the Project Company. The substation is midway along the string of turbines. The bus bar has s separate bays: p through which electricity is collected from different groups of turbines and t for distributing electricity to and collecting it from the storage device. The storage device will be physically situated adjacent to the substation on the low-voltage side of the step-up transformer.

The storage device will have a combined nominal storage capacity of l megawatt hours with a capacity to supply or absorb as much as m megawatts for short periods of time (roughly n megawatt hours per o-megawatt turbine). The device is comprised of l p-megawatt modules each of which will have a large number of lithium-ion batteries plus inverters and a transformer and cooling system. The batteries are grouped into battery packs or modules that are loaded into trays, and the trays are mounted in floor-to-ceiling racks inside a standard shipping container.

The storage device is equipped with telemetry that will blend the RTO dispatch signals with wind data collected by the SCADA system so that the project can better anticipate and adjust output. The majority of electricity stored in the device will come from the wind farm itself; less than q% of the electricity put on the grid over the course of an average year is expected to be electricity that was drawn temporarily from the grid by the storage device. (Any electricity drawn from the grid would step down to k kV as it passes through the transformer and cause the meter recording the output the project has delivered to run backwards.) Project revenue is expected to increase as a result of the agreement by the project to deliver electricity in a regulated manner. In essence, the Project Company will be paid more for being flexible about when it puts electricity on the grid. This incremental revenue is expected to amount to roughly r% of the total revenue of the project.

As stated above, the storage device will be used to store electricity. It can store up to l MWhs of electricity indefinitely. Wind speeds and the electricity generated vary. The device will be charged, meaning electricity will be stored, when the wind speed ramps up and discharged when it falls. The function of the storage device is to manage deliveries of wind electricity to the grid at an appropriate time. The storage device will not be used to modify the quality of the electricity generated, but to store it for later use. It will not actively filter voltage or transient noise. Inverters will convert the electricity from AC to DC so that it can be stored, and convert it back to AC when the battery is discharged.

The storage device is not transmission equipment. It is physically situated on the generating side of the project substation, just like the wind turbines. It connects to the project substation at the same k kv voltage level and through the same electrical bus connection as the wind turbines. It is part of the equipment at the wind farm that manages delivery of the electricity the wind farm supplies to the grid. Once the electricity leaves the wind farm (including storage device), the electricity must pass through a substation belonging to the Project Company, then through a second

substation belonging to the local utility, and down a radial line to the grid. The electricity passes through a transformer, in the project substation, that steps up the voltage from k kv to f kv so that the electricity can be put on the transmission system.

RULINGS REQUESTED

The Taxpayer has requested the Service to rule that:

(i) The storage device will be considered part of the "qualified property" at a "qualified investment credit facility" within the meaning of § 48(a)(5) and, therefore, an investment credit may be claimed on its full cost; and,

(ii) The investment credit claimed on the storage device will be subject to recapture pursuant to the recapture provisions described in §§ 50(a)(1)(A) and (B) for property disposed of or that ceases to qualify for progress expenditures.

LAW AND ANALYSIS

Sections 48(a)(5)(A)(i) and (ii) of the Code provide that in the case of any qualified energy property which is part of a qualified investment credit facility such property shall be treated as energy property and that the energy percentage with respect to such property is 30 percent.

Section 48(a)(5)(C)(i) provides that the term qualified energy facility includes a wind facility (described in § 45(d)(1) of the Code so long as the facility is placed in service in 2009, 2010, 2011, or 2012.

Section1.48-9(a)(2) of the 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.

Sections 1.48-9(e)(1) and (2) of the regulations provide as follows:

(e) Wind energy property--(1) In general. Energy property includes wind energy property. Wind energy property is equipment (and parts related to the functioning of that equipment) that performs a function described in paragraph (e)(2) of this section. In general, wind energy property consists of a windmill, wind-driven generator, storage devices, power conditioning equipment, transfer equipment, and parts related to the function of those items. Wind energy property does not include equipment that transmits or uses electricity derived from wind energy. In addition, limitations apply similar to those set forth in paragraph (d)(5), (6), and (8) of this section. For example, if equipment is used by both auxiliary equipment and wind energy equipment, such equipment is wind energy property only if its use of energy other than wind energy does not exceed 25 percent of its total energy input in an annual

measuring period and only to the extent of its basis or cost allocable to its use of wind energy during an annual measuring period.

(2) Eligible functions-- Wind energy property is limited to equipment (and parts related to the functioning of that equipment) that—

(i) Uses wind energy to heat or cool, or provide hot water for use in, a building or structure, or

(ii) Uses wind energy to generate electricity (but not mechanical forms of energy).

Section 1.46-3(f)(1) of the regulations, provides, in part that in the case of a partnership, each partner shall take into account separately, for his taxable year with or within which the partnership taxable year ends, his share of the basis of partnership new section 38 property and his share of the cost of partnership used section property placed in service by the partnership during such partnership taxable year. Each partner shall be treated as the taxpayer with respect to his share of the basis of partnership new section 38 property and his share of the cost of partnership used section 38 property.

Section 50(a)(1)(A) of the Code provides that if investment credit property is disposed of, or otherwise ceases to be investment credit property with respect to the taxpayer, before the close of the recapture period, then the tax under this chapter is increased by the recapture percentage multiplied by the credit taken for all earlier years as to the property. Section 50(a)(1)(B) of the Code provides that the recapture percentage begins at 100 percent if the property is disposed of or ceases to be section 38 property during the first full year after it is placed in service. The percentage decreases by 20 percentage points every succeeding full year. No investment credit is recaptured after the fifth full year.

Section 1.47-1(h) of the regulations generally provides, in part, that a recapture determination is required for the investment credit attributable to the energy percentage (energy credit) if property is (1) disposed of or (ii) otherwise ceases to be energy property with respect to the taxpayer.

Section 1.47-6(a)(1) of the regulations provides, in part, that if a partnership disposes of any partnership section 38 property (or if any partnership section 38 property ceases to be section 38 property in the hands of the partnership) before the close of the estimated useful life which was taken into account in computing qualified investment with respect to such property, a recapture determination will be made with respect to each partner who is treated as a taxpayer with respect to such property. Each such recapture determination is made with respect to the share of the basis (or cost) of such property taken into account by such partner in computing his qualified investment.

In the instant case, the regulations clearly provide that wind energy property includes a storage device. The device will be charged, meaning electricity will be stored, when the wind speed ramps up and discharged when it falls. The main function

of the storage device is to manage deliveries of wind electricity to the grid to an appropriate time. The storing of electricity for use at a later time is a classic use of a battery (and hence a storage device). Although the device will be used to store electricity to be used at another time, the device does not constitute transmission equipment. Further, the storage device will not be used by any property other than the wind farm and, therefore, will not constitute auxiliary equipment.

Accordingly, we conclude that

(i) The storage device will be considered part of the "qualified property" at a "qualified investment credit facility" within the meaning of § 48(a)(5) and, therefore, an investment credit may be claimed on its full cost and,

(ii). The investment credit claimed on the storage device will be subject to recapture pursuant to the recapture provisions described in §§ 50(a)(1)(A) and (B) for property that is disposed of or that ceases to qualify for progress expenditures.

In accordance with the Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representatives. A copy of this ruling must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling

We express no opinion concerning any issue not directly addressed in this ruling.

This ruling is directed only to the Taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. We are sending a copy of this letter ruling to the Industry Director.

Sincerely,

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

cc: