INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

December 09, 2010

Third Party Communication: None
Date of Communication: Not Applicable

Number: **201113025**
Release Date: 4/1/2011

Index (UIL) No.: 29.04-00
CASE-MIS No.: TAM-142365-10

Team Manager,

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

Legend:

State:
Authority:
Location:
Company:
A:
B:
C:
W:
X:
Y:
Z:
Year 1:
Year 2:
Year 3:
Year 4:
Time 1:
Time 2:
Time 3:

Time 4:
Time 5:
Time 6:
Time 7:
Time 8:
Time 9:

ISSUE

Was the facility at issue placed in service by the Taxpayer prior to July 1, 1998?

CONCLUSION

The facility at issue was placed in service by the Taxpayer prior to July 1, 1998.

FACTS

In Year 1, Taxpayer acquired technology including binding agents for making briquettes from combining A, B, and C with various binders. Taxpayer began developing a briquetting business and opened a prototype briquetting facility in Year 2. In Year 3 Taxpayer began negotiations with Company for the construction of a briquetting facility at Location, owned by Company. In Time 1, Taxpayer and Company entered into an agreement for the construction of a briquetting plant "to briquette [B] and other in-plant [A] or other suitable fine materials." That lease did provide that Taxpayer could bring other materials onto the site and briquette those materials with the written permission of Company.

In Time 2, Taxpayer received a patent for its briquetting process, providing for the briquetting of A, B, or C. In that some month, Taxpayer received a ruling letter from the Service which concluded that the application of its binder to C in its briquetting process resulted in a qualified fuel for purposes of § 29 of the Internal Revenue Code.

In Time 2, as part of its test of the equipment at Location, Taxpayer processed X tons of C through the briquetting facility to test the equipment. By letter dated Time 5, Taxpayer informed Company that it intended to briquette W tons of C briquettes. The letter was withdrawn after Company objected.

In Time 3, Authority issued a certificate of intent to approve an air quality permit for the briquetting facility at Location. The permit issued by Authority allowed Taxpayer to process A, B, and C at the facility at Location beginning in Time 4. A building permit and business license were also issued to Taxpayer by the relevant local authorities. On Time 6, Taxpayer and Company entered into a revised briquetting services agreement which restates that Taxpayer may not bring any C onto the premises without written

permission of Company. Taxpayer completed testing of the briquetting facility at Location and began commercial operations for the purpose of producing briquettes on Time 7.

From Time 7 through Time 8, Taxpayer produced and sold to Company, Z tons of briquettes using A as the feedstock material. By letter dated Time 8, Company notified Taxpayer that it was no longer supplying any raw materials for the briquetting operation. In addition to the X tons of briquettes produced using C in testing the equipment in Time 2, the facility also produced small amounts (less than one ton) of briquettes using C several times prior to beginning commercial operations on Time 7. Finally, in Time 9, Taxpayer produced approximately Y tons of briquettes using C. Part of this production was observed by an independent engineer who certified that the facility did produce briquettes using C. Those briquettes were consumed by Company in its operations.

In Time 9, Taxpayer and Company entered into a Memorandum of Intent to explore producing briquettes using C with the equipment. Later, Taxpayer and Company also discussed producing briquettes using A, B, and other materials. None of these was implemented due to Company's financial problems which ultimately resulting in its bankruptcy. Taxpayer removed the briquetting machinery from Location and attempted to find a buyer for the facility over the next several years. The facility was finally relocated in Year 4 to another state where the facility, with no mechanical changes, produced qualified synthetic briquettes with C as the feedstock.

LAW AND ANALYSIS

Section 29 provides a credit for the sale, to unrelated parties, of qualified synthetic fuel produced in a facility originally placed in service after December 31, 1992, and before July 1, 1998.

Section 1.46-3(d)(1)(ii) of the Federal Income Tax regulations provides generally that property is placed in service when it is placed in a condition or state of readiness and availability for a specifically assigned function. This definition of placed in service has been extensively analyzed in revenue rulings and court cases under both section 46 and section 167.

In order to determine when a facility has reached a condition or state of readiness and availability for a specifically assigned function, all facts and circumstances must be considered. The Service has generally looked to a number of factors to determine when a facility is in a condition or state of readiness and availability for a specifically assigned function. They are:

(1) approval of required licenses and permits;

(2) passage of control of the facility to taxpayer;
(3) completion of critical tests; and
(4) commencement of daily or regular operation.

See generally, Rev. Rul. 76-526, 1976-2 C.B. 46; Rev. Rul. 76-428, 1976-2 C.B. 47; Rev. Rul. 84-85, 1984-1 C.B. 103.[1] 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.

It is important to note that a facility need not have reached design capacity to be considered placed in service. Rev. Rul. 84-85. However, a facility must be ready and available to produce on a sustained and reliable basis in commercial quantities. To the factors used by the Service, courts have generally also required that the taxpayer be engaged in a trade or business. See, e.g., Piggy Wiggly Southern, Inc. v. Commissioner, 84 T.C. 739, 748 (1985), nonacq. on another issue, 1988-2 C.B. 1, aff'd on another issue, 803 F2d 1572 (11th Cir. 1986). While neither the Code nor the regulations defines when a taxpayer is carrying on trade or business, the Supreme Court has stated that the taxpayer must be involved in the activity with continuity and regularity and the taxpayer's primary purpose for engaging in the activity must be for income or profit. Commissioner v. Groetzinger, 480 U.S. 345, 352 (1971). Each of these requires that all of the relevant facts and circumstances be taken into account in determining whether the taxpayer has placed the facility in service as well as whether the taxpayer is in a trade or business.

As an initial matter, the briquetting facility was removed from Location and stored elsewhere for several years while Taxpayer attempted to locate a buyer for the facility. Once an asset is placed in service it remains in service unless the taxpayer abandons the property. See, e.g., Yellow Cab Company of Pittsburgh v. Driscoll, 24 F. Supp. 993 (D. Penn. 1938) (Taxicabs stored in garage by owner without gasoline, water, or batteries considered available for use even though they were warehoused due to economic conditions). Taxpayer took allowable depreciation deductions for the facility throughout this period and thus did not abandon the property.

Because section 29 requires that the Facilities be placed in service prior to July 1, 1998, we must examine the facts as they existed at that time. However, one cannot simply take a "snapshot" at a moment in time, as events before and after the key date must be considered to determine whether the facilities at issue here were placed in service prior to July 1, 1998. We shall first consider the four factors.

[1] The revenue rulings using these factors involve power plants but the four factors listed above are also useful in analyzing other types of facilities. A fifth factor, synchronization to the power grid, is useful only in the context of power plants.

The first factor is whether the Taxpayer had secured approval of all required licenses and permits. All licenses and permits necessary for operation of the facilities were secured by the Taxpayer prior to July 1, 1998.

The second factor, whether control of the facility had passed to Taxpayer prior to July 1, 1998, is also satisfied by the Taxpayer, inasmuch as the facility was constructed by the Taxpayer.

The third factor, completion of critical tests, is also in the Taxpayer's favor. By Time 7, the Taxpayer had completed all critical tests.

The fourth factor, commencement of daily or regular operation, is at the heart of this matter. "Daily or regular operation" is considered to have begun when a facility begins continuous operations at progressively increasing output consistent with minor testing to eliminate defects.

It is clear that, in general, a facility must be able to produce what a taxpayer intends to produce in order to be considered to be placed in service. For example, in Valley Natural Fuels v. Commissioner, T.C. Memo 1991-341, the Tax Court, relying on the taxpayer's offering circular, determined that the specifically assigned function of the facility was to produce 198.2 proof ethanol and concluded that the facility was not placed in service when it could not produce ethanol of that purity level because it lacked a certain molecular sieve. Production of other, less pure alcohol, was not considered. Similarly, in 85 Gorgonio Wind Generating Co. v. Commissioner, T.C. Memo 1994-544, the Tax Court found that the specifically assigned function of the taxpayer's wind turbines was to produce electricity on a regular, ongoing basis. The turbines lacked an automatic controller so they could not produce electricity on a regular basis so the court determined that they were not placed in service even though the turbines were capable of producing electricity for short periods of time.

The Taxpayer asserts that the facility at Location was placed in service to produce briquettes, including qualified synthetic fuel, and that all briquettes produced should be considered in determining whether the facility satisfies the placed in service tests. Contemporaneous documents, such as the lease and other agreements with Company, indicate that Taxpayer contemplated using the facility to produce several types of briquettes, including qualified synthetic fuel. From Time 7 through Time 8, Taxpayer produced and sold to Company Z tons of briquettes using A as a feedstock. These times are prior to July 1, 1998. Thus, the facility produced significant quantities of briquettes using A by July 1, 1998. Production of those briquettes demonstrated that the facility at Location met the regular or daily operation requirement for briquettes. While the actual production of briquettes using C as a feedstock was limited and intermittent, there was no mechanical change to the facility between the use of A or C as a feedstock and therefore the production of briquettes using A as a feedstock may be considered in determining whether the facility has met the daily or regular operation

requirement. Thus, the facility at Location met the regular or daily operation requirement for purposes of § 29.

Thus, after a review of all the relevant facts and circumstances, we have determined that the Taxpayer's facility at Location was placed in service prior to July 1, 1998.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.