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Person To Contact:
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Telephone Number:

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Date:
July 05, 2011

Re: Request for Private Letter Ruling under Section 168(k)

Taxpayer =
Parent =
Location2 =
Location3 =
Location4 =
Location5 =
Date1 =
Date2 =
Date3 =
Date4 =
Date5 =
Date6 =
Date7 =
Date8 =
A =
B =
Number1 =
Number2 =

Dear :

This letter responds to a letter dated December 29, 2010, and supplemental correspondence, submitted by Taxpayer requesting rulings under § 168(k) of the Internal Revenue Code.

FACTS

Taxpayer represents that the facts are as follows:

Parent is engaged in the industrial gas business with worldwide operations. The industrial gas business involves separating the atmosphere into its component parts through cryogenic and high pressure processes and delivering the resulting gases to customers.

Taxpayer is a limited partnership. For federal income tax purposes, Taxpayer is a disregarded entity that is included in Parent's consolidated federal income tax return.

Taxpayer is responsible for providing service to large industry customers in the United States. Taxpayer offers gas and energy solutions to these customers to improve their process efficiency and help them with their environmental responsibilities. In the United States, this business serves the refining, natural gas, chemical, and metals industries.

In connection with its business in the United States, Taxpayer operates a network of plants and an extensive pipeline system along the Location2 and the Location3. Taxpayer separates the components of the atmosphere at its plants and transports the resulting gases to its customers via a network of pipelines. Taxpayer generally constructs and/or acquires plant and pipeline assets in order to satisfy the requirements of specific customers and contracts. Depending on a customer's geographic location and the availability of plant and pipeline resources, Taxpayer has a variety of options regarding the method by which it provides the gases to a customer. Taxpayer may choose to construct a plant at or near a customer's location to supply the desired product or it may extend existing pipeline or plant resources to a customer location to supply the product.

On Date1, Taxpayer entered into a Hydrogen Supply Agreement ("Agreement") with A to supply hydrogen to A. The Agreement requires Taxpayer to provide specified quantities of hydrogen to A's refinery facilities in Location4. The Agreement also provides specifications regarding the hydrogen to be delivered under the contract as well as a minimum purchase obligation for A and a maximum supply obligation for Taxpayer.

The Agreement contemplated that, in order to furnish hydrogen to A under the Agreement, Taxpayer would be required to construct and operate a pipeline and meter station for the manufacture, transportation and delivery of hydrogen from Taxpayer's facilities to A. Specifically, § 3.01 of the Agreement provides that Taxpayer "shall, at its sole cost and expense, construct, own, maintain and operate [Taxpayer's] Facilities and the Pipeline Network to deliver the quantities of Hydrogen contemplated hereunder to [A] refinery." The Pipeline Network is defined under §1 of the Agreement as meaning "the facilities owned and operated by [Taxpayer] for transportation, compression and metering of the hydrogen to its customers, including [A]." Section 1 of the Agreement also defines the [Taxpayer's] Facilities as meaning "the production facilities, the Storage Cavern, the Hydrogen Pipeline Booster Station (as required), and equipment, meters, pipelines and related equipment owned, leased, and/or operated by [Taxpayer] and used for the production, procurement, purification and delivery of hydrogen to [A] and [Taxpayer's] other customers."

To supply hydrogen to A under the Agreement, Taxpayer constructed a pipeline network, which cost approximately $B. It consists of a steel pipeline that is Number1-inches in diameter and specially constructed to transport hydrogen and it is approximately Number2 miles long and stretches from Taxpayer's plant in Location5 to A's facilities in Location4. This pipeline network is the property at issue in this letter ruling request. Hereinafter, this pipeline network is referred to as "the Property." The Property is connected to another of Taxpayer's existing pipelines that were previously placed in service by Taxpayer and were being used by Taxpayer to service other customers.

Taxpayer made the decision to construct the Property in early Date2 and began putting out contracts to build the Property. Taxpayer's in-house engineering department acted as general contractor for the construction of the Property. Taxpayer entered into contracts with a number of subcontractors regarding the various aspects of the construction of the Property. These contracts were negotiated, finalized, and entered into between Date3, and Date4. Taxpayer began construction of the Property in Date2.

After construction of the Property was completed, Taxpayer commenced supplying hydrogen to A pursuant to the Agreement. Section 2.2 of the Agreement provided that the date Taxpayer would begin supplying hydrogen was to be no earlier than Date5, and no later than Date6. Taxpayer began supplying hydrogen to A in Date7.

Taxpayer represents that the Property was placed in service by Taxpayer in Date7 and that the Property is included in Asset Class 46.0, Pipeline Transportation, of Rev. Proc. 87-56, 1987-2 C.B. 674.

RULINGS REQUESTED

1. The Property is property which has a recovery period of 20 years or less pursuant to section 168(k)(2)(A)(i).

2. The original use of the Property commenced with Taxpayer in Date8 pursuant to section 168(k)(2)(A)(ii), notwithstanding the fact that the Property was attached to property previously placed in service and used by Taxpayer in its business.

3. The Property was acquired by Taxpayer within the requisite period of section 168(k)(2)(A)(iii), after December 31, 2007, and before January 1, 2013, and the Agreement is not considered a written binding contract to acquire the Property.

4. Assuming the placed in service requirement is met (a material representation made by Taxpayer), the Property is eligible for the additional first year depreciation deduction under section 168(k).

LAW AND ANALYSIS

Section 168(k)(1) provides a 50-percent additional first year depreciation deduction for the taxable year in which qualified property is placed in service by a taxpayer.

Section 168(k)(2)(A) (as amended by Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (December 17, 2010)) defines the term “qualified property” as meaning property (i) among other things, to which section 168 applies with a recovery period of 20 years or less, (ii) the original use of which commences with the taxpayer after December 31, 2007, (iii) that is acquired by the taxpayer after December 31, 2007, and before January 1, 2013, but only if no written binding contract for the acquisition was in effect before January 1, 2008, or acquired by the taxpayer pursuant to a written binding contract which was entered into after December 31, 2007, and before January 1, 2013, and (iv) that is placed in service by the taxpayer before January 1, 2013, or in the case of property described in section 168(k)(2)(B) or (C), before January 1, 2014.

ISSUE 1. Does the Property have a recovery period of 20 years or less for purposes of section 168(k)(2)(A)(i)?

To be qualified property under section 168(k)(2)(A), the property must satisfy the property description requirement provided in section 168(k)(2)(A)(i) (in addition to satisfying the other requirements in section 168(k)(2)). Section 168(k)(2)(A)(i)(I) is relevant to the facts present here and it provides that the property must be property to which section 168 applies which has a recovery period of 20 years or less. However, property is not qualified property if the property is required to be depreciated under the alternative depreciation system of section 168(g) pursuant to section 168(g)(1)(A) through (D) or other provisions of the Code. Section 168(k)(2)(D)(i) and section 1.168(k)-1(b)(2)(ii)(A)(2) of the Income Tax Regulations.

For purposes of section 168(k)(2)(A)(i)(I), section 1.168(k)-1(b)(2)(i)(A) provides that the recovery period is determined in accordance with section 168(c) regardless of any election made by the taxpayer under section 168(g)(7). The recovery period under section 168(c) is determined by the property’s classification under section 168(e).

For purposes of section 168(e), a property's classification is determined by reference to the property's class life or by statute. Section 168(e)(1) provides that property with a class life of 20 or more years but less than 25 years is 15-year property.

Section 168(i)(1) defines the term "class life" as meaning the class life (if any) that would be applicable with respect to any property as of January 1, 1986, under section 167(m) (determined without regard to section 167(m)(4) and as if the taxpayer had made an election under section 167(m)) as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990. Former section 167(m) provided that in the case of a taxpayer who elected the Class Life Asset Depreciation Range ("ADR") system of depreciation, the depreciation allowance was based on the class life prescribed by the Secretary that reasonably reflected the anticipated useful life of that class of property to the industry or other group.

Section 1.167(a)-11(b)(4)(iii)(b) provides rules for classifying property under former section 167(m). Property is included in the asset guideline class for the activity in which the property is primarily used. Property is classified according to primary use even though the activity in which the property is primarily used is insubstantial in relation to all the taxpayer's activities.

Rev. Proc. 87-56 sets forth the class lives of property that are necessary to compute the depreciation allowance under section 168. This revenue procedure establishes two broad categories of depreciable assets: (1) asset classes 00.11 through 00.4 that consist of specific depreciable assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of depreciable assets used in specific business activities. An asset that falls within both an asset group (that is, asset classes 00.11 through 00.4) and an activity group (that is, asset classes 01.1 through 80.0) would be classified in the asset group. See Norwest Corp. & Subs. v. Commissioner, 111 T.C. 105, 156-64 (1998). The asset classes described below are set forth in Rev. Proc. 87-56.

Asset class 46.0, Pipeline Transportation, of Rev. Proc. 87-56, includes assets used in the private, commercial, and contract carrying of petroleum, gas and other products by means of pipes and conveyors. The trunk lines and related storage facilities of integrated petroleum and natural gas producers are included in this class. Assets in class 46.0 have a class life of 22 years and, in accordance with section 168(e)(1), are classified as 15-year property. Pursuant to section 168(c), the recovery period for 15-year property is 15 years.

In this case, Taxpayer represents that it separates the components of the atmosphere at its plants and transports the resulting gases to its customers via a network of pipelines. Taxpayer entered into the Agreement with A to supply hydrogen to A. To do this, Taxpayer constructed the Property to transport and deliver hydrogen from Taxpayer's facilities in Location5 to A's facilities in Location4. Both Location5 and

Location4 are in the United States. Accordingly, the Property is included in asset class 46.0 of Rev. Proc. 87-56 and is 15-year property. Thus, for purposes of section 168(k)(2)(A)(i)(I), the recovery period of the Property is 15 years. Further, section 168 applies to the Property.

ISSUE 2. Does the original use of the Property commence with Taxpayer in Date8 for purposes of section 168(k)(2)(A)(ii), notwithstanding the fact that the Property is attached to property previously placed in service and used by Taxpayer in its business?

To be qualified property under section 168(k)(2)(A), the property must satisfy the original use requirement provided in section 168(k)(2)(A)(ii) (in addition to satisfying the other requirements in section 168(k)(2)). Section 168(k)(2)(A)(ii) provides that the original use of the property must commence with the taxpayer after December 31, 2007.

Section 1.168(k)-1(b)(3)(i) provides, in part, that, original use means the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer.

In the case of any addition to, or improvement of, any property, section 168(i)(6) provides that any deduction under section 168(a) for such addition or improvement is computed in the same manner as the deduction of such property would be computed if such property had been placed in service at the same time as such addition or improvement, and the applicable recovery period for such addition or improvement begins on the later of (i) the date on which such addition or improvement is placed in service, or (ii) the date on which the property with respect to which such addition or improvement was made is placed in service.

Here, the Property was connected to Taxpayer's existing pipelines after these existing pipelines were placed in service by Taxpayer. As a result, the Property is an addition to Taxpayer's existing pipelines. Because the Property was connected to Taxpayer's existing pipelines after these existing pipelines were placed in service by Taxpayer, the Property also is a separate asset for purposes of section 168. Accordingly, under the facts present here, we only need to determine whether the Property satisfies the original use requirement under section 168(k)(2)(A)(ii).

In this case, Taxpayer represents that after construction of the Property was completed, Taxpayer used the Property to supply hydrogen to A pursuant to the Agreement. Taxpayer further represents that it began supplying hydrogen to A in Date 7, and that the Property was constructed, placed in service, and used solely by Taxpayer. These representations are material representations. Date 7 is after December 31, 2007, and is during Date8. Based solely on these representations, we conclude that Taxpayer was the first user of the Property and such use began in Date8, which is after December 31, 2007.

ISSUE 3. Was the Property acquired by Taxpayer after December 31, 2007 and before January 1, 2013?

To be qualified property under section 168(k)(2)(A), the property must satisfy the acquisition requirement provided in section 168(k)(2)(A)(iii) (in addition to satisfying the other requirements in section 168(k)(2)). Section 168(k)(2)(A)(iii) provides that the property must be (I) acquired by the taxpayer after December 31, 2007, and before January 1, 2013, but only if no written binding contract for the acquisition was in effect before January 1, 2008, or (II) acquired by the taxpayer pursuant to a written binding contract that was entered into after December 31, 2007, and before January 1, 2013.

Section 168(k)(2)(E)(i) (as amended by Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (December 17, 2010)) provides that in the case of a taxpayer manufacturing, constructing, or producing property for the taxpayer's own use, the requirements of section 168(k)(2)(A)(iii) shall be treated as met if the taxpayer begins manufacturing, constructing, or producing the property after December 31, 2007, and before January 1, 2013.

Section 1.168(k)-1(b)(4)(iii)(A) provides that if a taxpayer manufactures, constructs, or produces property for use by the taxpayer in its trade or business (or for its production of income), the acquisition rules in section 1.168(k)-1(b)(4)(i) are treated as met for qualified property if the taxpayer begins manufacturing, constructing, or producing the property after [December 31, 2007], and before [January 1, 2013]. This regulation further provides that property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract (as defined in section 1.168(k)-1(b)(4)(ii)) that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer in its trade or business (or for its production of income) is considered to be manufactured, constructed, or produced by the taxpayer. See section 1.168(k)-1(b)(4)(iii)(B) for the rules for determining when construction begins.

Before January 1, 2008, Taxpayer entered into the Agreement with A. Under the terms of the Agreement, Taxpayer agreed to supply hydrogen to A at its facilities in Location4 and A agreed to purchase such hydrogen. Section 3.01 of the Agreement also provided that Taxpayer, at its sole cost and expense, would construct the Property in order to supply the hydrogen to A. The Agreement did not provide any specifications about the construction of the Property. Because Taxpayer and A recognized that Taxpayer would have to construct the Property in order to supply hydrogen to A under the Agreement, we view section 3.01 of the Agreement as providing which party – Taxpayer or A or both – would pay for the cost of the Property. Accordingly, we conclude that the Agreement is not a contract for the purchase or construction of the Property.

Taxpayer represents that it was the general contractor for the construction of the Property. Taxpayer further represents that it entered into contracts with subcontractors to construct the Property between Date3, and Date4, and it began constructing the Property in Date2. These representations are material representations. Date2, Date3, and Date 4 are after December 31, 2007, and before January 1, 2013. Based solely on these representations, we conclude that Taxpayer constructed the Property for its own use and the Property satisfies the requirements of section 168(k)(2)(E)(i) and section 1.168(k)-1(b)(4)(iii). Accordingly, the Property is treated as meeting the acquisition requirement of section 168(k)(2)(A)(iii).

CONCLUSION

Based solely on Taxpayer's representations and the relevant law and analysis set forth above, we conclude that: (1) pursuant to section 168(k)(2)(A)(i), the Property is property to which section 168 applies with a recovery period of 20 years or less; (2) pursuant to section 168(k)(2)(A)(ii), the original use of the Property commenced with Taxpayer in Date8, notwithstanding the fact that the Property was attached to property previously placed in service and used by Taxpayer in its business; and (3) the Property is self-constructed property that satisfies the requirements of section 168(k)(2)(E)(i) and, therefore, was acquired by Taxpayer after December 31, 2007, and before January 1, 2013, pursuant to section 168(k)(2)(A)(iii), and the Agreement is not considered a written binding contract to acquire the Property. Therefore, assuming the Property satisfies the placed-in-service date requirement of section 168(k)(2)(A)(iv), the Property meets all of the requirements to be qualified property under section 168(k)(2)(A) and is eligible for the additional first year depreciation deduction under section 168(k)(1).

Except as specifically set forth above, no opinion is expressed or implied concerning the tax consequences of the facts described above under any other provisions of the Code (including other subsections of section 168). Further, no opinion is expressed or implied: (i) concerning the application of section 168(k)(2)(E)(ii), (iii), or (iv) to the facts described above; (ii) concerning the placed-in-service date of the Property; or (iii) on whether Taxpayer's determination of when construction of the Property and each of its components began satisfies section 1.168(k)-1(b)(4)(iii)(B).

In accordance with the power of attorney, we are sending a copy of this letter to Taxpayer's authorized representatives. We are also sending a copy of this letter to the appropriate operating division director.

This letter ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Kathleen Reed

Kathleen Reed
Branch Chief, Branch 7
Office of Associate Chief Counsel
(Income Tax and Accounting)

cc: