Internal Revenue Service

Number: **201210004**
Release Date: 3/9/2012

Index Number: 168.36-00

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:ITA:7
PLR-122636-11
Date:
November 22, 2011

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

Taxpayer	=
State1	=
State2	=
A	=
B	=
C	=
D	=
E	=
F	=
Number	=
Year1	=
Date1	=
Date2	=
Date3	=
Date4	=
Date5	=
Date6	=

Dear :

This letter responds to a letter dated May 26, 2011, submitted by Taxpayer requesting rulings under section 168(k) of the Internal Revenue Code.

FACTS

Taxpayer represents that the facts are as follows:

Taxpayer is a corporation organized under the laws of State1. Taxpayer is the parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year basis. Taxpayer uses an accrual method of accounting.

Taxpayer owns, *inter alia*, all of the membership interests in A, a State2 limited liability company. A is an entity that is disregarded as an entity separate from its owner (a "disregarded entity") for federal income tax purposes. A earns revenues from selling, under contract or on the spot market, a range of diverse products such as electricity, natural gas, capacity, emissions credits, and a series of energy-related products used to optimize the operation of the energy grid.

A owns, *inter alia*, all of the membership interests in B, a State2 limited liability company which is a disregarded entity for federal income tax purposes. B owns interests in more than Number coal-, gas-, and oil-fueled electric generating plants. It operates most of these plants. While B is the legal owner of the assets of this subject letter ruling request, Taxpayer is the owner of the assets of this subject letter ruling request for federal income tax purposes because A and B are disregarded entities for federal income tax purposes.

Taxpayer's C Generating Station is comprised of two generating units: C Unit 1 is a gas-fired unit and C Unit 2 is a coal-fired unit. Taxpayer's D Generating Station is comprised of three generating units. Both D Units 1 and 2 are coal-fired units.

In Year1, Taxpayer committed to federal and state environmental authorities to construct, install, and operate a scrubber, a baghouse, a selective catalytic reduction system ("SCR"), and an activated carbon injection system ("ACI") at its C Unit 2 electric generating unit (the "C Project"). Taxpayer also committed to install and operate a scrubber and a baghouse at both its D Unit 1 and D Unit 2 electric generating units ("the "D Project"). The tax treatment of the assets constructed pursuant to these commitments is the subject of the requested rulings.

Before Date1, Taxpayer hired E as a consultant to assist Taxpayer in formulating a specific plan to discharge its environmental commitments. During this consultation period, Taxpayer paid E for its consulting work.

On Date2, Taxpayer entered into an engineering, procurement and construction management contract ("EPCM Contract") with E to assist Taxpayer in the construction and installation of a baghouse, a scrubber, an SCR, and an ACI for the C Unit 2. During the course of the C project, Taxpayer entered into numerous other contracts with various vendors who supplied goods and services necessary to complete the project. On Date3, Taxpayer entered into an EPCM Contract with F to replace E on the C Project. Under the EPCM Contracts, Taxpayer retained complete control of the C Project and made all important operational and strategic decisions. Taxpayer directly procured all services, materials, and components associated with the C Project. E and,

after E's dismissal, F, provided only construction management services to Taxpayer in accordance with their contracts.

The EPCM Contract as well as all of the other contracts relating to the C Project were completed at various times in accordance with the terms and conditions of each contract. The C Project included both the acquisition and self-construction of numerous components. The C Project was completed and placed in service after Date4, and before Date5.

On Date6, Taxpayer entered into a written binding engineering, procurement and construction contract ("EPC Contract") with E to construct a pulse jet fabric filter (a type of baghouse) and a spray dryer absorber (a type of scrubber) for each of D Units 1 and 2. The EPC Contract was a fixed price, "turn-key" contract. Generally speaking, a turnkey project is one in which the contractor is responsible for turning over to its customer the subject matter of the contract in a ready-to-use condition. Pursuant to the EPC Contract, Taxpayer made various "milestone payments" to E during its construction of the assets. The EPC Contract was completed when Taxpayer accepted the D Project which occurred after Date4, and before Date5. The assets were placed in service at the time the D Project was accepted.

RULINGS REQUESTED

In the case of the C Project:

1. For purposes of determining qualification for the 50-percent additional first year depreciation deduction, a self-constructed property is acquired when construction commences. If Taxpayer chooses to apply the safe harbor rule of section 1.168(k)-1(b)(4)(iii)(B)(*2*) of the Income Tax Regulations, such safe harbor rule applies for determining when construction commences. Under that rule, Taxpayer must determine when costs relating to the C Project have been incurred by applying the all events test and the economic performance requirement of section 461(h). That is, costs associated with the provision of services are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the services are rendered to Taxpayer and costs associated with the provision of property are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the property is provided to Taxpayer (*i.e.*, when the property is delivered, when it is accepted, or when title to the property passes, depending upon Taxpayer's method of accounting for determining when property is provided).

2. Under the limited election provided under section 3.02(2)(b) of Rev. Proc. 2011-26, 2011-16 I.R.B. 664:

a. In determining whether a self-constructed component of a larger self-constructed property qualifies for the 100-percent additional first-year depreciation deduction, Taxpayer may choose to apply the safe harbor rule of section 1.168(k)-1(b)(4)(iii)(B)(*2*). Under that rule, Taxpayer must determine when costs relating to the self-constructed component have been incurred by applying the all events test and the economic performance requirement of section 461(h). That is, costs associated with the provision of services are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the services are rendered to Taxpayer and costs associated with the provision of component are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the component is provided to Taxpayer (*i.e.*, when the component is delivered, when it is accepted, or when title to the component passes, depending upon Taxpayer's method of accounting for determining when property is provided); and

b. In determining whether an acquired component of a larger self-constructed property qualifies for the 100-percent additional first-year depreciation deduction, Taxpayer must determine the date of the component's acquisition by applying the all events test and the economic performance requirement of section 461(h). That is, Taxpayer has incurred the cost of the acquired component when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the component is delivered, when it is accepted, or when title to the component passes, depending upon Taxpayer's method of accounting for determining when property is provided.

In the case of the D Project:

3. For purposes of determining qualification for the 100-percent additional first year depreciation deduction, a self-constructed property is acquired when construction commences. If Taxpayer chooses to apply the safe harbor rule of section 1.168(k)-1(b)(4)(iii)(B)(*2*), such safe harbor rule applies for determining when construction commences. Under that rule, Taxpayer must determine when costs relating to the D Project EPC Contract have been incurred by applying the all events test and the economic performance requirement of section 461(h). That is, costs associated with the provision of property are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the property is provided to Taxpayer (*i.e.*, when the property is delivered, when it is accepted, or when title to the property passes, depending upon Taxpayer's method of accounting for determining when property is provided).

LAW AND ANALYSIS

Section 168(k)(1)(A) (as amended by the Economic Stimulus Act of 2008, Pub. L. No. 110-185, 122 Stat. 613 (February 13, 2008) ("Stimulus Act")) 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 the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (December 17, 2010) ("TRUIRJCA")) 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 that is 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.

Section 168(k)(2)(E)(i) (as amended by the TRUIRJCA) 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.

With the exception of the increased amount and the revised dates, the rules for determining whether depreciable property is eligible for the 50-percent additional first year depreciation deduction are the same as the rules in section 168(k) in effect before the enactment of the Stimulus Act. Accordingly, rules similar to the rules in section 1.168(k)-1 for "qualified property" or for "30-percent additional first year depreciation deduction" apply. *See* section 5.01 of Rev. Proc. 2008-54, 2008-2 C.B. 722.

Section 1.168(k)-1(b)(4)(i) provides the rules relating to section 168(k)(2)(A)(iii) [the acquisition requirement] and section 1.168(k)-1(b)(4)(iii) provides the rules relating to section 168(k)(2)(E)(i) [self-constructed property].

For purposes of the 50-percent additional first year depreciation deduction, section 1.168(k)-1(b)(4)(i) provides that depreciable property will meet the requirements of section 1.168(k)-1(b)(4) if the property is: (*1*) acquired by the taxpayer after [December 31, 2007], and before [January 1, 2013], but only if no written binding contract for the acquisition of the property was in effect before [January 1, 2008]; or (*2*) acquired by the taxpayer pursuant to a written binding contract that was entered into after [December 31, 2007], and before [January 1, 2013]. Section 1.168(k)-1(b)(4)(ii) defines a binding contract.

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.

Section 1.168(k)-1(b)(4)(iii)(B)(*1*) provides that for purposes of section 1.168(k)-1(b)(4)(iii), manufacture, construction, or production of property begins when physical work of a significant nature begins. Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching. The determination of when physical work of a significant nature begins depends on the facts and circumstances.

Section 1.168(k)-1(b)(4)(iii)(B)(*2*) provides that for purposes of section 1.168(k)-1(b)(4)(iii)(B)(*1*), a taxpayer may choose to determine when physical work of a significant nature begins in accordance with the safe harbor rule provided in section 1.168(k)-1(b)(4)(iii)(B)(*2*). Under this safe harbor rule, physical work of a significant nature will not be considered to begin before the taxpayer incurs (in the case of an accrual basis taxpayer) or pays (in the case of a cash basis taxpayer) more than 10 percent of the total cost of the property (excluding the cost of any land and preliminary activities such as planning or designing, securing financing, exploring, or researching). When property is manufactured, constructed, or produced for the taxpayer by another person, this safe harbor rule must be satisfied by the taxpayer. A taxpayer chooses to apply section 1.168(k)-1(b)(4)(iii)(B)(*2*) by filing an income tax return for the placed-in-service year of the property that determines when physical work of a significant nature begins consistent with section 1.168(k)-1(b)(4)(iii)(B)(*2*).

Section 1.168(k)-1(b)(4)(iii)(C) provides the rules relating to components of self-constructed property. If such component is acquired by the taxpayer, the rules in section 1.168(k)-1(b)(4)(iii)(C)(*1*) apply to the acquired component. If the component is self-constructed, the rules in section 1.168(k)-1(b)(4)(iii)(C)(*2*) apply to the self-constructed component.

Section 1.168(k)-1(b)(4)(iii)(C)(*1*) provides that if a binding contract (as defined in section 1.168(k)-1(b)(4)(ii)) to acquire a component does not satisfy the requirements of section 1.168(k)-1(b)(4)(i), the component does not qualify for the 50-percent additional first year depreciation deduction. A binding contract to acquire one or more components of a larger self-constructed property will not preclude the larger self-constructed property from satisfying the acquisition rules in section 1.168(k)-1(b)(4)(iii)(A). Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the 50-percent additional first year depreciation

deduction must not include the unadjusted depreciable basis of any component that does not satisfy the requirements of section 1.168(k)-1(b)(4)(i). If the manufacture, construction, or production of the larger self-constructed property begins before [January 1, 2008], the larger self-constructed property and any acquired components related to the larger self-constructed property do not qualify for the 50-percent additional first year depreciation deduction.

Section 1.168(k)-1(b)(4)(iii)(C)(*2*) provides that if the manufacture, construction, or production of a component does not satisfy the requirements of section 1.168(k)-1(b)(4)(iii)(A), the component does not qualify for the 50-percent additional first year depreciation deduction. However, if the manufacture, construction, or production of component does not satisfy the requirements of section 1.168(k)-1(b)(4)(iii)(A), but the manufacture, construction, or production of the larger self-constructed property satisfies the requirements of section 1.168(k)-1(b)(4)(iii)(A), the larger self-constructed property qualifies for the 50-percent additional first year depreciation deduction (assuming all other requirements in section 168(k)(2) are met). Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the 50-percent additional first year depreciation deduction must not include the unadjusted depreciable basis of any component that does not qualify for the 50-percent additional first year depreciation deduction. If the manufacture, construction, or production of the larger self-constructed property began before [January 1, 2008], the larger self-constructed property and any self-constructed components related to the larger self-constructed property do not qualify for the 50-percent additional first year depreciation deduction.

Section 168(k)(5) provides that in the case of qualified property acquired by the taxpayer (under rules similar to the rules of section 168(k)(2)(A)(ii) and (iii)) after September 8, 2010, and before January 1, 2012, and which is placed in service by the taxpayer before January 1, 2012 (January 1, 2013, in the case of property described in section 168(k)(2)(B) or (C)), a 100-percent additional first year depreciation deduction for the taxable year in which such qualified property is placed in service by the taxpayer is allowable.

Section 3.01 of Rev. Proc. 2011-26 provides that depreciable property is eligible for the 100-percent additional first year depreciation deduction if the property is qualified property (as defined in section 168(k)(2)) and also meets the additional requirements in section 3.02 of Rev. Proc. 2011-26. Further, it provides that for purposes of determining whether depreciable property is qualified property, rules similar to the rules in section 1.168(k)-1 for “qualified property” or for “30-percent additional first year depreciation deduction” apply.

Section 3.02(1) of Rev. Proc. 2011-26 provides that for purposes of section 168(k)(5), qualified property is eligible for the 100-percent additional first year depreciation deduction if the property meets all of the following requirements in the first

taxable year in which the property is subject to depreciation by the taxpayer, whether or not depreciation deductions for that property are allowable:

(a) The taxpayer acquires the qualified property after September 8, 2010, and before January 1, 2012 (before January 1, 2013, in the case of qualified property described in section 168(k)(2)(B) or (C)). Solely for purposes of section 168(k)(5) and section 3.02(1)(a) of Rev. Proc. 2011-26, a taxpayer acquires the qualified property when the taxpayer pays or incurs the cost of the property. Qualified property that a taxpayer manufactures, constructs, or produces (as defined under section 1.168(k)-1(b)(4)(iii)(A) and modified by section 3.02(1)(a) of this revenue procedure solely for purposes of section 168(k)(5)) for use in its trade or business or for its production of income is acquired by the taxpayer for purposes of section 168(k)(5) and section 3.02(1)(a) of Rev. Proc. 2011-26 when the taxpayer begins constructing, manufacturing, or producing that property (as determined under section 1.168(k)-1(b)(4)(iii)(B)).

(b) The taxpayer places the qualified property in service after September 8, 2010, and before January 1, 2012 (before January 1, 2013, in the case of qualified property described in section 168(k)(2)(B) or (C)).

(c) The original use of the qualified property commences with the taxpayer after September 8, 2010.

Section 3.02(2)(a) of Rev. Proc. 2011-26 provides, in relevant part, that if a taxpayer manufactures, constructs, or produces qualified property for use by the taxpayer in its trade or business or for its production of income, rules similar to the self-constructed property rules in section 1.168(k)-1(b)(4)(iii) apply for determining whether this property meets the acquisition requirement of section 3.02(1)(a) of Rev. Proc. 2011-26.

Section 3.02(2)(b) of Rev. Proc. 2011-26, however, provides a limited exception to sections 1.168(k)-1(b)(4)(iii)(C)(*1*) and (*2*) for certain components of a larger self-constructed property solely for purposes of section 168(k)(5) and section 3.02(1)(a) of Rev. Proc. 2011-26. If before September 9, 2010, a taxpayer begins the manufacture, construction, or production of the larger self-constructed property that is qualified property for use in its trade or business or for its production of income, but this larger self-constructed property meets the requirements of sections 3.02(1)(b) and (c) of Rev. Proc. 2011-26, the taxpayer may elect to treat any acquired or self-constructed component of that larger self-constructed property as being eligible for the 100-percent additional first year depreciation deduction if the component is qualified property and is acquired or self-constructed by the taxpayer after September 8, 2010, and before January 1, 2012 (before January 1, 2013, in the case of qualified property described in section 168(k)(2)(B) or (C)). The taxpayer may make this election for one or more components that are described in section 3.02(2)(b) of Rev. Proc. 2011-26.

Section 461(a) provides, in part, that a deduction shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 461(h) and section 1.461-1(a)(2) provides, in part, that under an accrual method of accounting, a liability (as defined in section 1.446-1(c)(1)(ii)(B)) is incurred, and generally is taken into account for federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. The first two requirements are commonly referred to as the all events test and the third requirement is called the economic performance requirement. *See also* section 1.446-1(c)(1)(ii)(A).

Section 1.446-1(c)(1)(ii)(B) defines the term "liability" as including any item allowable as a deduction, cost, or expense for federal income tax purposes. In addition to allowable deductions, the term includes any amount otherwise allowable as a capitalized cost, as a cost taken into account in computing cost of goods sold, as a cost allocable to a long-term contract, or as any other cost or expense.

Sections 461(h) and 1.461-4(a) provide, in part, that in determining whether an amount has been incurred with respect to any item during the taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item has occurred.

Section 461(h)(2)(A)(i) and (ii), and section 1.461-4(d)(2)(i) provide that if the liability of the taxpayer arises out of the providing of services or property to the taxpayer by another person, economic performance occurs as services or property is provided.

Section 1.461-4(d)(6) provides the rules relating to the provision of services or property to the taxpayer for purposes of section 1.461-4(d). Section 1.461-4(d)(6)(iii) provides that a taxpayer is permitted to treat property as provided to the taxpayer when the property is delivered or accepted, or when title to the property passes. The method used by the taxpayer to determine when property is provided is a method of accounting that must comply with the rules of section 1.446-1(e). Thus, the method of determining when property is provided must be used consistently from year to year, and cannot be changed without the consent of the Commissioner of Internal Revenue.

Section 461(h)(2)(D) provides that in the case of any other liability not specifically mentioned in section 461(h), economic performance occurs at the time determined by the Internal Revenue Service in regulations.

Section 1.461-4(g) provides a list of specifically enumerated items for which economic performance is satisfied by payment. Section 1.461-4(g)(7) provides that in the case of a taxpayer's liability for which economic performance rules are not otherwise

provided elsewhere in the Code or other rules, economic performance occurs as the taxpayer makes payments in satisfaction of the liability. Section 1.461-4(g)(7) further states that its only application is if the liability in question is not covered by rules provided elsewhere under section 461.

Ruling Requests 1 and 3

For purposes of the 50-percent and 100-percent additional first year depreciation deductions, the determination of whether property is a self-constructed property is made under section 1.168(k)-1(b)(4)(iii)(A).

In this case, the C Project is self-constructed property for purposes of the 50-percent additional first year depreciation deduction provided by section 168(k)(1). With the assistance of a construction manager (E and then F), Taxpayer constructed the C Project itself for use in its trade or business. Because the C Project is self-constructed property, it is acquired by Taxpayer when Taxpayer begins construction of the C Project for purposes of the acquisition requirement of section 168(k)(2)(A)(iii) and section 1.168(k)-1(b)(4)(i).

Also, the D Project is self-constructed property for purposes of the 100-percent additional first year depreciation deduction provided by section 168(k)(5). The D Project is constructed for Taxpayer by E under an EPC Contract that Taxpayer represents was entered into before construction of the D Project. Because the D Project is self-constructed property, it is acquired by Taxpayer when Taxpayer begins construction of the D Project for purposes of the acquisition requirement of section 168(k)(5) and section 3.02(1)(a) of Rev. Proc. 2011-26.

For self-constructed property, the acquisition requirement for purposes of the 50-percent additional first year depreciation deduction is treated as met if Taxpayer begins manufacturing, constructing, or producing the property after December 31, 2007, and before January 1, 2013. For self-constructed property that is qualified property, the acquisition requirement for purposes of the 100-percent additional first year depreciation deduction is treated as met if Taxpayer begins manufacturing, constructing, or producing the property after September 8, 2010, and before January 1, 2012 (before January 1, 2013, in the case of qualified property described in section 168(k)(2)(B) or (C)).

For purposes of the 50-percent and 100-percent additional first year depreciation deductions, manufacture, construction, or production of property begins when physical work of a significant nature begins. To make this determination, the taxpayer may choose to apply the 10 percent safe harbor rule under section 1.168(k)-1(b)(4)(iii)(B)(2).

Under this safe harbor rule, physical work of a significant nature will not be considered to begin before an accrual basis taxpayer incurs more than 10 percent of the

total cost of the property (excluding the cost of any land and preliminary activities). Because the term “incurred” is neither defined nor given any special meaning in section 168(k) or its underlying regulations or legislative history, or in Rev. Proc. 2011-26, the determination of when an accrual basis taxpayer has incurred more than 10 percent of the total cost of the property is made using the all events test and economic performance requirement of section 461, which specifically governs the timing of the deductions, costs, and expenses at issue.

If Taxpayer chooses the safe harbor rule of section 1.168(k)-1(b)(4)(iii)(B)(*2*) for the C Project and the D Project, such rule applies for determining when Taxpayer began construction of the C Project and the D Project. Under this safe harbor rule, Taxpayer, an accrual basis taxpayer, determines when it incurred more than 10 percent of the total cost of the C Project and when Taxpayer incurred more than 10 percent of the total cost of the D Project by applying the all events test and economic performance requirement of section 461.

In the case of the C Project, Taxpayer represents that services and property were provided to Taxpayer. Therefore, costs associated with the provision of services are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the services are rendered to Taxpayer. Costs associated with the provision of property are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the property has been provided to Taxpayer (*i.e.*, when the property has been delivered or accepted, or when title to the property passes, depending upon Taxpayer’s method of accounting for determining when property is provided and assuming section 1.461-4(d)(6)(ii) does not apply).

In the case of the D Project, Taxpayer represents that it is a turnkey project where the contractor (E) turned over the D Project to Taxpayer in ready-to-use condition. Thus, costs associated with the provision of property are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the property has been provided to Taxpayer (*i.e.*, when the property has been delivered or accepted, or when title to the property passes, depending upon Taxpayer’s method of accounting for determining when property is provided and assuming section 1.461-4(d)(6)(ii) does not apply).

Ruling Request 2

Taxpayer represents that the C Project includes both acquired components and self-constructed components. If the C Project and all of its components are qualified property, Taxpayer intends to determine whether any component of the C Project is eligible for the 100-percent additional first year depreciation deduction by applying the limited election in section 3.02(2)(b) of Rev. Proc. 2011-26.

That election applies to a taxpayer that began manufacturing, constructing, or producing a larger self-constructed property that is qualified property before September 9, 2010, but the taxpayer placed this larger self-constructed property in service after September 8, 2010, and before January 1, 2012 (before January 1, 2013, in the case of qualified property described in section 168(k)(2)(B) or (C)) and the original use of the larger self-constructed property commenced with the taxpayer after September 8, 2010. In such a case, the taxpayer may elect to treat any acquired or self-constructed component of that larger self-constructed property as being eligible for the 100-percent additional first year depreciation deduction if the component is qualified property and is acquired or self-constructed by the taxpayer after September 8, 2010, and before January 1, 2012 (before January 1, 2013, in the case of qualified property described in section 168(k)(2)(B) or (C)).

Solely for purposes of section 168(k)(5) and section 3.02(1)(a) of Rev. Proc. 2011-26, section 3.02(1)(a) of this revenue procedure provides that a taxpayer acquires the qualified property when the taxpayer pays or incurs the cost of the property. The term “pays or incurs” means pays or incurs within the meaning of sections 1.461-1(a)(1) and (2). Accordingly, an accrual basis taxpayer acquires qualified property solely for purposes of section 168(k)(5) when the accrual basis taxpayer incurs the cost of the property and a cash basis taxpayer acquires qualified property solely for purposes of section 168(k)(5) when the cash basis taxpayer pays the cost of the property.

If a taxpayer manufactures, constructs, or produces qualified property for use in its trade or business, section 3.02(1)(a) of Rev. Proc. 2011-26 also provides that such property is acquired by the taxpayer for purposes of section 168(k)(5) and section 3.02(1)(a) of this revenue procedure when the taxpayer begins constructing, manufacturing, or producing that property as determined under section 1.168(k)-1(b)(4)(iii)(B).

Under the limited election of section 3.02(2)(b) of Rev. Proc. 2011-26, the component must be qualified property and must be acquired or self-constructed by the taxpayer after September 8, 2010, and before January 1, 2012 (before January 1, 2013, in the case of qualified property described in section 168(k)(2)(B) or (C)). The dates of this acquisition requirement are the same dates as in the acquisition requirements in section 3.02(1)(a) of Rev. Proc. 2011-26. Although the acquisition requirements in section 3.02(1)(a) of Rev. Proc. 2011-26 do not specifically incorporate the limited election under section 3.02(2)(b) of Rev. Proc. 2011-26, the Service intended to apply such acquisition requirements also for purposes of section 3.02(2)(b) of Rev. Proc. 2011-26 for any acquired or self-constructed component of the larger self-constructed property described in section 3.02(2)(b) of Rev. Proc. 2011-26. Thus, for purposes of section 3.02(2)(b) of Rev. Proc. 2011-26, a taxpayer may elect to treat any acquired component of the larger self-constructed property described in section 3.02(2)(b) of Rev. Proc. 2011-26 as being eligible for the 100-percent additional first year

depreciation deduction if the acquired component is qualified property and if the taxpayer incurs (in the case of an accrual basis taxpayer) or pays (in the case of a cash basis taxpayer) the cost of the acquired component after September 8, 2010, and before January 1, 2012 (before January 1, 2013, in the case of property described in section 168(k)(2)(B) or (C)).

Further, for purposes of section 3.02(2)(b) of Rev. Proc. 2011-26, a taxpayer may elect to treat any self-constructed component of the larger self-constructed property described in section 3.02(2)(b) of Rev. Proc. 2011-26 as being eligible for the 100-percent additional first year depreciation deduction if the self-constructed component is qualified property and if the taxpayer begins manufacturing, constructing, or producing the component (as determined under section 1.168(k)-1(b)(4)(iii)(B)) after September 8, 2010, and before January 1, 2012 (before January 1, 2013, in the case of property described in section 168(k)(2)(B) or (C)). Pursuant to section 1.168(k)-1(b)(4)(iii)(B)(*1*), manufacture, construction, or production of property begins when physical work of a significant nature begins. To make this determination, a taxpayer may choose to apply the 10-percent safe harbor rule under section 1.168(k)-1(b)(4)(iii)(B)(*2*). Under this safe harbor rule, physical work of a significant nature will not be considered to begin before an accrual basis taxpayer incurs more than 10 percent of the total cost of the property (excluding the cost of any land and preliminary activities).

As we previously discussed under Ruling Requests 1 and 3, the term “incurred” is neither defined nor given any special meaning in section 168(k) or its underlying regulations or legislative history, or in Rev. Proc. 2011-26. Accordingly, our conclusion reached under Ruling Requests 1 and 3 also applies for purposes of section 168(k)(5) and sections 3.02(1)(a) and 3.02(2)(b) of Rev. Proc. 2011-26. That is, the determination of when an accrual basis taxpayer has incurred the cost of the acquired component is made using the all events test and economic performance requirement of section 461 and, for purposes of the safe harbor rule under section 1.168(k)-1(b)(4)(iii)(B)(*2*), has incurred more than 10 percent of the total cost of a self-constructed component is made using the all events test and economic performance requirement of section 461.

In the case of the C Project, if the larger self-constructed property is described in section 3.02(2)(b) of Rev. Proc. 2011-26, Taxpayer may choose to apply the safe harbor rule under section 1.168(k)-1(b)(4)(iii)(B)(*2*) to determine when construction commences for a self-constructed component(s) of that larger self-constructed property. Under that rule, Taxpayer must determine when costs relating to the self-constructed component have been incurred by applying the all events test and the economic performance requirement of section 461(h). That is, costs associated with the provision of services are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the services are rendered to Taxpayer and costs associated with the provision of component are incurred when all the events have occurred that establish the fact of

liability, the amount of the liability can be determined with reasonable accuracy, and the component is provided to Taxpayer (*i.e.*, when the component is delivered or accepted, or when title to the component passes, depending upon Taxpayer's method of accounting for determining when property is provided and assuming section 1.461-4(d)(6)(ii) does not apply).

Further, an acquired component(s) of that larger self-constructed property is acquired by Taxpayer when it incurs the cost of the acquired component. Consequently, Taxpayer must determine the date of the component's acquisition by applying the all events test and the economic performance requirement of section 461(h). That is, Taxpayer has incurred the cost of the acquired component when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the acquired component is provided to Taxpayer (*i.e.*, when the acquired component is delivered or accepted, or when title to the acquired component passes, depending upon Taxpayer's method of accounting for determining when property is provided and assuming section 1.461-4(d)(6)(ii) does not apply).

CONCLUSION

Based solely on Taxpayer's representations and the relevant law and analysis set forth above, we conclude that:

1. In the case of the C Project, for purposes of determining qualification for the 50-percent additional first year depreciation deduction, a self-constructed property is acquired when construction commences. If Taxpayer chooses to apply the safe harbor rule of section 1.168(k)-1(b)(4)(iii)(B)(*2*), such safe harbor rule applies for determining when construction commences. Under that rule, Taxpayer must determine when costs relating to the C Project have been incurred by applying the all events test and the economic performance requirement of section 461(h). That is, costs associated with the provision of services are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the services are rendered to Taxpayer and costs associated with the provision of property are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the property is provided to Taxpayer (*i.e.*, when the property is delivered, when it is accepted, or when title to the property passes, depending upon Taxpayer's method of accounting for determining when property is provided).

2. In the case of the C Project, under the limited election provided under section 3.02(2)(b) of Rev. Proc. 2011-26:

a. In determining whether a self-constructed component of a larger self-constructed property qualifies for the 100-percent additional first-year depreciation

deduction, Taxpayer may choose to apply the safe harbor rule of section 1.168(k)-1(b)(4)(iii)(B)(*2*). Under that rule, Taxpayer must determine when costs relating to the self-constructed component have been incurred by applying the all events test and the economic performance requirement of section 461(h). That is, costs associated with the provision of services are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the services are rendered to Taxpayer and costs associated with the provision of component are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the component is provided to Taxpayer (*i.e.*, when the component is delivered, when it is accepted, or when title to the component passes, depending upon Taxpayer's method of accounting for determining when property is provided); and

b. In determining whether an acquired component of a larger self-constructed property qualifies for the 100-percent additional first-year depreciation deduction, Taxpayer must determine the date of the component's acquisition by applying the all events test and the economic performance requirement of section 461(h). That is, Taxpayer has incurred the cost of the acquired component when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the component is delivered, when it is accepted, or when title to the component passes, depending upon Taxpayer's method of accounting for determining when property is provided.

3. In the case of the D Project, for purposes of determining qualification for the 100-percent additional first year depreciation deduction, a self-constructed property is acquired when construction commences. If Taxpayer chooses to apply the safe harbor rule of section 1.168(k)-1(b)(4)(iii)(B)(*2*), such safe harbor rule applies for determining when construction commences. Under that rule, Taxpayer must determine when costs relating to the D Project EPC Contract have been incurred by applying the all events test and the economic performance requirement of section 461(h). That is, costs associated with the provision of property are incurred when all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and the property is provided to Taxpayer (*i.e.*, when the property is delivered, when it is accepted, or when title to the property passes, depending upon Taxpayer's method of accounting for determining when property is provided).

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). Specifically, if the cost of any property (including any component of the larger self-constructed property) subject to this ruling request includes interest capitalized under section 263A(f)), no opinion is expressed or implied on whether such interest is included in the determination of the total cost of such property for purposes of the safe harbor rule of section 1.168(k)-1(b)(4)(iii)(B)(*2*).

Further, no opinion is expressed or implied on whether: (i) the EPC Contract, the EPCM Contract, and any other contract subject to this ruling request are written binding contracts for purposes of section 168(k); (ii) any property (including any component of the larger self-constructed property) subject to this ruling request is qualified property under section 168(k)(2); (iii) any property (including any component of the larger self-constructed property) subject to this ruling request qualifies for the 50-percent additional first year depreciation deduction provided by section 168(k)(1); (iv) any property (including any component of the larger self-constructed property) subject to this ruling request qualifies for the 100-percent additional first year depreciation deduction provided by section 168(k)(5); (v) Taxpayer's determination of when construction of any property (including any component of the larger self-constructed property) subject to this ruling request began satisfies section 1.168(k)-1(b)(4)(iii)(B); or (vi) Taxpayer's determination of the acquisition date of any acquired component of the larger self-constructed property is correct.

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)

Enclosures (2):
copy of this letter
copy for section 6110 purposes