Internal Revenue Service

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Telephone Number:

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Date:
October 31, 2014

Re: Request for Private Letter Ruling under § 168(g)(1)(A)

Legend

Taxpayer =

Project =

Country =

State1 =

State2 =

City =

Utility1 =

Utility2 =

Location =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

K =

L =

M =

N =

O =

P =

Dear :

This letter responds to a letter dated July 31, 2014, and supplemental correspondence, submitted by Taxpayer, requesting a letter ruling on whether an offshore wind farm known as the Project is not used predominantly outside the United States within the meaning of § 168(g)(1)(A) of the Internal Revenue Code.

FACTS

Taxpayer represents that the facts are as follows:

Taxpayer is a State1 limited liability company that is a partnership for federal income tax purposes. Taxpayer's current partners are A and B. However, at financial closing, two new partners (affiliates of large public companies) are expected to make capital contributions to Taxpayer in exchange for partnership interests, and the two existing partners are expected to contribute their interests to an upper-tier State2 limited liability company called C, leaving three partners in total. A, B, and C are affiliated with

D, a State1 corporation that is in the business of developing primarily renewable energy facilities, including the Project.

Taxpayer will own the Project. The Project is a wind farm that will be built off the coast of State1, in an area of water called Location. The Project is designed to have a capacity of E megawatts and to consist of F turbines. The Project will be built in two phases or “seasons.” The first season (season A) will consist of G H-megawatt turbines. All of the electricity from season A will be sold to the Utility1 and Utility2, two State1 utilities, under long-term power contracts. Another I turbines will be added in a later construction season (season B) if another power contract can be secured.

The wind turbines are expected to be spread over an area roughly the size of J. Each turbine will sit atop a K heavy duty mast or tower that will be embedded in the ocean floor. Undersea gathering lines will bring the electricity from each turbine to a L centrally-located electrical service platform from which the electricity will move to shore through two larger undersea and upland cables to a project substation in City, State1, where the electricity will be fed into the electrical grid.

The electricity will exit each turbine at M kV and then be stepped up to N kV by means of three step-up transformers on the electrical service platform. There will be no further step up in voltage before it reaches the grid.

The turbines and electrical service platform of the Project will be O to P miles off the State1 coast, which is more than 3 nautical miles but less than 12 nautical miles off the coast.

All of the turbines will be controlled from a control room on land in State1. The control room will have computers and large screens with pictorial renderings of each turbine, turbine collector system, subsea and upland cables, step-up transformers, circuit breakers and surge arrestors, performance data for each turbine and related equipment, and real-time data on weather conditions and overall wind farm performance. The wind farm is controlled by a SCADA system: sophisticated software that collects performance and conditions data from the individual turbines and the electrical service platform that are then converted into specific instructions back to individual turbines to adjust the pitch of the blades to react to shifts in wind direction and speed to control and optimize output. The SCADA system will also protect the turbines from operating out of their design parameters and effect shut down during emergencies and scheduled maintenance. The control room will also house a marine surveillance and security system used for monitoring marine traffic, maintenance activities and overall security of the wind farm, and ensuring compliance with U.S. Coast Guard requirements.

Taxpayer will sell all of its electricity to two State1 utilities: Utility1 and Utility2. There is no contract to resell the power to Country. Sales of U.S. electricity into Country require an export license. Neither Utility1 nor Utility2 holds such a license.

The Project is an integrated whole: none of the turbines can be placed in service without the undersea cables, control room, and the project substation to deliver the electricity to market.

The season B turbines could be owned by Taxpayer if the equity investors and lenders are willing to fund the additional cost. Alternatively, the season B turbines could be owned by a separate company that would enter into a "shared facilities agreement" with Taxpayer essentially to buy an undivided interest in the electrical service platform, undersea and upland cables, project substation, control room, and other common infrastructure so that the season B electricity can be moved to shore. The effect would be to reimburse the season A owners for the cost of the share of the common infrastructure that would be used by season B turbines.

The season B turbines, which will be tethered to shore in the same manner as the season A turbines, will be useless without the ability to get their electricity to shore. These turbines cannot be used by the Project without the step-up transformers, undersea and upland cables, SCADA system, and other infrastructure required to operate the turbines and bring the electricity to shore.

RULING REQUESTED

Taxpayer requests the Internal Revenue Service issue the following ruling:

The Project will not be considered used predominantly outside the United States within the meaning of § 168(g)(1)(A).

LAW AND ANALYSIS

Section 168(g)(1)(A) provides that any tangible property used predominantly outside the United States during the taxable year must be depreciated under the alternative depreciation system of § 168(g).

Section 168(g)(4) lists exceptions to § 168(g)(1)(A) for certain property used outside the United States. While none of the enumerated exceptions apply to the facts of this private letter ruling request, the background of § 168(g)(4) provides insight in determining whether property is used predominantly outside the United States. The rules in § 168(g)(4) are derived from former § 48(a)(2)(B). Prior to 1990, § 168(g)(4) provided, in relevant part, that for purposes of § 168(g), rules similar to the rules under § 48(a)(2) (including the exceptions contained in § 48(a)(2)(B)) shall apply in determining whether property is used predominantly outside the United States. Section

11813 of the Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-158 (the "Act") repealed § 48(a)(2) as "deadwood" and amended § 168(g)(4) by moving the enumerated exceptions under former § 48(a)(2)(B) to § 168(g)(4). The repeal of the "deadwood" provisions and the amendment to § 168(g)(4) by § 11813 of the Act were not intended to be substantive changes in the tax law. H.R. Rep. No. 101-894, 101st Cong., 2d Sess. (Oct. 17, 1990). Accordingly, guidance issued under former § 48(a)(2) provides insight in determining whether property is used predominantly outside the United States for purposes of § 168(g)(1)(A).

Former section 48(a)(2) provided that property used predominantly outside the United States is not eligible for the investment credit. Section 1.48-1(g)(1) of the Income Tax Regulations provides that the determination of whether property is used predominantly outside the United States (as defined in § 7701(a)(9)) during the taxable year is made by comparing the period in such year during which the property is physically located outside of the United States with the period during which the property is physically located within the United States. If the property is physically located outside the United States during more than 50 percent of the taxable year, such property shall be considered used predominantly outside the United States during that year. See also § 1.168-2(g)(5)(i) of the proposed regulations, which provides the rules under former § 168(f)(2), the predecessor to §§ 168(g)(1)(A) and 168(g)(4).

Section 7701(a)(9) provides that the term "United States" when used in a geographical sense includes only the States and the District of Columbia.

Rev. Rul. 69-2, 1969-1 C.B. 25, states that submarine cables that are used in connection with the provision of telephone and other communication services in Hawaii are functionally used at the terminals of the system even though such cables lie on the ocean floor in international waters. Because all of the terminals of this submarine cable system are physically located in California and Hawaii, Rev. Rul. 69-2 holds that the submarine cables are used solely within the United States for purposes of former § 48(a)(2).

Rev. Rul. 73-77, 1973-1 C.B. 34, states that transoceanic cables extending from terminal facilities located in the United States to terminal facilities located in foreign countries were functionally used in the United States for purposes of former § 48(a)(2). These cables were used for the transmission of messages between the terminals in the United States and the terminals in the foreign countries. Because 50 percent of the terminal facilities were physically located in the United States, Rev. Rul. 73-77 concluded that at least 50 percent of the functional use of the submarine cables was in the United States and, thus, the cables are not used predominantly outside the United States for purposes of former § 48(a)(2).

In light of the legislative history of § 168(g)(1)(A) and (g)(4), we believe that the "functional use" test in Rev. Rul. 73-77 applies for purposes of § 168(g)(1)(A).

In this case, Taxpayer represents that the Project is an integrated whole. The turbines cannot be used without the offshore gathering lines, undersea and upland cables, and offshore electrical service platform, as well as the project control room and substation on land. These components of the Project are necessary for the Project to operate and move its electricity to market. As a result, each component of the Project will be functionally dependent on the other components. Further, the part of the Project located off the coast of State1 will be physically connected with the substation located on the land in State1. Accordingly, the Project for purposes of the situs of its use under § 168(g)(1)(A) should be viewed as one integrated system.

Taxpayer also represents that the electricity generated by the Project will be sold to U.S. consumers. Based on that representation and because the Project will have no control room and substation located in a foreign country, the sole functional use of the Project is the generation, transmission, and distribution of electricity for domestic use in the United States. Therefore, under the functional use test of Rev. Rul. 73-77, Taxpayer's Project is not used predominantly outside the United States for purposes of § 168(g)(1)(A).

Because the functional use test of Rev. Rul. 73-77 applies in this case, it is not necessary for us to consider Taxpayer's alternative argument that United States territorial waters extend 12 nautical miles for purposes of § 168(g)(1)(A).

CONCLUSION

Based solely on Taxpayer's representations and the relevant law and analysis set forth above, we conclude that the Project will not be considered used predominantly outside the United States within the meaning of § 168(g)(1)(A).

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 § 168).

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

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

Sincerely,

Kathleen Reed

KATHLEEN REED
Chief, Branch 7
Office of Associate Chief Counsel
(Income Tax and Accounting)

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