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Date:
January 8, 2014

LEGEND:

Taxpayer =

State =
Water District =
Year A =
Director =

Dear . :

This letter responds to the request, dated July 18, 2013, of Taxpayer for a ruling on whether all four pieces of equipment comprising elements of a sludge power plant constitute an electric generating facility that uses municipal solid waste to produce electricity within the meaning of section 45(d)(7) of the Internal Revenue Code and thus may qualify for the tax credit under § 48(a)(5).

The representations set out in your letter follow.

Taxpayer is a limited liability company formed under the laws of State that plans to build a small power plant (Plant) on a site leased from Water District. Construction is expected to begin in Year A and the Plant will be constructed with entirely new components. In addition, Taxpayer represents that the original use of the Plant will commence with Taxpayer.

The Plant will use sludge from an adjacent sewage treatment plant owned by the Water District (Water District Plant) as well as sludge imported from other sewage treatment facilities as fuel to produce renewable electricity. Taxpayer represents that the sludge

that will be used as a fuel in the Plant is "solid waste" within the meaning of the Solid Waste Disposal Act, 42 USC § 6903.

The Plant will have four components: a sludge bin, a dryer, a burner, and a turbine generator. Water will move in a loop between the Plant and the Water District Plant with hot water from the Plant's dryers going to heat the Water District Plant's digesters and then cycling back to be reheated for use in the Plant's dryers.

After a de-watering device removes about 20% of the moisture the Plant will take the sludge from the Water District Plant, pulverize and dry it, burn the dried sludge powder and capture the heat in a turbine generator to generate electricity.

Taxpayer will sell the electricity that it generates to the Water District under a power purchase agreement with a term of 20 years at a discount to approximate the price that the Water District would have otherwise paid the local utility for electricity. The Water District will also pay Taxpayer a tipping fee for taking the sludge.

Taxpayer requests a ruling that each of the four components of the Plant are part of the "qualified facility" for purposes of § 45(d)(7) and are thus eligible for the credit provided in § 48(a)(5).

Law and Analysis

Section 38(a) provides for a general business tax credit that includes the amount of the current year business credit. Section 38(b)(8) provides that the amount of the current year business credit includes the renewable electricity production credit under § 45(a).

Section 45(a) provides a renewable electricity production credit, in an amount equal to the product of 1.5 cents, multiplied by the kilowatt hours of electricity produced by the taxpayer from qualified energy resources, and at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service, and sold by the taxpayer to an unrelated person during the taxable year.

Section 45(c)(1) defines "qualified energy resources" to include municipal solid waste. Section 45(c)(6) states that the term "municipal solid waste" has the meaning given the term "solid waste" under § 2(27) of the Solid Waste Disposal Act (42 U.S.C. 6903), except that such term does not include paper which is commonly recycled and which has been segregated from other solid waste (as so defined).

Section 45(d)(7) defines a "qualified facility," in the case of a facility (other than a facility described in paragraph § 45(d)(6)), which uses municipal solid waste to produce electricity, as any facility owned by the taxpayer that is originally placed in service after the date of enactment of this paragraph [October 22, 2004], and the construction of

which begins before January 1, 2014. Section 45(d)(7) further provides that such term shall include a new unit placed in service in connection with a facility placed in service on or before the date of enactment of this paragraph [October 22, 2004], but only to the extent of the increased amount of electricity produced at the facility by reason of such new unit.

Section 48(a)(1) generally provides, with exceptions that are not relevant in this case, that the energy credit for any taxable year is the energy percentage of the basis of each energy property placed in service during such taxable year.

Section 48(a)(5)(A) provides that in the case of any qualified property which is part of a qualified investment credit facility—

(i) such property shall be treated as energy property for purposes of this section, and
(ii) the energy percentage with respect to such property shall be 30%.

Section 48(a)(5)(C) provides, as relevant here, that for purposes of § 48(a)(5), the term "qualified investment credit facility" means any facility—

(i) which is a qualified facility (within the meaning of § 45) described in paragraph (1), (2), (3), (4), (6), (7) [trash facility defined in § 45(d)(7)], (9), or 11 of § 45(d),
(ii) which is placed in service after 2008 and the construction of which begins before January 1, 2014, and
(iii) with respect to which—
    (I) no credit has been allowed under § 45, and
    (II) the taxpayer makes an irrevocable election to have this paragraph apply.

Section 48(a)(5)(D) defines the term "qualified property" for purposes of this paragraph as property—

(i) which is—
    (I) tangible personal property, or
    (II) other tangible property (not including a building or its structural components), but only if such property is used as an integral part of the qualified investment credit facility,
(ii) with respect to which depreciation (or amortization in lieu of depreciation) is allowable,
(iii) which is constructed, reconstructed, erected, or acquired by the taxpayer, and
(iv) the original use of which commences with the taxpayer.

Section 1.48-1(a) defines, in general, the term 'section 38 property' to mean property (1) with respect to which depreciation (or amortization in lieu of depreciation) is allowable to the taxpayer, (2) which has an estimated useful life of 3 years or more

(determined as of the time such property is placed in service), and (3) which is either (i) tangible personal property, or (ii) other tangible property (not including a building and its structural components) but only if such other property is used as an integral part of manufacturing, production or extraction, or as an integral part of furnishing transportation, communications, electrical energy, gas, water or sewage disposal services, by a person engaged in a trade or business of furnishing any such service, or is a research or storage facility used in connection with any of the foregoing activities.

Section 1.48-1(c) states that if property is tangible personal property it may qualify as section 38 property irrespective of whether it is used as an integral part of an activity (or constitutes a research or storage facility used in connection with such activity) specified in § 1.48-1(a). For purposes of this section, the term "tangible personal property" means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures). Tangible personal property includes all property (other than structural components) which is contained in or attached to a building. Thus, such property as production machinery, printing presses, transportation and office equipment, refrigerators, grocery counters, testing equipment, display racks and shelves, and neon and other signs, which is contained in or attached to a building constitutes tangible personal property for purposes of the credit allowed by § 38. Further, all property which is in the nature of machinery (other than structural components of a building or other inherently permanent structure) shall be considered tangible personal property even though located outside a building. Thus, for example, a gasoline pump, hydraulic car lift, or automatic vending machine, although annexed to the ground, shall be considered tangible personal property.

Section 1.48-1(d)(1) of the regulations states, in general, that in addition to tangible personal property, any other tangible property (not including a building and its structural components) used as an integral part of manufacturing, production, or extraction, or as an integral part of furnishing transportation, communication, electrical energy, gas, water or sewage disposal services by a person engaged in a trade or business of furnishing any such service, or which constitutes a research or storage facility used in connection with any of the foregoing activities may qualify as § 38 property.

Taxpayer has represented that the sludge that will be used as a fuel in the Plant is "solid waste" within the meaning of the Solid Waste Disposal Act (42 U.S.C. § 6903). Thus, the fuel used by the Plant to produce electricity is considered "municipal solid waste" for purposes of § 45(c)(6), and is therefore a "qualified energy resource" for purposes of § 45. Provided that the Plant is placed in service before January 1, 2014, the Plant is eligible for the production tax credit under § 45(d)(7). Taxpayer may elect, under § 48(a)(5), to claim an investment tax credit in lieu of the production tax credit.

Section 48(a)(1) provides a credit for energy property placed in service during the taxable year. Section 48(a)(5) provides an election to treat certain qualified investment

credit facilities as qualified property. Plant, because it is described in § 45(d)(7), is eligible for this election. To this point, we have basically restated the legal implications of Taxpayer's representations. Taxpayer has requested a ruling on whether each of the four components is qualified property for purposes of the § 48 credit. To be included, the components of the investment credit facility must satisfy the definition in § 45(a)(5)(D). Section 45(a)(5)(D) defines "qualified property" (with other requirements not at issue here) as property which is tangible personal property or other tangible property (not including a building or its structural components), but only if such property is used as an integral part of a qualified investment credit facility. Each of the four components of the Plant are tangible personal property as defined in § 1.48-1(c). In addition, because Plant is described in § 45(d)(7), the components are other tangible property used as an integral part of a qualified investment credit facility under § 48(a)(5)(D)(i)(II). The components are of a type for which depreciation (or amortization in lieu of depreciation) is allowable. Taxpayer represents that it is constructing the Plant itself out of entirely new components and that the original use of the Plant will commence with Taxpayer.

Accordingly, each of the four components constitutes "energy property" for purposes of § 48(a)(1) and are thus eligible for the credit provided in § 48(a)(5).

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

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. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
(Passthroughs & Special Industries)