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IRS: Value of Facility-Specific Power Purchase Agreement Capitalized into Basis of Wind Facility

BY TRAVIS L. BLAIS

On April 6, 2012 the Internal Revenue Service (IRS) issued Private Letter Ruling 201214007, which concluded that where a taxpayer purchased wind energy facilities accompanied by facility-specific Power Purchase Agreements (PPAs), no portion of the purchase price need be allocated to the PPAs as a separate asset. Any consideration not allocated to real property could be capitalized into the tax basis of the facilities themselves. The result is very favorable for acquirers of renewable energy facilities seeking to take advantage of accelerated depreciation deductions (MACRS) and the investment tax credit (ITC).

The IRS's Private Letter Ruling is available here.

In the ruling, the taxpayer was an electrical utility acquiring (at arm's-length from unrelated parties) a number of existing and under-construction wind energy facilities. Each facility consisted of tangible property including land, wind turbines, towers, pads, on-site power collection systems, monitoring and meteorological equipment, and site improvements. Each facility also came with a facility-specific PPA, i.e., a contract to sell a specified amount of output from that specific wind facility. Neither the facility's owner, nor any transferee who could theoretically acquire the PPA separately, could fulfill the contract by selling output from any other generation source other than the specified wind facility.

The utility engaged an appraiser to value its purchased assets for financial accounting purposes. Partly because some of the existing PPAs called for above-current-market rates, the appraiser attributed separate value to the PPAs in addition to the value attributed to the facilities' tangible personal property components.

Nevertheless, for tax purposes, the IRS reasoned that where each PPA could only be fulfilled by a specific facility, the PPAs themselves retained no value separate from their respective specified wind facilities. Therefore, while presumably some portion of the purchase price was allocated to the real property, any remaining consideration could be capitalized into the tax basis of the facilities themselves.

This ruling has obvious and positive implications for acquirers of renewable energy facilities seeking to take advantage of MACRS and the ITC if those facilities are accompanied by facility-specific PPAs. Increasing the tax basis of the energy facilities increases the value of the 30% tax credit available under the ITC (including for wind and other facilities that elect to take the ITC in lieu of the production tax credit). Although the facility's remaining tax basis is decreased by 15% (i.e., half the amount of the ITC), the increased basis also increases the amount potentially depreciable over an accelerated five-year period under MACRS.

The IRS has previously stated that it will scrutinize the claimed tax basis of renewable energy property where the property is acquired from related parties or is accompanied by a separately valuable PPA. Although the Private Letter ruling cannot be used or cited as precedent, it does demonstrate that the IRS will accept favorable valuations of energy property where such valuations are indeed supported by the facts.

Of course, Mintz Levin's Energy & Clean Technology team will continue to monitor important legal developments in this area. Stay tuned for further updates.

If you have any questions about the tax implications of the IRS's ruling, please call Travis Blais at 617.348.1684 or TBlais@mintz.com, or reach out to any of our Energy & Clean Technology professionals.

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