Alternative & Renewable Energy Tax Newsalert

IRS Rules That Facility-Specific PPAs for Wind Farms Are Part of Facility Cost Basis

April 9, 2012

On April 6, 2012, the Internal Revenue Service released a private letter ruling, PLR 201214007, in which it determined that facility-specific power purchase agreements ("PPAs") for wind energy facilities are not treated as depreciable assets separate from the facilities themselves. Any value created by such a PPA is includable in the adjusted depreciable basis of the facility to which it is related.

The taxpayer that requested the ruling is an electric utility company, engaged in generation, marketing, transmission, and distribution of electric power. In a single transaction, the taxpayer acquired an entity with a portfolio of numerous wind energy facilities both operational and under construction. A number of the facilities were subject to PPAs that were facility-specific, *i.e.*, the agreements obligated the parties to the agreement to buy and sell, respectively, a specified amount of power output from that particular facility. The PPAs were drafted in such a manner that the facility owner could not satisfy the terms of the agreement with power generated from any other sources. Furthermore, the PPA could not be transferred and remain valid without transfer of the accompanying wind energy facility.

At the date of acquisition by the taxpayer, most of the PPAs for the facilities had remaining durations that were unspecified, but were described by the IRS as "significant." In addition, the IRS noted that the pricing of power under many of the PPAs was above current market rate. In conducting valuation of the acquisition, the taxpayer's appraiser determined separate values for the physical facility assets and the PPAs.

The IRS's analysis focused on the rule on depreciation of assets acquired subject to a lease under IRC section 167(c)(2). Relying on the fact that the PPAs were facility-specific and not separately transferable, the IRS determined that the agreements should not be treated as assets separate from the wind energy facilities subject to the agreements. Under this conclusion, upon acquisition, any value of a PPA would be part of the depreciable basis of the wind energy facility subject to that agreement.

PwC observations

In the ruling, the IRS has provided a clear and helpful statement that facility-specific PPAs are analogous to asset leases for tax purposes, and this analysis appears to be applicable to technologies beyond wind. This could affect the pricing and terms of new PPAs, as well as the pricing of energy generation facilities currently subject to PPAs. The ruling also may provide helpful inferences for many companies who have been considering whether PPAs must be

attributed separate basis under the Treasury section 1603 cash grant program.

Companies should remain cautious about generalizing the principles set forth in the ruling. While the factual details underlying the PPA in the ruling are not fully described, it appears that agreements were drafted to apply on a facility basis rather than a producer basis. It is unclear whether the IRS would reach the same conclusion where PPAs allow the power supplier more flexibility in how it meets its obligation to deliver energy or differ in other ways from the PPA analyzed in the ruling.

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