Internal Revenue Service

Department of the Treasury

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LEGEND:

Agency: =

State =

Company A =

Company B =

Company C =

Units =

a =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

This responds to your request for a ruling that the acquisition of certain electric power generators by Agency will not constitute the acquisition of nongovernmental output property under § 141(d)(2) of the Internal Revenue Code.

Facts and Representations

Agency makes the following factual representations. Agency is a municipal corporation created under State law and is a political subdivision of State. Agency has an ownership interest in electric generating plants and was created to provide a means for its members, which are all State municipalities, to secure a supply of electric power.

On Date 1, Company A, the business unit of a for-profit electric power producer, entered into an agreement (the "Company A Agreement") with Company B to purchase two newly manufactured electric power turbine generator sets (the "Units"). Company A's intent on Date 1 was to install the Units at one of the electric power generating facilities its owns. The Units are mass produced, "off-the-shelf" items that are generally available for sale to both public and private electric power producers. Company B's manufacturing process for the Units entails the following stages: (1) Company B accumulates the several hundred component part of each Unit; (2) the parts allocated to each Unit are crated and placed in storage; (3) at the time scheduled by the purchaser, the approximately 500 crates of component parts are delivered to the purchaser's designated site; (4) the Unit is assembled and installed over a period of approximately six to nine months, and then made ready for service after six to 18 weeks of testing.

At least three months prior to the completion date of stage (1) of Company B's manufacturing process as described above, Company A determined that it would not need the Units. S a result, Company A did not assign the Units to a generating project. However, because Company B would not allow Company A to cancel the Company A Agreement, Company A executed a letter of intent to sell its ownership interests in the Unit to Company C (the "Company A Letter of Intent"). Company C is an engineering company that constructs electric power systems but does not supply electric power. At the time that the Company A Letter of Internet was executed, component parts of the Units were still being manufactured and received at Company B's facility . Some of the component parts of the Units were not allocated to the Units, segregated in storage and made ready for shipment until Date 2.

On Date 3, eight days after Date 2, Agency, having identified the need for additional future generation capacity, executed a letter of intent to purchase the Unit (the

"Agency Letter of Intent"). On Date 4, approximately 45 days after Date 2, Agency

entered into an agreement (the "Unit Purchase Agreement") with Company A under which, for a payment of $a, Agency purchased the Units. Agency had previously, on Date 5, adopted a resolution stating its intent to issue bonds for the purpose of reimbursing itself for amounts spent acquiring and installing the Units.

Law and Analysis

Section 103(a) provides generally that gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141).

Section 141(a) defines "private activity bond" to include any bond issued as part of an issue that meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2). An issue meets the private business use test of § 141(b)(1) if more than 10 percent of the proceeds of the issue are to be used for any private business use. An issue meets the private security or payment test of § 141(b)(2) if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the term of such issue or any underlying arrangement) directly or indirectly (A) secured by any interest in property used or to be used for a private business use, or in payments in respect of such property, or (b) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(d)(1) provides that the term "private activity bond" includes any bond issued as part of an issue if the amount of the proceeds of the issue which are to be used (directly or indirectly) for the acquisition by a governmental unit of nongovernmental output property exceeds the lesser of five percent of such proceeds pr $5,000,000. Section 141(d)(2) defines "nongovernmental output property" generally as any property (or interest therein) which before such acquisition was used (or held for use) by a person other than a governmental unit in connection with an output facility (within the meaning of § 141(b)(4)) (other than a facility for the furnishing of water).

Under § 10631(c) of the Omnibus Reconciliation Act of 1987 (the "1987 Act"), 1987-3 C.B. 102,175, § 141(d) applies to bonds issued after October 13, 1987 (other than bonds issued to refund bonds issued before such date).

Under § 141(b)(4) (which sets forth lower private activity bond limits for certain output facilities) does not define output facility. The Conference Committee Report accompanying the 1987 Act (the "1987 Conference Report"). H.R. Conf. Rep. No. 100-

495, at 1007 (1987Z), 1987-3 C.B. 28, states that " as under present law, output property includes, e.g. facilities such as electric and gas generation, transmission, distribution an other related facilities.

According to the House Report accompanying the 1987 Act, H.R. Rep. No. 100-391. At

1138 (1987) (the "1987 House Report"), the term nongovernmental output property " also includes property which was constructed by or for an investor -owned utility with the expectation that it would be placed in service by an investor-owned utility but that is not actually placed in service before its acquisition by a governmental unit". The 1987 Conference Report at 1011, 1987-3 C.B. 291, sates that " if property is constructed for an investor-owned utility, that property is treated as nongovernmental output property. This determination is made without regards to whether the investor-owned utility actually placed the property in service".

Company A originally intended to install the Units as an out facility as that term in defined in § 141(b)(4) and the 1987 Conference Report. Therefore, pursuant to § 141(d)(2), the issue is whether the Units were used or held for use by Company A before Agency purchased the Units under the Unit Purchase Agreement for a payment of $a.

Based on the facts and circumstances of this case, we conclude that the Units were not used (or held for use) by Company A. First, the Units were mass produced, off-the-shelf products that were not customized to Company A's use. Second, units virtually identical (if not identical)to the Units were available for sale by Company B to government and nongovernmental electric power producers. Agency, had it not purchased the Units from Company A, could have purchased them from Company B. Third, Company A executed the Company A Letter of Intent to sell the Units three months before Company B had assembled the component parts necessary to construct the Units. Indeed, at the time of the Company A letter of Intent was executed, some of the component parts of the Units had not yet been manufactured. Thus, long before the Units actually existed as working units, it was clear that Company A did not intent to place the Units in service. This intent was carried through with the actual sale to Agency.

Conclusion

Under the facts and circumstances of this case, we conclude that the acquisition of the Units by Agency will not constitute the acquisition of nongovernmental output property under § 141(d)(2).

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in
support of the request for a ruling, it is subject to verification of examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6100(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

Assistant Chief Counsel
(Exempt Organizations/ Employment Task
Government Entities)

By:_____
Timothy L. Jones
Senior Counsel, Tax Exempt Bonds Branch